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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 look at the demographic opportunities and challenges facing Namibia.

Global Developments

With the Euro zone crisis intensifying, and economic activity in the US remaining weak – in addition to the spill over effects these dynamics continue to have in emerging and developing economies – the outlook for the global economy has weakened further in the third quarter of 2012. Indeed, these factors have prompted the IMF to once again lower its growth forecasts for world output, having already done so in July 2012. The IMF is now projecting **global growth of 3.3% and 4.1% in 2012 and 2013, respectively**. Medium-term prospects, however, although slightly weaker have remained largely unchanged, with the IMF now anticipating average growth of 4.4% over the 2013-16 period (compared to the 4.5% projected in July).

The ongoing woes in **advanced economies** are now expected to persist deep into 2013, leading the IMF to lower both its **2012 and 2013 growth forecasts to 1.3% and 1.5%, respectively**. The Euro zone crisis continues to deepen as debate persists among members over how to move forward, with the region's most troubled countries remaining hesitant about enacting harsh austerity measures, and leading economies reticent to extend further help unless fiscal and structural adjustments are carried out. This in turn is dragging on the entire global economy, exacerbating already precarious situations in other leading economies. Indeed, the UK is now expected to contract in 2012 by 0.4%, having previously been expected to grow by 0.2%, while the IMF has also lowered its growth forecast for 2013 to 1.1% (from 1.4% in July).

Meanwhile, economic activity has also showed renewed signs of weakness in the US. Although real GDP growth accelerated to 2.0% in the third quarter of 2012 from a lower than anticipated 1.3% in the second quarter, concerns about the health of the US economy persist, particularly against a backdrop of mounting fiscal concerns. Despite these worrying developments, the IMF has actually increased its 2012 growth forecast for the US to 2.2% (from 2.0% in July), largely on the back than better than expected outturn in the first quarter. However, this upwardly adjusted figure was based on second quarter growth of 1.7%, rather than the most recently revised number of 1.3%, so could be subject to further downgrading going forward. More in line with broader trends, the IMF lowered its 2013 forecast for the US to 2.1% (from 2.3% in July).

These weaker growth forecasts across advanced economies (forecasts for Japan were also downgraded, to 2.2% for 2012 and 1.2% in 2013) are based, however, on the assumption that European countries will continue to ease monetary policy in order to support growth and that the US will avoid the so-called 'fiscal cliff' by reaching a compromise on its budget law and tax cuts. Thus, risks are still weighted to the downside, and remain considerable should these vital policy actions fail to materialise.

Muted economic activity in advanced economies, meanwhile, continues to impact upon emerging and developing economies in the form of weaker demand for exports. **Emerging and developing economies are now forecast to grow by 5.3% in 2012 and by 5.6% in 2013** (down from previous projections of 5.6% and 5.9%, respectively). However, the blame for slower growth in the developing world cannot be solely attributed to the deteriorating conditions in advanced economies, as home-grown problems also continue to dampen the outlook across emerging and developing economies.

Indeed, a combination of weaker external demand, a tightening of credit conditions to ward off the threat of real estate bubble and a return to more sustainable levels of public investment has seen the IMF cut its projections for China for both 2012 and 2013. Growth is now forecast to dip below eight percent in 2012 and to come in at only 8.2% in the following year. Meanwhile, India's growth forecast for 2012 was slashed to 4.9%, down from the 6.1% projected in July after growth slowed more than expected in the first half of the year on the back of the weaker external environment, stalled investment activity caused by slow approvals for projects, deteriorating business confidence and interest rate hikes to rein in inflation. With these issues unlikely to witness a speedy resolution, the IMF also cut its 2013 forecast to 6.0% (from 6.5% in July).

The other BRIC nations have also been downgraded by the IMF, with Russia now expected to grow by 3.7% and 3.8%, respectively, in 2012 and 2013, and Brazil – hindered by the effects of past efforts to tightening monetary policy to curb inflation and credit growth – forecast to growth by 1.5% and 4.0% over the same time horizon. However, even in light of this more downbeat outlook, just as for advanced economies, significant downside risks to growth exist in emerging and developing economies, both on domestic and external fronts.

Sub-Saharan Africa

In line with the weaker global outlook, **the growth forecast for Sub-Saharan Africa (SSA) has also been lowered for 2012, to 5.0%** from the 5.4% projected by the IMF in July. However, **economic activity is now expected to bounce back stronger than previously anticipated next year, with the IMF forecasting SSA growth of 5.7% in 2013**, up from its prior projection of 5.3%.

