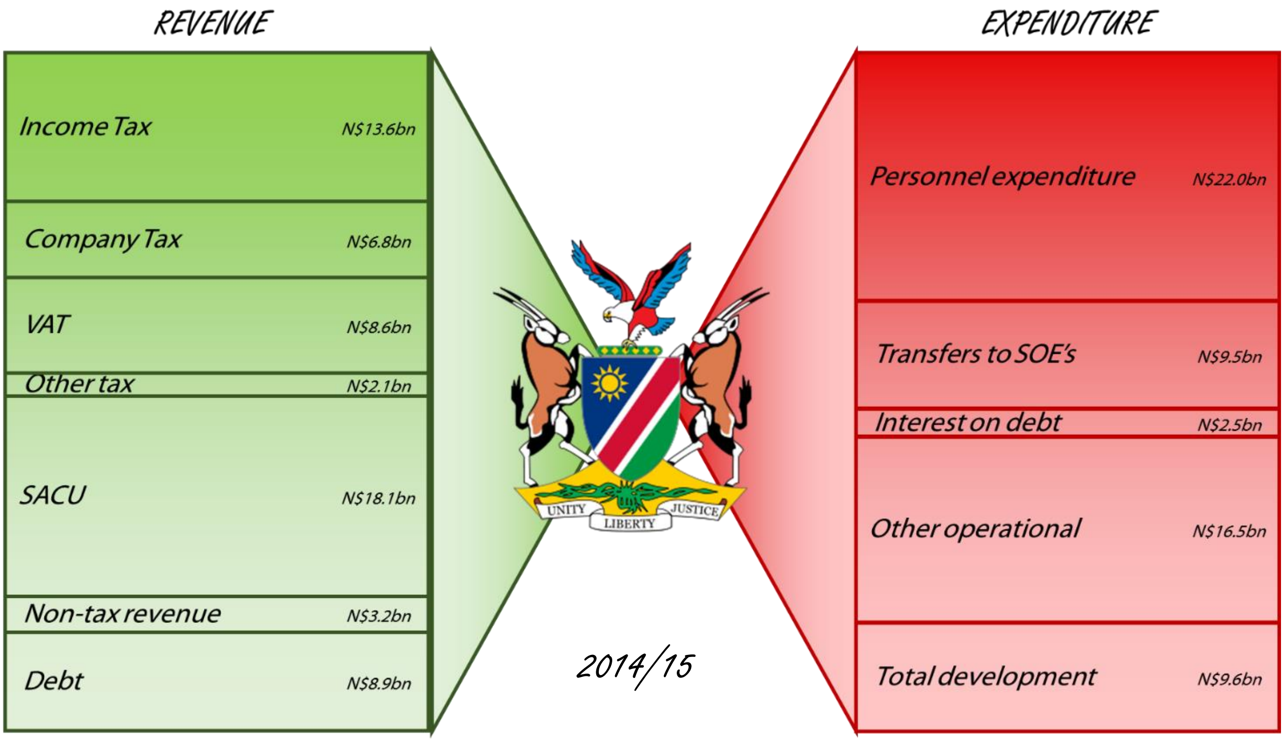
National Budget Review 2014/15-2016/17

Thursday, 20 February 2014



Headlines:

- ✓ *In her 2014/15 budget speech, the Minister of Finance announced a highly expansionary budget, as per the expectations of local analysts.*

- ✓ *In many ways, the current budget displays a growth story, as strong growth expectations, particularly for 2014, lead to strong revenue growth expectations, and go a long way towards eroding the projected deficit for the 2014/15 financial year.*

- ✓ *In total, revenue is expected to expand by over 30 percent in 2014/15 when compared to the previous financial year, largely on account of better than expected revenue collection by Government.*

- ✓ *Particularly notable is the expected revenue from personal income tax payments, which are estimated to increase by over 70% between 2013/14 and 2014/15.*

- ✓ *As such, taxes on incomes and profits are expected to surpass taxes on international trade (SACU) as the main source of revenue for Namibia's Government.*

- ✓ *Expenditure is also expected to expand significantly in 2014/15, growing by some 26 percent when compared to the previous financial year.*

- ✓ *This expenditure growth is largely on account of increases in personnel expenditure, as well as large increases in transfers to state owned enterprises (SOE's) and a large increase in vehicle purchases.*

- ✓ *While the expansionary expenditure will be partially offset by increasing revenue, a deficit of N$7.7bn is expected during the 2014/15 financial year, representing some 5.4% of GDP.*

- ✓ *Nevertheless, the house view is that the expansion in both the revenue and expenditure estimates are highly ambitious, and unlikely to be realised in their entirety.*

- ✓ *Given the current state of the economy and the growth projection for such, the current expansionary fiscal policy stance is no longer the counter-cyclical stance originally intended, but a pro-cyclical stance that may result in the economy overheating if not reigned in over the MTEF period.*

- ✓ *Nevertheless, in the short term, the expansionary policy of Government will continue to have a positive impact on domestic growth.*

- ✓ *On the other hand, the expansionary fiscal policy will continue to place substantial pressure on the country's current account, through the importation of construction goods, vehicles and consumer goods.*

Outturn 2013/14

Revenue

The revenue outturn for 2013/14 is expected to come in significantly higher than was estimated in the 2013/14 MTEF, largely on account of better than expected performance in domestic tax revenue streams, given a better economic performance than originally forecast and increased tax collection and administrative efforts. As such, projected revenue for 2013/14 now stands at N$43.8bn, up from the N$40.1bn projected in February 2013.

Expenditure

Preliminary expenditure figures suggest that total expenditure for the 2013/14 fiscal year will come in at N$44.7bn, an effective execution rate of 94%, down marginally from the previous year's execution rate of 95.5%.

