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MINISTRY OF FINANCE
Economic*Update*

This Issue…

NEW…

This is the first in a series of short economic publications from the Ministry of Finance.

INFORM…

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 look at inflation faced by different income groups in the economy.

Global Developments

News on the global front continues to be fairly negative and uncertain. Between April and July, the IMF has downgraded its global economic projections only slightly, to **3.5% and 3.9% growth in 2012 and 2013 respectively.** Over the medium term, low rates of growth should be expected.

Advanced economies still face the lowest growth prospects over 2012 and 2013 (**1.4% and 1.9% respectively)**. The source of low growth and high uncertainty again rests with sovereign debt problems, especially those faced by Euro periphery countries (notably Greece and Italy). Uncertainty is both political and financial – with strong opposition to austerity measures being put in place to reduce debt. The situation appears to be a lose-lose: either tightening fiscal policy to reign in the massive debt (thereby reducing growth and increasing unemployment further) or implementing fiscal stimulus (thereby increasing debt further and missing targets). A delicate middle ground must be found, and political/economic coordination in the Euro Zone is essential. In the US, growth prospects are marginally higher, at 2.0% and 2.3% in 2012 and 2013, around the same levels projected last in April.

Growth rates in all the BRICS countries remain high but appear to be slowing. The slowdown is partly due to weakened external demand in Europe, as well as risk aversion by investors. On the whole, growth in **emerging and developing economies** is projected at **5.6% in 2012 and 5.9% in 2013.**

The global picture is much the same as presented in the 2012/13 Macroeconomic Framework. Over the rest of the year, global growth depends on EU leaders following through with the positive decisions made at the June 2012 EU summit. The IMF also assumes that the US will relax its federal budget deficit rules; otherwise a large fiscal contraction would be required (with knock-on effects to global growth).

Sub-Saharan Africa

Growth momentum slowed in the first half of 2012 in Sub-Saharan Africa, but overall growth continues to perform well, and is above global growth rates. **In 2012 and 2013 growth is projected at around 5.4%**, just below the rate for developing and emerging regions as a whole.

Developments in South Africa, as Namibia's trade partner, are of significance. Growth in SA remains fairly subdued, at a projected **2.6% in 2012 and 3.3% in 2013.**

Going forward, countries most at risk in Africa are those which depend on resource exports as any decline in global growth can cause large falls in demand for commodities and their prices, as has occurred in early 2012.

Namibian Economy

The Preliminary National Accounts data for 2011 suggest that the Namibian economy performed slightly better than expected in **2011, with growth of 4.9%** (higher than the Macroeconomic Framework projections of 4.2%). This resilience is encouraging, given the ongoing problems at the global level.

Growth in 2011 was driven by the secondary and tertiary industries, with primary industries performing poorly as expected (off the back of reduced mining activity).

So far in 2012, the real sector has shown a mixed performance. Diamonds and zinc have shown declines, whereas Uranium and copper production have increased. Manufacturing continues to post below potential performance, and growth in construction is likely to remain high but not at the rates witnessed in 2011. The tertiary sector also showed signs of slowing in early 2012, although some of this may be explained by seasonality, e.g. tourism.

In 2012, business confidence started on a high, with the Business climate index (as published by the IPPR) reaching record levels. However, we may see this trend reversing with the investment and construction components of the index having shown negative trends in recent months.

On the whole, we do expect that the high growth rates of 2010 and 2011 may not be witnessed in 2012.

