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Fitch Ratings drops Namibia's outlook to 'negative' due to concerns over the budget deficit and growth in public debt, but President Hage Geingob (2015-present) says there is no prospect of any debt default. Fitch is concerned that implementing the BEE law will hit foreign investment. To reduce the cost of external borrowing, new bond issues will be priced in rands. Finance minister Calle Schlettwein says he will set out spending cuts in October's mid-year budget review. Inflation has dipped but is forecast to remain high into next year; commissioning of the \$2.2 billion Husab mine is underway.

Geingob says no debt default after Fitch downgrade

President **Hage Geingob** (2015-present) has sought to calm the nerves of foreign investors and external creditors in the wake of ratings agency **Fitch** downgrading **Namibia's** outlook from 'stable' to 'negative' on 2 September. Fitch downgraded the outlook due to its concerns about the government's ability to meet deficit reduction targets as projected public debt (external and domestic) exceeds the government's 2016 target of 35% of gross domestic product (GDP). Fitch kept Namibia's international sovereign credit rating at BBB-, which is investment grade, and local bond issuance in the Namibian and **South African** markets at AA+. The agency noted:

"... a track record of political stability, slightly stronger governance indicators than rated peers, a net external creditor position, financing flexibility enhanced by access to the deep South African capital markets and a liquid banking system".¹

The presidency's economic adviser and former head of the **Namibia Statistics Agency (NSA)**, **John Steytler**, commented:

"We are not entirely surprised that this happened, knowing that globally there have been a lot of headwinds. Some countries have lost their credit ratings, so we're glad that we remain creditworthy and able to borrow at good rates."²

One of Fitch's key concerns was the budget outturn for 2015/16 resulted in a budget deficit of 8.3% of GDP – almost double the originally projected 4.3% due to low revenue (see *ARC Briefing Namibia March 2016*). This raised the prospect that the government might be unable to narrow the deficit in coming years.

*"Meeting deficit targets will prove challenging, particularly amid a secular (long-term) decline in revenues from the **Southern African Customs Union (SACU)** which the government projects will fall to under 7% of GDP by 2018 from 12% in 2014."³*

Fitch also highlighted the negative impact on business confidence of the proposed black economic empowerment (BEE) law, officially known as the **New Equitable Economic Empowerment Framework (NEEEF)**, which is currently out for consultation. The government may modify controversial clauses include the compulsory cessation of 25% equity stakes in all firms to BEE entities/individuals. Fitch stated:

¹ Fitch Ratings, 2 Sep 2016; New Era, 6 Sep 2016.

² Fitch Ratings, 2 Sep 2016; New Era, 5 Sep 2016.

³ Fitch Ratings; New Era 6 Sep 2016.

*“While lacking in details, it is likely that the law will be approved by parliament [although the **Supreme Court** might end up blocking it]. This has caused some unease in the business community and could slow down foreign investment in manufacturing and services.”⁴*

Capricorn Investment Management analyst **Suta Kavari** picked up the comment:

“Needless to say, NEEEF has caused a lot of jitters and unease in the local economy, leading to a major slowdown in foreign investment.”⁵

However, the president remains confident in Namibia’s economic trajectory. Geingob told delegates at the 71st session of the **United Nations (UN) General Assembly in New York** on 21 September that Namibia would not default on its debt. He said the global economic slowdown and low commodity prices had pushed the economy into a downturn after five years of robust growth. The government remains optimistic about the country’s long-term outlook as “*key economic fundamentals*” including fiscal sustainability, remain intact.⁶ He confirmed his government remains committed to managing the economy in a responsible manner:

“We would like to assure all our partners that there is no risk that Namibia will not honour its debt obligations in the near and medium term.”⁷

Namibia to issue \$5 billion in rand-denominated bonds in next decade

Geingob revealed Namibia intends to raise \$5 billion over the next decade in loans and bonds to finance the diversification and industrialisation of Namibia’s economy. Geingob said Namibia is looking at the South African bond market and some concessional loans:

“Rand bonds would be much better than [United States] US dollar-denominated Eurobonds.”⁸

To restrain further growth in foreign-currency denominated external public debt, Namibia will not issue any more Eurobonds in the foreseeable future. Namibia issued a \$500m Eurobond in 2011 and another \$750m one in 2015. As the Namibia dollar is pegged one-to-one to the rand, rand-denominated bonds would reduce exposure to the rand’s depreciation and make debts less expensive to repay.⁹ Namibia may also raise more concessional funding from **China, India, Japan** and the US, along with **German** investment, as a form of reparation for the **Nama/Herero genocide** in the early 20th century (see *ARC Briefing Namibia July 2016*).¹⁰

The latest **Bank of Namibia (BoN)** (central bank) data showed that central government external debt was N\$27.4 billion (US\$1.7 billion) in March 2016 – 17% of GDP, compared to N\$12.1 billion (US\$1.0 billion) in March 2015, up by 121% and 70% respectively. The Eurobonds comprised 68% of the total (50% previously) at N\$18.7 billion (US\$1.2 billion), respective increases of 207% and 127%.¹¹ Local economist **Rowland Brown** said investors would not be willing to lend Namibia additional money if the government spends unwisely.¹² However, borrowing to industrialise could be positive,

“... should these funds be used to address infrastructure constraints – as opposed to publicly-owned manufacturing industry supported by government contracts, subsidies and handouts – and provide for strategic public and social services.”¹³

⁴ Fitch Ratings; New Era 5 Sep 2016.

