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MINISTRY OF FINANCE - EPAS
Quarterly Economic Update

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The aim of these Updates is to inform the public of any recent economic developments, focusing on global, regional and domestic developments that are likely to impact on the Namibian economy. Every Update will contain a standard update on the global, regional and domestic economy.

Special features will also be included on specific analysis conducted in the Ministry.

IN THIS ISSUE: We analyse The Southern African Customs Union and its link in revenue and trade with Namibia

Global Developments

Global output growth is forecast at 3.1% for 2016 and 3.4% for 2017, this however indicates a 10 basis points downward revision from the April forecast for both years. The downward revision was partly prompted by uncertainty emanating from the "Brexit"[1]. Unresolved issues in the European banking system; turbulence in the financial markets; continued lower commodity prices; the credit driven growth in China and other noneconomic risk (geopolitical tensions, drought in SSA and political division in the EU on immigration issues) are some of the factors negatively affecting global output growth.

Growth in advanced economies is expected at 1.8% for 2016 and 2017, which represents a 0.1 percentage point upward revision for 2016 and marginally lower than 1.9% recorded in 2015. For 2017, the 1.8% growth rate is marginally lower than 2.0% previously forecast in April 2016. The slower grow is based on the uncertainty of the Brexit, the duration and implications of which are unknown.

The US is projected to grow by 2.2% in 2016 – growth was revised down by 0.2 percentage point – **and 2.5% in 2017**. The decline in the forecast resulted from slower than expected growth in Q1, but this is expected to recover in the Q2 and towards the end of year. The expected growth will be driven by less US Dollar appreciation, weaker investment in the energy sector coupled with a long-term monetary normalisation – interest rates – in the US.

The Euro area economy is expected to grow by 1.6% for 2016 and record a further slowdown for 2017 to 1.4%. 2016 was revised up by 0.1 percentage points on the back of stronger activities in Q1; however, growth for 2017 was revised down by 0.2 percentage point as growth is clouded by the uncertainty of the Brexit (for both consumer and producer confidence), unresolved banking system issues and political division regarding immigration.

GDP growth for Japan is forecast at 0.3% in 2016 and 0.1% in 2017, with both years' forecast reduced by 0.2 percentage point as the expected inflation fell, with domestic demand remaining relatively weak. The postponed consumption tax hike also had dampening effect on the 2017 forecast.

Growth for emerging markets and developing economies remained unchanged at 4.1% in 2016 and 4.5% for 2017. The growth prospects for these group of economies are driven by stabilizing Chinese growth and improvements in other large economies, i.e. marginal growth in oil prices, improvements in business confidence, while other economies have adapted their strategy to the current global situation.

China is forecast to grow by 6.6% in 2016 and 6.2% in 2017; growth was revised up marginally by 0.1 percentage points as the economy has stabilised on the back of policy support – lower lending rates, fiscal expansion and accelerated credit growth coupled with increased infrastructure spending. Implications of Brexit are muted for now, but if the EU is negatively affected than China could be affected significantly going forward. **The forecast for India was reduced by 0.1 percentage point for both 2016 and 2017 to 7.4%**, on the back of anticipated weaker investment recovery.

Brazil is forecast to remain in recession, but at an improved rate of -3.3% in 2016, and rebound in 2017 at 0.5%. The contraction in 2016 is a 0.5 percentage point improvement from the April forecast. The improvement is prompted by stronger recovery in business and consumer confidence despite the political uncertainty, which is weighing on growth going forward. On the other hand **the Russian economy** is being affected by the mild recovery in oil prices, with **GDP expected to contract by 1.2% in 2016 and bottom out, before returning to growth in 2017 at 1.0%.** GDP was revised upwards by 0.6 and 0.2 percentage point for 2016 and 2017, respectively. The impact of economic sanctions on productivity and structural bottlenecks are expected to rein in growth going forward.

Sub-Saharan Africa

GDP growth for the region was slashed significantly to 1.6% in 2016 (down from 4.0%) and 3.3% in 2017 (down from 4.0%). This growth has reached its lowest level in over two decades. The cut in this forecast is a reflection of how the two major regional economies are struggling to maintain strong growth as structural bottlenecks and low commodity prices prevail, and currency depreciation remains at the forefront of challenges.

GDP for Nigeria is expected to contract by 1.8% - lowered by 4.1% relative to April – **in 2016 before rebounding to 1.1% in 2017**. The economy is facing macroeconomic challenges emanating from lower revenue – due to continued low oil prices – declining foreign reserves and weak investor confidence, coupled with power generation constraints.

