

Namibia Capital Market Fixed Income Analysis July 2020

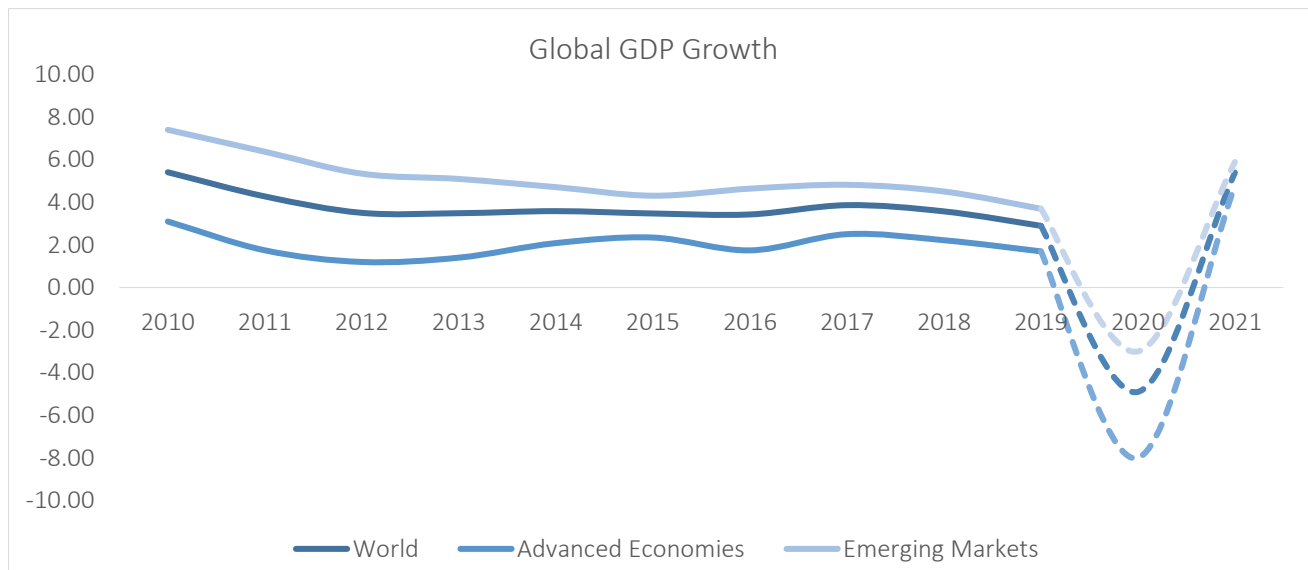
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Global Macro

2020 will likely be looked back upon as the year the wheels came off. Global growth is projected to contract by 4.9% in 2020, a 1.9% downward revision from the IMF's April 2020 World Economic Outlook (WEO) forecast as the impact of the COVID-19 outbreak is proving more troubling than initially thought. Furthermore, the anticipated recovery in 2021 is also expected to be slightly lower than initially expected, which means that over the next two years, the global economy is expected to contract. However, any type of forecast is made with a large degree of uncertainty, as many assumptions have been made around the duration and effects of the pandemic. As we cycle through the alphabet of likely recovery patterns, hopes of a quick V-shaped rebound are starting to fade as global markets have shown signs of concern around the potential fallout of a second wave of infections.



Source: IMF

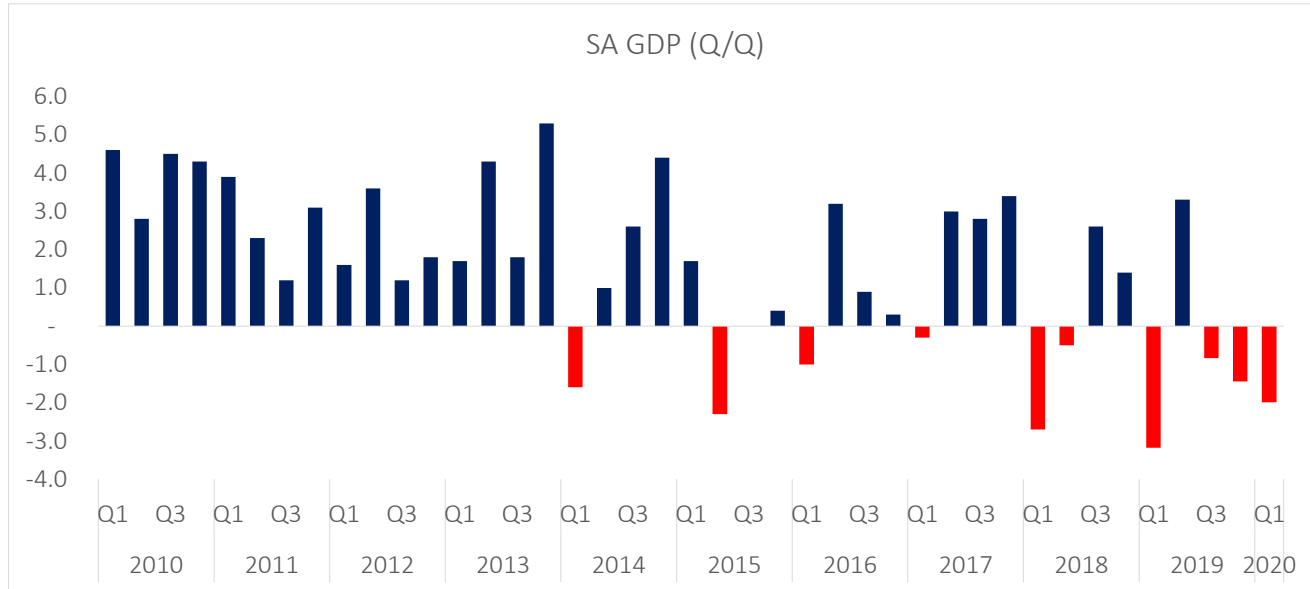
The global monetary response to COVID-19 has been wildly accommodative, and interest rates in most developed economies have been dropped as low as many of them can go. The US cut its federal funds rate by 150bp to 0 – 0.25% which is pretty much rock bottom as the Fed remains opposed to the idea of negative interest rates, opting instead for widespread liquidity support in the form of rapidly expanding its balance sheet. Europe, which was already at negative interest rates, decided not to cut rates further but also inject large amounts of liquidity into its system by means of targeted longer-term refinancing operations. Furthermore, many economies have eased the financial policies for banks, reducing the need for various capital and countercyclical buffers and allowing the use of portions of liquidity buffers to increase lending capacity. Finally, borrowers have been offered some relief through the restructuring of loan terms or the granting of payment holidays. All in all, the vast monetary measures have pressed short term yields down and injected large amounts of liquidity into the system.

