IJG SECURITIES

ECONOMIC OUTLOOK UPDATE

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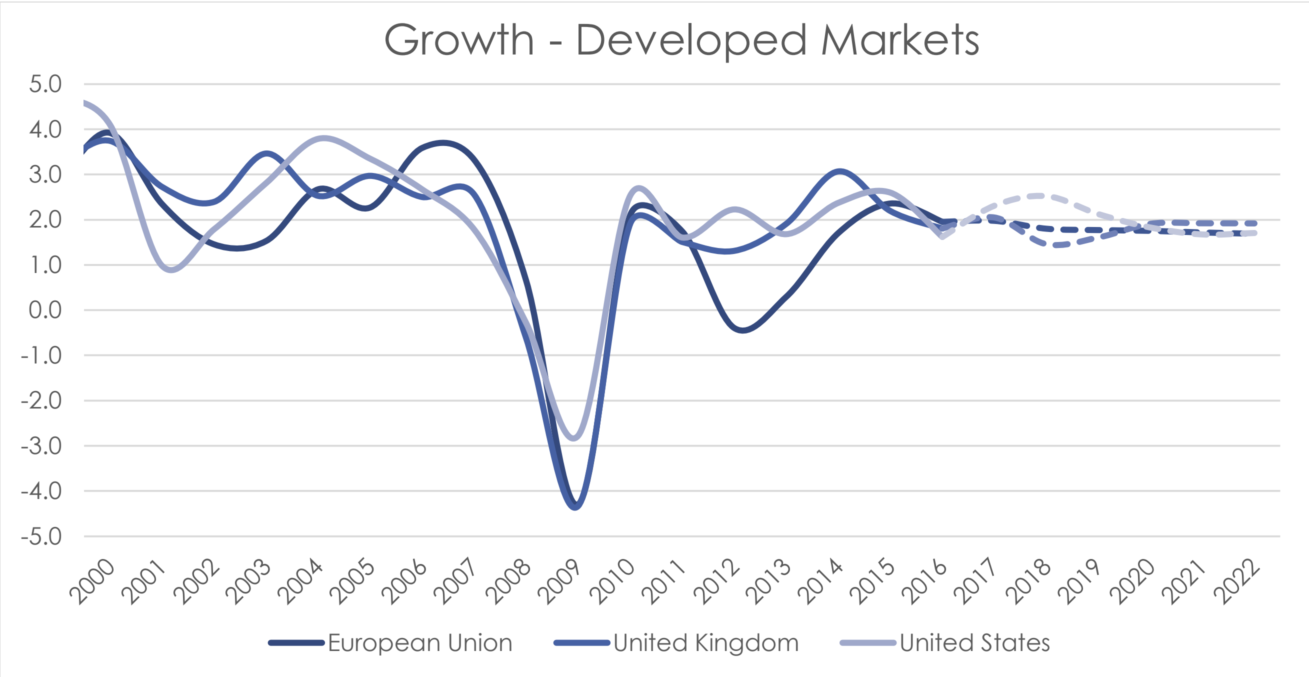
Global Economic Overview

After many years of slow recovery, the global economy recorded real growth of 3.1% in 2016, the lowest rate since 2009 according to the International Monetary Fund (IMF). However, some green shoots have started to appear and growth is expected to pick up in coming years. The IMF expects global GDP growth to rise to 3.5% in 2017 and 3.6% in 2018. Global demand seems to be gaining momentum as confidence indicators, industrial production, employment and global trade have improved in most markets.

Developed Markets

Growth in developed markets is expected to increase to around 2% over the next two years. Projected growth has been revised upwards for most developed economies, reflecting an increase in both investment and overall confidence.



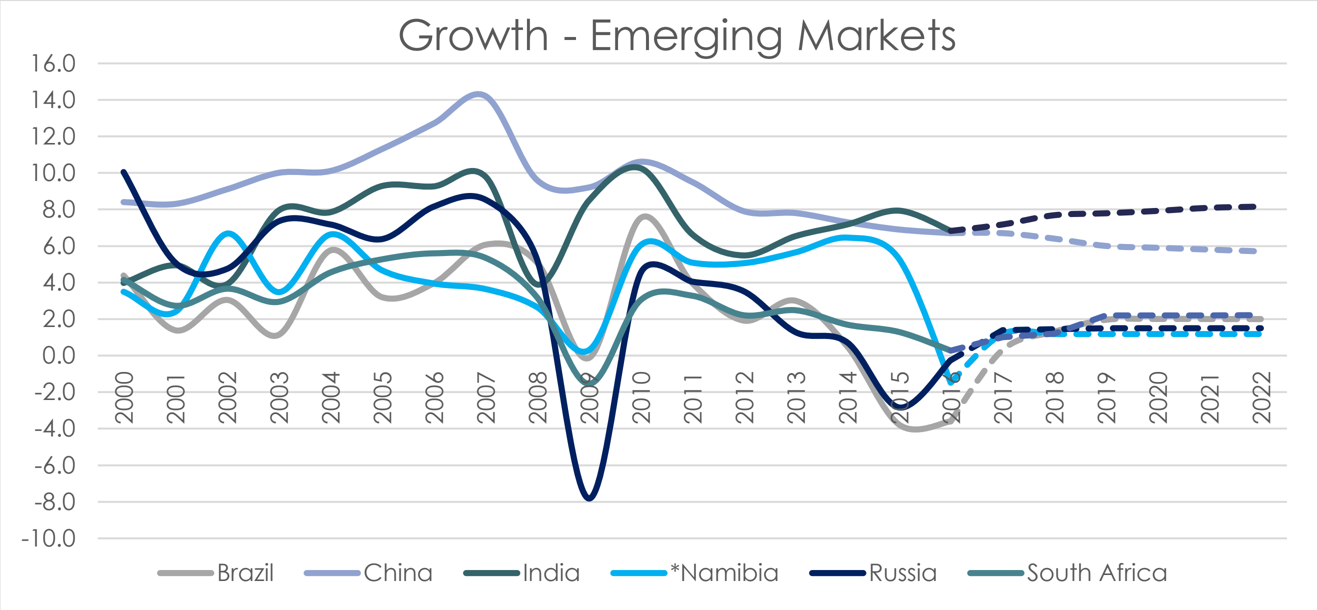
Source: IMF WEO April 2017

In developed markets, the improved outlook is mainly attributable to higher projected growth in the United States, which set a low base in 2016 as a result of low levels of investment and drawdowns in inventory. GDP growth is expected to accelerate from the 1.6% witnessed in 2016 to 2.3% in 2017 and 2.5% in 2018. Since the Election of president Trump in November 2016, confidence has been revitalised by expectations of increased infrastructure spending and looser fiscal policy, which has led to a stronger US dollar, higher inflation and higher treasury rates.

