The Namibian Balance of Payments, Foreign Exchange Reserves and the Currency Peg.

By Rowland Brown

As a small open economy, Namibia's balance of payments is arguably the single most important indicator of the health of the local economy. This is particularly true of Namibia, where a currency peg and twin deficits (current account and fiscal) present a form of "impossible trinity" if continued in perpetuity. In this vein, should a twin deficit situation exist for an extended period of time, an economy is likely to be forced to undergo a structural change (such as a currency peg decoupling), which can undermine the country's ability to generate inclusive and sustainable economic growth (Sustainable Development Goal 8), and as a result, sustain social development.

A country's balance of payments is the net of all imported and exported goods, services, financial capital and financial transfers. Thus, it represents a summation of demand for the country's currency, and the country's demand for foreign currencies. In the balance of payments, sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items and uses of funds, such as for imports, are recorded as negative or deficit items.

The balance of payments is made up of two accounts, namely the current account, and the capital and financial account. The current account consists of the balance of trade and cash transfers – payments or receipts for goods and services - while the capital account illustrates the net change in ownership of national assets.

Simply put, however, the balance of payments reflects goods and capital changing hands into and out of a country.

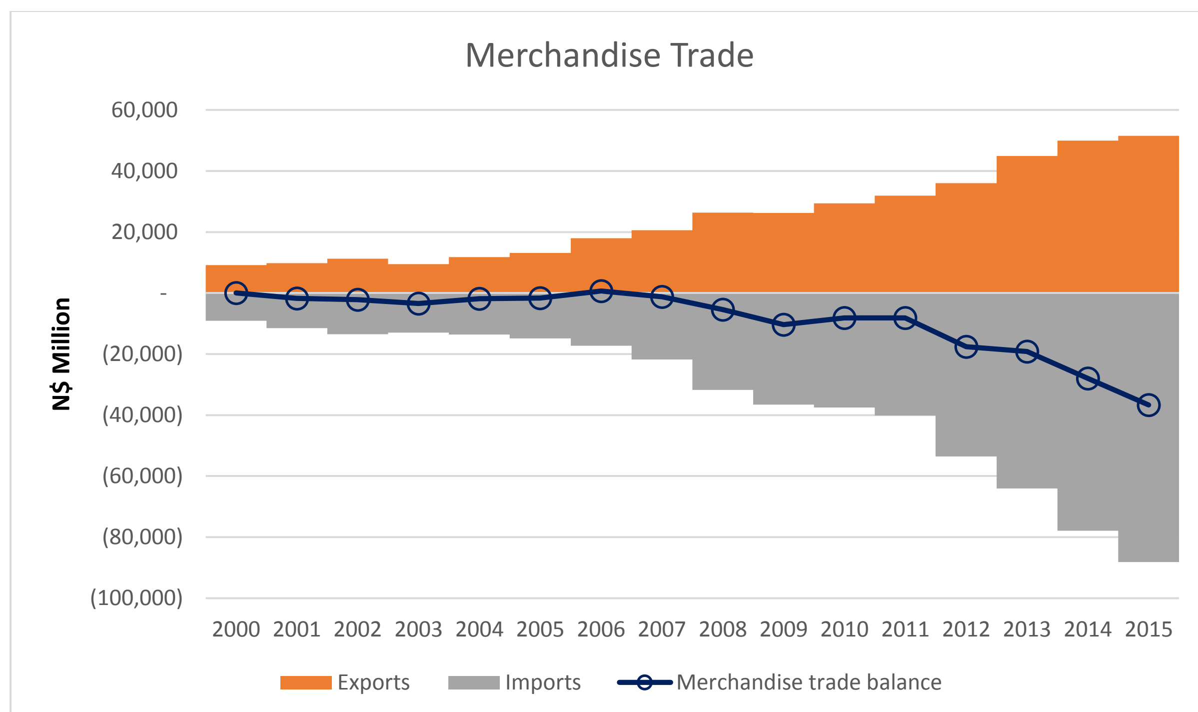
The Namibian balance of payments is determined by a handful of key factors as follows: On the side of the current account, the balance is largely determined by merchandise trade, with trade in services playing a smaller role, while on the capital account side, the overall balance is determined by portfolio flows into and out of the country, and foreign direct investment inflows, primarily.