The South African economy is forecast to barely grow at 0.1% in 2016 and to expand by 1.0% in 2017, revised down by 0.5 and 0.2 percentage points respectively. The economy is facing macroeconomic instability and weak investor confidence – with its sovereign credit rating on the edge – and depreciating currency. Going forward, GDP is expected to bottom out but remain clouded with the uncertainty of Brexit's implications.

The Namibian Economy

The first quarter GDP registered growth of 3.5%, a y-o-y deceleration compared to the 7.3% recorded in Q115. However, this represents a q-o-q acceleration from a growth rate of 0.6% - revised down from 1.8% -in Q415.

The low growth was mainly due to subdued global output which had detrimental effects on the Namibian economy. The slower growth was influenced by contractions in the *agriculture* and *fishing*, as well as the *health* sector. *Agriculture and forestry* experienced a contraction further down, from -2.1% previously recorded to -12.2%, as a result of subdued performance in the *livestock farming*, as weak rainfall was recorded due to the prevailing drought in the Southern African region. *Fishing and fish processing on board* also recorded a contraction from 8.0% in Q115growth down to 3.5% - however an improvement when compared to the 15.0% contraction recorded in the Q415. This huge decline was recorded as *fish landings* declined due to lower TACs, and due to the effects on the fishing industry strikes that took place towards the end of 2015 come forth. The *health* sector recorded a larger contraction of 4.7%, down from lower contraction of 2.9% - in Q415 and contraction of 1.9% in Q115- as all subsectors recorded slower or no growth.

Other sectors recorded positive but slower growth, also contributing to weak performance of the economy. The *construction* sector recorded the biggest fall from a high rate of 34.5% the previous year, down to a mere 0.2% growth, resulting from high base effects and slower activities in both planned government expenditure and private sector expenditure. This represents the weakest growth for this sector since 2012, when single-digit growth was last recorded. *Water and electricity* recorded relatively slower growth of 9.4%, a significant decline compared to 15.4% recorded the same period in 2015, whereas this growth indicates an expansion when compared to 0.6% growth in Q4 of 2015. On the other hand, *wholesale and retail* recorded growth of 4.9%, marginally lower than 5.5% y-o-y and 5.7% q-o-q, due to slower economic activities in the sector.

Growth in *transport and communication* slowed rather significantly from a high of 7.8% in Q115 y-o-y down to 2.8%, but q-o-q it accelerated marginally from the 1.8% recorded in the last quarter. *Financial intermediation* recorded declining growth from a high of 7.5% the previous year, down to 3.9% as economic activities slowed in the banking subsector. *Education* grew by a 5.0%, a deceleration when compared to the

10.6% recorded the previous year; however, this indicates an improvement when compared to the 0.3% growth from the previous quarter. *Mining and quarrying* also recorded slower growth of 2.5% in Q116, compared to 3.3% in Q115, but an improvement compared to a contraction of 8.0% in Q415.

Overall growth was mainly supported by *manufacturing* and *hotels and restaurants* as robust activities prevailed in the said sectors. The *manufacturing* sector grew both q-o-q and y-o-y by 4.8%, up from a contraction of 1.0% and 15.1% respectively, as most of the subsectors expanded significantly. At the same time, *hotels and restaurants* expanded sturdily by 9.5% y-o-y, although this represents a q-o-q slowdown from 11.3% in Q415. Growth was strongly supported by expansion in the tourism subsector during the reporting period.

Balance of Payments

Namibia's current account registered a wider deficit y-o-y (over three times larger than Q115), totalling to N$4.5bn on the back of weaker *merchandise trade balance*, net foreign payments and reduced inflows of current transfers. However, the q-o-q performance was marginally better, as the deficit has narrowed marginally from N$5.3bn (a 16% decline).

Merchandise trade balance worsened y-o-y during the first quarter of 2016 to N$6.1bn from a marginally lower deficit of N$5.7bn as the value of *imports* grew faster than *exports* – although *exports* grew by 26% and *imports* grew by 20% y-o-y, the total value of imports of N$20.6bn outweighed total exports valued at only N$14.5bn – therefore dragging the deficit further down. *Services* and *investment income* recorded outflows of N$950mn and N$2.2bn respectively, with both of these deficits increasing considerably compared to Q115, when *services* recorded an outflow of N$270mn and *investment income* recorded an outflow of N$512mn. Although *current transfers* recorded an inflow of N$4.8bn, it was relatively (2%) lower than the N$4.9bn registered in Q115 and was not substantial enough to offset other outflows in the current account.

