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MINISTRY OF FINANCE
Economic *Update*

This Issue…

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 Namibia's trade position**.

Global Developments

While recent policy actions in the Eurozone and the US have somewhat alleviated the acute downside risks to global economic activity of late, the outlook for global growth nonetheless remains rather downbeat. Indeed, although the IMF remains positive that growth of **world output** will accelerate in 2013, from an estimated 3.2% in 2012, it **has recently revised down its forecast for this year, from 3.6% to 3.5%**. It has also **lowered its growth forecast for 2014, from 4.2% to 4.1%**. While this may seem a very minor adjustment, it nonetheless underscores the ongoing concerns surrounding the nascent global economic recovery.

Despite intensified region-wide policy responses and some promising progress being made towards much-needed readjustment at the national level, the Eurozone remains a key source of anxiety in terms of the global outlook. Increased momentum for reform has seen sovereign spreads narrow and bank liquidity improve across the region, but it is feared that these developments are likely to have a lagged effect on economic activity; moreover, concerns that this reform impetus will not be maintained persist, and continue to weigh on the growth outlook. Against this backdrop, therefore, the IMF is now **expecting the Eurozone to contract in 2013, by 0.2%, having previously forecast modest growth of 0.2%**. The Eurozone is, however, **expected to return to positive growth in 2014, with the IMF forecasting an expansion of 1.0%** (a slight downgrade from its previous forecast of 1.1%).

Growth prospects in **the US**, meanwhile, remain solid with the IMF projecting **an economic expansion of 2.0% in 2013**. Although this is 0.1 percentage points lower than the IMF's previous forecast – and represents a slowdown from an estimated 2.3% growth in 2012 – it still represents one of the fastest growth rates projected among developed economies for 2013. Moreover, real GDP is projected to accelerate to 3.0% in 2014. These robust growth numbers are predicated on a rebound in the housing market, which, alongside brighter prospects for financial markets, should provide a fillip to private consumption. Downside risks, therefore, lie in a failure for housing and financial market improvements to materialise, or for them to fall short of the magnitude required to offset an anticipated decline in government spending. Indeed, although immediate concerns surrounding the so-called 'fiscal cliff' have abated, debate still persists over the future path fiscal consolidation in the US, and this too remains an important risk to global growth.

The IMF has left its **2013 growth forecast for Japan unchanged at 1.2%**, despite the world's third largest economy re-entering recession as the recent weakness is believed to be the result of temporary factors which will abate going forward. Moreover, a combination of fiscal and monetary stimulus is expected to help support economic activity over the coming year. That said, the IMF has **downgraded its growth forecast for Japan for 2014 by 0.4 percentage points to 0.7%** on concerns that the impact of the government's expansionary fiscal policy will be somewhat short lived.

Against this backdrop, therefore, the IMF has **lowered its growth forecast for developed economies from 1.5% to 1.4% for 2013**, **and from 2.3% to 2.2% for 2014**. Similarly, the IMF has **downgraded its growth forecast for emerging and developing economies for 2013, from 5.6% to 5.5%**, as weaker activity in advanced economies feeds through to emerging and developing countries, primarily via trade channels. Compounding this, anticipated weaker commodity prices in 2013 will also affect emerging and developing economies as terms of trade of commodity exporters deteriorate.

That said, emerging and developing economies are still expected to post robust growth in 2013 as supportive policies help to ensure that economic activity remains buoyant. Indeed, the IMF's forecast for **China remains unchanged at 8.2%** as economic activity gathers momentum in the world's second largest economy following a moderation in 2012, which is estimated to have seen China's growth drop below 8% for the first time since 1999. This rebound in economic activity will be driven by stronger corporate and infrastructure spending as urbanisation continues unabated, in addition to improved prospects for exports. Further, the IMF is expecting China's **recovery to continue in 2014 with growth expected to accelerate to 8.5%**, which will help to drive **growth in emerging and developing economies to 5.9%**, a figure which remains unchanged from the Fund's previous forecast.

Sub-Saharan Africa

Sub-Saharan Africa is expected to register its strongest growth performance since 2007 this year, with the IMF leaving its **forecast for Sub-Saharan Africa unchanged at 5.8%**. This is based on a series of supportive economic policies and improved fundamentals across the region, in addition to the fact that Sub-Saharan Africa remains relatively insulated from the financial turmoil that continues to threaten developed economies.