At present, Namibia faces challenging times with regards to the balance of payments. There are a few reasons for this. From a merchandise trade perspective, Namibia historically relied on primary sector outputs for export earnings, particularly diamonds, uranium, gold, meat, fish and grapes. Through the commodity super cycle of the early 2000s, export prices were broadly favourable, especially for commodities. More recently, however, commodity prices have taken a dive, which has resulted in lower export earnings for Namibia, at least in hard currency terms. This has been partially offset by a weakening Namibia Dollar vis-à-vis major currencies, as well as some growth in sales volumes, particularly with regards to gold. Added to this risk is the ever-present possibility of drought, and the resultant negative impact on agricultural exports, particularly beef exports.

At the same time, Namibia's economy has grown admirably over the past half-decade. As a result of this, household incomes have expanded dramatically, and with the major growth seen, particularly in the middle class, has come major growth in demand for relative luxuries. As

Namibia does not produce very many luxury products, these goods must be sourced externally. As money flows out of the country to purchase these goods, it reflects as a negative on Namibia's current account. At the same time, Namibia has been through a sizable construction boom since 2011, which has added fuel to this fire. Some of this construction has been externally funded, particularly in the mining sector, while the rest has been funded domestically. Once again, little construction material is domestically produced, and as such these products have been imported.

As a result, Namibia has experienced ever larger merchandise trade deficits over the past five years, as illustrated below.