However, growth is still expected to remain robust due to the region's relative insulation from external financial shocks, and will be underpinned by continued strong growth in oil-exporting countries. Indeed, Nigeria – the region's second largest economy – is forecast to grow by 7.1% in 2012 and by 6.7% in 2013 while Angola (SSA's third biggest economy) is expected to grow by 6.8 and 5.5%, respectively, in 2012 and 2013.

That said, risks to growth in both of these economies – and in commodity exporting countries in SSA general – are weighted to the downside due to the ongoing uncertainties in the global economy. If the ongoing economic concerns in advanced economies continue to worsen, and global demand continues to weaken as a consequence, this would have significant repercussions for SSA, both in terms of softer demand for the region's exports and in terms of lower commodity prices. This scenario could be made even more acute if weaker growth in advanced economies spills over into China, resulting in a sharp slowdown in the world's most populous nation. This would not only be because of the deepening trade linkages between SSA and China, or because of the impact slower growth in China may have on commodity prices, but also because of China's increasingly important contribution to the region's FDI and official financing.

Meanwhile, South Africa – the region's largest economy and Namibia's most important trading partner – remains particularly vulnerable given its close linkage with Europe. Indeed, South Africa is expected to experience a period of subdued growth over the near term, with economic growth forecast to be 2.6% in 2012 and 3.0% in 2013 – a downgrade from the IMF's July forecast of 3.3%.

Namibian Economy

Latest NSA figures showed that **domestic economic activity rebounded in the second quarter of 2012 to grow by a seasonally adjusted 1.6% y-o-y**, following a contraction of 0.7% in Q1. Unadjusted, GDP grew by 8.9% y-o-y in Q2, accelerating from the 3.7% growth figure posted in Q1 and bringing growth for the first half of the year to 6.3%.

Having shrunk by 10.8% in the first quarter of 2012, the primary sector grew by 29.4% y-o-y in Q2, despite contractions in both the agriculture (-12.7%) and fishing (-7.4%) sub-sectors, as mining and quarrying rose by a mammoth 89.6%. Meanwhile, growth of secondary industries accelerated from the 2.6% y-o-y growth figure posted in Q1 as they expanded by 14.7% in the second quarter. After contracting by 2.6% in the first quarter, manufacturing bounced back in Q2 to post growth of 14.0%, while the electricity and water and the construction sub-sectors also recorded double-digit growth, expanding by 15.9% and 16.4%, respectively.

Finally, the tertiary sector – which accounted for 56.5% of GDP in nominal terms in 2011 – experienced weak growth in Q212, expanding by only 1.5% y-o-y having posted growth of 5.7% in the previous quarter. Of the nine sub-sectors that make up the tertiary sector, only transport and communication (which grew by 13.1%) and health (1.2%) saw faster growth in Q2 than in Q1, although growth in the education sub-sector remained unchanged at 4.6%. Meanwhile, the hotels and restaurants and the financial intermediation sub-sectors shrank in Q2, falling by 7.5% and 8.2%, respectively.

Despite the positive outturn in the first half of 2012, the outlook for the rest of the year is somewhat more downbeat. As a small and open economy, Namibia remains very vulnerable to developments in the world economy, particularly in Europe given that the Euro zone accounted for more than 25% of Namibia's exports in 2011. Indeed, this figure rises to 55% if the UK, Switzerland and Sweden – all of which continue to suffer from the fallout in the Euro zone – are included, while South Africa (Namibia's largest trading partner) is also heavily exposed to the Euro zone crisis. Therefore, against a backdrop of weakening global growth, **Namibia is forecast to grow by 4.0% in 2012 and by 4.3% in 2013**.

Balance of Payments

Having recorded a surplus of N$796mn in the final quarter of 2011, **Namibia's current account registered a deficit of N$1.3bn in the first quarter of 2012**, according to the latest Bank of Namibia (BoN) data. The trade deficit widened from N$3.4bn in Q411 to N$3.8bn in Q112, despite imports falling by N$186mn to N$12.0bn, as exports contracted by N$522mn. This decline from the N$8.8bn posted in Q411 was led by a 18.5% q-o-q fall in exports of food and live animals, and compounded by 5.6% and 5.3% declines, respectively, in the exports of manufactured products and other mineral products.

Meanwhile, although services recorded a surplus of N$432mn in Q112, investment income reverted to a deficit of N$697mn, having posted a surplus of N$1.1bn in the previous quarter. This saw the goods, services and income balance more than double in the first quarter of 2012, widening to N$4.0bn from N$1.9bn in Q411. Current transfers, however, were able to somewhat offset the large goods, services and income deficit. Current transfers totalled N$2.7bn in Q112, marginally (N$39mn) higher than the previous quarter. Transfers from SACU and development assistance made up the vast majority of current transfers, accounting for 96.5% of the gross total.

