IJG SECURITIES

ECONOMIC OUTLOOK 2018

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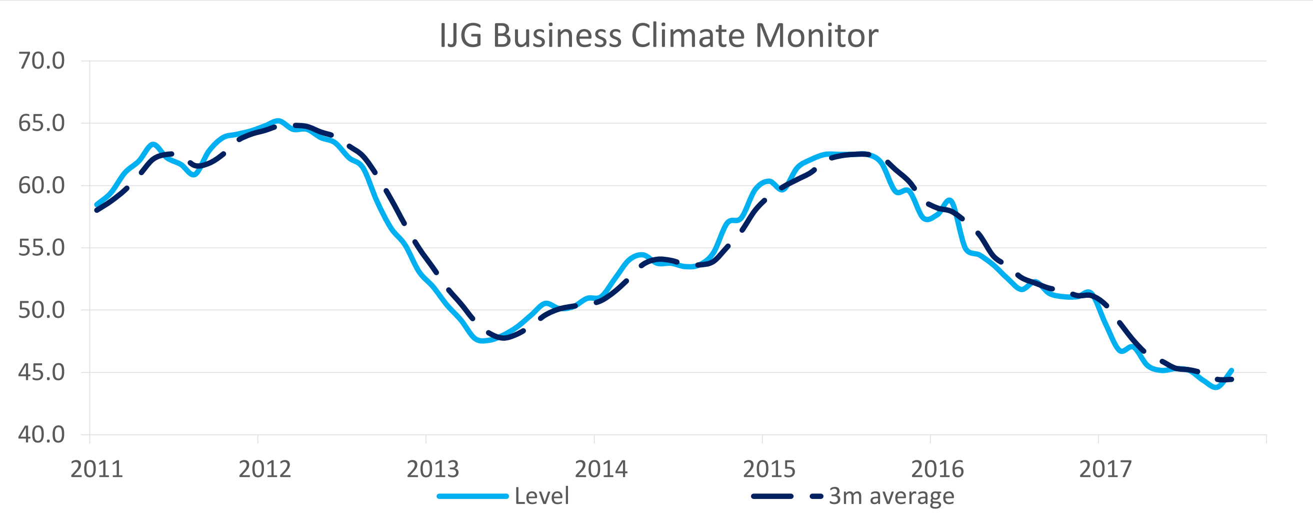
Outturn of 2017

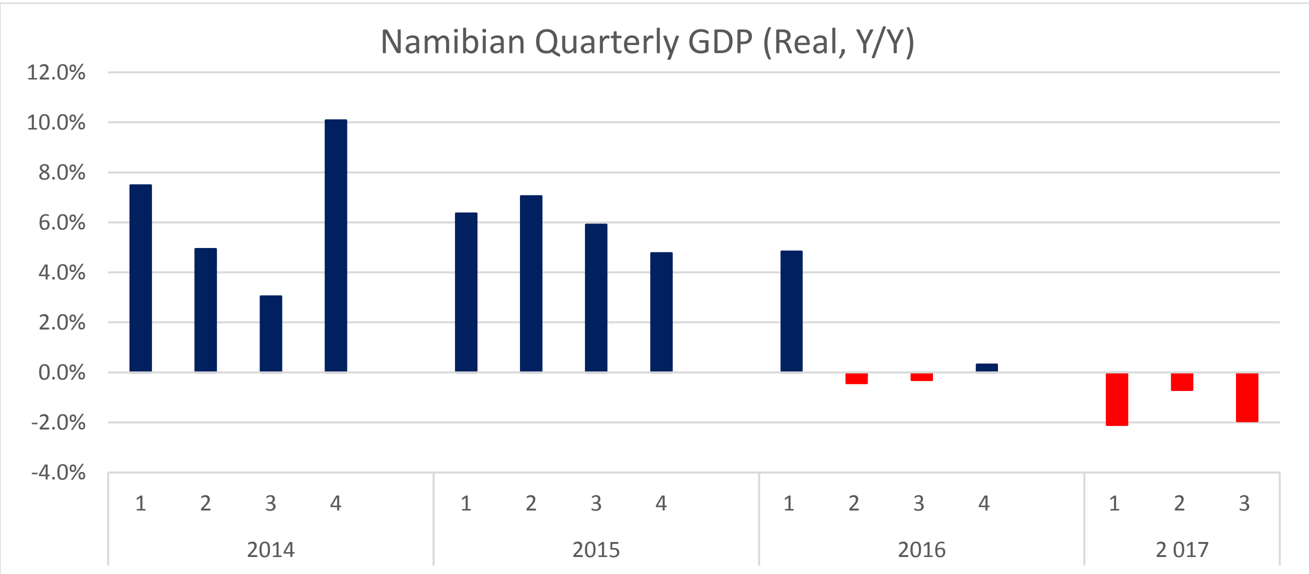
It is challenging to view 2017 with much optimism when looking at the Namibian economy as a whole. Despite initial optimism forecasting a recovery after the rapid economic deceleration witnessed in the previous year, a multitude of high frequency indicators show that the slump experienced in 2017 was likely worse than in 2016. The effects of continued depressed economic conditions on business confidence is very evident in credit extension figures and commercial vehicle sales, among others. However, it would be wrong to assume that there were no metaphorical silver linings during the year. Below is a brief look at the good, the bad and the ugly for 2017, in reverse order.



Source: IPPR, IJG

The Bad and the Ugly

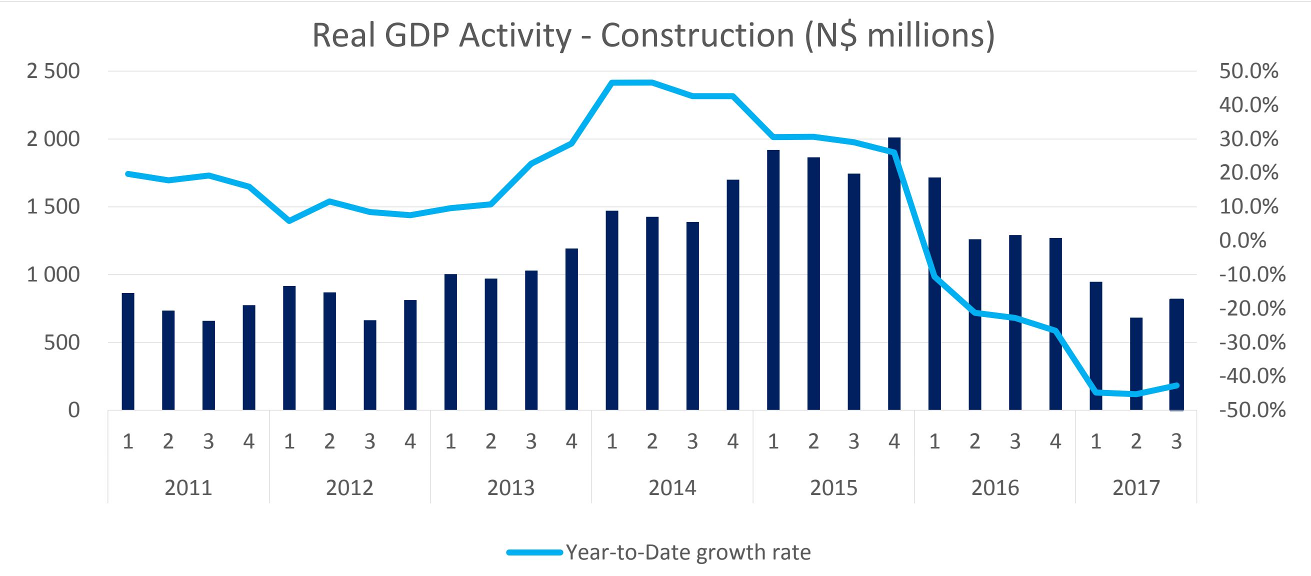
The poor performance of the Namibian economy in 2016 spilled over into 2017 from an elevated base set in 2015. This base, set over the previous half decade, was largely the result of above average growth due to a mixture of political and economic stability underpinning foreign direct investment, rapidly increasing government expenditure partially fuelled by an expansion of public debt, and private consumption growth fuelled by real wage increases and private sector credit extension. As much of this economic expansion was fuelled by public and private debt combined with foreign investment into specific mining projects, a slowdown was to be expected.



Source: NSA

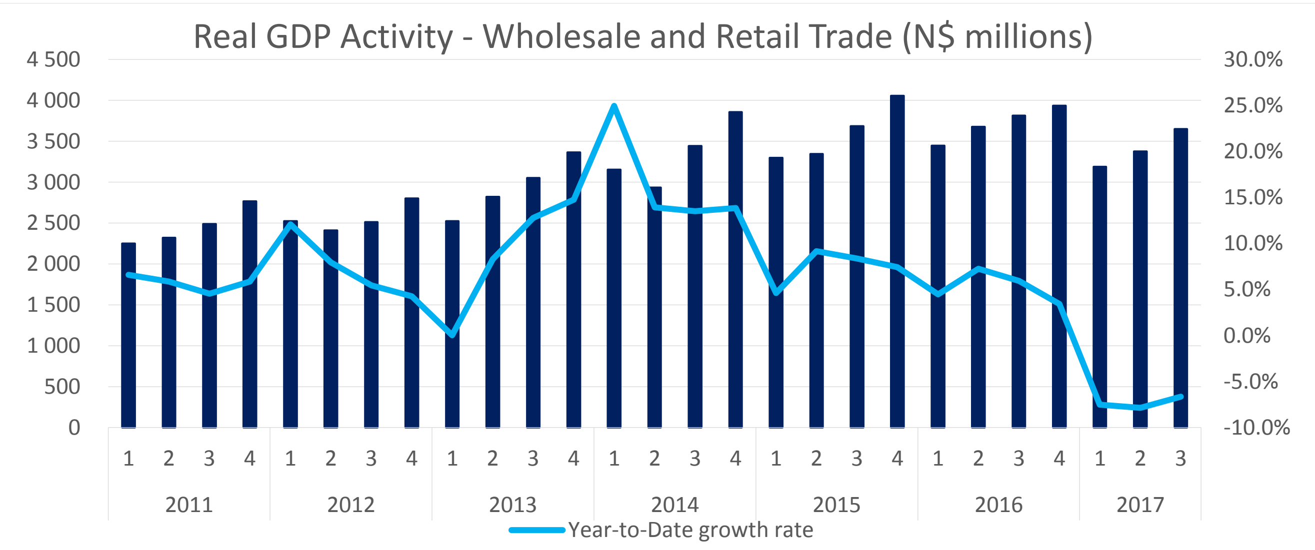
Real GDP growth, as shown in the above figure, came to a halt in the second quarter of 2016, with all three quarters of 2017 indicating an economic contraction. A contraction for the first three quarters of 2017 of 1.6% on a cumulative basis points to a very high likelihood for an official (NSA data) contraction for the year. While the quarterly GDP data could still see some revision by the time that the final national accounts are released in the second half of 2018, there is little chance of positive real growth being recorded for 2017 once the dust settles.

While the economy as a whole shrunk in real terms, some sectors performed worse than others. Construction was the main drag on the economy, largely due to the transitory nature of the sector. The completion of the B2Gold, Tschudi, and Husab mines in preceding years, as well as the slowdown in government spending on capital projects, resulted in a substantial contraction of over 50% from the peak for the sector. In addition to the above causal factors, the slow payment of government for work done exacerbated the contraction in the sector and resulted in layoffs and increased costs for projects affected by delays. The increase in costs for capital projects undertaken by government has the further knock on effect of contributing to an increase in government debt which may limit the extent to which debt may be raised to fund future projects, effectively creating a drag on the future performance of the sector.



Source: NSA

Wholesale and retail trade posted the second largest value decline in real terms and has contracted 5.7% from the cumulative four-quarter peak recorded in Q3 2016. The latest quarterly GDP figures (Q3) show that the sector is trailing not only 2016 in real terms, but 2015 as well. The slowdown in the construction sector resulted in large layoffs which would have played a role in wholesale and retail trade performance. Unemployment resulting from the drought is likely to have contributed as well as tighter credit conditions.

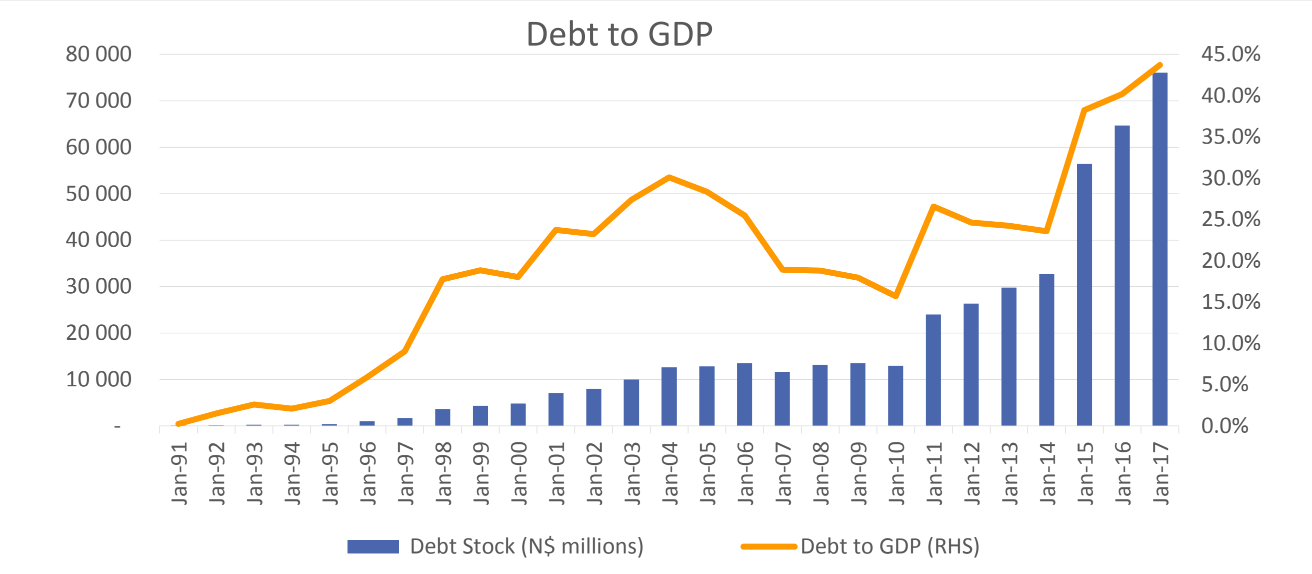


Source: NSA

The last major drag on real GDP stemmed from public administration and defence, or government. Government spending has been streamlined and wasteful habits curtailed to some extent. This is of course a positive action given the disproportionately large role that government plays in the Namibian economy. After years of running large deficits and expansionary budgets some consolidation in government was necessary, and the resulting drag is thus due to a normalisation of government operational expenditure. The fact that this contraction in government activities coincided with the overall economic slowdown is also not surprising due to the role that government plays in the economy.

Debt-to-GDP

A rapid increase in debt-to-GDP during the last few years was the result of years of running large budget deficits. A slowdown in government revenue collection and elevated expenditure profile caused large discrepancies between forecasted budget deficits and actual deficits. Budget deficits were funded by a mixture of foreign and domestic debt issuance, at a rate previously unheard of. As much of government's expenditure is consumptive in nature the debt raised to fund these deficits did not add much to productive capacity. This is particularly concerning given that Namibia currently has a growing infrastructure deficit and further infrastructure development is necessary to support a sustainable growth rate going forward.



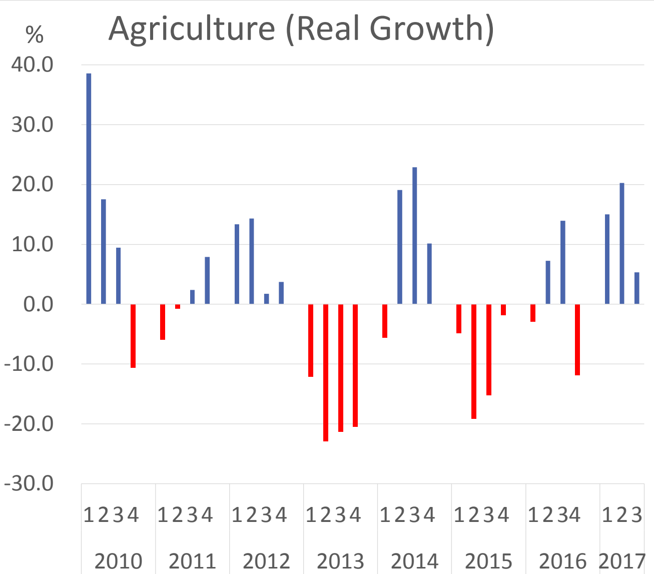
Source: BoN, IJG Securities

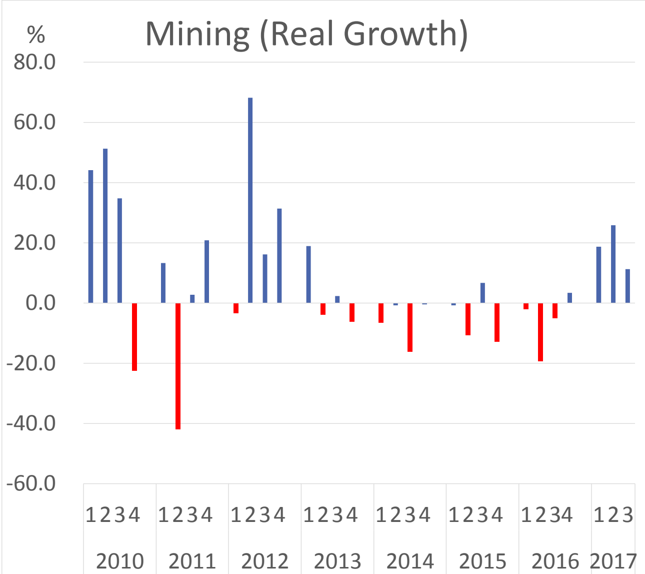
Credit Ratings

Fiscal slippage and large twin deficits in a low growth environment contributed to the downgrade of the Namibian credit rating in 2017. Moody's was first to downgrade the Namibian sovereign to sub-investment grade in August. Fitch ratings followed in November, also downgrading Namibia's credit rating to sub-investment grade. The two reports echoed concerns that IJG previously documented in earlier Outlooks and Budget reviews. Structural issues in fiscal expenditure, namely a bloated civil service wage bill and related consumptive expenditure, placed pressure on development spend resulting a drag on the economy. While not sustainable in the long run, this fiscal indiscipline was masked in the short run by rapid growth in government revenues. As revenue started to falter, debt was issued at a rapid rate in order to service the larger than expected budget deficits. This increase in debt decreased the policy space required to deal with the shock of a downturn in the commodity super-cycle. These factors make Namibian debt relatively riskier and as such the credit ratings agencies had little choice other than to downgrade their ratings of the Namibian sovereign.

The Good

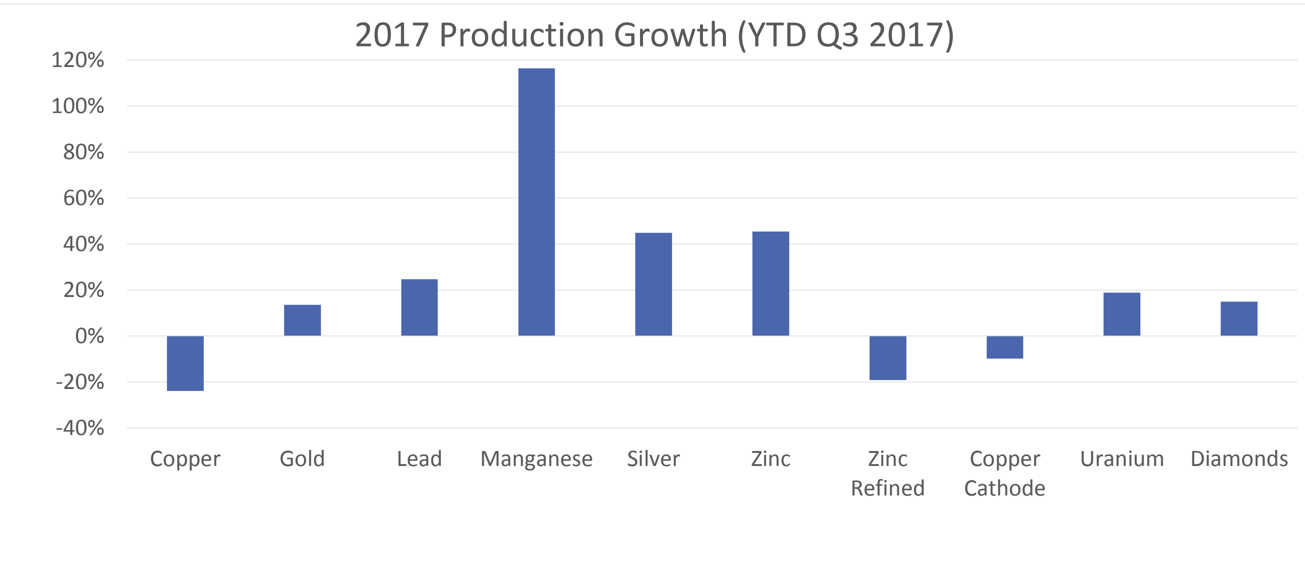
The fact that the contraction in the local economy was not larger is due to strong performance from the primary industries. While fishing has been performing sub-optimally as a sector for a number of years now, mining and agricultural activity more than made up the difference in 2017.