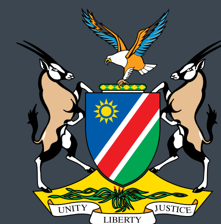
The capital and financial account recorded a surplus of N$2.8bn during the reporting period – an 8% increase from Q115, however this was 86% lower than the N$20bn in Q415. The y-o-y growth was prompted by strong inflow growth in *direct investment* and *other investment - long term*, while net capital transfers also recorded a significant net inflow. The outflows recorded in *other investment – short term* and *portfolio investment* had a relatively small offsetting effect on the overall performance.

Direct investment in Namibia registered a net inflow of N$2.7bn, growth of over 180% in Q116 from N$980mn Q115, on the back strong inflows of N$1.7bn in other capital – emanating from growth in liabilities to direct investors. *Reinvested earnings* also had a positive impact on the inflow in *direct investment* as it registered an inflow of N$980mn, up by 30% over the inflow recorded in Q115.

Other investments – long term recorded strong growth of 78% with an inflow of N$2.5bn, up from N$1.4bn in Q115, though this was slower than the N$5.5bn recorded in Q415. This y-o-y growth was prompted by a net inflow of N$2.7bn in other sectors (liabilities in particular) up from N$916mn inflow in.

Direct investment abroad, *portfolio investment* and *other investments – short term* all recorded net outflows with *direct investment abroad* recording the lowest outflow of N$3mn – as *equity capital recorded* an outflow N$82mn, reversing the effects of the inflow from *other capital* (N$69mn) and reinvested earnings (N$10mn). *Portfolio investment* recorded a net outflow of N$2.2bn as *equity and debts* registered net outflows of N$1bn and N$1.1bn, respectively. These represent a decline, if compared to the inflows recorded in Q115 and Q415 where *equity* recorded respective inflows of N$1.4bn and N$350mn, while *debt* registered respective inflows of N$290mn and N$10.7bn (the latter being proceeds from the 2015 government Eurobond). *Other investment – short term*, on the other hand, registered a smaller outflow of N$660mn in Q116, an improvement from an outflow of N$1.8bn in Q115, despite all subsectors recording outflows.

The overall balance of payments registered a total outflow of N$1.3bn as the deficit of the *current account* outweighed the surplus of the *capital and financial account* for Q116.



MINISTRY OF FINANCE ECONOMIC POLICY ADVISORY SERVICES (EPAS)

Quarterly Economic Update

Consumer Prices

Consumer price inflation for June stood at the same rate as May at 6.7% y-o-y, leaving average annual inflation for the first half of 2016 at 6.3%, which is twice as much as the average for the same period last year of 3.4%. This was mainly due to acceleration in price growth in most categories.

The 6.7% growth in prices – which is currently the highest for this year –is reflected by strong growth in *transport* prices, which registered an increase of 3% y-o-y, up from a mere 1.5% in May. This can be traced through increases in prices of *vehicles purchased* (up from 7.4% to 8.1%), while prices for *operation of personal transport equipment* also increased relatively from -0.2% to 2.0%. Prices in *Furnishings, household equipment and routine maintenance of the house* also registered a significant increase of 6.3%, up from 5.5% in May, as most of the major subcategories recorded price increases.

Food and non-alcoholic beverages; *alcoholic beverages and tobacco*; *health* and *hotels, cafes and restaurants* recorded subdued price growth, thereby maintaining overall price growth. *Food and non-alcoholic beverages* recorded inflation of 11.3%, a decline with reference to the 12.1% recorded in May, as prices growth slowed marginally in *Bread and cereals* (from 16.1% in May to 15.3%); *Fruit* (from 20.6% in May to 15.2%); *Vegetables including potatoes and other tubers* (from 20.0% in May to 18.3%) and *Non-alcoholic beverages* (from 7.5% in May to 5.7%). *Alcoholic beverages and tobacco* recorded slower price growth of 7.1%, down from 7.3% in May, and relatively the lowest price rise since December 2015; this is affected by relative lower inflation in both *alcoholic beverages* (from 8.0% in May to 7.8%) and *tobacco* (from 4.8% in May to 4.3%).