Namibia's capital account balance also plunged into the red in Q112, recording a deficit of N$2.5bn having posted a positive balance of N$3.8bn in Q411. This transpired despite direct investment increasing almost five-fold in the first quarter of 2012, to N$1.5bn from N$315mn recorded in the fourth quarter of 2011, due to a sharp reversal in portfolio investment Portfolio investment posted a surplus of N$2.8bn in Q411 on the back of a substantial debt issuance of N$3.9bn, but without a repeat of this in Q112, portfolio investment reverted to a shortfall of N$1.6bn.

Fiscal Policy

Weak global and domestic growth prospects presents a significant challenge to fiscal policy as low economic growth has a significant impact on tax revenues. With this in mind, therefore, there is currently little room for fiscal manoeuvring to support flagging growth – particularly given the need to address remuneration and conditions of service for public servants following recent union negotiations. The current budget estimates that revenues and grants will total N$35.4bn in 2012/13, while total expenditure will be N$40.2bn, resulting in a fiscal deficit of N$4.7bn, or 4.5% of GDP. This is forecast to widen to N$5.7bn in 2013/14, or to 4.9% of GDP, as revenues dip slightly to N$35.3bn and expenditure rises to N$41.0bn. These budget deficit figures are subsequently expected to translate into total debt of N$28.3bn (27.1% of GDP) in 2012/13 and N$34.5bn (29.6% of GDP) in 2013/14. It should be noted, however, that these estimates are subject to revision in the upcoming Fiscal Policy Framework, which is due to be published in January.

Monetary Policy

In the statement released following its most recent meeting on 11 December 2012, the Monetary Policy Committee (MPC) of the BoN highlighted that in light of recent developments on both the global and domestic fronts, the MPC "continues to hold the view that the current low interest rate environment should be maintained in order to ensure that growth is supported in the local economy going forward". The MPC also stated that by maintaining the current low interest rate environment, "it will also help to mitigate, as far as possible, the impact of the slowdown in growth seen in many of our trading partners".

The BoN cut the benchmark Repo rate by 50 basis points at its August 2012 meeting to its current level of 5.50%, but "resolved to keep the Repo rate unchanged" in December. Given the ongoing uncertainty currently being experienced in the global economy, **the BoN is expected to maintain interest rates at 5.50% for the foreseeable future**, although the MPC is likely to retain a hawkish bias, meaning that any movements in the Repo rate are liable to be downwards.

Consumer Prices

Having steadily decelerated from a peak of 7.4% y-o-y in February to a nine-month low of 5.6% in July, consumer price inflation has once again begun to tick higher. Consumer price inflation accelerated to 7.1% in October, from 6.7% in September, largely on the back of higher food prices. The price of food and non-alcoholic beverages – which hold a weighting of 26.9% in the consumer price index (CPI) – rose by 10.1% in October, up from 9.2% in the previous month, with price increases accelerating in all sub-groups baring non-alcoholic beverages. The food items which posted the biggest increases in November included Bread and cereals (12.4% y-o-y), Oils and fats (12.1%) and Meat (11.8%). That said, Housing, water, electricity, gas and other fuels – which holds the second largest weighting in the CPI at 20.6% – did see a slight moderation in price increases in October, decelerating from 7.6% y-o-y in September to 7.4% in October, while Transport, the third biggest component of the CPI at 14.8%, followed suit, slowing from 6.3% y-o-y to 6.1%.

Inflation looks as though it is set to continue trending upwards over the near term as cost-push pressures drive prices higher. Global food prices are expected to continue trending higher until around the second quarter of 2013, and given the heavy weighting of food and non-alcoholic beverages in Namibia's CPI, this will maintain upward pressure on domestic prices. Moreover, the recent depreciation of the rand – and therefore of the Namibian dollar – will also add to inflationary pressures as imports become more expensive, while labour unrest in South Africa could spill over into Namibia in the form of supply constraints on imported goods from SSA's largest economy.

Although an expected downward trend in oil prices over the remainder of 2012 and throughout 2013 could help to mitigate inflationary pressures somewhat, this positive development is likely to be offset by the aforementioned rising food prices and a weaker currency. Moreover, in light of ongoing under-recoveries in the fuel price mechanism, there is an increasing chance of further hikes in pump prices going forward.

Against this backdrop, therefore, **consumer price inflation is expected to remain elevated through Q412 and Q113 before easing over the remainder of 2013, with inflation expected to average 6.6% in 2012, falling to 5.5% in 2013**.

