MID-TERM BUDGET REVIEW 2017/18

2017/18 - 2019/20

02 November 2017

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Key Points in the Speech

- Limited additional resources will be provided to address spending on outstanding contractual obligations and meeting critical needs in respect of the delivery of essential public services.

- The fiscal consolidation policy stance will be maintained with added impetus to enhance the growth friendliness.

- It is proposed that the development budget priority infrastructure spend should be scaled up through the establishment and operationalization of the Infrastructure Fund with a knock-on effect on growth and activity in the construction sector.

- The outturn of the 2016/17 financial year saw public revenue recorded at N$50.85bn, reflecting a collection rate of 98.7% and a shortfall of 1.3% or some N$647.1m relative to the revised target.

- Total expenditure outturn for FY2016/17 stood at N$62.2bn, 1.4% more than the revised appropriation of N$61.5bn.

- As a result, the budget deficit for FY2016/17 increased from the revised budget estimate of 6.3% to 6.9%.

- Public debt as a ratio of GDP stood at 38.3%, about 0.8% better than the budget estimate of 39.1%. This was thanks to better nominal GDP outturn relative to the revised forecast.

- In respect to the current year budget execution rate, the Mid-Year revenue collection amounted to N$28.03bn, equivalent to 49.7% of the budgeted revenue of N$56.4bn.

- Revenue collection is expected to be in line with budget expectations, with a moderate over performance of about N$300m expected due to ongoing Tax Arrear Recovery Incentive Program and the elasticity of some revenue streams.

- The budget expenditure execution rate by the end of September 2017 stood at 48.9%, compared to 50.2% execution rate for the corresponding period.

- Revenue beat stems from individual income taxes, environmental taxes, export levies, improved fuel levies.

- The outturn on VAT has however to be adjusted downwards by 12.9% on account of low consumption demand.

- Over the MTEF, total revenue is projected at about N$56.6bn in FY2018/19, N$59.78bn in FY2019/20 and to reach about N$62.5bn in FY2020/21.

- Debt to GDP is projected to peak at 44.2% and then reduce gradually due to reduction of the budget deficit.

- Within this policy stance, aggregate expenditure ceilings for the next MTEF are proposed at N$64.5bn in FY2018/19, N$65.5bn in FY2019/20 and N$66.9bn in FY2020/21.

- The budget deficit has been revised to 5.3% in FY2017/18 to about 4.2% in FY2018/19 and is expected to hover around 2.9% over the next MTEF.

- As the economic recovery takes shape, it is not the minister's intention to increase general tax rates. But the finance ministry intends to bring all potential taxpayers in the tax net and achieve full compliance.

- The FY2017/18 Budget Review has to address the settlement of accumulated spending arrears which have not been reported for budgeting purposes. The review also has to meet urgent resource shortfalls to prevent adverse reversals in the provision of public services and basic needs in the social sectors. Net funding needs for this amount to N$4.04bn.

- N$2.2 billion is to cater for FY2016/17 expenditure arrears whose payments were frontloaded in August 2017.11.02

- N$2.4 billion is for allocation to the various OMAs with critical resource shortfalls for the provision of services. Largely education.

Growth Environment

The Ministry of Finance have revised their 2017 growth expectation down to 1.6% from the 2.5% expected in March, while the economy is still expected to grow at 3.7% in 2018. Although a hefty downward revision, these figures are well above IJG's forecasted growth figures as well as IMF forecasts which point to growth of 0.8% and 2.5% for 2017 and 2018 respectively.

According to the Minister's speech, growth will be led by the primary industries, particularly mining and agriculture. Tertiary industries will continue to support growth, on the back of contributions from transport, financial intermediation, tourism, and telecommunication. However, secondary industries will likely continue to weigh on growth for as long as the construction industry continues its state of contraction.

Consumption is expected to remain weak, largely due to the contraction in general government expenditure, while fixed capital formation is expected to contract in the current year. However, higher commodity prices are expected to support exports as the prospects for metal prices, specifically zinc, lead, and gold, have improved. Imports are expected to contract due to lower domestic demand.

We will likely continue to remain in a challenging economic environment as the tools to stimulate growth have been depleted. The use of fiscal policy is limited due to the stretched nature of our budget coupled with ballooning government debt. Monetary policy effectively lies beyond our control and may become less accommodative should South Africa's local currency credit rating be downgraded.

In this challenging environment we will need to find some type of balance between spending and consolidation, as excessive spending is unsustainable while our recent fiscal consolidation had some adverse effects, slamming the brakes on too hard in sectors such as construction.