Domestic demand and both public and private investment are projected to be the key drivers of growth across Sub-Saharan Africa, with prospects looking particularly bright in low-income countries. Indeed, growth prospects for middle-income countries across the region remain weaker than their low-income counterparts, as middle-income countries tend to track global developments more closely due to their closer linkages to developed economies. To be sure, **South Africa** continues to suffer due to its close trade and financial ties to Europe, and this has prompted the IMF to **lower its 2013 growth forecast for Sub-Saharan Africa's largest economy by 0.2 percentage points to 2.8%**.

That said, growth prospects in the region's second largest economy remain bright, with the IMF projecting **real growth of 6.7% for Nigeria in 2013**. Economic activity will be boosted by a rebound from the flood-related disruptions to output witnessed in 2012, as well as stable oil production and strong private consumption and public investment. **Angola too is on course to post a strong outturn in 2013, with the IMF forecasting a 5.5% expansion** as new oil fields come online and private consumption and investment perform strongly.

In light of these brighter prospects for the region, he IMF has also **upgraded its forecast for Sub-Saharan Africa for 2014, from 5.6% to 5.7%**. Although this does mark a slight decline from 2013 projections, due to moderations in consumer spending and investment, the robust headline figure nonetheless highlights the health of the region's economy. Indeed, the IMF is expecting **South Africa to register growth of 4.1% in 2014** – which would mark the first time since 2007 that Sub-Saharan Africa's largest economy had secured growth in excess of 4% – while **Nigeria and Angola are forecast to expand by 6.6% and 5.4%,** respectively.

South African Economy

The South African economy expanded by 2.5% y-o-y in the fourth quarter of 2012, marking a slight acceleration from the 2.3% posted in the previous quarter as the manufacturing and the finance, real estate and business services sub-sectors posted strong performances. Manufacturing grew by 3.6% in Q412, up from the 2.5% expansion recorded in Q312, contributing 0.6 percentage points to overall growth, while finance, real estate and business services grew by 3.4% – marking an acceleration from the 2.3% growth posted in the previous quarter – to add 0.7 percentage points to headline growth. Meanwhile, the mining and quarrying sub-sector registered a sixth straight quarter of y-o-y declines, contracting by 3.5% in Q412 having shrunk by 1.2% in Q312.

The fourth quarter's 2.5% y-o-y expansion brought full-year growth to 2.5% - slightly above the IMF's projection of 2.3% growth, but significantly down on the 3.5% recorded in 2011. The IMF is expecting **higher growth in 2013, forecasting real GDP to expand by 2.8%**, but has recently lowered its growth forecast for Sub-Saharan Africa's largest economy by 0.2 percentage points due to ongoing concerns over growth prospects in Europe – to which South Africa is particularly vulnerable. Both household and government spending are expected to weaken somewhat in 2013, as is investment, but a rebound in exports and a concomitant fall in import growth due to lower domestic demand is anticipated to help offset these factors and keep growth buoyant. However, as domestic demand recovers going forward, the IMF is projecting **real GDP growth to come in at 4.1% 2014** – its highest level in seven years.

Namibian Economy

The Namibian economy recovered from the 3.7% y-o-y decline posted in the third quarter of 2012 in Q412, recording an expansion of 4.3% y-o-y in the final quarter of the year despite contractions in fishing, manufacturing and hotels sub-sectors. Fishing shrunk by 10.0% y-o-y in Q412 due to the fact that a number of quotas had already been exhausted, while manufacturing fell by 8.0% on the back of a 47.7% decline in 'other manufacturing', which includes items such as rubber and chemical products. While other categories of manufacturing such as meat and mineral processing managed to post positive growth, this was not enough to offset the dismal performance of 'other manufacturing'. Meanwhile, hotels and restaurants – which serves as a proxy for tourism – contracted by 16.4% y-o-y as the number of bed night and room nights cold fell by 19.8% and 19.3% y-o-y, respectively.

Nonetheless, in spite of the poor performance of these sub-sectors, economic growth in the fourth quarter of 2012 remained well supported as the agriculture, electricity and water, and mining sub-sectors registered strong expansions. Agriculture grew by 21.1% y-o-y as the number of cattle marketed witnessed a substantial increased and crop production was boosted by the grape harvesting season, while electricity and water recorded growth of 17.2% y-o-y. However, it was mining and quarrying which really helped to drive headline growth, with the sub-sector recording growth of 47.7% y-o-y on the back of a strong rebound in diamond and uranium output, which increased by 51.4% and 26.5% y-o-y, respectively. That said, Other mining and quarrying also played its role, expanding by 23.7% y-o-y. Meanwhile, the construction and transport and communication sub-sectors also recorded positive growth, the former by 3.7% y-o-y and the latter by 1.3% y-o-y.