Deficit

As a result of better than projected revenue collection and below 100% execution of expenditure, the projected deficit for 2013/14 will be significantly below the 6.4% budget deficit projected in the 2013/14 MTEF, and is in fact likely to be below 1% of GDP.

Debt

Debt issuance through 2013/14 was fairly minimal on account of Government drawing down on cash reserves with the Central Bank rather than issuing new debt. As such, only N$1.8bn worth of debt is expected to be issued in the 2013/14 financial year, and as a result of reasonable growth in GDP over the year, the debt-to-GDP ratio is expected to have declined through the year.

Revenue

Over the 2014/15 MTEF, the main sources of revenue for the Government will remain tax revenues, particularly income tax revenue, value added tax revenue and SACU receipts from the common revenue pool for the free-trade area.

Taking into consideration the projected economic outlook, total revenue and grants for the MTEF are projected to increase by about 30.7% in the 2014/15 financial year, with growth mainly derived from increases in domestic taxes on income and profits, increasing 52.1%.

SACU revenue for 2014/15 is estimated at N$18.1bn or 34.5% of total revenue, which comprises N$17.3bn from current collections and N$812m from the surplus emanating from 2011/12.

Taxes on goods and services revenues are projected to increase at a moderate pace of 11.2%. Taxes on property and other taxes are expected to increase by 12.5% and 23.2%, respectively.

N$ '000	Estimate 2013/14	Forecast 2014/15	*2014/15 Growth*	*2014/15 Contribution*	Forecast 2015/16	Forecast 2016/17
Taxes on income and profits	13,924,401	21,182,252	*52.12%*	*40.4%*	23,876,457	27,369,761
Taxes on property	243,841	274,123	*12.42%*	*0.5%*	302,945	335,162
Domestic taxes on goods and services	8,436,878	9,366,589	*11.02%*	*17.9%*	9,952,512	10,898,297
Taxes on international trade (SACU)	14,726,563	18,116,627	*23.02%*	*34.5%*	20,336,152	22,563,993
Other taxes	222,037	273,586	*23.22%*	*0.5%*	325,783	342,712
Total tax revenue	**37,553,720**	**49,213,177**	***31.05%***	***93.8%***	**54,793,849**	**61,509,925**
Total Non-tax revenue	2,374,880	3,245,866	*36.67%*	*6.2%*	3,716,793	4,371,468
Other	212,885	13,475	*-93.67%*	*0.0%*	187,593	192,546
Total Revenue	**40,141,485**	**52,472,518**	***30.72%***	***100.0%***	**58,698,235**	**66,073,939**
As a % of GDP	34.5%	37.1%			36.6%	36.3%

Source: MoF, IJG

The Minister announced a number of changes to tax rates in her budget statement, however unlike 2013/14, the individual income tax rates remained unchanged. The adjustments are as follows:

- ✓ The non-mining corporate income tax rate will be further reduced by 1% as announced in last year's budget. The rate reduction is aimed at creating a more favourable environment for businesses in Namibia in order to encourage investment and economic growth.

Corporate Income Tax	
FY2013/14	33%
FY 2014/15	32%

- ✓ The VAT threshold will be raised from N$200,000 to N$500,000. The higher threshold is focused on encouraging investments and creating a more conducive business environment for small businesses.

VAT threshold	
FY2013/14	>200,000
FY 2014/15	>500,000

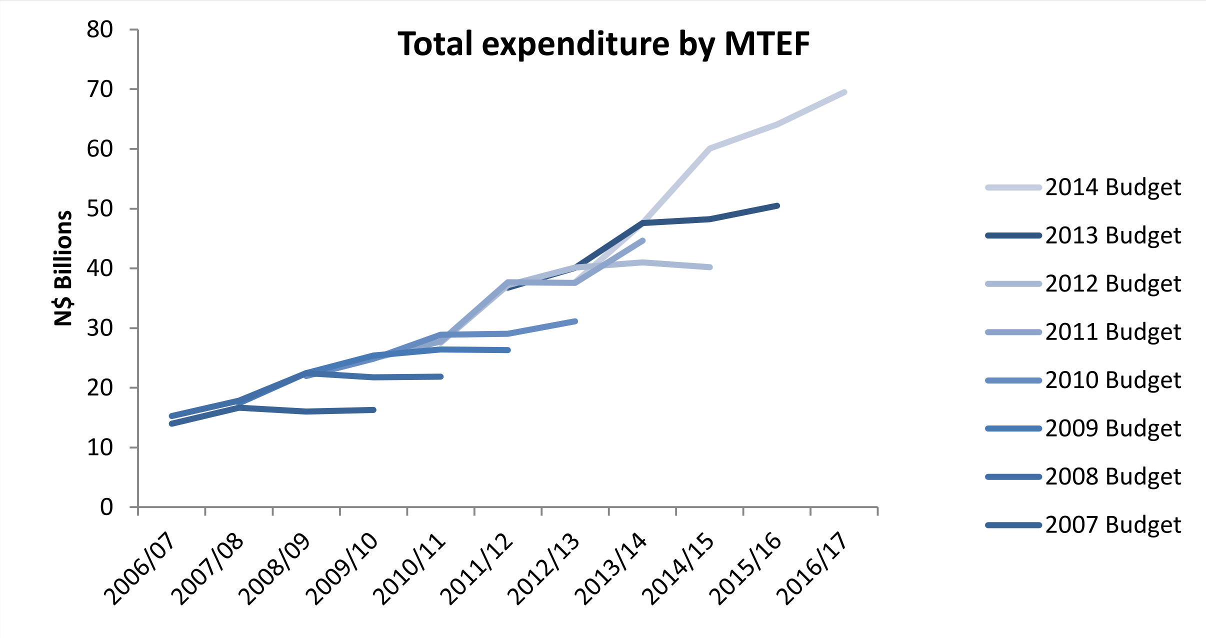
- ✓ Taxes to promote domestic value-addition in the primary commodity and natural resources sectors have also been finalised and are soon to be introduced.

