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Reserves and the Namibian currency peg – By Rowland Brown

Over the past few years, Namibia's international reserve position has come under increasing pressure, as demand for Namibian currency by external parties has been severely outstripped by demand for foreign currency by Namibians. In 2015, the import coverage ratio (international reserves/monthly value of imports) fell to critically low levels, prompting hard currency bond issuance by the Ministry of Finance in order to protect the external position and fund part of the budget deficit.

At the time, this external issuance was necessary, but only to address a symptom of a problem, before it became a catastrophe (in the form of a rating downgrade to "junk" status). However, the issuance did little to address the root cause of the problem, which took the form of a huge trade account deficit, whereby Namibia was importing far more tradable goods than we were exporting.

Subsequently, the root cause of the problem has largely remained, despite some improvement in its magnitude, largely thanks to slightly higher interest rates and less government spending on consumables. As such, the country's external position remains under huge pressure, with reserves once again in notable decline. And this really matters.

The main reason for this is that reserves are needed to maintain the currency peg between the Namibia Dollar and the Rand, and the peg is desperately needed to maintain Namibia's development path. While this peg is not currently at risk, poor policy could see it under pressure, and very suddenly. The reason for this is that demand on reserves come from many angles. The aforementioned trade balance, and reserves for the CMA agreement are two such angles, however, of increasing importance is a third: the capital account.

The capital account is a measure of the flow of financial assets into and out of a country, with inward investment into Namibia being a positive, and outflows being a negative. With the recent decline in global commodity prices, one of the major drivers of capital inflows, namely investment into the mining sector, has all but dried up. However, more concerning of late has been changes/proposed changes to domestic policy/legislation that have made both domestic and international investors more cautious on the country. These developments may end up spooking capital, which is likely to have many consequences for the county. Most concerning amongst these, is the reserve and thus currency peg implication, as relatively small volumes of capital flight could cause a collapse in reserves, and a decoupling of the peg. Thus, if not cautiously managed, Namibia's development may well be derailed, and thus a call for better research into economic implications of policy proposals is not just warranted, but critical to our country's future.