Namibia Capital Market
Fixed Income Analysis
July 2019

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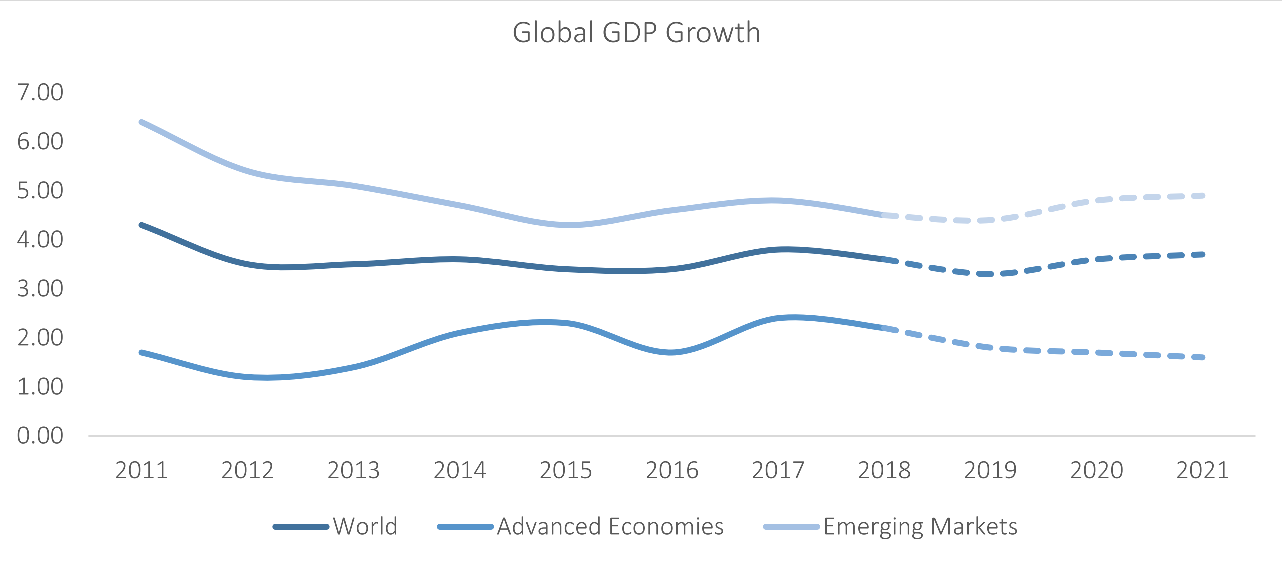
IJG

Global Macro

In their Global Economic Outlook, released in June 2019, Fitch Ratings revised their growth expectations for the world economy down to 2.6%, compared with a projection of 2.9% it made in January, and easing from an estimated 3% last year. This is in part due to the escalating trade tensions between the US and the rest of the world but has also been influenced by a rising chance of a no-deal Brexit and a slowdown in global manufacturing.



Source: IMF

At the end of the first quarter of 2019, global macro-economic conditions were precarious due to the aforementioned factors. The second quarter saw trade tensions continue to escalate. The highlight of which has been the blacklisting of Huawei Technologies and other top Chinese tech companies by placing them on the now infamous “Entity List”, preventing them from trading with any US based firm. Fortunately, tensions eased on the second last day of the quarter as President Trump affirmed that existing US tariffs would remain in place against Chinese imports, but additional tariffs would not be implemented for the time being while negotiations continue. Additionally, the US president alluded to the fact that some of the restrictions on sales to Huawei would be lifted.

Since mid-2017, the US-led tariff wars have effectively undermined the global recovery. However, in recent months it has become apparent that a major deal between the US and China on structural issues, such as intellectual property protection and issues surrounding currency manipulation, will be difficult to reach. Although the latest announcement of a fresh round of negotiations has been a breath of fresh air for markets, serious obstacles remain, and, in our opinion, it is unlikely that either side will be willing to compromise much. Thus, the risk is high that the new round of talks will also end in a deadlock, and that the trade war may continue.

Should the US impose new tariffs, this will likely be reciprocated by China. Many of the tariffs already in place, especially those on Chinese goods entering the US, are on intermediary goods and any further increases will risk interrupting supply chains, heighten efficiency losses and add to production costs for US manufacturers. This will underpin slowing growth in both the US and China, which has the potential to lead to a shock on global economic growth. In a move which has added a bit more fuel to the fire, the US threatened to increase tariffs to pressure Mexico to change migration policies which will have a negative effect on US regional trade too.