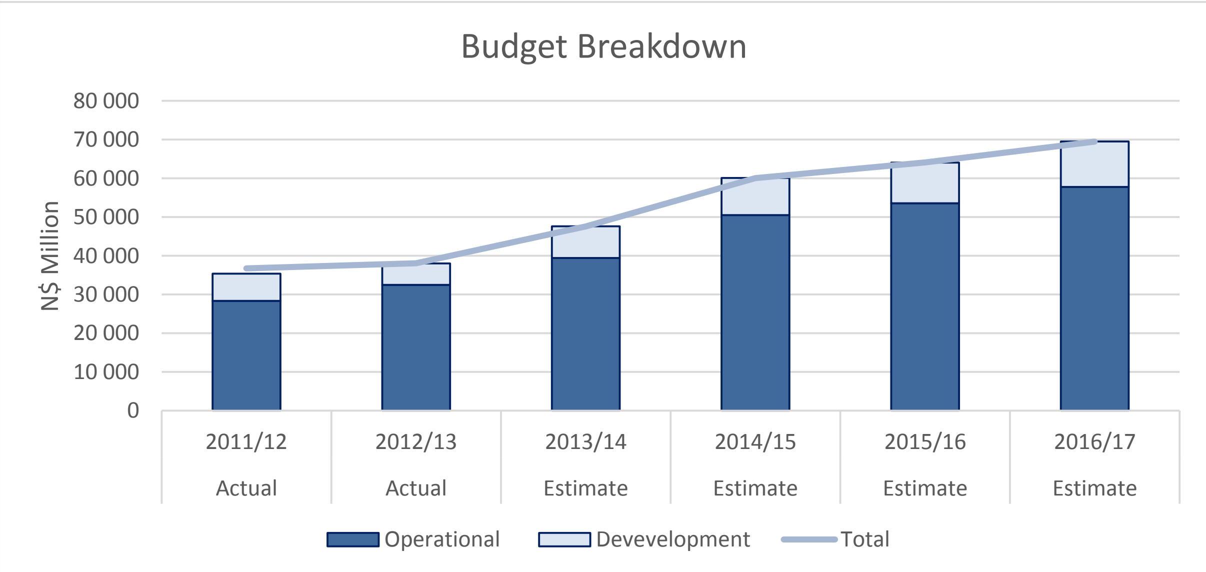
The first phase of environmental taxes is ready for implementation and will encompass the carbon dioxide emission tax on motor vehicles, incandescent light bulbs and motor vehicle tyres.

Additionally, excise taxes will be adjusted as per the new excise duty rates announced in the South African Budget.

Expenditure

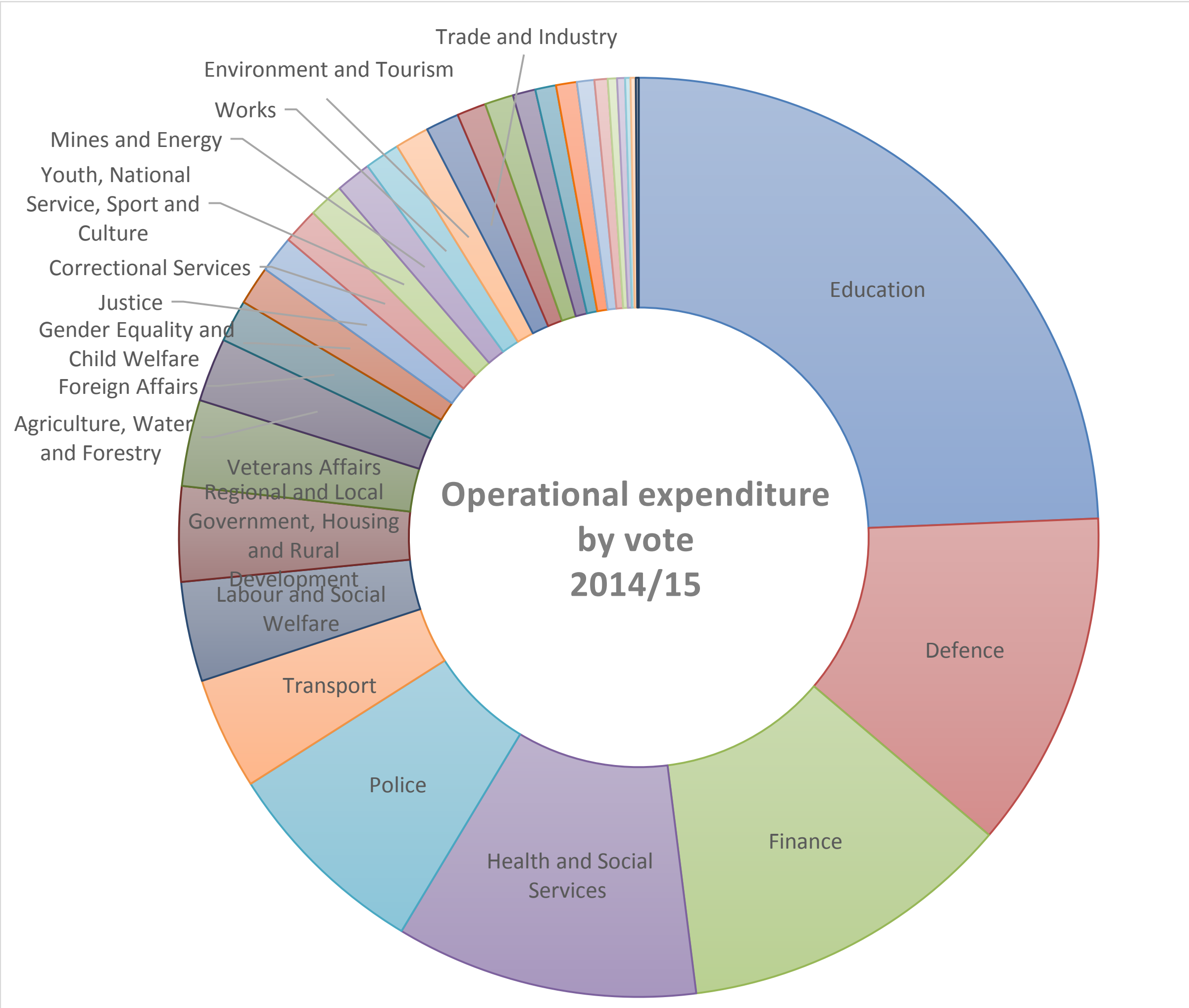
As with revenue, the expenditure figures for the current MTEF, starting in 2014/15, are highly expansive, increasing from total expenditure of N$47.6bn in 2013/14, to N$69.5bn in 2016/17 (CAGR: 9.9%). The 2014/15 financial year witnesses the largest increase, however, with a 26.3% increase in expenditure when compared to the current year. This is largely to be expected on account of 2014 being an election year. Over the MTEF period, the breakdown of expenditure continues to miss the target of 20% development, 80% operational, with operational expenditure representing 84% of the total on average, and developmental expenditure making up the remainder.