The outlook for Europe has also improved as a cyclical recovery in manufacturing and trade starts to filter its way through to growth. The European Union is expected to record GDP growth of 2.0% in 2017 and 1.8% in 2018. Growth remained stable in the United Kingdom, which proved to be more resilient than expected in the aftermath of the Brexit referendum. Negotiations on the future economic relations between the United Kingdom and the European Union should proceed without raising excessive uncertainty, and most evidence points to a “soft Brexit”, or one that avoids a large increase in barriers to economic relations.

Emerging Markets

Overall the prospects for growth in emerging markets have been revised slightly downward. However, economic performance across emerging markets remains very mixed. While China's growth remains elevated, boosted by ongoing monetary and fiscal stimulus, other economies such as that of India have started to slow and Brazil finds itself in a deep recession.



*Source: IMF WEO April 2017, *IJG Forecasts*

A rebound in commodity prices has boosted growth in many emerging economies while reducing some of the deflationary pressures globally. The resumption of growth in the major commodity-producing economies accounts for much of the expected growth over the next three years.

While the recent focus on fiscal policy and infrastructure has largely been in developed markets, emerging markets also have a substantial need for infrastructure development. The potential impact of such improvements and other fiscal stimulus in emerging markets is much larger than the proposed US$1 trillion US infrastructure spend. This spending, stretched over a period of 10 years, equates to the amount that China spent in just the first eight months of 2016. Thus, China remains a key driver of commodity prices going forward.

China's transition from an investment led economy to a consumption based economy has continued unabated. This year is set to be the fifth consecutive year in which services industries will make up a larger porting of GDP than the industrial sector meaning that the Chinese consumer is driving an increasingly larger share of economic growth. The near-term outlook for China has strengthened in recent months, with policy support expected to maintain steady growth for the foreseeable future. Talks of a "hard landing" have vanished as the world's number two economy is expected to grow at 6.6% in 2017 and 6.2% in 2018 according to the IMF, declining gradually to 5.2% by 2022.

Among commodity exporters, Brazil is expected to emerge from one of its deepest recessions, with growth forecasted at 0.2% in 2017 and 1.7% in 2018. The gradual recovery is to be supported by reduced political uncertainty, easing monetary policy, and further progress on the reform agenda. In India, the growth forecast for 2017 has been trimmed by 0.4% to 7.2%, primarily because of the temporary negative consumption shock induced by cash shortages and payment disruptions from the recent currency exchange initiative. Russia is poised to exit the prevailing recession, with growth reaching 1.4% in 2017. The pickup in activity reflects firming oil prices and a recovery in domestic demand attributable to easing financial conditions and improved confidence.

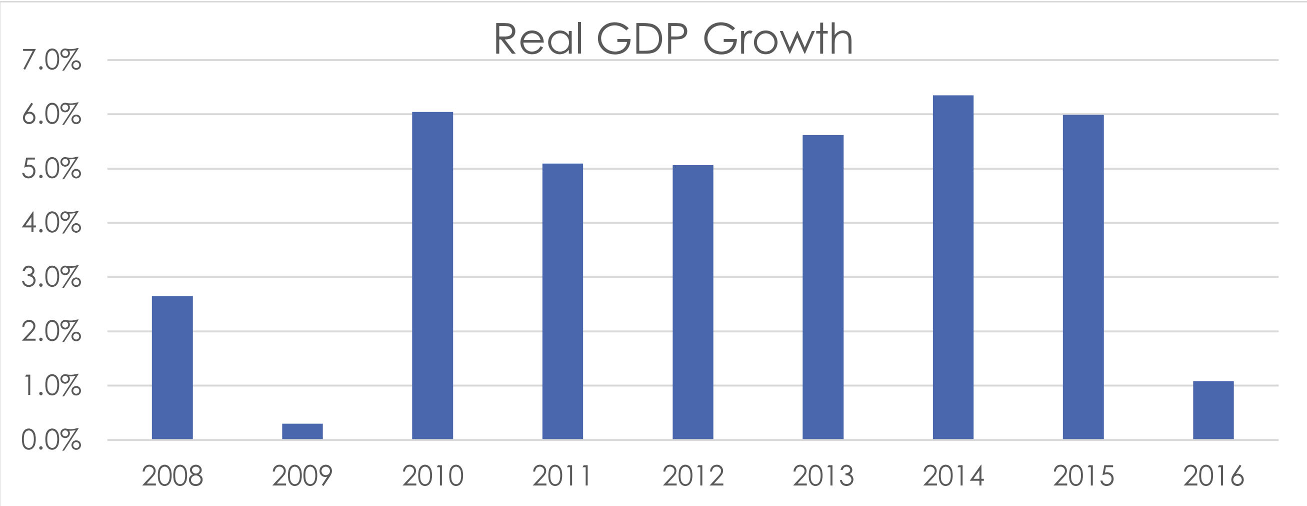
Growth in South Africa is expected to tick up, to 0.8% in 2017 and 1.6% in 2018, as drought conditions ease and commodity prices continue to rise. However, due to perceptions of deteriorating governance and rising policy uncertainty, short-term growth remains below general population growth. Inflation has moderated more quickly than expected, as good rainy seasons have allowed food price inflation to decelerate rapidly. This has allowed the South African Reserve Bank to embark on a rate cutting cycle in an effort to support economic growth.

Both Fitch Ratings and Standard and Poor's downgraded South Africa's foreign currency credit rating to sub-investment grade in April 2017. This followed the removal of Pravin Gordhan from the position of finance minister. Political gamesmanship such as the cabinet reshuffle that brought about this change are decidedly negative for investor sentiment and threaten the fragile economic recovery. Uncertainty in the political landscape will likely remain elevated until the ANC National Conference in December 2017, when the next president of the ANC will be elected.

Given the close ties between Namibia and South Africa, a low growth environment coupled with political uncertainty in our southern neighbour may have negative repercussions for trade and economic activity in Namibia as well. These repercussions may be moderated, however, by an easing in monetary policy in both countries. Of key significance during this time is the South African local currency credit rating. Should this rating be lost, a rapid outflow of funds from the South African bond market is expected to lead to a sharp depreciation in the Rand, and a swift end to the rate cutting cycle. In the event that a local currency downgrade takes place, South African economic growth is likely to remain lower for longer.

