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This Issue…

GLOBAL ECONOMIES OUTLOOK

Russian invasion in Ukraine has triggered economic crisis contributing to a significant slowdown in global growth in 2022. A severe double-digit drop in Ukraine GDP and a large contraction in Russia due to imposed sanctions are more likely, along with worldwide spill overs through commodity markets, trade, as well as financial channels (April WEO, 2022). This crisis unfolds while the global economy was on a mending path but had not yet fully recovered from the COVID-19 pandemic. The war in Ukraine has exacerbated two difficult policy trade-offs; between tackling inflation and safeguarding the recovery; and between supporting the vulnerable and rebuilding fiscal buffers. Central banks found themselves, between managing price pressures and ensuring growth that will be complicated by rising inflation. They expected to tighten policy, interest rates are projected to rise, putting pressure on emerging market and developing economies.

Table 1: Overview of IMF Economic Outlook Real GDP Projections-annual % changes

	WEO APRIL 2022			**Difference from January Projections**	
	2021e	**2022**	**2023**	**2022**	**2023**
World Output	6,1	3,6	3,6	-0,8	-0,2
Advanced Economies	5,2	3,3	2,4	-0,6	-0,2
United States	5,7	3,7	2,3	-0,3	-0,3
Euro Area	5,3	2,8	2,3	-1,1	-0,2
Japan	1,6	2,4	2,3	-0,9	0,5
United Kingdom	7,4	3,7	1,2	-1,0	-1,1
Emerging Market and Developing Economies	6,8	3,8	4,4	-1,0	-0,3
China	8,1	4,4	5,1	0,4	-0,1
India	8,9	8,2	6,9	-0,8	-0,2
ASEAN-5 5/	3,4	5,3	5,9	-0,3	-0,1
Sub-Saharan Africa	4,5	3,8	4,0	0,1	0,0
Nigeria	3,6	3,4	3,1	0,7	0,4
South Africa	4,9	1,9	1,4	0,0	0,0

Source: IMF, WEO Jan 2022 **a=actuals, e=estimates, p=projections**

With these new developments the global growth has been revised downward in April 2022. the International Monetary Fund revised down the 2022 and 2023 growth projections in April 2022, from the January 2022 releases, on account of sharp increase in risks. It is now projecting a 3.6 percent GDP rate for the global economy this year and for 2023 (Table 1). This represents a 0.8 and 0.2 percentage point drop, respectively, from its forecasts published in January. Crucially, this forecast assumes that the conflict remains confined to Ukraine, further sanctions on Russia exempt the energy sector and a sharper than anticipated deceleration in China as a strict zero-COVID strategy is tested by Omicron, and a renewed flare-up of the pandemic should a new, more virulent virus strain emerge.

IMPACT OF SANCTIONS ON RUSSIA ON THE GLOBAL ECONOMIES

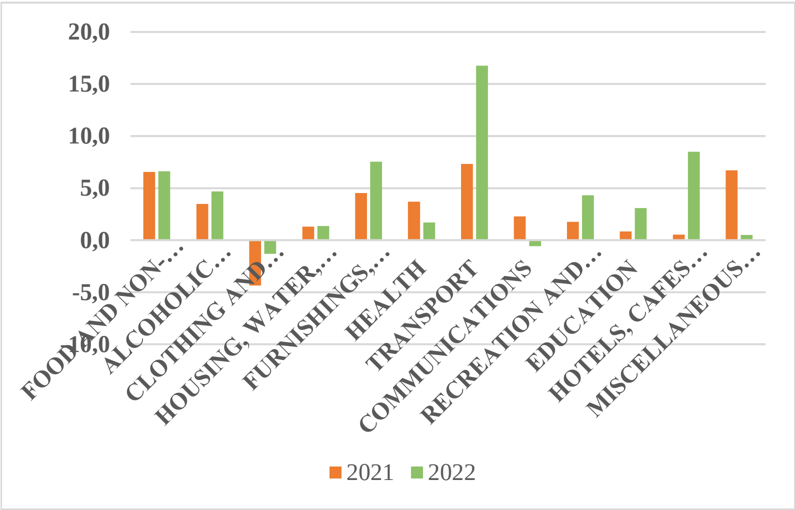
War-related interruptions to production, sanctions, and strongly impaired access to cross-border payment systems will disrupt trade flows, notably for energy and food. The extent of these changes depends not only on the decline in exports because of the conflict and sanctions, but also on the elasticity of global supply and demand. Though the price of oil has risen sharply, spare capacity in other countries and the release of petroleum reserves will likely mean that these increases will be contained over the medium term. Additionally, the prices of agricultural commodities are likely to rise further particularly wheat (given that together, Russia and Ukraine account for close to 30 percent of global wheat exports) and, to a lesser extent, corn. These changes will add to already soaring prices of staple foods (Figure1) and mean that disruptions to Russian exports may be windfalls for other commodity exporters.