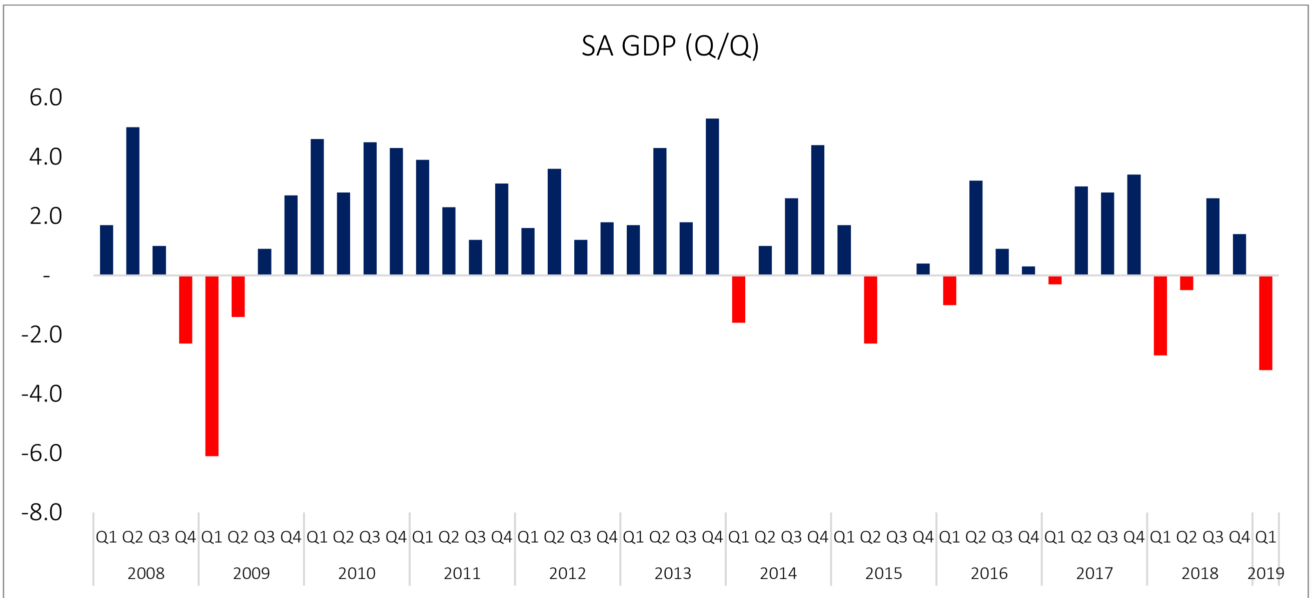
In addition to trade frictions, world industrial production growth has fallen below 1.5% y/y, the lowest rate since late 2015. This is largely due to the fact that the demand for capital goods has been falling globally. Additionally, vehicle sales have been declining in many key markets, and demand is expected to be broadly flat for 2019.

The German automotive industry has been one of the worst hit. This has been further complicated by the U.K.'s attempted departure from the EU as German manufacturers rely heavily on cross-border traffic of parts and components and may find it more difficult to sell their cars in the region. The German economy relies heavily on its car manufacturers and its automotive market is the largest in Europe. A slowdown could impact employment thought Europe meaning that long awaited recovery in Europe might remain elusive.

The weaker global economic climate brings with it a higher chance of more accommodative monetary policy. However, given that global interest rates are already at relatively low levels, it is unlikely to be able to fully offset the impact of a slowdown in growth. According to Bloomberg's World Interest Rate Probability calculator, Fed funds futures are now pointing to a 100% probability of a cut in July while European Central Bank deposit rates have a more than 80% chance of diving further into negative territory.

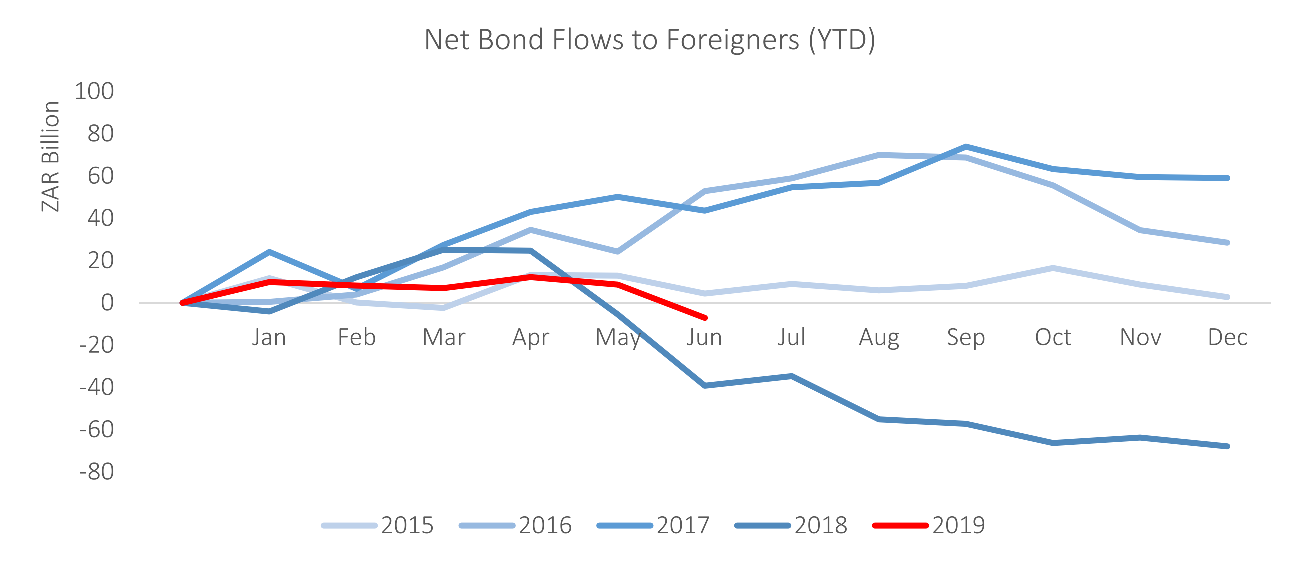
South Africa

Since the previous quarter, the South African macroeconomic situation has also deteriorated. According to latest figures from Statistics South Africa, the economy contracted by 3.2% q/q (SAAR) in the first quarter of 2019, posting the largest quarterly decline since the 2008 global financial crisis, and the second highest drop seen in over two decades. Year-on-year growth remained flat at 0.0% and will likely mean growth for 2019 will be revised down from the 1.3% expected previously to about 0.5%. The main contributors to the contraction were manufacturing, mining and agriculture. This would indicate that a combination of drought conditions and Eskom's electricity load shedding was to blame for the larger than expected plunge.