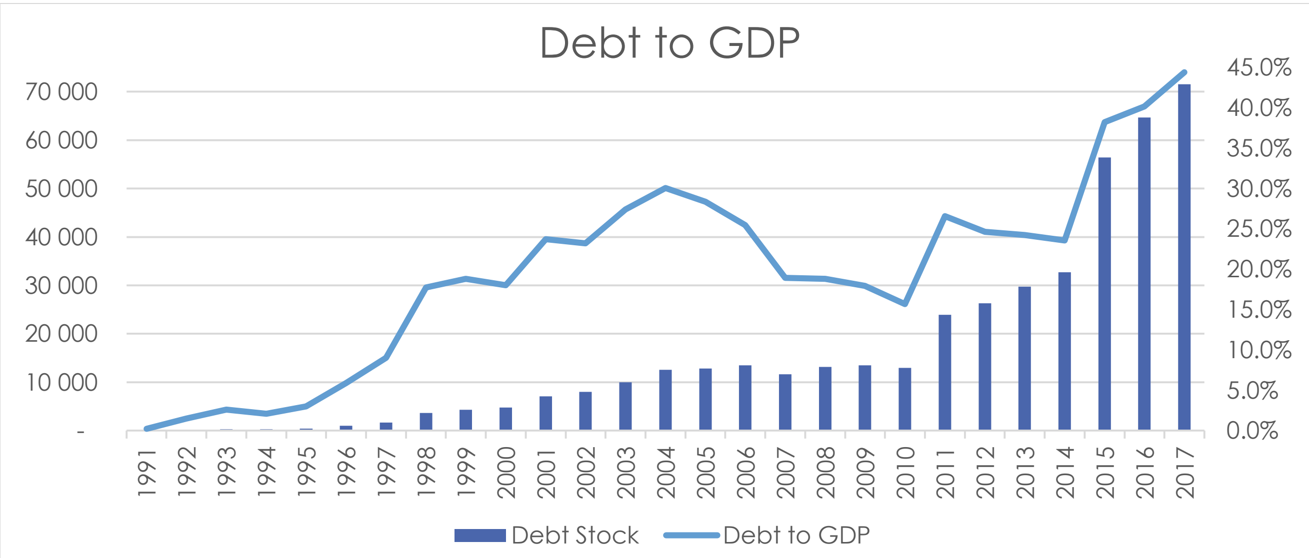
Domestic Developments

Prior to 2016 the Namibian economy made substantial gains, with growth averaging 5.7% over the six-year period between 2010 and 2015. These gains were driven by a combination of expansionary fiscal policy, accommodative monetary policy, and foreign direct investment into Namibia. In 2015 signs that economic growth was deteriorating were beginning to appear. Previous IJG Outlook documents pointed out that this was likely to be the case due to expansionary fiscal and monetary policy amplifying the business cycle to a point where the economy was overheating. A subsequent slowdown in foreign direct investment inflows and completion of construction on various mining projects, coupled with a slump in commodity prices and slowdown in government revenue growth, effectively applied the brakes on economic growth.



Source: NSA

Elevated levels of government expenditure led to a large increase in public debt during 2015 and 2016, limiting fiscal policy intervention. At the same time, the South African Reserve Bank (SARB) started hiking interest rates forcing Bank of Namibia (BoN) to follow, marking the end of monetary stimulus. This happened to coincide with a decline in commodity prices, decreased diamond production, slowing in the Angolan and South African economies, and local and regional drought. Thus, when economic stimulus was needed its application was limited due to pro-cyclical policy decisions taken in preceding years.



Source: BoN, IJG Securities

The Namibian economy now finds itself in a recession with little policy tools available through which to kick-start growth. Government debt is already at elevated levels and, since the Moody's downgrade to sub-investment grade, likely to become more expensive to raise going forward. BoN's monetary policy is effectively limited by the SARB's decisions due to there being no buffer between the rates of the two central banks. Limited policy space has left Namibia vulnerable to external shocks. We believe that rebuilding policy space is of fundamental importance in the current economic climate.

The Namibian economy showed signs of slowing during 2015, but these signs were largely masked by expansionary fiscal policy as well as the boom in construction which only began to taper toward the end of that year. It was by mid-2016 that the economic slowdown became evident. 2016 Final National Accounts data shows GDP growth figures for 2016 significantly depressed at 1.1% from 6.0% in 2015. The construction sector was hardest hit posting a real contraction of 26.5%. Diamond mining output too disappointed, contracting by 9.6% last year. The official figures do differ from our own and we elaborate on these differences later in this document.

Primary industries contracted by some 2.0% in 2016 following a 5.2% contraction in 2015. The decline in commodity prices, due to a drop in global demand, has proved to be a drag on the mining and quarrying sector for three years now. Agriculture and forestry grew by 0.8% in 2016 after significant drought driven contractions in 2013 and 2015. Fishing and fish processing displayed strong growth of 7.7% in 2016, largely supported by lower input costs and favourable currency moves. Within the mining sector. Uranium output grew by 13.6% in 2016 despite low uranium prices. However, uranium production is still significantly down from 2010 highs.

Secondary industries contracted by 7.8% in 2016, dragged down by a 26.5% contraction in construction activity. The manufacturing sector registered decent growth of 3.4% after contracting by 4.6% in 2015. Growth in the manufacturing of other food products of 4.0% more than offset a contraction in beverage production of 1.6%, and basic non-ferrous metals manufacturing returned positive growth of 1%, the first positive figure in 5 years.

Tertiary industries registered strong growth of 3.9% in 2016, elevating overall GDP into positive territory. Wholesale and retail trade, the largest contributor to GDP (among tertiary industry sectors), grew by 3.4%, down from 7.4% in 2015. Public administration and defence grew by 3.3% and real estate and business services by 2.5%. Financial intermediation grew by 3.7% during the year, while large contributors to GDP such as Education and Health recorded growth of 3.5% and 10.5% respectively.

Real GDP growth has been revised up to 1.1% from the preliminary National Accounts figure of 0.2% released earlier this year. Upward revisions to the preliminary data include growth in Agriculture and Forestry of 0.8% from -0.4% in the preliminary figures, a 2.2% upward revision in Manufacturing, a 3% upward revision in Construction, an upward revision in Hotels and Restaurants of 3.8%, a 1.3% upward revision in Public Administration and Defence and an upward revision of 1.7% for Education. These are all large line-items in the national accounts and explain the upward revision in overall real GDP growth to 1.1%.

GDP Growth

The National Accounts numbers are often revised as data is made available to the NSA after the figures are reported. Thus the 2016 National Accounts growth figures are likely to change with next year's National Accounts. For this reason, our models provide a "nowcast" of our expected growth for 2016. This "nowcast" is based off the official national accounts figures as well as our own industry research and inputs. The below table provides our expectations for 2016 growth and forecasts for future growth based on our research on various industries.