This fourth quarter outturn brought full-year growth to a healthy 5.0%, marking a slight improvement on the recently upwardly-revised 4.9% growth posted in 2012. This far exceeded the Ministry's growth forecast for 2013 of 4.0% as diamond production surprised on the upside. Given this new information, the Ministry is therefore **currently reviewing its 4.3% growth forecast for 2013 with a view to revising it upwards**.

Balance of Payments

Namibia managed to post a current account surplus for the second consecutive quarter in Q312, but only to the tune of N$25mn, marking a steep q-o-q decline from the N$2.2bn recorded in Q212. This came on the back of weaker exports – which fell by 11.0% q-o-q as diamond exports plunged by 27.0%

q-o-q – as well as stronger import demand. With imports rising by 6.0% q-o-q, the country's merchandise trade deficit widened by N$1.7bn between the second and third quarters of 2012, from N$2.5bn to N$4.2bn. Net services did rise over the same period, but by nowhere near enough to plug the trade deficit, only coming in at N$98mn in Q312, up from N$12mn in the previous quarter. Further, net investment income fell into the red in Q312, reverting from a surplus of N$302mn in Q212 to a deficit of N$441mn in Q312. This brought Namibia's balance on goods, services and income to a deficit of N$4.6bn in Q312, marking a widening of N$2.3bn from the N$2.2bn deficit posted in the previous quarter. However, current transfers of N$4.6bn (N$3.4bn of which came from SACU) in the third quarter – a slight increase on the N$4.5bn recorded in Q212 – meant that a slight current account surplus was maintained in Q312.

Moreover, Namibia's financial and capital account deficit narrowed in Q312, to N$576mn from the N$1.2bn registered in the previous quarter. This came on the back of improvements in net direct investment in Namibia which rose back into the black in Q312 to the amount of N$708mn, having posted a deficit of N$365mn in Q212, and other long term investments, which rose from a surplus of N$215mn in Q212 to N$638 in the third quarter. These developments helped to offset increases in net outflows of portfolio investment – from N$1.2bn in Q212 to N$1.5bn in Q312 – and other short term investment (from N$188mn to N$711mn). However, it was not enough to prevent the country's overall balance of payments falling back into deficit in Q312 after recording its first surplus since Q408 in Q212. Indeed, compounding the weakening of current account position was a reversal in the net errors and omissions figure, which reverted from a surplus of N$1.0bn in Q212 to a deficit of N$228mn in Q312. This helped contribute to an overall deficit of N$764mn in Q312, following a surplus of N$1.4bn in Q212.

Consumer Prices

Consumer price inflation slowed in February, to 6.2% y-o-y from the 6.6% recorded in the previous month. This was the lowest outturn in six months, raising hope that inflation has now at least stabilised somewhat after breaking above 7.5% in November 2012.

Hotels, cafes and restaurants posted the largest price increase in February, rising by 9.7% y-o-y, but given its small weighting in the Consumer Price Index (CPI) basket, this had a relatively minor impact on headline inflation. However, the same cannot be said for the price of Housing, water, electricity gas and other fuels, which accounts for approximately 20% of the CPI basket and which rose by 8.5% y-o-y in February, marking a third straight month of acceleration.

On a more positive note, food price inflation– which accounts for the single largest weighting in the CPI basket – slowed for a third month in a row, with the price of food and non-alcoholic beverages rising by 7.5% y-o-y in February, down from the 7.8% recorded in January and the near three-and-a-half-year high of 11.0% posted in November 2012. That said, food price inflation nonetheless remains high, and moreover, the recent deceleration is likely to be at least partly a result of high base effects. Indeed, the fact that food prices are still rising despite the historically high levels seen in 2012 is of some concern.

In addition to ongoing anxiety about the impact of rising food prices on headline inflation, the depreciation of the South African Rand is also of some concern. Since Namibia is a net importer of goods and services, the weaker currency will likely registered in 2012, it is nonetheless projected to feed through into imported inflation. Against this backdrop, therefore, although consumer price inflation is expected to slow from the 6.5% figure registered in 2012, it is nonetheless projected to remain elevated, **averaging 6.1% in 2013**.