Revenue

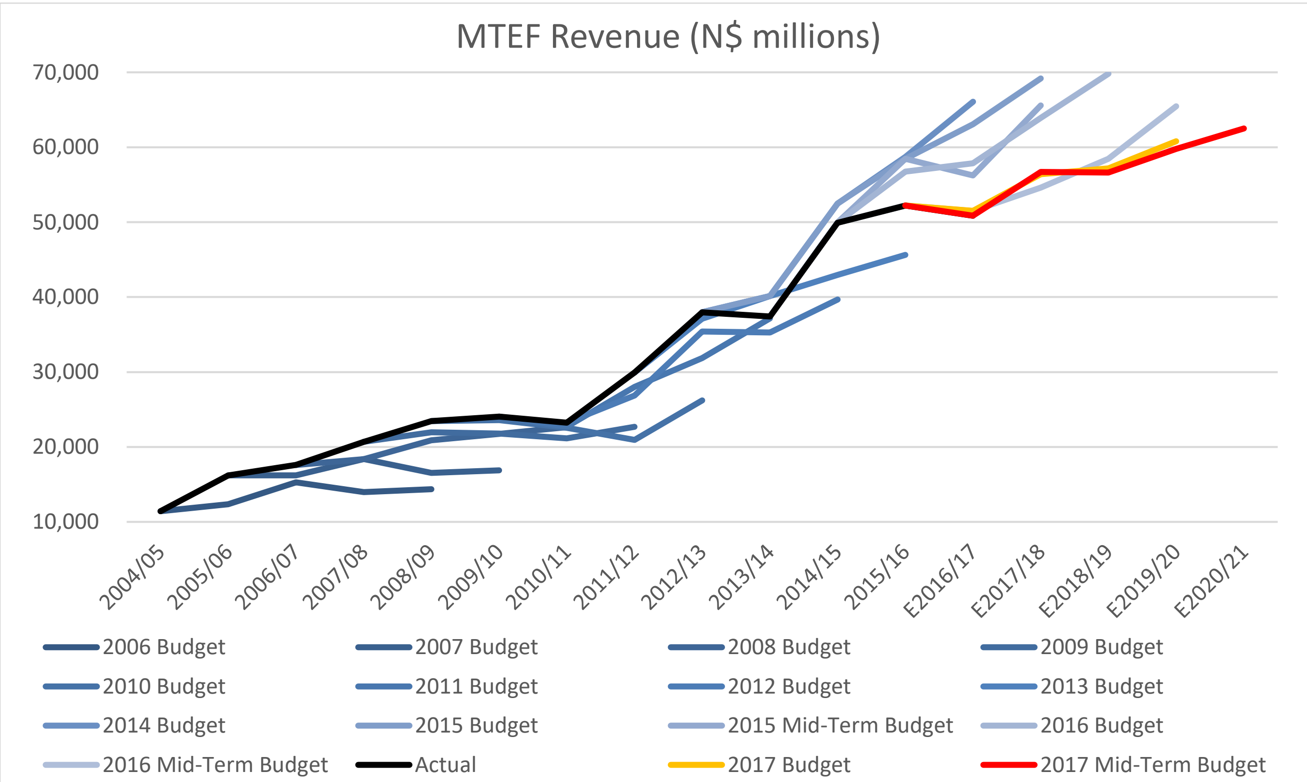
2016/17 Outturn

Revenue collection for 2016/17 came in at N$50.85bn, 1.3% below the revised March figure. This is 19.3% below the 2015/16 estimate, and 12.1% below the 2016/17 estimate. These large deviations between revenue estimates and actual revenue collection have been the source of the rapid increase in public debt over the last two years. Revenue collection for 2016/17 was 2.6% lower than that of 2015/16, due largely to disappointing SACU revenues.

Revenue collection started underperforming in the 2014/15 budget year, a veritable sign of things to come. A N$2.5bn miss for 2014/15, recorded in the 2015/16 mid-term budget review, did not lead to adjusted expectations for the rest of the MTEF period. It was only when actual revenue disappointed that the trend was recognised by the planners. The 2016/17 mid-term review thus recorded a revenue decrease of N$6.2bn for 2015/16 versus the 2015/16 mid-term review expectation. Due to the lack of adjustment to revenue expectations, the expenditure profile was left largely unchanged (there were insignificant downward adjustments) leading to the rapid increase in public debt.

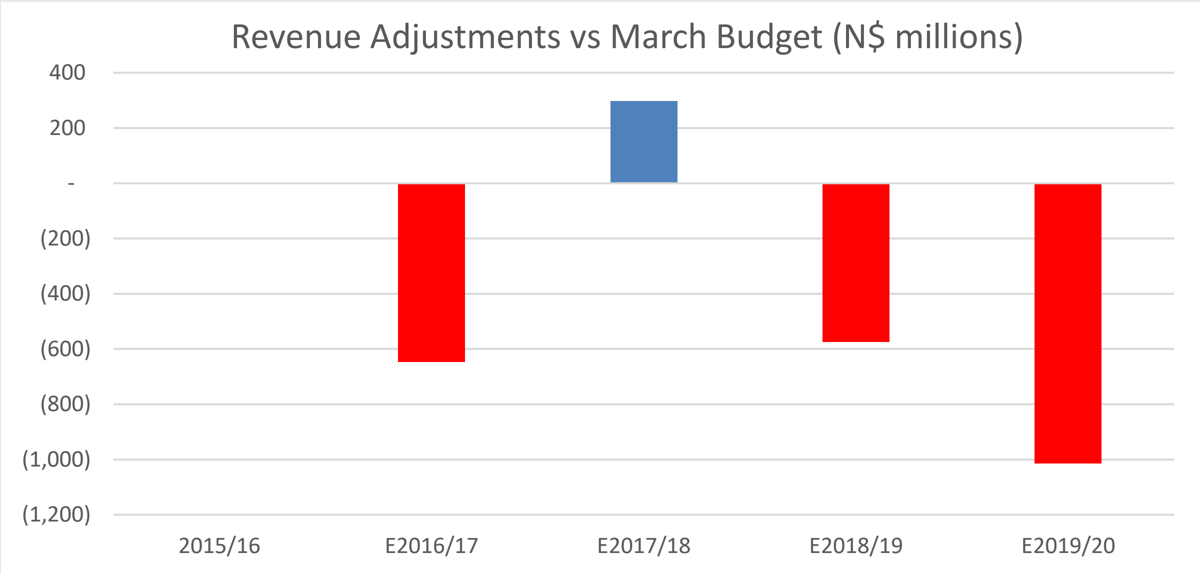
In our March review we noted that the ministry of finance expected to meet or modestly surpass the revenue target for 2016/17. The actual figure came in slightly below estimate (as noted above). Since the mid-term review tabled this time last year, revenue estimates have improved significantly although possibly still leaning toward the optimistic. Improved revenue forecasting should aid in fiscal consolidation efforts going forward. Despite this we would prefer to see the finance ministry erring on the side of caution instead of optimism as the expenditure framework is built off of revenue estimates.

2017/18 Mid-Term Review



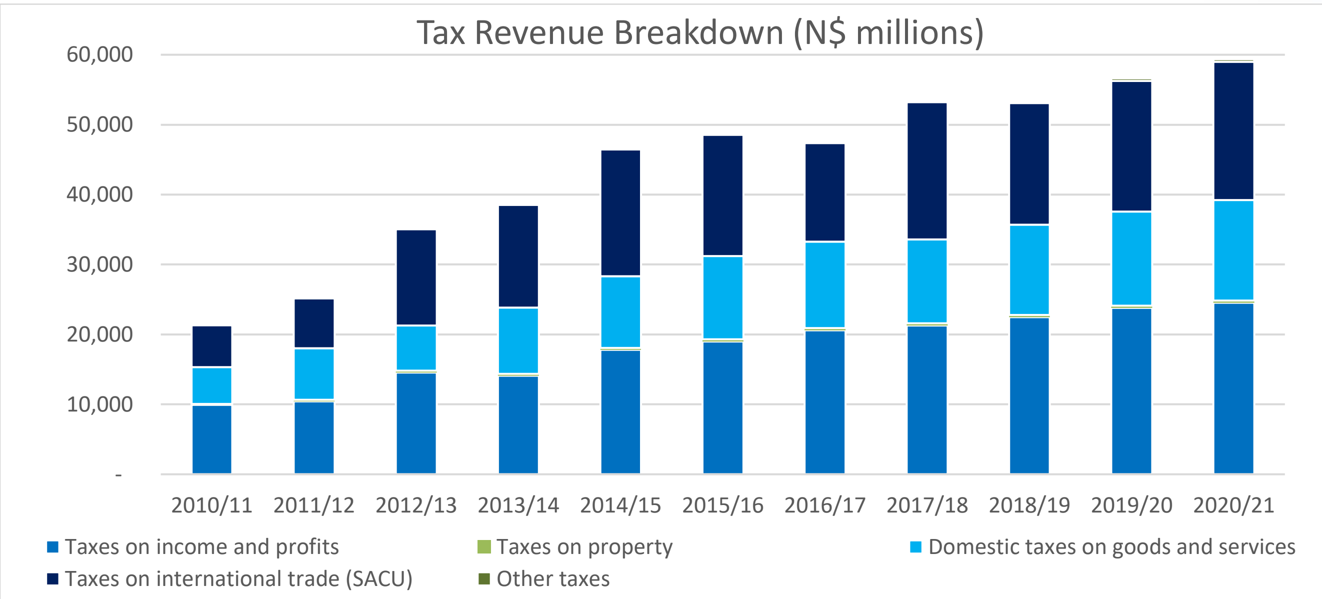
Source: MoF, IJG Securities

Revenue collection for 2017/18 is expected to exceed the prior estimate by some N$300m despite being 18% lower than the amount forecasted in the 2015/16 budget, two and a half years ago. This is an underperformance of N$12.5bn compared to the first estimate for 2017/18. Considering the revenue collection disappointments recorded over the last few years and the continued optimistic forecasting, the outcome for 2017/18 may differ from current estimates.