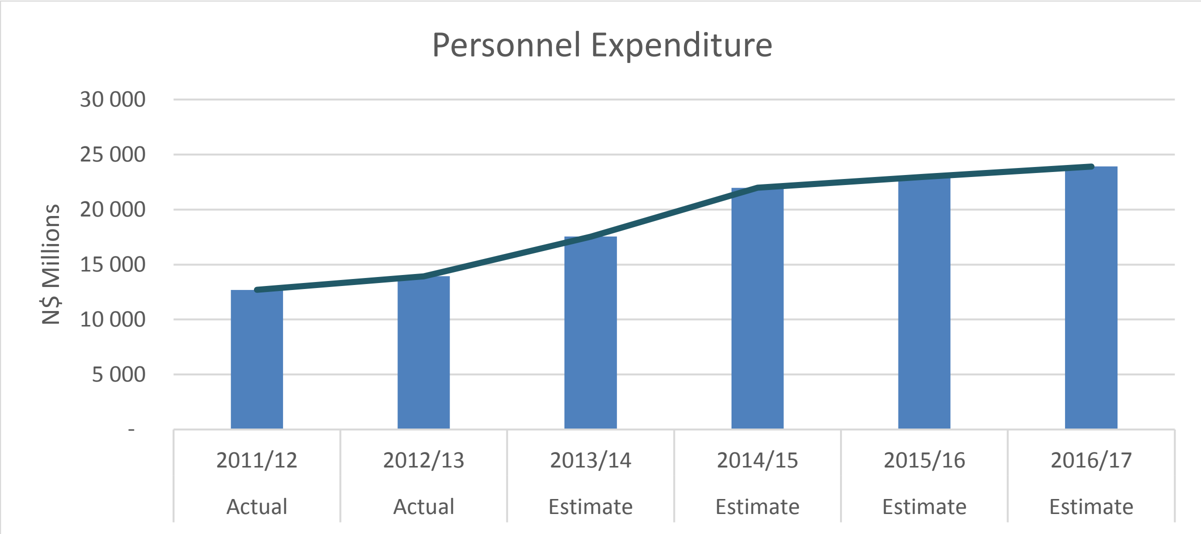


Operational Expenditure

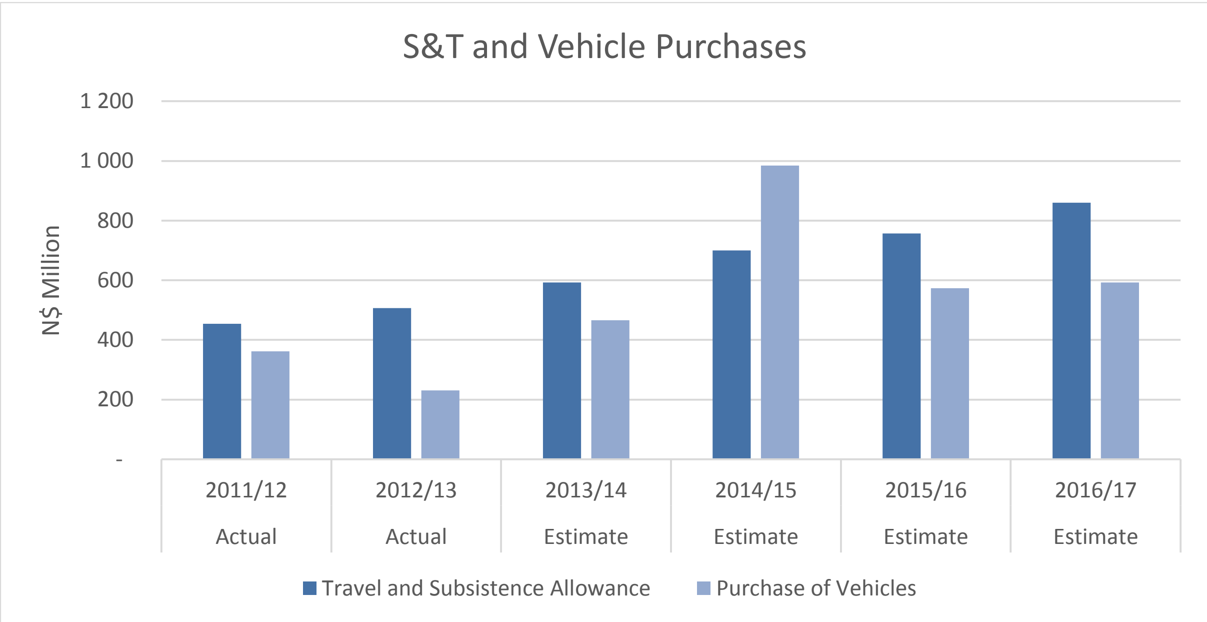
Operational expenditure increased dramatically between 2013/14 and 2014/15, going from N$39.5bn to N$50.5bn, and increasing to N$57.8bn by 2016/17. As is usually the case, the largest single share of the operational budget in 2014/15 is allotted to education, with the vote receiving some N$12.3bn, or 24% of total operational expenditure. This is followed by defence and finance, each of which receives just under N$6bn, then health, which receives N$5.4bn.