It is clear that the pandemic will do lasting damage to productivity and output, and unfortunately, it seems that low-income households across the globe will be affected the most as per capita incomes in most emerging and developing economies will likely shrink this year. The global fiscal policy focus remains on mitigating the human costs of the outbreak while also minimizing the damage done to economies by intermittent lockdowns and supply chain disruptions. Once the pandemic has been dealt with, the world will have to commit to kickstarting global growth, which will not be an easy feat as the last decade has seen relatively low growth across most developing economies.

Emerging markets face a particularly difficult task as many already indebted developing economies have had to borrow extensively to combat the spread of the virus and provide social support. The combination of rapid increases in debt, falling GDP and lower tax revenues has led to rapidly deteriorating fiscal metrics. Sub-Saharan Africa is by far the worst hit of the emerging markets in this regard as Fitch Ratings forecasts the median government debt/GDP ratio for the area to reach

71% at end-2020, from 57% at end-2019 and 26% in 2012. Additionally, interest payments as a percentage of revenue are expected to be in the region of 17% of government revenues in 2020 and remain above the 15% level for the foreseeable future. This means that overall creditworthiness and the credit ratings which measures this will come under severe pressure in years to come.

South Africa

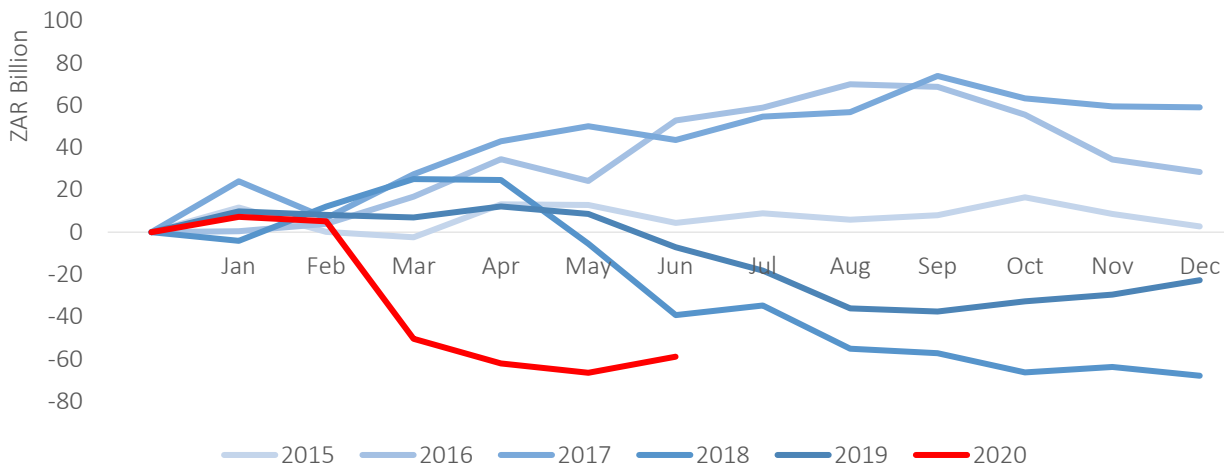


Source: StatsSA

Although South Africa remains one of the top-rated nations in Africa in terms of credit, the country will face severe pressure over the next couple of years. The IMF expects the South African economy to contract by 8.0% in 2020 and then grow by only 3.5% in 2021, while the SARB expects a similar pattern (-7.0% / +3.8%). Additionally, real GDP growth for 2022 and 2023 is also expected to be only marginally positive. That means that in 2023 the South African economy will still be 1.9% smaller than it was in 2019. In per capita GDP terms this implies that the average South African will be 8% poorer in 2023, based on a population growth rate of 1.5%.

It is in the face of extremely lackluster growth that the South African supplementary budget has been presented. This budget, expected by many to be the implementation plan for president Ramaphosa's announced R500 billion stimulus, has drawn sharp criticism from a coalition of economist and policy experts (A group of 122 economists and policy experts, called the Economists Initiative combined with the Budget Justice Coalition) who have called for Parliament to reject the Budget and send it back for reformulation. In an open letter to the Standing Committee on Finance, the coalition highlighted the fact that the R500 billion rescue package announced by the president will largely be funded by reallocations, and the net increase in spending is a mere R36 billion. The coalition is of the opinion that the small increase in spending will not be adequate stimulus to keep economic growth from a complete downward spiral and provide support to the most vulnerable. This is completely at odds with the objectives of finance minister Tito Mboweni, who has his eyes set on the sharply increasing debt levels and deteriorating fiscal metrics, and who views budget consolidation as desperately needed. As per the minister's speech, some very unpopular decisions have to be made as: "The wide gate opens to a path of bankruptcy. A sovereign debt crisis is when a country can no longer pay back the interest or principal on its borrowings. We are still some way from that. But if we do not act now, we will shortly get there." This is unfortunately a catch 22 scenario, where increases in spending will result in higher deficits, but will hopefully be a boost to growth and reduce deficits in the future, while on the other hand austerity will limit the deficits in the current year, but will likely be a drag on growth, increasing future deficits.