Exchange Rate Developments

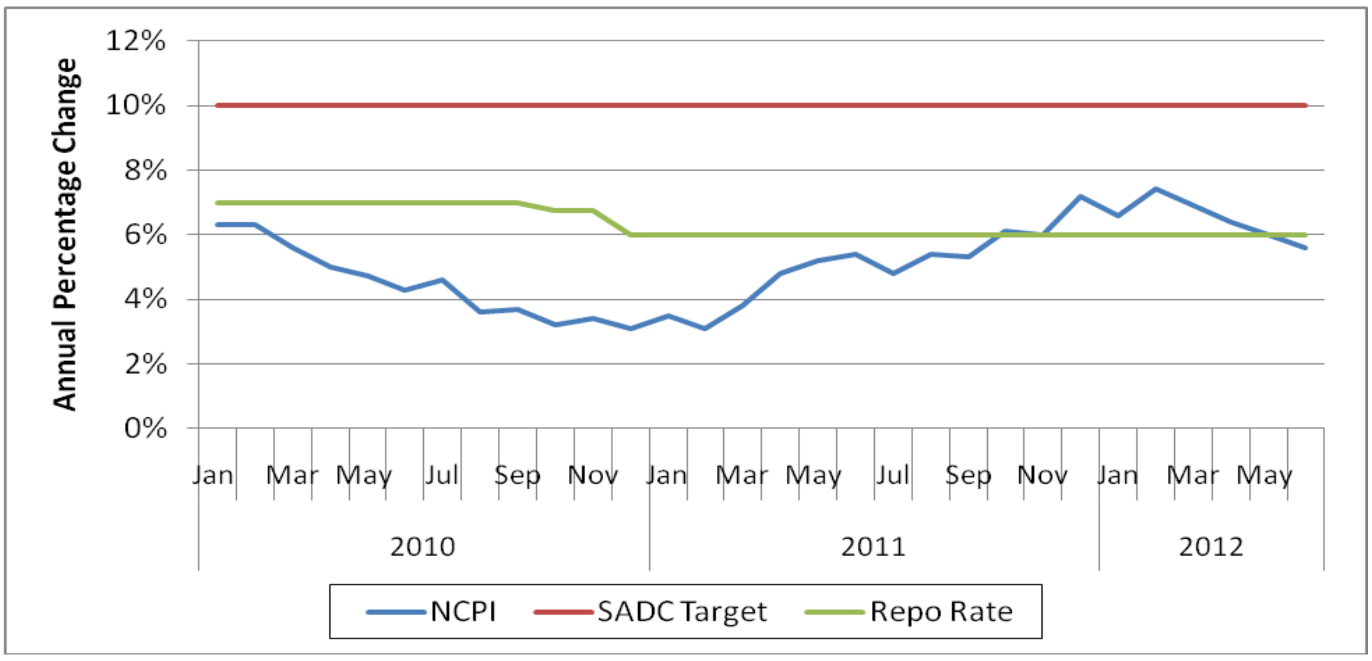
The South African Rand, and hence the Namibia Dollar, is highly susceptible to global developments. After weakening against the US dollar in late 2011, the Rand has strengthened during the first quarter of 2012 before weakening again in the second quarter. A similar pattern has been observed against other major currencies such as the Euro and the British pound, although volatility against the Euro has been more muted over 2012.

The weakening of the Rand has been in line with other emerging market currencies, as global risk aversion continues (and investors favour 'safe havens' such as Germany). This weakening improves Namibia's export competitiveness but makes imports more expensive.

Predicting movements in the Namibia dollar exchange rates are very difficult, and depend very much on the unpredictable situation in the Euro zone.

Overall Inflation Trend

Following an upward trend in 2011, inflation has been slowing over 2012, and continues to fall. This suggests that a reduction in the Repo rate is unlikely in the short term. The reduction in inflation is mainly due to falling oil prices (which impact indirectly on other inflation categories) and reduced food inflation, amongst other factors. Going forward inflation is likely to remain relatively low, due to demand factors at the global level. However, the possibility of exchange rate fluctuations would impact on inflation.



Source: NSA and BoN

Oil Prices

Oil price developments present positive news for Namibia, as an oil-importing country. Global supply conditions have improved and overall demand conditions remain weak, hence leading to reduced prices. From a high of US$125 per barrel in March, prices have fallen to around US$90 per barrel in July.

When considering oil prices, it is also important to remember the exchange rate. In US dollars, the price of oil has dropped by 40%. But, given that the Namibia dollar weakened over the same period, the drop in oil prices is around 28% in local prices.

The decrease in international oil prices has translated into reduced pump prices, with July witnessing the first reduction since October 2010.

Geopolitical risks to oil supply are also perceived to have decreased, meaning large fluctuations in oil prices are less likely. However, as explained above, volatility in the Namibia Dollar may lead to volatile local fuel prices.

Commodities and Diamonds

Global commodity prices have important implications on the Namibian economy.

On the export side, the key price movements are those of uranium and diamonds, and to a lesser extent zinc, copper and gold.

Uranium spot prices are yet to pick up from the lows of 2011 (as a direct and indirect result of Fukushima). In the medium to long term price prospects are favourable as nuclear power will no doubt be a key source of energy at the global level. Demand for diamonds has recovered somewhat although uncertainty remains due to the stalling Euro Zone recovery.