⁵ New Era, 6 Sep 2016.

⁶ New Era, 22 Sep 2016.

⁷ New Era, 22 Sep 2016.

⁸ The Namibian, 22 Sep 2016.

⁹ The Namibian, 22 Sep 2016.

¹⁰ Geingob quoted in The Namibian, 22 Sep 2016.

¹¹ Bank of Namibia, Quarterly Bulletin June 2016.

¹² The Namibian, 22 Sep 2016.

¹³ The Namibian, 22 Sep 2016.

Government to cut spending in October

The government will cut operational spending in its 2016/17 mid-year budget review in October 2016. Finance minister **Calle Schlettwein** identified a long-term decrease in SACU revenue as one of the key challenges to Namibia's finances:

*"One simply cannot expect to see the strong revenue growth of the 2012-14 period repeated in the coming few years."*¹⁴

Schlettwein said that the department plans to curb expenditure,

"... to ensure that we live within our means, doing more with less and improving the quality of spending, without relenting on initiatives to improve revenue performance".¹⁵

Specifically, Schlettwein disclosed that an analysis of the 2016/17 budget and three-year (2016/17-2018/19) **Medium Term Expenditure Framework (MTEF)** is underway, with the emphasis on spending cuts, including freezing civil service recruitment and funding.¹⁶ He added that the government was ready to pursue fiscal consolidation and deficit reduction at a faster pace than contemplated in the current MTEF.¹⁷

The situation may be more urgent than the government lets on. Unpublished figures from **Windhoek**-based stockbrokers **IJG Securities** indicate both the 2015/16 budget deficit and outstanding public foreign debt may be worse than official figures disclose.¹⁸ An analyst confirmed that when the government tabled the 2016/17 budget in March, there was strong scepticism about the finance ministry's revenue growth assumptions for the current MTEF period to 2018/19.¹⁹

At a Windhoek press conference where he was accompanied by Steytler and **National Planning Commission (NPC)** director general **Tom Alweendo**, Schlettwein pledged that the necessary expenditure "*realignment*" will be undertaken to ensure public finances are placed on "*a sustainable trajectory*" without jeopardising economic growth. This would involve revising tenders for government contracts, which he acknowledged "*are usually inflated and not value for money*".²⁰ Subsequently, the finance ministry took the unprecedented step of issuing a directive, on 12 September, freezing all new tenders.²¹ The directive instructed government bodies to suspend awarding new contracts until after the mid-year budget review.²²

Inflation is expected to stay high for now

Year-on-year (y/y) inflation decreased slightly to 6.8% in August from 7.0% in July according to the Namibia Statistics Agency.²³ Food and non-alcoholic beverages (16.5% weighting in the NCPI basket) recorded slower inflation of 11.5% (from 12.2% in July), along with housing, water, electricity, gas and fuels (28.4% of the basket) at 8.0% (8.2% previously).²⁴ Nevertheless, IJG noted that prices for most sub-components "*are increasing in double digits, which can largely be ascribed to the drought currently experienced in Namibia and South Africa*".²⁵

Because of slowing real GDP growth, the BoN is expected to keep its repurchase (repo) rate unchanged on 7.0% at its final two rate setting meetings on 19 October and 7 December, in line with a predicted pause in further monetary policy tightening by the **South African Reserve Bank (SARB)**.

¹⁴ Calle Schlettwein quoted in New Era, 6 Sep 2016.

¹⁵ New Era 7 Sep 2016.

¹⁶ New Era 7 Sep 2016.

¹⁷ New Era 7 Sep 2016.

¹⁸ Source, financial analyst, Windhoek

¹⁹ Source, financial analyst, Windhoek

²⁰ The Namibian, 7 Sep 2016.

²¹ The Namibian, 16 Sep 2016.

²² The Namibian, 16 Sep 2016.

²³ Namibia Statistics Agency (NSA)

²⁴ Namibia Statistics Agency (NSA)

²⁵ IJG Securities, Namibia CPI- August 2016.