Namibia suffered a longwinded drought between 2013 and 2016 which resulted in poor agricultural performance over the period. The above average rainy season in 2016/17 resulted in the sector rebounding to normal levels and thus contributing to positive GDP growth from the primary sectors. Agriculture plays a large role in the wellbeing of a large portion of the population and as such the rains brought much relief. Record white maize production resulted in Namibia being approximately 50% self-sufficient in this regard. Mahangu production posted a strong rebound during the year. The drought has left many communal and some commercial livestock farms with reduced herds though, and it will take some time to rebuild these going forward. The record number of cattle (largely weaners) marketed to South African feedlots during 2017 has sustained many commercial beef farmers in 2017 but will act as a drag on future production.

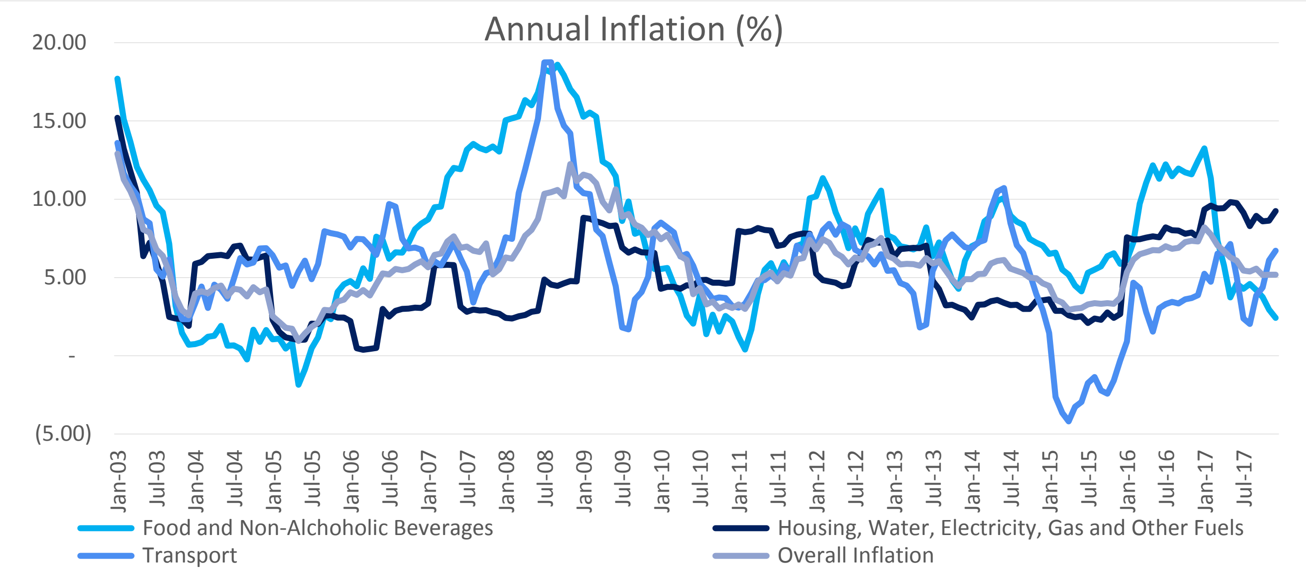
The strongest performance by any sector in 2017, in terms of contribution to growth, came from the mining sector. While numbers have not been finalised, Diamond, Gold, Uranium, and Zinc production showed strong growth over the first three quarters of the year. Uranium production was buoyed by production from the Husab mine despite Rössing and Langer Heinrich struggling as a result of low uranium prices. Diamond production was supported by strong growth in marine diamond mining while land based mining operations remained challenging. The B2Gold mine continued to produce record amounts of the precious metal, supported by low cash costs. Zinc production picked up in 2017 off a low base set in 2016, although refined zinc production lagged mining activity.



Source: Chamber of Mines (subject to change with Q4 data release)

Inflation

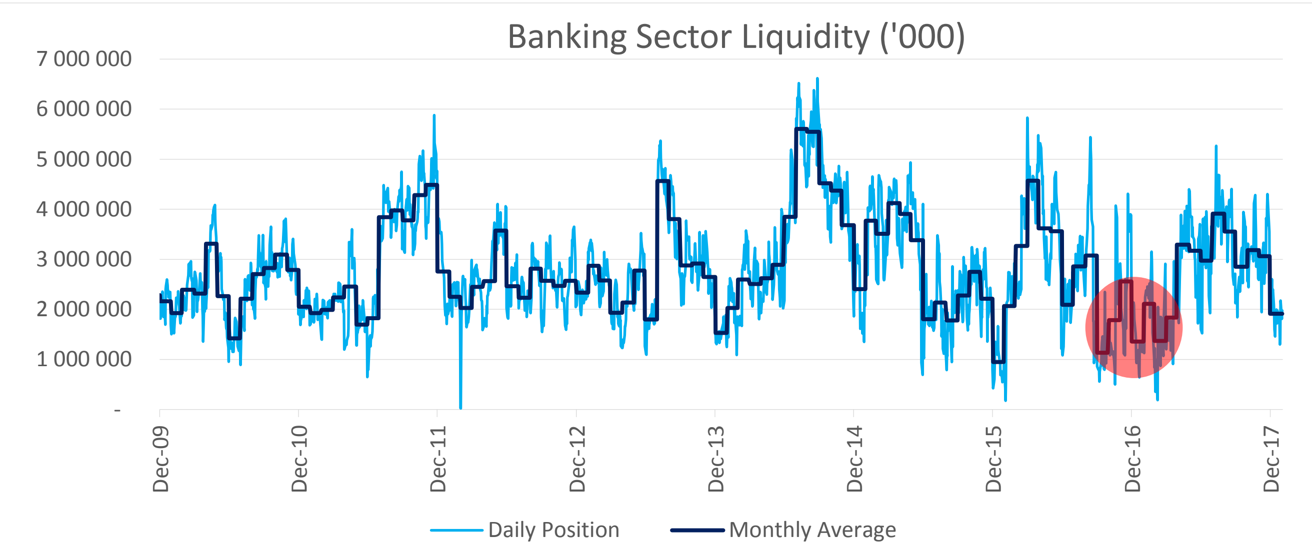
Inflation was a source of some relief in 2017, largely driven by a moderation in food price increases. Average inflation for 2017 was 6.2%, with annual inflation falling to 5.2% in December. Food and non-alcoholic beverage prices increased by only 2.4% y/y in December, providing much relief to lower income households who spend a greater proportion of their incomes on this basket. Some of this relief would have been offset by higher transport and utilities costs but the overall moderation in price increases remained skewed to the positive.



Source: NSA

Liquidity

Banking sector liquidity which all but dried up towards the end of 2016 (highlighted below), improved from the second quarter of 2017. The use of the Bank of Namibia's repo facility went from being the norm to seeing light use over the majority of the year. Liquidity during the year was supported by higher SACU revenues, inflows from various foreign loans as well as regulated capital repatriation. The overall improved health of government's cash balances and the payment of outstanding private sector invoices by government acted as the mechanism through which this uptick in liquidity was realised.

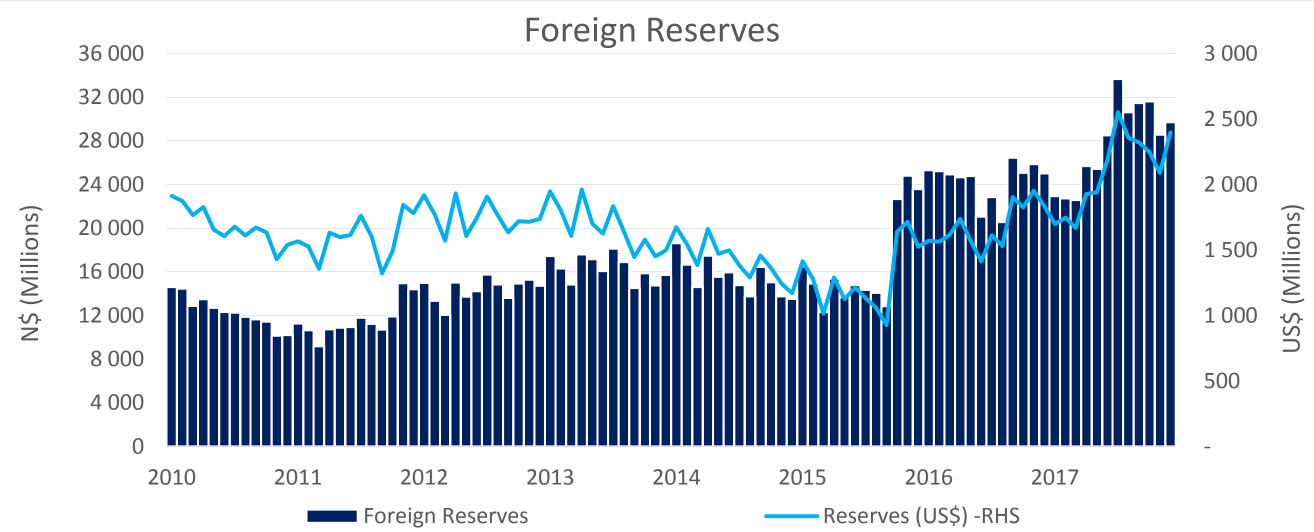


Source: Bank of Namibia (not adjusted for inflation)

The improved liquidity position meant that the premiums on market interest rates were more in line with administered rates during most of 2017. This brought relief to the banking sector which came under much pressure towards the end of 2016. This does not mean that the banks had an easy year though, as private sector credit extension slowed considerably. Regulatory requirements on mortgage and vehicle lending as well as deflated business confidence contributed to this. Yet banks would have had an easier time managing their asset and liability positions over the last three quarters of 2017 than over the preceding two.

International Reserves

Namibia's international reserve position improved during the course of 2017, ending on a high note after the second disbursement of the AfDB loan. The foreign inflows from the AfDB loan, higher SACU receipts, and improved mineral production reinforced Namibia's international reserve position which was already under less pressure than before due to a much-reduced trade deficit. The stronger reserve position lends stability to the currency peg which in turn provides price stability. As Namibia is a small open economy that imports more than is exported, this is a positive position to be in at present and an improvement over 2015 and 2016.

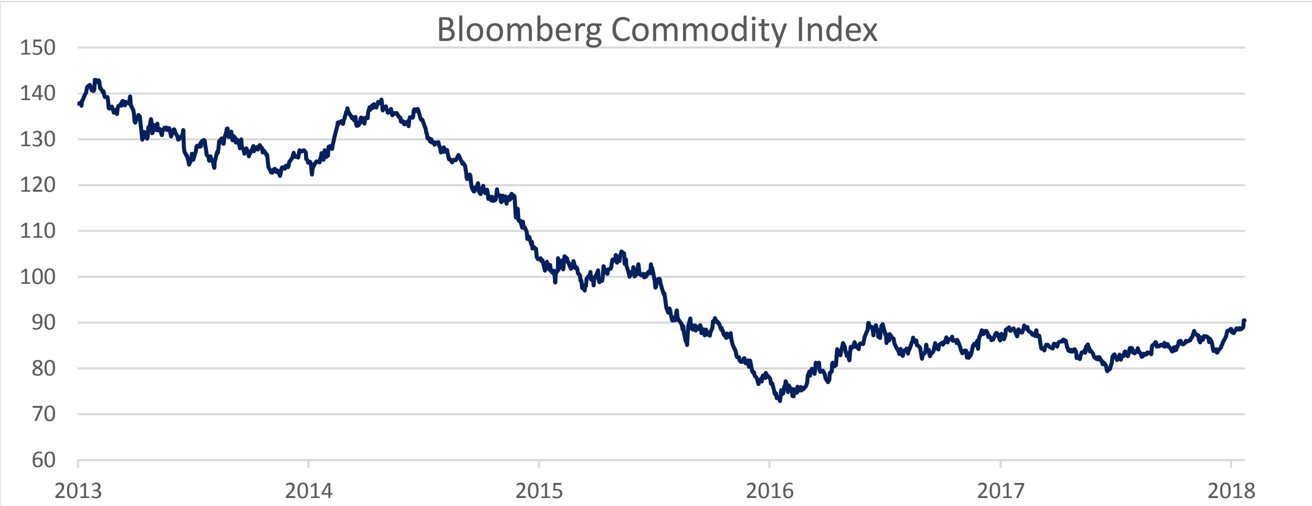


Source: BoN

Key Themes for 2018

Commodity Prices

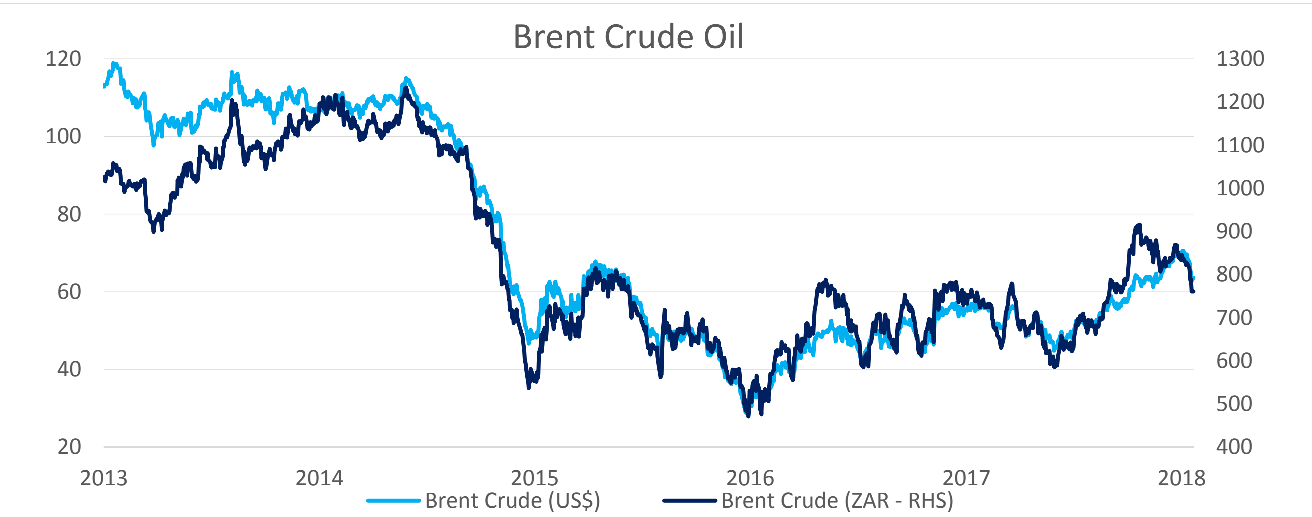
Commodity prices are sure to be a key theme in 2018 as commodity prices are crucial to the short to medium term sustainability of the mining sector, which in turn has a large impact on the Namibian economy. Indeed, the fall in commodity prices between 2014 and 2016 contributed to a widening of the trade deficit necessitating the raising of Namibia's second Eurobond in late 2015. Thus, commodity prices not only play a role in employment and output in Namibia, but also in maintaining the stability of the international reserve position. According to the 2016 labour force survey, mining and quarrying employed 14,825 people in 2016, and these figures do not always capture all contract workers employed in the industry.



Source: Bloomberg

Oil

Oil prices bottomed out in early 2016 after having halved in US dollar terms during the second half of 2014. This drop in oil prices fed through to inflation and contributed to average annual inflation of only 3.4% in 2015 in Namibia and 4.6% in South Africa. As Namibia is not an oil producing nation low oil prices are a net benefit to the economy, with the notable exception of the effects on trade with our northern neighbour, Angola.



Source: Bloomberg

The last two years have seen oil prices increasing modestly in both rand and US dollar terms. These increases have resulted from a combination of OPEC supply management (as well as a drop in Venezuelan production) and global demand growth, notably from China. In January the IMF revised their global growth expectations for 2018 up to 3.9% from 3.7% previously expected. This uptick in growth is expected to come from emerging markets ex-China, which is expected to slow somewhat in 2018 and 2019. While slower growth means slower demand growth it still means demand growth. This demand growth will be partially offset by efficiency gains in the major uses of oil (such as with electric vehicles). Demand growth is thus likely to be muted in 2018.

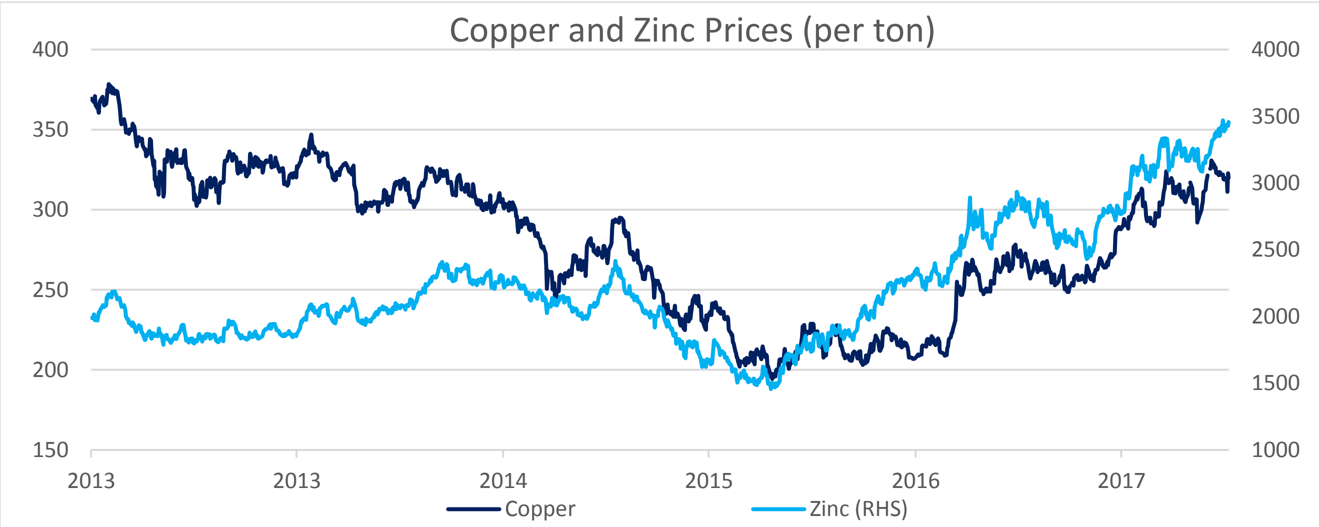
Supply side growth has been picking up steadily with the US expected to increase supply further in 2018 (MacQuarie Research). Other sources of onshore supply, which reduced production due to low prices in 2015 and 2016, are possibly poised to increase supply should prices rise further. These factors may put downward pressure on oil prices despite the modest demand increases expected. However, OPEC continues to produce below their stated output levels and are expected to continue to do so over the medium term (although in the past they have not always stuck to targets). As a result oil prices are expected to remain between US$60/bbl and US$70/bbl, with some research houses calling for a drop below US$60/bbl (and some a spike above US$70/bbl).

Given the strong currency at present, and the expected range in oil prices, it is likely that oil prices will not be a significant driver of inflation in 2018, although some of the pass through effects from fuel price increases in 2017 will be seen in 2018. This should support a more dovish stance on monetary policy at the margin. Political uncertainty aside, a stable oil price is largely supportive of the view that South African inflation will remain within the target band, allowing the SARB some room to manoeuvre. Of course, there are risks to this view as global demand growth could result in an elevated oil price, but this remains an outside risk in our view. A dovish SARB should provide BoN with some firing power to ease monetary policy to aid in the Namibian economic recovery.

Non-Ferrous Metals

The main non-ferrous metals mined in Namibia are copper and zinc, both of which have benefitted from rising prices through 2016 and 2017. Zinc prices are particularly buoyant reaching prices not seen since 2007. While copper prices have not improved to the same extent, a renewed surge in demand has led to heightened enthusiasm from the mining community. Anglo-American indicated that up to 22 big new copper mines are likely to be needed by 2030 to meet copper demand. Indications like these could have a large impact on the Namibian mining sector as such enthusiasm leads to a renewed push into exploration. The increase in the copper price could further lead to Weatherly re-evaluating the Matchless and Otjihase copper mines, potentially reinvesting and restarting those operations.