Real GDP Growth Rates	Actual		Nowcast	Forecast		
Industry	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Agriculture and forestry	11.1	-10.4	0.8	6.5	1.2	3.6
Livestock farming	13.9	-13.3	2.3	7.7	-0.3	2.6
Crop farming and forestry	7.6	-6.6	-1.2	5.0	3.2	5.0
Fishing and fish processing on board	-2.5	2.3	-1.3	-1.8	4.3	4.3
Mining and quarrying	-6.0	-4.9	-7.3	15.5	21.4	1.5
Diamond mining	4.9	-4.1	-10.8	18.0	7.8	2.5
Uranium mining	-9.9	-18.1	12.9	26.2	97.3	0.0
Metal ore mining	0.6	60.0	-8.8	2.6	0.0	0.0
Other mining and quarrying	-36.4	-44.1	-19.8	2.5	2.5	2.5
Primary industries	**-1.6**	**-5.2**	**-2.9**	**10.1**	**13.7**	**2.4**
Manufacturing	-0.4	-4.6	4.9	0.6	0.9	0.5
Meat processing	-17.2	-3.0	-2.1	3.4	0.9	0.4
Grain Mill products	13.7	13.0	0.7	2.5	2.5	5.0
Other food products	11.7	-12.3	4.0	0.0	-0.3	-0.5
Beverages	-16.5	-2.1	-1.6	2.6	1.2	1.1
Textile and wearing apparel	-2.9	-8.9	3.7	-3.5	3.7	-3.5
Leather and related products	10.7	-1.8	-3.4	0.0	0.0	0.0
Wood and Wood product	1.7	-2.6	3.5	-2.1	-0.2	0.5
Publishing and Printing	10.6	6.3	-1.5	-7.2	0.0	2.2
Chemical and related products	1.2	-3.3	-2.6	-5.0	0.0	0.0
Rubber and Plastics products	5.4	26.9	5.8	4.5	4.5	4.5
Non-metallic minerals products	5.6	8.1	-0.1	-2.4	1.7	-0.3
Basic non-ferrous metals	-3.2	-8.3	7.2	-1.7	-1.7	-1.7
Fabricated Metals	3.7	-6.4	4.9	-0.3	1.3	0.4
Diamond processing	19.0	-24.1	65.9	10.0	5.0	2.5
Other manufacturing	-2.9	-8.1	-13.8	5.0	0.0	0.0
Electricity and water	1.5	14.2	6.8	0.9	0.9	0.9
Construction	42.6	26.0	-26.5	-10.0	5.0	5.0
Secondary industries	**10.7**	**7.2**	**-6.9**	**-2.6**	**2.1**	**1.8**
Wholesale and retail trade, repairs	13.9	7.4	-2.5	-10.0	0.0	2.5
Hotels and restaurants	10.8	5.6	5.1	6.5	6.0	6.0
Transport, and communication	5.7	6.9	6.1	2.1	2.6	3.3
Transport	3.3	7.9	4.7	2.0	2.5	3.9
Storage	5.7	-0.6	1.2	2.5	3.0	2.7
Post and telecommunications	8.6	8.9	9.5	2.0	2.5	3.0
Financial intermediation	10.9	3.7	3.7	-1.0	2.5	3.0
Real estate and business services	2.7	4.7	2.5	-1.7	0.4	3.5
Real estate activities	3.0	3.6	2.6	-2.0	0.0	3.9
Other business services	1.7	7.8	2.1	-1.0	1.5	2.4
Community, social and personal service activities	3.0	12.6	1.9	1.7	1.7	1.7
Public administration and defence	1.4	13.0	3.3	-5.5	-2.0	0.0
Education	10.3	4.1	3.5	3.1	3.1	3.1
Health	10.2	16.7	10.5	1.0	1.0	1.0
Private household with employed persons	5.5	1.7	1.4	2.5	2.5	2.5
Tertiary industries	**7.7**	**7.6**	**2.6**	**-2.4**	**1.0**	**2.4**
Less: Financial intermediation services indirectly measured	5.3	0.1	0.6	0.5	6.1	6.1
All industries at basic prices	**6.5**	**5.4**	**-0.1**	**-0.6**	**3.3**	**2.3**
Taxes less subsidies on products	4.1	12.5	4.5	0.0	0.0	5.0
GDP at market prices	**6.3**	**6.0**	**0.3**	**-0.6**	**3.0**	**2.5**

Source: NSA, IJG Securities

2016 Nowcast

Our approach when integrating the 2016 final national accounts figures was to make use of the official figures wherever they were close to our estimated figures. For those line-items where we have reason to believe that our estimates are a better reflection of reality or or where we believe future revisions will be made we retain our modelled estimates unchanged.

We estimate a contraction of 2.9% in primary industries in 2016. This differs from the final national accounts figure of -2.0% due largely to slightly lower diamond production growth, slightly lower uranium production growth and a contraction in metal ores mining stemming from lower zinc, lead, and copper concentrate production figures. The contribution of primary industries to GDP has declined from over 22% in 2007 to under 14% in the latest set of results. Over this period primary industries have contracted by 9.6% in real terms indicating an economy that is increasingly services driven. The number of people employed in primary industries in 2016 was down 34.3% from 2014, largely due to agriculture, forestry and fishing sectors shedding jobs.

Similarly, the contribution of secondary industries to GDP has decreased from 17.9% to 16.5%. The final national accounts figure for 2016 indicates a contraction of 7.8% in secondary industries, compared to our estimate of 6.9%. Much of the difference stems from our estimate of basic non-ferrous metals production growth of 7.2% versus 1% growth in the NSA figures. Our estimate is based off copper cathode production which is classified as a manufacturing activity. Copper cathode production increased by 55.7% according to data supplied by the chamber of mines. Interestingly, despite the decline in secondary industries' contribution to GDP, employment is up 28.4% in the last two years.

Tertiary industries make up 62.1% of the Namibian economy, up from 53.6% in 2007. According to the final national accounts these industries grew by 3.9% in 2016 after growing by over 7% for the three preceding years. We estimate a more conservative growth figure of 1.7% for tertiary industries last year. Large line-items where our estimates diverge from the national accounts include wholesale and retail trade, as well as public administration and defence. We do not believe that wholesale and retail trade recorded growth of 3.4% in 2016, we conservatively estimate a contraction of 2.5%. This is based on discussions with industry, a decrease in Angolan retail tourist activity and declines in foot-counts in some of the larger centres. Additionally, employment in the sector has decreased by 32.4%, shedding over 31,000 jobs between 2014 and 2016 according to the NSA. The deflator for this sector also seems low at 5.1% considering that inflation for the basket categories that fall under wholesale and retail trade experienced inflation of over 7% on average in 2016.