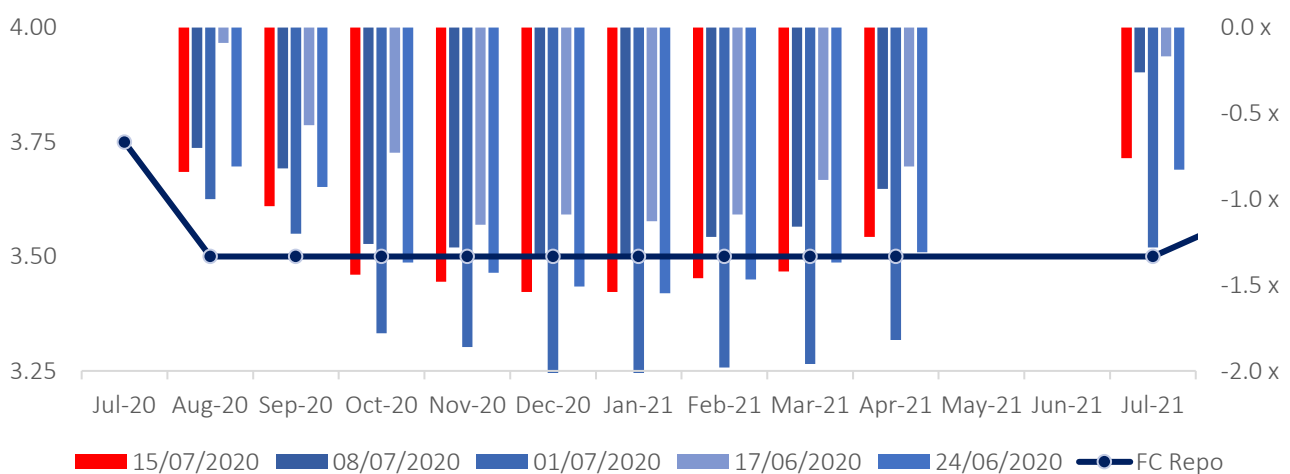
South African Foreign Bond Flows



Source: Bloomberg, IIG

Following the exclusion of South Africa from the World Government Bond Index, foreigners sold off a large amount of South African bonds. Data from the National treasury indicates that a large proportion of this was taken up by local banks (as well as other financial institutions), who have been net buyers of South Africa government bonds since February 2020.

Implied Probability

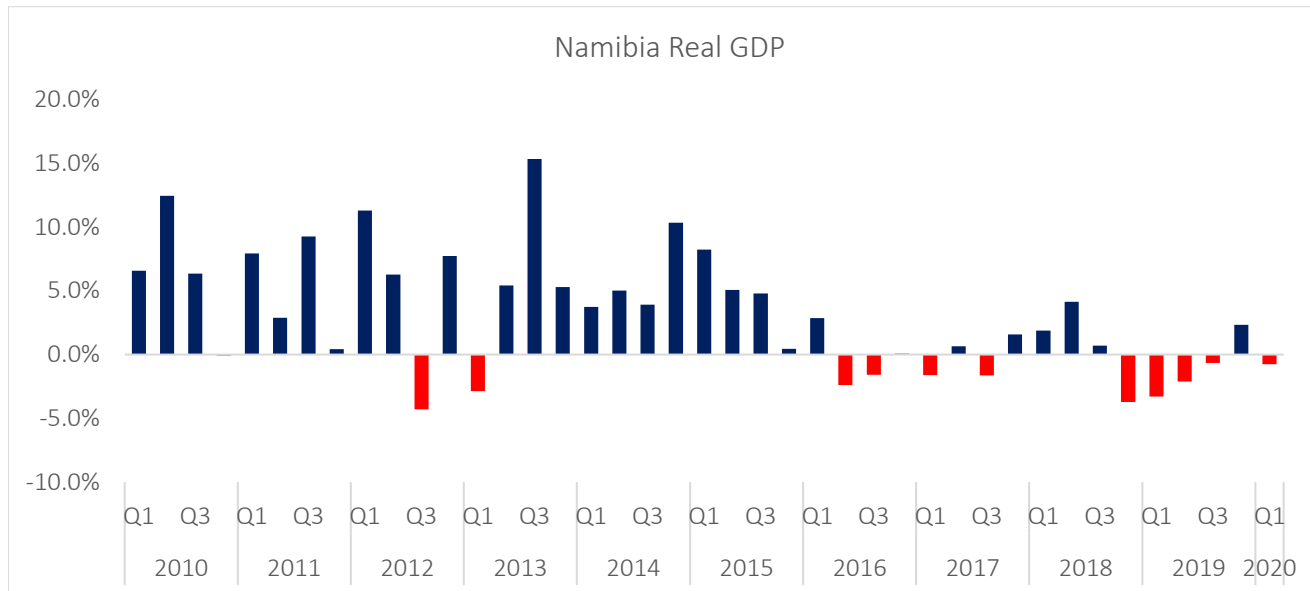


Source: Bloomberg, IIG

South Africa is expected to cut interest rates either once over the next twelve months, from the current repo rate of 3.75%. It is unlikely that 25 basis points, will have much effect on stimulating the economy seeing as interest rates are already at decade lows. However, with low inflation and very low growth, the SARB has carte blanche to take rates as low as they find prudent.

Namibia

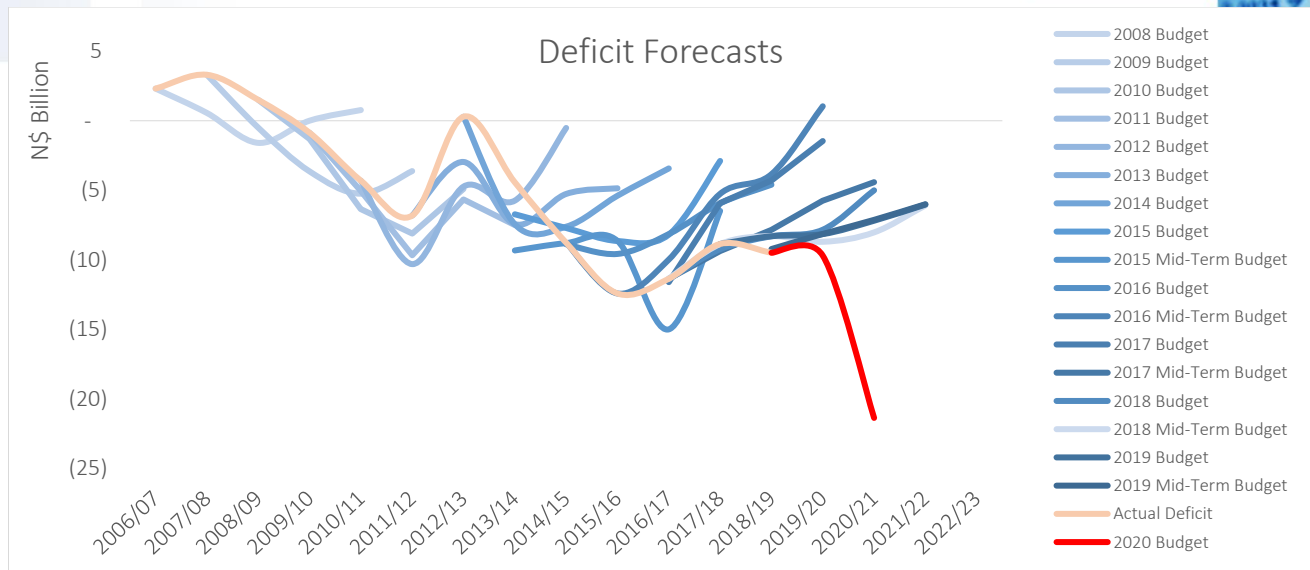
Namibian growth has been poor since the beginning of 2016, while fiscal consolidation has put further brakes on an already slow economy. The Outlook for the Namibian economy has very few silver linings as policy uncertainty, specifically around troublesome legislation such as the New Equitable Economic Empowerment Bill and the Investment Promotion act, remain huge barriers to attracting foreign investment and reviving our dwindling gross fixed capital formation. As growth has been poor in the years leading up to the pandemic, the lockdown, and the economic impacts thereof, could not have come at a worse time for the already fragile Namibian economy.