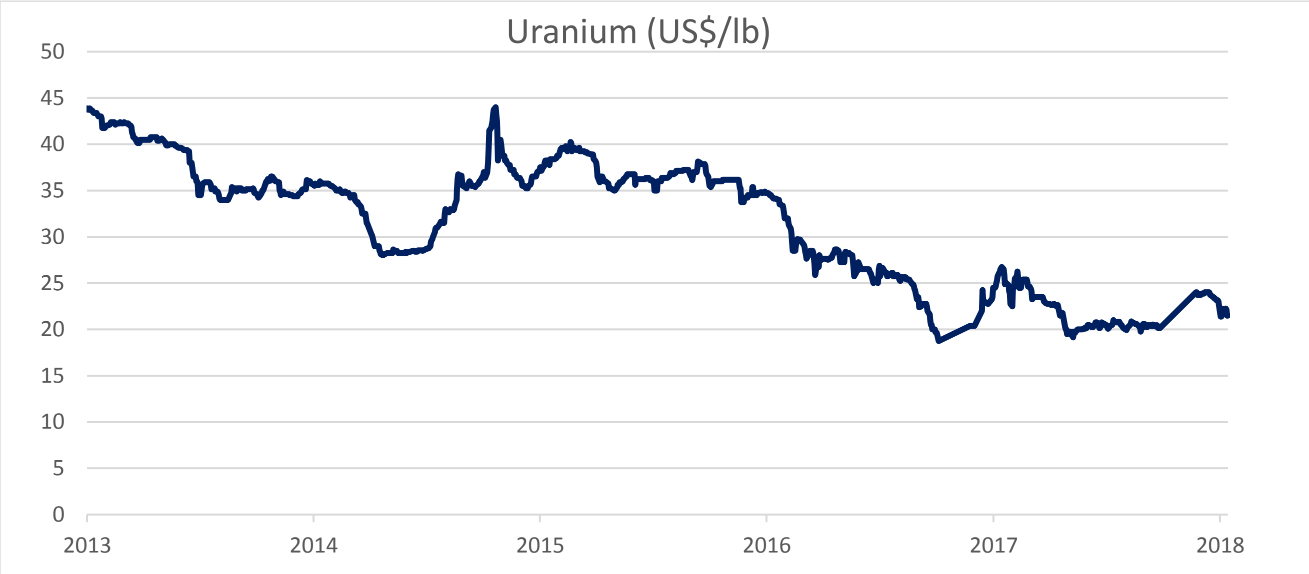
Similarly, current zinc prices should lead to increases in the life of mine at Rosh Pinah and Skorpion as the mining companies invest in exploration as well as less rich ore bodies becoming financially viable. Investment in this regard already kicked off at Skorpion in 2017 and should extend the life of mine to 2021 or beyond. This a good example of price driving investment and why the copper and zinc prices could contribute to marginal growth in the coming years. These prices will have to remain buoyed in order for the full benefits of increased investment and exploration to translate to employment and growth.



Source: Bloomberg

Uranium

Namibia has long been one of the top uranium producers in the world. The depressed uranium price has however limited the upside of this position in recent years. Spot prices remain depressed and contract prices have fallen to some of the lowest levels on record. Low prices translate to less taxes paid and uncertainty surrounding the continuation of operation, often resulting in job losses. Low prices are largely the result of the surge in renewable energy generation which has led to countries like Germany moving away from nuclear as well as the slow restart of the Japanese nuclear reactors following the Fukushima disaster.



Source: Bloomberg

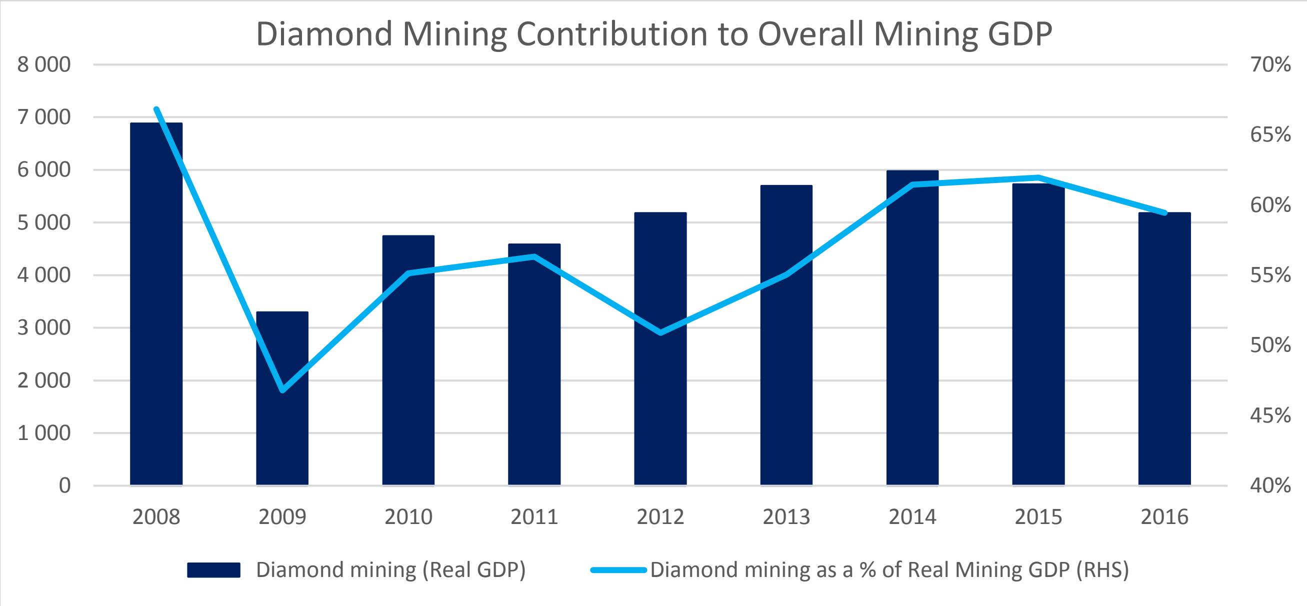
The outlook for uranium prices remains depressed over the short to medium term with most producers and analysts agreeing that prices should pick up post 2020. The delay in restarting the Japanese reactors in the wake of the Fukushima disaster has resulted in an abundance of supply. At the same time German and other developed nations have reduced their reliance on nuclear as a power source. China and India are expected to drive future demand increases but the lag between the start of construction and the commissioning of nuclear plants tends to be significant. The Chinese nuclear build programme is lagging behind initial estimates for construction. Future demand from China alone is expected to be significant in the global context as the country diversifies its energy mix away from air polluting sources. India too is ramping up its nuclear generation capacity as it seeks to produce 25% of its electricity from nuclear by 2050, a significant demand increase considering the population. The demand for uranium is thus due to increase substantially over the longer term.

This may however be too late for some of Namibia's older mines in the short term, with both Rössing and Langer Heinrich currently under pressure. Should uranium prices not pick up within the next year or so the operations at these mines could be in danger of being put on care and maintenance. These mines employed almost 2,500 people in 2016 when including temporary positions and contractors. The slowdown in operations have already resulted in reduced jobs and further losses at a time when the economy is stagnating would be highly undesirable. The uranium price thus plays a big role in the future of these mines, the lives of their employees and their families, as well as government revenues from the sector.

The Husab uranium mine which recently started operations is expected to ramp up to 65% of nameplate production capacity during 2018. This should result in total uranium production from Namibia improving by close to 60%. In addition to this large increase in production, Husab has also soaked up some of the employees from the other mines who may have become unemployed otherwise. Husab production however, may not translate to tax and royalty revenues for government if the uranium price does not improve. The contribution of uranium mining to government coffers and overall economic growth in Namibia is thus subject to the price of the commodity. A recovery in the uranium price during 2018, although unexpected, could thus provide some economic relief.

Diamonds

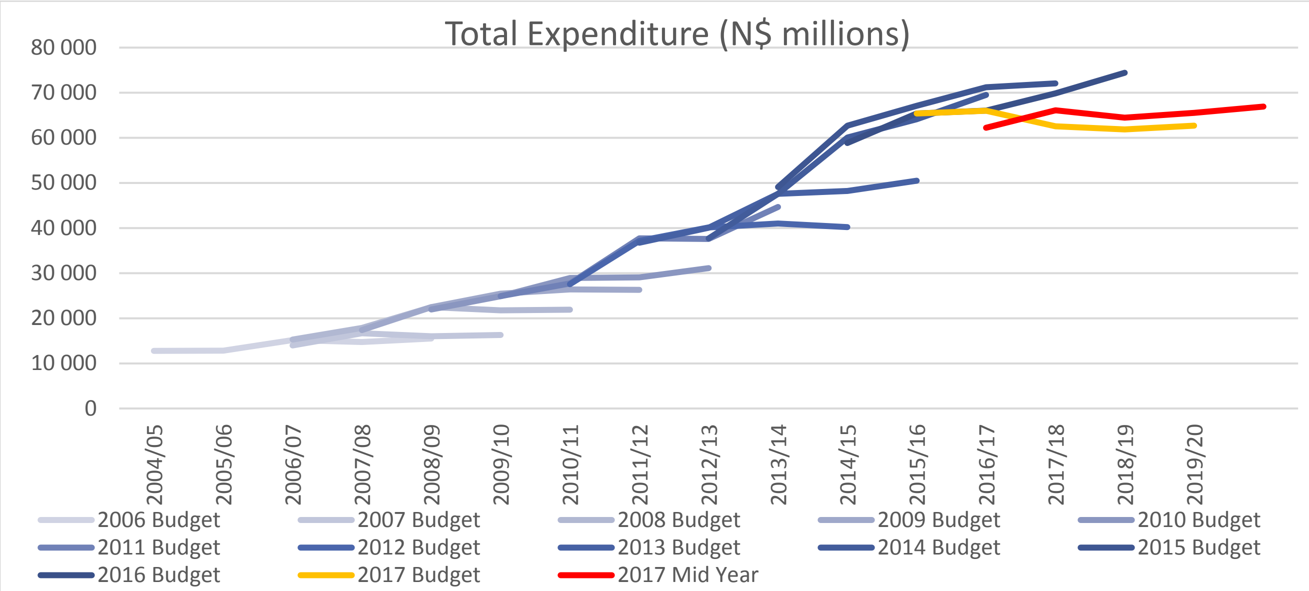
Diamonds remain Namibia's most important mining export. In terms of government revenue generation and foreign exchange earnings diamond mining provides a significant contribution. Over the last ten years diamond mining has provided an average of 57% of all mining and quarrying activities GDP contributions. A good year for diamond mining could thus support the economy to some extent. While prices have been under pressure for a number of years Namdeb has continued to produce and invest in their operations ensuring the sustainability of the operations going forward. This alone will not drive above expectation revenue growth though, demand and price could play a key role in the outperformance or underperformance of the sector.



Source: Namibia Statistics Agency

Fiscal Consolidation

The mid-term budget review saw government take a pro-growth fiscal consolidation stance. What this effectively means is that the fiscal consolidation will not be as harsh as was announced in the 2016/17 mid-term budget. Expenditure will not be severely reduced but will be better managed, with a focus on shifting expenditure to priority ministries. While this does not sound like a consolidation, it is a vast reduction in budgeted future expenditure. Thus, while the budget has not been cut by much, it will not grow by much over the MTEF (as illustrated below).



Source: Ministry of Finance: IJG

MTEF expenditure is limited by revenue collection expectations and the flat expenditure trajectory aims to converge with the expected upward trajectory of revenue collection, reducing the budget deficit over the MTEF. This will reduce government's reliance on debt issuance if successful, while avoiding putting undue pressure on the economy. Fiscal expenditure over the next few years will be a fine balancing act, with not much room for economic stimulus, at least not at levels seen through the first half of the decade. Expansionary fiscal policy was a major driver of real GDP growth between 2010 and 2015, with said growth averaging 5.7% over that period. Less room for policy manoeuvrability translates to lower growth rates all else equal.

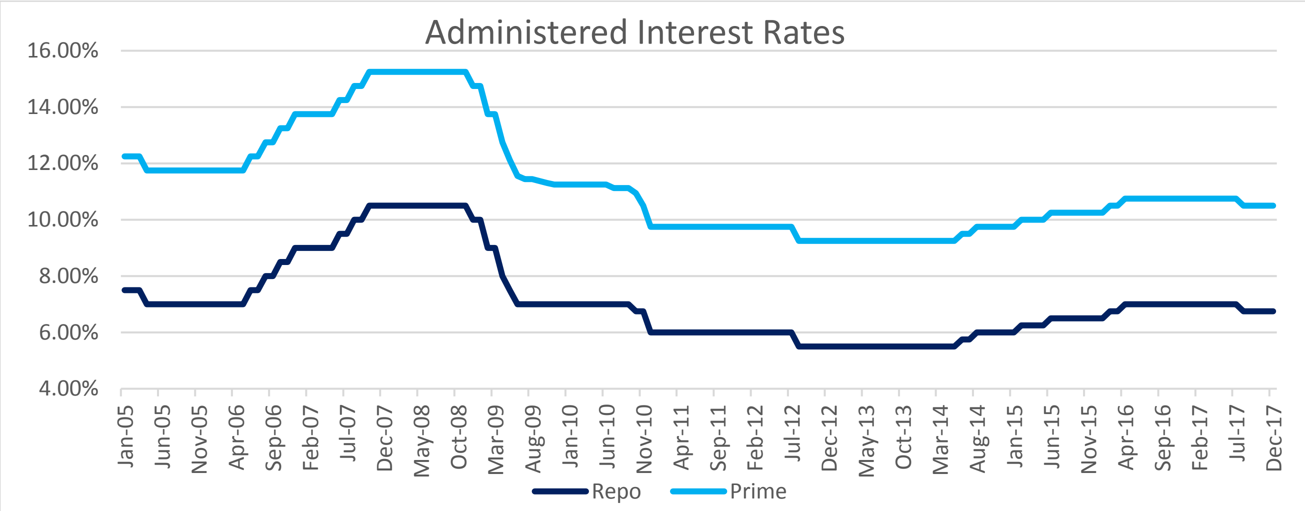
Government's expenditure profile is dominated by operational expenditure such as salaries and wages and subsistence and travel (S&T). This part of the budget has been growing in relation to total budget expenditure which has resulted in a reduced allocation to the development budget. The development budget has a large impact on the private sector directly and indirectly through the provision and maintenance of infrastructure. This is particularly important in Namibia given that we currently have an infrastructure deficit. Water is a good example of a limiting factor for industrialisation in and around the capital where most businesses want to be due to the high population density.

The development budget has been squeezed between operational budget growth and funding constraints limiting the size of the budget deficit. Funding development/infrastructure projects has thus become ever more challenging over the last three years. Some relief came last year in the form of an African Development Bank loan to the tune of N$10 billion, of which N$4 billion is specifically allocated to development projects, and N$6 billion available for general budget purposes. The loan is split over two years with the final N$5 billion (N$2 billion development portion) due to be put to work in government's 2018/19 financial year. This does bolster developmental spend somewhat and should result in some of the infrastructure projects that were put on hold or received reduced budget allocations from 2016/17 gaining some ground once again.

In addition to some relief on the funding side, there is much to be gained by reallocating and prioritising expenditure within the current expenditure ceiling. Some gains should come from the recent directive, issued by the Prime Minister, putting in place measures to control personnel and other expenditure in the Public Service of Namibia in an effort to enhance efficiency in the management and use of public resources. This will reap some of the low hanging fruit in terms of reallocating inefficiently used resources and is a welcome measure, if not timely. More light may be shed on other measures to be taken by government with the tabling of the 2018/19 budget within the next few weeks. These could provide further relief on the margins by allowing government revenues to be more efficiently deployed. As stated earlier, fiscal policy space is limited and thus unlikely to be a major driver of the economy this year, but marginal gains could be achieved through more efficient allocation of the available funds.

Credit Ratings, Monetary Policy and Interest Rates

The lack of fiscal policy space is precisely why monetary policy is a more likely source of economic stimulus in 2018, and a necessary one given the current economic climate. The caveat is that the Bank of Namibia (BoN) will not cut the repo rate before the South African Reserve Bank (SARB) has done so. The SARB, although dovish, is likely to be restrained by the possibility of a Moody's credit ratings downgrade wreaking havoc on the currency. This "standoff" is likely to be resolved early in the year however (by end February).



Source: Bank of Namibia

Much uncertainty surrounds the future of South African politics and economic policies. New ANC leadership in Cyril Ramaphosa has been viewed by markets as positive and has resulted in the rand rallying to sub-twelve to the dollar (Feb 2018). The recently tabled budget, with VAT hike and all, was largely received with optimism despite there not being a change in finance minister. It is expected that the end of the corrupt Zuma regime will be accompanied by economic policies aimed at fostering investment and a return of business confidence as a result. This would be viewed as positive by Moody's Credit Ratings which is to effectively determine whether South African bonds remain in global benchmark indices.

In November 2017 Moody's placed South African government debt on review for a downgrade citing budget shortfalls and thus the likelihood for a larger rise in debt-to-GDP than previously expected. Moody's, being the last ratings agency to rate South African local currency sovereign debt as investment grade, thus effectively holds the key to whether or not these bonds are included in global benchmark bond indices. This is important because a large amount of foreign capital has been invested in these bonds and exclusion from the indices would result in substantial outflows of funds, driving currency weakness. Thus, Moody's decision later in February could have a large impact on the near-term outlook for the rand and whether or not the SARB has enough room to move on interest rates. Whether the imminent political changes will positively affect Moody's decision or delay a downgrade is unclear but a possibility to be factored.

Should the Moody's review take the stance that the new political regime is positive for the ability of the South African government to honour debt obligations we may see the agency defer a local currency downgrade. This would give the SARB room to resume the rate cutting cycle in order to aid economic recovery in South Africa. BoN would then be able to follow suit and reduce Namibian benchmark rates, spurring corporate investment and consumer spending. Other factors equal this could go some way in driving an economic recovery in 2018 and beyond.

Policy

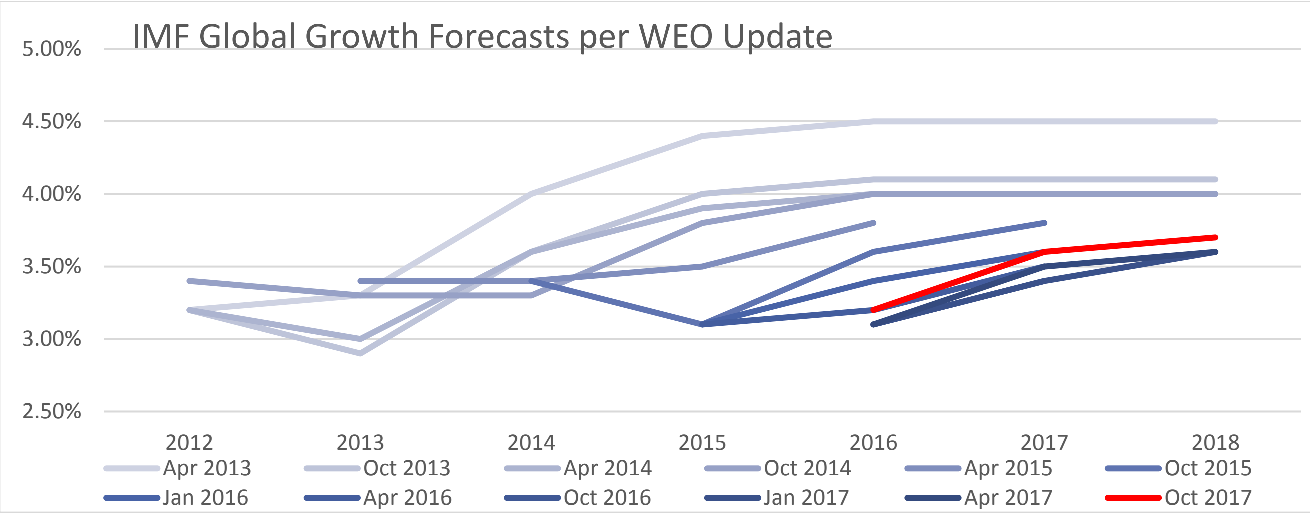
The elephant in the room in 2018 is policy in our view, namely the New Equitable Economic Empowerment Framework and the Namibia Investment Promotion Act. The uncertainty surrounding these two policies has been detrimental to investment from both foreign and domestic sources. Uncertainty raises the required return on investment as it is a risk. In other words, if the added uncertainty of probable future policy changes elevates the required rate return on an investment to above the expected return on that investment it would not be a feasible investment and the investor would then seek other opportunities elsewhere. Thus, the uncertainty of the final structure of these two policy pieces has added risk to investing in an economy already fraught with risk, with investors who have a reduced appetite for risk.

Clarity on the final form of theses two policy pieces will help substantially through the elimination of uncertainty. Whether these pieces of policy are coming and when is thus almost as important as the contents. Private sector investment, whether from domestic or foreign sources, is essential in order for Namibia to gain economic traction at this point in time. And herein lies a possible positive shock with clarity surrounding these two policies likely in 2018. This will illuminate a murky investment landscape which will allow investors to accurately assess the risks involved with investing in Namibia.

Policy may be the single most important theme for Namibia in 2018. It has the potential to bring private sector investment back into the Namibian economy. This will in turn lead to employment creation at a time when unemployment is ticking up. The form or substance of these policies is also important in creating an investment friendly environment within Namibia. The importance of this may be great given that neighbouring countries are looking ever more investable and competition for funds will likely become more challenging than has been the case in the past.

