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EAN Commentary

Moody's downgrades Namibia to non-investment grade

Moody's Investors Services has downgraded Namibia's long-term senior unsecured bond and issuer rating from Baa3 to Ba1 with a negative outlook on 11 August 2017. This has moved Namibia from a lower-medium investment grade to a non-investment grade or to 'junk' status as it is often referred to. Moody's Ba1 rating is equivalent to Fitch's BB+ rating. Namibia has however, so far maintained the investment rating with Fitch at BBB-.

Moody's cites the following reasons for its decision:

1. Erosion of Namibia's fiscal strength due to sizeable fiscal imbalances and an increasing debt burden

Rising total debts that rose to currently 42% of GDP, vulnerability to exchange rate risks, potential deterioration of SACU revenues as well as potentially higher than expected expenditure because of the upcoming SWAPO congress end of this year and the next presidential elections scheduled for end of 2019 are the factors behind the reassessment of Namibia's fiscal position.

2. Limited institutional capacity to manage shocks and address long-term structural fiscal rigidities

Fiscal consolidation based mainly on SACU revenue increases as well as the rising share of recurrent expenditure, in particular the high wage bill at the expense of the infrastructure expenditure are behind Moody's concerns about the fiscal consolidation path.

3. Risk of renewed government liquidity pressures in the coming years

Domestic liquidity concerns have been alleviated by the loan advanced by the African Development Bank, the improved inflation and exchange rate as well as improved revenue. However, future liquidity pressures cannot be ruled out, if fiscal consolidation does not move ahead as planned. Of concern to Moody's are the unbudgeted arrears to the private sector that could put pressure on the banking sector if the private sector cannot settle its debts.

EAN comments:

Moody's points out some valid risks on the revenue side. Lower than expected growth in South Africa could result in a reduction of the SACU Common Revenue Pool and hence in lower transfers to the SACU member states including Namibia. Although the South African rand and hence the Namibia dollar have appreciated against the USD and other currencies until end of July, the currency could come under pressure because of global and regional political events, such as the ANC congress later on this year. A depreciation of the NAD against the USD would result in an increase of the value of the Euro bond in local currency and in interest payments.

However, some of Moody's arguments seemed to be taken out of context. The increase of the relative share of wages and salaries in the current Financial Year 2017/18 is due to the budget cuts Government has initiated in order to rein the budget deficit and total public debts. Instead of using this increase as a sign for an increased fiscal vulnerability, Moody's could have used it as a sign for Government's efforts to reduce expenditure, the budget deficit and total public debts. Furthermore, Moody's is not taking into account Government's promise to settle outstanding debts with the private sector, which will reduce the risk of private sector defaults on loans and will improve the cash flow situation of companies and the liquidity in the economy. Finally, Moody's knew about the upcoming SWAPO congress end of 2017 and the next presidential elections in 2019 and should have taken concerns about expenditure overruns in the last assessment into account. It is not known whether these concerns are based on an analysis of previous budget performances ahead of party congresses and elections. The current budget does not provide any evidence that Government is embarking on an expansionary budget ahead of these two events.

Despite reservations with some of the assessment, the downgrading indicates that Government needs to continue and not relax the fiscal consolidation path. Government has taken serious steps to address a number of issues, such as 'wasteful' expenditure and bailouts for State-owned Enterprises (SOEs). However, other structural and policy issues need to be addressed as well in order to improve Namibia's investment rating:

- Government could conduct a comprehensive review of the public sector including the number of Offices, Ministries and Agencies as well as their functions and responsibilities with a view to streamline operations and reduce recurrent expenditure in particular the wage bill (see also the EAN opinion piece in Business 7 on 26 April 2017).
- A leaner public sector would free financial resources for vital investment in infrastructure that will create jobs in the construction and related sectors in the short term and can attract private sector investment and consequently job creation in the medium and long term. While cuts of capital expenditure are the easiest short-term measure to reduce expenditure, they jeopardise growth prospects, job creation and eventually tax revenue.
- Government needs to ensure that it receives value for money regarding infrastructure investment. It could therefore be considered to contract external (foreign) expert with no conflict of interest to review complex tender documents and bids. This could reduce the risk of inflated bids
- A public-sector review needs to review the need of the about 100 SOEs and their structures. The recent refusal to bail-out under- and non-performing SOEs, even if it results in their closure, is an encouraging sign that Government is taking a much stronger stance against non-performing and mismanaged SOEs. Unless there is strong evidence that bail-outs will contribute to social and economic development, scarce financial resources should be channelled to infrastructure developments that could create sustainable jobs.
- Some SOEs could be in part or fully privatised in order to reduce the risk exposure of Government as well as to provide opportunities for the private sector.
- Namibia's trade account deficit has to be levelled out by capital inflows. The country, therefore, needs an attractive policy environment to not only encourage foreign direct, but also domestic investment. The recently reported review of the Namibia Investment Promotion Act after submissions from the private sector indicates that Government is interested in working with the private sector to provide the best possible policy environment. The draft New Equitable Economic Empowerment Framework (NEEEF) has also sparked a necessary debate of how best to address the major challenges of inequality, poverty and unemployment and resulted in a substantial number of submissions from various stakeholders. Government in close consultation with the private sector

could design a policy that incentivises domestic and foreign direct investment and job creation and hence results in additional business opportunities.

Some of these steps can cause pain and hence need to be accompanied by mitigating measures. However, they are necessary in order to regain fiscal space, improve the investment climate and support economic growth and job creation.