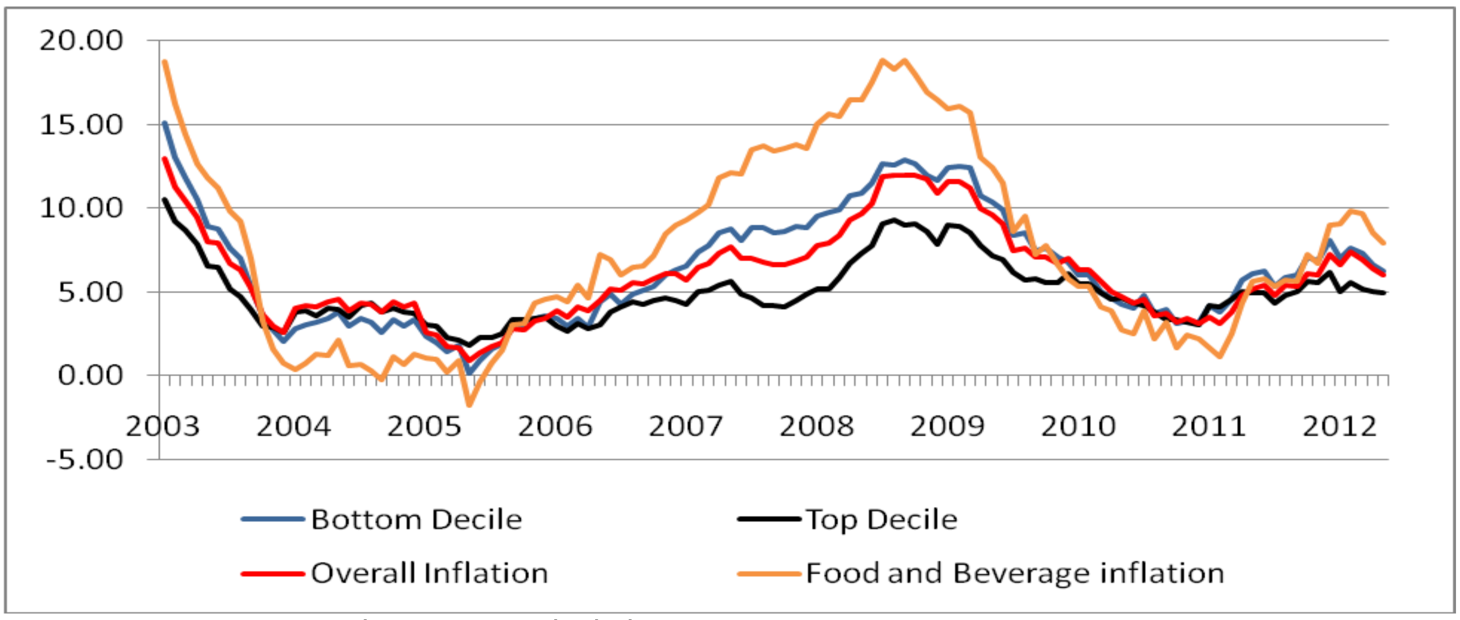
Metal commodity prices have increased in recent months, but zinc and copper prices are around 20% lower than a year ago. Gold prices, on the other hand, have increased but gold remains a relatively small contributor to the Namibian exports.

On the import side the most important commodity is fuel (as discussed under oil prices). Food prices are also very important, especially to those on low incomes. Global food prices fell substantially over the end of 2011 and beginning of 2012, which should filter through to a drop in local prices.

Poverty Inflation Analysis

Inflation is published by the NSA as a single figure for Namibia, namely the NCPI. This single inflation figure is based on a 'basket' of goods, with different weightings for each good/service and different regions. In other words, inflation reflects price increases across a range of goods and services, based on the assumption about how the average Namibian spends his/her money. However, in reality, everyone spends their money differently, and therefore, a single inflation rate for the whole economy can disguise important differences among different consumers in the economy. For this reason, The Ministry of Finance has created a simple inflation model, to show the inflation faced by different income groups and different sections of the economy. This was done using the consumption data from the 2009/10 NHIES and then applying these consumption patterns to monthly inflation data (which is broken down by different categories of goods/services).

The graph below, for example, shows that the bottom 10% of income earners have generally faced higher inflation than the top 10% of income earners and the average income earner. This is because the poorest in society spend a higher proportion of their income on food, which has faced high levels of inflation in recent years.



Source: NSA, NHIES and MoF own calculations

The analysis in the model also extends to sources of income. People whose main source of income is the state pension have faced higher inflation than those with steady salaries. Again, this is mainly due to the large proportion of their income spent on food.

The difference in inflation faced by different sections of society is not massive, but it does show that the most vulnerable in society may often face higher inflation than presented by the overall NCPI. This has important policy implications for social grants, pension increases, and increases to salaries, for example.

Overall Conclusions

The Ministry of Finance is regularly monitoring developments in the economy in light of the new data emerging. The Preliminary National Accounts data for 2011, as well as the July 2012 IMF projections have given the Ministry an opportunity for such a review. The preliminary data show that the Macroeconomic Framework for the 2012/13 budget is still a prudent basis for fiscal planning.

However, as highlighted above, uncertainty remains, particularly amongst Namibia's key trading partners. GDP growth in Namibia for 2012 remains uncertain and the first half of the year has shown a mixed picture across different sectors of the economy.

Enquiries and comments can be addressed to:

Director: Economic Policy Advisory Services
Ministry of Finance
Fiscus Building
Private Bag 13295
10 John Meinert Street
Windhoek
NAMIBIA
Tel: +264 61 209 2131
Fax: +264 61 245 696
http://www.mof.gov.na