As previously stated, the budget for the current financial year has increased dramatically over the level budgeted for this year in the previous MTEF. Operational expenditure for 2014/15 increased by some 28% when compared to the previous year, and increased by 35% over the previously budgeted operational expenditure for the current year. These increases came about as a result of a number of factors, however were mainly driven by a 25% increase in personnel expenditure. As such, personnel expenditure now makes up 44% of operational expenditure, and 37% of total expenditure.



An additional driver behind the large increase in budget for 2014/15 is the purchase of vehicles by government, the cost of which has more than doubled over the past year, representing some N$500m increase in this expenditure sub-division. Subsistence and travel expenses (S&T) has also seen a sizable increase over the period, of over N$100m.



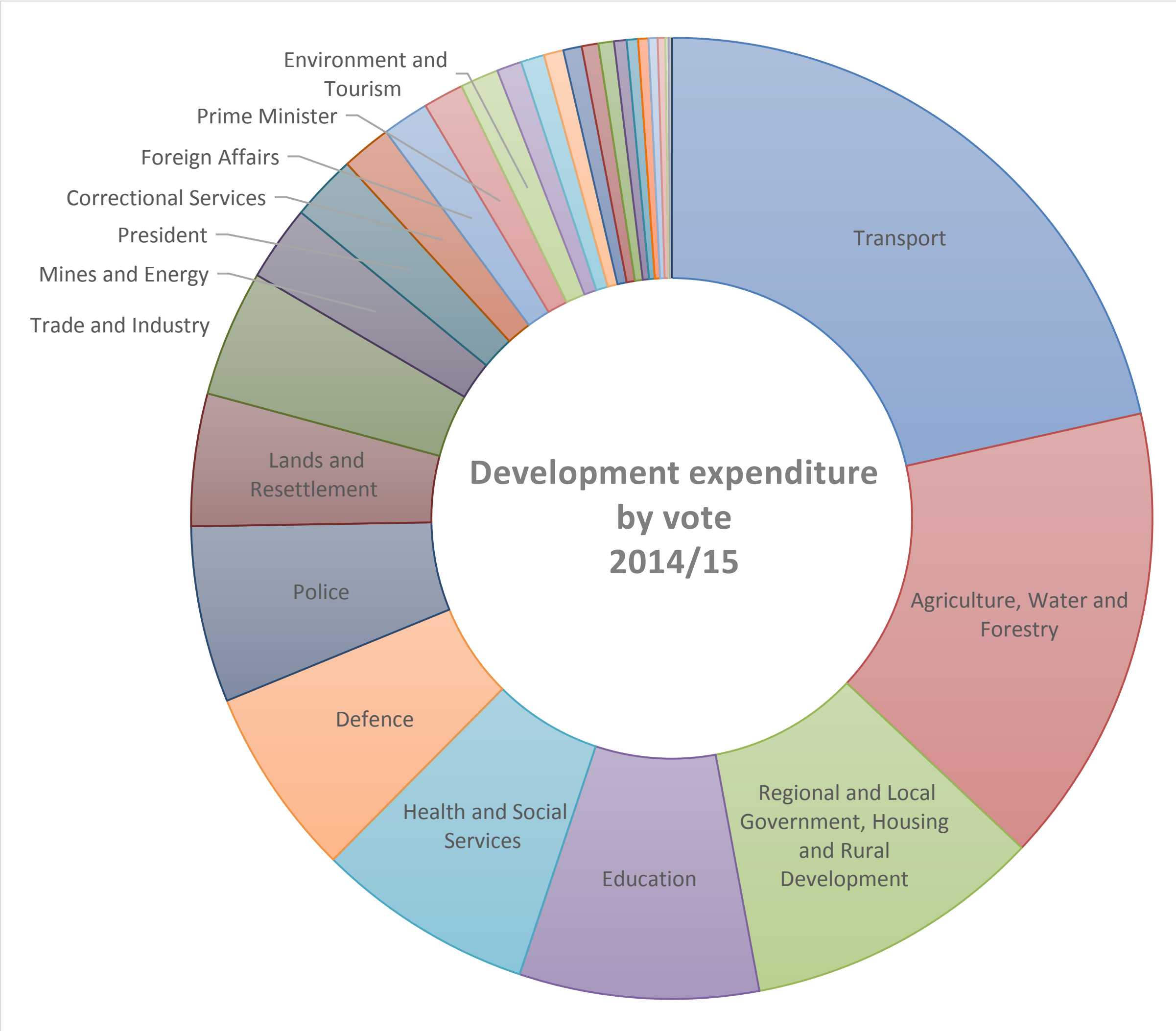
Six votes alone represented 60% of the increase in operational expenditure in 2014/15, with large increases in defence and education remuneration adding almost N$3bn additional expenditure to the operational costs of Government.