Commodity Prices

While the IMF's All Commodity Price Index (ACPI) rose for a third consecutive month in February, climbing by 1.7% m-o-m, commodity prices continued to slide lower on a y-o-y basis, with February marking a fourth straight month of y-o-y declines, and the tenth fall in past eleven months. With the exception of beverages and agricultural raw materials – which fell by 2.1% m-o-m and 0.6%, respectively – all sub-components of the ACPI registered m-o-m increases in February, with the largest gains being registered by fuel prices, which rose by 2.4% m-o-m. This helped to propel the index to a 10-month high, suggesting that the near term outlook for commodities is bright.

That said, the outlook for the various commodity sub-groups is somewhat mixed for 2013. Fuel prices are forecast to decline slightly in 2013, led by a slight softening in oil prices on the back of higher supply, while raw agricultural prices are also expected to trend lower. Declines in raw agricultural materials will be driven primarily by cotton and rubber, which continue to withdraw from their recent record highs as supply improves.

On the other hand, metals and food are projected to outperform 2012 this year. Prices of metals are expected to be driven higher by renewed appetite in China as economic growth continues to rebound, most notably aluminium and zinc which are forecast to post robust gains in 2013. The latter will largely be driven by increased demand for stainless steel (the end-use for more than two-thirds of nickel production), while the former will be driven by substitution effects as producers shift away from far more expensive copper. Indeed, as of February 2013, copper was almost four times more expensive than aluminium. The flip side of this is of course that copper prices are consequently expected to fall over the course of 2013. Meanwhile, with the exception of cereals, food prices are expected to rise across the board on the back of strong demand and the ongoing fallout from adverse weather in the US and Europe in 2012 which has affected supply.

SPECIAL FEATURE
Spotlight on: Trade

The month of March saw the publication of the Namibia Statistics Agency's (NSA's) Annual Trade Statistics Bulletin, which revealed that Namibia successfully managed to narrow its trade deficit for a third consecutive year as export growth outpaced that of imports.

Once again diamonds were the mainstay of the export sector, with diamond exports growing by 18.4% in terms of value to claim a 28.6% share of total exports – up from the 27.6% recoded in 2011. Underlining how vital diamonds are to Namibia's export sector, this figure was more than 50% as large as the share occupied by Namibia's second largest export item, *Ores, Slag and Ash* - a category defined by the Harmonised System (HS) covering the likes of Uranium, Zinc and Copper ore.

That said, *Ores, Slag and Ash* still accounted for 18.4% of total exports in 2012, up from 14.5% in 2011 after posting phenomenal growth of 45.0%. Moreover, mining products – specifically zinc and copper (excluding ores) and *Salt, Sulphur, Earth and Stone, Lime and Cement*, respectively – assumed positions four, six and nine on the list of Namibia's top ten exports of 2012, taking the total proportion of exports hailing from the mining industry to at least 58.0% of total exports in 2012[1].

Table 1: Namibia's Top Exports, 2011 and 2012

HS Code	Commodity Description	2012		2011		Growth (%)
		Value (N$mn)	% Share	Value (N$mn)	% Share	
71	Diamonds, precious or semi-precious stones and metals	12,054	28.6	10,184	27.6	18.4
26	Ores, slag and ash	7,766	18.4	5,356	14.5	45.0
03	Fish and crustaceans, mollusc and other aquatic invertebrates	5,716	13.6	5,145	14.0	11.1
79	Zinc and articles thereof	2,265	5.4	2,391	6.5	-5.3
22	Beverages, spirits and vinegar	1,982	4.7	1,663	4.5	19.2
74	Copper and articles thereof	1,550	3.7	2,992	8.1	-48.2
87	Vehicles	1,525	3.6	952	2.6	60.2
02	Meat and edible meat offal	1,493	3.5	1,388	3.8	7.6
25	Salt, sulphur; earths and stone; plastering materials, lime and cement	837	2.0	744	2.0	12.5
28	Inorganic chemicals; organic or inorganic compounds of precious metals, or rare earth metals, of radioactive elements or isotopes	772	1.8	37	0.1	1,986.5
Other products		6,210	14.7	5,987	16.3	3.7
TOTAL		42,170	100.0	36,839	100.0	14.5

