

Namibia Economic Outlook

04 Sep '20

Update – August 2020

We estimate an 8.5% contraction for the Namibian economy in 2020, the deepest in the nation's history. The base effect is expected to lead a rebound of 3.0% in 2021, and increased mining output is expected to boost growth to 4.4% in 2022.

The deep contraction this year comes after four years of economic stagnation, and cumulatively these put Namibia's economic output back seven years. In addition to this, population growth over the same period has resulted in a material deterioration of real GDP per capita to levels from the start of last decade. It will take many years of relatively high, continuous growth to return real GDP per capita to the 2015 high.

Production interruptions and volatile prices will reduce mining output this year; uranium output affected by the former, while the latter driving diamond mining stoppages. The livestock sector will see reduced marketing activity as farmers opt to restock after devastating years of drought, however a better rainfall season is promising for agriculture. Fishing activities will be negatively affected by the strict lockdown conditions imposed on the coast for much of this year.

The supply shock from lockdowns will see manufacturing output decline, particularly for beverages. Reduced livestock marketing feeds into lower abattoir activity (i.e. meat processing). Reallocated spending and a focus on current expenditure will see even less activity for construction than what had been planned, delaying a recovery for the battered sector until next year (again, a base effect recovery). Better rains have driven high output at Ruacana, seeing improved electricity production for the first half of 2020.

The tertiary sector will see contractions across most lines as the service sectors are heavily impacted. Wholesale and retail trade will be adversely affected by reduced household consumptive ability and the banks will see earnings decline. The public sector will, however, show some growth as more hirings occur in the health and education sectors during the pandemic.

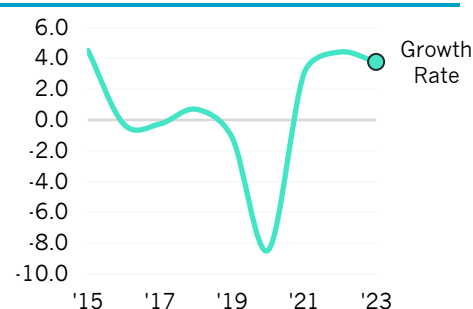
Many important themes have developed during the course of this year, which qualify our belief that the (base effect) growth post-2020 will be a phenomenon confined to the realm of statistics. Significant damage has been done to the Namibian economy this year, which will result in a slow recovery for employment, disposable income, and government revenue (from domestic sources).

Summary data

Primary Industries	-12.0%
Secondary Industries	-8.3%
Tertiary Industries	-7.1%
GDP at Market Prices	-8.5%

Source: Cirrus Securities

Growth forecast



Source: Namibia Statistics Agency, Cirrus Securities

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Table of contents

Table of contents	2
Overview.....	3
Health.....	4
Politics	5
Tourism and hospitality	6
Supply shock	7
Trade balance.....	8
Public finance.....	9
Inflation	11
Interest rates	12
Commercial property.....	12
Banks.....	13
The post COVID-19 recovery period	16
National Accounts Forecast.....	18

Overview

The COVID-19 pandemic has spread at an alarming rate with over 20 million cases worldwide. In an attempt to mitigate the negative health consequences associated with the virus, countries the world over implemented similar strategies such as lockdowns and social distancing.

These mitigation techniques had devastating effects on economic activity. The World Bank's latest estimates indicate that 92.9% of all countries will enter a recession in 2020, the largest synchronisation of national recessions since 1870. This synchronisation was also followed by a period of significant economic growth displayed globally, with the decade average of share of economies in recession being the second lowest on record. It bears repeating that Namibia has been an outlier, both regionally and globally, in these last few years of global economic growth.

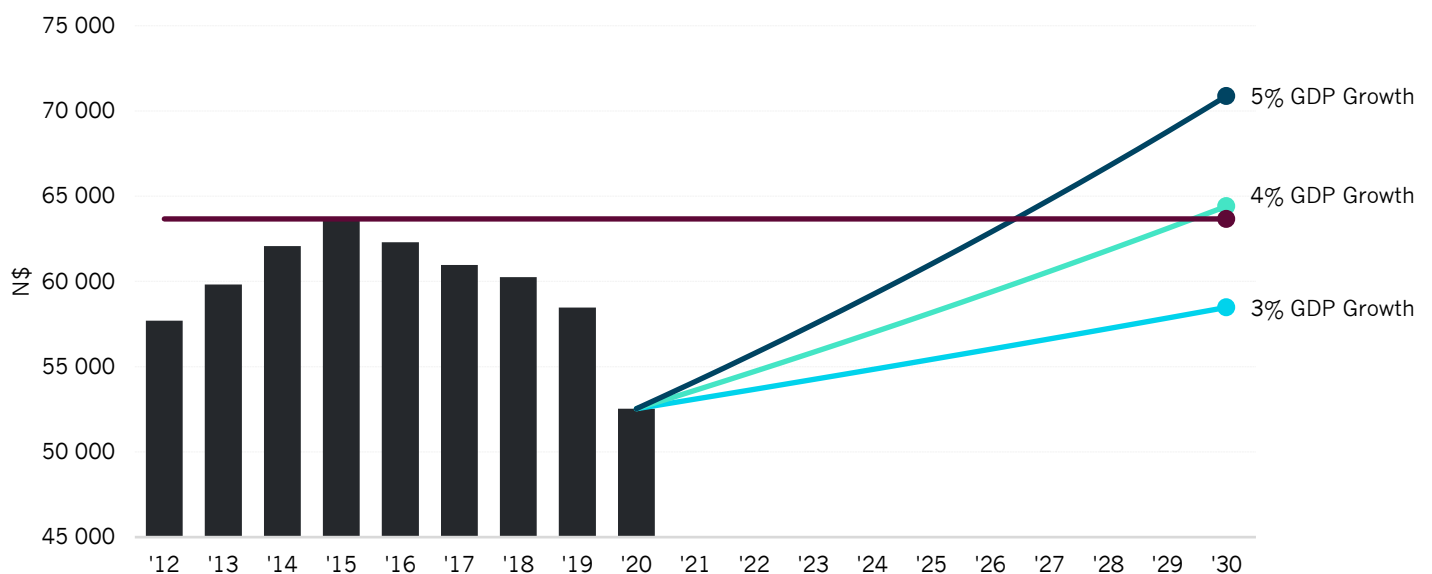
Moreover, the IMF estimates that the world economy will contract by 4.9% in 2020, after which it is expected to recover significantly by 5.4% in 2021. The significant contraction in 2020 will largely be driven by a GDP contraction of 8.0% in Advanced Economies (AE), with a contraction of 3.0% expected in Emerging Markets and Developing Economies.

The Namibian economy started the year with a contraction of 0.8% for the first quarter. It is important to note that the contraction for Q1 comes before the widespread impact of COVID-19 on the economy, as the State of Emergency was only declared on 17 March, and the official lockdown (for the Erongo and Khomas regions) came into effect on 27 March – the very end of the first quarter. The poor performance in Q1, before the full extent of COVID-19 and the lockdown, forebodes a dismal Q2 and remainder of 2020.

The record 8.5% contraction we expect this year, after four years of stagnation, will see real GDP decline to levels last seen in 2013. Not only has value addition declined in real terms, but the population has continued to grow during this period. The result is that GDP per capita is expected to regress back to 2010 levels, and it will take several years of high growth to simply return to the 2015 peak of GDP per capita.