	2014/15 Budget		Change		Reasons given for increase
	As Budgeted in 2013 (N$ Million)	**As Budgeted in 2014 (N$ Million)**	**%**	**Value (N$ Million)**	
Police	2 965	3 720	25%	756	N$278m worth of new vehicles
Defence	3 880	5 996	55%	2 116	N$1.4bn increase in remuneration, N$500 million increase in operational equipment
Education	10 975	12 298	12%	1 322	N$1.4bn increase in remuneration
Health and Social Services	4 530	5 366	18%	837	N$300m salary increase and other
Mines and Energy	115	626	446%	512	N$500m to NamPower for Kudu.
Transport	999	1 997	100%	997	New Vehicles, transfers to NamPort, Air Namibia, Trans Namib, Namibia Airports Company
Veterans Affairs	389	1 534	295%	1 145	N$1.5bn for "reducing poverty and reintegration of unemployed veterans"

Development Expenditure

On the development budget side, total expenditure increased from N$8.1bn to N$9.6bn between 2013/14 and 2014/15, and is expected to continue to increase over the MTEF, reaching N$11.7bn by 2016/17.

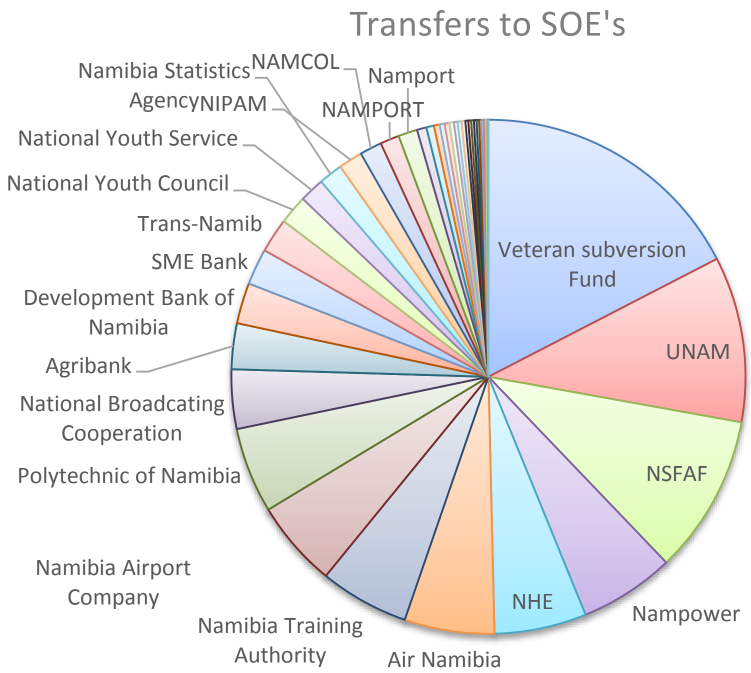
The largest single share of development expenditure, N$2.1bn, is directed to the Ministry of Works and Transport, primarily for the upgrading of a number of roads to bitumen standard. As well as transport, agriculture receives a substantial portion of the development budget allocations, totalling N$1.5bn in 2014/15, a large percent of which will be spent on the Green Scheme project.



Transfers to SOE's

Transfers to SOE's increased from N$5.9bn in 2013/14, to N$9.5bn in 2013/14. The largest single share of this allocation went to the Veteran Subvention Fund, followed by allocations to educational institutions and funds (UNAM and NSFAF) and NamPower (for the Kudu project). In total, 41 SOE's will receive funds from Government in 2014/15, up from 39 in the previous financial year.

Largest Allocations to SOE's, 2014/15	(N$ Million)
Veteran Subvention Fund	1 455
UNAM	871
NSFAF	836
NamPower	500
NHE	484
Air Namibia	472
Namibia Training Authority	469
Namibia Airport Company	456
Polytechnic of Namibia	449
National Broadcasting Cooperation	312
Agribank	240
Development Bank of Namibia	214
SME Bank	190
Trans-Namib	181
National Youth Council	152
National Youth Service	130
Namibia Statistics Agency	126
NIPAM	126
NAMCOL	116
NAMPORT	100



Contingent liabilities

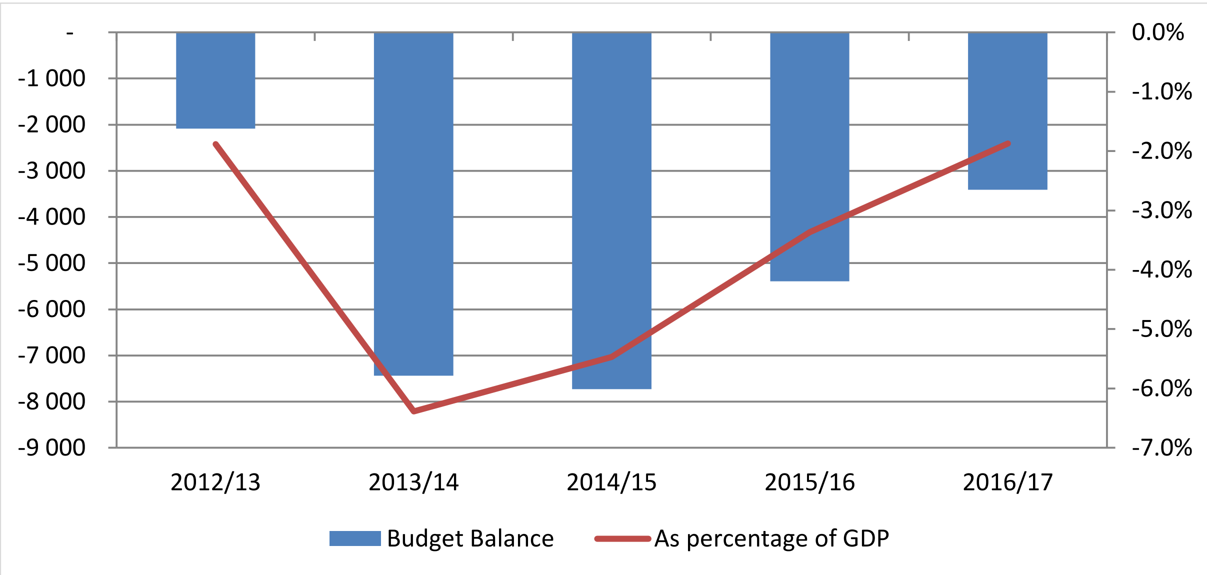
Contingent liabilities have increased somewhat over recent years, however remain well below the 10% of GDP benchmark level. Over the current MTEF, contingent liabilities will average 4.5% of GDP, despite the expectation of issuance of number of sizable government guarantees on key infrastructure projects over the period.