DOMESTIC ECONOMICS DEVELOPMENTS

CONSUMER PRICES MAY 2022

The annual inflation for May 2022 stood at 5.4 percent compared to 3.8 percent recorded in same period of 2021, an increase of 1.6 percent on yearly basis. On a monthly basis a 0.1 percent inflation was recorded in the current month lower than the 1.4 percent recorded in the month of April. The increase in inflation for May was on the back of growth in the price level of *food* and *non-alcoholic beverages and alcoholic beverages*, and *tobacco, albeit the increase was at a slower pace than the previous month*. The marginal decline in the inflation for May was attributed to the slower increase in the prices *of transport hotel, café and restaurant clothing and footwear, housing, water, electricity, gas and other fuels, furnishings, household equipment* as well as *routine maintenance of the house,* as well as *transport.* But the price of *health, communication and education* remained constant.

Figure 1: May inflation Categories



Source: NSA,2022

The annual inflation for food *and non-alcohol beverages* category stood at 6.6 percent, indicating same growth as what was recorded in the preceding year. However, on the monthly basis recorded an increment of 1.5 percent compared to 1.4 percent recorded in April 2022. the inflation in this category emanated from the increase in the price of subgroup categories, except meat, *sugar, jam, honey, syrups, chocolate* and *confectionery, Coffee, tea,* and *cocoa* that recorded a decrease in their prices. In comparison to other category, this category was the main contributor to the monthly inflation of May after transport sector.

An annual inflation of 4.7 percent was recorded in *alcoholic beverages* and *tobacco* as compared to an inflation of 3.5 percent recorded in the same period last year. The increase in this category was mainly due to an increase in the subgroup categories of *alcoholic beverages* and *tobacco* that recorded an increase of 4.3 and 6.3 percent respectively.

The *Transport* category recorded an annual inflation of 16.7 percent in 2022 higher than 7. 3 percent recorded in 2021. The increase was driven by the increase in the sub-categories of transport namely *operation of personal transport equipment* and *public transportation services*. On monthly basis, *transport* recorded a contraction of 1.2 percent as compared to an increase of 5.7 percent recorded in the previous month. This was mostly reflected by a contraction in *operation of personal transport equipment* by 2.5 percent. However, this category contributed the most to the monthly inflation of categories of the baskets. In addition, the contraction may also be supported by the reduction in some fuel levies.

Housing, water, electricity, gas, and *other fuels* annual inflation grew by 1.3 percent the same rate as in 2021. However, contracted by 0.3 percent on monthly basis due to a contraction recorded in *electricity gas and other fuels* by 1.7 percent.

Inflation expectations

The impact of the war in Ukraine and broadening of price pressures; inflation is expected to remain elevated for longer than in the previous forecast. The conflict is likely to have a prolonged impact on commodity prices, affecting oil and gas prices and food more severely in 2022 and going forward. The Prices of agricultural commodities such as wheat, corns and sunflower will continue to rise due to production disruptions in Russian and Ukraine. This may impose pressure on local manufacturers and the biggest of these potential impacts might have inherent risks to economic recovery and inflation. Adding financial burdens on pressured household budgets and corporates in Namibia. Food price inflation on basic food staples will worsen food insecurity.

FITCH FURTHER DOWNGRADES NAMIBIA

History and Background

Since Fitch started assessing the Namibian government in 2005, the government was first accorded the BBB-, a low medium investment grade, a position government maintained until the 19th of November 2017. On the 20th of November 2017, government lost the investment grade position and was moved to non-investment grade position of BB+ which was maintained until 31 September 2019. The credit quality for the government as evaluated by Fitch deteriorated further on the 01 October 2019 following a down grade to the BB scale which government held until the 23 June 2022. Fitch Ratings Agency has once again downgraded the domestic biggest debt issuer from BB to BB- on the 24th of June 2022 and changed the outlook from negative to stable.

What does the downgrade mean for Namibia?