Real GDP per capita

Relatively strong average annual growth required to return to 2015 per capita peak

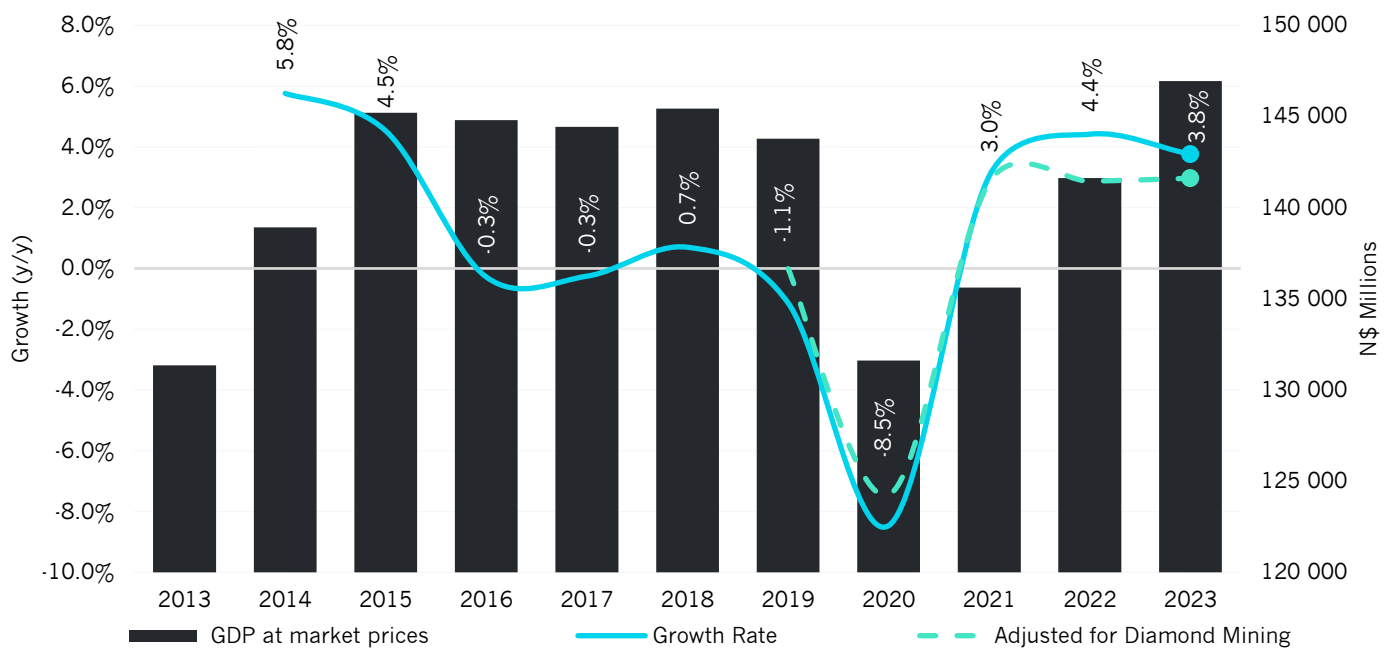


Source: Namibia Statistics Agency, Cirrus Securities

We anticipate a relatively strong statistical rebound, which can be misleading. What appears to be relatively high growth is simply the base effect coming into play as many sectors slowly return to more normalized output levels (e.g. mining, manufacturing). More particularly, a recovery in diamond output will play a key role in driving growth in the outer years, given the large drop anticipated for 2020 and the new vessel expected by Debmarine Namibia c.2022 (although we will reassess this view next year).

Growth forecast

The base effect results in high growth, but total GDP will take several years to recover to pre-pandemic levels



Source: Namibia Statistics Agency, Cirrus Securities

Although we anticipate to report growth after 2020, we expect this to be mostly confined to the realm of statistics. It is therefore to observe not just the growth rate, but to the total value of real GDP – particularly contrasted against the 2019 value. For the average Namibian, 2021 will not feel like a material improvement (barring more freedom as pandemic regulations are eased). This is aptly reflected in our real GDP per capita graphic, showing that it will take many years to see a more broad-based and tangible recovery. The themes throughout this document go into further depth, expounding on our concerns around long-lasting damage particularly to households and the private sector.

Health

After an initial, pre-emptive lockdown, Namibia has since seen a sharp increase in total cases, active cases, and deaths. At the time of writing, total cases amounted to 7 365, of which 4 364 were active and 72 deaths had been recorded. Research thus far indicates that the most vulnerable groups, in the context of fatalities, are the elderly and individuals with pre-existing conditions. Current estimates indicate that fatality rates for older age groups are significantly higher than for the youth. Moreover, pre-existing conditions are also associated with higher fatality rates.

The country's initial outbreak was seen in Walvis Bay, which was inevitably followed by an outbreak in Windhoek, the country's most recent epicentre. This prompted the government to put the Khomas region (including the districts of Okahandja and Rehoboth) under a relatively harsher lockdown as had been done at the coast, and motivated implementation of a curfew which was subsequently implemented nationwide. Frankly, we believe the measures are disproportionate in their final outcomes when taking into consideration the severe harm that has been done, and continues to be done, to livelihoods.

One motivation for this is the demographic distribution of the Namibian population. Not only does Namibia boast a relatively small population across a large geographic area – resulting in one of the lowest population densities in the world – but the Namibian population is also extremely young with a median age of approximately 21.8. The older population is more likely present in rural areas, whereas the youth are more likely to find themselves in urban areas (likely seeking employment). As witnessed with the initial lockdown for the Khomas and Erongo regions, such measures drove many people to other parts of the country (including the urban areas) in order to escape the stricter measures (and likely poorer living conditions) in the urban areas. This has been one of the unintended consequences of the approach.

Namibia population breakdown

Broad Age Group	Rural	Urban	Namibia
0-14	506 225	375 541	881 676
15-24	272 929	204 147	477 076
25-34	128 247	271 585	399 832
34-44	95 659	174 231	269 890
45-54	78 195	97 547	175 742
55-64	66 955	50 154	105 998
65+	73 204	30 225	103 429
Total	1 210 303	1 203 340	2 413 643

Source: Namibia Statistics Agency

Moreover, in urban areas, where individuals are likely to be more vulnerable due to higher population density, the older urban population is more likely to be relatively wealthy and able to isolate. Urban areas also provide better access to healthcare facilities.

Despite the country's low population density, informal settlements present a major issue for local and regional spread. As informal settlements represent approximately 30% of housing, a breakout in these congested areas could potentially lead to a mass exodus of individuals from urban areas to rural areas, where majority of at-risk people reside. Added to the high population density in these areas are other problems like poor access to clean water, toilets and general difficulty maintaining hygiene. Additionally, self-isolating in poor housing conditions while living hand-to-mouth is simply impossible for many.

It goes without saying that there are health imperatives, but these must be very carefully balanced against the long-lasting damage to employment, and household and business balance sheets – lest we forget that poverty, too, is deadly. Policies should ultimately be judged by the outcomes they achieve, not merely their stated objectives.

Politics

While the idea of political realignment is heretical to the incumbent party, it is fundamental to a working democracy. After a few decades of political stability, the economic stagnation and contraction of the last five years – coupled with the reaching of a demographic tipping point whereby more voters have no recollection of the pre-independence period than do – has caused an accelerated change in political dynamics.

This change is largely due to this young voter base and their unmet aspirations. High degrees of youth unemployment (the 8th highest level in the world, and more than double the global average, according to the ILO), a shrinking economy shedding rather than creating formal sector jobs, housing backlogs and similar have contributed to a sense of despair amongst many young voters who see limited prospect of improvement in their lives under the status quo of leadership.

Furthermore, fuel has been added to this fire from corruption exposés implicating high-level politicians, which have generated or exacerbated the belief amongst many young voters that the current political leadership is rather looking to satisfy its own interests, rather than the interests of the country's youth.

This was highly visible in the 2019 National Assembly and Presidential elections, where support for the incumbent party and candidate dropped dramatically from the pre-economic collapse levels. Moreover, the support for the incumbent party and official candidate was weakest in urban areas, where opposition parties and the independent candidate secured larger, and often dominant, shares of the vote.

