MID-TERM BUDGET REVIEW
2016/17-2018/19
27 October 2016

Research Analysts:

Rowland Brown
rowland@ijg.net
+264 61 383 513

Eric van Zyl
eric@ijg.net
+264 61 383 530

Jan-Hendrik Conradie
janhendrik@ijg.net
+264 61 383 523

Dylan van Wyk
dylan@ijg.net
+264 61 383 521

Contents

Summary:

The Minister of Finance tabled his mid-term budget for the 2016/17 fiscal year on the 27th of October, 2016.

The budget was characterised by deep spending cuts, driven as a result of weaker than expected revenue collections in the first half of the year, and thus major downward revisions to full year revenue expectations. In total, revenue has been revised down by N$6.3 billion, of 10.9% in 2016/17, and has been revised down by an even larger N$9.3 billion or 14.6% in 2017/18. Revenue for 2016/17 is now expected to be 1.4% lower than the “preliminary” revenue for 2015/16, illustrating a revenue contraction. 2017/18 is still expected to see revenue growth, but only by 6.0%.

The weak revenue outturn has resulted from a number of macroeconomic factors, including but not limited to drought, increasing interest rates, lower government spending (feedback loop), the end of a construction boom, less foreign direct investment, commodity price weakness, less Angolan activity in the Namibian market and infrastructure challenges. As a result, most of the major revenue lines have been revised down as follows:

- Income Tax on Individuals, revised down N$4.3 billion, or 27.9%.
- Company Taxes revised down N$1.1 billion, or 12.5%.
- VAT + Additional Sales Tax + General Sales Tax revised down N$23 billion, or 15.6%.

Due to the low revenue, deep, and deeper than expected, expenditure cuts have been required so as to ensure that the ballooning debt stock does not continue to expand at an unsustainable rate. Following a number of years of large budget deficits, the country’s debt to GDP ratio is now well beyond the target 35% threshold, having surpassed 40%. Thus, given the options available to the Ministry, these expenditure cuts were undoubtedly the right call.

Nevertheless, cuts of this magnitude will undoubtedly have a negative impact on the local economy going forward, and 2016/17 and 2017/18 are likely to prove extremely challenging years for Namibia. It should be noted that these challenging years come after six particularly good growth years, which cause a major rebasing in the size of the local economy. However, the magnitude of the current cuts, coupled with the various other macroeconomic challenges faced by the country, mean that a contraction is very likely in 2016, while 2017 growth will hinge on hopes for no further exogenous shocks, and the performance of the uranium industry, particularly.

While expenditure cuts will create challenges for the country, the more-orderly and strategic cutting of expenditure will mitigate growth risks to the greatest degree possible. In this regard, it is good to see that many of the cuts are targeted at consumptive or non-productive expenditure, and expenditure with limited multiplier effects. This is a positive move, and will hopefully help to limit long-term damage to the economy. However, an expenditure-to-revenue feedback loop certainly does exist, and thus, unless growth is sourced elsewhere, revenue may be on the brink of a contractionary cycle. This can be addressed by substituting for the reduction in Government expenditure through other economic activity. One such option, proposed by Finance, is to encourage private investment into some of the Government infrastructure and other projects.

Key metrics:

For the FY2016/17				
	2015/16 Budget	2015/16 Mid-Term Review	2016/17 Budget	2016/17 Mid-Term Review
GDP Growth 2016 (Real)	5.0%	5.5%	4.3%	2.5%
Revenue (N$bn)	63.1	56.0	57.8	51.5
Expenditure (N$bn)	71.2	71.2	66.0	61.5
Deficit (% GDP)	-4.6%	-8.7%	-4.3%	-6.3%
Debt to GDP	32.9%	29.2%	34.6%	42.4%