Oil Prices

Having steadily declined over the course of Q2 to reach an 18-and-a-half-month low of US$88.22/bbl in June, the price of Brent crude oil once again ticked higher in Q3. Brent crude – the key price benchmark outside the North American market – averaged US$109.63/bbl in Q3, but has since begun to trend down again since reaching a peak of US$117.48/bbl in September. **This downward trend is expected to persist throughout the remainder of 2012 and throughout 2013 as a result of both weaker demand and an improved outlook for supply**. Demand is expected to fail in line with slower global economic growth, while although geopolitical risks still persist – particularly with regards to ongoing conflicts across the Middle East – previous supply constraints such as the Libyan civil war are expected to abate.

Commodity Prices

The IMF's All Commodity Price Index (ACPI) fell for the eighth straight month in November, by 2.8% y-o-y, led by a 4.5% fall in fuel prices and a 4.3% decline in industrial inputs prices. This fall in the price of industrial inputs was the result of the price of both agricultural raw materials and metals once again posting declines in November, of 1.4% y-o-y and 5.8%, respectively. This marked a 13th consecutive month of declines for agricultural raw materials and a 14th straight month for metals. However, it should be noted that the pace of declines for both sub-categories has been decelerating in recent months, suggesting that positive price growth could soon once again be registered.

The declines in the prices of raw agricultural materials and of metals can largely be explained by the ailing health of the global economy, which has seen demand weaken. Conversely, however, demand for food and beverages has remained robust, even in the face of waning economic activity. Indeed, despite the fall in industrial inputs prices, non-fuel prices recorded their first increase September 2011 in November, climbing by 0.6% y-o-y. This was the result of the ongoing strong growth in food prices, which continue to be well supported by a combination of healthy demand and weather-related disruptions worldwide putting a strain on supply. Indeed, although food price growth slowed from the 7.9% y-o-y figure posted in October, it remained high at 7.7% in November.

Global food prices are expected to continue trending higher until around the second quarter of 2013, after which time they are once again expected to head gradually south, although they are expected to remain elevated. Meanwhile, **the prices of raw agricultural materials and metals are forecast to maintain their current downward trend over the remainder of 2012, although an improving outlook for global growth next year – particularly in China – will see prices of these commodities reverse their recent trend in 2013**.

SPECIAL FEATURE
Spotlight on: Demographics

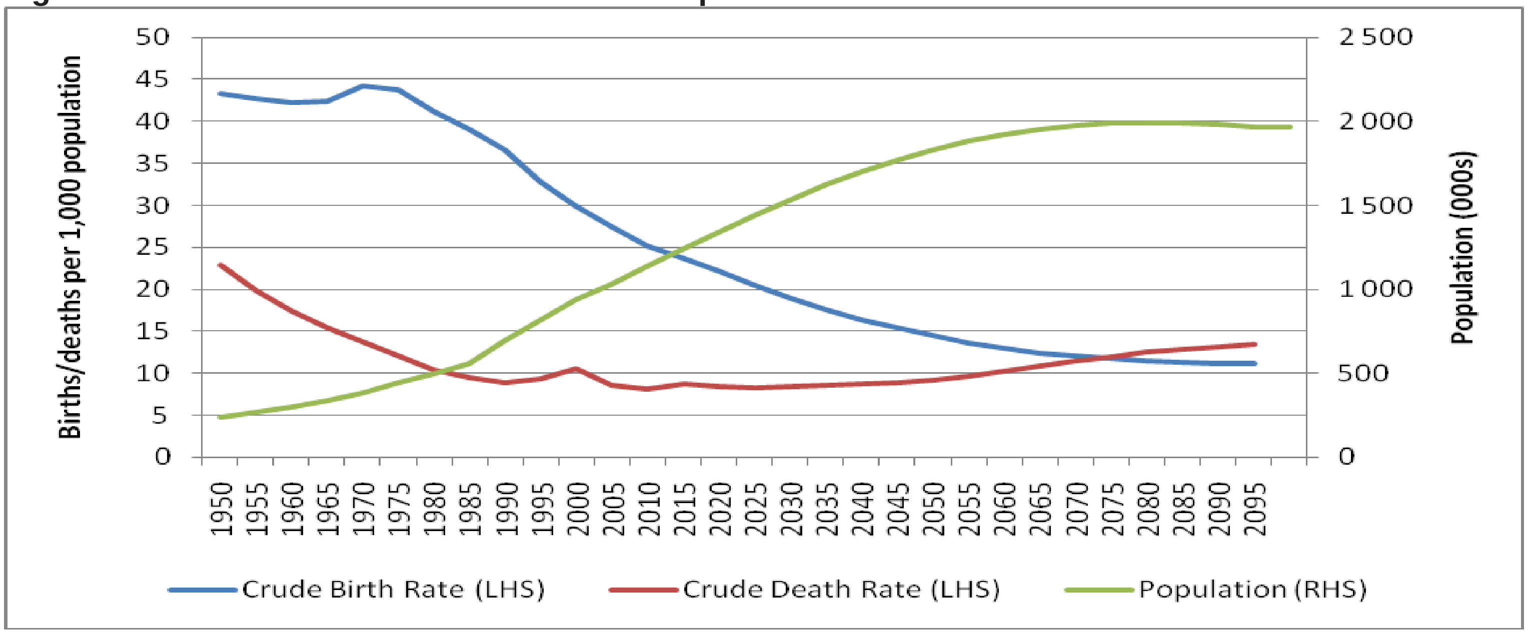
Launched in 2004, *Vision 2030* sets out the Government's long-term development agenda for Namibia, envisioning that by 2030, Namibia will be a prosperous, harmonious, industrialised nation. To achieve this goal, the document emphasises the importance of attaining sustainable development, going as far as to state that "the principle of sustainable development is the cornerstone on which the strategies for realizing the objectives of Vision 2030 pivot"[1].