Extensive local authority elections are due to take place in November. For the first time since independence, there appears to be a good chance that many urban constituencies will no longer rest in control of the incumbents come December. However, given the fragmentation of potential opposition, while SWAPO may be less dominant and may lose certain local authorities, no single party is expected to take their place or achieve country-wide majorities. A notable exception in this regard is the Landless People's Movement, which is expected to be dominant in much of the !Karas (excluding Lüderitz and Oranjemund) and Hardap regions.

As the regional councils elect members to the National Council, the upper chamber of the Namibian Parliament is expected to have materially more non-SWAPO members than it has had in many years (perhaps ever). While SWAPO may not lose the majority in the National Council, there will certainly be substantially higher levels of disruption and resistance when it comes to reviewing legislation sent to the Council from the lower house. In the event that the majority of the Council positions are in opposition hands, the legislative process may well be severely restricted, subject to substantially more scrutiny and “politicking”, and generally more contested than was the case historically. Particularly relevant in this regard is that with the loss of a two-thirds majority in the National Assembly, should the Council fall to the opposition parties, SWAPO will not be able to strong-arm legislation through without Council consent, without the support of at least one opposition party member of the National Assembly.

Although the local authority elections will certainly prove interesting from a future legislative process perspective, their main point of fascination is the temperature gauge that they provide the nation (and us analysts) with regards to the feeling towards the incumbent leadership. Given the past five years of no growth, and given the stringent COVID response measures (despite a young population with specific health strengths rather than vulnerabilities, and despite poor livelihood conditions), coupled with generally unmet youth aspirations, we expect a poor showing for the incumbents. Perhaps true introspection and change will follow?

Tourism and hospitality

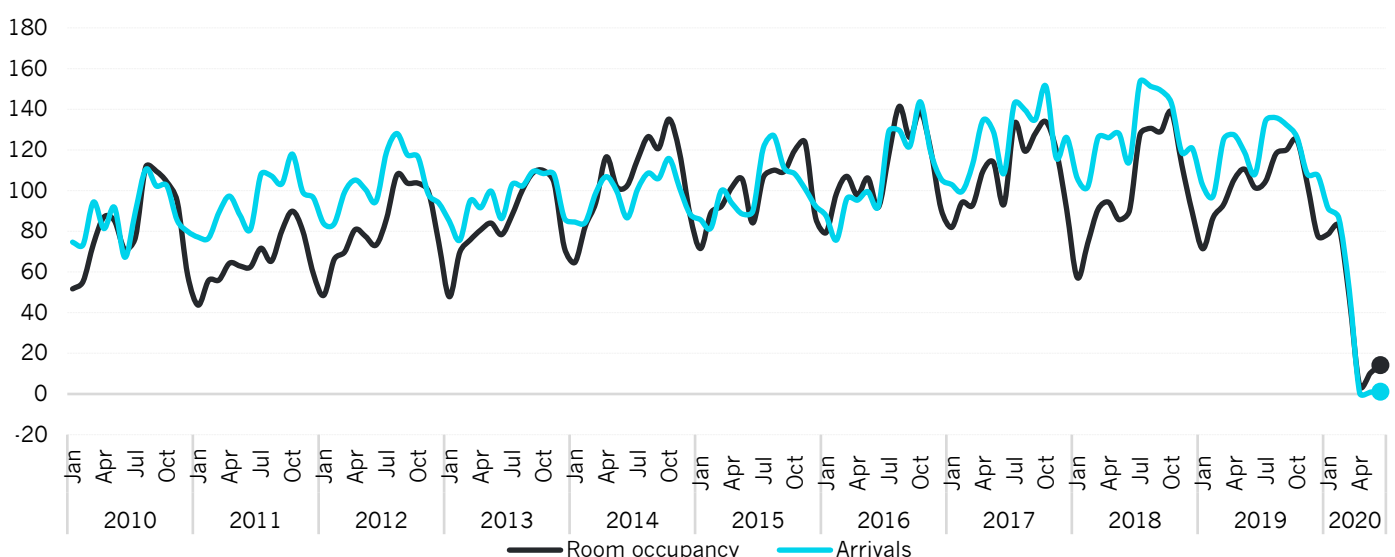
While the tourism industry is a relatively small direct contributor to Namibian GDP (just 2.13% of 2019 real GDP), it is one of the largest employers in the country, with over 80,000 employees. As a result, the sector has some of the highest multiplier effects in the economy, particularly as it pays cash wages in rural areas.

From a national economy perspective, the sector is amongst the most important for the country; however, it is also the hardest hit by the COVID-19 shock. This is due to several factors, both domestic and external. From an external perspective, the external demand shock experienced by the sector (the reduction in foreign clients) hit long before the country went into lockdown, with arrival figures dropping by more than 50% between December and March, and tourism facility occupancy rates dropping by approximately 40% over the same period. Thus, while most of the country was still largely oblivious to the impending shock, the tourism industry had already experienced a halving in revenue.

The vast majority of revenue generated by the sector is derived from foreign tourism. Approximately 10% comes from local tourists. Not only are the number of Namibians that go to and can afford (even at heavily discounted prices) many of the local tourism destinations materially lower than foreigners, but the average spend per visitor is also substantially lower amongst domestic tourists when compared to foreign. The result is that the external demand shock has all but wiped the industry's revenue.

Tourism indices

Total collapse in 2020



Source: Namibia Statistics Agency

The response from industry players was highly varied, with some reacting swiftly to go into hibernation, while others attempted to continue operating on local tourism. This was despite it being clear from early on that the drop global travel drop last for an extended period of time (as the outlook for either herd immunity or a vaccine was expected to be at least 12 months). Additionally, travel – particularly long-haul travel – is likely to recover relatively slowly post-COVID.

Following the early-onset external shock, industry revenue pressure was further exacerbated by a domestic supply and demand shock, whereby lockdowns and inter-regional travel restrictions made it impossible for many facilities to sell their services, and also impossible for users to utilize their services.

The outlook for the sector remains highly worrying. As a relatively low-margin, high-fixed-cost industry, the collapse in revenue has done extensive damage to balance sheets. The extent of this damage is largely dependent on the fixed cost structure of the individual companies, but also their response, and rate of response, to the shock. Those that reacted fast and downscaled will likely be better positioned for a restart than those that did not, and some local industry consolidation is highly likely. Moreover, the recovery period is likely to be extended for two reasons. Firstly, while travel is slowly reopening, it will take an extended period of time for long-haul destinations to recover to pre-COVID levels. Our assumption in this regard is that best case for a full recovery is by the 2023 tourism season.

Secondly, in all likelihood, the aggressive lockdown the country had in late March (started when just seven known cases existed in Namibia) delayed, rather than prevented, the inevitable spread of the virus. This has likely prolonged the combined shock for the Namibian economy, although may have bought time for improved medical preparedness for when the virus did hit in earnest in May 2020. The impact of this is that while much of the rest of the world is getting to the tail-end of their pandemic, Namibia is likely just in the early throws of it. This may well mean that local movements are restricted for an extended period of time.

Given the operating leverage of the industry, there is a very good chance that these measures will do more harm than good. Tourism players that remain operating, despite much lower revenue (even as tourists slowly return), are likely to incur deep balance sheet damage. Should these operators miscalculate the duration of recovery, as we feel many have done to date, it may well be the case that they will not have reserves to survive the shock, and ultimately the restart. Those that acted quickly to go into “hibernation” will likely recover far faster than those that attempted to service on “bread and water” from the local market, and indeed, industry consolidation can be expected. A slow recovery currently appears to be the best possible case.

Supply shock

The pandemic and response measures impacted the Namibian economy in three waves:

1. The initial collapse in external demand (tourism, some export commodities);
2. The supply shock as lockdowns restricted the ability of companies and workers to produce; and
3. The internal demand shock as households and businesses lose income, meaning they consume less, and thereby requiring less production in the first place (reinforcing point 2).