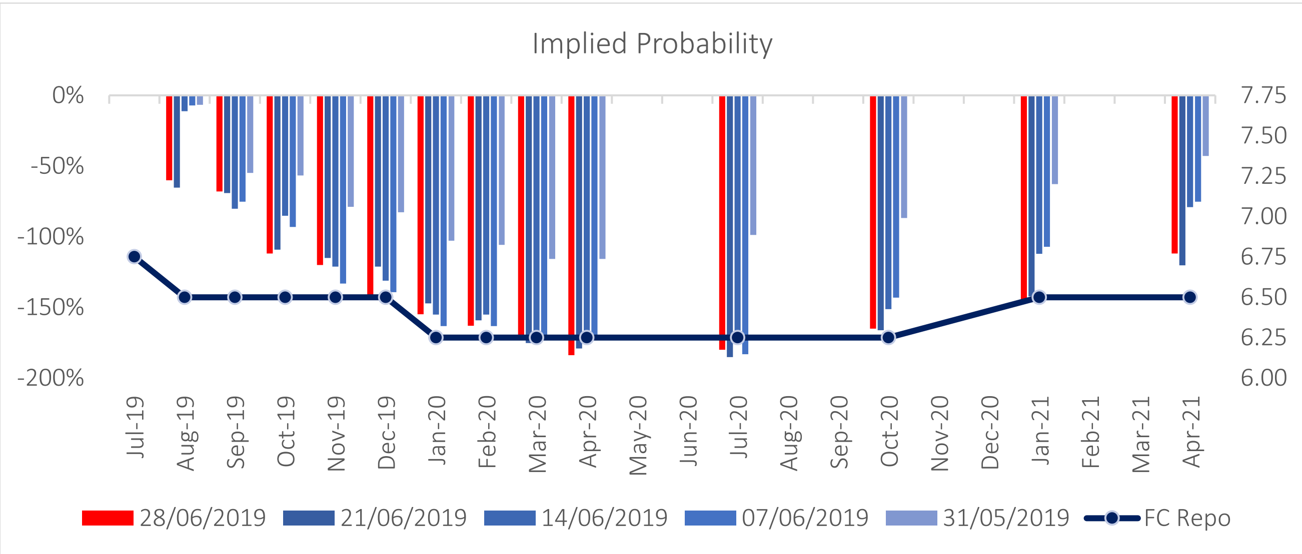
Source: StatsSA

President Ramaphosa's State of the nation address in June did little to alleviate the fears surrounding South Africa's prospects, as many have dismissed his speech as "I have a dream, but I don't have a plan". The main highlight of the SONA was the pledge for support for the ailing electricity company, as the president announced that the South African government would bring forward some of the ZAR230 billion earmarked for Eskom over the next 10 years. Seeing as this has not been budgeted for, the front-loaded support will have to be funded through larger deficits which will see increased issuance of South African sovereign bonds. This news was accompanied by hints of an accelerated land reform programme, but no mention was made of expropriation without compensation. Broadly speaking the address was not well received by investors.



Source: Bloomberg, IJG

Foreigners have been selling large amounts of ZAR denominated debt. A total ZAR15.7 billion worth of sovereign bonds were sold by foreign investors during the month of June. This dropped the net sale of South African sovereign bonds to foreigners into negative territory for 2019 year-to-date.