The national accounts figures show that the public administration and defence figures were inflated from nominal to real in 2015 and that the deflator in 2016 was below 1%. This seems removed from reality, a feeling which is reinforced by the fact that nominal public expenditure in the budget has decreased for the 2016/17 year while the nominal figure in the national accounts has risen by 4%. Despite our suspicion of the growth figures for public administration and defence we have used the official figures in the above table. Should we adjust growth for this sector down to zero (which may still be too optimistic), our GDP growth for 2016 falls to zero too. Public administration and defence employment also dropped by over 28% between 2014 and 2016, casting further doubt on the growth figures.

Given that quarterly GDP growth figures for the last three quarters of 2016 were negative, and factoring in the above arguments, it would seem that the official growth figures are optimistic. We optimistically expect that the economy grew by 0.3% in 2016, but only if the anomalies for public administration and defence hold true. It remains highly likely that real GDP growth for 2016 was negative in reality.

Revised 2017 Outlook

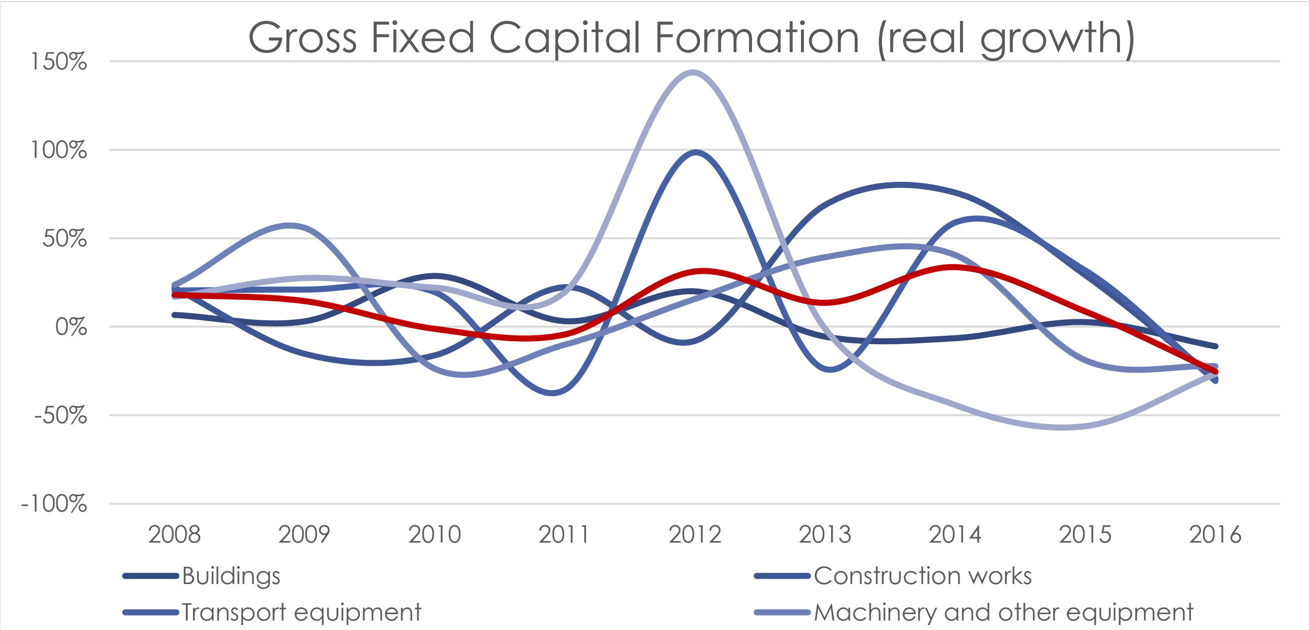
Industry	Jan 2017	Aug 2017	Explanation
Diamond mining	24.0	18.0	Based on production figures for 2017 thus far we have reduced our expected growth in diamond production.
Uranium mining	104.6	26.2	Due to delays in the Husab mine coming online, as well as plant challenges, we now expect a more modest increase in uranium production. We now expect Husab to reach full production in 2019.
Grain Mill products	8.8	2.5	After strong growth in grain mill manufacturing in 2014 and 2015, we expect to see growth slow as prices normalise following the end of the regional drought.
Diamond processing	-7.0	10.0	We expect diamond processing to be up further in 2017 due largely to increased diamond production.
Construction	-8.0	-10.0	Industry insiders point to greater declines in construction activity than first assume. Unpaid invoices were also underestimated and project delays are resulting in additional costs.
Financial intermediation	5.0	-1.0	PSCE growth continues to slow. Banks are more cautious to lend, especially to individuals and certain business sectors. Real growth may well be negative in 2017.
Real estate and business services	3.0	-1.7	We expect to see a contraction in real estate services particularly as property prices stagnate or decline.
Public administration and defence	-7.5	-5.5	We expect a smaller contraction in this line-item due to uncertainty surrounding 2015 and 2016 figures where our expectations deviated from the official figures.

The above table represents some of the larger line-items in the national accounts and what we expect from these in 2017. We forecast a contraction of 0.6% for the year as such. Growth in primary industries, specifically mining, is expected to be offset by contractions in secondary and tertiary industries.

Fixed Capital Formation

Fixed capital formation is likely to contract again in 2017 after a 25% contraction in 2016. This contraction does come off a substantial base, largely as a result of foreign direct investment (FDI) flows slowing after the completion and near completion of three large mines in 2015. Fixed capital formation contracted in real terms in all five asset classes displayed below. Construction works, the largest of these asset classes over the last three years, contracted by 29%. Investment into transport equipment contracted by 31%, while investment into machinery and other equipment fell by 22%.

By far the smallest asset class, mineral exploration, has registered declines in fixed capital formation for the last four years. Despite this asset class' insignificant weighting, much of the fixed capital formation in recent years was related to the construction of mining operations, and as such this does not bode well for expectations of growth in fixed capital formation going forward. Low future fixed capital formation in turn points to a possible further decrease in the roles played by primary and secondary industries in the Namibian economy. While not necessarily a bad thing, such a shift toward tertiary industries will necessitate the generation of foreign currency earnings through tertiary industries in order to maintain the external position of the country.