The strict lockdown implemented early on in Namibia resulted in an abrupt supply shock, particularly for Windhoek and more so for the coast as parts of the Erongo region faced an extended hard lockdown. While many sectors of the economy were willing to produce, and demand initially remained relatively stable, the lockdown measures imposed have seen many entities unable to produce and thereafter see demand drop. This applied to both the formal and informal sectors, as well as for goods and services that are elastic and relatively inelastic.

The initial period of hard lockdown saw many sectors of the economy producing well below optimal levels, meaning they were not able to produce revenue to the extent that they otherwise could. Given that the initial shock was not fully expected to persist for a long time, many entities (and employees) absorbed the revenue losses without significant reductions in expenses or staff complement. However, after several years of economic stagnation few businesses had sufficient accumulated savings to withstand such a lengthy imposition, meaning we have seen significant balance sheet destruction as the private sector has tried to remain afloat (businesses remaining operational, continued remuneration of employees, debt and interest payments, etc.).

Despite subsequent relaxation in regulations (or rather, the waxing and waning thereof), demand has not recovered sufficiently after the initial lockdown. This has necessitated broader wage reductions, retrenchments and even business closures. Those employers who have managed to remain operational have seen their buffers worn down, leaving them particularly vulnerable to any future disruptions – this is already evident in the tourism, restaurant and entertainment industries.

The damage done to Namibia's business sector will be long-lasting, as savings are worn down and net direct investment has turned into outflows. As restrictions continue to be imposed (or relaxed and re-imposed), the disruptions will exhaust ever more reserves of otherwise viable businesses. This is followed by more retrenchments and increasing household duress, as already highly leveraged households will have to rely on a shrinking pool of income. Smaller businesses will be hit particularly hard, as there is only so much downsizing that can be done and they are unlikely to have large retained earnings to weather the storm.

Furthermore, the closure of businesses results in a long-term loss for the economy, both in terms of output and employment opportunities. Given the low savings rate and risky macroeconomic environment, a recovery in the business sector will be slow as those who failed will be cautious of trying again (as will lenders), while many other investors would opt to deploy their capital somewhere else with better prospects. The unintended consequences of the pandemic measures will be around for many years to come, and thus demand not only a careful balancing act now between the health and economic imperatives, but also positioning for rapid growth as soon as possible.

Trade balance

Namibia's net export position will improve in 2020 to a materially smaller trade deficit. This apparent improvement, however, is more the result of household constraints rather than improved export production.

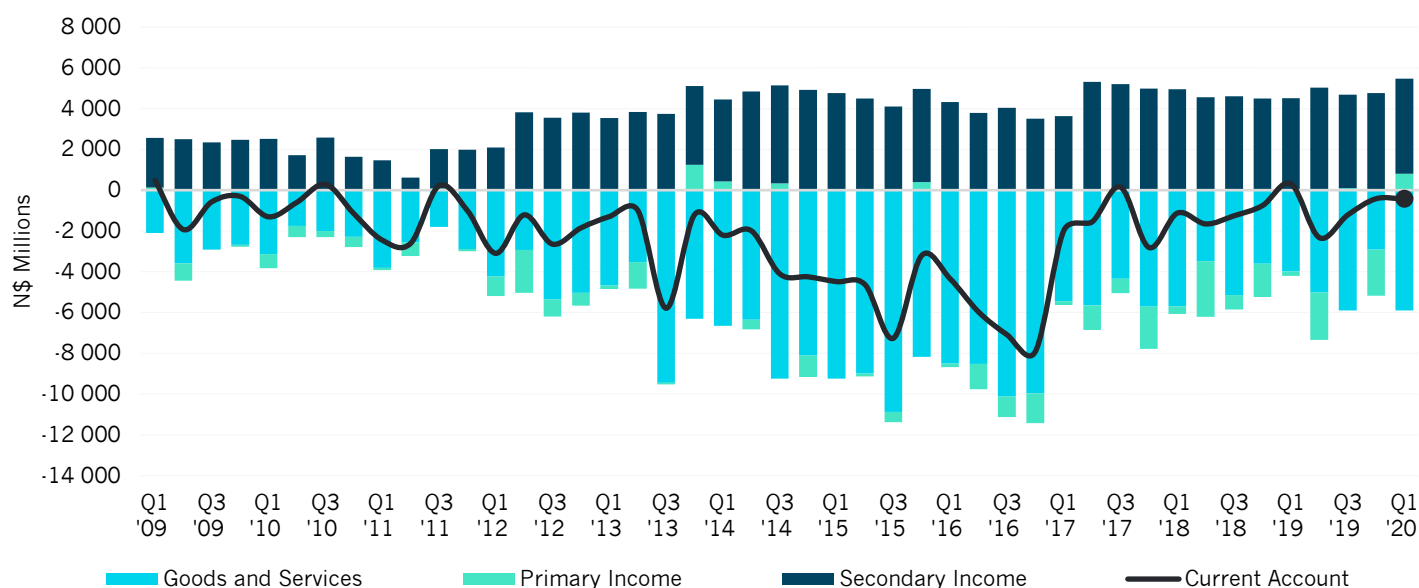
The import bill has declined markedly so far this year, particularly as households have been forced to tighten their belts and direct discretionary spending towards necessities, spending less on expensive consumer goods which are imported, as well as reduced overall business activity. Reduced demand for fuel and lower international oil prices have also benefitted the import bill, although the latter has been somewhat offset by the weaker rand.

Currency weakness usually benefits Namibia's exports, but several core export volumes and values have declined markedly – notably diamonds and uranium. The former is due to falling market prices, whereas the latter is due to water shortages severely hampering output at Namibia's two operative uranium mines. Livestock exports have also fallen significantly, although expectedly, as farmers begin the restocking process after the drought years.

The smaller trade deficit this year is thus not due to improvements domestically, but rather a reduced standard of living as consumers are far more cautious with their spending. The market for commodities appears bullish, but Namibia's exposure here is unfortunate. The prospects for Namibia's core export, diamonds, are poor. Sightholder sales have remained weak, constrained by travel restrictions and plummeting demand amidst the global pandemic, given the luxury nature of diamonds. Despite better output in the first half of the year, these events have led to voluntary mining stoppages (alternating between onshore and offshore) which will see diamond output fall to levels last seen a decade ago. Additionally, some of Namibia's high value-add exports will likely also come to an end after this year, notably special high-grade zinc (from Skorpion Zinc) and copper cathode production (from Weatherly's Tschudi mine). Skorpion has plans to convert its refinery to process ore from neighbouring Rosh Pinah Zinc Corp, however such a project will take some time yet if it does materialize.

Current account

Reduced trade deficit and greater secondary income flows expected for '20



Source: Bank of Namibia

The improvement in the net export position this year will be complemented by extremely healthy SACU receipts, expected to lead a decent Current Account surplus for the first time in well over a decade. However, this will be short-lived. The production interruptions and reduced trade (intra- and extra-SACU) will see SACU revenue decline materially compared to the forecasts underpinning the FY2020 disbursements to member governments. The result is that future allocations will have to make up for the current shortfall, which will not just see reduced inflows on the Balance of Payments but also much lower revenue for government from SACU. The better Current Account position will offset the anticipated continued outflows in net direct investment on the Financial Account.

Imports will eventually recover, but this will be a slow recovery given the collapse in household incomes this year and slow growth in employment we expect. Firms will be far more cautious in their hiring going forward, meaning household incomes will only improve very gradually. Overall, this will benefit the net export position – but again, it is an indication of the poorer standard of living rather than improved value addition within Namibia's borders.

Public finance

The last decade saw Namibia run deficits in nine of the ten years and the public debt stock increasing from 16% of GDP to 55% of GDP. As a result, Namibia entered the pandemic with relatively little dry powder at its disposal to offset the economic shocks, coupled with a revenue collapse that will be slow to rebound.