The downgrade means that government credit quality has deteriorated, and it’s deemed a risky investment. The higher risk will be accompanied by higher cost of borrowing than before. Moreover, it means that the government will have to compensate lenders for consuming extra risk on their investments. The higher cost of capital will stem from increased interest payments resulted from higher leverage and increased borrowing requirements resulting from increased government budget deficit. The increased credit risk might trigger risk averse investors to reconsider investments in government issued securities, causing a reduction in demand for government instruments as increasing risk exceed their risk appetite thresh ford.

The poor credit quality will also result in the flight of capital moving to better quality investment environments in search for better risk-return investments. The downgrade of the government debt/instruments is expected to have an impact on other domestic issued securities since the government bonds are regarded as risk free instruments and benchmarks against other securities. On a good note, the higher yield building from credit downgrade will likely compensate investors on the downside risk building from inflation due to increased risk premium.

SUMMARY OF ANALYSIS OF BUILDING STATISTICS AND HOSPITALITY OCCUPANCY AND BOP

Building Statistics

During the month of April, a total of 188 and 95 building plans were approved in Windhoek and Swakopmund respectively. Compared to 247 and 34 in the prior month; and 268 and 38 in April 2021 respectively. The approved plans in Windhoek have a combined value of N$107.6 million whereas in Swakopmund has a value of N$119,996,557. On an annual basis, 478 building projects have been completed, compared to 550 in 2021 and 361 in 2020 for the same period in Windhoek. On the other hand, 133 building projects have been completed in Swakopmund, compared to 121 in 2021 and 131 in 2020 on an annual basis. The construction activity seems to be declining in Windhoek, whereas construction activity in Swakopmund might increase based on the year to date (YTD) trend of plan approvals. There appears to be an increase in corporate mortgages and that analogy seems to support that an uptick might be seen in additions or new commercial properties. The decline in annual households' mortgage uptake might suggest that households are using savings to pay for home additions. The rise in building costs and interest rates might also lead to a delay in building projects or postponements for the plans that have been approved in recent months.

Hospitality Occupancy

In April 2022, Namibia recorded the highest number of tourist arrivals since the detection of COVID-19, but the number slightly declined in May 2022 on the monthly basis but remains higher on the annual basis. The national occupancy rate has increased in the first two months of the second quarter, an increment of 39.4 percent and 36.5 percent was witnessed in May 2022 and April 2022 respectively. The occupancy rate continued the uptrend according to Hospitality Association of Namibia (HAN). The increased number of flights demanded to Namibia has increased business confidence inducing some Airlines such as Belgium Air, Quarter Airways and KLM to return flights to Namibia following the previous suspension of flights to Namibia at the onset of the COVID-19 pandemic outbreak in 2020.

The Hospitality sector is likely to be stable and record steady growth due to the anticipated growth in the international arrivals. However, the international arrivals is expected to post the downside risk for the reminder of the year owing to the recent decision by America Centre for Disease Control to place Namibia on a high COVID-19 risk list on 05th of June 2022 and the detection of Monkey pox reported on the 23 of June 2022 in neighbouring South Africa. The increasing COVID-19 cases are not anticipated to prompt government to implement strict travel restrictions as the government is expected to strike a balance between protecting lives and livelihoods. However, the detection of monkey pox is expected to cause some uncertainty in demand for hospitality services.

BOP

Namibia's current account recorded a deficit of N$16.5 billion during 2021, coming from a surplus of N$4.9 billion recorded in 2020. The current account turned into a deficit during 2021, primarily due to a deterioration of the merchandise trade deficit as well as a decrease in secondary income inflows and an increase in primary income outflow. This CA deficit emanated from a worsening merchandise trade deficit that reflected a significant rise in import payments, while export receipts grew at a slower pace. In addition, the decline in the secondary income account, mainly ascribed to lower SACU receipts during 2021.On quarterly basis the last quarter of 2021 recorded an improved deficit of N$ 3.0 billion as compared to N$ 6.9 billion deficits recorded in Q3-2021 but worse as compared to a surplus of N$ 96 million recorded in the fourth quarter of 2020.

In the fourth quarter of 2021, Namibia's trade balance deficit worsens to N$5.0 bn from a deficit of N$ 4.6 bn in the corresponding quarter of the preceding year. The diminishing in the **trade balance** follows **exports** that improved by 11.0 percent, slower than the increase in **import** of 16 percent. The reduction in **exports** was buoyed in the export volumes of *Manufactured products, processed fish* as well as a reduction in *re-exports* on a quarterly basis. The value of **imports** increased by 16 percent to the tune of N$22.8 bn, mainly attributed by the demand for the imports of *consumer goods, mineral fuel, base metal, and machinery*. The **capital account** balance decreased in the last quarter of 2021 from N$ 378 million to N$ 328 million during the same period in 2020. The out-flows on the **capital account** decreased because of a lower capital transfer.