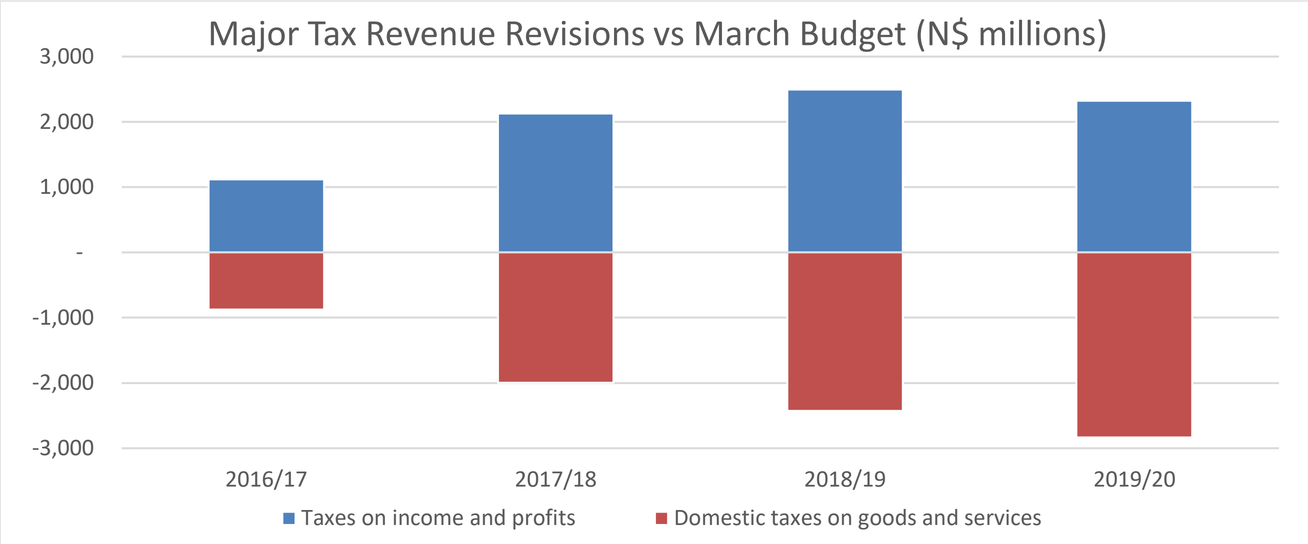
Source: MoF, IJG Securities

The mid-term budget for 2017/18 shows downward revisions to revenue forecasts for all years bar the current one as illustrated above. Revenue collection is expected to decrease slightly year-on-year in 2018/19 after which estimates pick up to N$62.5bn in 2020/21, a growth rate of 3.3% per year over the three-year period. This is a far cry from the 17% plus growth rate experienced between 2011/12 and 2015/16, although prudent considering the current economic climate. Revenue estimates going forward are significantly less optimistic and are much more prudent than previously. The prudent nature of the estimates is positive as prudent revenue estimates should translate to prudent expenditure estimates which will aid in fiscal consolidation.



Source: MoF, IJG Securities

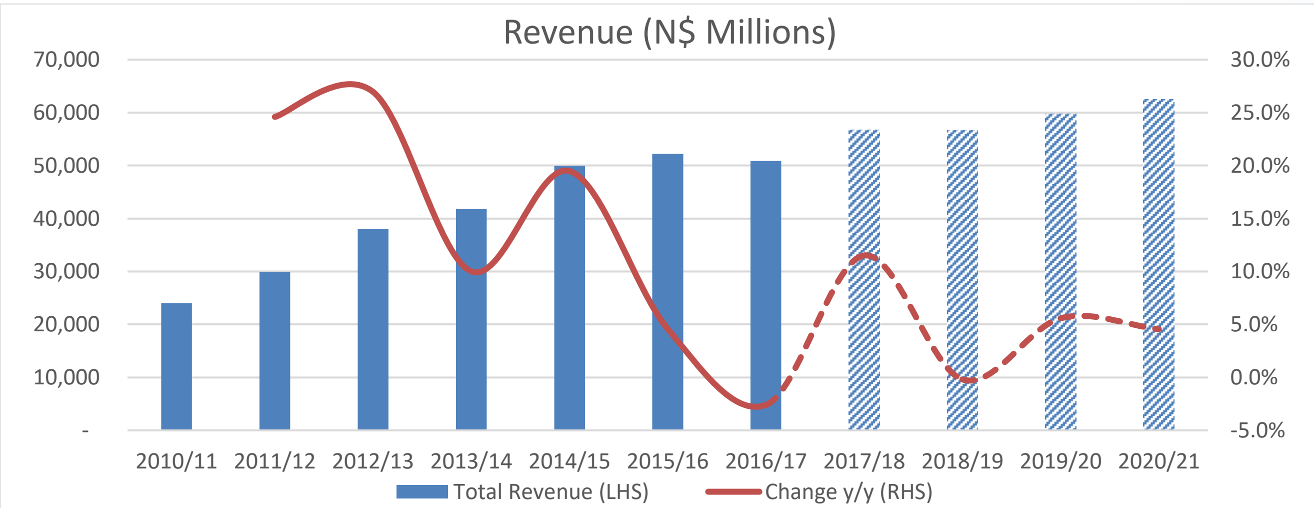
As always taxes make up the bulk of government revenues in 2017/18. SACU revenues make up 36.6% of estimated tax revenue and 34.5% of estimated total revenue for the current financial year. Taxes on income and profits make up the largest share of total revenue at 37.5%, and taxes on domestic goods and services make up 21.2% of estimated revenues in 2017/18.



Source: MoF, IJG Securities

Domestic taxes on goods and services (largely VAT collections) have been revised down from the figures in the March budget due to "slack domestic demand conditions". The economic slowdown is not expected to impact taxes on income and profits according to the ministry of finance as estimates for these revenues are up right across the MTEF. This is contrary to IJG's expectations for personal and company taxes to come under pressure due to economic headwinds.

The reasoning behind the steady growth in income tax revenues stems from the process whereby unchanged tax brackets result in larger personal income tax collections due to inflation adjustments to wages. This is also part of the reason why there are no income tax amendments within the current year. This phenomenon is very useful as it effectively means that tax payers contribute more tax to government revenues without any explicit increase in tax rates.



