Economic Association of Namibia

PO Box 6148
Windhoek, Namibia
M +264 81 155 9775
F: +264 88 622 267
E: info@ean.org.na
W: www.ean.org.na

EAN Commentary

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Fitch downgrades Namibia to below investment grade

Fitch Ratings has downgraded Namibia from BBB- to BB+, which is a non-investment rate on 20 November 2017. The revision was the result of extensive stakeholder consultations in Namibia at the end of October and beginning of November unlike the downgrading of Moody's Investors Services on 11 August 2017 that was based on desk research. Fitch Ratings accorded a stable outlook to Namibia in contrast to Moody's negative outlook.

The main reasons for the downgrade include:

- Government has not met its fiscal targets for the budget deficit and for public debts. Fitch expects a budget deficit of 6% for the Financial Year (FY) 2017/18 rather than the 5.3% anticipated by Government. Government revised the budget deficit for the FY2019/20 upward from 1% to 2.9%, while Fitch expects a deficit of 4.6%.
- Previously unreported arrears of NAD2.7 billion will put further upward pressure on the budget deficit and public debts and have highlighted shortcomings in the management of public finances.
- Government expects the public debt to GDP ratio to increase to 44.2% rather than to drop below 40%, while Fitch projects the ratio to rise to 47%.
- The payroll could absorb 50% of the total budget and the upcoming elections in 2019 could prevent more decisive steps to curb the wage bill.
- Fitch projects economic growth of 0.8% for 2017, which is half of Government's projection of 1.6%. Economic growth is expected to remain over the Medium-term Expenditure Framework well below growth rates in previous years (average of 5.7% between 2010 and 2015).
- Medium growth prospects are restraint by lack of fiscal space, subdued growth in Angola and RSA, as well as low commodity prices.
- Depreciation of the South African rand can affect public finances negatively since 30% of public debt is denominated in hard currencies.
- Foreign-currency reserves are expected to average 4.2 months mainly owing to the African Development Bank loan, repayments by the National Bank of Angola repayment, and asset repatriation. The latter is due to the gradual increase in the domestic asset requirement from 35% to 45%.
- Loss-making State-owned-Enterprises carry significant contingent liabilities due to Government guarantees.
- The current account deficit is expected to narrow from 14.5% in 2016to 6.9% on average between 2017 and 2019, which remains above the median of 2.1% for BB-rated peers.
- Fitch expects some policy uncertainties such as the New Equitable Economic Empowerment Framework (NEEEF) and the Namibia Investment Promotion Act (NIPA) to be removed after the SWAPO Congress.

EAN comments:

The writing was on the wall after Moody's downgrade in August and the tabling of the Mid-year Budget Review on 2 November 2017 that did not meet expectations. A number of measures could be implemented to reduce the budget deficit and total public debts:

- The budget review focussed to a large extent on the revenue side. However, tax revenue is dependent on the performance of the economy or in the case of SACU transfers on the performance of the South African economy and hence revenue is not under full control of the Namibian Government.
- However, Government has exempted quite a number of food items from Value Added Tax (VAT) some years ago. Most of these exemptions benefit mainly the better off and urban population, since the rural population has hardly any access to e.g. milk and bread or the poor cannot afford items such as milk. A review of the exemptions could increase revenue that could be used to strengthen the social safety net.
- More emphasis needs to be placed on the expenditure side, in particular the huge wage bill. It cannot be expected that natural attrition will result in a leaner and more efficient public sector. This will require a thorough analysis and review of the functions and structures of Government.
- There is room for efficiency gains by merging ministries or directorates with similar and or overlapping functions such as the ministries responsible for managing social grants - Ministry of Poverty Eradication and Social Welfare, Ministry of Gender Equality and Child Welfare, Ministry of Veterans Affairs. Another example are the Ministries of Agriculture, Water and Forestry and of Urban and Rural Development that are responsible for water supply to and sanitation in different areas.
- Some Government functions could be outsourced to the private sector, which would create jobs in the private sector and generate tax revenue.
- Public Sector Employees' contributions to the Public-Sector Employees' Medical Aid Scheme (PSEMAS) cover just 14% (NAD355.4 million) of the total costs of PSEMAS that amount to NAD2,533.3 million. Instead of using a flat rate that puts a much higher burden on low-income than on high-income earners, Government could replace the current system with a percentage contribution that would include a re-distributional element and recover a larger share of the total costs.
- Proper stock records could potentially save millions of NAD for goods, such as medicines, that disappear or expire.
- Cuts in the operational budget are inevitable in order to increase investment in vital infrastructure that will attract domestic and foreign investors, create jobs and generate tax revenue.

Closer cooperation between the public and private sector would improve the design of policies that are needed to address the main challenges Namibia is facing such as income inequality, poverty and unemployment on the one hand and to create an environment for the private sector to grow and create the necessary jobs. It is encouraging to note that Government has been listening to concerns regarding NEEEF and NIPA and is taking comments into account. Involving the private sector at an earlier stage would reduce potential pitfalls in policy design and avoid the risk that investors turn to other destinations. Private sector investment is vital to reduce imports and increase exports, hence reducing the current account deficit, but also to increase economic growth in order to reduce the budget deficit and public debt ratio.

Although the import cover of foreign currency reserves has improved significantly, this is no reason to relax since it is not due to increased economic activities and exports, but because of foreign loans, repayments and repatriation of assets. In order to increase the sustainability of foreign exchange reserves the trade deficit has to be addressed and foreign investment has to be encouraged.

The downgrading is expected to increase the future costs of borrowing, which will increase the allocation to statutory expenditure and will reduce the funds available for other vital expenditure. However, borrowing costs are most likely not affected in the short term, since the financial markets have to some extent factored in the possible downgrading.

The downgrading could result in foreign direct investors to review their investment decisions and expect a higher return that compensates for the increased risks. The downgrading could also affect Namibia's attractiveness for Public-Private Partnerships since some financial institutions might be prevented from financing PPP's in countries that do not have an investment grade.

However, not all is doom and gloom. The downgrading is again a reminder that we need to do things differently and break with old, bad habits. Some examples are given above regarding the budget. Other areas include the lack of accountability in some parts of the public sector and State-owned Enterprises that prevents the taxpayer from reaping the benefits from tax payments and prevents the economy to grow faster. With the right policies in place and mechanisms implemented to improve the business climate and competitiveness, Namibia will be able to turn the tide although it will take a few years probably to regain an investment grade.