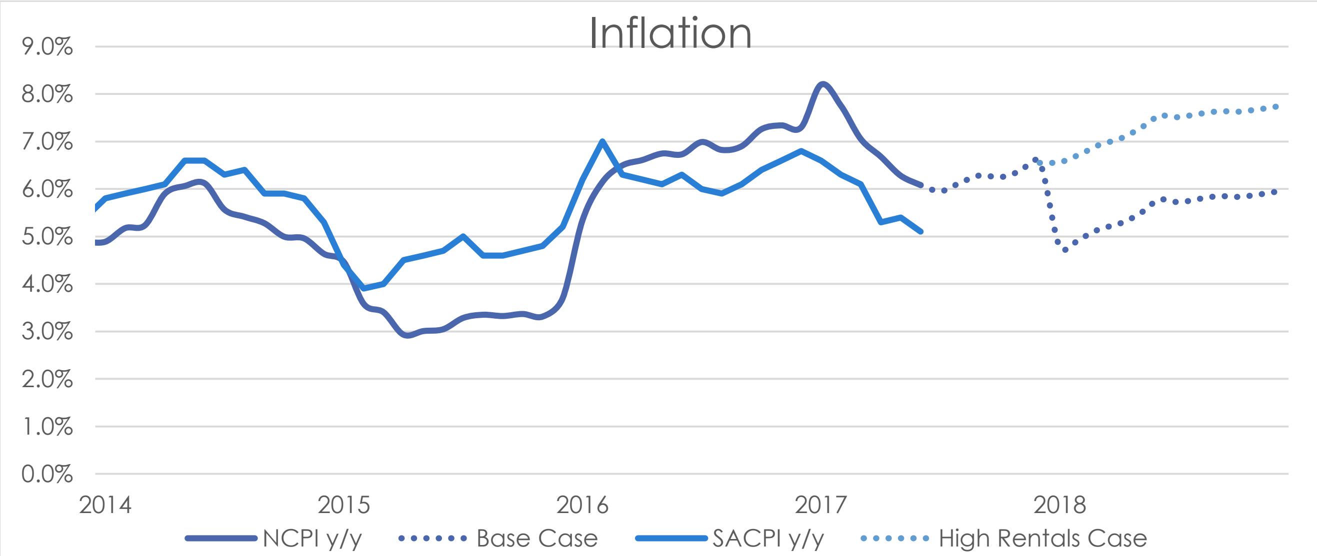
Source: NSA

We expect further declines in fixed capital formation in 2017 as the economy languishes. Delays in construction projects in particular are set to be a drag on investment as budget allocations within the 2017/18 budget year are insufficient to allow for completion of these in many cases. As such much of the work in progress previously expected to contribute to GDP growth will not materialise. These projects fall under public investment, which has to date posted positive growth in fixed capital formation.

The large decrease in fixed capital formation in 2016 stems from a decrease in private investment into fixed assets. As mentioned earlier this is as a result in a slowdown of FDI inflows. FDI inflows thus have a sizable impact on GDP growth in Namibia and as such investor confidence is something our small open economy cannot afford to lose. The recent credit ratings downgrade is one example of a loss in investor confidence which, if persistent, will see Namibia enter a prolonged period of slow growth.

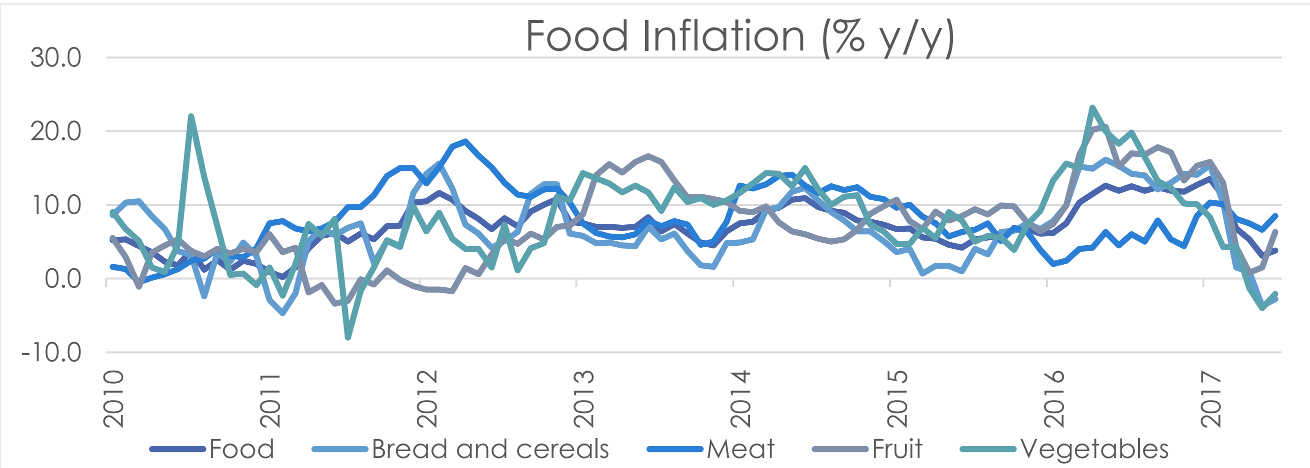
Inflation

The South African inflation rate has returned to the 3-6% target range, as per the SARB's expectations. However, the most recent readings have surprised to the downside as inflation moderated more rapidly than expected. The downside surprises have largely been due to slowing food price inflation as the effects of the drought in the Southern African region ceased and agricultural production picked up. Similarly, the Namibian headline inflation rate has also moderated expeditiously, driven by the same factors. However, Namibian inflation remained above 6% for the first half of the year, dropping to 5.4% in July.



Source: NSX, IJG Securities

The Namibian annual inflation rate is expected to average 6.6% in 2017, down from 8.2% in January. This is largely due to a slowdown in food price inflation as well as a smaller pass-through effect of sin taxes on the price of alcoholic beverages and tobacco. Administered price increases such as those for water and electricity tariffs that come into effect in the second half of the year underpin our expectations. Inflation has briefly dipped below 6% before we believe it will commence on an upward trajectory leading up to 2018. Should rental escalations higher than 9% be captured in January 2018 (as was the case in 2017) then we are likely to see inflation exceed 7% during 2018. Should rental escalations come in at long term average levels then inflation could dip below 5% due to base effects.