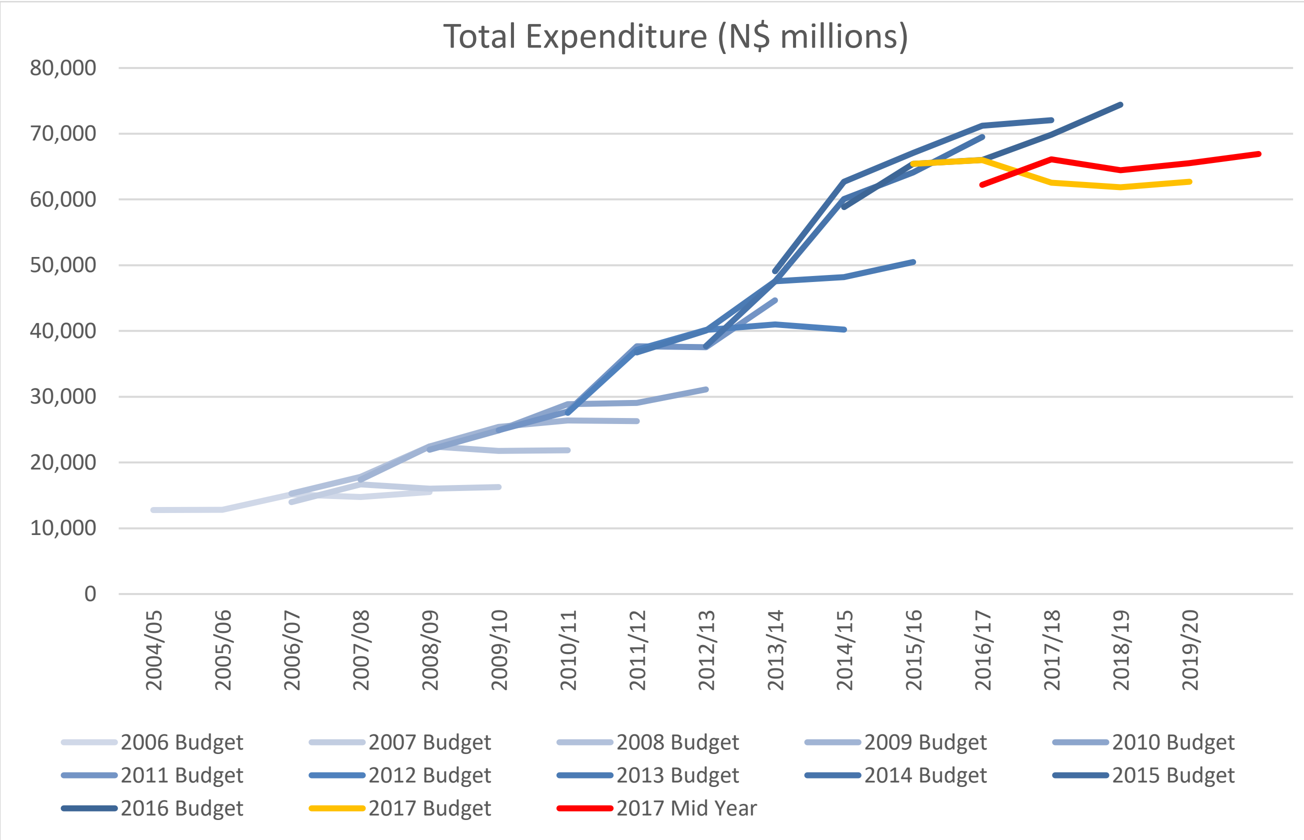
Source: MoF, IJG Securities

MTEF Revenue Estimates

SACU revenues are expected to disappoint in the 2018/19 financial year due to the revenue pool collecting less than expected. As such SACU revenues have been revised down by 3.4% to N$17.37bn. SACU revenues may remain under pressure due to the poor performance of the South African economy. The revenue sharing formula remains a contentious issue with recent changes in the DeBeers diamond aggregation arrangement resulting in Botswana receiving a larger share of the revenues than before. SACU revenue growth over the MTEF is estimated at only 0.4% which does err on the cautions side.

Tax revenues as a whole are expected to grow at an annualised rate of 3.5% over the MTEF, largely due to taxes on income and profit growth. Revenue is estimated to grow at 3.3% over the MTEF period, also relatively prudent. Risks to these estimates can largely be attributed to poor economic performance of South Africa affecting the SACU revenue pool as well as domestic economic weakness putting pressure on personal and company taxes. We still expect to see these line-items disappoint, although this will only show up in the figures at next year's mid-term budget review. Revenue growth is expected to be stable but at the rates mentioned above the fiscal consolidation process will be slow and stretched out unless expenditure cuts are enforced.

Expenditure

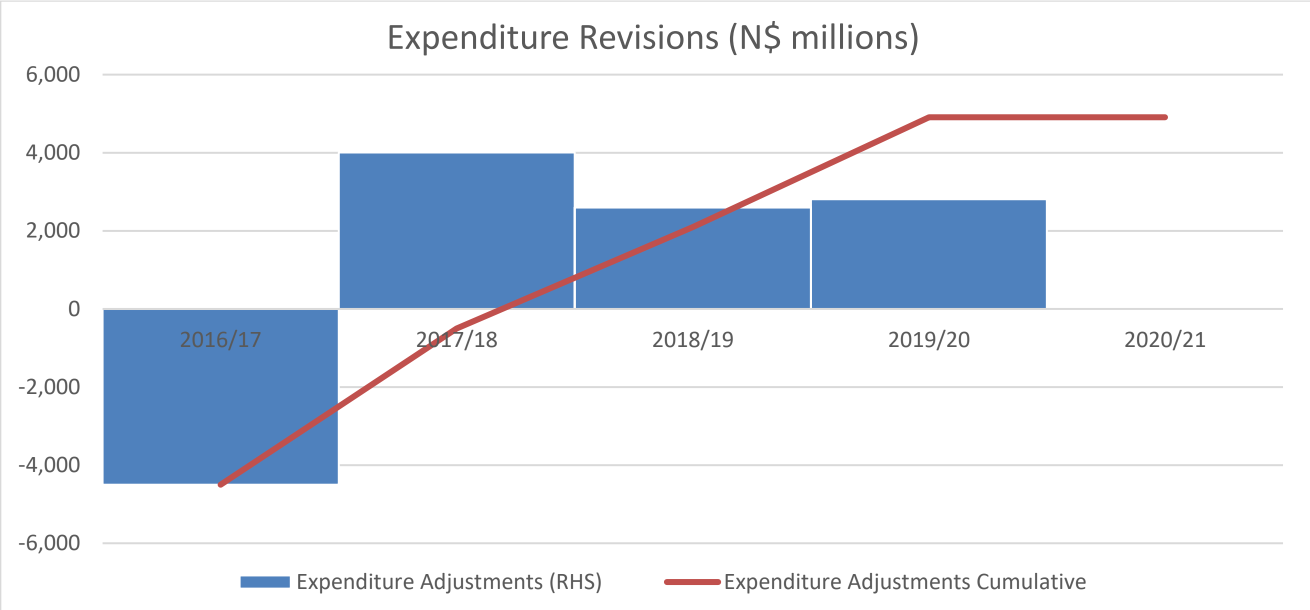


Source: MoF, IJG Securities

Expenditure is expected to increase to N$66.1bn in 2017/18, a substantial upwards revision of N$3.5bn from the N$62.5bn expected at the March full year budget. For the remainder of the MTEF expenditure ceilings of N$64.5bn in 2018/19, N$65.5bn in 2019/20 and N$66.9bn in 2020/21 are proposed.