The **Financial account** recorded a net inflow of N$13.7 bn in 2021 compared to a net outflow of N$4.6 bn in 2020. The net inflow emerged from increased inflow of *net direct investments*, other *investments, and financial derivatives*. The increase of N$ 5.8 bn of inflow in *direct investment* is associated with the upward in *net incurrence of liabilities* and the decline in *acquisition of financial assets*. An inflow of N$ 11.5 bn was recorded by *other investments,* with decrease in net *acquisition of financial assets* and a N$ 10.7 bn increase in outflow of *net occurrence of liabilities*. *Financial derivatives* recorded an inflow of N$344 million as both net *acquisition of assets & incurrence* of liabilities recorded an inflow of N$ 531 million and N$ 187 million.

SPECIAL FEATURE: IS FUEL SUBSIDIES A BURDEN ON CONSUMER?

Introduction

Access to affordable energy for all is a precursor for economic development, and countries across the globe have taken various measures to lighten the burden for their citizens; often done through subsidies for fuel. The world spent a staggering US$5.9 trillion in fossil fuel subsidies in 2020 (IMF, 2021) which was equivalent to 6.8 percent of global GDP, with the figure expected to rise to 7.4 percent by 2025. A study done by the IMF (IMF working paper, 2010) found that the total impact of a $0.25 per litre increase in fuel prices generally results in a 5.9 percent decline in household real incomes but with varying impacts across different geographical regions.

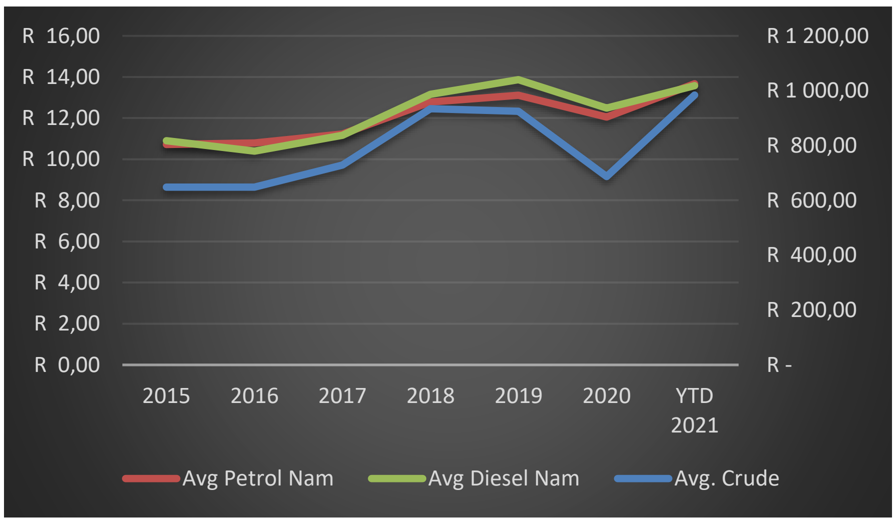
The impact of rising fuel prices on households' transitions through two channels, directly, through higher fuel prices and indirectly through higher prices for other goods. In Africa, the indirect effects of rising fuel prices are more than 60 percent of the total impact that rising fuel prices have on consumers (IMF, 2021). This is reflective of the consumption patterns in the region, where a large portion of an average household's income is spent on food. Fuel is an important input in the manufacturing process and its cost is factored into the prices of most goods, including food which has a high inflation pass-through characteristic.

Under this assumption, many countries have made it a priority to regulate fuel prices in an attempt to increase the welfare of vulnerable households by protecting them from the burden that rising fuel prices imposes on them. However, subsidising fuel prices is a practice that has come under fire in the last few years, criticized by the likes of the IMF and International Energy Agency (IEA), with the argument that subsidies crowds-out high priority public spending on infrastructure, health, and education on top of steep fiscal costs to maintain.