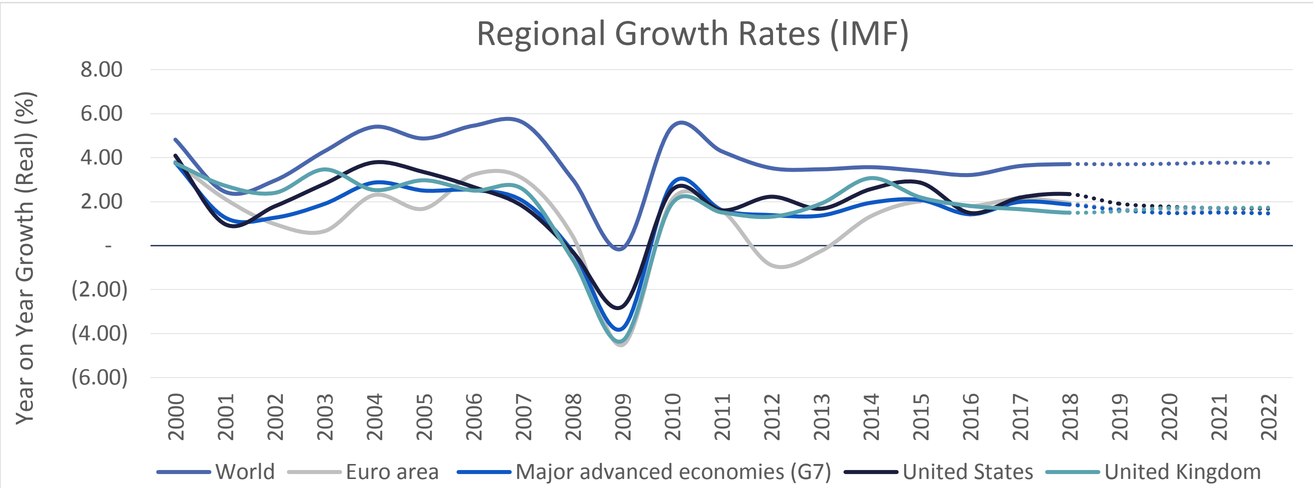
Global economy

Global growth for 2017 was projected at 3.4% in January 2017 by the International Monetary Fund (IMF) in its World Economic Outlook update. In its January WEO update the IMF provided for increased optimism towards an upturn in global growth, with growth for 2017 revised upward at 3.7%. The IMF World Economic Outlook update further projects global growth for 2018 at 3.9%. The last few years have been characterized by global growth estimates coming in below forecasts with accelerated growth going forward. Prior to January 2017, global growth estimates by the IMF were revised with each Outlook update and in April 2017 the IMF made a 0.1% upward revision to the 2017 global growth forecast. This was then followed by another 0.2% upward revision to the 2018 forecast. This is the result of an upturn in global economic activity as well as the anticipated impact of US tax reforms.



Developed Markets

The IMF expects developed markets to grow by 2.3% in 2017, a 0.1% upward revision from its October 2017 Outlook update. Thereafter the IMF projects growth to stagnate at 2.3% in 2018 before slowing to 2.2% in 2019. The upward revisions are reflective of expectations that favourable global conditions and sentiment will continue to maintain the recent acceleration in demand, most notably in investment.



United States of America

The IMF expects that the US economy would have expanded by 2.3% in 2017 and projects growth for 2018 at 2.7%. Growth is expected to have been buoyed by tax policy changes expected to stimulate the economy. These 2018 growth forecast is a 0.3% upward revision while 2019 is project to record 2.5% growth. The year 2017 saw the continuation of monetary policy correction with the fed having hiked rates three times last year. Jerome Powel was appointed chair of the Federal Reserve in February, taking over the reins from Janet Yellen. The FOMC under Jerome Powell is very likely to continue on its path of tighter monetary policy in 2018. The longer-term view for the US economy is for growth to moderate, the base case calling on continued sluggish growth in total factor production and diminished growth in the workforce because of an ageing population.

Eurozone

The euro area recovery is expected to have gathered momentum during 2017, with growth expected to have risen to 2.4% in 2017, before moderating to 2.2% in 2018. The relative increase in growth stems largely from an uptick in exports driven by the broader pickup in global trade and continued strength in domestic demand growth supported by accommodative financial conditions amid diminished political risk and policy uncertainty. In Germany, growth is expected to have picked up in 2017 to 2.5% before moderating to 2.3% in 2018. Growth in Spain is expected to hold steady at 3.1%, followed by slower growth in 2018 of 2.4%. France is forecast to have grown by 1.8% in 2017, accelerating to 1.9% in 2018. In Italy, growth is expected to come in at 1.6% in 2017, before slowing to 1.4% in 2018. The medium-term outlook remains subdued as projected potential growth in likely to be held back by weak productivity, adverse demographics and in some countries, a public and private debt overhang.

United Kingdom

Growth in the UK is forecast to have dwindled down to 1.7% in 2017, followed by further slowing in growth of 1.5% in 2018. The 2017 projection is a 0.3% downward revision of the IMF's April 2017 update and unchanged from October's outlook. This revision was fueled by weaker-than-expected growth outcomes for the first two quarters of 2017. The slowdown was driven by softer growth in private consumption as the pound's depreciation weighed on household real income. The medium-term growth outlook is vastly uncertain and is dependent largely in part on the new economic relationship with the EU and the extent of the change in trade, migration and cross-border financial activity.

Japan

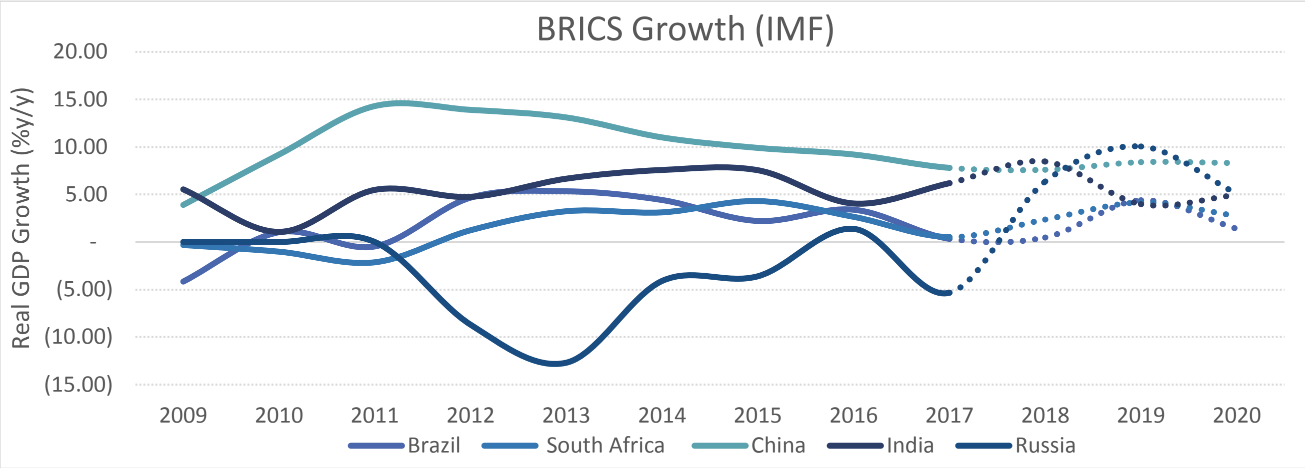
Japan is expected to have grown by 1.8% in 2017, with momentum set to taper in 2018, recording expected growth of 1.2%. The momentum that carried 2017 was driven by strengthening global demand and policy actions to sustain a supportive fiscal stance. The diminished outlook for 2018 is based on the assumption of fading support to the fiscal stance, moderating private consumption growth, as well as the expected boost from the 2020 Olympics-related private investment being offset by higher imports and slower projected growth in foreign demand. A diminishing labour force will restrain GDP growth and this forms the basis of the IMF's medium-term outlook for the Japanese economy.

Developing Countries

The IMF's WEO update for emerging economies is unchanged from its October, with growth forecasted to rise to 4.7% in 2017, followed by growth of 4.9% in 2018. Over the medium-term growth in emerging and developing economies is expected to hover around 5%. Most of the projected growth over the medium-term is sustained by fast growth in the two largest countries, namely China and India, which account for 40% of GDP and more than 40% of the population of emerging markets and developing economies.

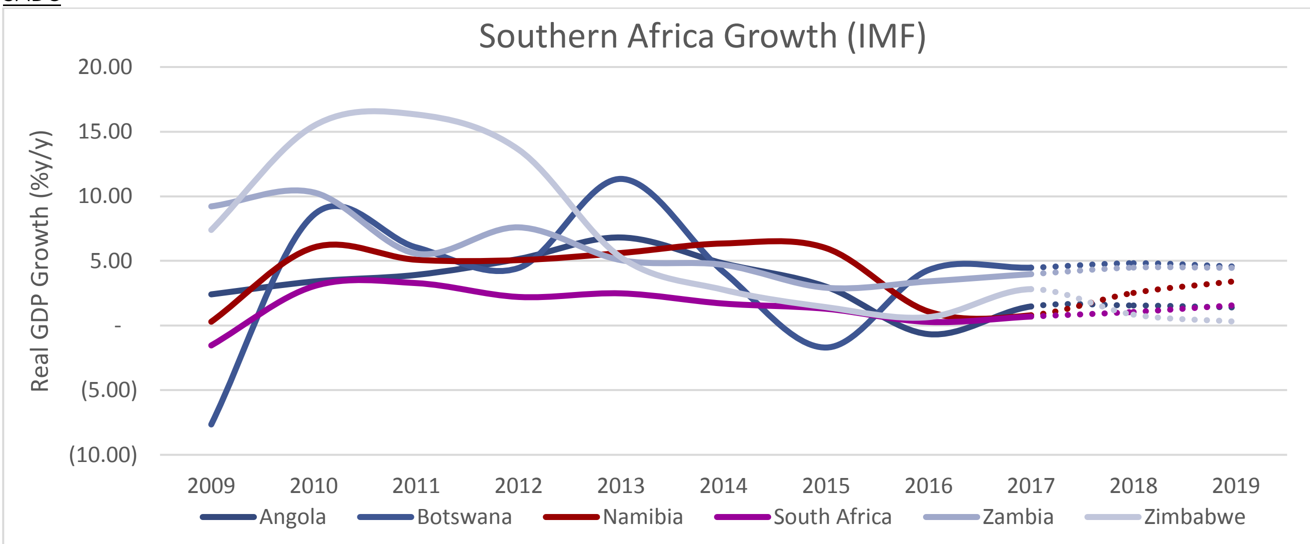
A meek cyclical recovery is shaping up in several emerging markets that underperformed in recent years because of terms-of-trade losses and idiosyncratic factors. Support to this recovery come in the form of a strengthening Chinese economy, as well as broader cyclical rebound in manufacturing and trade. Although commodity prices have had a relative decline, they remain generally higher than their 2016 averages.

Moving forward, growth in commodity exporters is projected to recover further, contributing significantly to the projected pickup in global growth. While remaining below historical averages, growth for commodity exporters account for a modest share of the total growth in emerging economies. For commodity importing countries growth is expected to remain high, these group of countries also account for the lion's share of global growth. Higher growth in India and other commodity importing countries will offset the slowdown in China.



Growth in China is expected to have increased to 6.8% in 2017 before slowing to 6.6% in 2018. The upward revision to 2017 growth emanates from a stronger-than-expected outturn in the first half of 2017 supported by previous policy easing and supply side reforms. The 2018 projection is based off of the expectation that authorities will maintain a sufficiently expansionary policy mix to meet their target of doubling GDP between 2010 and 2020.

SADC



Growth for sub-Saharan Africa is projected to rise to 2.7% in 2017 and then go on to reach 3.3% in 2018. Risks towards the downside have risen because of idiosyncratic factors in the region's largest economies and delays in implementation of policy adjustments. Nigeria is expected to recover from the 2016 recession caused by low oil prices and the disruption of oil production. Growth for Nigeria is expected to reach 0.8% in 2017. Angola received an upward revision to its forecast, with growth for 2017 expected at 1.5% as a downward revision in oil production in 2016 has raised the extent of the expected rebound. The outlook for fuel-importing countries is optimistic with an aggregate growth rate of 3.9% expected in 2017, before increasing to 4.4% in 2018.

In South Africa the IMF expects growth to have been a subdued 0.9% in 2017 and have revised growth for 2018 and 2019 to 0.9% for both years. The market widely regarded December's ANC elective congress result as favourable and positive reactions were evident in the strengthening of the rand. Favourable commodity prices and strong agricultural production will be the driving force behind the projected economic growth. A ratings downgrade still looms over SA's local currency debt, which will have a bearing on the interest rate and credit environment in the country. A Moody's downgrade will result in a fallout from major global bond indices leading to capital outflows which would result in currency weakness, if only temporarily.

Supply Side Growth

The final national accounts figures for 2017 will not be released for at least six months, but it is widely accepted that negative real GDP growth will be recorded for the calendar year. This contraction stemmed largely from the construction and wholesale and retail trade sectors, although slow or negative growth is expected to be recorded over a wider range of industries. Below we analyse 2017 growth and forecast growth over the medium-term based on industry analysis and consultation.

Real GDP Growth Rates

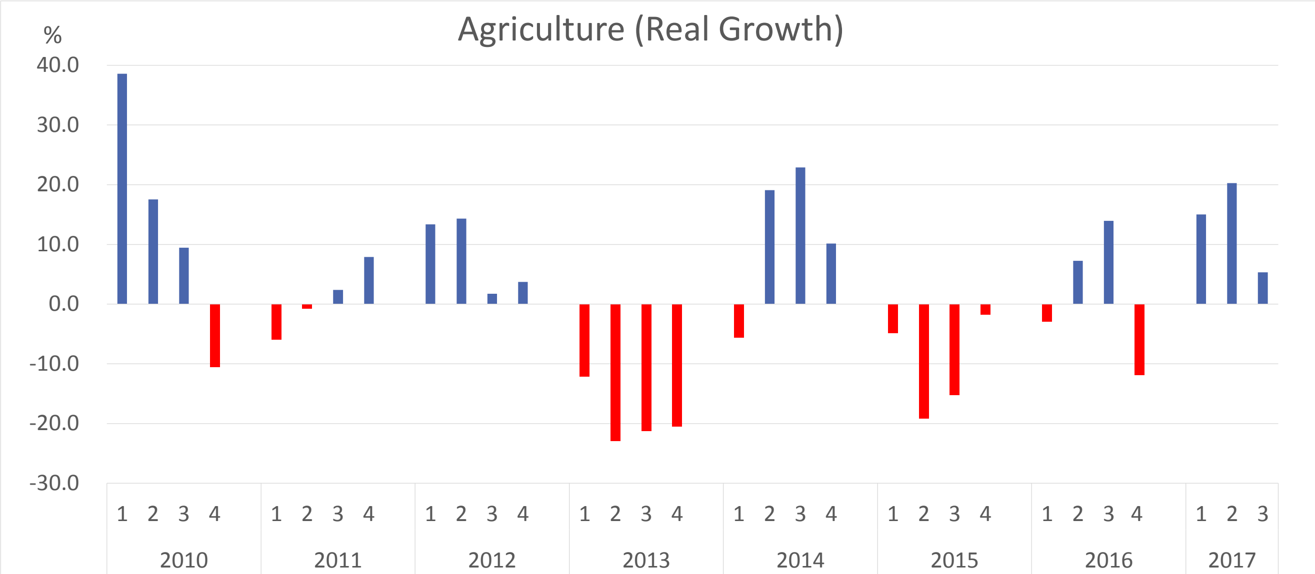
	Actual			Nowcast		Forecast		
Industry	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Agriculture and forestry	-19.3	11.1	-10.4	0.8	9.6	-1.6	3.0	3.4
Livestock farming	-25.6	13.9	-13.3	2.3	10.9	-5.2	1.4	2.0
Crop farming and forestry	-9.7	7.6	-6.6	-1.2	7.8	3.2	5.0	5.0
Fishing and fish processing on board	3.0	-2.5	2.3	7.7	-2.5	1.2	-0.5	4.7
Mining and quarrying	1.7	-6.0	-4.9	-7.3	13.0	18.3	-0.9	-0.6
Diamond mining	10.0	4.9	-4.1	-10.7	14.9	12.6	-4.9	0.0
Uranium mining	-6.9	-9.9	-18.1	12.9	18.8	60.8	6.2	-4.4
Metal ore mining	-25.8	0.6	60.0	-8.7	5.5	1.5	1.5	1.5
Other mining and quarrying	6.4	-36.4	-44.1	-19.8	2.5	7.5	7.5	3.0
Primary industries	**-3.7**	**-1.6**	**-5.2**	**-2.9**	**9.3**	**10.6**	**0.0**	**1.1**
Manufacturing	4.4	-0.1	-4.6	3.4	1.6	2.6	2.5	1.9
Meat processing	30.4	-17.2	-3.0	-2.1	3.4	0.9	0.4	0.7
Grain Mill products	12.8	13.7	13.0	0.7	2.5	2.5	5.0	9.2
Other food products	3.3	11.7	-12.3	4.0	0.0	0.0	0.0	0.0
Beverages	13.7	-16.5	-2.1	-1.6	-2.0	3.0	3.0	3.0
Textile and wearing apparel	8.2	-2.9	-8.9	3.7	-2.8	2.0	2.0	2.0
Leather and related products	-7.3	10.7	-1.8	-3.4	0.0	-0.3	-0.3	-0.3
Wood and Wood product	3.1	1.7	-2.6	3.5	-5.0	-5.0	8.0	-1.7
Publishing and Printing	6.8	10.6	6.3	-1.5	-7.2	0.7	0.7	0.7
Chemical and related products	4.3	1.2	-3.3	-2.6	-5.0	0.0	3.6	3.6
Rubber and Plastics products	5.6	5.4	26.9	5.2	-2.0	2.0	6.0	0.0
Non-metallic minerals products	3.8	5.6	8.1	-0.1	-3.0	0.0	8.0	8.0
Basic non-ferrous metals	-4.0	-3.2	-8.3	1.0	8.5	5.0	5.0	0.3
Fabricated Metals	5.6	3.7	-6.4	-1.1	-5.0	-5.0	0.0	0.0
Diamond processing	-11.6	24.4	-24.1	65.9	14.9	12.6	-4.9	0.0
Other manufacturing	8.9	-2.9	-8.1	-13.9	-2.9	-2.9	-2.9	-2.9
Electricity and water	-4.4	1.5	14.2	6.8	3.6	4.2	5.6	3.0
Construction	28.7	42.6	26.0	-26.5	-21.8	-5.0	5.0	7.0
Secondary industries	**8.6**	**10.9**	**7.2**	**-7.8**	**-5.3**	**0.9**	**3.5**	**3.3**
Wholesale and retail trade, repairs	14.8	13.9	7.4	-1.5	-10.0	-2.0	4.7	4.7
Hotels and restaurants	9.0	10.8	5.6	5.1	3.0	3.0	2.5	2.5
Transport, and communication	6.4	5.7	6.9	6.1	2.1	2.6	3.3	4.2
Transport	12.8	3.3	7.9	4.7	2.0	2.5	3.9	4.0
Storage	3.7	5.7	-0.6	1.2	2.5	3.0	2.7	2.4
Post and telecommunications	0.8	8.6	8.9	9.5	2.0	2.5	3.0	5.0
Financial intermediation	17.9	10.9	3.7	3.7	0.3	-1.0	2.5	4.5
Real estate and business services	4.6	2.8	4.7	2.5	-1.7	-1.1	0.7	2.5
Real estate activities	4.9	3.0	3.6	2.6	-2.0	-2.0	0.0	2.5
Other business services	4.0	2.4	7.8	2.1	-1.0	1.5	2.5	2.5
Community, social and personal service activities	-9.9	3.0	12.6	1.9	1.5	1.5	1.5	1.5
Public administration and defence	3.8	1.4	13.0	3.3	-2.3	-2.0	0.0	2.1
Education	3.3	10.3	4.1	3.5	1.5	-5.0	1.5	3.5
Health	8.9	10.2	16.7	10.5	2.4	-1.2	1.5	3.5
Private household with employed persons	-6.7	5.5	1.7	1.4	0.0	0.0	2.5	2.5
Tertiary industries	**7.3**	**7.7**	**7.6**	**2.9**	**-2.0**	**-1.4**	**2.1**	**3.4**
Less: Financial intermediation services indirectly measured	18.8	5.3	0.1	0.6	2.5	-2.5	-2.5	2.5
All industries at basic prices	**5.1**	**6.6**	**5.4**	**-0.1**	**-1.0**	**1.1**	**2.0**	**3.0**
Taxes less subsidies on products	11.5	4.1	12.5	4.5	-5.0	-0.5	5.0	5.0
GDP at market prices	**5.6**	**6.4**	**6.0**	**0.3**	**-1.3**	**0.9**	**2.3**	**3.2**

Source: IJG Securities

We have decided to keep our 2016 growth figure in line with our previous calculation as this figure is likely to change again with the release of the 2017 national accounts. This does affect our forecast for 2017 somewhat as we are starting from a lower base. We expect a contraction of 1.3% to be recorded for 2017, after a largely flat year in 2016. As is evident from the above forecast, we do not expect to see a strong V-shaped recovery in 2018. Below we take a brief look at some of the larger sectors of the economy and how they performed in 2017, and break down our expectations for these sectors for the year ahead.

Agriculture

Agriculture output rebounded in 2017 after a good rainy season. Both the agronomic and livestock subsectors performed well when compared to the preceding drought years. Year-to-date GDP figures for the first three quarters of 2017 show a 13.5% increase over the first three quarters of 2016, a 20.4% increase over the first three quarters of 2015 and a 4.0% increase over the first three quarters of 2014. While the GDP figures are not finalised yet, the preliminary results show that in real terms 2017 lagged only 2012 in terms of real GDP derived from agriculture over the last ten years.