This revised budget adds about N$9.0bn to planned expenditure over the MTEF. After factoring in the N$4.5bn cut from the previous budget year, N$4.5bn has been added to expenditure since embarking on fiscal consolidation.

According to the Ministry of Finance the additional resources will be used to fund priority funding needs within the expressed policy stance and address unbudgeted outstanding invoices. This seems to be a relatively abrupt departure from the fiscal consolidation efforts set out in the full year and previous mid-year budgets.

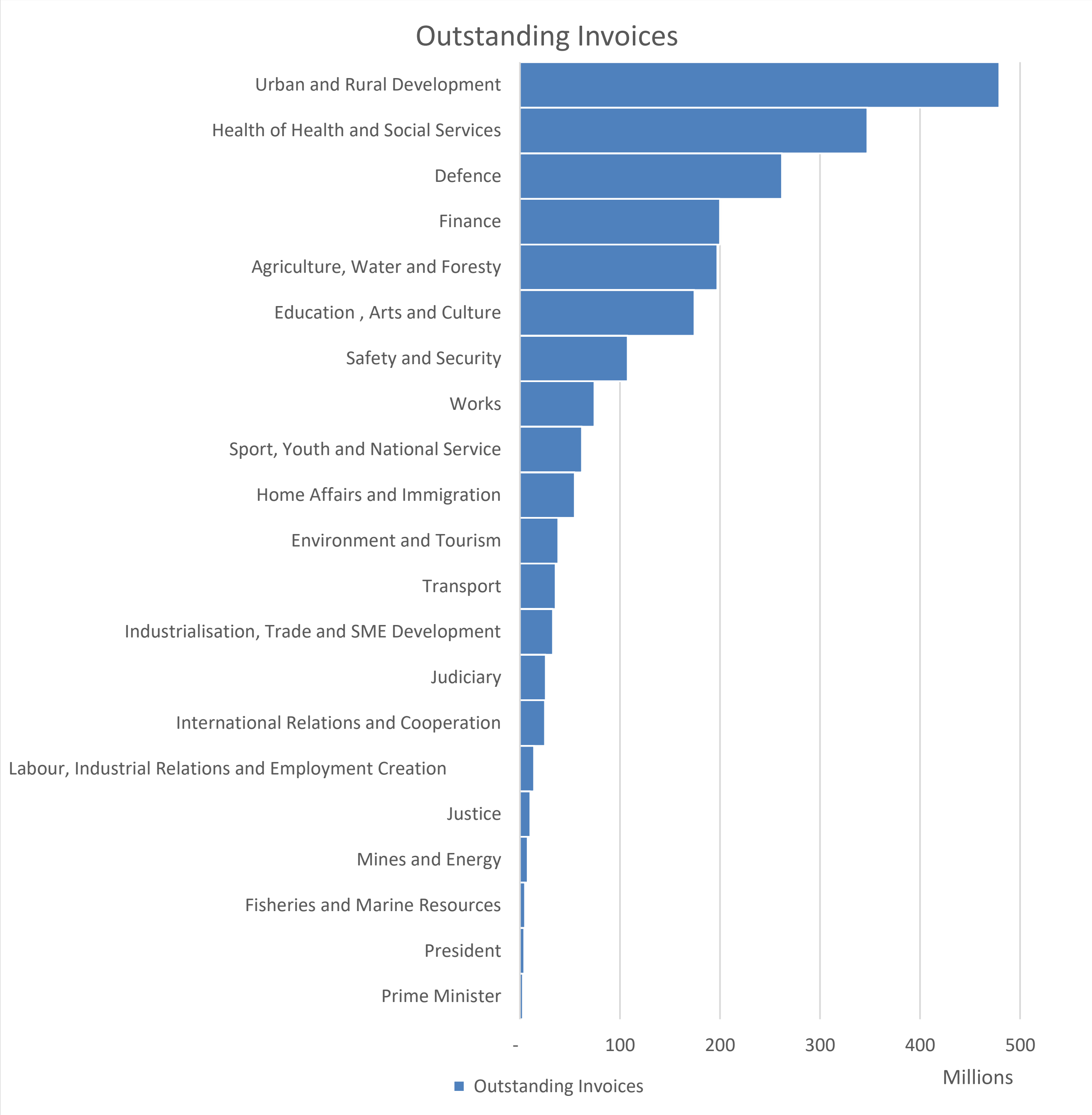


Source: MoF, IJG Securities

About half of the increase in spending is to address the settlement of accumulated spending arrears, which were not reported, and therefore were not budgeted for. About N$2.2bn worth of unforeseen spending arrears from prior periods were incurred on top of the N$1.8bn budgeted for in the March budget review.

The uncovering of another N$2.2bn worth of outstanding invoices is the highlight of this mid-year budget review. The Ministry of Finance has identified that there was a mismatch between budgeted amounts for projects versus actual amounts contained in contractual agreements. Cabinet has since decided that the implementation of the large projects must now be centralized at Treasury to ensure proper budgeting and funding of these projects.