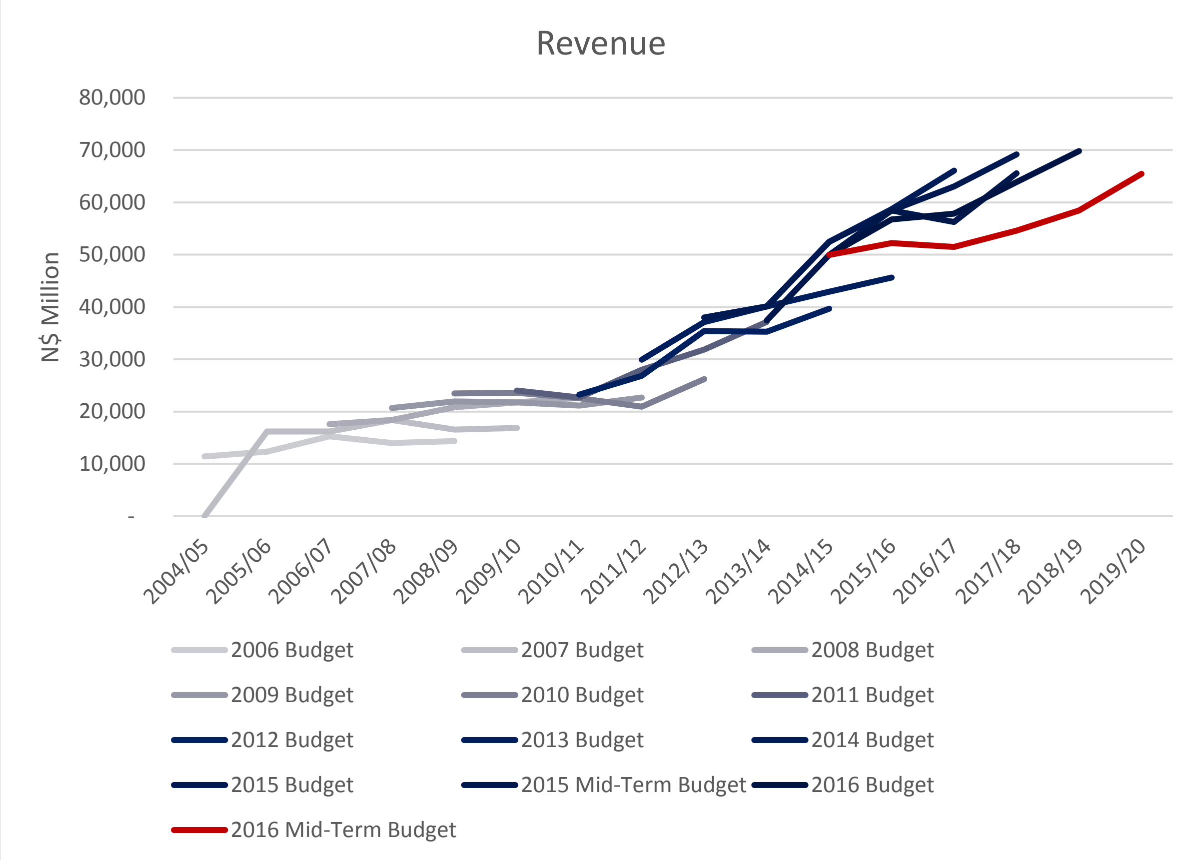
Source: MoF, IJG Securities

Key points in the speech

- The total revenue for 2015/16 stood at N$52.22 billion, 10.6% lower than the budgeted revenue, but a 4.6% increase from the previous year.
- Revenue for the FY2016/17 was revised down to an estimate of N$51.51 billion, from the previously expected/budgeted N$57.85 billion.
- Total spending for the FY2015/16 amounted to N$64.64 billion, reflecting an execution rate of 96.4%, compared to 97.5% in the previous year.
- Operational expenditure, including statutory expenditure, amounted to N$54.61 billion in 2015/16, representing an execution rate of 95.9%.
- Development budget spending for the same period amounted to N$10.02 billion, representing an execution rate of 90.8%.
- **The budget deficit for FY2015/16 has changed from the budgeted 5.3% to 8.3%, above the 5% target.**
- **The financing needs have increased as a result of the widening budget deficit. As such, public debt for FY2015/16 has increased from the budgeted 36.7% to 40.1% of GDP. Absent timely action, this would rise to 42.4% of GDP by the end of this financial year, seen against the threshold of 35%.**
- Interest payments will constitute approximately 7.5% of revenue by FY2016/17.
- The key policy objective over the next MTEF is the strengthening of hard-won macroeconomic stability and placing public finances on a sustainable path through the stabilization of public debt. To be achieved as follows:
    - Undertake expenditure reduction and suspend 2.8% of GDP from the current FY2016/17 budget;
    - **undertake cumulative expenditure reduction of about 6% of budgeted GDP, to be phased over the next MTEF to achieve a balanced primary budget by FY2018/19 and overall stabilization of growth in public debt by the end of the MTEF;**
    - reduce expenditure-to-GDP ratio from 40% of GDP to below 35% of GDP and gradually reduce the budget deficit threshold from 5% of GDP to below 3% of GDP;
    - accelerate implementation of measures to improve the quality of spending, tax administration and tax policy reforms, curbing the erosion of revenue base and introduction of alternative forms of revenue and an increased tax collection effort; and
    - implement measures to contain growth of the wage bill within acceptable levels and in line with international benchmarks.
- **In the framework of this policy stance, the reduction in the FY2016/17 budget would reduce the revised budget deficit from the estimated 7.8% to about 6.3%.**
- The indicative expenditure ceilings for the next two years as announced in the current MTEF are reduced by a cumulative 6.0% of GDP, with the **maximum ceiling for FY2017/18 revised from N$69.86 billion to N$59.85 billion** and, for FY2018/19 the ceiling is revised to N$62.29 billion and by the end of the MTEF, reach N$64.42 billion.
- Within this framework, total expenditure as a percent of GDP would average around 33%. The budget deficit would reduce to about 3% of GDP in FY2017/18 and average around 2.5% of GDP over the MTEF.
- Growth in public debt is projected to stabilize at about 42% of GDP in FY2018/19 before it starts gradually reducing by the end of the MTEF.

- **In February 2017 the minister of finance will table the Namibia Revenue Agency Bill to transform the Inland Revenue Department and Customs and Excise Directorate of the Ministry of Finance into an autonomous Revenue Agency.**
- During the coming budget the minister of finance intends to table:
    - the tax proposal for the introduction of the presumptive tax on small units;
    - proposals to eliminate various categories of tax exemptions, both of VAT and income taxes as well as tax deductibility of some of items not related to cost of production such as the resource rent; and
    - redesign the proposals for **Solidarity Wealth Tax into a high income-based Wealth Tax**, coupled with further expansion and strengthening the provisions of **Capital Gains Tax**.
- **With regards to the broader agenda for domestic resources mobilization, Regulation 28 will be amended to lift the threshold for local asset requirement from the current 35% of total assets to about 50% through a phased process.**
- With regards to the FY2016/17 Appropriation Amendment Bill, a total of N$5.50 billion was identified as expenditure cuts during the Mid-Year Budget Review.
- On the operational budget, the total operation budget is cut by N$2.82 billion. Non-interest expenditure is cut by N$1.82 billion.
- To support the consolidation effort, N$1 billion will be suspended from savings on the statutory expenditure.
- The development budget expenditure is cut by N$2.7 billion, with about 11% of the cut due from projects that have not been implemented, and others from projects that have to be phased over the MTEF.
- Out of the N$5.5 billion freed-up funds, the following is proposed:
    - An amount of N$4.5 billion expenditure, equivalent to 81.8% of the total budget cut is to be suspended,
    - The remaining N$1 billion is to be reallocated to urgent funding needs and priorities.

Revenue:



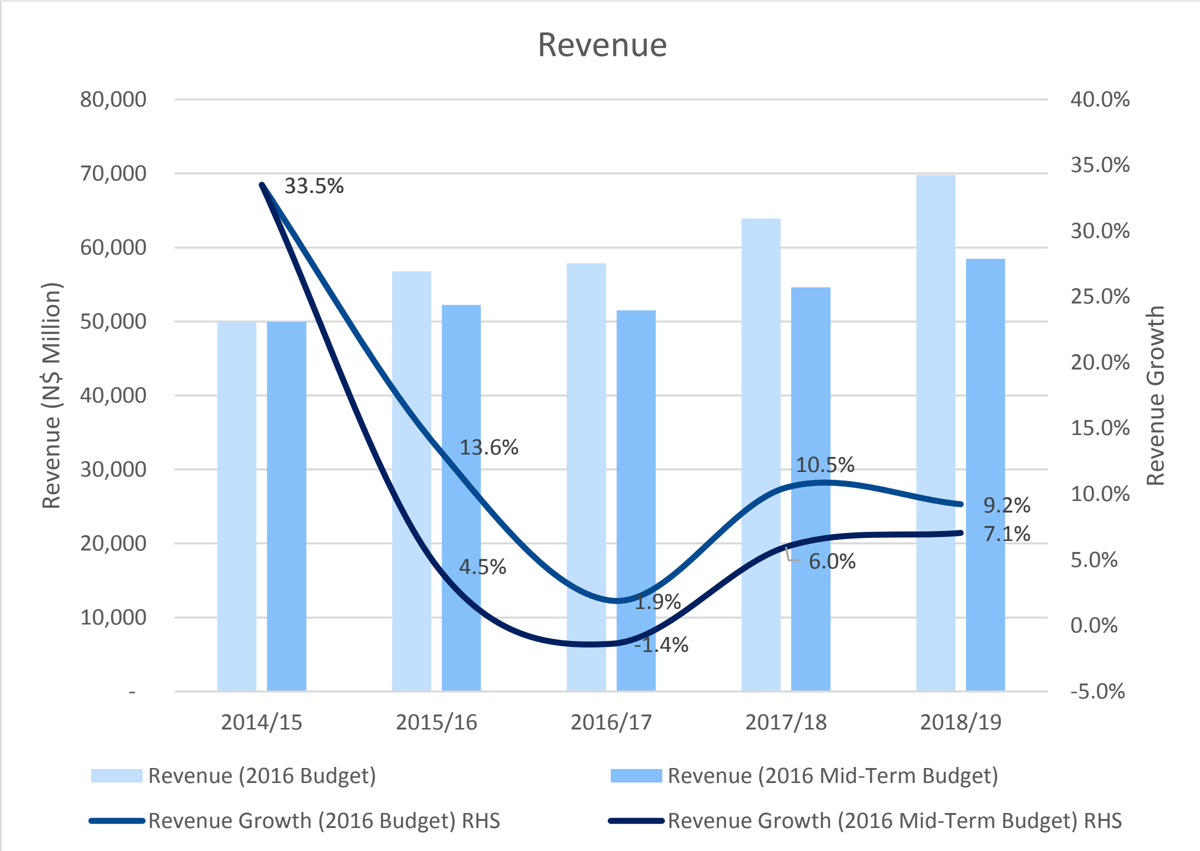
Source: MoF, IJG Securities

Revenue Outturn - 2015/16

In FY2015/16, total revenue amounted to N$52.22 billion, representing a 4.6% growth from N$49.97 billion collected in FY2014/15. However, this was a major reduction when compared to the February budget estimates of N$58.44 billion, reflecting weaknesses in projected nominal GDP growth and related overstatements in budgeted revenue estimates, especially in respect of Personal Income Tax.