Population issues are critical to achieving sustainable development. Among other things, demographic factors affect poverty and inequality levels, economic activity and public finances, all of which are central to launching Namibia onto a sustainable development path and achieving its long-term goal of establishing itself as a prosperous, harmonious industrialised nation.

Demographic Transition

The demographic transition model proposes how populations change over time by examining changes in birth and death rates. The first stage of the demographic transmission model is the 'high stationary' stage, which is characterised by high and fluctuating birth and death rates, and low population growth. This is followed by the 'early expanding' stage, where death rates fall due to improved healthcare, sanitation, education and food supply, while birth rates remain high, leading to high population growth. The third stage is the 'late expanding' stage where the gap between birth and death rates narrows due to improvements in family planning and increases in female literacy and employment, urbanisation and wages. As the birth rate falls in stage three of the demographic transition model, population growth begins to level off. Stage four of the model is the 'low stationary' stage, where both death rates and birth rates remain low, giving rise to low population growth and a steady and high population. The final stage – which has been added recently to the model based upon recent countries experiences – is the 'declining' stage, where birth rates fall below death rates and the population begins to fall.

Figure 1: Crude Birth and Death Rates and Population in Namibia



Source: UN

Namibia is currently at the 'late expanding' stage of the demographic transmission model, with a low crude death rate of 8 per 1,000 population as of 2010 and a crude birth rate which has been steadily falling since the 1970s, from a high of 44 per 1,000 population in 1975 to 25 per 1,000 population in 2010. This transformation has consequently seen population growth slow from as high as 24.2% over the 1985-1990 period to 10.2% over the five-year period to 2010.