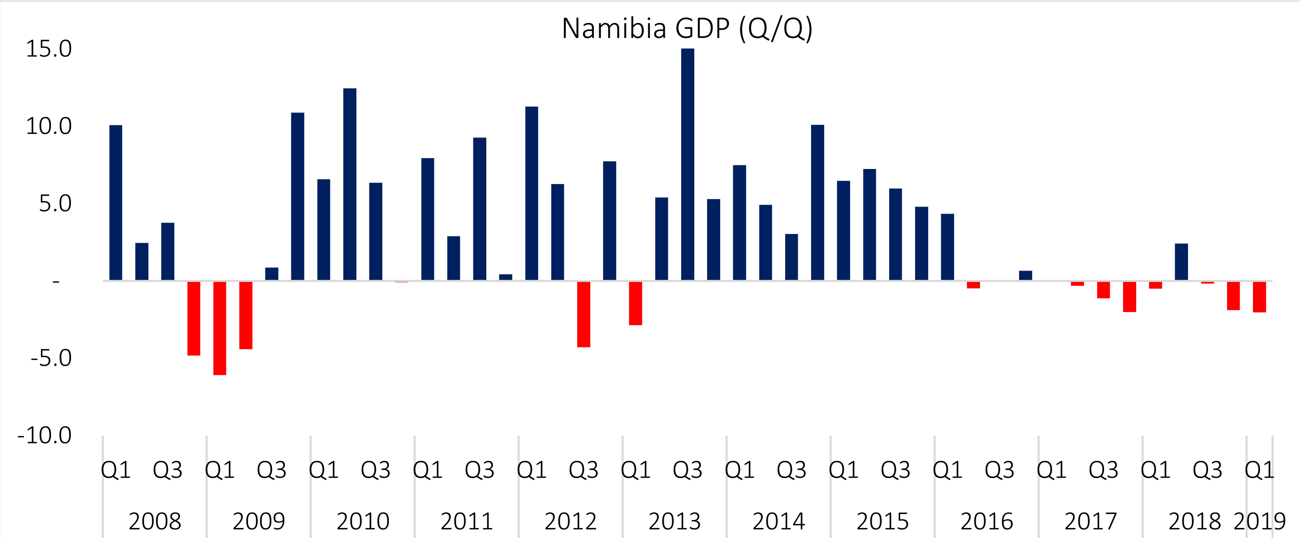


Source: Bloomberg, IJG

Low levels of growth, and relatively subdued inflation, combined with expectations of global monetary policy easing, has led expectations for lower interest rates for South Africa. The market consensus, according to the forward rate agreement market, now points to two interest rate cuts in the next twelve months, the first of which is expected as soon as the July MPC meeting. IJG believes that at least one cut is likely in the near term but are expecting the move slightly later in the year. Whenever the cut takes place, we expect the Bank of Namibia to follow suit and cut the Namibian repo rate shortly after the move is announced at the South African Reserve Bank.

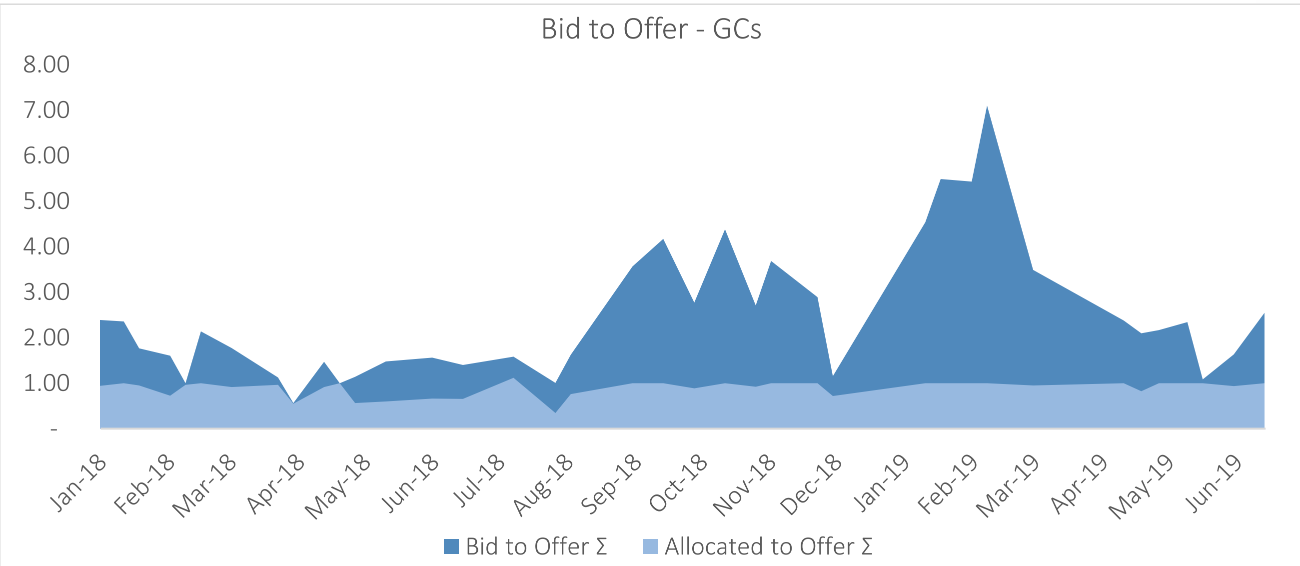
Namibia

The latest Namibian quarterly GDP figures have also come out in the red as the domestic economy recorded a contraction of 2.0% y/y. Thus, the trend of stagnation which started in the beginning of 2016 continues unabated. The decline was evident across most industries, as more than half of the major sectors posted negative growth rates. The key drivers of the contraction could be attributed to construction (-27.8%), wholesale and retail trade (-6.7%), agriculture and forestry (-6.7%), as well as hotels and restaurants (-8.7%). The decline in hotels and restaurants sector is an especially worrying factor, as it indicates that our tourism industry may also be struggling, despite the favorable exchange rates for foreigners.