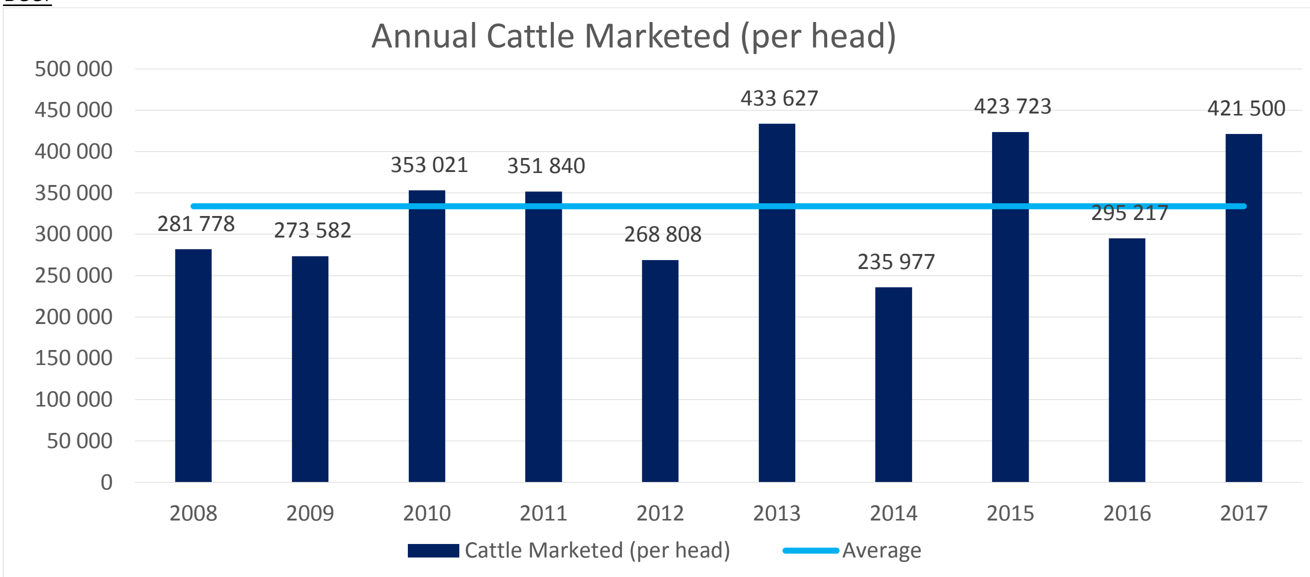


Source: NSA

The year ahead remains fraught with uncertainty as rainfall came relatively late, although possibly just in time for many farmers. While the rains may have come just in time, the late start does increase pressure on farmers and as such agricultural output would be hard pressed to top last year's figures. Due to the elevated base set in 2017 we may see very low or negative growth in 2018 as herd numbers remain under pressure and late rainfall could affect dryland maize production.

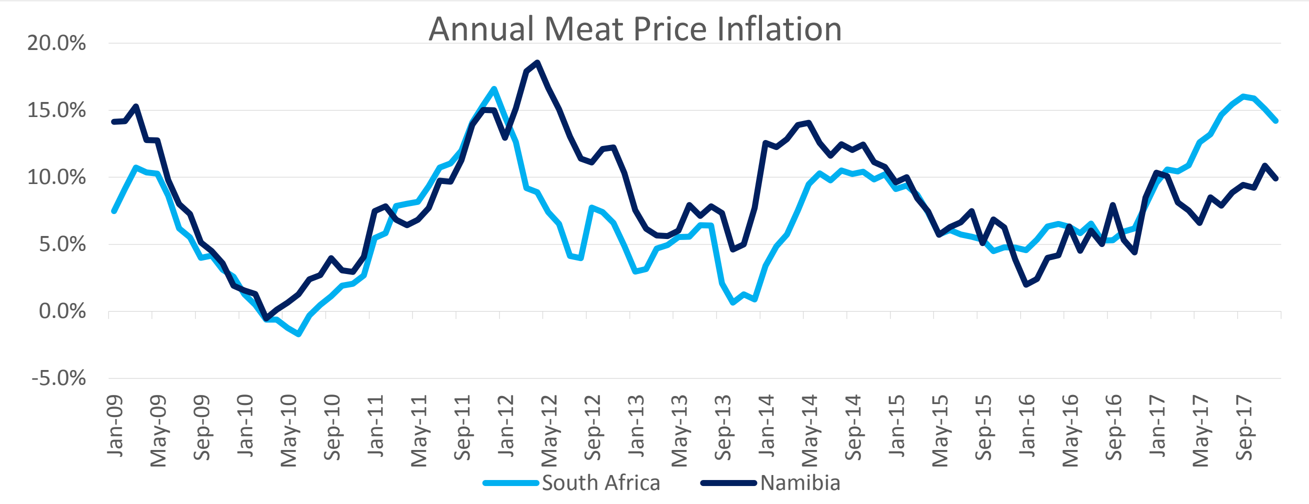
The drought spanning the better part of the period between 2013 and 2016 led to agriculture shedding a large number of jobs, largely from subsistence farming. Subsistence farmers struggle to rebuild herds at the same rate as commercial farmers and thus 2017 would not have been a return to the norm for many. As such employment in the sector is expected to have remained under pressure in 2017. A poor rainy season in 2018 could aggravate this further.

Beef



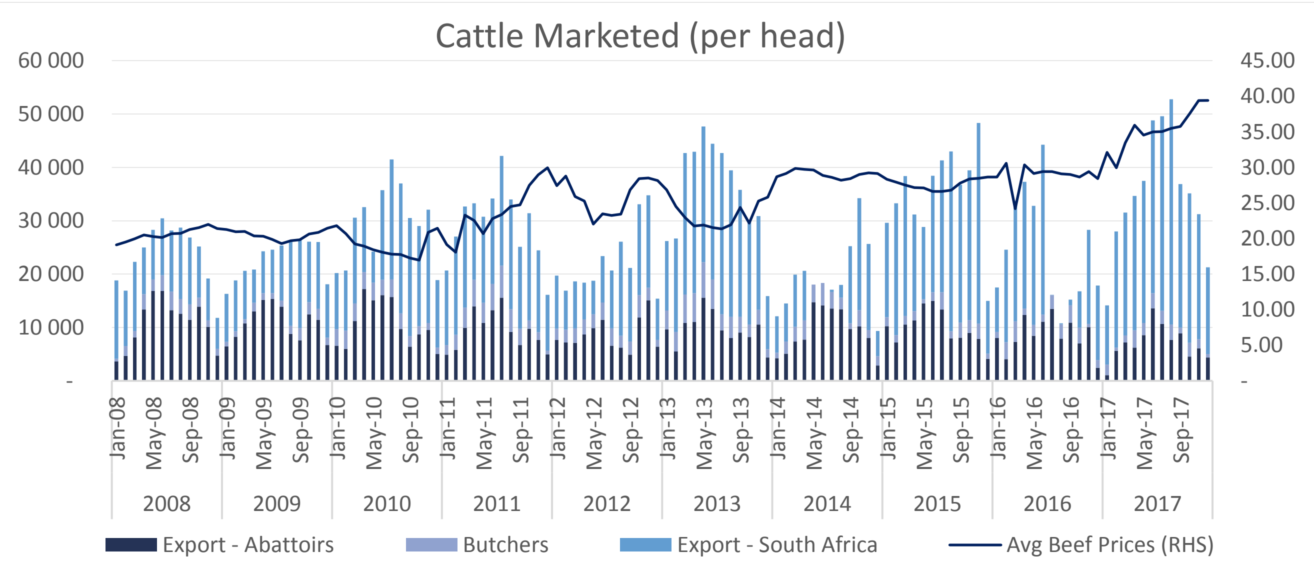
Source: Namibia Meat Board

Beef production for 2017 was strong in terms the total number of cattle marketed during the year, registering an increase of 43% over the prior year. The base was set relatively low due to large numbers of cattle marketed in 2013 and 2015 as a result of a lengthy drought and the need to restock in 2016. Much of the increase in the number of cattle marketed in 2017 stems from an almost doubling in the number of live exports to South Africa. This may look good in the current GDP numbers, but it hides an economic cost, namely that the size of the national herd continued to be depleted and may need years to recover.



Source: Stats SA, NSA

The regional drought lies at the root of the increase in live exports to South Africa. South Africa too saw a decline in their stock of cattle as the drought ravaged the southern African region. This resulted in an increase in meat prices and prices for livestock on the hoof marketed in South Africa. The prices were high enough to encourage a larger proportion of cattle to be sold on the hoof to South African feedlots and less to the Namibian abattoirs. Thus, even though the total number of cattle marketed increased greatly in 2017, the number marketed to the abattoirs declined.



Source: Namibia Meat Board

Last year we were already concerned with the state of the cattle industry due to the drought related reduction in the national herd. The large number of cattle marketed in 2017 would have put further pressure on the outlook for the industry for future years. As well as this there are various challenges weighing on the industry which may affect output from the industry in 2018. Of primary concern will be rainfall and the ever more unpredictable climate. Initially an above average rainfall year was expected. Poor rainfall would affect the carrying capacity of the land and combined with the price premium for livestock in the market, this makes restocking farms a challenge. Some farmers will have little choice but to market their livestock in order to cover costs, which would place pressure on the longer-term sustainability of such farms. These pressures have led to farmers selling farms and leaving the industry in the past, and will continue to be a challenge in 2018.

Inefficiencies at local abattoirs are partly to blame for the marketing of cattle in South Africa rather than to Namibian abattoirs. These inefficiencies result in local abattoirs not being able to offer competitive prices to local farmers. While this does result in lost value add within Namibia, marketing livestock in South Africa still brings money into the country (albeit rands, and not euros or dollars). The real loss is in the size of the national herd and the impact that this has on the industry's future output.

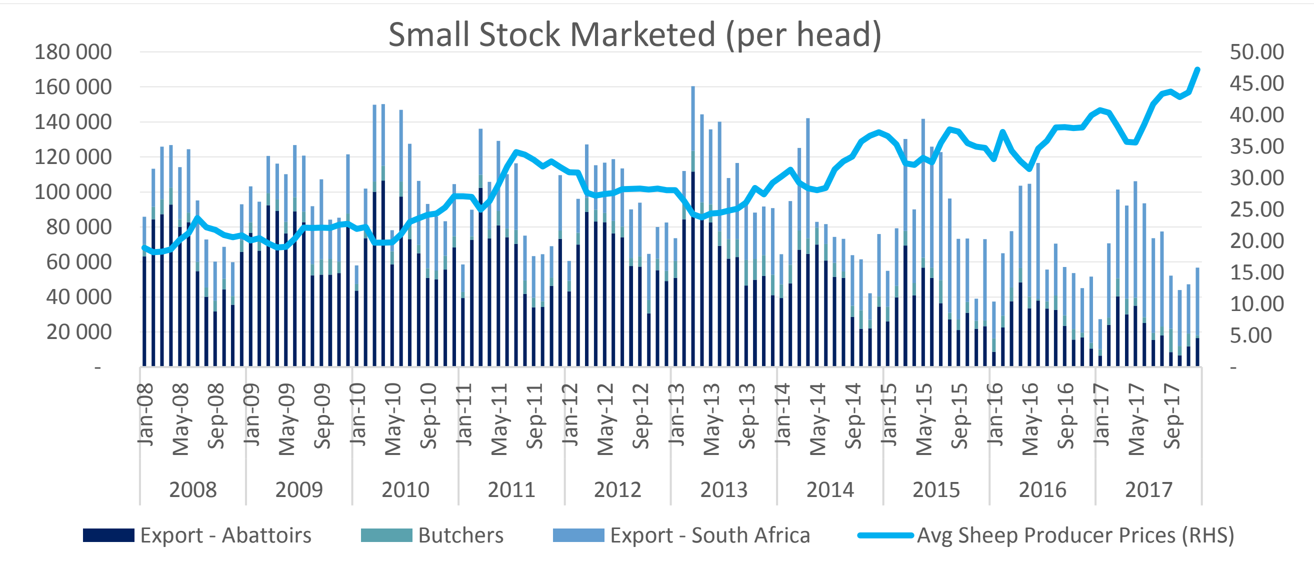
Further challenges facing the industry include the funding of the Directorate of Veterinary Services (DVS) according to the Livestock Producers Organisation. The DVS is responsible for maintaining animal health in order for Namibia's livestock to be marketable abroad. The fiscal consolidation of the last 18-months has resulted in a tighter budget for the organisation which could jeopardise the efficiency thereof. An inefficient DVS could lead to less animals marketed abroad (inability to issue permits in a timely manner) as well as a reduced ability for Namibian producers to market livestock abroad.

Outlook for Beef

The outlook for the beef/cattle industry is marginally negative in our view. The large number of cattle marketed in 2017 will likely slow the restocking process and lead to a contraction in growth. Poor rainfall could lead to the number of cattle marketed during 2018 exceeding the average, but this would come at the expense of future production, and in all likelihood a reduction in the number, or size, of commercial farming operations in the country. A decent rainy season may have the opposite effect, with farmers deciding to restock rather than market their livestock. Price will also affect the decisions taken by farmers, with current elevated meat prices favouring the continued marketing of livestock, although probably not at the same rate as in 2017. A strengthening exchange rate is likely to place further pressure on exports as Namibian beef becomes marginally more expensive, and this coupled with the inefficiencies in export abattoirs could lead to further pressure on the number of cattle marketed to these abattoirs. Overall growth in the beef industry is thus likely to be subdued in the short term, with negative growth likely in 2018.

Small Stock

The total number of sheep and goats marketed in 2017 increased by only 0.5% after declining by 23.7% in 2016. The number of small stock marketed over the last four years has been below the 10-year average for the sub-sector. This seems to indicate an industry in decline. The drought over the preceding years played a role in the number of animals marketed. After a substantial number of animals were marketed in 2013, poor rainfall in subsequent years made restocking a challenge – but a priority. Additionally, stock theft and predators make the sub-sector challenging in general.



Source: Namibia Meat Board

South Africa remains a large importer of Namibian small stock, and as is evident in the above figure, this has become increasingly important to the Namibian sub-sector as exports out of local abattoirs have been in decline for the last four years. As producer prices increase this becomes more and more evident. An increase in prices in South Africa will affect the small stock industry in a similar manner to the cattle industry in that inefficient local abattoirs struggle to compete on price and thus struggle to offer producers competitive prices.

Outlook for Small Stock

The outlook for small stock marketing figures may surprise to the upside as farmers would have been restocking where possible. This will be marginal though as the national herd has been in decline since long before the drought began. Export abattoirs are likely to come under further pressure due to the currency strength. Prices are likely to come down marginally towards the end of 2018 as good rains in South Africa lead to less foreign demand, and input costs moderate along with the stronger rand.

White Maize

The 2017 white maize harvest set an all-time record high according to the Namibia Agronomic Board. This is despite the havoc caused by the Fall Armyworm, which affected the maize under irrigation on the green schemes to a worse degree than the dryland crops. Production in 2017 was in the region of 50% of the national demand for white maize. This is encouraging as white maize, along with mahangu, remains the most important staple food in Namibia.

A resilient 2017 rainy season supported commercial maize farmers who marketed 73,000 tonnes during the year. This figure is close to the total production figure as white maize is predominantly grown on commercial farms and green schemes, with only marginal communal farming of the staple. The fall army worm which ravage the region played a particularly destructive role in the output from the green schemes in 2017. The adaptability of the pest makes it particularly difficult to bring under control. The white maize producers proved their resilience over the last four years, facing a long drought and this destructive pest. The record yield during 2017 stands testament to the adaptability and effort of the Namibian farmer.

Outlook for Maize

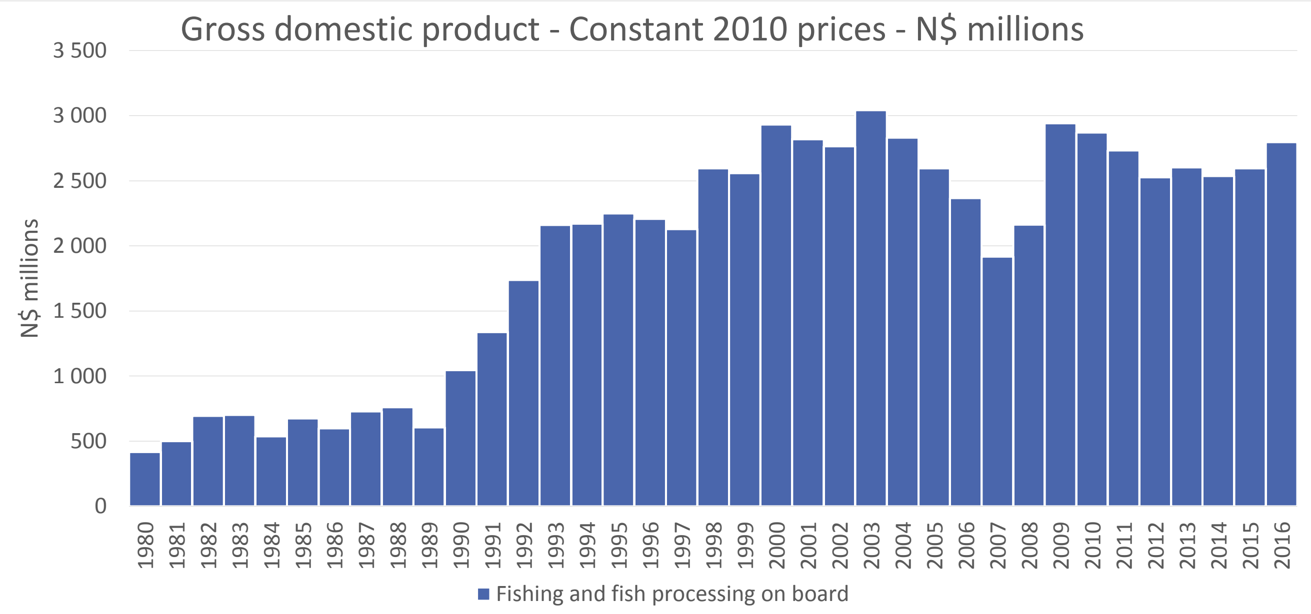
Rainfall is the single biggest determining factor for maize production. Rainfall has come later than expected but by most accounts, in time, for most farmers. The strong maize production figures for 2017 do provide an elevated base of off which growth will be challenging however. In addition, the threat of the fall army worm remains in 2018. As such expectations are for a marginal contraction in maize production for the year.

Outlook for Agriculture

Expectations for agriculture to drive economic growth in 2018 are ambitious. While the sector is expected to perform well, growth is likely to be muted at best given the base set in 2017. Our expectations are for a slight contraction in the sector due to delayed rains, the threat of pests and dwindling herd numbers in recent years. The multiplier effects of the rebound in agriculture in 2017 should however not be overlooked as it will have resulted in much relief and job creation among subsistence farmers in particular. A moderate 2018 should not reverse these gains and therefore the outlook, despite our expectations for a slight contraction, is rosier than for many sectors in the economy.

Fishing

In 2016 the Namibian fishing industry was estimated to have recorded 7.7% in real value added following 2.3% growth in 2015. Demersal landings contributed largely towards the strong performance in 2016, with a 19.2% increase in landings compared to a 11.6% contraction in 2015. The current expectations for the fishing sector for 2017 are rather subdued, with data from the NSA showing two consecutive quarters of contraction for the sector of 8.6% and 1.3%, in Q2 and Q3 respectively.

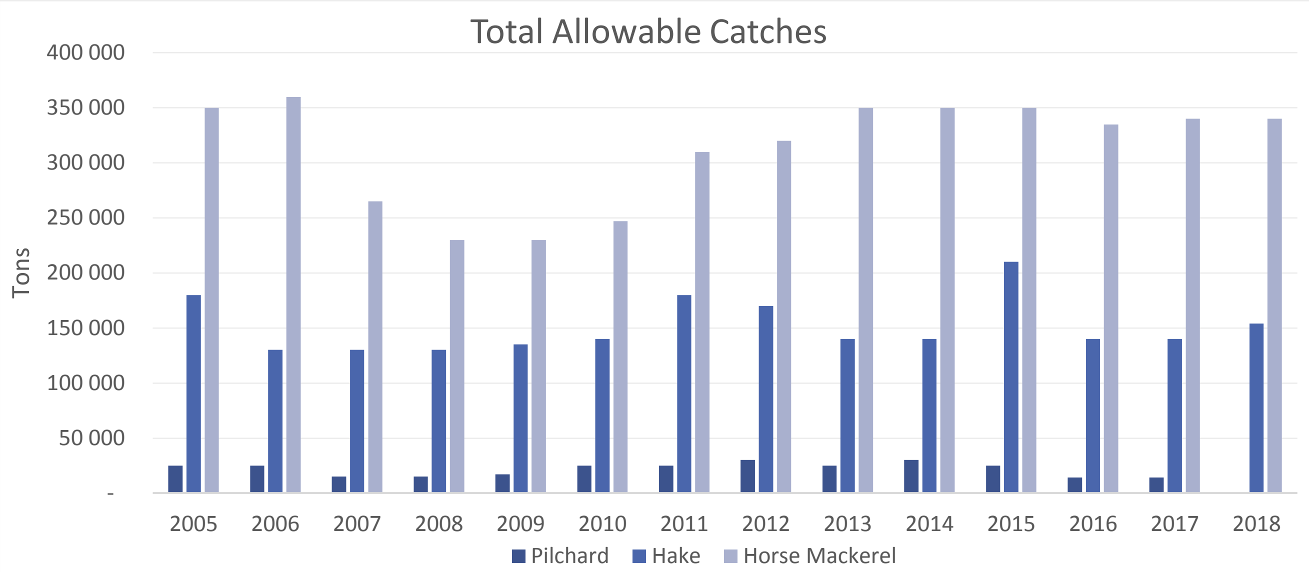


Source: NSA

The fisheries sector continues to play an important role in the Namibia economy with Q3 statistics from the NSA placing the resource as the second largest export product at N$2.2bn. Diamonds, jewelry and precious metal were the largest worth N$5.2bn in exports. The N$2.2bn Q3 performance made up 14.5% of Namibia's total exports, it further represents a 1.7% q/q contraction or N$39m over the same period in 2016 but underpins the sector's vital role as a major contributor to the domestic economy. The decline is attributed to weakening external demand from the largest consumers which are Zambia, Portugal and the Democratic Republic of Congo. Exports to these markets declined by 19.1%, 45.7% and 29.4% respectively.