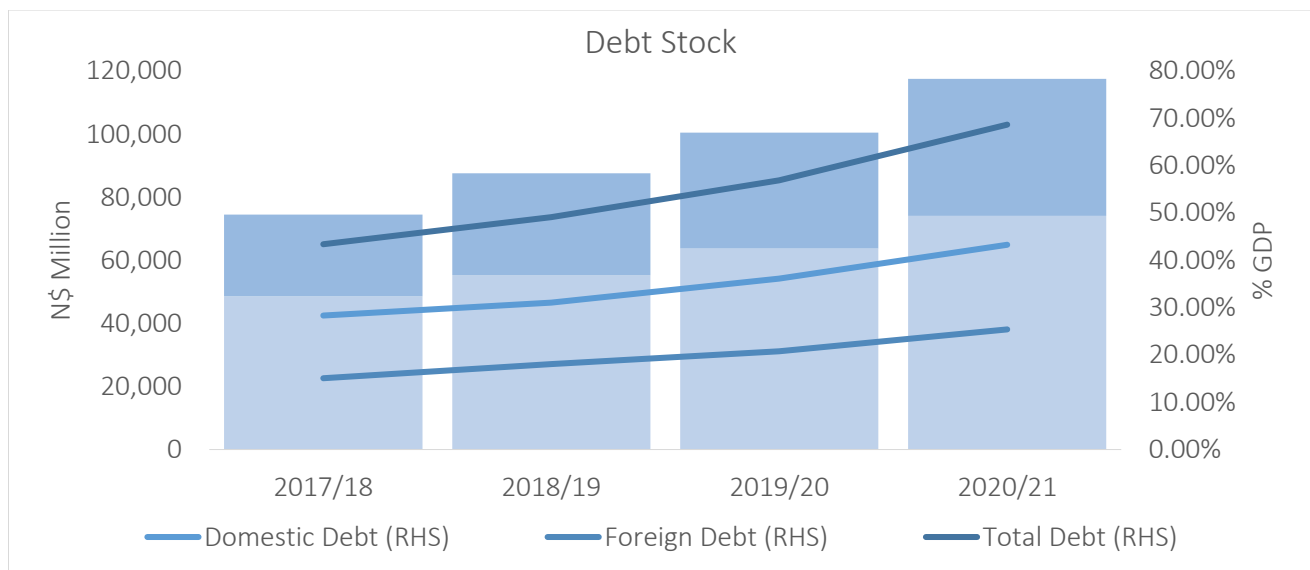
Source: NSA, IJG

The monetary policy response to COVID-19 was very much in line with the South African response, seeing two emergency cuts of 100bp, followed by another 25bp cut. This leaves the Namibian repo rate at 4.0%. Contrary to our expectations, BoN did not follow the SARB in the last decision, rather opting to build up a slight buffer between the two countries' repo rates. This is good news for Namibian banks, who have a slightly higher lending rate and good news for buyers of Namibian Money Market instruments, which will have slightly higher yields than their South African counterparts. Additionally, the Bank of Namibia implemented many of the same measures mentioned in the global section to aide the banking sector and its lenders.

The fiscal response to the outbreak of COVID-19 was, however, less satisfactory largely due to the constrained fiscal position Namibian continues to find itself in. Initially, a stimulus package of N\$8.1 billion was announced, roughly 4.5% of GDP. However, of this N\$3.8 billion (2.1%) was the payment of overdue invoices and VAT refunds. A further N\$2.3 billion (1.3%) was tax back, agricultural and SME loans which would be guaranteed by the Government. Of the remaining N\$2.0 billion, about N\$962 million (0.5%) was for direct wage support measures for employees affected by the pandemic, while the remaining N\$1.1 billion (0.6%) was earmarked for health interventions.



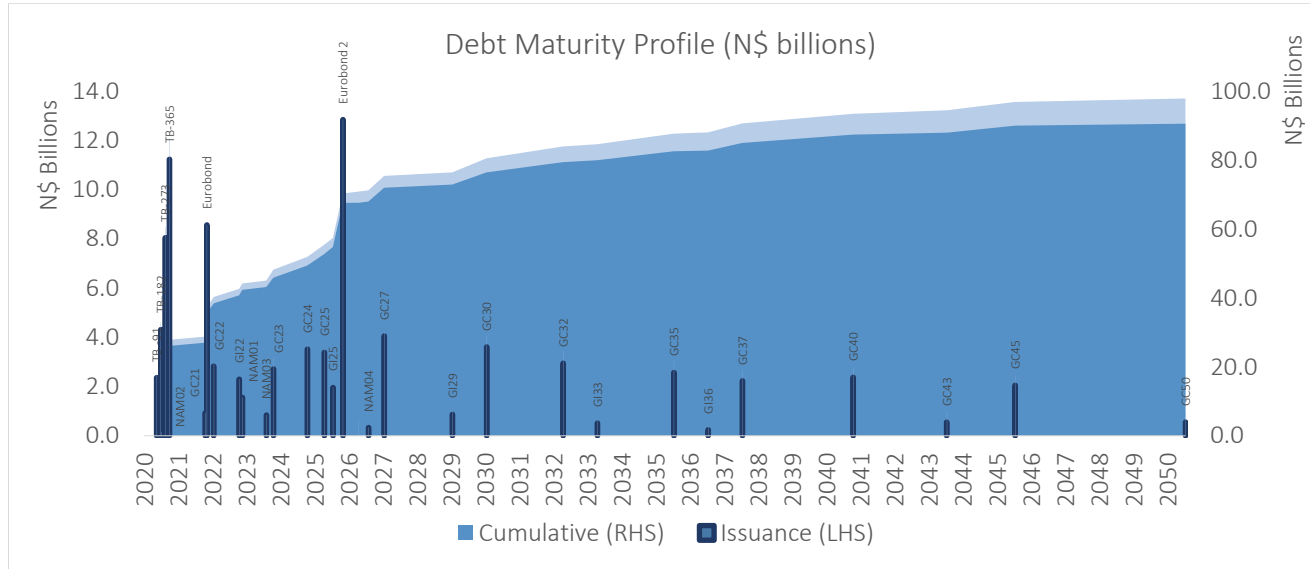
The Namibian budget also left much to be desired. Leading up to 2020 the Namibian economic climate was already very much stagnant with little growth expected and persistent twin deficits, and as with South Africa, Namibia has limited fiscal space to provide meaningful stimulus. The lockdown will have a severe impact on the Namibian government's revenues for at least this year, possibly longer. SACU revenue makes up roughly a third of our government revenue, and this will remain depressed should trade between member countries continue to be hampered by weak demand, while local tax revenues will also come under pressure. Revenues are expected to decline by 11.7% y/y in the current financial year. Expenditure was forecast to increase by 7.1% y/y, and is focused largely on funding the abovementioned stimulus package as well as other COVID-19 related health expenditures and contingencies. However, increased expenditure also contained more bailouts to Air Namibia, who received a N\$1.0 billion transfer, as well as a N\$396 million increase in the defense budget. The result is a N\$21.4 billion budget deficit (12.5%) and a N\$26.2 billion funding requirement for the 2020/21 financial year. Utilizing N\$8.5 billion of cash reserves, mostly from debt redemption sinking funds, and considering that N\$6.8bn will be raised from external sources such as AfDB and the like, Namibia's domestic issuance would be in the region of N\$10.6 billion. This would increase Namibia's debt to GDP ratio to 69% by 2020/21.