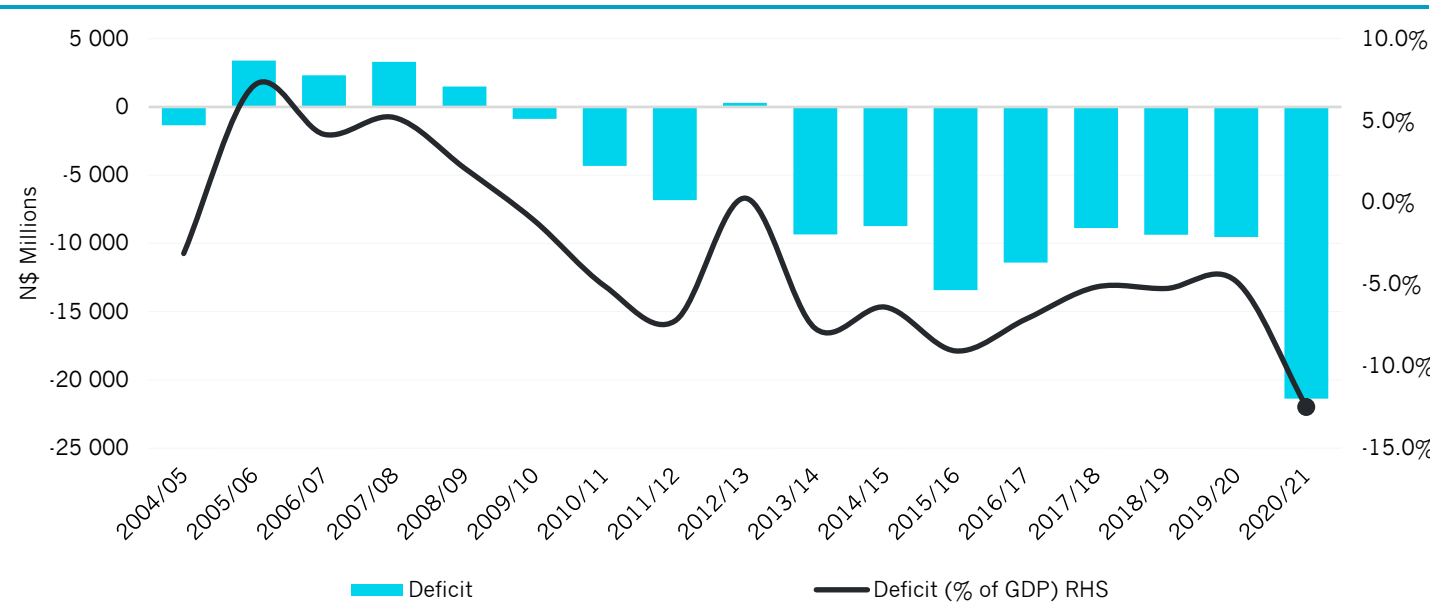
The poor performance in regional economies this year is expected to result in reduced SACU receipts for government in the coming years, which receipts have bolstered the fiscus this year by offsetting much of the collapse in domestic revenue. We anticipate significantly reduced income from Government's largest source of revenue for the next two-to-three years, however, owing to the forward-looking nature and thus delayed correction of SACU disbursements.

Of itself, this would not be so concerning. However, two concerns arise. Firstly, government is already heavily reliant on SACU revenue as the single largest source – accounting for 43.4% of revenue in FY2020. Secondly, it is coupled with what we expect will be a much slower than anticipated recovery in domestic revenue sources (i.e. personal income tax, company profit taxes, and VAT) over the medium term. The collapse in the domestic economy will lead to lower personal income taxes as employees see reduced salaries/wages or are retrenched, and this line will not recover quickly as surviving businesses will be cautious in taking on new fixed costs. Businesses will see significantly reduced activity this year and will recover slowly as demand will not recover quickly (in part due to lower household incomes), reducing their revenues and thus profits. Additionally, many businesses will shut permanently (if they have not done so already) or run at losses, meaning they pay no profit taxes, and those with losses could carry these forward reducing their tax burden for the coming years. These both feed into VAT, as reduced

demand from lower household incomes and business activity will see less consumption taking place, meaning less VAT revenue for the state.

Budget deficit

Record deficit for FY2020/21



Source: Ministry of Finance

The conundrum is that government will face severe revenue challenges in the coming years, meaning the deficit gap will remain large. Normally this necessitates deep expenditure cuts, but we do not believe this will materialize given the stickiness of current expenditure, particularly the large wage bill. Tackling the wage bill presents a dilemma, as unemployment is already unsustainably high and right-sizing the civil service would be politically unpalatable in an ailing economy. A growing cost is debt servicing, which has increased faster than nominal GDP for many years now – an indication that the rate of debt accumulation.

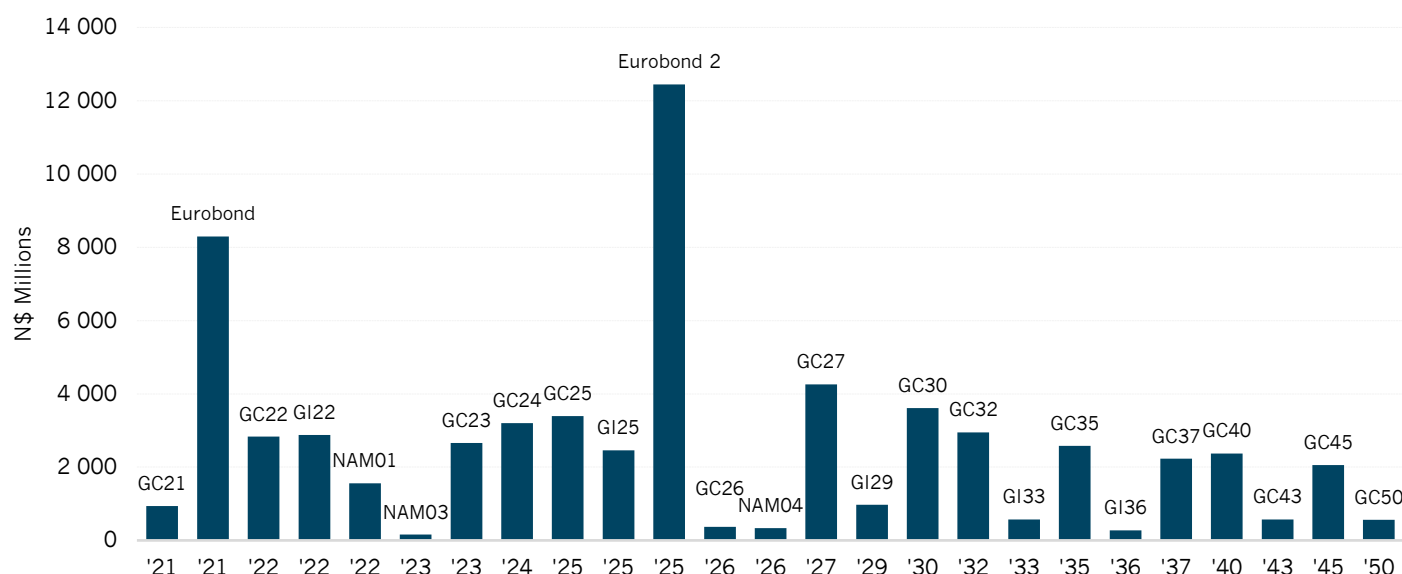
The poor revenue outlook and likely inability to significantly cut expenditure mean that relatively large budget deficits will be run for the coming years. Running deficits leads us to question how these will be funded – by foreign or domestic debt?

Much of Namibia's foreign debt matures over the next five years, notably the two Eurobonds and remaining JSE debt. Should the foreign debt be redeemed, it will put pressure on the reserve position as there will be a resultant large outflow of foreign currency. However, a struggling South African economy and weak rand would be beneficial in rolling the Eurobonds if need be. This is especially so in a world of negative-yielding bonds and money printing seeing investors cast the net ever wider in the search for yield.