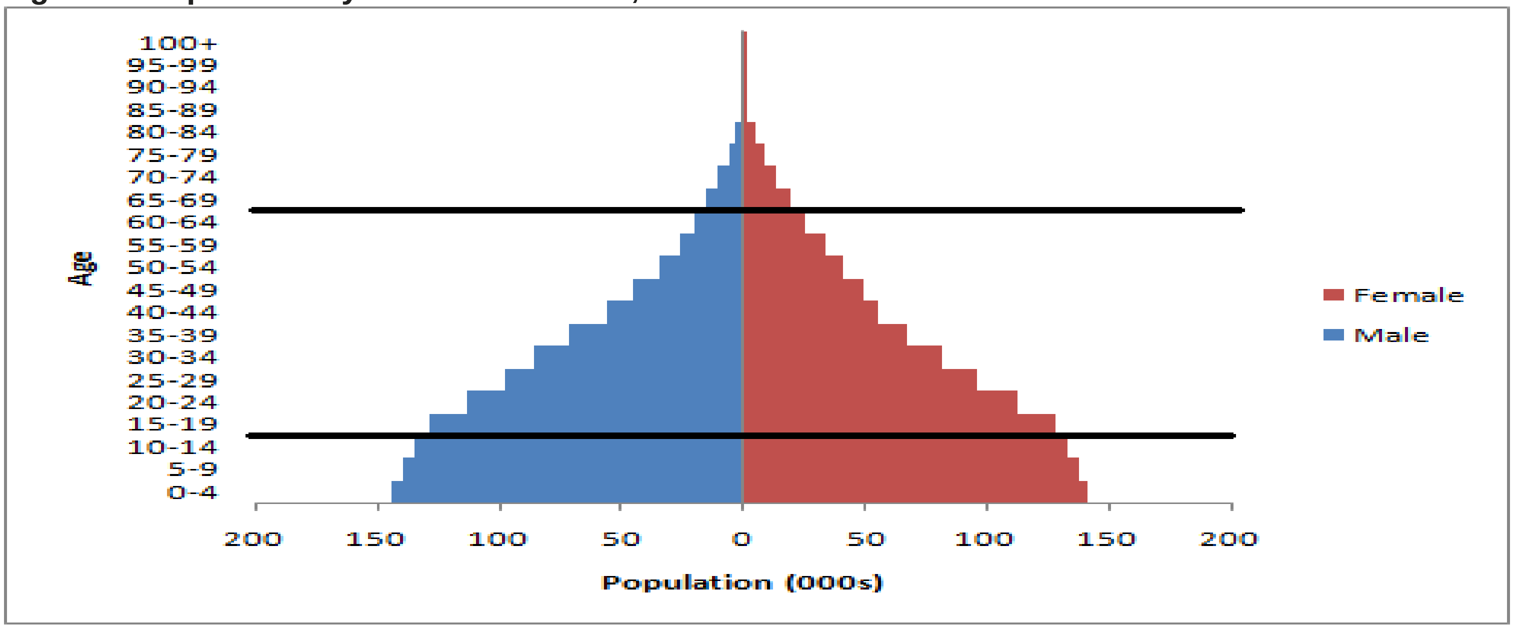
Population Structure

Accompanying changes in birth rates, death rates and population size are corresponding changes in population structure. During the first stage of the demographic transition model, a country's population pyramid (a graphical illustration that shows the distribution of various age groups within a population) is typically very wide at the base and very narrow at the top, forming a triangle with very steep sides. The typical population pyramid in stage two assumes a similar shape as in stage one, but with shallower sides, while in stage three, the sides of the population pyramid become straighter and the top becomes flatter. Finally, in stage four, the population pyramid assumes a barrel-like shape, with the middle wider than either the top or the base.

The structure of a country's population has important implications for its economic development, as well as for planners, policy makers and researchers. A country with a population pyramid featuring a wide base and a narrow top tells us that that the country in question has a young population and an associated high child dependency ratio. This is the ratio of the number of people aged 0-14 to the number of people of working age (aged 15-64), and is critical in assessing the pressure being placed on a country's economically productive population (those of working age). Similarly, a population pyramid which has a wide top will have an ageing population with an attendant high aged dependency ratio (the ratio of the number of people aged 65+ to the number of people of working age), which will also place pressure on the economically productive population.

Although Namibia has entered the third stage of the demographic transition model, with low death rates, falling birth rates and slowing population growth, the country's population pyramid more closely resembles a country in 'early expanding' phase of its demographic transition. Indeed, in 2010 the child dependency ratio for Namibia was 60.8 while the aged dependency ratio was only 7.0.