Source: MoF, IJG Securities

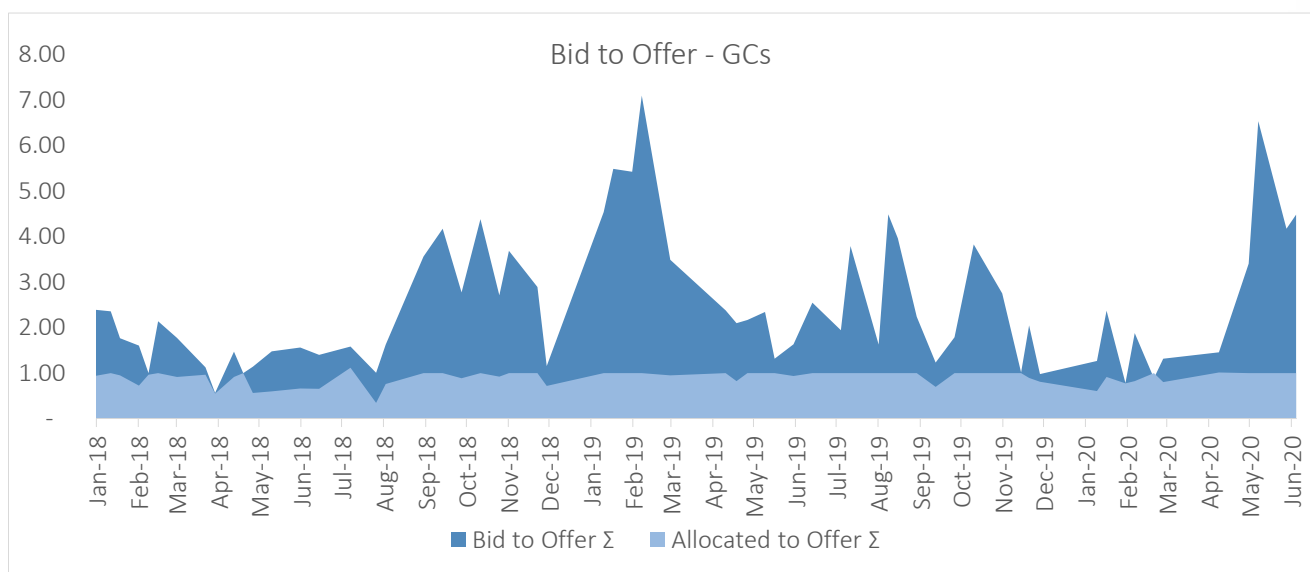
The borrowing plan released in July indicated a targeted domestic issuance of N\$10.6 billion, which would be made up of N\$3.1 billion treasury bills, N\$7.1 billion fixed rate bonds and N\$360m inflation linked bonds. The large issuance of treasury

bills means Namibia's debt maturity profile continues to become more and more front-loaded. Currently, about 39% of Namibia's debt will mature before the end of 2021, while about 61% will mature within the next five years. This is largely due to the two large Eurobond maturities in 2021 and 2025 which collectively make up about 24% of the country's total debt. Seeing as the redemption accounts have been tapped, it is highly likely these bonds will have to be rolled once they mature.