Mid-Year - 2016/17

In respect to the current year, the mid-year revenue collection amounted to N$24.71 billion, equivalent to 42.7% of the budgeted revenue of N$57.85 billion, compared to 44.2% collection rate achieved in the previous corresponding period. The budget execution rate by the end of September 2016 stood at 40.4%, compared to 42.3% execution rate for the corresponding period of 2015/16.



Source: MoF, IJG Securities

Revenue Revisions

	2015 Mid-Term Budget	Revision	2016 Budget	Revision	2016 Mid-Term Budget	Revision
2014/15	49,968	-4.8%	49,961	0.0%	49,961	0.0%
2015/16	58,442	0.0%	56,765	-2.9%	52,230	-8.0%
2016/17	56,230	-10.8%	57,845	2.9%	51,511	-10.9%
2017/18	65,579	-5.2%	63,915	-2.5%	54,595	-14.6%
2018/19			69,816		58,445	-16.3%

Source: MoF, IJG Securities

Detailed Revenue Revisions

Revenue Head	2016/17			2017/18		
	Budget	Revised	Difference	Budget	Revised	Difference
TAX REVENUE	55,543	48,287	(7,256)	65,937	51,100	(14,837)
Income Tax on Individuals	15,481	11,163	(4,318)	19,092	11,567	(7,525)
Company Taxes	8,672	7,592	(1,080)	12,166	7,933	(4,233)
-Diamond Mining Companies	2,341	2,174	(167)	2,482	2,056	(426)
-Other Mining Companies	491	97	(394)	66	122	56
-Non-Mining Companies	5,840	5,322	(518)	9,619	5,755	(3,864)
VAT + Additional Sales Tax + General Sales Tax	14,597	12,318	(2,279)	16,350	13,373	(2,977)
SACU Revenue Pool Share	14,071	14,071	-	15,842	15,834	(8)
Other Tax revenue	2,722	3,143	421	2,487	2,393	(94)
NON - TAX REVENUE	2,122	3,032	910	2,052	3,319	1,267
Diamond Royalties	620	1,146	526	600	1,073	473
Other Non-Tax Revenue	1,502	1,886	384	1,452	2,246	794

Source: MoF, IJG Securities

Revenue Outlook - MTEF

The revised economic outlook by the Ministry of Finance estimates GDP growth for 2016 at 2.5%, significantly lower than the 4.3% projected in the budget and 5.3% recorded in 2015. Thus, total budget revenue for FY2016/17 has been revised down to N$51.5 billion, from the previously budgeted N$57.85 billion. The downward revisions reflects base effects from lower outturns from the previous budget year as well as reduced economic activity in 2016 impacting on various categories of tax revenue.

Over the MTEF, GDP growth is projected to pick up moderately to 4.5% in 2017 and average about 3.8% over the MTEF, which according to the Ministry of Finance is attributed to increased activity in the mining sector stemming from the coming onto production of the new mining investments. In our view, this outlook hinges heavily on the local uranium industry. This industry remains under enormous pressure at the spot price of uranium has more than halved since January 2016.

On account of this growth trajectory, the medium-term outlook on revenue reflects moderate growth, in line with improvements in economic activity. Thus, total revenue for FY2016/17 is estimated to decline to N$51.51 billion, from N$52.22 billion recorded in FY2015/16. Over the MTEF, revenue growth is projected to average 8.3%, increasing to N$54.60 billion in FY2017/18 and reach about N$65.47 billion by FY2019/20. As a proportion of GDP, revenue is estimated to slow to 32.5% in FY2016/17, from 35.5% in FY2015/16 and hover around 32.5% over the next MTEF.

However, we believe that the growth figures forecasted by the Ministry of Finance for 2016 and 2017 remain ambitious, and that expected revenue may too be ambitious, although more accurate than the February budget numbers.

As is usually the case, taxes make up by far the largest component of total revenue, representing some 93.5% of total revenue in the 2016/17 financial year. Within non-tax revenue, diamond and other mineral royalties, and dividends from SOEs, represent the lion's share.

Within tax revenue, taxes on income and profit represents the largest revenue source, at N$24.8 billion in 2016/17, followed by VAT (N$14.6bn) and SACU receipts (N$14.1bn). Generally, SACU receipts represent a larger share of total revenue than VAT, however as Namibia was overpaid by SACU in 2014/15, the country will now have to pay back just under N$3 billion in 2016/17.

Tax Policy, Revenue enhancement and Tax Administration Reforms

The current process of fiscal consolidation is not only focused on cutting expenditure, but also the improved mobilisation of domestic revenue sources.

By February 2017, the Ministry will table the Namibia Revenue Agency Bill to transform the Inland Revenue Department and Customs and Excise Directorate of the Ministry of Finance into an autonomous Revenue Agency.

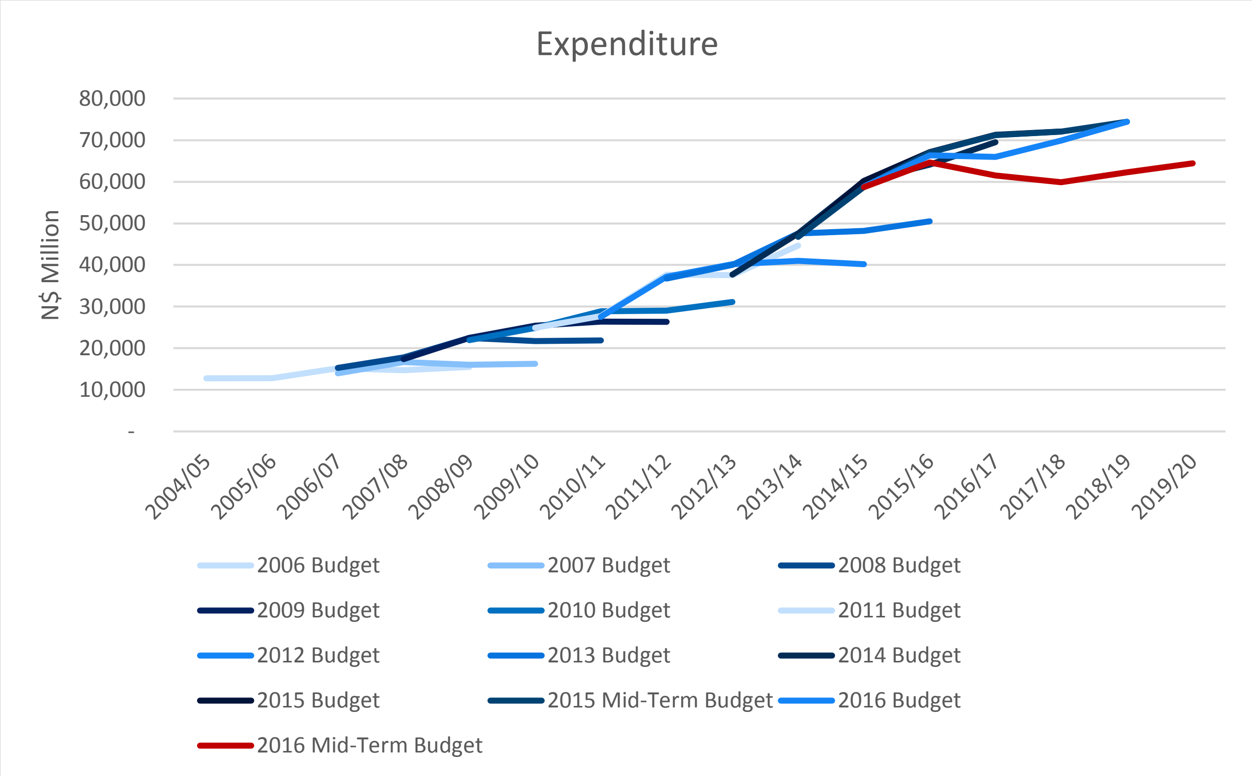
During the coming budget, it is the Ministers intention to table:

- A tax proposal for the introduction of the presumptive tax on small units;
- proposals to eliminate various categories of tax exemptions, both of VAT and income taxes as well as tax deductibility of some of items not related to cost of production such as the resource rent; and
- redesign the proposals for Solidarity Wealth Tax into a high income-based Wealth Tax, coupled with further expansion and strengthening the provisions of Capital Gains Tax.

In regard to the broader agenda for domestic resources mobilization, Regulation 28 is also to be amended to lift the threshold for local asset requirement from the current 35% of total assets to about 50% through a phased process. This will be undertaken in line with the initiatives in the Financial Sector Strategy to develop the domestic market alongside actions to grow bankable asset classes to accommodate the inflow of funds.

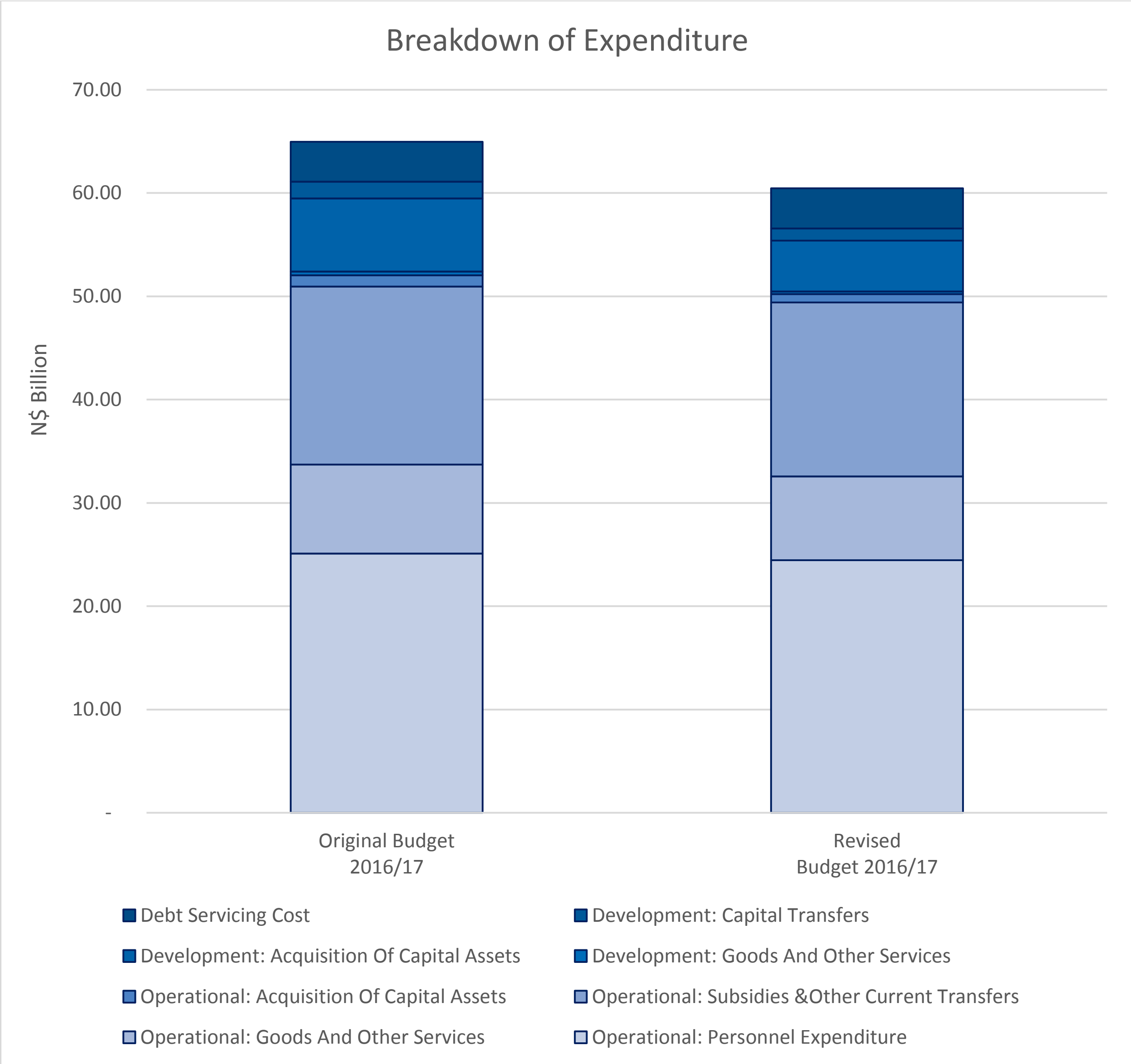
Expenditure

Total expenditure



Source: MoF, IJG Securities

Expenditure is expected to total N$61.5 billion in 2016/17 and to decrease to N$59.9 billion in 2017/18, before increasing to N$ 62.3 billion in 2018/19. The phased fiscal consolidation expenditure cuts have been frontloaded in the current financial year but consolidation will continue over the MTEF. Government will reduce total spending ceilings by a cumulative 6% of GDP over the MTEF. Expenditure cuts of N$10.0 billion are budgeted in the 2017/18 year while another N$12.12 billion can be expected in 2018/19. The Ministry of Finance is targeting expenditure as a percentage of GDP to drop from 38.8% for this financial year to 31.0% at the end of the MTEF, illustrating a substitution away from Government activity for future economic growth.



Source: MoF, IJG Securities

Execution thus far 2016/17

Source: MoF, IJG Securities

During the first half of the 2016/17 financial year, Government spending amounted to N$27.0 billion of the N$ 61.1 billion total budget. This translates into an execution rate of 44.2%, sharply increasing from last year's 37.2%.