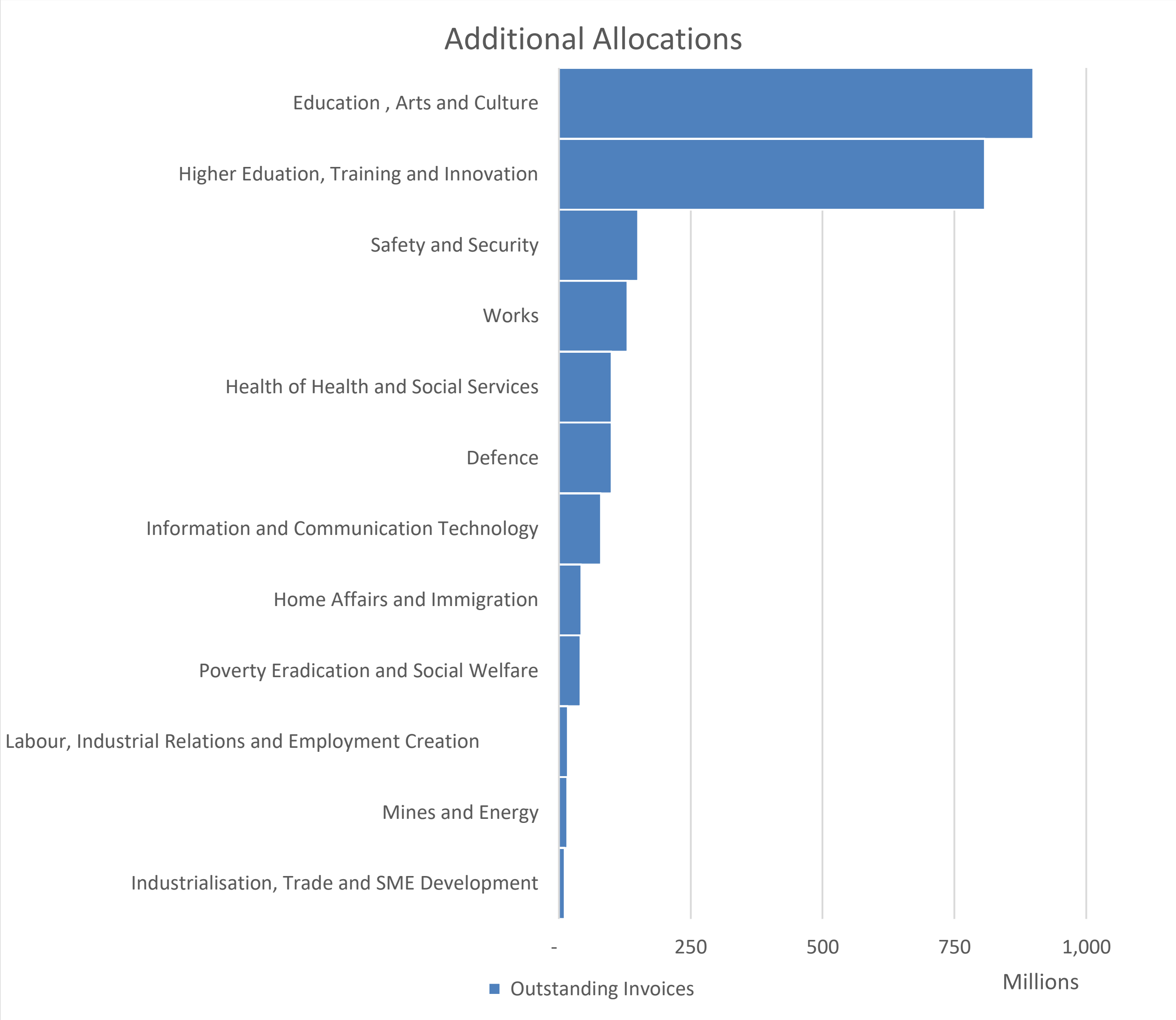
Other measures such as the implementation of the Central Procurement Board and the establishment of an Infrastructure Fund, housed at the Development Bank of Namibia are expected to aide in the monitoring and reporting on these types of commitments. However, the occurrence of such a large amount of unbudgeted and unapproved expenditure has highlighted the extremely inadequate control measures which are in place within the various ministries.



Source: MoF, IJG Securities

The main culprits which led to the accumulation of outstanding invoices were the Ministry of Urban and Rural Development with N$479.3m worth of unapproved invoices, the Ministry of Health and Social Services with N$347,3m and the ministry of Defence with N$262.1m. However, the most shocking of these is the ministry of Finance itself, which accumulated unbudgeted invoices of N$200m, although this may have been due to transfers to parastatals which had overruns. Together, these four ministries make up 59.6% or nearly N$1.3bn of the additional outstanding invoices.

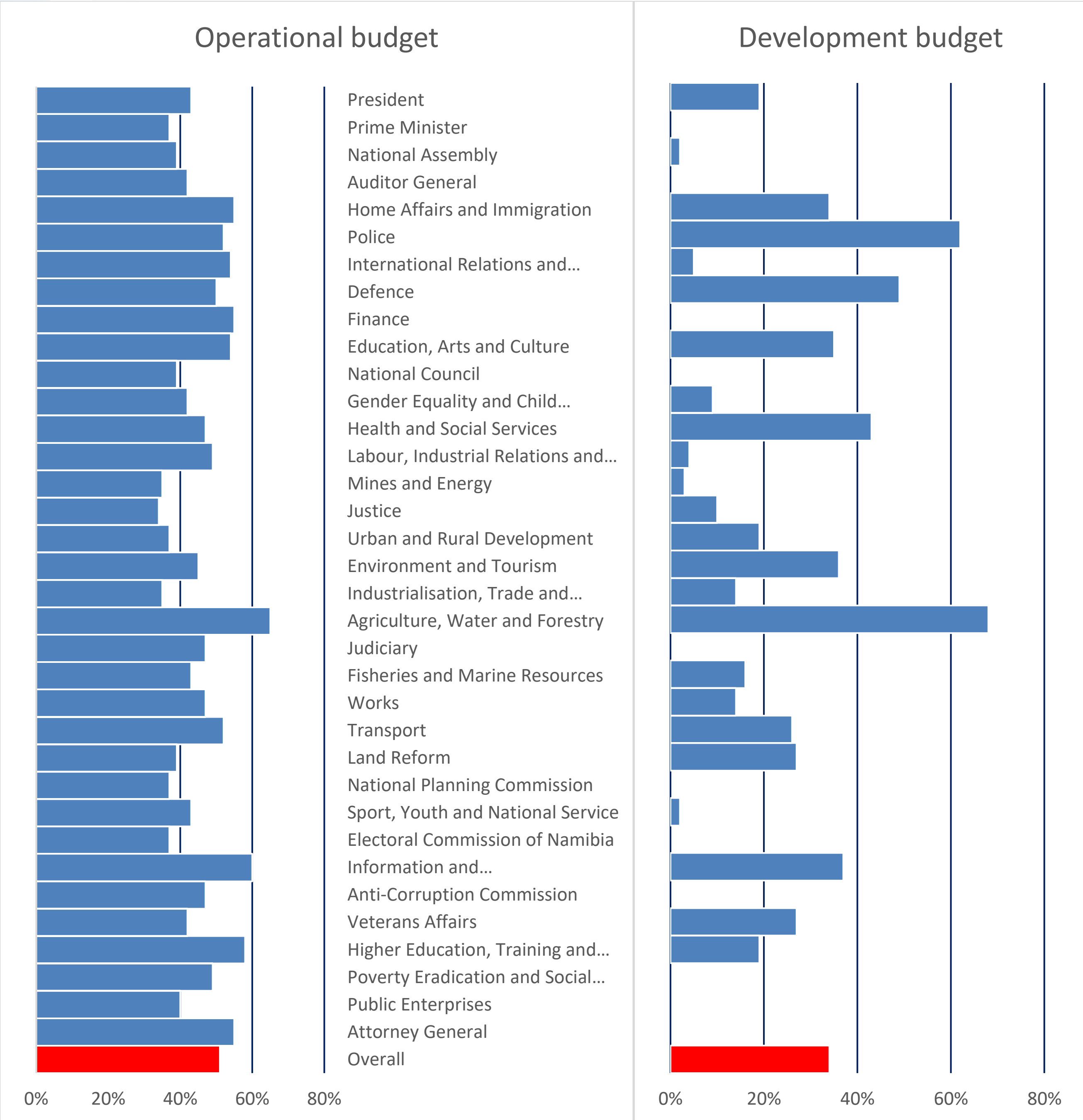
Additionally, according to the minister, rapid fiscal consolidation has caused urgent resource shortfalls which need to be addressed to preserve the provision of basic public services and urgent needs in the social sectors. The largest portion will be headed to the two education ministries which will receive 71.3% or N$1.7bn worth of the additional allocations.