Source: NSA, Annual Trade Statistics Bulletin 2012

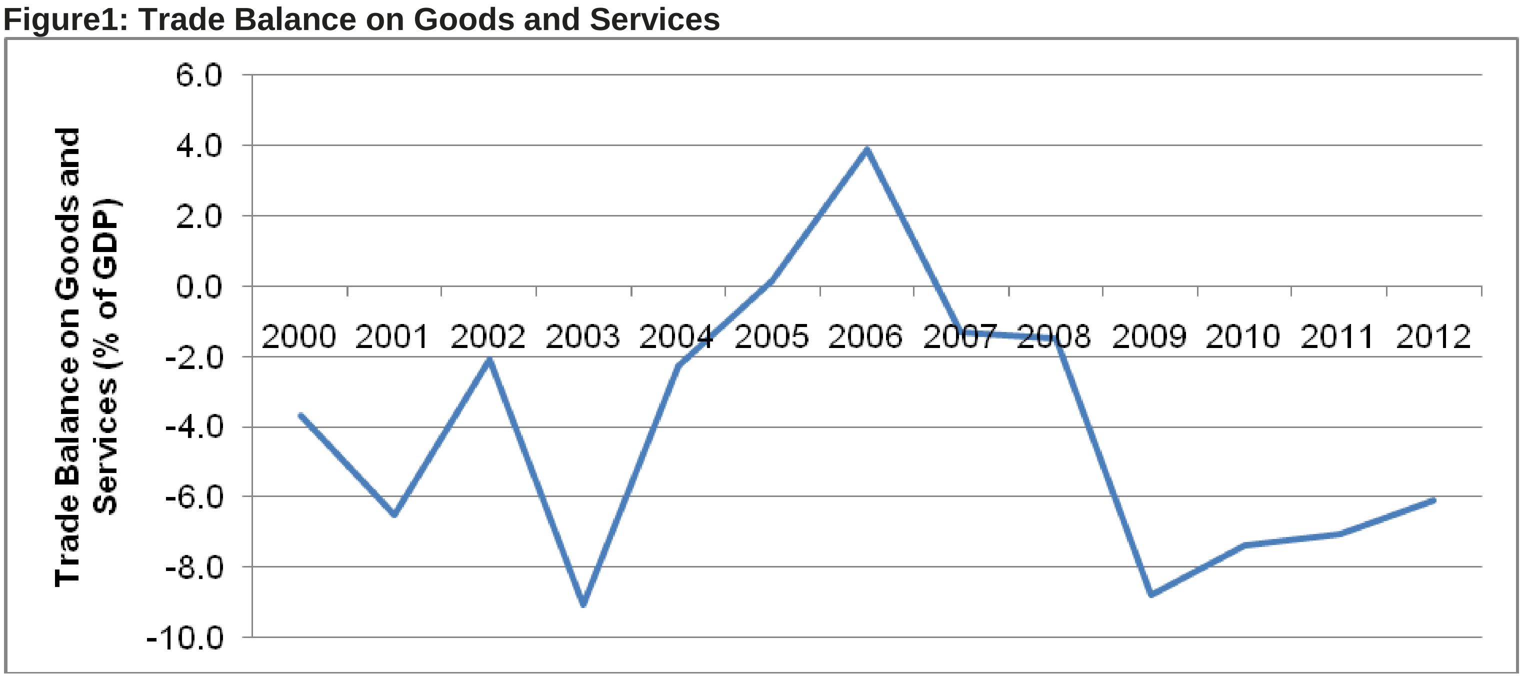
This, unfortunately, makes Namibia vulnerable to downturns in the global economy and particularly to downturns in commodity prices. It also exposes Namibia to higher income volatility. These factors are further compounded by the small size of Namibia's economy, which compels the country to be more open to trade since it relies heavily on imports to satisfy domestic demand.

These weaknesses were harshly exposed in 2009, when Namibia's trade deficit widened to N$6.6bn (8.2% of GDP), from N$1.1bn (1.4% of GDP) in the previous year, as exports of goods – which have averaged around 85% of total exports of goods and services over the past 10 years – plummeted by 12.5% in the wake of the global financial crisis. Perhaps this may be considered an unfair example given that it could be argued that the financial crisis was a 'Black Swan' event; however, it nonetheless underscores Namibia's vulnerability to exogenous, trade related shocks.