In 2021, volatile geopolitical environment, rising demand, and supply constraints saw the price of fuel skyrocketing, with both Western Texas Index and Brent breaking through the US$80/barrel mark. The latter recorded its highest level of US$83.65/barrel (R 1 217, 94) in October 2021 since five-years ago, last reaching the $80 a barrel was in September 2018. Despite the surge in international fuel spot prices, the Basic Fuel Prices (BFP) is determined from the basis of global oil prices, retail pump prices in Namibia remained relatively stable although gradually gaining momentum due to lagged effect. For instance, on annual basis between September in 2021 and 2020, the pump price of petrol 95 octanes per litre (inland) recorded an increase of 21 percent, while diesel rose by 16 percent, while Brent crude oil recorded gains of more than 35 percent over the same period. The reduced volatility of domestic fuel prices relative to the Brent index is the result of the fuel subsidy employed by the government of the Republic of Namibia (GRN). The GRN achieves this through regulated pricing of petroleum products through the National Energy Fund (NEF). The NEF is the to provide a buffer for consumers against fuel price shocks caused by market volatility and exchange rate fluctuations in the short run. The NEF influences the price that suppliers (Wholesalers & retailers) charge consumers for fuel through an account it administers known as the "Slate Account," this account is between the state and suppliers of petroleum products. Payments are then made to suppliers for any under-recoveries. To this end, the period between 2015 and 2021 has seen the fund making a total payment for under-recoveries to the tune of N$2.6 billion. The NEF is funded through funds collected from its petroleum equalization levy on controlled petroleum products. In Namibia, the subsidies are paid to keep fuel prices stabilized however, the data indicates that the NEF is self-sustaining as it had not received any fiscal injections for the last 6 to 10 years from the government but from fuel equalization levy.

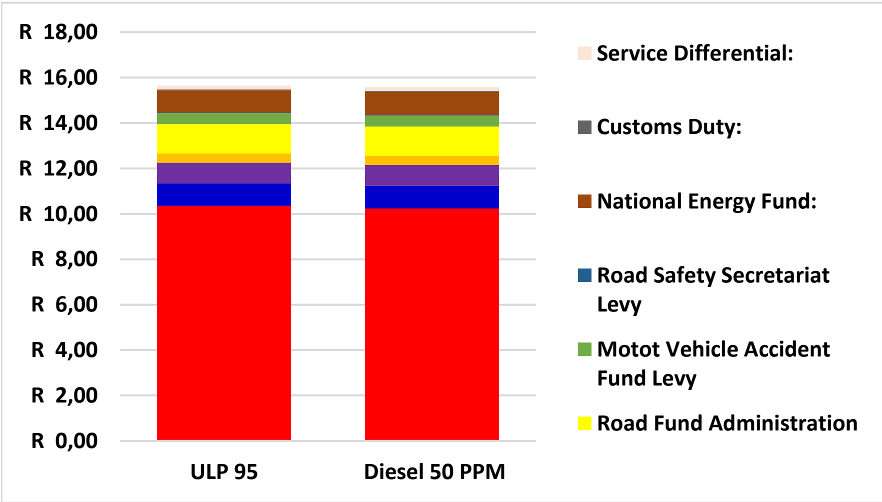
This is despite the persistent under recoveries incurred by the NEF, this implies that there have been no apparent fiscal costs to government, holding opportunity costs constant. The true cost is borne by consumers through taxes and distribution charges. The fuel prices in Namibia includes charges (taxes and levies) such as the fuel levy; road fund administration levy; motor vehicle accident fund levy; fuel equalization levy; road safety secretariat levy and the National energy fund. These statutory costs add up to N$3.18 (60% of the N$5.3 added to landed cost/basic fuel prices), while the dealers margin, industry margin, customs duty, and service differential add a combined N$2.12 (40%) price that is then used to determine the retail pump price. It should be noted that these levies are calculated in a proportionate manner.