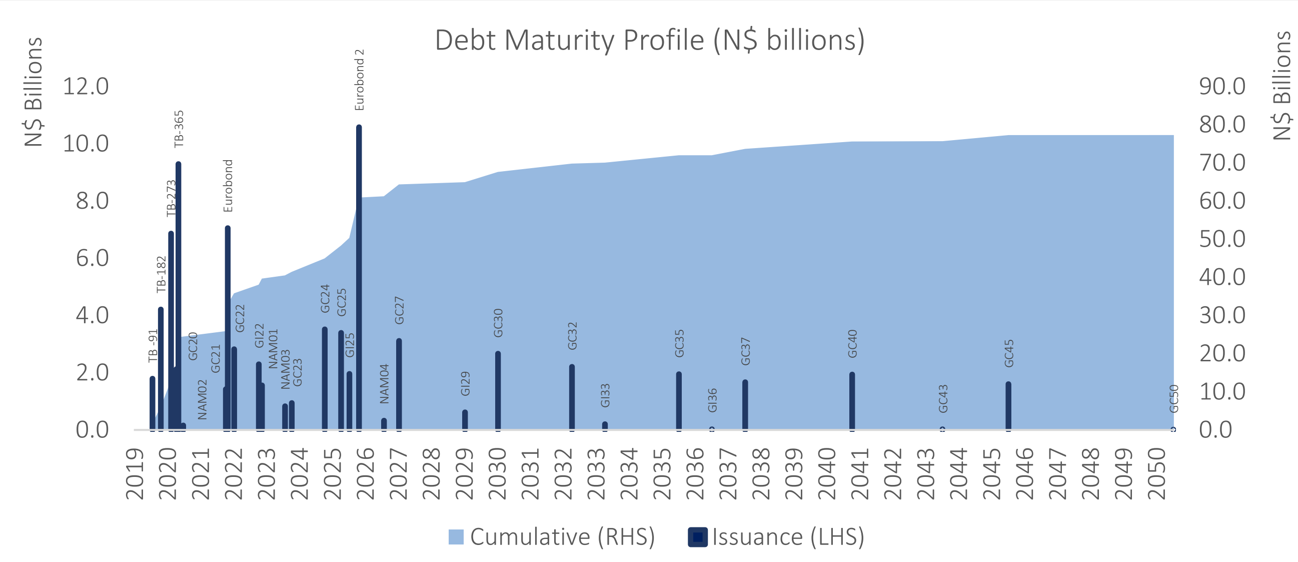
Source: NSA, IJG

In short, consumer demand remains depressed and disposable household income has remained under pressure, intensified by the impact of a local drought. Given the current state of affairs we do not expect real growth to pick up anytime soon. Seeing as equity investments will likely not yield high returns in this economic climate, interest bearing securities make a good alternative. Demand for fixed government debt remained strong during the second quarter, with only two instances of bonds being undersubscribed recorded during the last three months. Two new long dated bonds were introduced during the quarter, namely the GC43 and GC50, which were both more than 2x oversubscribed in their inaugural auctions in June, indicating that there is appetite for longer dated maturities.



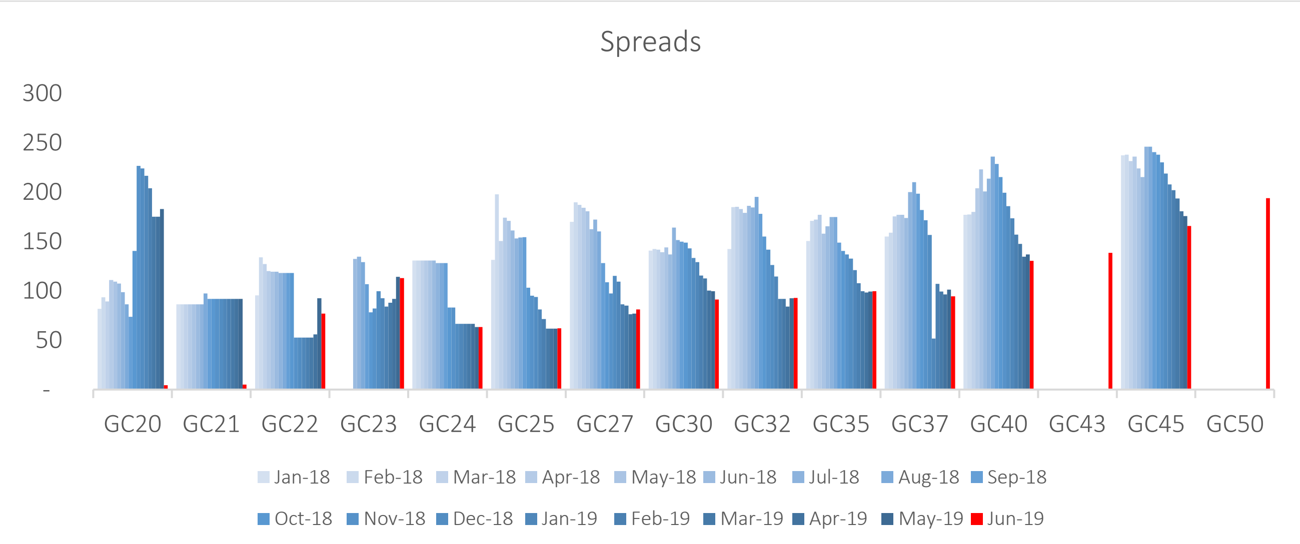
Source: BoN, IJG

Furthermore, the first GC20 switch auction was well subscribed and just under N$1.0 billion of the N$3.1 billion total issuance was rolled into longer maturities. This is encouraging given Namibia's front-loaded debt maturity profile, which is slowly being spread out over the curve. For the treasury, this reduces the roll risk associated with large issuances, but does add to the overall cost of financing due to the increasing duration.