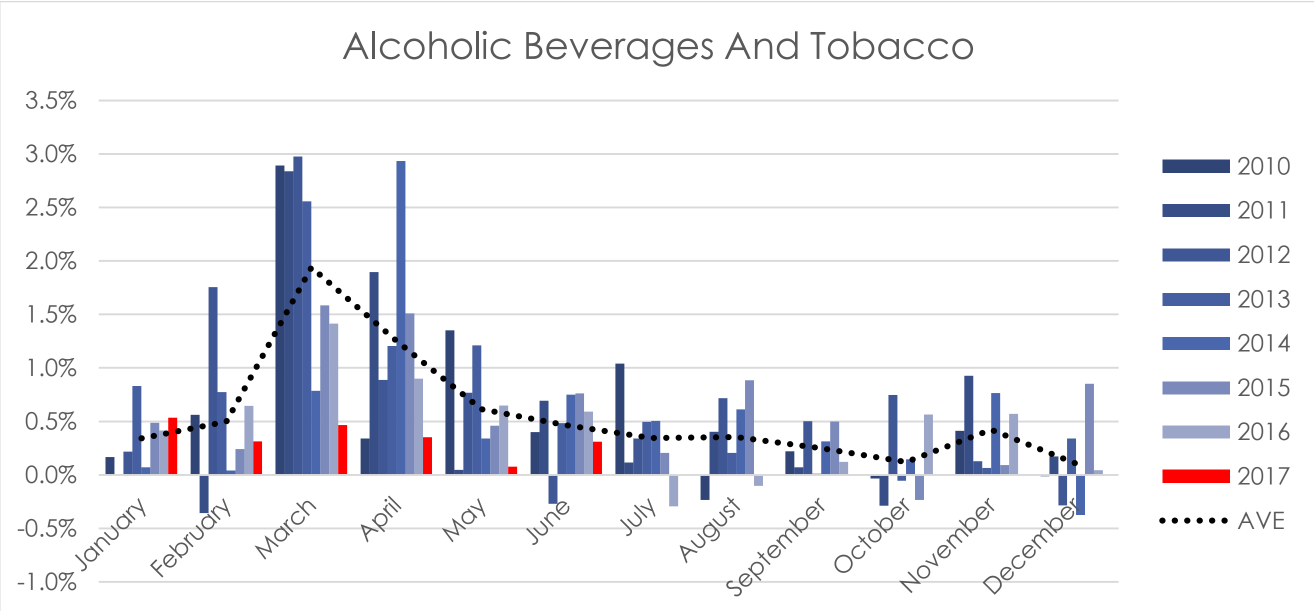


Source: NSA, IJG Securities

The general decline in food inflation is largely on the back of a broad recovery in agricultural production. In fact, bread, cereal and vegetable prices have recorded year on year decreases in price. While we expect the overall food inflation to continue to decelerate moderately over the coming months on the back of large maize and vegetable supplies, meat price inflation should remain high as farmers rebuild their herds. Additionally, the outbreak of avian flu has halted the import of chicken to Namibia. As a result of the reduced supply, we expect chicken prices to remain elevated.

Housing and utilities remains the largest contributor to annual inflation due to its 28.4% weighting in the basket and the effect of irregularly high rental increases of 9.7% in January. Furthermore, the City of Windhoek has put into effect a 13% tariff increase on water consumption, effective the 1st of June, with a request for a 10% electricity tariff increase submitted to the Electricity Control Board (ECB) pending approval. With the increases in utilities likely to be passed on to the consumer, we believe that this will most likely put upward pressure on this basket category going forward.

Based on our model, inflation is set to rebase in January 2018 if rental increases revert to normalised levels. We believe this is likely as the housing market in Namibia, Windhoek specifically, has softened. Rental escalations should be contained as tenants have more bargaining power in negotiating rentals. However, if rental escalations more than 9% are seen again, then the inflation is likely to continue on its current trajectory, averaging around 7% in over the next 18 months.



Source: NSA

Additionally, Alcoholic beverages and tobacco, which make up 12.6% of the overall inflation basket, recorded an average of 5.2% increase in the first six months of the previous six years. This is normally a result of the annual increase in sin taxes. However, this year increases in these products amounted to only 2.1% despite sin taxes increasing at the usual rate. This resulted in our inflation expectation decreasing by 0.4%.

Due to these factors, we have revised our inflation expectations for 2017 down to 6.6% from our previous revision of 7.4%. The main reason for the decrease comes from the faster than expected deceleration in food price inflation, but also the anomaly witnessed in alcoholic beverages and tobacco category. Our inflation expectation continues to be underpinned by the high inflation for rental payments, currently at 9.6%, which will provide buoyancy to the overall inflation number for the rest of the year.

Interest Rates

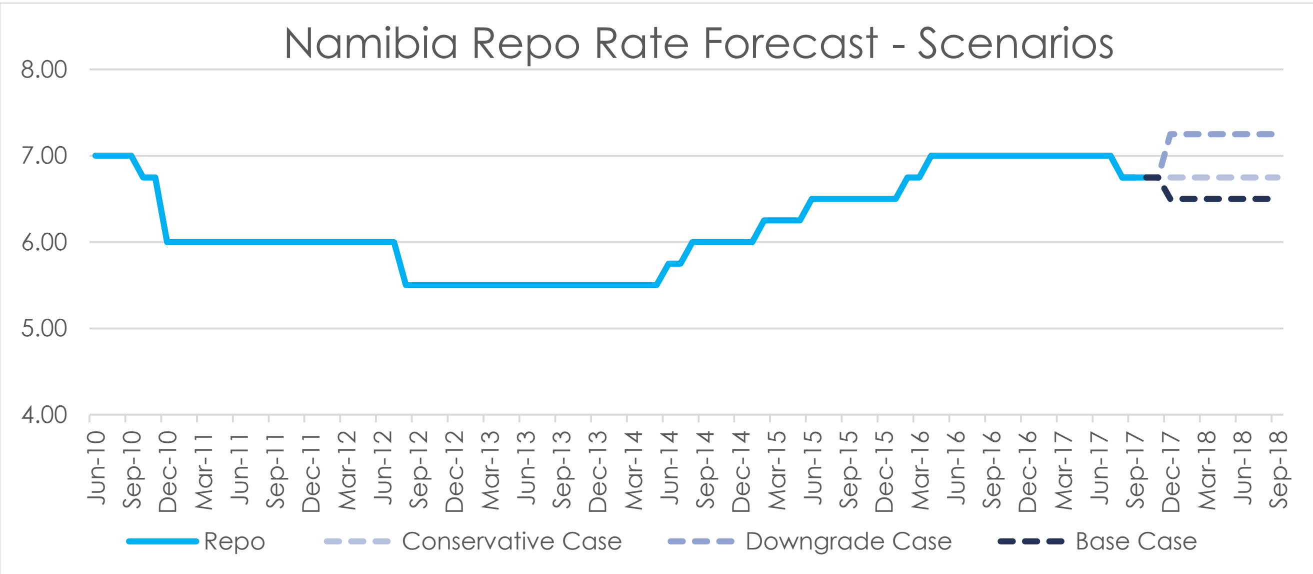
Until August this year, the Namibian repo rate remained constant at 7% since April 2016, after a two-year rate hiking cycle. The pace and magnitude of the hiking cycle was moderate in both respects and monetary policy remained relatively accommodative as a result. During the rate hiking cycle, the Bank of Namibia (BoN) allowed the 50 basis point buffer between the South African benchmark rate and Namibian benchmark rate to close. As a result, toward the end of the hiking cycle, BoN was forced to follow the SARB's hiking path, albeit with a one-month lag.