The sector is also a one of the biggest employers in the country with 2016 figures showing the sector directly employed 16,800 people according to the ministry of fishing and marine resources. However, employment security within the sector remains volatile as could be expected with the recessionary period Namibia is in but in particular due to diminishing fish stocks. 3,000 jobs are estimated to have been lost in 2017, especially in the pilchard industry following very low catches for consecutive seasons. The severely diminished pilchard stocks are still struggling to recover. Government's steps in an attempt to save the resource, was to set the total allowable catch for the species to zero for the 2018 – 2020 fishing seasons. The dwindling supply of the species is highlighted by the fact that of the 10,000 metric tons allocated last year, only 3,400 metric tons could be caught. Horse mackerel continues to represent the largest TAC allocation in terms of mass, receiving 340,000 tons followed by hake with a TAC of 154,000.

A total 107 fishing rights will be renewed and or reallocated this year. The process could potentially be disruptive, putting at risk Namibian jobs and fixed investment. Fishing rights are generally awarded for 7, 10, 15 or 20 years. 32 rights expired in December 2017, with the remaining 75 expiring in December 2018. By 20 February many applicants, new and current, still did not know whether they were successful in landing the fishing rights. Though this creates uncertainty the ministry has noted that it will not be very disruptive as the process follows the Marine Resources Act of 2000.



Source: Ministry of Fisheries and Marine Resources

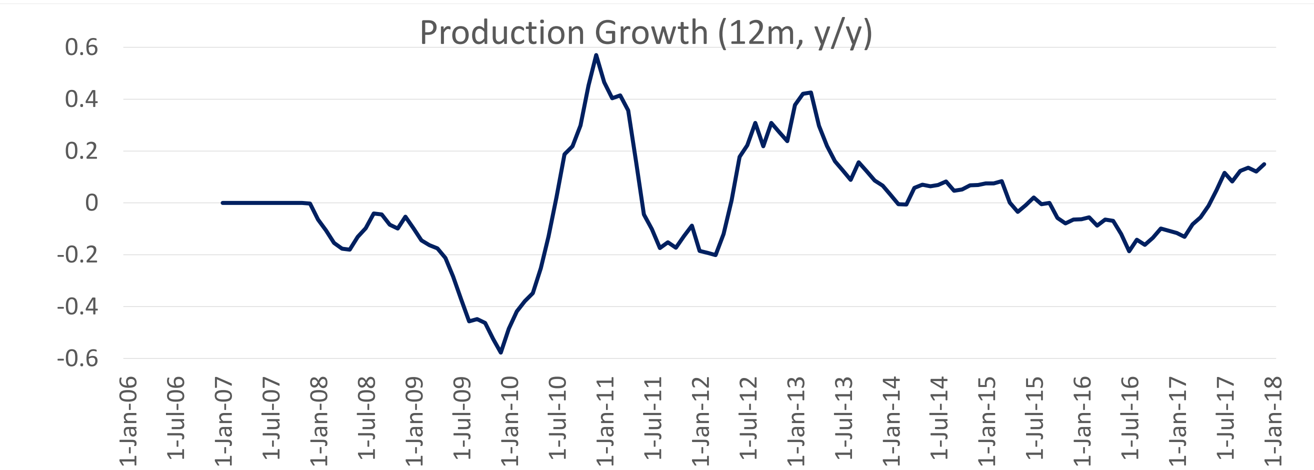
Currency volatility will play an important role in gauging how well the sector performs and with Namibia being a net exporter of fish and fish products, revenues are realized in hard currency. Namibia's large export destinations are Europe and central Africa, with products priced in Euro's and US dollars respectively. A stronger currency does not bode well for revenues, with stronger exchange rates garnering lower revenues. The price of oil is an important factor since it has large cost implication for vessel operators. Oil average US$54 per barrel in 2017 and on 21 February 2018 was trading higher at US$64 a barrel. A strengthening currency will put pressure on the top lines of companies in the industry, while an oil price above that seen in 2017 translates to an increase in operating costs, effectively squeezing margins in the industry. This feeds into our expectation of a tighter year and a slight contraction for the industry in 2018.

Mining and Quarrying

Mining and quarrying had a turnaround year in 2017 after three consecutive years of contraction. No other industry grew as quickly, although this was off of a low base. The fall in commodity prices over the last number of years started to reverse meaningfully in 2017 which bolstered the outlook for many different mining operations. The three new mines contributed greatly to the performance of the industry, with only the Husab mine lagging expectations (although the magnitude of the mine led to a large increase in uranium production despite this production being behind schedule). Third quarter 2017 GDP figures show cumulative growth of 18.1% y/y for the mining sector, moderating the overall economic contraction we expect for the country.

<u>Diamond Mining</u>

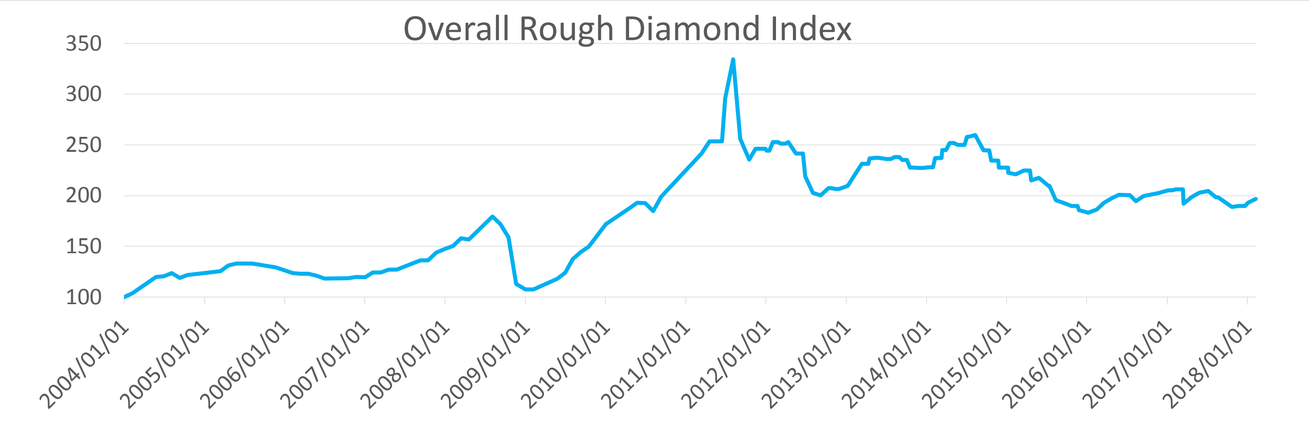
Diamond mining had a good 2017 with production up 14.9% y/y according to data released by the Chamber of Mines. This was largely due to NamDeb's Debmarine arm having access to a full complement of vessels for exploration and mining activities, as well as higher grades at the company's land based operations. This is positive for government coffers too as diamond mining taxes and royalties make up a material portion of revenues.



Source: Chamber of Mines

We expect diamond production to increase in 2018 due to an increase in production from land based sources. These sources have become more and more difficult to operate profitably and may only be feasible for a few more years. This is evident from the potential sale of the Elizabeth Bay mine which may be feasible for a smaller operator with lower overheads. That said, there remain a number of good years left in some of the other land based operations which we expect to lead to a decent uptick in production of 12.6% in 2018, after which we expect the production from these sources to start to taper.

Diamond production from marine sources should be in line with that of 2018 which will underpin total production for the year. Marine diamond mining makes up the bulk of NamDeb's operations in Namibia and we expect to see this source grow further over the medium to long term as the land based resource becomes scarcer.

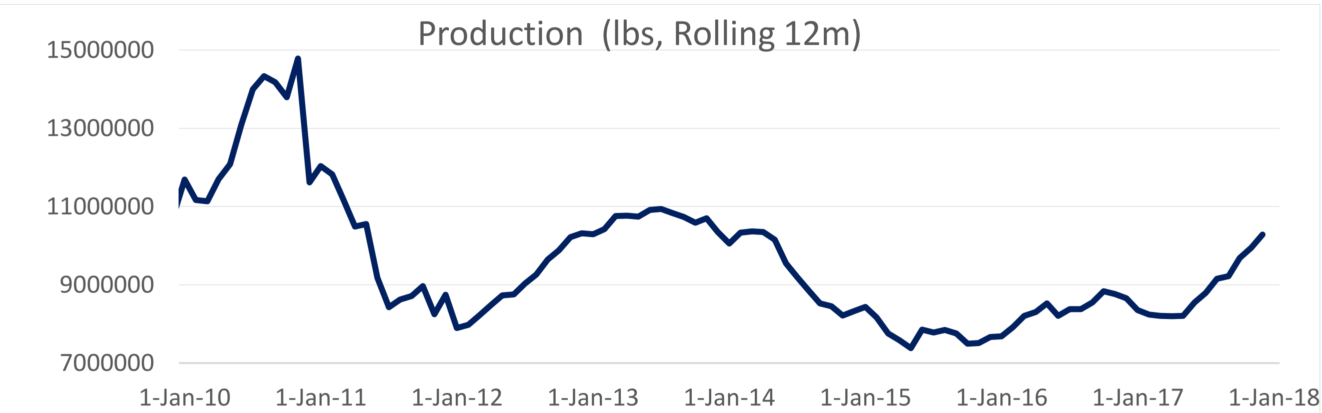


Source: Bloomberg, PolishedPrices.com

Diamond prices will play a role in government revenues and royalties, as well as in future production capacity. Rough diamond prices are somewhat off of their highs at present with mixed views on where they may be headed. The industry view is that demand is slowly increasing and that millennials are becoming an ever more important market as they age toward their most affluent years. Whilst this may be so, the counterargument points to the ever-increasing popularity of man-made diamonds and the price advantage they offer. The trend of late points toward lower prices, but we do not expect to see a rapid decline over the next 12 to 18-months. Currency strength and a rise in the oil price are however factors which could cancel out the effects of increased production on government revenue and royalties.

Uranium Mining

Uranium production increased by 18.8% in 2017 due to Swakop Uranium's Husab mine coming online. This is despite lower figures from Langer Heinrich, and Rössing producing somewhat less than capacity. Low uranium prices have resulted in various large producers such as Cameco and Kazakhstan's KazAtomProm cutting production recently. So too low uranium spot and contract prices threaten the sustainability of operations at the Rössing and Langer Heinrich mines. Our forecasts do take this into account but even with expectations for reduced production from these mines Namibia's uranium output is set to increase in 2018 due to Husab gaining momentum. The Husab mine seems set to continue ramping up to full production irrespective of the uranium price. While this does not seem rational given that most forecasts only expect prices to increase in 2020 or beyond, the fact that Husab ramped up to a third of capacity during a period where prices have been under so much pressure does lead us to believe that they will continue ramping up production in 2018.



Source: Chamber of Mines

Other Mining Activities

Being a commodity rich country exposes the economy of that country to external shocks as the commodity super-cycle weaves its way through time. The increase in commodity prices thus comes as a silver lining under the present economic stress Namibia faces. Rising copper prices, discussed earlier, should bolster the current producers and could lead to reinvestment into the Matchless and Otjihase mines in the medium-term (depending on whether the price rally continues). At the very least it should make up for the strengthening currency and rising input costs at the Tschudi mine and Tsumeb smelter, leading to improved long term sustainability.

The same holds for zinc. A sharp rise in the zinc price has renewed the outlook for the two mines in the south of the country who not too long ago were either approaching the end of their life-of-mine (LOM) or subcontracting to reduce costs. Zinc deposits, known about for some time, have become feasible due to the increase in the zinc price. The Rosh Pinah Zinc Corporation mine could see its LOM extend by 12 years if these deposits are successfully exploited. Similarly, Vedanta's Skorpion zinc mine has received a new lease of life due to exploration efforts. Both these mines may not produce more zinc in 2018 than they did in 2017 but will continue operating, which means that they continue to support the economy, despite being scheduled to have closed by 2017 previously.

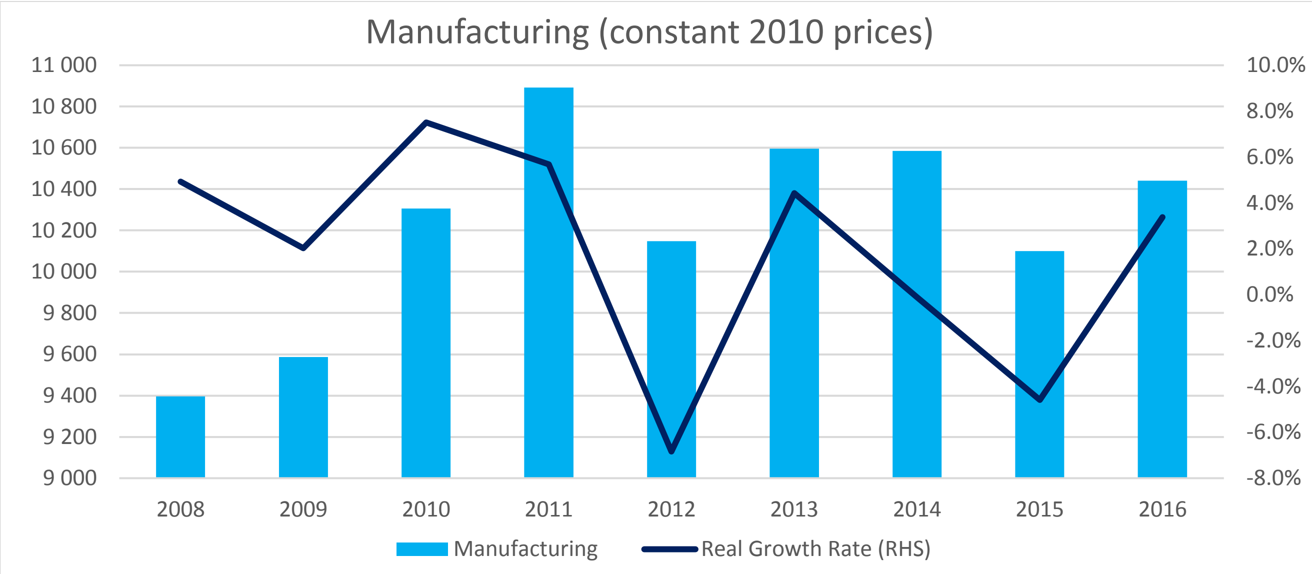
Gold production figures have continued to increase after more than doubling in 2015, the first full year of production from the B2Gold mine. This mine has gone from strength to strength and been very profitable in the process. At current gold prices Namibian gold production is under little threat despite the currency strength seen after Cyril Ramaphosa was nominated to the head of the ANC, due in large to the low cash operating costs of the B2Gold mine. We expect little in terms of production growth for the year but this is off of an elevated base set over the last three years.

Other metals mined in Namibia that have benefitted from an increase in prices are lead and lithium. Lead production for 2017 increased over the previous year while lithium production is new to Namibia in 2018. Both lead and lithium could contribute marginally to the growth of the sector in 2018. The outlook for both metals, along with the other metals and minerals mined in Namibia, seems good. We expect modest increases in output from these sources although we have tempered our expectations purposefully as the increase in commodity prices may be fragile. Expectations for 2019 and beyond could be revised up substantially should commodity prices hold up or increase over the next year.

The sustainability of mining a commodity largely comes down to the current price of that commodity. It was thought of the oil stock in the 1960's that it was being depleted at such a rate that by the 1990's there would be none left. In contrast we now know of more oil reserves below ground than we ever have. Technological efficiencies and price increases lead to new resource discoveries which effectively enhances the sustainability of the mining operations and the use of the resources mined. So too we expect higher commodities prices to lead to an increase in exploration in Namibia over the coming years and the development of new mines as a result. Mining may once again drive growth in Namibia in the medium or long term. We have moderated our expectations since the increase in commodity prices in a relatively recent trend.

Manufacturing

The contribution of the manufacturing industry to GDP has been declining. Whereas manufacturing made up almost 12% of GDP in 2007, it only contributed 9.5% to GDP in 2016. While manufacturing has been growing over the period, growth has been erratic and lagged behind overall economic growth. Manufacturing in Namibia has always been challenging as it is sparsely populated and arid. The fact that neighbouring South Africa has the expertise and economies of scale to manufacture most goods at a lower cost has resulted in Namibia importing most of what it needs from this more efficient market. Namibia has few competitive advantages when it comes to manufacturing and this is reflected in the slow growth of the industry despite tax incentives.

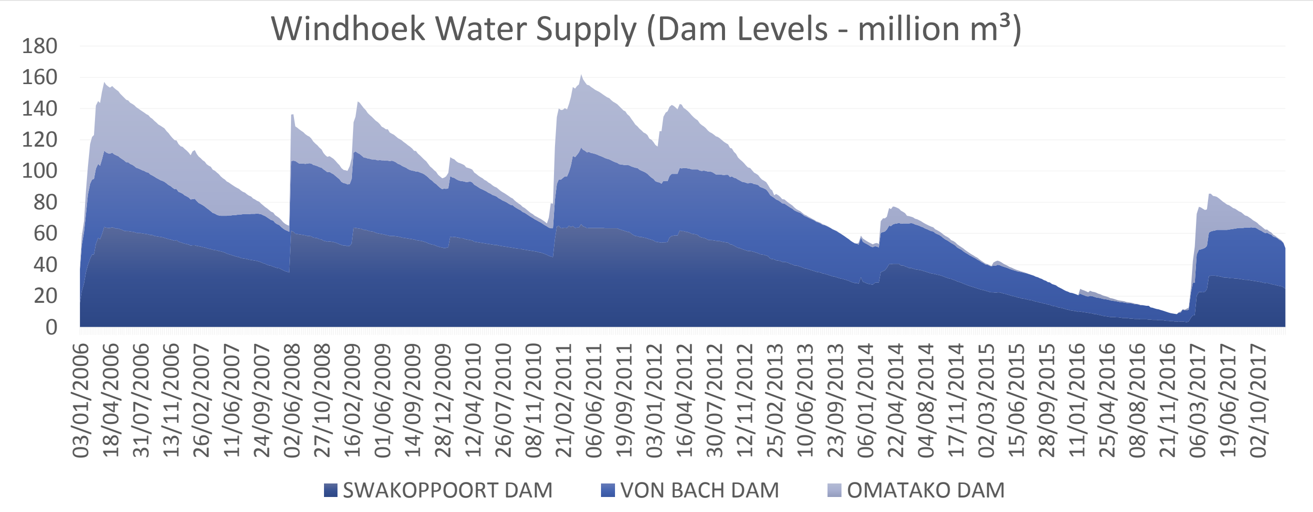


Source: NSA

We expect to see growth of around 1.6% for manufacturing for 2017. This is based on some growth in food processing and growth in the diamond processing subsector. We expect this momentum to be carried into 2018 with growth of 2.6%, above our expectation for overall growth. Water and electricity should not be a determining factor during 2018 as the availability of both should be largely uninterrupted during the year. Policy clarity could provide a boost to the industry if it results in a return of domestic and foreign investors. Over the medium-term however we do not see manufacturing growth surpassing overall long-term growth (more or less 4.5%) due to the factors mentioned previously.

Water

The supply of water plays a vital role towards the output of Namibia and with an average 300 days sunshine, Namibia is one of the sunniest countries worldwide and generally arid. Forecasts from the South African Regional Outlook Forum expects the bulk of the SADC region to receive normal to above-normal rainfall for most of the period from January to May 2018. Namibia endured four drought-stricken years that depleted dam water levels between 2013 and 2016. Improved rainfall in 2017 brought much relief and resupply to the dams, especially in the heavily populated central region. The outlook for 2018 provides for more optimism.



The three dams supplying water to the central part of Namibia have recovered markedly since the end of 2016. However, risks are that these dams will not have sufficient water supply if the current rainy season is to disappoint. NamWater's weekly dam bulletins observed from December to date show a slight overall decline in the supply levels. As at 12 February the Swakoppoort and Von Bach dams were 39% an 54% full. Two of the three central area dams recorded declines in supply between the period from 27 December to 12 February. Swakoppoort's supply dropped by 5% and Von Bach declined by 11%, while Omatako, although up from 1% in December, is worrying low at only 1.6% of capacity. Statistics for 12 February shows significant improvement in overall dam levels for the central area which stood at 51 million m³, compared to the 25 million m³ recorded the corresponding period last year.

The northern region has been hit by phased rehabilitation of Angola's Calueque Dam, causing intermittent disruptions in the supply of water. The restorations to the Calueque Dam, which is the main source of abstraction for the region, was necessitated due to a burst pipe, leaving only one pipe operational. As well as this, extensive weed growth and silt accumulation at the base of the Calueque Oshakati canal further compounded the issue.

The coastal regions water dependency is spread across Swakopmund, Walvis Bay, Henties Bay, Arandis and the three Uranium mines. The three coastal towns between them consume about 13 million m³ per annum while the surrounding mines could use up to 25 million m³ per annum. Consumption by the mines is very much dependent on whether or not they are in full production. The vast demand for water is gradually surpassing supply. An estimated 5% annual growth in population is one of the main reasons the coastal region is concerned with the sustainability of water supply. A longer-term solution rests in an additional desalination plant to supplement the activities of the privately owned Areva Namibia plant.
The southern part of the country that houses the largest dams will welcome the Neckartal Dam to the stable. The dam, after numerous delays, is scheduled for completion in October according to the constructor Salini Impregilo and senior government officials. Salini further advised that the dam is ready to collect water. Water for the dam will be harnessed from the Fish River and will be used to produce hydro-electricity, creating a reservoir capable of holding 857 million m³ of water and irrigating 5,000 hectares of land for agricultural production.