The potential IMF RFI would play a large role in funding this year's record deficit, and at favourable rates. The downside is the repayment period, which places around the second Eurobond maturity. The maturity of two large foreign-denominated instruments will make redemption difficult, and will have a significant impact on the reserve position. If the second Eurobond is rolled, this issue may be averted or eased. However, Namibia also request some leniency from the IMF (not necessarily by choice) under the guise of a Balance of Payments threat. Should this be the case, the IMF could grant leniency – but the agency will likely require specific commitments and conditions for such an undertaking. This is not to say this is the path Namibia will travel, but it is one the nation may (need to) follow.

Maturity profile

The majority of public debt matures in the next few years



Source: Bank of Namibia, Cirrus Securities

Deficits in coming years will likely, once again, be funded mostly through domestic issuance. Domestic appetite as it stands, however, will not be able to meet the required issuance size – and not at rates favourable for the fiscus. This raises the spectre of increased domestic asset requirements for pension funds, which simply is not in the best interests of these savers. The debt will also likely be used to finance relatively unproductive spending – such as the wage bill. The weak revenue outlook and increasingly borrowing to fund recurrent expenditure or debt servicing put Namibia on a dangerous trajectory towards a debt trap. Namibia cannot monetize the deficit as easily as some developed nations are doing now, as not only would it increase the cost of living but also jeopardize the currency peg. The resultant increase in inflation would also result in a material deterioration in the standard of living, and would be most harmful to those already most vulnerable in our society.

The likelihood of more large deficits going forward and an ailing economy will result in further deterioration of several key metrics, including debt-to-GDP which will breach 70% in FY2020/21 owing to the large deficit and historic economic contraction. The outlook is concerning, and the gravity of the situation requires us to refrain from pulling our punches. The path towards balancing the budget is a mammoth task, more so given the slow recovery in domestic tax revenue and the impact of such large reliance in SACU revenue over many years. This would necessitate more active reduction on public spending, but this is also not without consequence. Namibia's current fiscal position and trajectory are a harsh lesson in what happens when the good times are taken for granted, and preparation for a rainy day is not made.

Inflation

Inflation will remain low for this year, and remain anchored fairly low going forward due to the deflationary housing market in Namibia. Downward pressure on rent prices (23.3% of the NCPI basket) will persist owing to the impact of falling household disposable income and rising unemployment.

Historically low interest rates will do little to spur inflation. Credit extension will remain low given the many risk factors, including reduced household disposable income, already high debt to disposable income levels, and the anticipated slow pace of recovery in employment. Rather, the risks to inflation are more likely to stem from producer inflation in South Africa and exchange rate depreciation. The former is likely to remain subdued for a while, as weak demand will leave little scope for higher costs pushed through to consumers.

While we believe the rand is currently undervalued, any sudden depreciation in future would have inflationary effects as the cost of non-rand imports would increase – most notably fuel. The volatility in global markets, as well as sensitivity to political events in South Africa, mean that a sudden depreciation is not (once again) out of the question. As the global economy recovers, demand for oil products is anticipated to rise as well and will likely see oil prices (and thus fuel prices) rise, which will increase the costs of transport of goods as well.

The overall large weighting of the rent portion, however, is expected to remain the driving force behind low inflation for the foreseeable future. Given that rent inflation is generally set at the start of the year and not altered much thereafter, we expect continued deflation in this line for 2021 offsetting much of any potential rise in prices in other lines of the inflation basket.

Interest rates

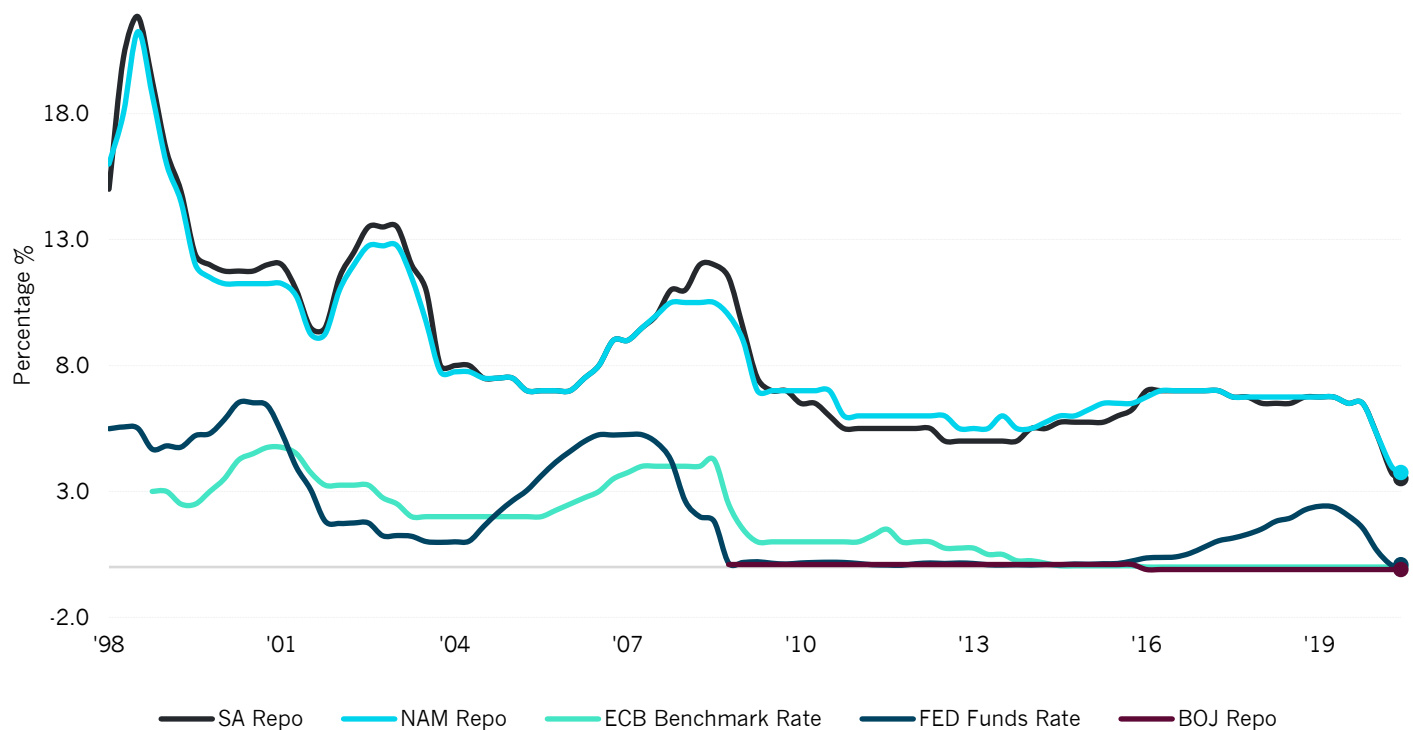
Central banks have responded to the novel coronavirus by cutting interest rates and pursuing non-conventional monetary policy (such as reinvigorated Quantitative Easing). The Bank of Namibia has done the same, given the leeway by the South African Reserve Bank, cutting the repo rate with a cumulative 275 basis points so far this year. This brings the current repo rate to a historically low 3.75%. The benchmark rate cuts in South Africa have been slightly more aggressive, with cumulative YTD cuts of 300 basis points, bringing the repo rate there to 3.50%. The large cuts have seen Namibia opt to re-establish a 25bp spread above the South African repo rate.

The poor outlook for the South African economy suggests that the SARB will keep rates low for a while longer. Such a move is supported by signals from advanced economies that low rates are here to stay for several years – the US Fed being the most recent.

In the near term, the weak economic growth forecasted for Namibia coupled with low inflation, will see the Bank of Namibia opt to maintain low rates for the remainder of the year. The market expectation is that the Bank of Namibia will not cut the repo rate at in the two remaining Monetary Policy meetings (October and December), however this may change if the SARB were to surprise with further cuts. With subdued inflation and the moribund economy, the SARB is likely to maintain the low rate environment and hold off on hiking until external pressures necessitate such a move.