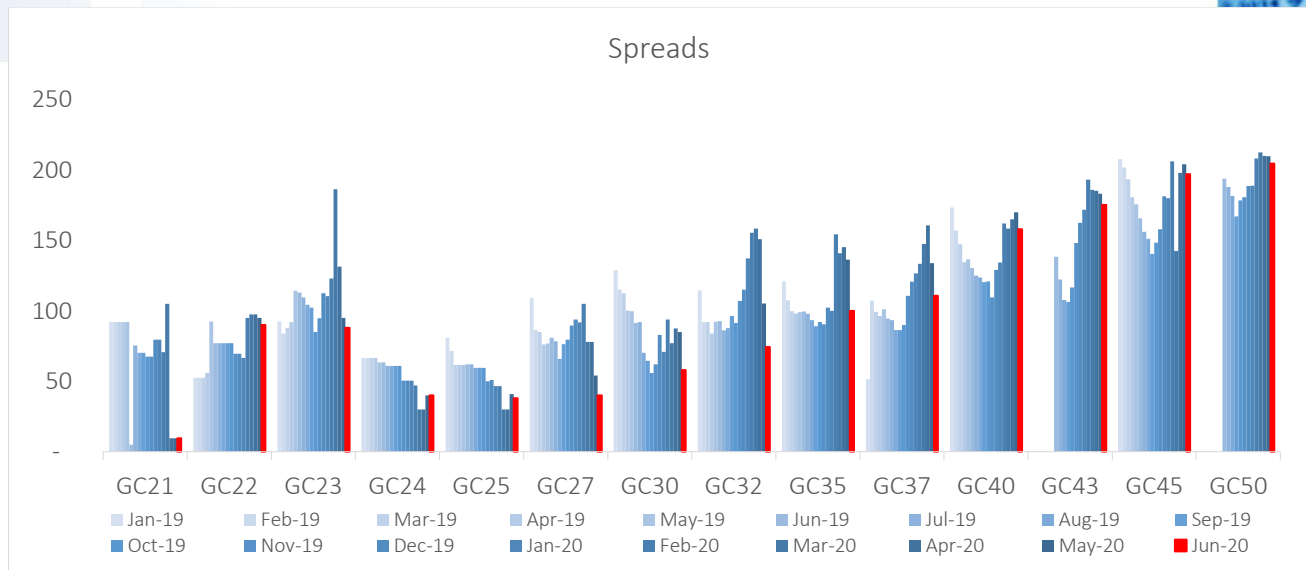


Source: BoN, IJG

Demand at local auctions has seen a resurgence in May and June. We believe the demand is currently being driven by three main factors. Firstly, banks have excess liquidity while private sector credit extension remains very low and are parking funds in short term government securities. Secondly, many pension funds have seen strong performance in their offshore positions due to local currency depreciation, requiring them to rebalance their portfolios. Finally, pension fund players, such as the GIPF are still not completely compliant with the 45% local asset requirement. They have been granted an extension until 31 March 2021, however, they will also be in a similar position to the other pension funds, who have drifted away from their asset allocation targets due to strong performance in the offshore portions of their portfolio, and will likely be participating quite aggressively at bond auctions.