Budget deficit:

From an absolute perspective the budget deficit is projected to increase by a mere 3.2% or N$240m to N$7.7bn in 2014/15. This comes as a result of very strong growth in revenue of 30.9%, outstripping the aggressive 26.5% increase expenditure, thus the dollar increase in the budget deficit is merely attribute to the larger base of expenditure.

The 3.2% increase in the dollar budget deficit is relatively small when compared to nominal growth of 21.3%, therefore the budget deficit compared to GDP improved considerably from the original projection of 6.4% in 2013/14 to a forecasted 5.5% in 2014/15.

A projected consolidation in expenditure (as is usually the case in the MTEF, but usually not the outturn) in the tail end of the MTEF, as opposed to continuing double digit growth in revenue and strong nominal growth in GDP, leads to a natural drop in the deficit to N$3.4bn or 1.9% of GDP towards the end of the MTEF.



The outturn of the borrowing requirement

The bigger than forecasted funding shortfall in 2013/14 was predominantly financed out of the government's cash balance, with the N$4.0bn cash utilization accounting to 49% of the borrowing requirement. The remainder of the borrowing requirement was financed through N$3.4bn[1] in net debt issuance in the domestic market.

The borrowing requirement over MTEF

The budget deficit is projected to increase to N$7.7bn in 2014/15, after which it is projected to gradually decline to N$5.4bn in 2015/16 and N$3.4bn in 2016/17, amounting to a cumulative deficit

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[1] Domestic debt issuance according to the *Estimates Book* amounted to N$3.435bn. However our analysis of the *Borrowing Plan 2013/14* and the *Domestic Debt Database* released by BoN suggests that net domestic debt issued in 2013/14 was closer to N$2.0bn.

of N$20.3bn over the MTEF. This compares to N$11.9bn over the previous MTEF, pointing to the expansionary nature of this budget on top of a number of expansionary budgets over recent years.

The GC14 (N$1.53bn) and GC15 (N$1.647bn) will be redeemed during the current MTEF, increasing the gross borrowing requirement to a projected level of N$9.7bn in 2014/15, before declining to N$7.3bn in 2015/16 and N$3.4bn in 2016/17.

Financing the budget shortfall will see a shift away from cash towards debt over the MTEF, after government cash balances started to run relatively low towards the end of the 2013 calendar year. Cash financing will decrease to 20.6% of the shortfall in 2014/15 and 2015/16.

Government will be increasingly reliant on debt to finance the budget deficit, with domestic debt securities projected to account for 50.8% of the borrowing requirement in 2014/15, 58.9% in 2015/16 and 59.6% 2016/17. This translates to net domestic debt issuance of N$4.9bn in 2014/15 which represents a 43.7% increase over the net issuance seen in 2013/14. Net issuance is however projected to decrease in 2015/16 and 2016/17 on account of the lower borrowing requirement and the previously mentioned tail-end consolidation.

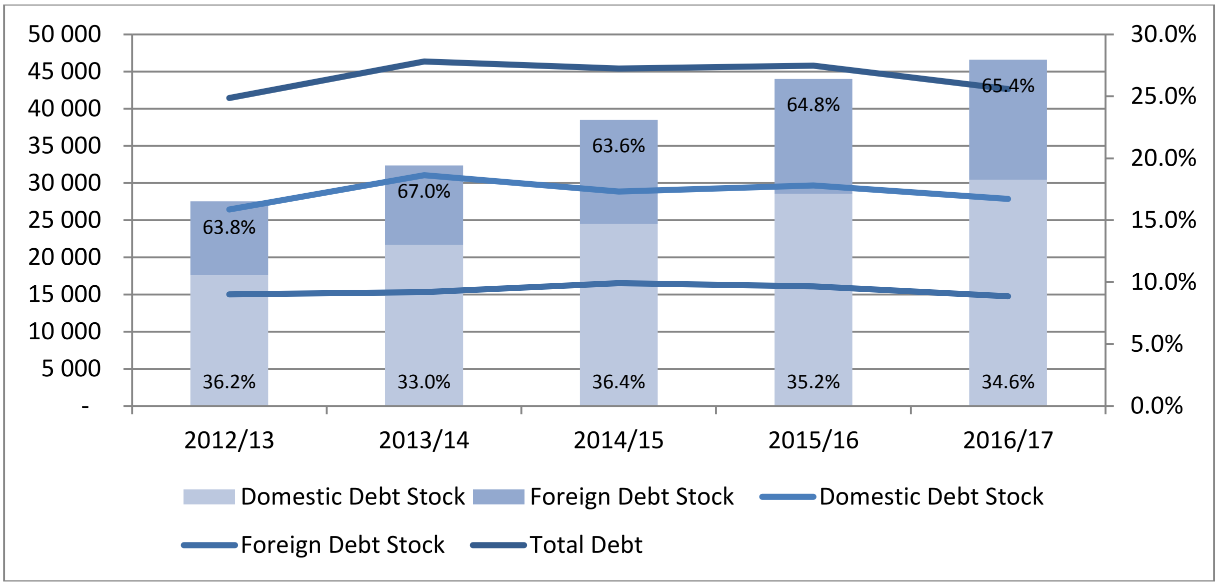
Government will continue to make use of its N$3 billion medium term note programme listed on the JSE of which N$850m was utilized when the MTNP was listed November 2012. N$1.5bn is projected to be issued in 2014/15 and the balance (N$650m) in 2015/16.