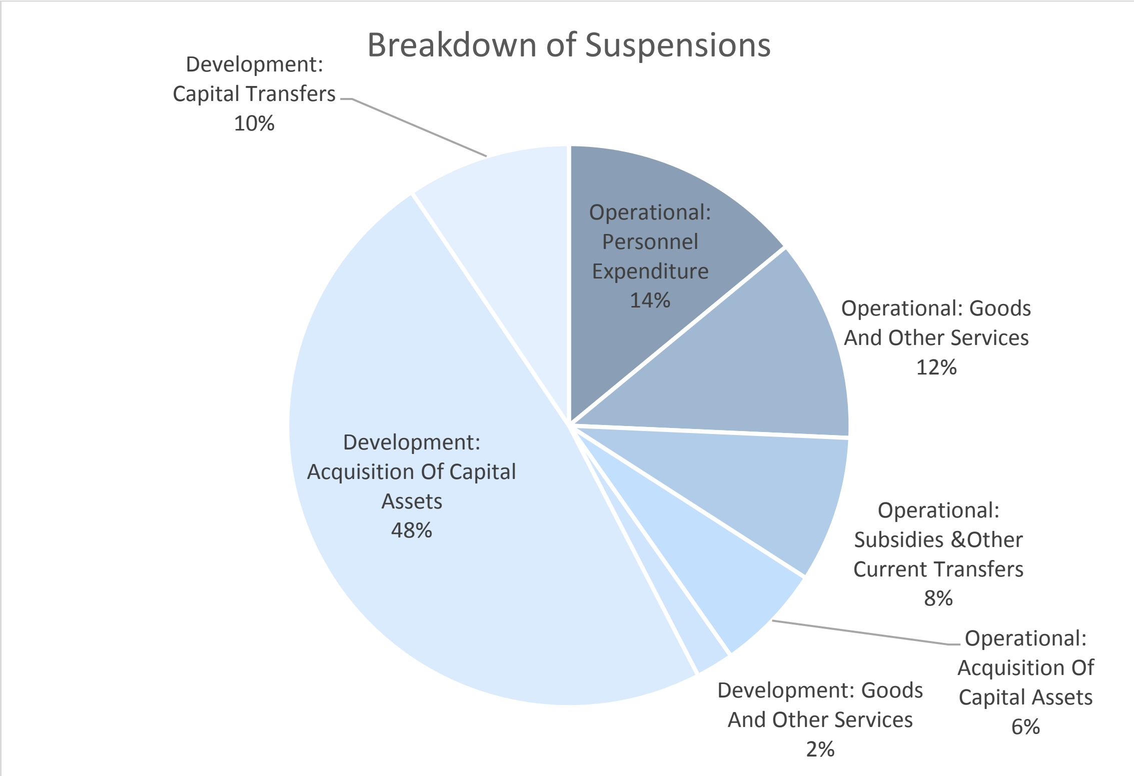
N$23.2 billion of the N$52.1 operation budget has already been spent. Much like the overall budget, the operational budget is also on track to see higher execution than the previous year with eight of the 36 Votes already past the 50% mark by midyear. These Votes will need to scale down on expenditure in the second half of the year so as to not overspend.

Expenditure Cuts

A total of N$5.5 billion has been identified as spending cuts during this year's Mid-Year budget review. Of this, N$2.82 billion will be cut from the operational budget, while N$2.70 billion will be cut from the development budget. N$1.0 billion of the savings will be reallocated to urgent priorities, bringing the cumulative decrease in expenditure to N$4.5 billion for the 2016/17 financial year.

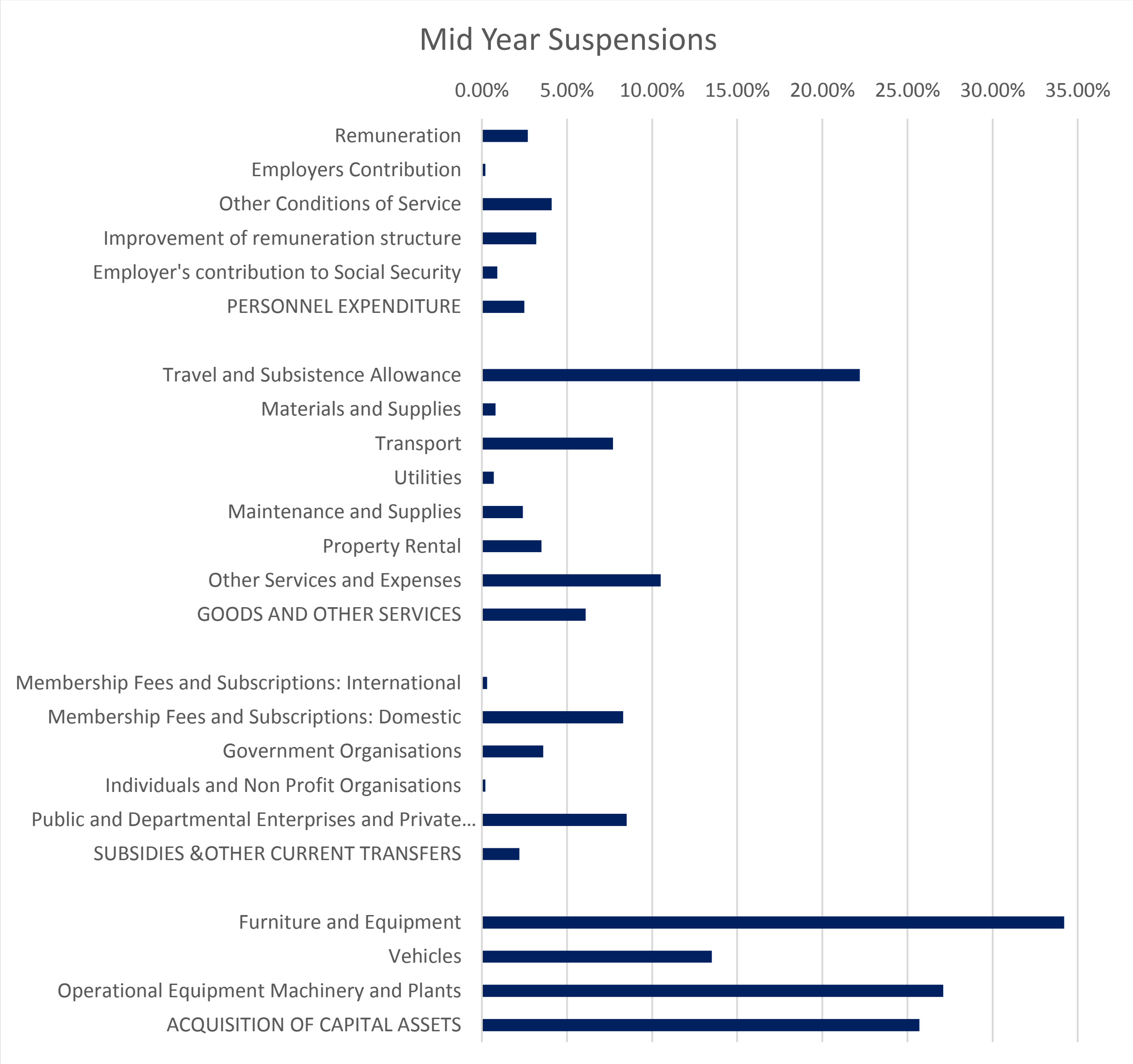
This constitutes a suspension of 3.5% and 29.8% of expenditure of each budget respectively. Total suspensions are spilt roughly 40% from the operating budget and 60% from the development budget.

As a result, the development budget now represents below 10% of total expenditure, well below the 20% target.