Source: MoF, IJG Securities

The remainder of the additional allocations of N$2.4bn are made up as follows:

- N$100 million is allocated to Health and Social Services to cater for pharmaceuticals and personnel expenditure.
- N$41 million is allocated to Poverty Eradication and Social Welfare for social grants.
- N$42.8 million is allocated to Home Affairs and Immigration for remuneration.
- N$16 million is allocated to Mines and Energy for operational expenses.
- N$17 million is allocated to Labour and Social Welfare for utilities and court disputes.
- N$150 million is allocated to Safety and Security for operational expenses.
- N$100 million is allocated to Defence to meet long-term contractual obligations.
- N$ 80 million is allocated to Information and Communication Technology for NBC operational expenses.
- N$130 million is allocated to Works to cater for rental fees (Office accommodation).
- N$11 million is allocated to Industrialization, Trade and SME Development for operational expenses (Namibia Standards Institute).



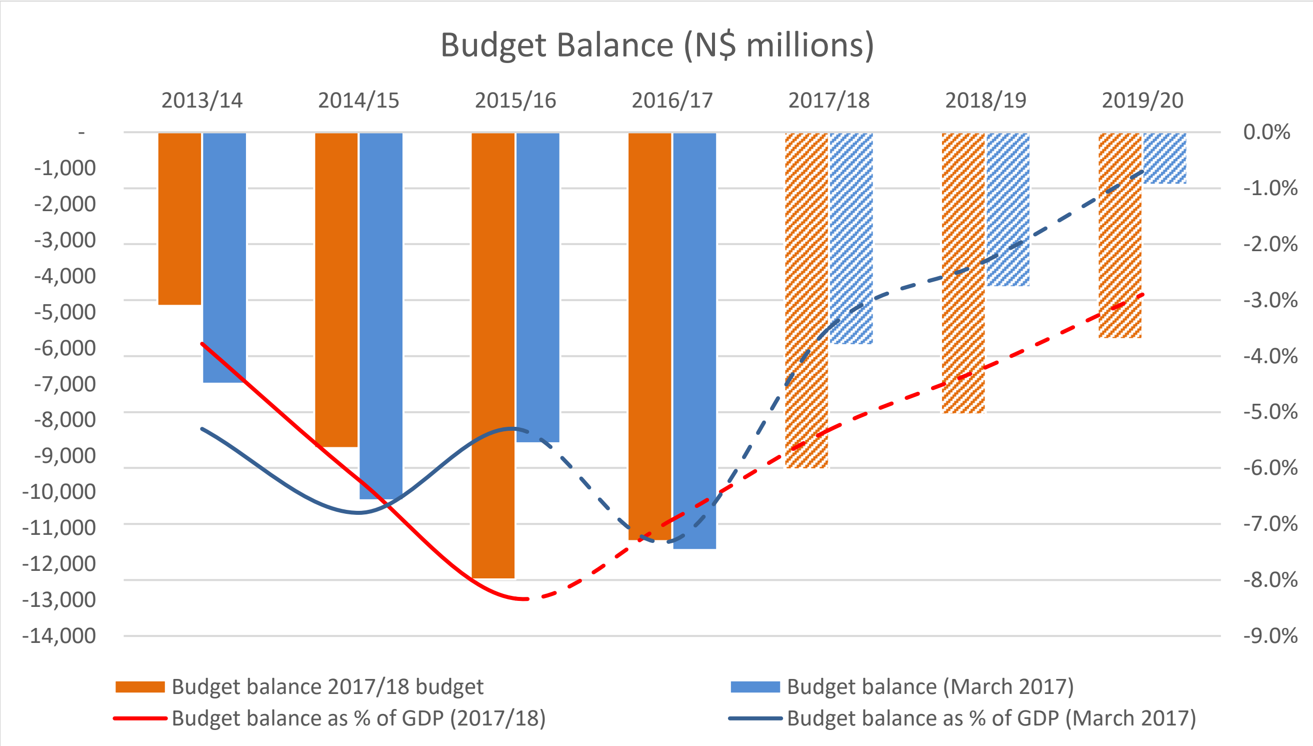
Source: MoF, IJG Securities

On a positive note, the expenditure that was budgeted for has been well contained, as the execution rate of the operational budget stood at 51% for half of the year and compares well with previous budget years. The development budget execution rate stood at 34%.

Budget Balance and Financing

2016/17 Outturn

The total revenue for the 2016/17 stood at N$50.85bn, 1.2% lower than the budgeted revenue for the fiscal year and 2.6% lower than the revenue collected in 2015/16. Total spending for the 2016/17 amounted to N$62.22bn, resulting in an expenditure overrun of 1.2%. The total budget deficit for the fiscal year was thus N$11.36bn, accentuated by a shortfall in revenue collection and excessive consumptive spending that resulted in the budget deficit deteriorating to 6.9% of GDP in 2016/17.