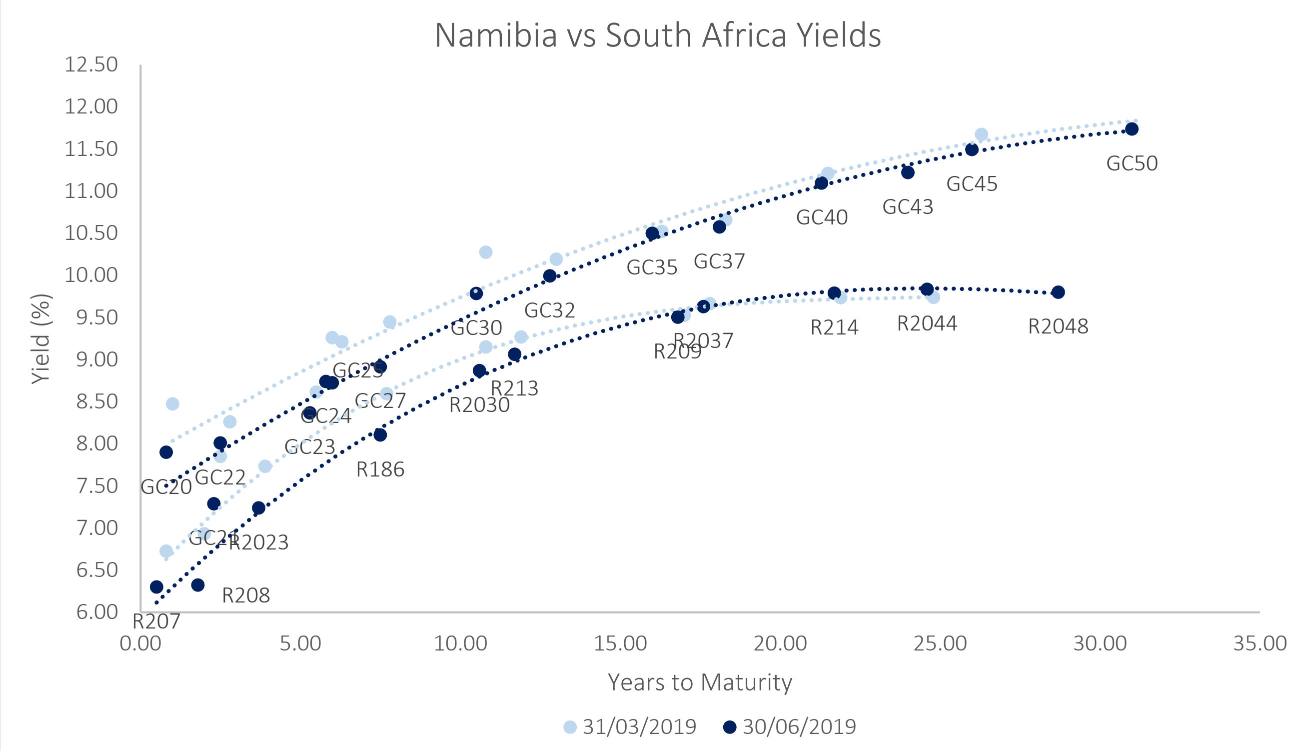
Source: BoN, IJG

On average, spreads of Namibian government bonds over their south African benchmarks have been contracting. However, there are some differences across maturity buckets. The GC30, GC40 and GC45 have seen their spreads decline the most, declining by 21bp, 17bp and 28bp respectively over the quarter. On the other hand, the shorter dated bonds have seen an uptick in their spreads. The GC22 and GC23 have both seen their spreads increase by 25bp over the quarter. The GC20 and GC21 have had their benchmarks changed to the 26 April 2019 TB and the R2023, and as such, their spreads would have been down by 15bps and up by 5bps, where the benchmarks left unchanged.



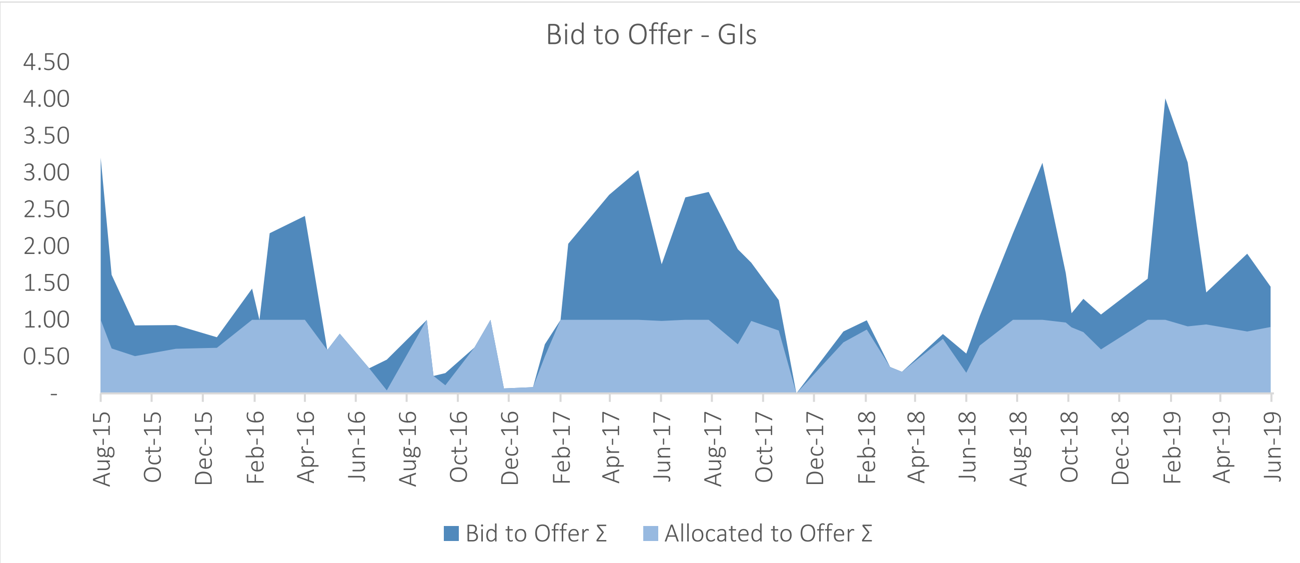
Source: BoN, IJG

The South African yield curve has seen yields decline by roughly 24 bps since the end of the last quarter. However, this was not a parallel shift and most of this move has been in the shorter end of the curve. The Namibian curve has followed the South African curve down on the short end, but has widened slightly.