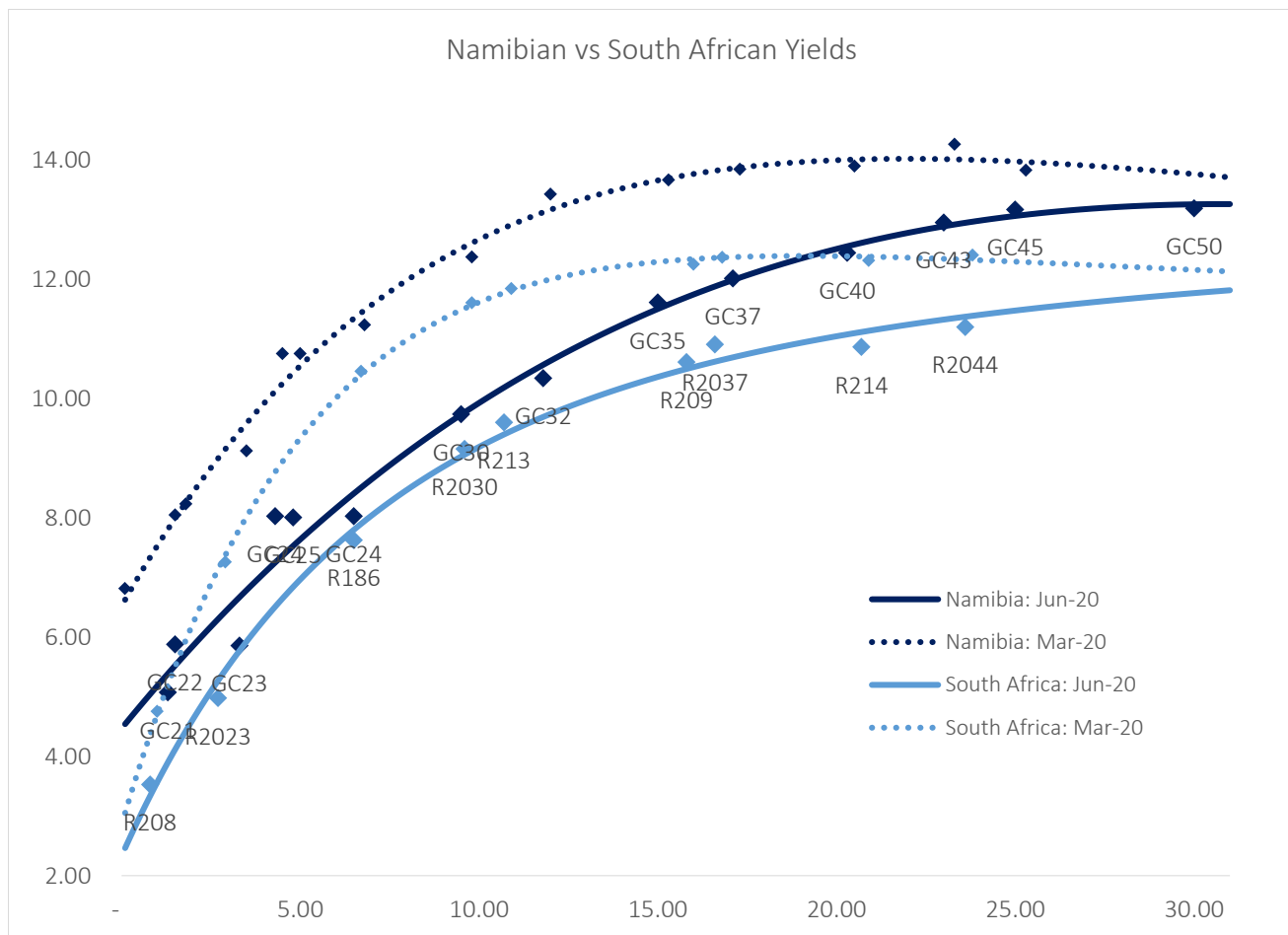


Source: BoN, IJG

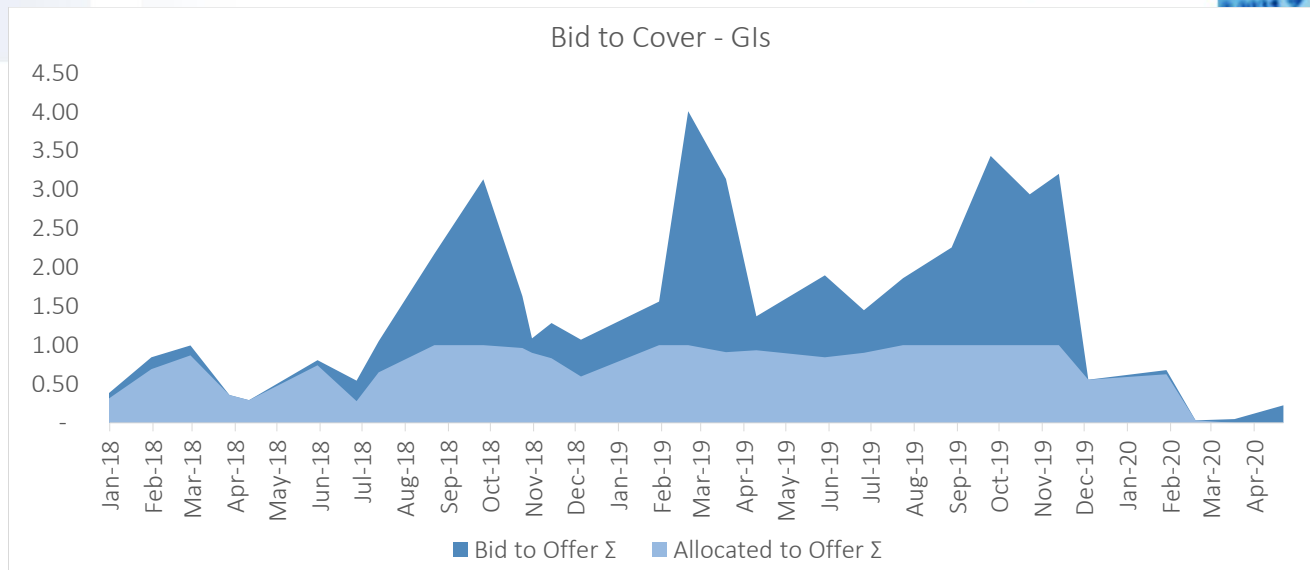


Source: BoN, IJG

The increased demand in auctions have put downward pressure on spreads which have been declining rapidly over the last two to three months. As a result, the Namibian curve has benefitted from both lower yields on the benchmark curve and compressing spreads to more demand at auction.

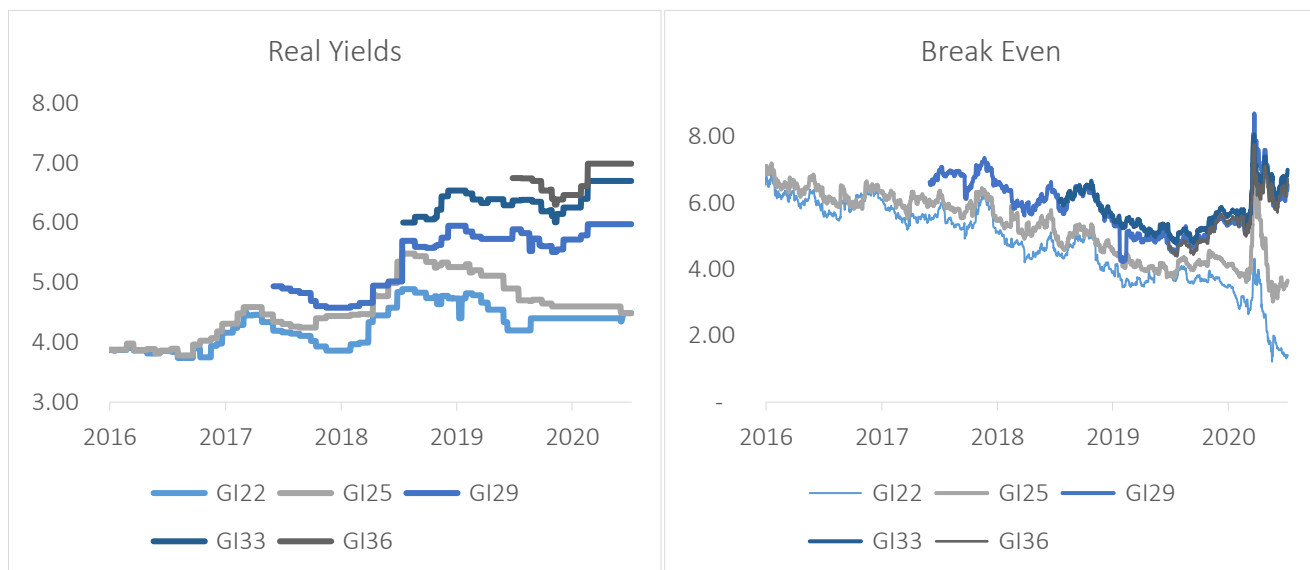


Source: Bloomberg, IJG



Source: BoN, IJG

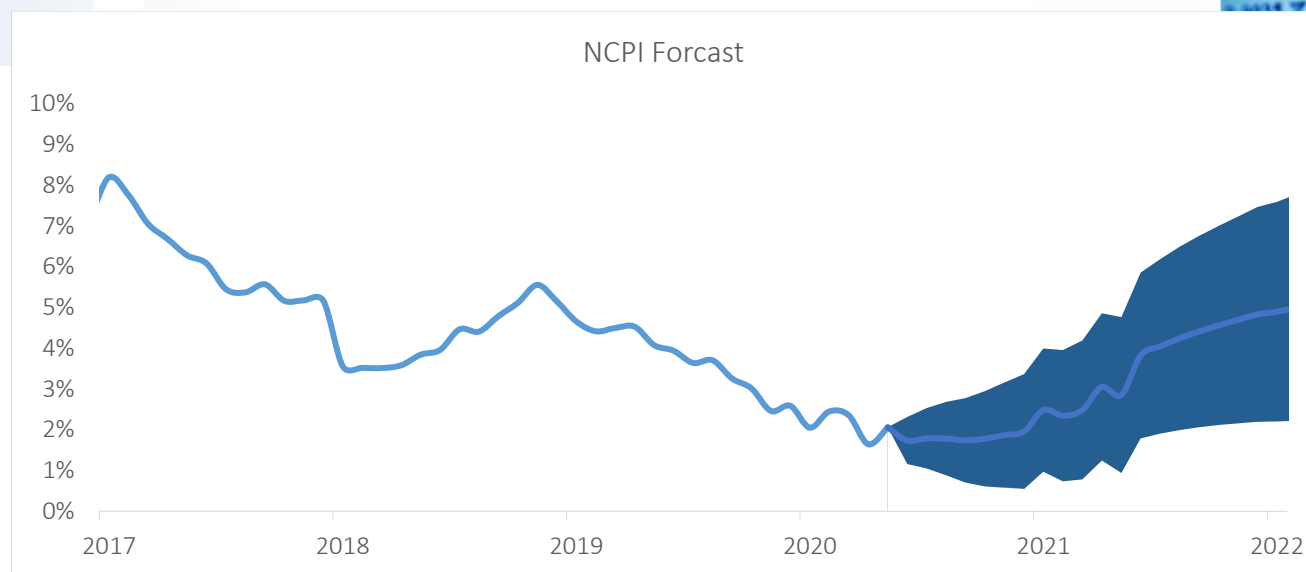
Inflation-linked bonds were extremely poorly bid from March as demand sagged with lower inflation. As a result, the Bank of Namibia cancelled GI auctions and recently announced they will only be returning to the calendar from August onwards. Seeing as the GI22 and GI25 have been off the run for more than a year, the break-even inflation rate on these bonds have dipped to reasonably attractive levels of 1.4% and 3.5% respectively, although picking these bonds at the current mark-to-market yields may be difficult.