Source: MoF, IJG Securities

Operational Budget



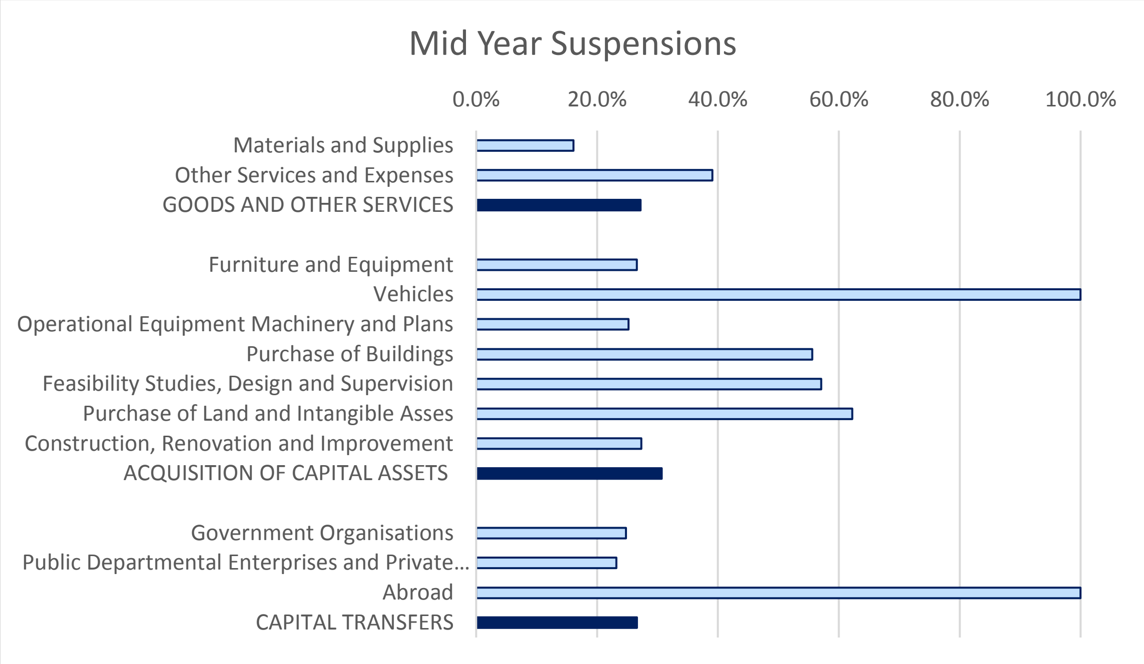
Source: MoF, IJG Securities

For the operational budget, non-interest expenditure is cut by N$1.82 billion. The savings will arise from:

- Personnel expenditure, which is being cut by 2.5% or N$633.39 million, this largely being due to the 2.7% reduction (N$554.40 million) in remuneration expense;
- goods and other services being reduced by 6.1% or N$527.87 million;
- subsidies and other current transfers being decreased by 2.2% or N$379.57 million; and
- acquisitions of capital assets being cut by 25.7% or N$278.01 million.

A further N$ 1.0 billion in budgeted savings are to be realised from a reduction in interest payments. How the interest payments will be reduced by such a large amount remains enigmatic.

Development Budget



Source: MoF, IJG Securities

Development budget cuts are as follows:

- Goods and other services are decreasing by 27.2% or 97.52 million;
- acquisition of capital assets is being cut by 30.7% or 2.175 billion; and
- capital transfers are being cut by 26.6% or 426.54 million.

Developmental budget expenditure cuts are made on projects with zero or low implementation rates to date, including any feasibility studies on new projects. A moratorium has been placed on the construction of new office buildings including the new Parliament building and office of the Prime Minister. New projects will only be considered once the fiscal situation of the country has improved.

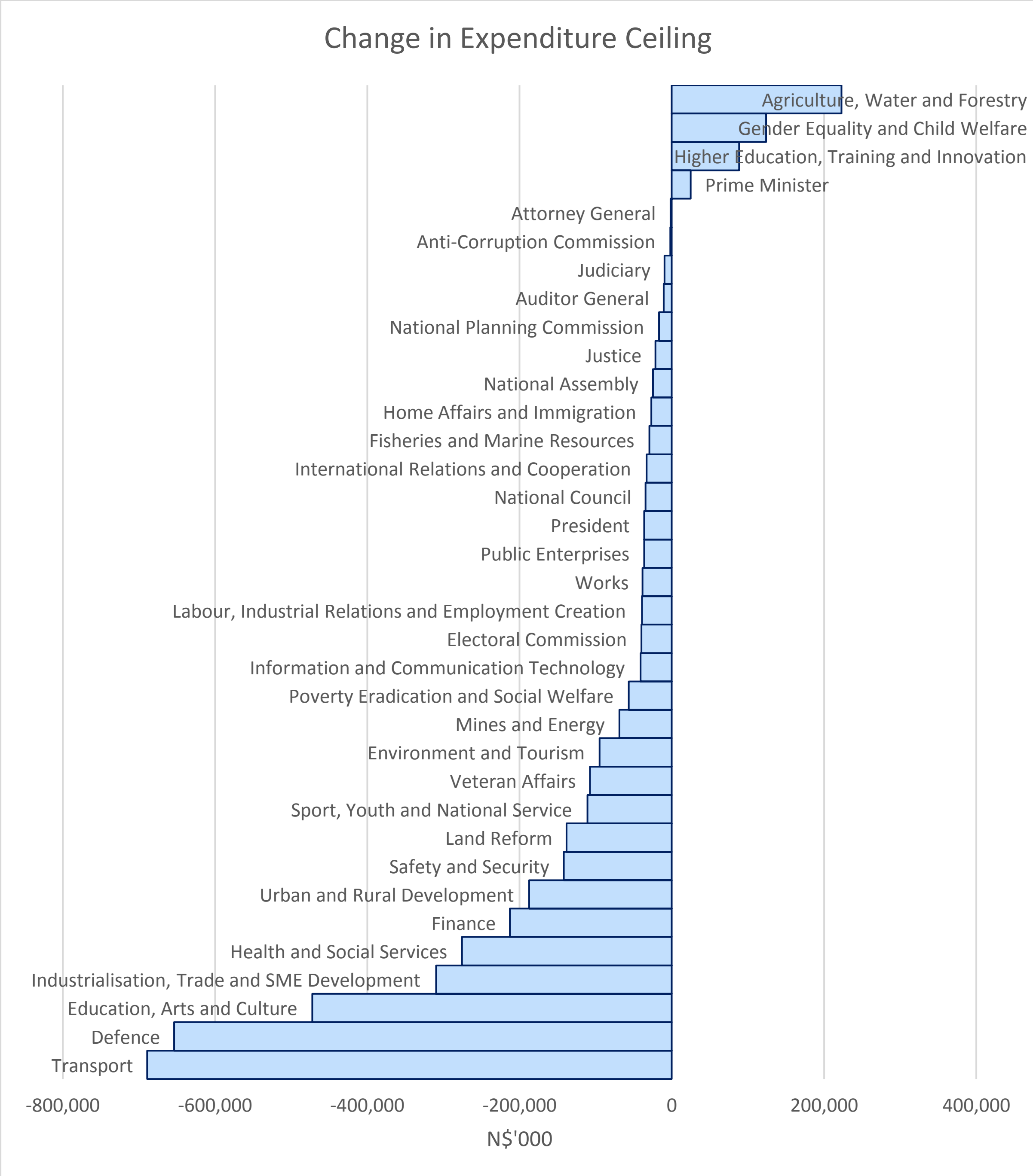
The severity of these cuts cannot be overemphasised. The knock-on effect that falling government expenditure will have on the rest of the economy will be severe. One of the hardest sectors hit will likely be the construction industry, which will see over N$1.5 billion less government spending in the current financial year alone.