Health recorded a price growth increase of 6.6%, significantly lower than the previous 7.4% in May as prices in *Medical products, appliances, and equipment* decelerated to register growth of 4.9%, down from 6.7% in May, while inflation in *Outpatient Services, medical, dental and paramedical* remained the same as May at 9.1%. *Hotels, cafes, and restaurants* recorded price increases of 7.6%, from 9.1% in May as prices in *catering* and *accommodation services* slowed significantly from 6.9% in May to 5.1% and from 11.5% in May to 10.5%, respectively.

There was no change in the price growth for *Education* and *Housing, Water, Electricity, Gas and Other Fuels,* which helped stabilise overall inflation at 6.7%.

Commodity Prices

The IMF all commodity price index recorded a y-o-y 14.3% decline as major commodity prices fell, in particular metal prices and crude oil. Month-on-month, however, the all commodity price index recorded a mild recovery of 3.1%, resulting from increases in crude oil prices and food prices.

The IMF metal price index fell by 0.3% m-o-m and 14.7% y-o-y, as the downward trend continued in the third consecutive year. The biggest contributors to falling prices were oversupply and increased inventories at port facilities. Chinese regulators have halted importation of iron and weak manufacturing has caused weak demand for most metals, thereby aggravating the oversupply issue.

The prices of metals produced in Namibia all recorded a fall, with the biggest fall recorded in uranium, which fell by 24.9% y-o-y and by 2.3% m-o-m, reaching an 11-year low at U$27.15 per pound in June. Copper prices fell by 20.4% y-o-y and 1.1% m-o-m as total global output grew considerably, while demand declined relatively, especially from China. Diamond price index (IDEX) fell by 1.4% y-o-y and 0.7% m-o-m, on the back of market mismatch resulting from high supply while demand keeps declining. Diamond miners are lowering prices to push sales up.

The crude oil price index recorded a decline of 22.4% y-o-y, albeit with m-o-m recovery of 3.7%, as global output declined marginally with delayed production in the US. Brent Crude oil prices fell by 22.2% y-o-y in line with the crude oil price index. Brent Crude oil prices are expected to remain at low levels during 2016 as output is anticipated to increase on the back of production from Iran and Libya. The possibility of the US lifting the ban on crude oil exports; and lower demand from emerging economies are factors that would negatively affect the price of Brent crude oil in the short to medium term.

SPECIAL FEATURE:

The Southern African Customs Union

Background

The membership of the Southern African Customs Union (SACU) is made up of Botswana, Lesotho, Namibia, South Africa and Swaziland. Following the implementation of the 2002 SACU Agreement which came into force in 2004, several initiatives focused more on the SACU Mission and Vision as well as the new work programme, with emphasis on:

- Regional industrialization,
- Establishment of institutions,
- Review of the revenue sharing arrangements,
- Trade facilitation,
- Unified engagements in trade negotiations,
- Trade in services, and
- Strengthening the capacity of the Secretariat.

The evolution of SACU

The Southern African Customs Union dates back to the 29th June 1910, when the Government of the Union of South Africa and the territories of Basutoland, Swaziland, and the Bechuanaland signed an agreement at Potchefstroom, with only Britain and South Africa having been involved in the 1910 negotiations. This Agreement was based on the duty attributable to goods consumed in each Member State from 1907 to 1910. This Agreement lasted until the British Protectorates received Independence in the mid-1960s. It was then renegotiated with the South African apartheid government, culminating in the 1969 Agreement.

The 1969 Agreement was based on each BLS (Botswana, Lesotho, and Swaziland) member's share of total SACU imports multiplied by 42%, with South Africa receiving the residual. This Agreement also ensured that South Africa maintained the sole decision making and recommendations body on the external trade policy as well as retain control over tariff decisions, because it was the largest and most industrialized country. The main weakness of the 1969 SACU Agreement was the absence of joint decision-making by all member states. South Africa alone determined the external tariff policy of the customs union: all changes to customs tariffs, rebates, anti-dumping and countervailing duties were affected by the South African Minister of Trade, upon the recommendation of the South African Board of Tariffs and Trade.