Figure 2: Population Pyramid for Namibia, 2010



Source: UN

Demographic Dividend

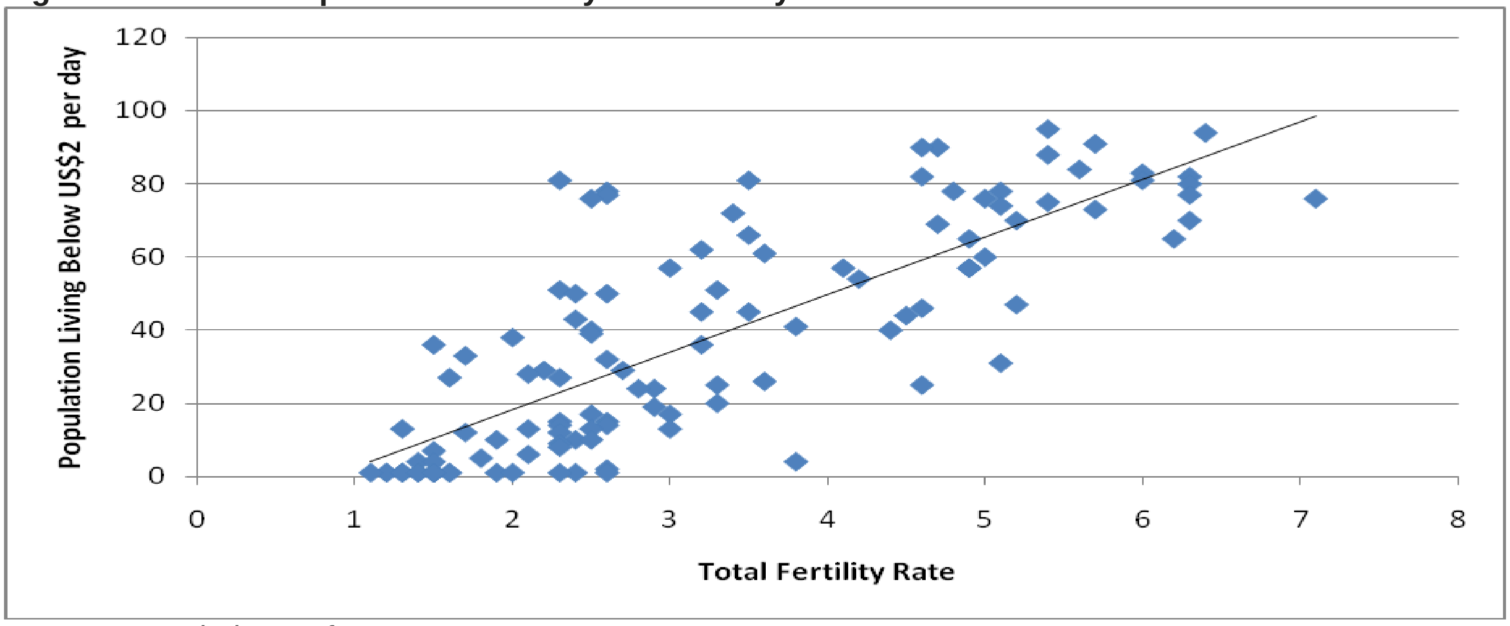
As Figure 1 shows, the birth rate in Namibia has been declining since the 1970s. This has lead to slowing population growth as well as an ageing of the population, with the average age in Namibia having risen from a nadir of 23.6 in 1985 to 26.0 in 2010. In addition to these developments, the fertility rate (the average number of children per woman) has declined, from a high of 6.6 in 1975-80 to 3.4 in 2005-10. This combination of factors has led to a bulge in the population which starts at the base of the population pyramid and gradually works its way up over time.

While this population bulge initially proves to be a burden on society as it swells the child dependency ratio, as it moves up the population pyramid it can create what is known as the 'demographic dividend' or 'demographic gift'. This is where a large and expanding workforce combined with a low dependency ratio as a result of demographic change provides a significant boost to economic growth. Indeed, the World Health Organization (WHO) estimates that the demographic dividend can increase a country's GDP growth by as much as a third.

There are four main mechanisms for growth in the demographic dividend. Firstly, the increase in the working age population leads to an **increased labour supply**. Secondly, as the number of dependents decreases, individuals can save more. This **increase in savings** increases the stock of capital, leading to higher productivity as the accumulated capital is invested. Thirdly, decreases in fertility rates result in fewer economic pressures at home as there are fewer children to care for. This subsequently allows parents to invest more resources per child, leading to better health and educational outcomes and thus **improvements in human capital**. Finally, with fewer dependents and a higher working age population, households have more disposable income which creates **increased domestic demand**.

The demographic dividend also has important implications for poverty and income inequality as the growth it generates helps to increase the incomes of poor households and thus helps to lift them out of poverty – a development which should also help to narrow the gap between the poorest and wealthiest in society. Moreover, falling fertility rates also have an important impact on poverty. As was previously noted, decreases in fertility rates alleviate economic pressures on households, and this also contributes to helping the poor escape from poverty. Indeed, there is a well established positive correlation between fertility and poverty rates, as highlighted in Figure 2. While causation may be argued (do high fertility rates cause high poverty rates, or do high poverty rates cause high fertility rates?), the general consensus is that the causality is circular with countries often experiencing a 'high fertility-poverty trap' in which low incomes may exacerbate high fertility rates and vice versa. Thus, it becomes clear that lower fertility rates will have a positive impact on poverty reduction as this cycle is broken. These developments are of particular importance in Namibia, where most recent figures show that 51.1% of the population live on less than US$2 per day[1] while the country's Gini coefficient stands at 0.58.