Reallocation

Of the N$5.5 billion of freed up funds, an amount of N$4.5 billion is to be suspended permanently to restore financial sustainability and market confidence, while the other N$1.0 billion will be reallocated to urgent priories as follows:

- N$ 350 million for the completion of the Neckartal dam
- N$ 150 million for the drought relief programme
- N$ 150 million for the Orphans and Vunerable children programme
- N$ 50 million for the Visa Stickers project
- N$ 100 million for the settlement of mass housing contracts
- N$ 100 million allocated to UNAM
- N$ 100 million allocated to NUST

Budget Cuts by Ministry



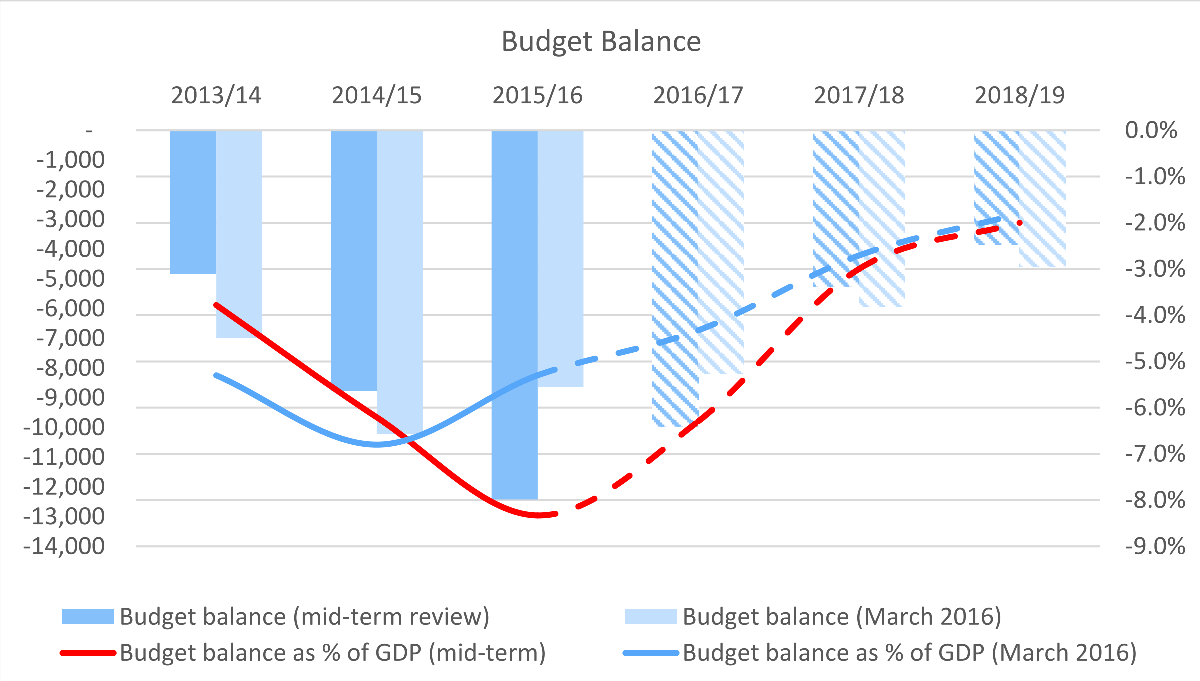
Source: MoF, IJG Securities

The largest losers due to the spending cuts in absolute terms are the Transport, Defence and Education, who are losing N$689 million, N$ 654 million and N$472 million respectively. The Ministries of Agriculture, Water and Forestry, Higher Education, Training and Innovation and Gender Equality and Child Welfare all have increasing budgets, but adjusting for the targeted reallocations, they are losing N$ 127 million, N$ 26 million and N$ 111 million elsewhere, respectively. On a relative basis, Public Enterprises is seeing its budget nearly halve, while the Ministry of Industrialisation, Trade and SME Development is seeing its expenditures drop by 37%.

Budget Deficit and Financing

2015/16 Outturn

The total revenue for 2015/16 stood at N$52.22 billion, 10.6% lower than the budgeted revenue for the fiscal year, but a 4.6% increase from the previous year. Total spending for the FY2015/16 amounted to N$64.64 billion, reflecting an execution rate of 96.4%, compared to 97.5% in the previous year. The total budget deficit for the fiscal year was thus N$12.41 billion or 8.3% of GDP versus expectations of 5.3% of GDP from the full year budget released earlier this year. This highlights the extent to which revenue collection disappointed.



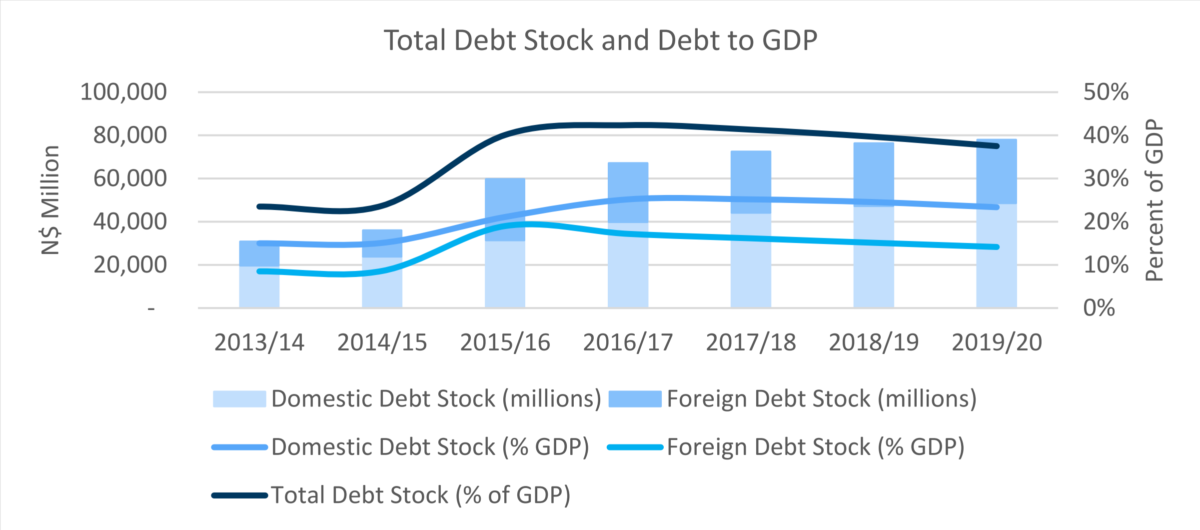
Source: MoF, IJG Securities

2016/17

Revenue for FY2016/17 was revised down to an estimate of N$51.51 billion, from the previously budgeted N$57.85 billion. The medium-term budget has seen expenditure cuts and consolidation resulting in revised total expenditure of N$61.50 billion and a budget deficit of N$9.99 billion, or 6.3% of GDP. It should also be noted that GDP expectations for 2016/17 have been revised down to N$158.62 billion from the previously expected N$179.84 billion thus the deficit as a percentage of GDP is inflated due to a lower denominator as well as a larger numerator.