Y/y growth in private sector credit extension (PSCE) slowed to 11.1% overall in July, down from 11.7% in June, while borrowing by individuals fell by two percentage points to 9.7%, the lowest level for almost two years.²⁶ Credit growth to business decreased by a fractional 0.1 percentage point to 12.8% in July.²⁷

IJG expects inflation to remain relatively high into 2017.²⁸ Last year's sharp depreciation of the South African rand has inflated the local currency-denominated cost of imports into the **Common Monetary Area (CMA) (Lesotho, Namibia, South Africa and Swaziland)**.²⁹ Crude oil prices, while remaining weak, appear to be stabilising, and the previous deflationary impact has fallen away. The rand's depreciation has also raised costs for domestic services, including electricity and water utilities, while regional drought and poor harvests mean food prices will continue to rise.³⁰

Husab begins commissioning

Construction of the \$2.2 billion **Husab** uranium mine inland from **Swakopmund** is complete and commissioning is underway.³¹ **Swakop Uranium (SU)** chief executive officer **Zheng Keping** announced Husab's completion at the 15-16 September annual symposium of the **World Nuclear Association (WNA)** in **London (United Kingdom)**.³² SU had previously indicated Husab would complete commissioning by October but the process is taking longer due to routine technical difficulties, Zheng told *ARC* on the margins of the conference (see *ARC Briefing Namibia August 2016*). But he confirmed that Husab is still expected to ramp up to its full capacity of 6,800 tonnes per year of uranium oxide during 2017. The schedule is important for Namibia's prospect of accelerated growth next year as Husab alone is expected to increase GDP growth by at least one percentage point, as well as expanding export earnings by around 5%.

Taurus Mineral, a **Hong Kong**-based non-operative subsidiary of state-owned **China General Nuclear Power Corp (CGN)** and **China-Africa Development Fund (CADFund)** owns 90% of SU. Namibian government-owned **Epangelo Mining Co.** owns a 10% free-carried interest. The uranium spot market price remains low at \$25 per pound of uranium oxide, compared to an average range of \$35-40 per pound last year. This is due to restricted demand caused by continued high inventory levels at nuclear power utilities. Most Husab output will be supplied to China's expanding fleet of nuclear power plants, so the prevailing market price is not a factor. However, Husab may initially be producing at a loss.³³

Implications

The impact on Namibia of the deterioration in regional growth prospects – in South Africa and **Angola** in particular – and the government's fiscal policy failures lie behind the outlook downgrade. This has served as a wake up call. The government needs to accelerate the five years of fiscal expansionary policies that began in the 2016/17 budget tabled in March. This is especially true if the government's figures are optimistic, as sources suggest.

On the positive side, the government, from President Geingob downwards, has been pro-active in its response to Fitch's outlook downgrade. This could be the prelude to a ratings downgrade, unless the government implements sufficient spending cuts. It may also need to recalibrate expenditure forecasts for the remaining two fiscal years of the current MTEF, as the projected deficit targets now look unattainable. Deciding not to issue any US dollar-denominated Eurobonds (in retrospect, the decision to issue a second, large bond last year looks ill-conceived) for the foreseeable future is a start, as is the freeze on the award of any new government-funded tenders. Commissioning Husab will

²⁶ IJG Namibia, PSCE- July 2016.

²⁷ IJG Namibia, PSCE- July 2016.

²⁸ IJG Securities, Namibia CPI- August 2016.

²⁹ IJG Securities, Namibia CPI- August 2016.

³⁰ IJG Securities, Namibia CPI- August 2016.

³¹ Uranium Mining at Husab, 15 Sep 2016.

³² Uranium Mining at Husab, 15 Sep 2016.

³³ Fuel Cycle Week, 22 Sep 2016.

provide the government with a much-needed income boost in the current climate. Despite the initial risk of a small loss, the sales pipeline to China makes it an example of a profitable FDI deal.

These factors make the October mid-year budget review crucial to ward off a credit rating downgrade. BBB- is only just investment grade, a downgrade would put Namibia perilously close to junk status. It may be unable to avoid this as South Africa is at risk of a rating downgrade due to unsustainably high debt levels. One reason for Namibia's alacrity in responding to the outlook downgrade, is that Fitch (since 2005) and **Moody's** (since 2011) are the two credit rating agencies retained by the government for regular independent credit ratings assessments. These underpin external borrowing at affordable rates. Balancing spending cuts with maintaining pro-growth policies and poverty reduction goals – which Geingob told the UN General Assembly remain key priorities – will prove difficult.

It would help Namibia's creditworthiness if the government substantially modifies the proposed BEE law to remove the potentially destructive aspects that ARC highlighted in previous briefings this year. In his general assembly address, Geingob emphasised that private sector involvement in the economy was vital as the government is unable to fully fund all its development strategies. Dropping or significantly watering down BEE seems an obvious solution to achieve this. John Steytler, whose advice Geingob highly values, has raised hopes that BEE could be revamped in a more business-friendly shape by saying Fitch's criticism of the current proposal was premature, hinting that the final draft could be different. Both the local business sector and foreign companies are waiting for a clear signal that the government has heeded their message.

About Africa Risk Consulting:

Africa Risk Consulting (ARC) is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

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