Source: BoN, IJG

Inflation in Namibia is expected to remain low for the remainder of 2020. Currently, we expect NCPI to end 2020 at 1.9% and pick up gradually from this low base to 4.5%, the centre of the 3-6% target band, being driven largely by rebasing effects off the lows of 2020.

0.0005	4.85%
0.0003	13.04%
0.0001	50.00%
0.0003	14.29%
0.0005	12.50%



Source: NSA, IJG

Instrument	Closing Date (t)	Issue Date(t+1)	Due Date
Jul-20			
364-day TB	Thursday, 02 July, 2020	Friday, 03 July, 2020	Friday, 02 July, 2021
91-day TB	Thursday, 09 July, 2020	Friday, 10 July, 2020	Friday, 09 October, 2020
Coupon Payments (GC22, GI25, GC27, GI29, GC30, GC35, GI36, GC37, GC43, GC45 & 50)	Wednesday, 15 July, 2020		
182-day TB	Thursday, 16 July, 2020	Friday, 17 July, 2020	Friday, 15 January, 2021
273-day TB	Thursday, 16 July, 2020	Friday, 17 July, 2020	Friday, 16 April, 2021
364-day TB	Thursday, 16 July, 2020	Friday, 17 July, 2020	Friday, 16 July, 2021
IRS	Wednesday, 22 July, 2020	Thursday, 23 July, 2020	
91-day TB	Thursday, 23 July, 2020	Friday, 24 July, 2020	Friday, 23 October, 2020
182-day TB	Thursday, 23 July, 2020	Friday, 24 July, 2020	Friday, 22 January, 2021
182-day TB	Thursday, 30 July, 2020	Friday, 31 July, 2020	Friday, 29 January, 2021
364-day TB	Thursday, 30 July, 2020	Friday, 31 July, 2020	Friday, 30 July, 2021
Aug-20			
GC21 Switch Auction	Wednesday, 05 August, 2020	Thursday, 06 August, 2020	
273-day TB	Thursday, 06 August, 2020	Friday, 07 August, 2020	Friday, 07 May, 2021
IRS	Wednesday, 12 August, 2020	Thursday, 13 August, 2020	
182-day TB	Thursday, 13 August, 2020	Friday, 14 August, 2020	Friday, 12 February, 2021
273-day TB	Thursday, 13 August, 2020	Friday, 14 August, 2020	Friday, 14 May, 2021
IRS	Wednesday, 19 August, 2020	Thursday, 20 August, 2020	
91-day TB	Thursday, 20 August, 2020	Friday, 21 August, 2020	Friday, 20 November, 2020
364-day TB	Thursday, 20 August, 2020	Friday, 21 August, 2020	Friday, 20 August, 2021
ILBs	Tuesday, 25 August, 2020	Thursday, 27 August, 2020	
273-day TB	Thursday, 27 August, 2020	Friday, 28 August, 2020	Friday, 28 May, 2021
364-day TB	Thursday, 27 August, 2020	Friday, 28 August, 2020	Friday, 27 August, 2021
Sep-20			
IRS	Wednesday, 02 September, 2020	Thursday, 03 September, 2020	
91-day TB	Thursday, 03 September, 2020	Friday, 04 September, 2020	Friday, 04 December, 2020
273-day TB	Thursday, 03 September, 2020	Friday, 04 September, 2020	Friday, 04 June, 2021
GC21 Switch Auction	Wednesday, 09 September, 2020	Thursday, 10 September, 2020	
182-day TB	Thursday, 10 September, 2020	Friday, 11 September, 2020	Friday, 12 March, 2021
IRS	Wednesday, 16 September, 2020	Thursday, 17 September, 2020	
91-day TB	Thursday, 17 September, 2020	Friday, 18 September, 2020	Friday, 18 December, 2020
273-day TB	Thursday, 17 September, 2020	Friday, 18 September, 2020	Friday, 18 June, 2021
Book Closure (GC20, GC21, GI22, GC23, GC24, GC25, GC32, GI33 & GC40)	Monday, 14 September, 2020		
ILBs	Wednesday, 23 September, 2020	Thursday, 24 September, 2020	
364-day TB	Thursday, 24 September, 2020	Friday, 25 September, 2020	Friday, 24 September, 2021
Oct-20			
364-day TB	Thursday, 01 October, 2020	Friday, 02 October, 2020	Friday, 01 October, 2021
IRS	Tuesday, 06 October, 2020	Wednesday, 07 October, 2020	
91-day TB	Thursday, 08 October, 2020	Friday, 09 October, 2020	Friday, 8 January 2021
IRS	Wednesday, 14 October, 2020	Thursday, 15 October, 2020	
Coupon payments (GC20, GC21, GI22, GC24, GC25, GC32 & GC40)	Thursday, 15 October, 2020		
182-day TB	Thursday, 15 October, 2020	Friday, 16 October, 2020	Friday, 16 April 2021
273-day TB	Thursday, 15 October, 2020	Friday, 16 October, 2020	Friday, 16 July 2021
ILBs	Wednesday, 21 October, 2020	Thursday, 22 October, 2020	
91-day TB	Thursday, 22 October, 2020	Friday, 23 October, 2020	Friday, 22 January 2021
182-day TB	Thursday, 22 October, 2020	Friday, 23 October, 2020	Friday, 23 April 2021
273-day TB	Thursday, 29 October, 2020	Friday, 30 October, 2020	Friday, 30 April 2021
364-day TB	Thursday, 29 October, 2020	Friday, 30 October, 2020	Friday, 29 October 2021

Source: BoN



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