Aside from the issuance on the JSE, foreign debt stock is projected to increase by an additional N$1.8bn in 2014/15 and N$800m in 2015/16. We assume the increase is as a result of the weakening Namibian dollar and resulting translational impact on the US$500m nominal Eurobond.

The debt position

Based on the borrowing requirement, domestic debt is projected to increase by 41.9% over the MTEF to N$30.8bn or 25.6% of GDP, remaining well within the prudential threshold of 30%. Domestic debt is likely to constitute a marginally smaller proportion of total debt at 65.4% from the current levels of 67.0%.

Interest payments are projected to increase 14.4% CAGR over the MTEF relative 14.0% growth in total debt. The differential is most likely attributed to increased financing costs considering the macro environment which entails a steepening yield curve.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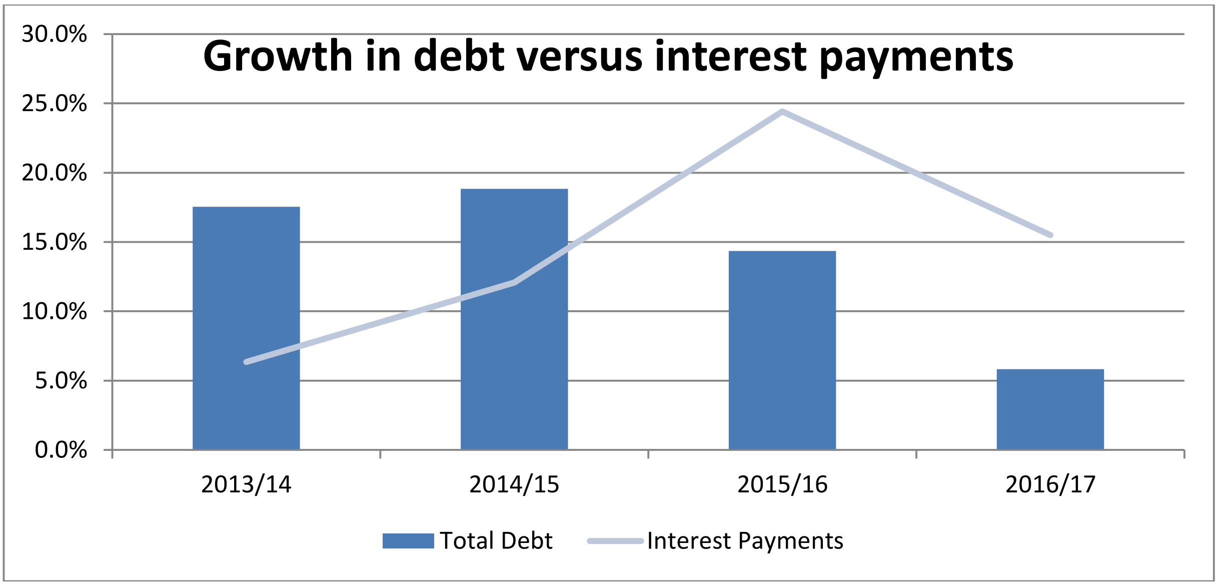
65.4%
36.2%
33.0%
36.4%
35.2%
34.6%
2012/13
2013/14
2014/15
2015/16
2016/17
Domestic Debt Stock
Foreign Debt Stock
Domestic Debt Stock
Foreign Debt Stock
Total Debt


Growth in debt versus interest payments
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
2013/14
2014/15
2015/16
2016/17
Total Debt
Interest Payments

Investment Implications

The combination of both continuing expansionary fiscal and monetary policies in an upbeat, above trend economy have moved from being traditionally counter cyclical to being pro-cyclical. This will be very supportive to the Namibian economy in the immediate future while challenges may arise over the medium to longer term.

i. Growth in disposable income

One of the strongest observations made from the national budget this time round is spectacular growth coming through in disposable income, both on account of increased Government wages and lower income tax rates. On the revenue side “taxes on income and profits” are project to grow 52.1% in 2013/14 and 18.5% CAGR over the MTEF. Of particular interest is the 71.1% increase projected for “Income from individuals”.
On the expenditure side personnel expenditure is projected to increase by 25% (N$4.0bn) in 2014/15. Considering that government is the single biggest employer in the country, it bodes well for the average household’s income.

National disposable income is statistically significant in explaining change in private sector credit extension, thus these increases are positive for our forecasts of credit demand and potential balance sheet growth for the Namibian banks.

Overall consumption will also be underpinned by the growth in disposable income and will be positive for manufacturers and retailers selling to the Namibian consumer.

ii. Growth in operational spending

Operational expenditure for 2014/15 increased by some 28% when compared to the previous year, and increased by 35% over the previously budgeted operational expenditure for the current year. A key driver behind the large increase in budget for 2014/15 is the purchase of vehicles by government, the cost of which has more than doubled over the past year, representing some N$500m increase in this expenditure sub-division. Government is projected to spend close to a billion dollars on its new vehicle bill.

Considering the past correlation between new vehicle sales and real GDP growth, this again supports the case of above trend growth in Namibia and upbeat activity levels in general.

iii. Borrowing requirement

Government will be increasingly reliant on debt to finance the budget deficit, with domestic debt securities projected to account for 50.8% of the borrowing requirement in 2014/15, 58.9% in 2015/16 and 59.6% 2016/17. This translates to net domestic debt issuance of N$4.9bn in 2014/15 which represents a 43.7% increase over the net issuance seen in 2013/14.

Following the recent amendments to the Long-Term Insurance Regulations and Regulations for Pension Funds, the increase in domestic issuance will be welcomed by the investment community.

However this is bitter sweet as this comes at a time when preferred asset allocation tends to prefer underweight fixed income relative to cash and equities.
In our view the relative low levels of government cash balances and a potential undershoot in the of ambitious revenue forecasts could put the bargaining power in the investors' court and will likely increase the GC spread and the cost of funding for government.

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