Introduction of the Revenue Sharing Formula

The most notable inclusion of the 1969 Agreement was the introduction of the Revenue Sharing Formula designed to distribute the Common Revenue Pool (CRP) between the Member States of which the BLNS are customs and excise duties and South Africa receiving the remaining amount. This arrangement was adjusted in 1976 to include a "stabilizing factor" that required that the BLNS receive between the range of 17% – 23% of the value of their imports plus excisable production, inclusive of excise duties. Perhaps the most controversial and misunderstood aspect of the 1969 Agreement is that cash payments to the BLNS from the CRP lag accruals by up to two years: the so-called 'two-year lag'. In simple terms, this meant that for the duration of the 1969 Agreement, the BLNS received payments in year *N* on the basis of trade and consumption data from year *N*-2. In practical application this means there is no two-year delay in payment, though the real value of the payment is partially reduced by the effect of inflation and the non-payment of interest on the value of the estimation error only.

The above flaws in the 1969 Agreement, coupled with the fact that this agreement was considered outdated and no longer adequately catered for the needs of a 21st century customs union, prompted for re-examination of the SACU agreement and thus the introduction of the 2002 Agreement. This updated agreement was based on three broad areas, namely governance and administration; economic policy and regulatory issues; and revenue sharing. Key objectives of the new revenue sharing formula are enshrined with the purpose:

- To promote the integration of the Members into the global economy;
- The facilitation of cross-border movement of goods between the Members;
- The establishment of effective, transparent and democratic institutions which will ensure equitable trade benefits to the Members;
- To facilitate the equitable sharing of revenue from customs, excise and additional duties;
- To promote fair competition, substantially increase investment and facilitate economic development; and
- To facilitate the development of common policies and strategies.

The Current SACU Revenue Sharing Formula

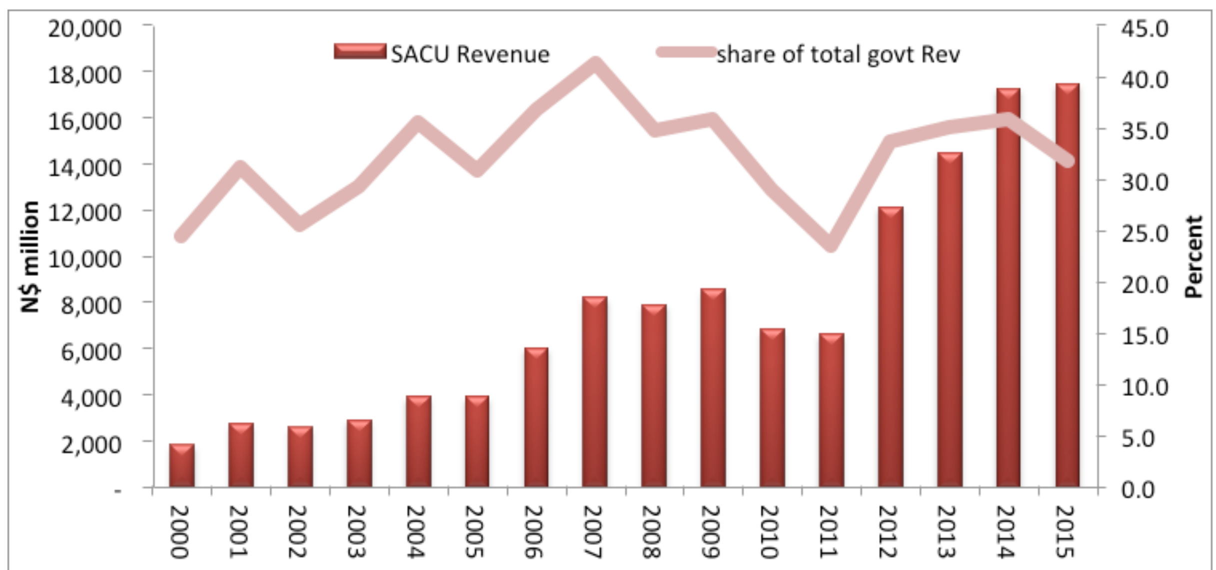
There have only been three different basic formulae for sharing tariff revenue within SACU– the original 1910 formula based on actual import duties collected on goods from outside SACU, the 1969 formula with tariff revenue distribution based on shares of imports from both inside and outside SACU, and the 2002 formula with the tariff revenue distribution based only on shares of intra SACU imports. There were two adjustments - the first in an adjustment in the shares for countries other than South Africa in the 1910 formula and the second to the (1969) formula in 1976, when a stabilization element was introduced.
Currently SACU operates a Common Revenue Pool (CRP) into which all customs, excise and additional duties are paid; each member state receives a share from the pool, calculated in accordance with the formula. The components of the SACU revenue formula are:

- the **customs component**, whereby revenue is collected on the basis of each country's share of intra-SACU imports, thus countries that import the most from within the union receive the largest share of the customs pool;
- the **excise component**, which is allocated on the basis of each country's share of SACU GDP, a proxy for the value of excisable goods consumed South Africa, as the largest economy in the region stands to benefit from not less than 80% of excise revenue collected;
- the **development component**, which was initially set at a fixed 15% of total excise revenue, and will be equally shared amongst all member states.