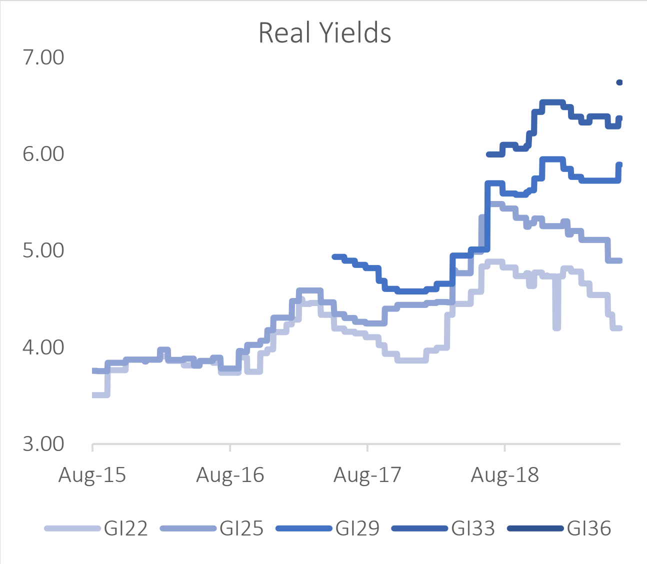
Source: Bloomberg, IJG Securities

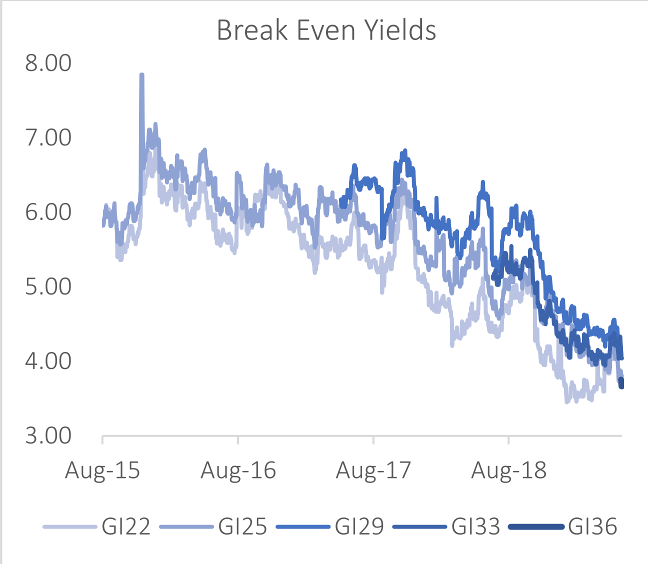
Inflation liked bonds have also been well subscribed in the last couple of auctions, roughly 1.6x oversubscribed on average. One new inflation linked bond has been introduced, the GI36 which was more than 2x oversubscribed at its first auction in June. The two shorter dated bonds are now off the run which, in our opinion, is a positive development as the 2021 – 2025 part of the maturity profile has become quite crowed and each of these two linkers now have about N$2.0 billion outstanding.



Source: BoN, IJG

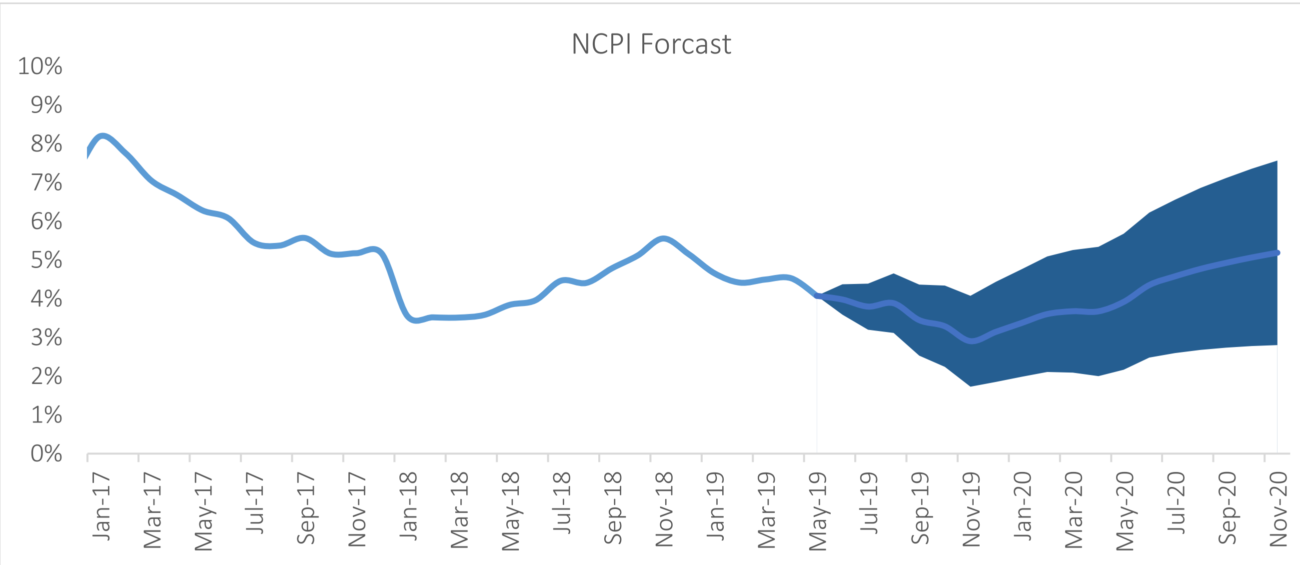
Yields on the inflation lined bonds remain attractive both on an absolute and relative basis. Given the continued decline in GC yields, the break-even levels of GI bonds have continued to decline and are currently around 3.9% on average. Based on the break-even metric the GI36 is now the most attractive bond as its break-even inflation rate is 3.7%.