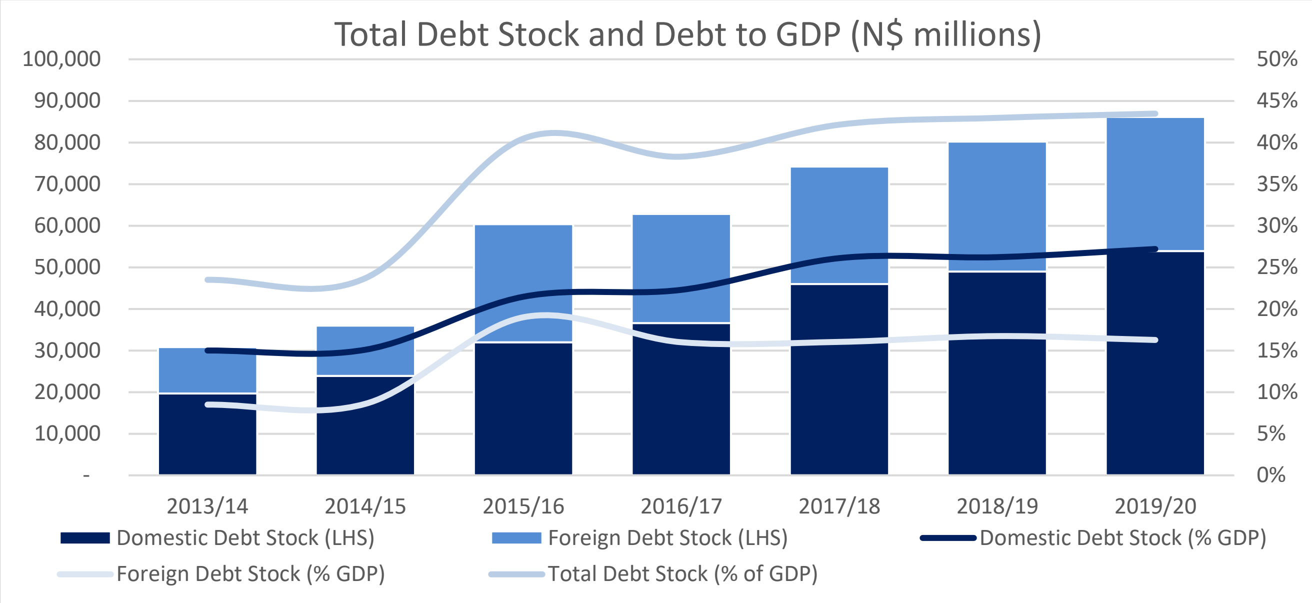
Source: MoF, IJG Securities

2017/18 Mid-Term Review

Revenue for 2017/18 has been revised upward to N$56.72bn, from the previously budgeted N$56.43bn. Expenditure seems to be shying away from the theme of fiscal consolidation, having been revised up to N$66.09bn for 2017/18 from the N$62.54bn tabled earlier in the year. The budget deficit is thus forecast to be N$9.36bn, or 5.3% of GDP. This constitutes a severe deterioration in the deficit and equates to a larger than expected increase in government debt, albeit from non-domestic sources.

The net borrowing requirement for the 2017/18 budget tabled in March, was N$5.91bn or 3.5% of GDP. The borrowing requirement is not explicitly stated in the budget documents but the deficit of N$9.36bn gives a good indication of the debt financing used to plug the revenue-expenditure gap. Debt stock is expected to increase to N$74.23bn in 2017/18 from N$62.87bn 2016/17. As a result, public debt as a percentage of GDP is set to reach 42.1% according to the finance ministry. Of course, this will be influenced by nominal GDP growth as well. A total of N$6.48bn domestic debt is projected to be issued through Bank of Namibia's borrowing plan, to fund this deficit. Worth mentioning is that the borrowing plan was adjusted upward by N$1.0bn, staggered throughout the rest of this calendar year.

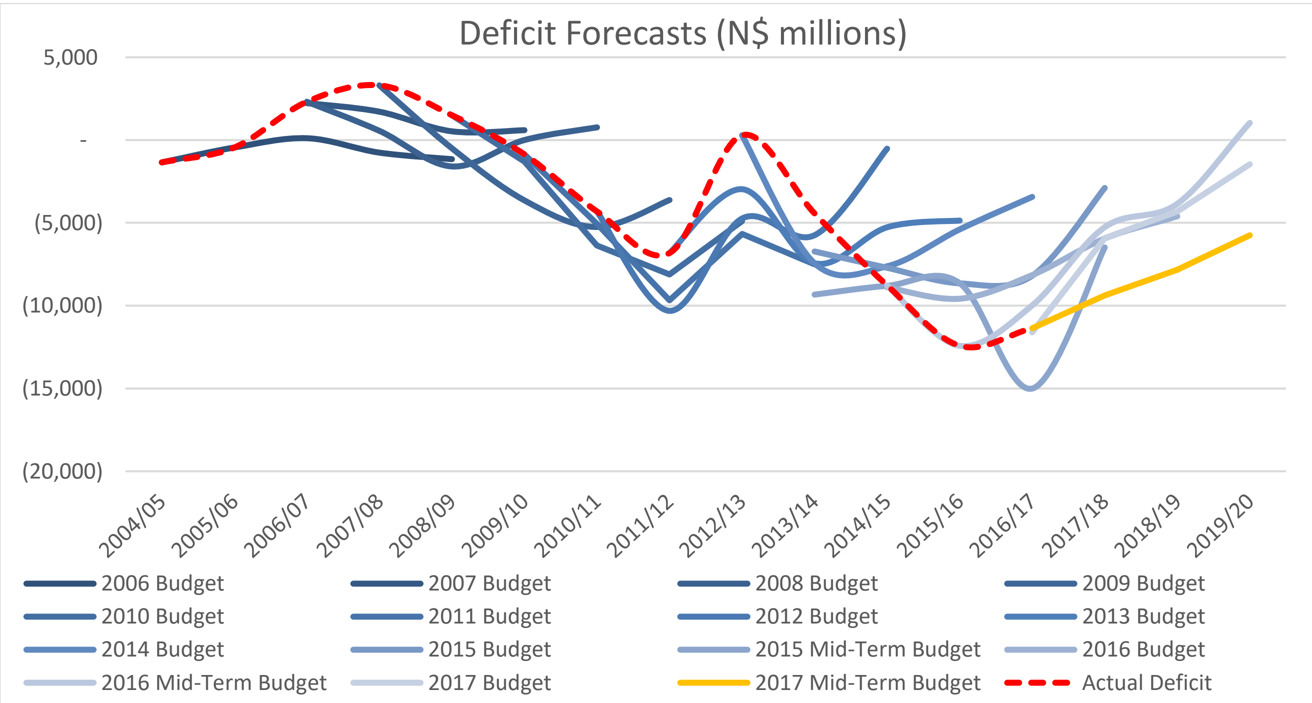
We assume that this adjustment in debt financing coupled with the African Development Bank (AfDB) loan facility of N$3bn will be used to fund the budget deficit.



Source: MoF, IJG Securities

MTEF Deficit Estimates

The budget deficit for 2018/19 is forecasted to contract to N$7.84bn, or 4.2% of GDP, higher than what was forecasted in the full year budget tabled earlier this year. Revenue is projected to come under pressure due to a slowdown in SACU receipts, projected to decline by 10.2%. The deficits for 2019/20 and 2020/21 are estimated at 2.9% and 2.1% of GDP respectively. The debt to GDP ratio is forecast to remain above 42% and reach a peak of 44% in 2019/20 before declining gradually towards the 35% debt to GDP level.



Source: MoF, IJG Securities

Conclusions

The 2017/18 mid-term budget review fails to achieve the stated objective of fiscal consolidation due to unbudgeted expenditure and additional strategic resource allocations not previously included in the budget. A lack of controls within ministries as well as between the ministry of finance and the various other ministries seems to be the root cause of expenditure overruns and the large increase in public debt over the last three years.

Expenditure increases between 2017/18 and 2019/20 of N$9.5bn over the mid-term budget tabled last year will be hard to pass off as a consolidation. It is more in line with fiscal stimulus than growth-friendly fiscal consolidation. That said, the goal of fiscal consolidation was always going to be a difficult task given the unbudgeted expenditure and unpaid invoices resulting from this expenditure. Hopefully this is behind us and the ministry of finance will be allowed to start producing budgets that it, and other ministries, can stick to. Should better checks and balances be implemented there should be no reason why the ministry would not be able to achieve fiscal consolidation.

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