Figure 2: Relationship between Fertility and Poverty



Source: Population Reference Bureau

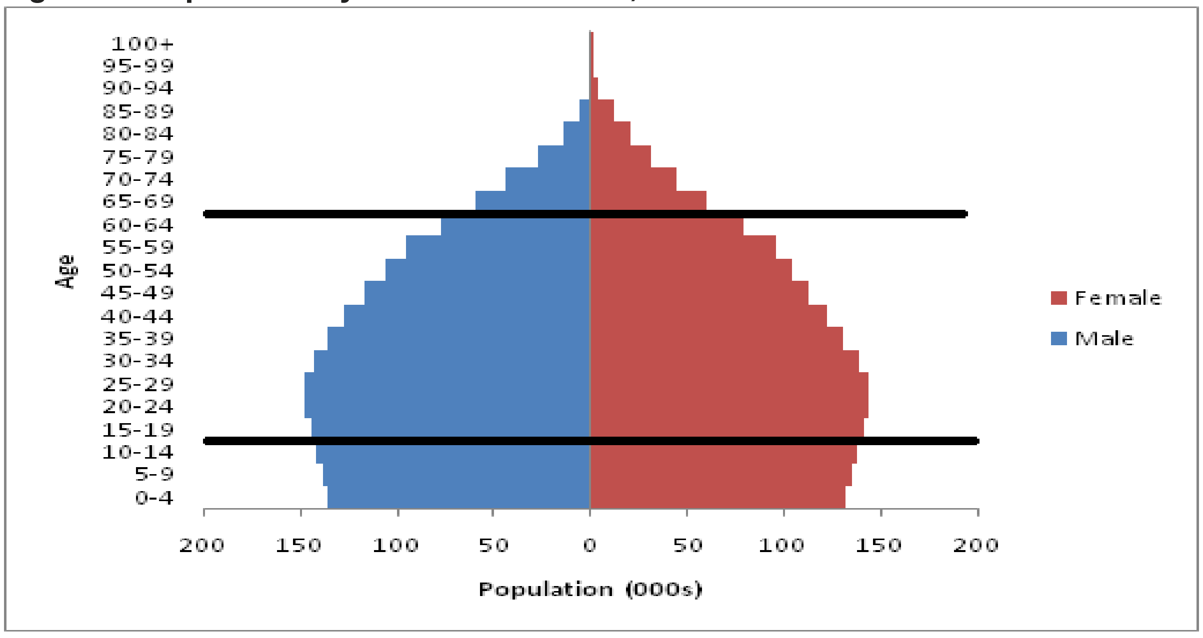
Key Challenges

As can be seen in Figure 2, this population bulge in Namibia is just starting to enter the economically productive population age range, suggesting that Namibia should begin to benefit from the demographic dividend over the coming years. However, it is crucial to note that in order to take full advantage of the demographic gift, it must be accompanied by effective public policies. Indeed, a country's ability to benefit from the demographic dividend is heavily dependent on its ability to absorb and productively employ the extra workers it provides.

This is a challenge already facing Namibia. With officially reported unemployment standing at 37.6% under the strict definition of employment – a figure which rises to a massive 51.2% under the broader definition – job creation remains a key Government priority. NDP4 is targeting the creation of 18,000 jobs per year over its five-year time horizon across all sectors of the economy, although specifically in the areas of wholesale and retail trade and repairs, manufacturing and construction.

However, recent initiatives to tackle unemployment and boost job creation have fallen short of their intended goals. NDP3 targeted employment growth of 2.6% a year between 2007/08 and 2011/12, but employment actually fell during 2004-2008. Meanwhile, the Targeted Intervention Programme for Employment Creation and Economic Growth (TIPEEG), which is targeting the creation of 104,000 jobs over the 2011/2012 to 2013/2014 MTEF period, only succeeded in creating 25,338 jobs in its first year, with just 7,326 (29%) of these permanent jobs. Moreover, the execution rate of available funds for the programme was only 71%. This suggests that greater efforts are still required if Namibia is to be in a position to take full advantage of its demographic dividend. Indeed, the urgency of this situation is magnified by the fact that the population bulge that created the demographic dividend will eventually pass beyond the working age population and once again become a burden on society as it swells the old-aged population and consequently increases the aged dependency ratio. Indeed, the UN projects that Namibia's overall dependency ratio will bottom out in 2050, after which time it will once again start to rise.

Figure 3: Population Pyramid for Namibia, 2050



Source: UN

This will pose further problems for policy makers as demand for public services such as healthcare rises, and state pensions also increase. The Ministry of Health and Social Services is already the third largest of the Offices, Ministries and Agencies (O/M/As) in terms of expenditure, spending N$3.6bn – or 8% of Namibia's total expenditure – in 2011/12, while Employers Contribution to the GIPF and MPOOBPF cost the Government around N$1.3bn in the same year, equal to approximately 5% of total recurrent operational spending.

In addition to this, fewer workers means lower tax revenues, which will consequently put further strain on the fiscus, while economic growth will also be put under pressure – via lower savings (and therefore investment) rates and weaker domestic demand – as the benefits brought about by the demographic dividend are reversed.

These issues really underscore the importance of Namibia placing itself in a position to take advantage of the demographic dividend by both absorbing and productively employing the extra workers it provides. Unless the demographic changes currently underway are combined with effective public policies to harness the benefits on offer, Namibia risks missing out on an important opportunity to boost growth and address key challenges such as reducing poverty and income inequality.