Figure 1: Domestic Fuel Prices Vs Brent Crude Index, 2015 - 2021YTD



Source: Ministry of Mines and Energy, 2021

Figure 2: Walvis-Bay Retail Pump Price components, December 2021

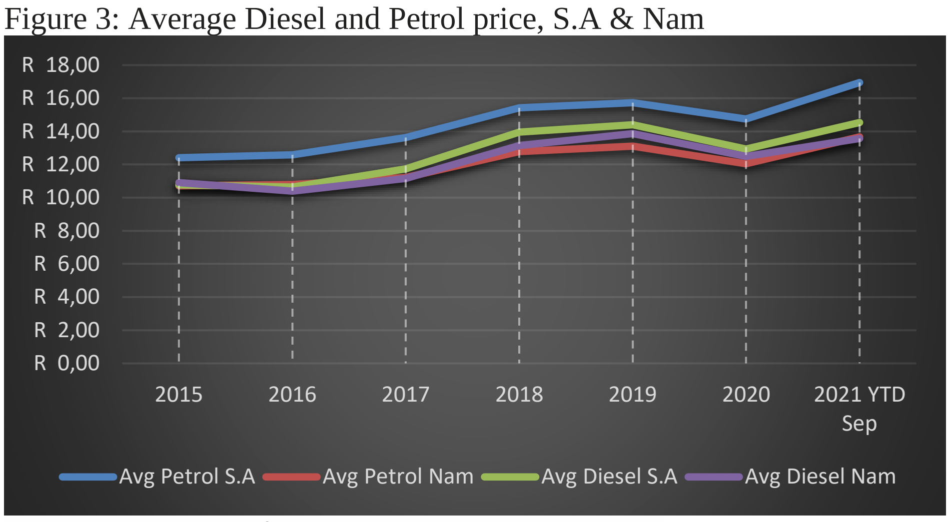


Source: Ministry of Mines and Energy

2. COMPARISON WITH SOUTH AFRICA

Fuel prices in Namibia have remained relatively lower than the prices of fuel in South Africa between 2016 and 2020, where the regime does not subsidise fuel prices. The fluctuations observed in the retail pump price of ULP95, and diesel 50 ppm indicates that the price paid per litre of petrol and diesel increased approximately by 18% (N$1.19) and 20% (N$1.20) between 2016 and 2021 in South Africa. While in Namibia, the pump price of ULP95 and diesel 50 ppm rose by N$1.12 (12%) and N$1.15 (15%) per litre each over the same period. This indicates that an increase in the prices of petrol and diesel could have been higher if Namibia did not have an equalization levy that funds the subsidy. Although the components that are included in the retail pump prices of fuel (taxes and costs) are considerably higher in South Africa than in Namibia, none of those components are used for consumer compensation. For instance, ta to the total cost consumers pay for petrol in South Africa and Namibia resp

Figure 3: Average Diesel and Petrol price, S.A & Nam



Source: MME, South African National Energy database 2021

The South African government collects about R5.98 from *fuel tax; petroleum products levy; road accidents fund levy; DSML*[1] *and customs levy* for every litre sold and none of these are used to equalise fuel prices in South Africa. Whereas in Namibia, ***the revenue gains from fuel taxes are foregone in favour of fuel equalization***, as the funds collected from the NEF levy are used to subsidise fuel product.

Conclusion

The study revealed that fuel prices in Namibia have been relatively lower than in South Africa, where fuel prices are not subsidised. An indicative that the NEF has this far been successful in creating a buffer against volatile fuel prices for consumers in Namibia.

However, in the same vein, the mechanisms in place work to protect consumers from sudden fuel price increases, the price lag disadvantages consumers when international fuel prices trade lower. This was evident in 2020 when crude oil declined by 23% while ULP95 and diesel retreated by 10.4% and 11.7% respectively with petrol price per litre and diesel price per litre averaging to N$ 12.04 and N$ 12.49 respectively in the year under review. This may be explained by added costs to the price of fuel as well as the lagged effect.

As alluded to earlier, taxes and supplier margins make up about 33% of the retail price of petrol and diesel. However, excluding the dealer and industry margins for petrol, the remaining statutory costs accounts for 22% of the pump price, while the fuel and NEF levy cumulatively make up 8% of this. With that said, and assuming no change in any other variable, the elimination of the NEF levy could lead to a reduction in final prices of petrol and diesel of 6.3% and 6.5% (December 2021 prices) respectively, benefiting consumers.

In the short-to-medium term, there are significant risks to the trajectory of international fuel prices due to supply shortages caused by the corona virus, labour shortages, limited supply capacity, and heightening geopolitical tensions. This may pose a threat to the sustainability of the NEF should the aforementioned factors keep the price of fuel elevated for a longer period. Our study is however limited by a lack of data to sufficiently determine whether the NEF is sufficiently capitalized to weather the storm of rising fuel prices in the short-to-medium term or would it require a lifeline from government.

Nonetheless, withdrawing the subsidy during times of elevated fuel prices without any mitigating measures such as improving the public transport system and increasing the minimum wage may cause further public outrage (disruptions). This has a high risk of manifesting into demonstrations by consumers ***(general public)*** who are already battling rising living costs. This is because fuel rises are eventually fed into the cost of production and distribution of goods.

This publication was produced by:

Ministry of Finance
Economic Policy Advisory Services

Head Office, Moltke Street
P/Bag 13259, Windhoek
Tel: (061) 209 2131