Namibia's receipts from the SACU Common Revenue Pool

More than 30% of Government's revenue is received from the CRP on an annual basis. The nominal value of SACU receipts has been on an upward trend since 2012 (Figure 1) and this has coincided with the country's expansionary policy era. A decrease in SACU receipts would imply a possible widening budget deficit – among other consequences – if government spending is to maintain its historical expenditure patterns.

Figure 1: SACU receipts to Namibia



Trade between Namibia and SACU

Exports

During 2015, Namibia's overall exports declined by N$6.3 billion or 9.8 percent to N$58.4 billion, compared to N$64.7 billion registered in 2014. This was mainly due to a contraction in foreign demand for domestic goods mainly by Angola, the USA, Canada and Germany. Namibia's top five leading export commodities in 2015 were diamonds, copper cathodes, fish, copper ores and zinc.

SACU has maintained its position as Namibia's number one export market over the past ten years. Export revenue from this region grew by 25% to account for N$24.4 billion in 2015, from N$19.5 billion recorded in 2014. In addition, SACU accounted for 28% of total exports to different economic regions, up from 25% obtained in 2014. Within SACU, Botswana topped Namibia's export destinations with N$13.1 billion, which translates to a 21.5% increase from N$10.7 billion obtained in 2014, as Botswana's demand for diamonds, mineral fuels and oils, and processed fish rose. South Africa followed in the second position as the destination for 19.5% of Namibia's exports.

Imports

In 2015 overall import value rose by 6% as domestic demand for foreign goods increased to N$97.6 billion from N$92.1 billion in 2014. Mineral fuel and oils, vehicles, boilers, electrical machinery and copper ores dominated the list of imports to Namibia.

As was the case in exports, Namibia mostly imported from the SACU region compared to other economic regions, with South Africa and Botswana the main beneficiaries. The South African import bill continued to grow to 19.8% of all imports to account for N$62 billion, compared to N$57.8 billion in 2014, whilst the Botswanan import bill stood at 19.4%, mainly because of commodities such as diamonds, vehicles, pharmaceuticals and mineral fuel and oils.

Import expenditure from SACU for 2015 increased by 19.7% to N$64.6 billion compared to the N$54 billion recorded in 2014. In addition, the import bill from SACU accounted for a share of 40% of total imports in 2015, similar to what was recorded in 2014.

Namibia and SACU: Economic Policy and Industrial Development

SACU's trade policy regime has two broad goals, as detailed in Article 2 of the Agreement:

- To deepen SACU integration, and;
- To promote the integration of SACU countries into the global economy through enhanced trade and investment.

These two processes are assumed to underpin the achievement of the SACU government's overarching aim to enhance the economic development, diversification, industrialization and competitiveness of member states.

The SACU Agreement permits national protection for infant industries in the BLNS but not in South Africa. Under this Article, the BLNS can impose duties on imports from South Africa provided the same duties are also imposed on imports from the rest of the world. An infant industry is defined as an activity that has not been located in the BLNS for more than 8 years, and this protection is also limited to 8 years.

Although the new agreement does provide for democratic decision-making in all SACU structures and requires the development of common industrial and agricultural policies, the approach remains fundamentally unchanged. Nonetheless, Lesotho, Namibia and Swaziland will continue to receive more than a third of their total budget revenue through the revenue sharing formula.

This will do little to stimulate economic development and grow the tax base in these countries. Instead, such dependence increases the risk that the smaller members of SACU will measure the success of the Agreement in revenue terms rather than in its impact on trade or investment. At the same time, the BLNS member states continue to face a lack of control over SACU's external tariff policy, removing an important tool that could otherwise be contributing to their economic development.

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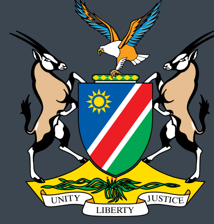

REPUBLIC OF NAMIBIA

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Ministry of Finance
Economic Policy Advisory Services

Fiscus Building
P/Bag 13259, Windhoek
Tel: 061-209 2131