Source: BoN, IJG

In their June MPC meeting Bank of Namibia expressed that their expectation is for inflation to average 4.7% in 2019. The IJG model sees NCPI slightly lower at 3.9% for 2019. However, seeing as oil prices have seen some recovery of late, transport inflation remains the biggest upside risk to the forecast. Additionally, the effect of the drought has seen a large increase in animals slaughtered which has put downward pressure on meat prices. As this reverses food inflation is expected to also contribute to rising prices.



Source: NSA, IJG

Seeing as inflation linked bonds are attractive relative to their nominal peers and that there is significant upside risk in inflation, inflation linked bonds continue to be IJG's favoured investment choice.

Instrument	Closing Date	Issue Date	Due Date
Jul-19			
364-day TB	Thursday, 04 July, 2019	Friday, 05 July, 2019	Friday, 03 July, 2020
IRS	Wednesday, 10 July, 2019	Thursday, 11 July, 2019	
91-day TB	Thursday, 11 July, 2019	Friday, 12 July, 2019	Friday, 11 October, 2019
Coupon Payments (GC22, GI25, GC27, GI29, GC30, GC35, GC37 &GC45)	Monday, 15 July, 2019		
IRS	Wednesday, 17 July, 2019	Thursday, 18 July, 2019	
182-day TB	Thursday, 18 July, 2019	Friday, 19 July, 2019	Friday, 17 January, 2020
273-day TB	Thursday, 18 July, 2019	Friday, 19 July, 2019	Friday, 17 April, 2020
364-day TB	Thursday, 18 July, 2019	Friday, 19 July, 2019	Friday, 17 July, 2020
ILB	Wednesday, 24 July, 2019	Thursday, 25 July, 2019	
91-day TB	Thursday, 25 July, 2019	Friday, 26 July, 2019	Friday, 25 October, 2019
182-day TB	Thursday, 25 July, 2019	Friday, 26 July, 2019	Friday, 24 January, 2020
Aug-19			
182-day TB	Thursday, 01 August, 2019	Friday, 02 August, 2019	Friday, 31 January, 2020
272-day TB	Thursday, 01 August, 2019	Friday, 02 August, 2019	Thursday, 30 April, 2020
364-day TB	Thursday, 01 August, 2019	Friday, 02 August, 2019	Friday, 31 July, 2020
GC20 Switch Auction	Wednesday, 07 August, 2019	Thursday, 08 August, 2019	
IRS	Wednesday, 14 August, 2019	Thursday, 15 August, 2019	
182-day TB	Thursday, 15 August, 2019	Friday, 16 August, 2019	Friday, 14 February, 2020
273-day TB	Thursday, 15 August, 2019	Friday, 16 August, 2019	Friday, 15 May, 2020
IRS	Wednesday, 21 August, 2019	Thursday, 22 August, 2019	
91-day TB	Thursday, 22 August, 2019	Friday, 23 August, 2019	Friday, 22 November, 2019
273-day TB	Thursday, 22 August, 2019	Friday, 23 August, 2019	Friday, 22 May, 2020
364-day TB	Thursday, 22 August, 2019	Friday, 23 August, 2019	Friday, 21 August, 2020
ILBs	Wednesday, 28 August, 2019	Thursday, 29 August, 2019	
Sep-19			
IRS	Wednesday, 04 September, 2019	Thursday, 05 September, 2019	
91-day TB	Thursday, 05 September, 2019	Friday, 06 September, 2019	Friday, 06 December, 2019
Book Closure (GC20, GC21, GI22, GC23, GC24, GC25, GC32, GI33 & GC40)	Friday, 13 September, 2019		
IRS	Wednesday, 18 September, 2019	Thursday, 19 September, 2019	
91-day TB	Thursday, 19 September, 2019	Friday, 20 September, 2019	Friday, 20 December, 2019
182-day TB	Thursday, 19 September, 2019	Friday, 20 September, 2019	Friday, 20 March, 2020
273-day TB	Thursday, 19 September, 2019	Friday, 20 September, 2019	Friday, 19 June, 2020
ILBs	Wednesday, 25 September', 2019	Thursday, 26 September, 2019	
364-day TB	Thursday, 26 September, 2019	Friday, 27 September, 2019	Friday, 25 September, 2020

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