Now that the global economy is starting to take tentative steps towards recovery, Namibia's trade position is gradually improving. The country's trade deficit narrowed for a second consecutive year in 2012, from the 6.6% of GDP recorded in 2011 to 6.1% as exports of goods grew by 11.7% while import growth lagged behind at 8.9%. This marked a third straight year of accelerated export growth and a third consecutive year in which export growth outperformed that of imports. With global growth forecast by the IMF to gradually accelerate to back above 4.5% by 2017 – and significantly for commodity exports, with China projected to return to 8.5% growth as early as 2014 – the outlook for Namibia's trade deficit is a relatively positive one. That is, however, not to say that risks to the country's external position have now disappeared.

[1] *The NSA Annual Trade Statistics Bulletin only provides data for Namibia's top ten exports, meaning that if any mining exports exist outside of the top ten, this concentration would be higher than 58.0%.*

Figure1: Trade Balance on Goods and Services



Source: NSA

For a start, the global economy is not out of the woods yet. Although prospects in the Eurozone have much improved in recent months, there are still ongoing concerns that appetite for reform may not be maintained. Should the Eurozone suffer any further setbacks on its tentative road to recovery, global growth prospects could take a hit, and with this, so too could demand for Namibian exports.

There are, however, other reasons Namibia should be particularly worried about further weakness in Europe. The NSA Annual Trade Statistics Bulletin revealed that in 2012 exports to the EU totalled N$15.1bn, or 31% of total exports, which places the economic bloc second only to SADC in terms of importance for Namibia's exporters, and even then only just, with exports to SADC totalling N$15.8bn, or 32% of total exports in 2012. Weakened demand in Europe would, therefore, have a significant direct impact on Namibia's trade position. It would also have an important indirect impact, as subdued demand in Europe would have negative implications for growth in China, which in turn would have harmful repercussions for demand for commodities.

Beyond this, recent ZAR weakness is also a concern for Namibia's trade deficit. With a weaker currency, imports become relatively more expensive, which will see the country's import bill inflate as consumers cannot switch out of foreign and into domestically produced goods since this alternative does not exist for a small economy such as Namibia. Further, although the flip side of this is that exports will become more competitive, Namibia is unlikely to fully realise the benefits associated with this due to the structure of its export sector.

The prices of Namibia's major exports are determined at the world level and quoted in US dollars, and are traded on exchanges, which means that the demand dynamics are not the same for items such as manufactured goods. That is, people won't demand more diamonds or uranium because the ZAR has weakened; they will demand more diamonds and uranium because, *inter alia*, the growth outlook has improved, or the world price is considered to be attractive. Therefore, while a weaker currency will translate in to higher earnings for exporters, it will not necessarily see demand for exports increase as one might expect. Further, the supply curve for a number of Namibia's key exports (i.e. minerals) is almost perfectly inelastic in the short term, as most mines in Namibia are operating at or close to full capacity. Therefore, a weaker currency would have very little impact on exports since it is not physically possible to produce more to meet any additional demand.

Ultimately, the benefits brought about by currency depreciation in terms or higher exports will not be able to offset the drag on the trade deficit due to more costly imports. This – along with the risk of a renewed bout of global economic weakness – poses an important risk for Namibia's macroeconomic stability, since an inability to finance its trade deficit through capital inflows will put pressure on the country's already thin reserves. And, given the link between risk appetite and the health of the global economy, it is likely that a deterioration in Namibia's trade deficit is likely to go hand in hand with an outflow of portfolio investment, further heightening the risk to the country's external position.

Despite these concerns, Namibia is, unfortunately, fairly limited in what it can do to address these structural weaknesses. The small size of its economy means that reducing the import bill by producing domestically is not a viable option since it would be too expensive. Meanwhile, diversifying exports is difficult, and may not be successful given that new export products are unlikely to benefit from comparative advantage.

In order to overcome this obstacle, it would be necessary to create a more conducive environment in which to do business and therefore lower the costs of producing and exporting. Namibia was ranked only 87th out of 185 countries in the World Bank's Ease of Doing Business, but more disconcertingly as far as exports are concerned, only managed to secure 140th position in the *Trading Across Borders* category. In addition to this, Namibia could seek to diversify its export markets, to try to reduce its vulnerability to dynamics in Europe and indeed South Africa – Namibia's single largest export destination, accounting for N$7bn or 16% of total exports in 2012. This may perhaps be especially pressing given the current negotiations surrounding the Economic Partnership Agreement (EPA), which could potentially prove damaging to Namibia's trade with the EU.