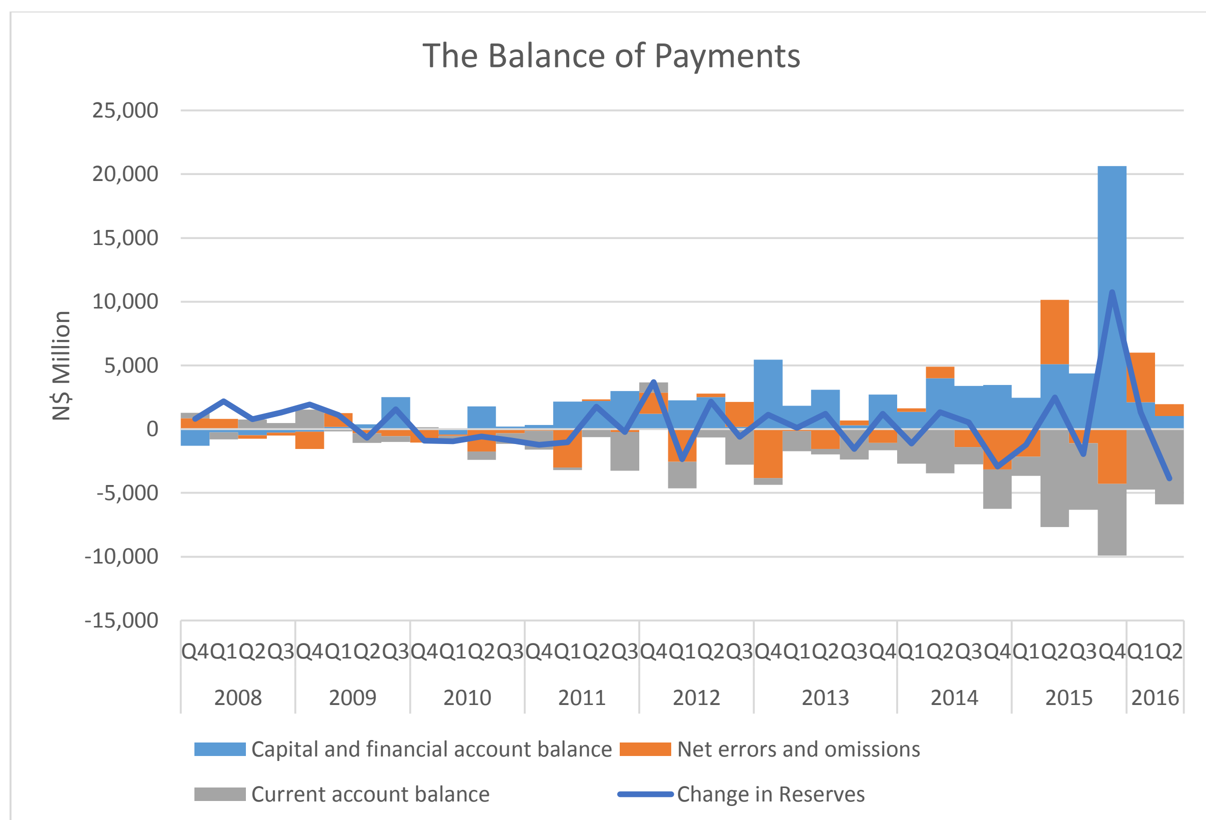
Source: Bank of Namibia

The merchandise trade deficit has historically been funded from three major sources: firstly, within the current account, via net inflows from tourism activities as well as inflows from the Southern African Customs Union (SACU); secondly from capital and financial account surpluses, primarily driven by inward foreign investment; and of late, by foreign public debt issuance.

However, in the recent past, SACU receipts have started to come under increasing pressure, as regional and global trade, the taxes from which form the bread and butter of the SACU revenue pool, has declined, taking with it SACU receipts. 2016/17 has been particularly harsh in this regard, as Namibia has been required to refund an overpayment made to the country in prior years, and as such the SACU inflow has been particularly weak. However, this situation is not likely to change dramatically in the immediate future, and SACU inflows are likely to remain under pressure. Thankfully, a weak Namibia Dollar, thanks to the goings-on in South Africa, has helped to make it relatively cheap for foreigners to visit Namibia. As such, the local tourism sector is booming, bringing with it foreign earnings.

On the other hand, capital flows have not been favourable of late, driven, particularly, by commodity price weakness. While historically much of our foreign investment came in the form of direct investment into the mining sector, this has now all but stopped, as the commodity price cycle turns against the country, like so many countries on the continent. In addition to this, policy uncertainty, particularly with regards to the New Equitable Economic Empowerment Framework/Bill, and the new Investment Promotion Act have also put local and foreign investors on the back-foot, with anecdotal evidence suggesting that these may be reducing foreign and domestic investment in the local economy. This is, of course, not to say that these policies are without merit, but rather to say that the uncertainty that currently surrounds them and their implementation, presents a challenge for foreign and local investors.

What all this means is that the current year, and in all likelihood, the next few years, are likely to prove challenging to the local balance of payments, and all things being equal, deficits can be expected.



Source: Bank of Namibia

The "last resort", if you will, for the funding of the deficit is the stock of international reserves held by the central bank – the result of the accumulation of historic surpluses. In the event of on-going deficits, this stock of foreign reserves will be called upon to "settle the bill", and a reserve drawdown will thus be incurred. While a reserve buffer is important to ensure that Namibia honours its foreign commitments, it is equally important to protect the currency peg with the Rand. As the Namibia Dollar can't depreciate in the event of large domestic demand for foreign currency over the Namibia Dollar, the Common Monetary Area Agreement stipulates that Namibia must maintain sufficient reserves to cover Namibian currency in

circulation, thus enabling the country to honour all external obligations to the South African Reserve Bank, the ultimate guarantor of the one-to-one currency peg.

At present, Namibia has approximately N$20 billion worth of foreign reserves, more than four times the amount required to protect the currency peg. However, not all reserves are created equal. Approximately half of Namibia's reserves have direct liabilities associated with them, making these funds accessible, but their use inadvisable. Nevertheless, for now, and despite the expected deficits, Namibia is still very capable of defending the currency peg with the Rand.

The good news is that Namibia remains a net-creditor to the rest of the world from a stock perspective, particularly due to large contractual savings pools that sit outside of the country. This situation creates a buffer for Namibia's balance of payments, as if the country is in a desperate situation, these funds can be recalled to avoid a balance of payments crisis. However, these funds are finite in nature, and if not carefully managed once returned to the country, it will take little time for the outflows to once again commence.

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