The net borrowing requirement for 2016/17, according to the February budget, was N$8.69 billion, including N$536 million worth of foreign debt repayments and other adjustments. Considering that the revised budget deficit is N$9.99 billion this would necessitate debt issuance in excess of the current borrowing plan.

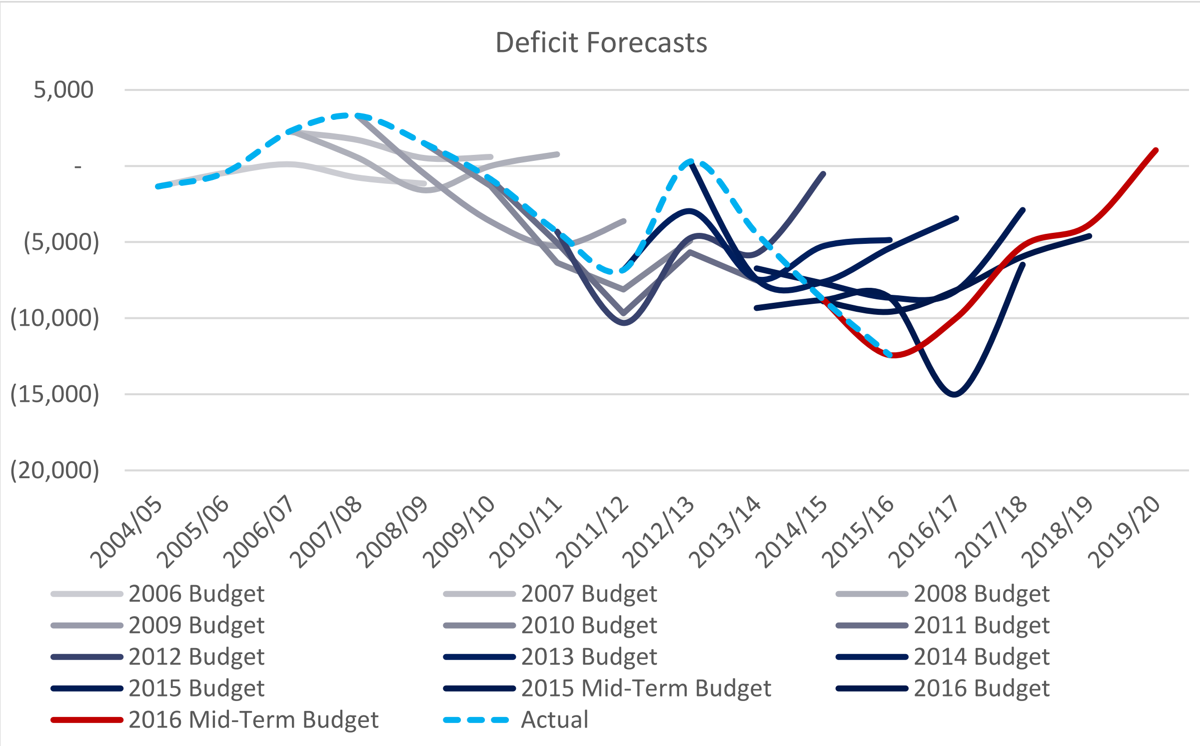
According to the mid-year budget documents the half-year cumulative debt stock by September 2016 amounted to N$62.8 billion and full year debt issuance is budgeted at N$67.18 billion, indicating that a net of N$4.38 billion is to be raised during the second half of the year. The breakdown of foreign debt stock to domestic debt stock indicates however that foreign debt stocks will decline and that domestic debt stock will increase toward year end. Thus the expected domestic issuance for the second half of the year would be in excess of the net figure indicated above although an amount is not expressed in the budget document. **We thus expect the release of a revised borrowing plan during the coming weeks with further detail regarding this.**



Source: MoF, IJG Securities

2017/18

The budget balance for 2017/18 is forecasted at N$5.26 billion, or 3% of GDP, slightly lower than the figure forecast in the full year budget review earlier this year despite subdued revenue growth, and largely due to further cuts in expenditure. The financing of this deficit seems to be made up primarily of domestic issuance which is in line with comments made by the President Geingob earlier this year. The debt to GDP ratio is forecast to remain above 40% for the period although declining slightly from 42.4% from FY2016/17.



Source: MoF, IJG Securities

Conclusion

Fiscal consolidation was emphasized in the mid-term budget today and the budgeted figures reflect accordingly. Depressed revenue collection has forced more realistic GDP and revenue growth expectations which are visible in the revised expenditure figures for 2016/17 and beyond. We welcome the forecasted reductions in the budget deficit as well and although this comes at a bad time for the economy, it is necessary to contain debt issuance and bring the rate of growth in the debt stock and the debt-to-GDP ratio back under control.

Nevertheless, a number of peculiarities in the figures, such as the expected N$1 billion in debt cost savings make us somewhat concerned as to whether the targeted consolidation will be possible. It should be noted as well, that we expect 2016 to see little growth, or even a contraction in GDP, with 2017 relying heavily on uranium output for growth. Should the latter not materialize, the debt-to-GDP ratio will increase far faster than the Ministry of Finance is currently forecasting, and returning to sub-40% ratios will not be possible.

IJG Holdings

Group Chairman	**Group Managing Director**	**Group Financial Manager**
Mathews Hamutenya	Mark Späth	Helena Amutenya
Tel: +264 (61) 256699	Tel: +264 (61) 383 510	Tel: +264 (61) 383 517
mathews@millennium-invest.com	mark@ijg.net	helena@ijg.net

IJG Securities

Managing Director	**Sales and Research**	**Equity & Fixed Income Dealing**
Romé Mostert	Rowland Brown	Lyndon Sauls
Tel: +264 (61) 383 520	Tel: +264 (61) 383 513	Tel: +264 (61) 383 514
rome@ijg.net	rowland@ijg.net	lyndon@ijg.net
Money Market & Administration	Jan-Hendrik Conradie	Leon Maloney
Tashiya Shekutamba	Tel: +264 (61) 383 523	Tel: +264 (61) 383 512
Tel: +264 (61) 383 511	janhendrik@ijg.net	leon@ijg.net
tashiya@ijg.net		
	Eric van Zyl	
	Tel: +264 (61) 383 530	
	eric@ijg.net	
	Dylan van Wyk	
	Tel: +264 (61) 383 521	
	dylan@ijg.net	

IJG Capital

Managing Director	**Portfolio Manager**	**Business Analyst**
Herbert Maier	Jakob de Klerk	Mirko Maier
Tel: +264 (61) 383 522	Tel: +264 (61) 383 517	Tel: +264 (61) 383 500
herbert@ijg.net	jakob@ijg.net	mirko@ijg.net

IJG Advisory

Director	**Business Analyst**
Jolyon Irwin	Jason Hailonga
Tel: +264 (61) 383 500	Tel: +264 (61) 383 529
jolyon@ijg.net	jason@ijg.net

100 Robert Mugabe Avenue, Heritage Square
P O Box 186, Windhoek, Namibia
Tel: +264 (61) 383 500 Fax: +264 (61) 304 671
www.ijg.net www.ijgdirect.net