The longer-term sustainability of water is of utmost importance and its supply was challenged during the drought Namibia experienced. The importance water plays in any economy is unquestionable, in addition to being the most basic human necessity, most industries are heavily reliant on water. The agriculture and mining sector which have been projected to perform well this year will pin heavy reliance on water and future investment will be driven by water security and its sustainability of supply.

It is unlikely that 2018 will see the same pressure on water resources as during the 2013 – 2016 drought. As such water supply should not be much of a limiting factor during the year, but the lack of tangible projects to increase supply to key areas of the country during the year is slightly concerning. The central and coastal regions are at a point where demand exceeds, or is soon to, supply over the long run (when the coastal mines are in full operating mode), and the northern regions still have sparse access to formal water sources. Water supply will be a major hurdle for the current administration to address. A limited water supply is sure to be a drag on growth and output, as Cape Town can currently attest to.

Electricity

Much like water, economic activities and therefore growth are heavily dependent on energy input. The more an economy expands, or as is with Namibia, wishes to expand the more energy it will require in order to grow. Namibia's electricity requirements are predominantly sourced externally through import agreements. The three power plants currently fulfilling the role of generating domestic supply in Namibia, Ruacana Hydro, Van Eck and Anixas Power plants, do not have the capacity to meet the country's energy demands. Expanding mining activities further adds to the vast demand that needs to be catered for, resulting in the excess being sourced from neighbouring countries.

Namibia imported 57% of its electricity consumed for the year ended 2017 as per NamPower's annual report. This is lower than the 63% imported in 2016, which is attributed to an improvement in the integration of renewable energy and more specifically the REFIT programme. A reduction in imports was realized despite only two of the three power plants being utilised. The Van Eck plant was also not being utilised to maximum production due to the ongoing rehabilitation of the plant, leaving only the Ruacana Hydro Power plant fully utilised. NamPower decommission the Paratus plant in 2015/16 and hoped to bring it back online but plans to install new diesel engines have been shelved.

Namibia's energy demands are forecast to reach 930MW in 2025 before escalating to 1,330MW by 2035. These forecasts signify a possible perpetual reliance Namibia will have on imports if effective steps are not taken to grow domestic supply. Namibia sources its supply gap from the Southern African Power Pool (SAPP) with Eskom being the largest provider with a 200MW contract. This rand denominated contract frees Namibia from the exchange rate volatility it faces with the rest of the SAPP countries (from which we source 36% of imports), who sell power in US dollars. NamPower and Eskom successfully negotiated the five-year Power Purchase Agreement effective the 1st April 2017 to replace the one that expired in March 2017.

NamPower's five-year strategy is to have 75% of electricity demand generated domestically and the corporation plans to realize this through building several new power plants. Three of the proposed plants are a 40MW biomass-fueled plant in the central area of Otjiwarongo, another 20MW plant in the Otavi area and a third 150 MW concentrated solar power plant to be build in Arandis. The 25-year PPA between NamPower and Diaz Wind Power will see the setup of a 44MW wind power plant near Lüderitz. The power plant is expected to deliver output of 200 million kilowatt hours per year, providing energy supply to over 10,000 households.

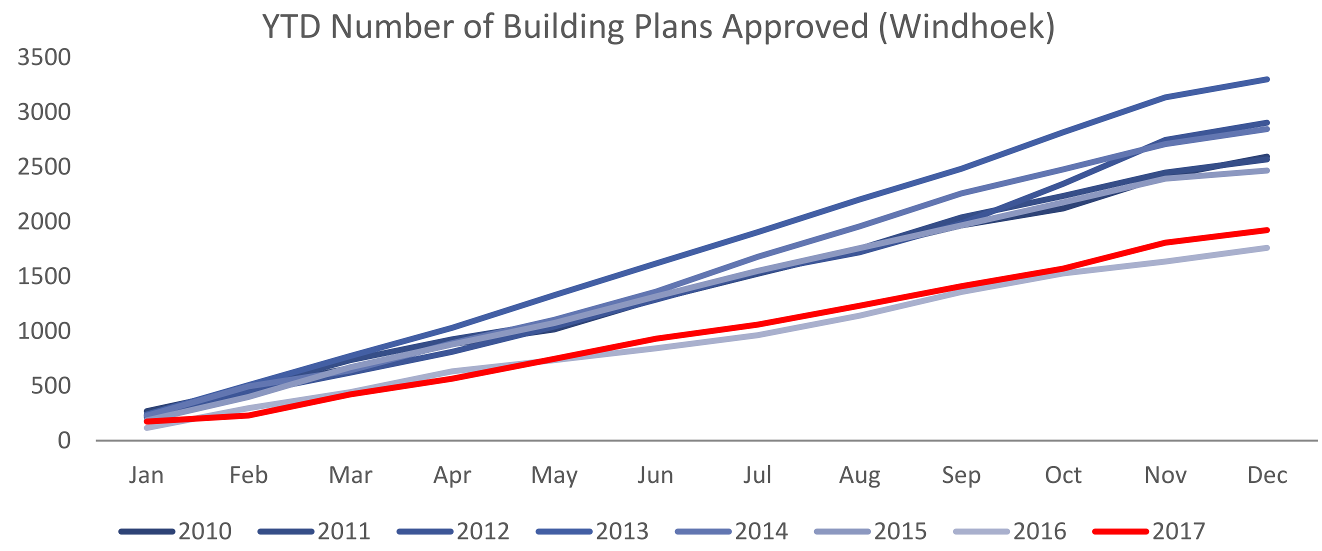
In contrast to water supply, proactive steps in the right direction are being taken to address the energy needs for the near to medium-term. It is however undeniable that longer-term solutions need to be explored. One of these may be the Kudu gas-to-power project, projected to provide 885MW, with the Bains Hydro project another option. A final investment decision regarding Kudu is expected between the December 2017 and June 2018, although it is doubtful if anything will come of this as has been the case for decades now. With the Eskom PPA in place however, Namibia's medium-term supply of energy is stable and should be boosted by the various projects envisioned for future supply.

The proposed unbundling of NamPower by government presents an opportunity for new entrants into the energy generation space. This could be very positive as it would result in competition between power suppliers which will inevitably drive down costs. Cheaper electricity would be a piece in the puzzle of making Namibia more attractive to investors. It may take some time for this to take place though.

We do not expect to see a large increase in local power generation capacity during 2018 as the larger projects proposed above will take time to construct. The Diaz wind plant is set to be completed in 2019 only. NamPower expects the last of the refit projects to be commissioned in 2018, adding about 4% to installed generation capacity. Along with this two larger solar plants should come on-line during the year. This increase in generation capacity is offset to some extent by the expectation of less power production in total this year from the Ruacana hydro plant due to lower river levels.

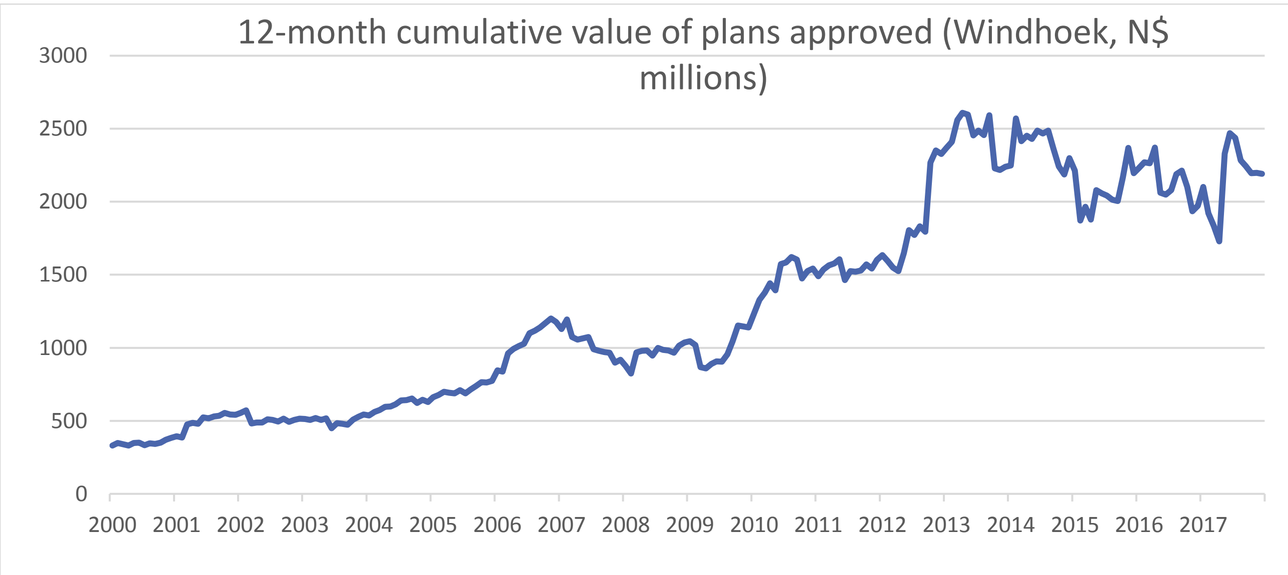
Construction

We expect construction to have recorded a second annual contraction in 2017. The restructuring of the budget late in 2016 resulted in a slowdown in capital spend by government which drove much of the growth in the construction sector previously. As well as that, unbudgeted projects resulted in late or non-payment of invoices for work done on government projects. Construction was not the only sector to suffer from this. This caused a cash flow crisis within the construction industry and resulted in company closures and layoff, events that are still occurring in the industry a year later, despite most outstanding invoices being settled. Government capital projects are still scarce and are likely to remain so for the foreseeable future as persistent budget deficits and continuing consumptive requirements limit the amount available to be allocated to capital projects in the budget. The rapid growth of the industry pre-2016 is unlikely to happen again any time soon. Private sector growth could however provide some upside potential over the medium term.



Source: City of Windhoek

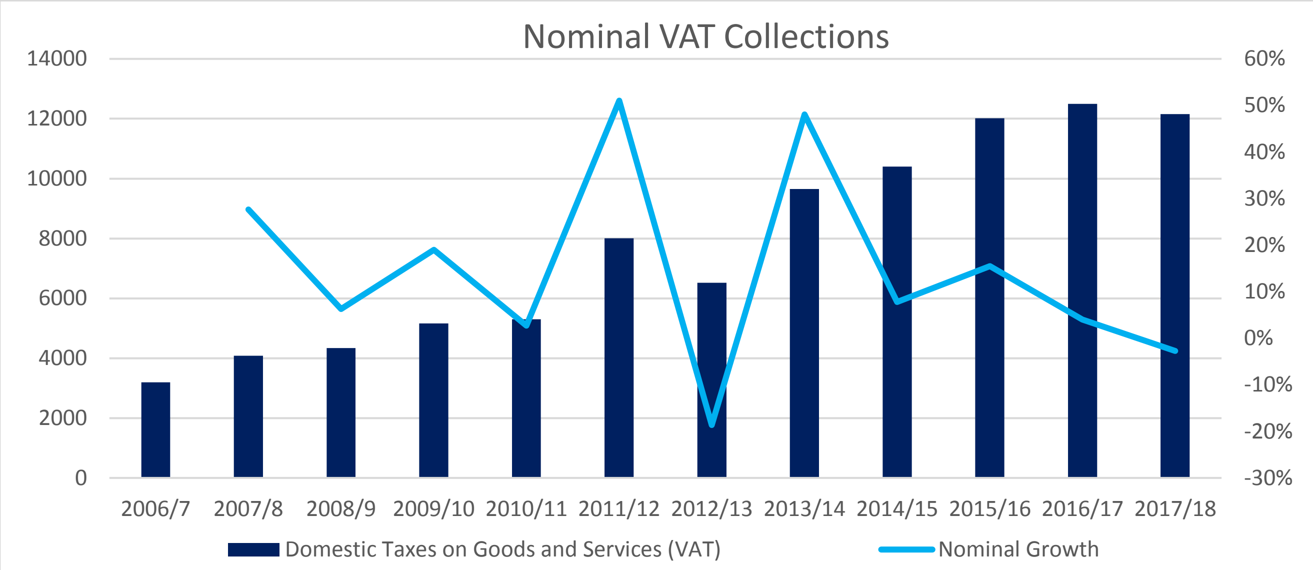
Our expectations for 2018 are for a further moderate contraction in the construction industry as businesses in continue to be under pressure and financing becomes a bigger challenge due to effect of IFRS9 regulations on the banks. Conditions are thus set to remain challenging in the short-term. This will reverse as the economy finds its feet but may take some time. We optimistically expect growth from the industry from 2019 on. Namibia has a supply/demand mismatch on the housing front and a n infrastructure deficit which will be addressed slowly but surely over the medium to long-term, breathing some life back into the construction industry.



Source: City of Windhoek (not adjusted for inflation)

Wholesale and Retail Trade

Wholesale and retail trade, as noted earlier, was the second largest drag on the economy in real value terms in 2017 (up to Q3). The figure below illustrates that in even nominal terms VAT collections (a proxy for the industry) declined in 2017/18. VAT collections are in no way a perfect proxy for the industry, but the industry is one of the largest contributors to VAT collections and a such this gives an indication of the real contraction expected in the industry. A year-to-date contraction of 6.6% was recorded in the Q3 GDP release late last year. While these numbers are subject to change we expect to see a negative rather than a positive adjustment in the final figures for 2017.



Source: Ministry of Finance

For 2018 we expect to see a further mild contraction in wholesale and retail trade due to tight credit conditions as banks implement IFRS9 reporting regulations, as well as a lack of consumer confidence as the economy struggles to find its feet. We expect the industry to return to longer term growth levels from 2019 onward.

Tourism

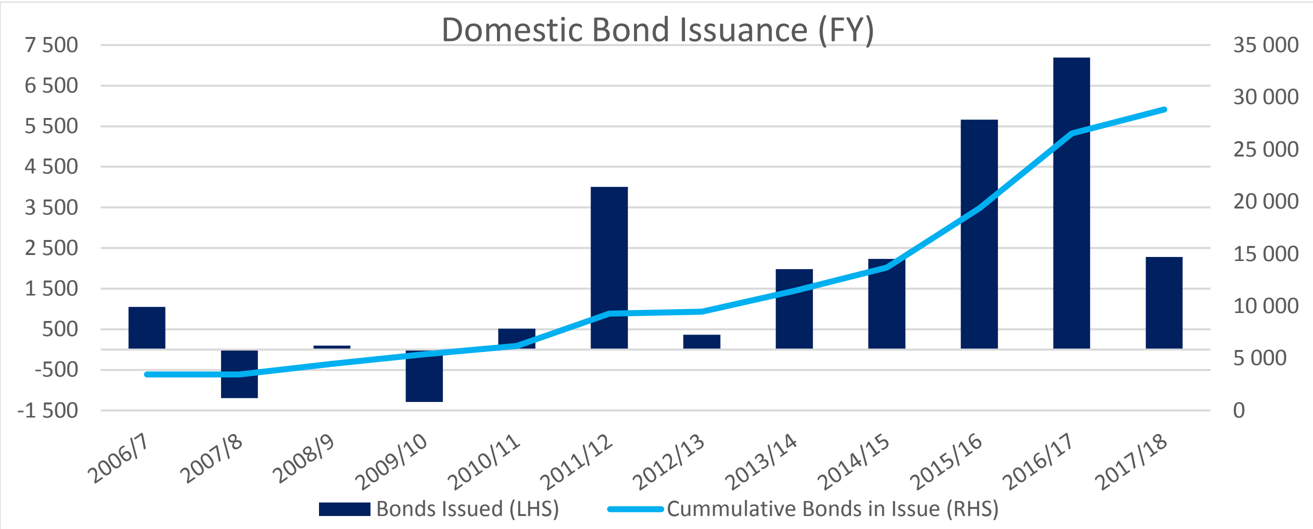
Tourism is likely to remain a green shoot in 2018 after showing strong growth over the last few years. The industry has grown to the point where Namibia has one of the longest waiting lists (in relation to capacity) of prospective tourists of any country. Capacity is one of the key constraints on growth for the year. During the high season occupancy is pushing at the seams of capacity. New investment is necessary to ensure continued growth from the tourism industry, but there are constraints on this too. The investment promotions act (briefly mentioned under Key Themes) remains a factor, as well as the saturation of the current tourism hotspots. Poor roads have also been a burden on the industry. Going forward we continue to expect growth from tourism, if not at the same pace as seen over the last few years.

Fixed Income

For FY2017/18, the Namibian government set out to follow the fiscal consolidation measures which were adopted during the 2016/17 mid-year budget review. The 2017/18 mid-year budget review however revised this goal to one of a pro-growth fiscal consolidation, which resulted in the tabling an upward revision of expenditure from N$62.5bn to N$66bn. Revenue collection expectations were also revised upwards in the Mid-term Budget review, but only by N$300m. The increase in expenditure thus resulted in a large upward revision to the budget deficit for the current fiscal year. The funding for this deficit was largely to come from domestic debt issuance. In addition to the domestic bond program, government has been successful in acquiring loans from the African Development Bank (AfDB) and the German government to the tune of N$10bn (split 50:50 over this fiscal year and the next) and N$950m respectively.

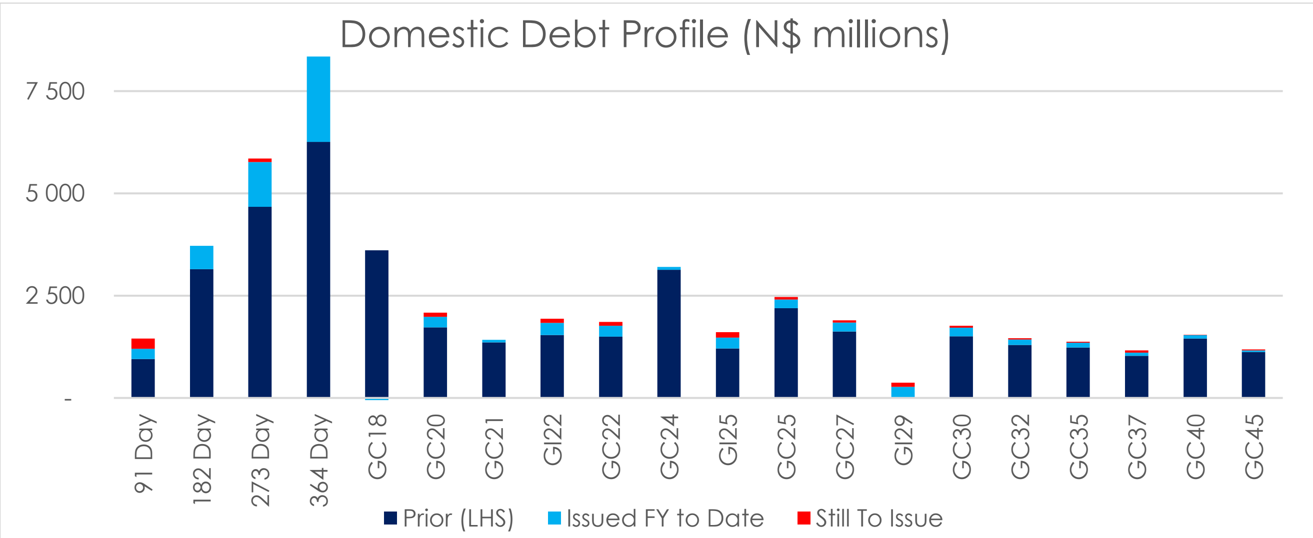
<u>Issuance</u>

A total of N$6.5bn in domestic debt has been raised thus far in the 2017/18 fiscal year, made up of N$2.5bn government bonds and N$4bn worth of treasury bills. The budget deficit, which is mainly funded through domestic debt issuance, sought out to raise N$5.4bn in the market according to the borrowing plan released at the start of the FY2017/18.



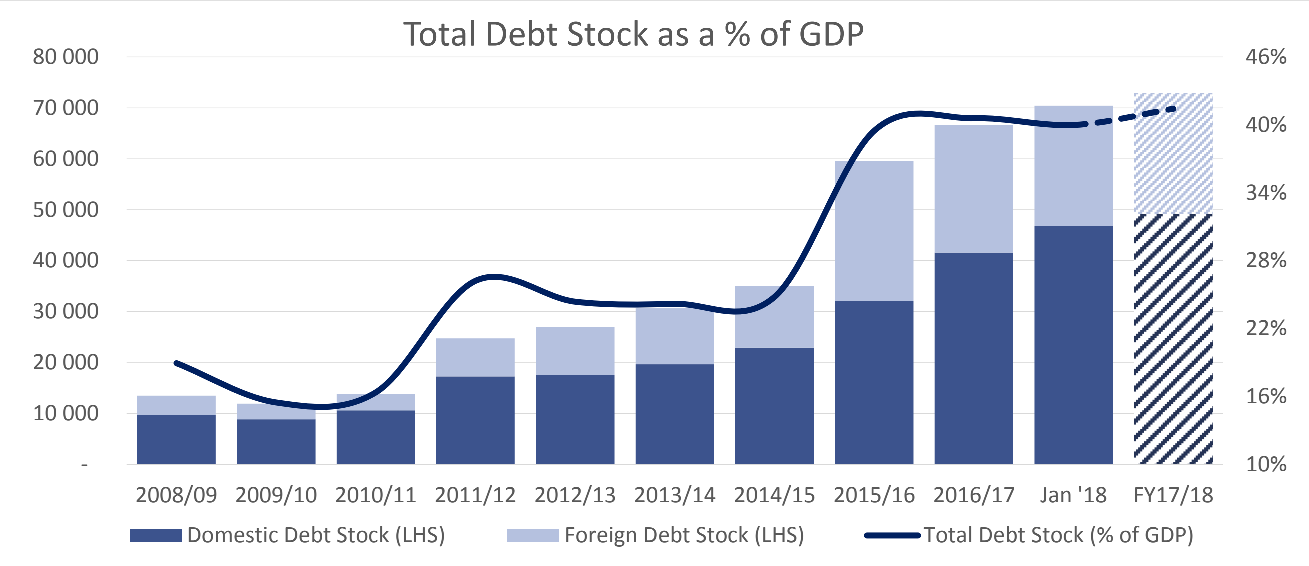
Source: BoN, IJG Securities

Changes to the borrowing plan were sent to market in September with BoN increasing the desired amount of issuance by N$1bn while advising that the additional issuance was required to shore up government's cash reserves. The increased amounts on offer were strategically spread toward where demand had been observed at the bond tenders. As illustrated below, issuance is very much focused toward the shorter end of the curve. Then at the end of January, BoN strayed from the issuance guidance once more with a newly revised borrowing plan with and additional N$1.2bn, bringing cumulative issuance for the year to N$7.7bn. In contrast to FY2016/17, issuance for the current fiscal year has thus far been devoid of any private placements.