The July SARB monetary policy meeting saw an unexpected 25 basis point cut in the South African repo rate. While a rate cut during the course of 2017 was expected, it was largely expected to take place toward the end of the year. The South African economy has languished in a low growth environment for some years now, in much need of stimulation. The SARB, as an inflation targeting institution, was not able to provide accommodative policy due to elevated rates of inflation as well as political pressure on the currency. Stability in the rand and a falling inflation rate during the first half of 2017 provided the necessary conditions for interest rates to be cut, in support of economic growth.

The SARB is expected to announce one further 25 basis point cut during the second half of 2017, and this forms our base case expectations for interest rates going forward. We expected BoN to follow the SARB and cut rates at the recent August MPC meeting. This proved correct and we believe that, should the Rand maintain current levels, another SARB interest rate cut towards the end of 2017 is expected. As the Namibian economy has come under pressure, our base case scenario expects BoN to cut interest rates, effectively following the SARB. Thus, it is likely that the Namibian economy will benefit from a further interest rate cut of 25 basis points.

Risks to the base case are that the political environment in South Africa leads to further credit ratings downgrades. Should South Africa lose its local currency investment grade rating, large fund flows out of South African bonds will take place. This will lead to currency depreciation and an uptick in inflation as a result. In our downgrade scenario, the SARB will be forced to defend the currency by raising interest rates by at least 50 basis points.

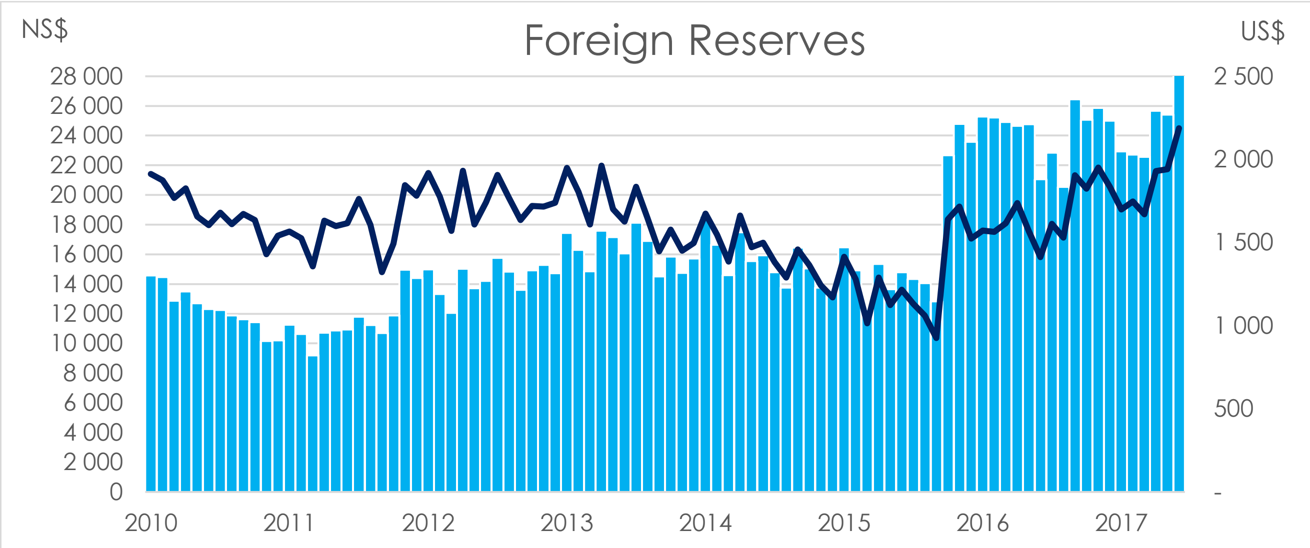
The conservative case scenario is one where the SARB adopts a wait and see policy in the build-up toward the ANC National Conference. Political gamesmanship may lead to a volatile Rand and thus the SARB may wait for this event to pass in order to determine the direction of interest rates necessary for price stability going forward.



Source: BoN, IJG Securities

The above scenarios are centred around the SARB's possible decision on policy rates, with BoN likely to continue following the SARB. The past 12 months have been characterised by fiscal consolidation efforts from government coupled with BoN's tightening cycle. There's been an improvement in the commercial banks liquidity position, with the influx of funding from SACU receipts and the African Development Bank (AfDB) loan. Current economic conditions are in support of, or rather, in need of, a turn towards relaxed monetary policy in aid of supporting a struggling economy.

External Position



Source: BoN

Foreign reserves reached their highest levels yet in both local and hard currency terms in June this year as the first tranche of the AfDB loan was received and parked with BoN. Improved SACU receipts have bolstered this position further. At present, it would seem as though the external position is in good stead. However, this elevated level may be short lived as the first tranche of the AfDB loan is earmarked for use within the current budget year. Consequently, these funds are unlikely to remain with BoN and it is likely that some of these funds have already been used for operational expenditure purposes. However, removing the N$3 billion AfDB loan from the foreign reserve position still results in adequate reserve levels to cover imports and currency in circulation.

At current levels of imports and exports there remains a natural rate of decline in foreign reserves. To some extent SACU receipts balance this difference out, but not completely. In the past, investment flows into Namibia have mitigated the effects of the large merchandise trade deficit for the most part. The slowdown in foreign direct investment into Namibia may result in the external position coming under pressure again in the years to come. Investor confidence plays a large role in a small open economy like Namibia's. Recent years have seen a decline in investor confidence. The decrease in fixed capital formation in 2016 points to this. The recent Moody's downgrade in August is also a clear sign of a loss in investor confidence.

Conclusion

Peaks and troughs in the business cycle are normal, as are recessions. The fact that Namibia is now experiencing a recession is not unique, nor something to be ignored. Recognising and addressing the factors which brought about the current downturn are necessary in order to prevent the same happening in the future.

Namibia will recover from this current economic slowdown, but this is likely to take some years. Pro-cyclical fiscal policy, which contributed to the overheating of the economy, may now result in it languishing in a low growth environment for an extended period. Balancing structural reforms while undertaking fiscal consolidation will be challenging, but necessary. Fiscal policy space needs to be created through structural reforms to government's expenditure profile in order to return expenditure to sustainable levels. The current process of fiscal consolidation is the first step in the right direction. The rate at which recurrent, consumptive expenditure, has increased over the last few years needs to be reduce drastically in order to grow productive expenditure.

The outlook for the rest of the year and the year to follow remains downcast. The fuscus is likely to remain under pressure and low liquidity, such as that seen in 2016/17, could reappear going forward. Namibia is now more vulnerable to external shocks than at any point since the global financial crisis due to limited monetary and fiscal policy space. Effective fiscal reforms and consolidation, investor friendly policy, and public-private cooperation are the tools that remain available to us, and if implemented effectively, are likely to lead to a return to long term sustainable growth.

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