Interest rates

Dovish global rate environment



Source: Bloomberg, Cirrus Securities

Commercial property

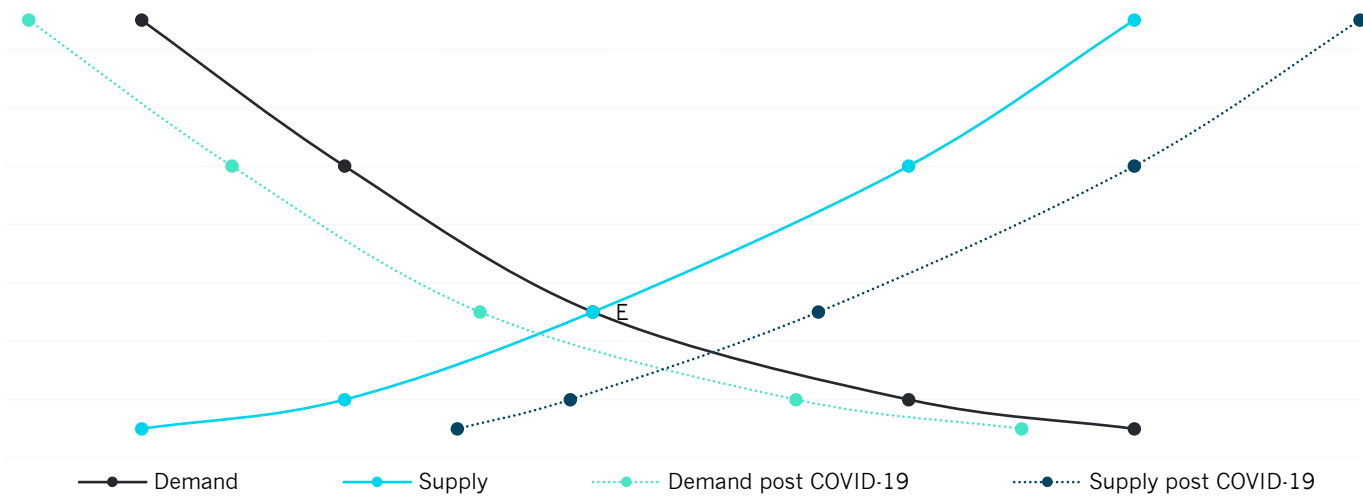
Corporates in Namibia have had to contend with a stagnating economy for the last half-decade, erasing the financial buffers within the private sector. This has been illustrated by the increased use of short-term debt facilities utilised by businesses over the last three years. The initial supply shock and latent demand shock arising from lockdowns, starting in March this year, has dramatically reduced business activity, seeing many firms drawing down on what reserves they still have available or increasing

the use of short-term credit facilities. Others, who are able to, have opted for strategies such as employees working from home, while those unable to cut costs sufficiently have engaged in lay-offs or even closed permanently.

This has naturally led to decreased demand for commercial property throughout the country. Moreover, with more corporates working from home many businesses seem poised to migrate to working from home or rotational office spaces (such as 'hot desks'), reducing the need for as much office space. Simultaneously, more new commercial properties have come onto the market and, coupled with businesses needing less space, has led to a rise in supply. Naturally, this has led to downward pressures, due to both demand and supply forces, on commercial property prices. This has moved the commercial property market out of equilibrium (point E on the illustrative chart below) to a lower price due to the increased supply and lower demand.

Property market (dis)equilibrium

Supply and demand forces driving down property prices



Source: Cirrus Securities

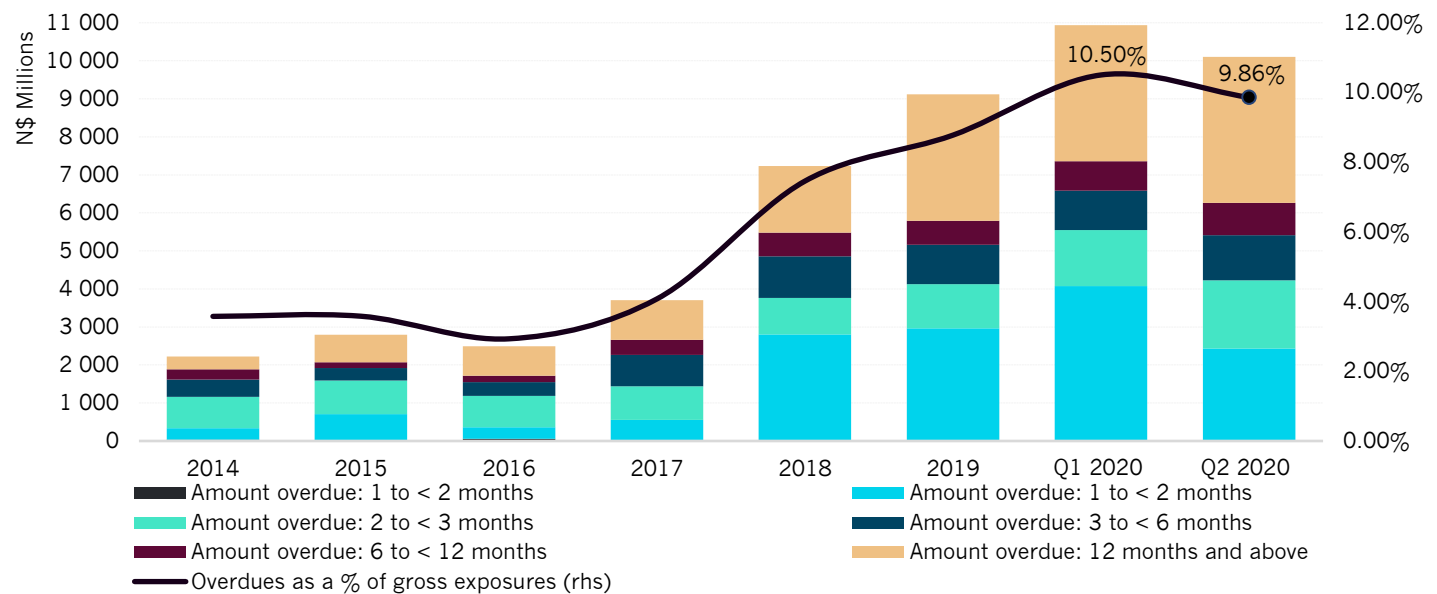
Newspaper classifieds and online advertisements attest to the decline in prices, even for A-grade office space. There has been a surge in commercial property offered at increasingly lower prices, particularly during the second and third quarters of 2020.

Banks

The deflationary property market in Namibia is no longer confined to residential properties. Coupled with the hamstrung economy, this will continue to pressure commercial bank credit quality. This has already become evident: as of 31 March 2020, 12.0% of all mortgages were overdue and 7.1% of mortgages were classified as non-performing. The apparent improvement between Q1 and Q2 '20 is explained by impairments which have increased significantly over the same period, from 4.8% to 5.7%. The writing off of these loans sees them removed from the overdue category, resulting in the apparent improvement.

Total overdue loans

Overdue loans have fallen, but only because of increased impairments



Source: Bank of Namibia

The deflationary property market will decrease balance sheet collateral values and thereby increase loss given default (LGD) calculations. The lower collateral and higher LGDs will force banks into changing their provisioning, hence increasing their expected credit losses and decreasing net interest income.

Furthermore, the repo cuts this year do nothing to alleviate credit risk, rather adding further pressure on bank earnings while pressuring risk-adjusted returns. The rising credit risk, given the deteriorating macro, makes it more rewarding for banks to purchase government debt rather than extending new loans. *Vis-à-vis* private sector debt, government debt has:

- Lower credit risk
- Lower counterparty risk
- Shorter duration
- Possible higher yield
- Favourable risk reward ratio

The lower administered rates have not resulted in increased credit growth, as seen in the low nominal and flat real PSCE growth. We believe that the issue lies not on the demand side (as lower rates theoretically increase demand), but rather on the supply side. As explained, the low rates are not a driver of credit extension given the macro environment. Rather, the low administered rates seemingly suggest that the banking sector should be pricing risk lower; evidently this is unwise given the overdue and non-performing loan data already seen (and the increased impairments).