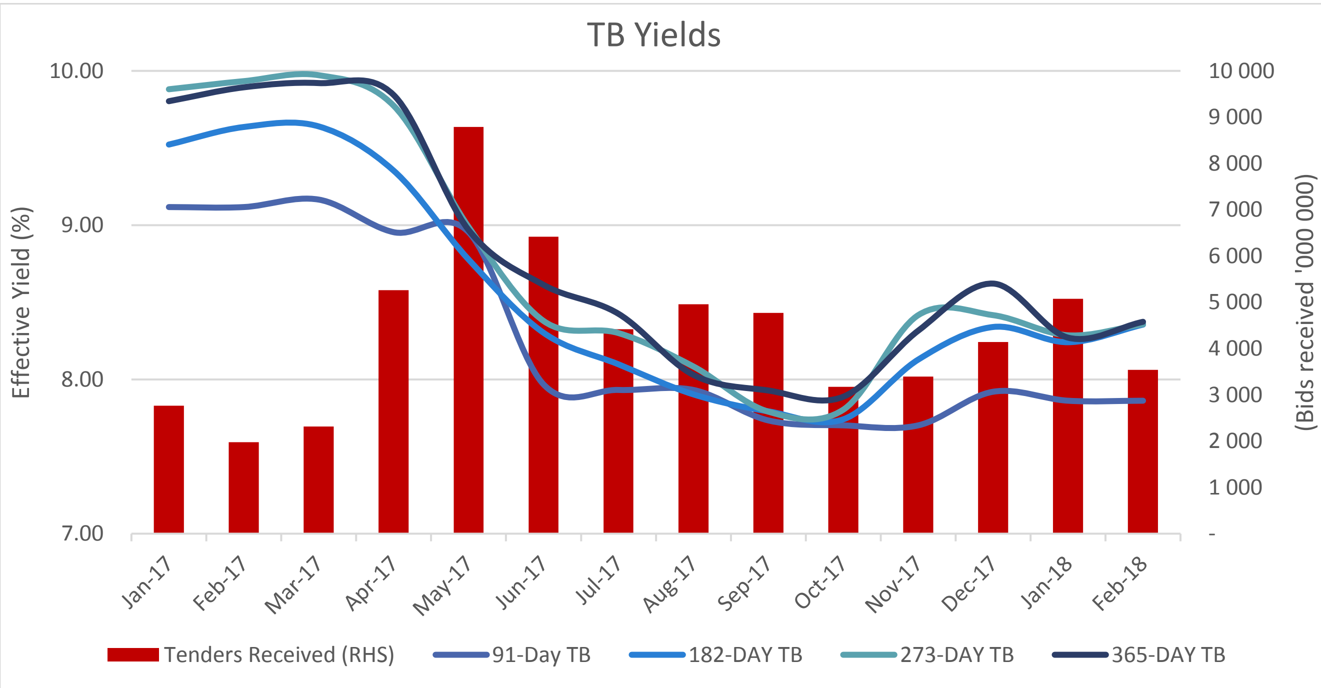
Source: BoN, IJG Securities

In keeping up with a widening budget deficit, government debt issuance escalated rampantly over the last three years. A rise in government expenditure was met with disappointing revenue collection which later left government with no option but to adopt fiscal consolidation. Curtailing expenditure led to delayed, or in some cases, non-payment of government invoices. Credit rating agency Moody's viewed these events as fiscal indiscipline, outlining Namibia's ballooning debt accumulation as a heightened risk to the country's fiscal position. The growing domestic and foreign bond issuance, which is budgeted to culminate to over N$72bn is inclusive of international loan agreements from the African Development Bank as well as from the German government (€60mn). N$10bn will be received from the AfDB in two tranches of which the first N$5bn has been received for the FY2017/18 and the second to flow in the FY2018/19. These debt obligations combined bring Namibia's total debt to GDP to almost 42%, well above the self-imposed 35% debt to GDP limit.



Source: IJG Securities

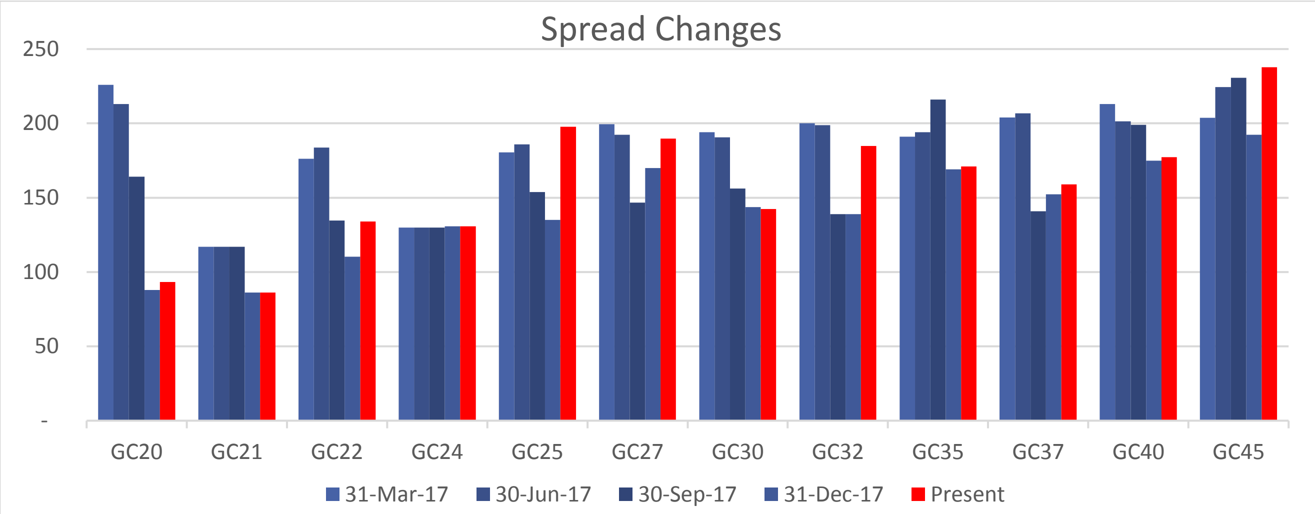
Treasury bill yields have come down markedly from the levels observed a year ago. Liquidity shortages toward the end of 2016 led to treasury yields rising to the highest levels since the global financial crisis in 2009.The 2017/18 fiscal year has seen a much-improved overall banking sector liquidity position as well as foreign reserve levels. Liquidity was boosted by a combination of higher SACU receipts, the payment of outstanding invoices by government, and the advancement of the loans from the AfDB. Supply-demand dynamics have also favoured lower T-Bill yields over the 2017/18 fiscal year with bids on all T-Bill maturities consistently exceeding supply at the TB auctions.



Source: BoN, IJG Securities

Spreads

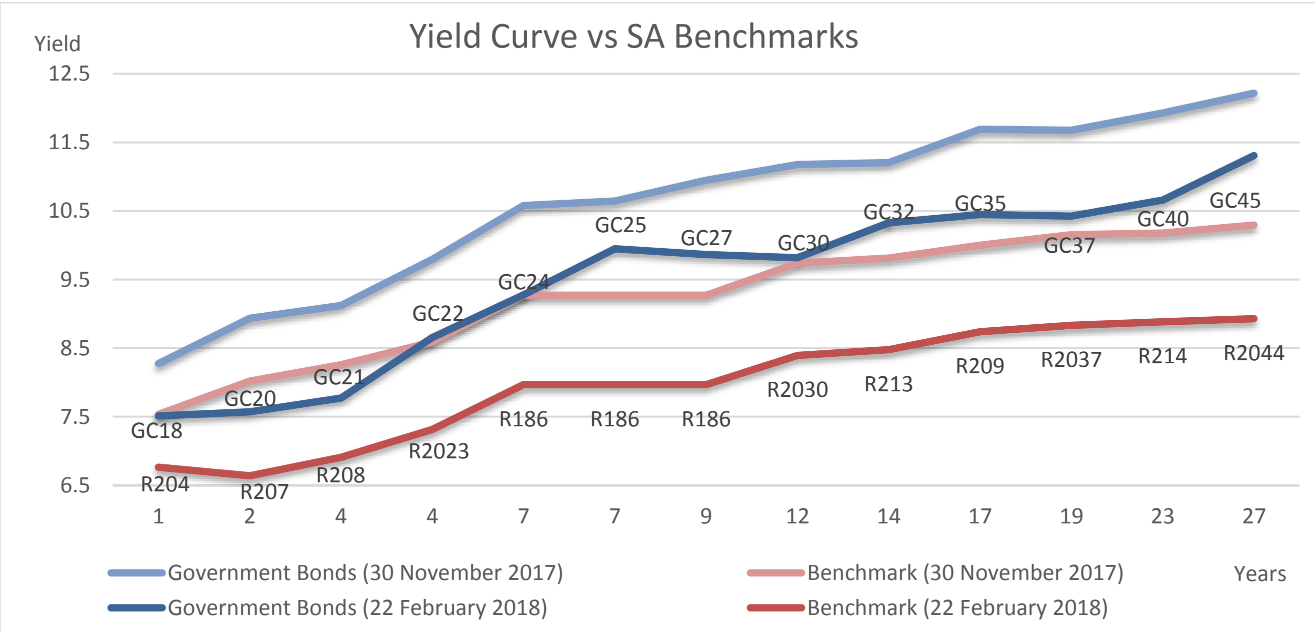
Namibian bond premiums over the SA benchmark yields have generally contracted over government's fiscal year bar a few exceptions GC25 and GC45). A return of liquidity following the squeeze seen between November 2016 and March 2017 contributed largely to this. At the same time government indicated that the budget deficit for 2017/18 would be smaller than in the previous year, and as such issuance would be reduced, driving spreads tighter. Some confidence was lost however following the two increases in the borrowing requirement for the year and the upward revision in the expenditure ceiling. This additional debt issuance has in our view justified an increase in spreads.



Source: IJG Securities

As has been noted in previously in this document, the change in ANC leadership in December has been viewed with optimism and this is reflected in the South African yield curves below.

Yield Curves



Source: IJG Securities

Market rates in Namibia will largely be influenced by South African credit ratings in 2018 and monetary tightening in developed markets. Spreads will be influenced by the Namibian borrowing requirement, expected after the budget review early in March.

Interest Rates

Our “Outlook 2017” interest rate scenario was vindicated with only one rate cut enacted by both the South African Reserve Bank (SARB) and the Bank of Namibia (BoN). Monetary policy remained very much accommodative in Namibia, although macro-economic data could have been considered as supportive of more than just the one cut. Recessionary growth as well as moderating inflation did lay forth room for monetary policy easing.

South Africa was unable to avoid credit rating downgrades last year with two of the three big ratings agencies, namely Fitch and S&P, downgrading SA’s credit rating to sub-investment grade i.e. junk status. Moody’s has placed SA’s credit rating in review while maintaining a negative outlook and its 90-day review decision is due by the end of February. Moody’s is likely to reserve publication of their review decision until after the 2018/19 budget speech is tabled in parliament on the 21st of February 2018.

The SARB, with its mandate as an inflation targeting central bank, would have been pleased that inflation moderated to within the 3% - 6% target in April 2017. SA CPI slowed to 4.4% in January 2018 and average inflation for 2017 was 5.3%. Following the only rate cut for 2017 in July, the SARB kept the repo rate unchanged and maintained the rhetoric of upside inflation risks as ever present, especially in the long term. The credit ratings downgrades that ensued during the latter part of 2017 did confirm the basis for those fears, with the imminent fear of a Moody’s downgrade reinforcing the negative outlook.

Questions remain regarding whether both rises in the currency and commodity prices can be sustained going forward. Should a Moody’s local currency credit rating downgrade materialise, which will be the proverbial straw that broke the camel’s back, a fallout from global bond indices will be followed by capital outflows that will in turn lead to (possibly substantial) currency weakness. A weaker rand will exert inflationary pressures which the SARB will then counteract with a tighter policy stance, leading to a possible rate hiking cycle.

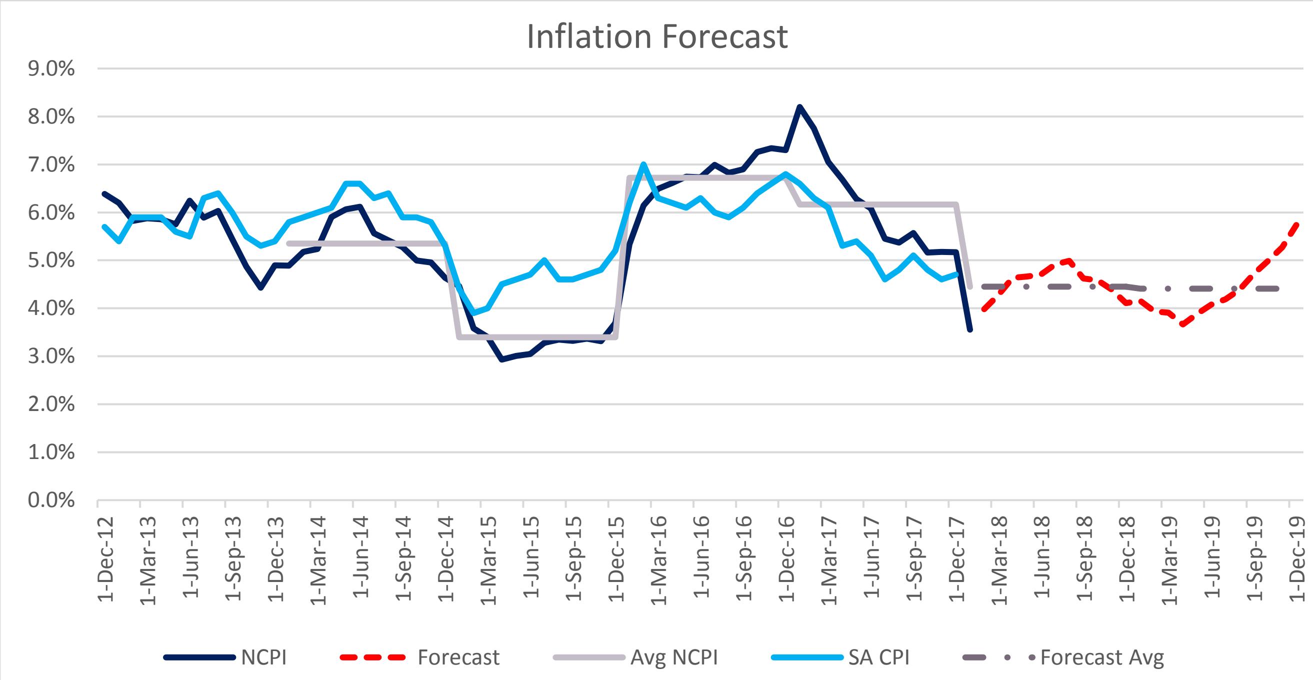
The political environment within SA has been volatile with Jacob Zuma surviving numerous attempts to have him ousted from office. It thus comes as little surprise that the market reacted well to the outcome of the ANC elective congress in December with Cyril Ramaphosa victorious as ANC president and subsequent swearing in as president of the Republic. The new dawn in leadership has been widely welcomed and market sentiment has mirrored the optimism the transition of power brought with it.

With developed markets now slowly moving away from loose monetary stances, exemplified by US balance sheet reduction and the tapering of the EU bond repurchase program, capital flows into South African fixed income instruments may slow or reverse over the longer term. The near-term risks on capital flows are likely to be influenced by policy decisions and the ability to maintain the Moody’s local currency credit rating.

As the Moody’s review is imminent we defer our interest rate outlook until after this takes place. A supplement to this outlook will delve into the interest rate outlook for 2018. We will also look at PSCE and the expectations for the year ahead in this supplement.

Inflation Forecast

Inflation moderated through 2017 coming down from 8.2% in January to just 3.6% in January 2018. SA CPI moderated as well, from a high of 6.6% down to 4.6% in November, well within the SARB's target band. Much of this moderation in price increases stemmed from reasonably slow food price inflation due in part to a better rainy season in the region. The important implication of moderating inflation is that it enables the SARB to ease monetary policy should it see fit to. The Bank of Namibia is largely restricted by what the SARB does due to the currency peg. Thus the BoN can only act if the SARB does so first. With both economies struggling, easing monetary policy is desirable as it should stimulate the economy to some extent. Elsewhere in this document we explore the possibility of interest rate cuts further.



Source: NSA, IJG

We expect inflation to fluctuate between 3% and 5% during 2018, with the January figure likely being the low point for the year. We expect inflation to average around 4.5% for the year, moderating further to 4.4% in 2019. Thus we expect inflation to remain well within the target band over the next two years, providing the SARB and BoN with room to implement a more dovish monetary stance.

We expect inflation to average around 4.5% for the year. The first possible shock on the near-term horizon is the Moody's review which could see South Africa lose its local currency investment grade credit rating. This could take place within a week or two of the release of this document. A downgrade at this time is widely expected to be followed by an outflow of capital from the South African bond market leading to currency weakness. However, if this hurdle is averted it brings the South African government's policies into the spotlight going forward. Averting the downgrade in the coming weeks is sure to reduce the probability of one going forward as the Cyril Ramaphosa regime goes to work to restore investor confidence in the fragile SA economy.

Roundup

Optimism is in short supply in Namibia at present. Last year proved to be even tougher than 2016 for many, and the green shoots or silver linings have been few and far between. We believe that the worst is behind us and that the economy will grow in 2018, even if only at a paltry 0.9% (our forecast is below consensus). We expect growth to be driven by the primary industries, largely mining. Improved commodity prices will support current operations and drive exploration activities, improving the sustainability of the industry as a whole. Secondary industries should support economic growth at the margin, with growth expected from manufacturing and electricity production. As is expected to have been the case in 2017, tertiary industries are likely to contract further in 2018.

While low growth is positive growth, growth below the population growth rate does translate to decreasing GDP per Capita. We expect growth to pick up to 3.2% by 2020 which translates to a five-year average growth rate of just over 1% between 2016 and 2020. This is well below the population growth rate and translates to a half decade of relative stagnation. This would also result in a ten-year growth rate of under 3.5%, below the 4.5% long term average for Namibia despite five years of above average growth at the start of the ten-year period. This highlights the importance of sustainable economic policies and the need for fiscal space in order to be able to apply counter cyclical policy in the event of external shocks. It also highlights the susceptibility of Namibia's small open economy to external shocks such as a drop in commodity prices.

There are a number of things that will play a role in the economic performance of Namibia in 2018 (our Key Themes). Of utmost importance will be for government to provide clarity on the Empowerment Framework and Investment Promotions Act. Clarity on these pieces of policy will at least help potential domestic and foreign investors to quantify risks which is likely to lead to some investment into capital projects. The form of the final structure of these policies will also be of utmost importance and could stimulate investment into the economy during the year.

The potential for accommodative monetary policy is present in 2018. A few short weeks should give further clarity on this as Moody's is set to make a crucial credit ratings call. Should South Africa avert a local currency credit ratings downgrade, easing monetary policy becomes highly likely. The Bank of Namibia will likely follow the SARB if rate cuts are made, in order to stimulate the struggling economy. Monetary policy is generally less affective than fiscal policy but any form of relief will be welcomed by consumers and corporates in the current climate.

As winds of change sweep through the region, so too does optimism grow. Changes in leadership in South Africa, Angola and Zimbabwe have raised sentiment and could result in a flood of investment to the region. At present it is hard to determine what impact these changes will hold for Namibia. Some impacts are likely to be positive while others may force adaptation in order to remain relevant.

The recession of 2017 will, as all recessions do, produce the need to rebuild and relook at the way we do things as a country, both private and public sectors. This endeavour will lead to efficiency gains and increased competition. Businesses with sustainable business models will survive and emerge stronger. We see renewed efforts in government toward the same goals of better resource allocation and efficiency. Sometimes it takes a recession to point out weaknesses in an economy and how we address these weaknesses will determine where Namibia goes from here. 2018 thus presents the opportunity to re-evaluate and course correct, and the decisions made this year may well be the foundations for future standard of living gains for all Namibians.

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