Prime vs 5- and 10-year generic yield

Recovered from the Q1'20 lows, but still lower than pre-COVID

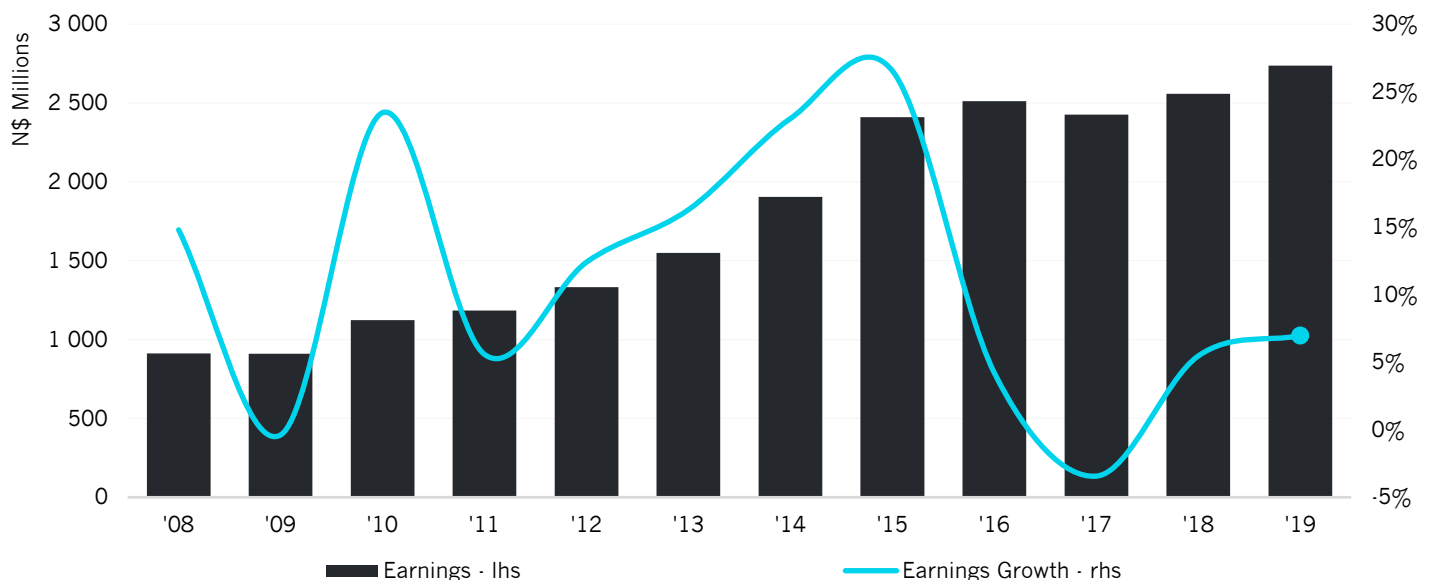


Source: Cirrus Securities

Cumulatively cutting the benchmark rate by 275bps YTD will result in bank margins being squeezed excessively, as the banks' earnings reprice faster than their costs. We expect this to take bank earnings back to levels last seen several years ago. However, we believe the sector will remain profitable as non-interest revenue provides a pillar for bank earnings, with a slow recovery in the years ahead. The factors weighing on the recovery include the deflationary property market (residential and now commercial), increased job losses, reduction in salaried/employed persons, and the increasing credit risk particularly relative to administered rates.

Banking industry profit after tax

Earnings resilience in the industry, but subdued during the last five years



Source: Bank of Namibia

Namibian banks came into the COVID crisis on already uneven footing, a direct consequence of the stagnant economy. As a result, local banks have had to contend with highly indebted households, decreasing asset prices (collateral, i.e. property) and now decreasing administered rates. Despite the unfavourable economic environment, commercial banks showed earnings resilience. Collectively, the industry grew earnings in ten out of the last 12 calendar years, although at a much slower pace in

the recent years. However, 2020 will be a net negative year for the industry, showing the wide-reaching impact of the pandemic and response measures on what has been a generally resilient sector.

The post COVID-19 recovery period

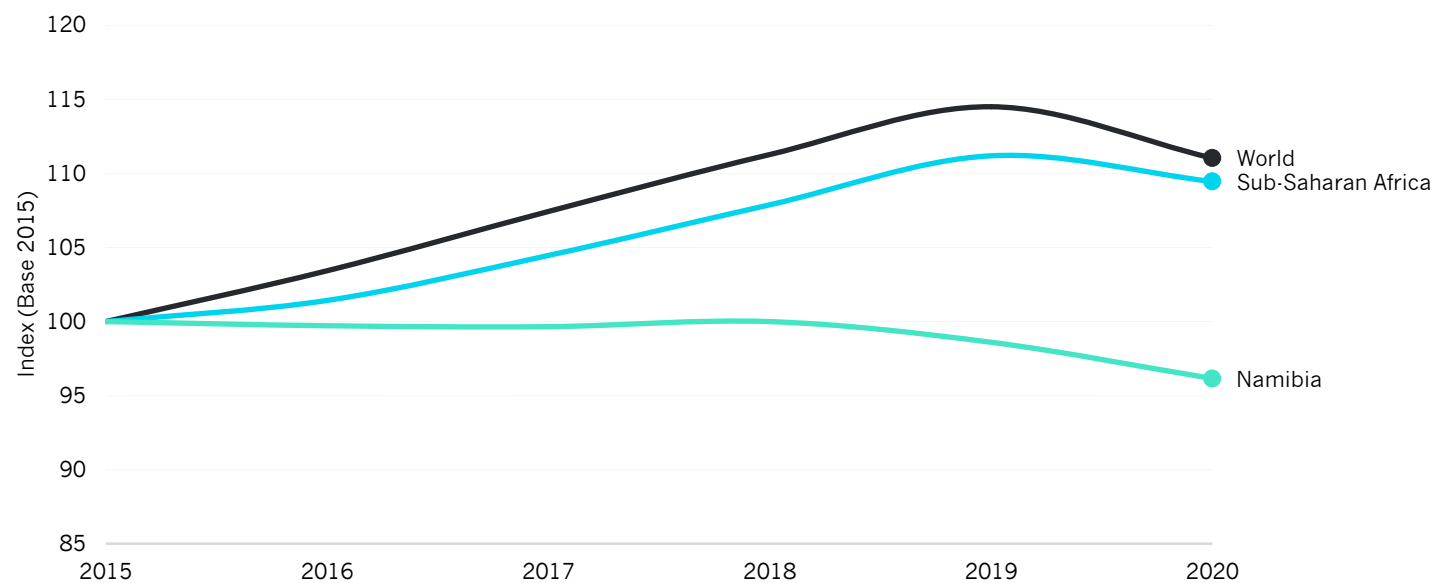
Needless to say, COVID-19 and more importantly, the global response thereto, has devastated many economies around the world, and Namibia, like most others, will take a number of years to recover.

However, Namibia entered this crisis in a worse position than many other nations. Off the back several years of weak economic performance, slow divestment of capital and material budget deficits, the country entered this shock with little in the way of reserves, and thus, may take longer than many others to recover to pre-pandemic levels.

Despite claims to the contrary by local politicians, the past five years (2015-2019 inclusive) saw average global growth of 3.45%, average sub-Saharan Africa growth of 2.80%, and average Namibian growth of 0.63%. Thus, while external conditions have been relatively favourable, local conditions have caused a material drag on growth. The compounding impact of this differential is substantial, as indicated below. Entering this crisis on such a weak footing will likely exacerbate its impact, both in terms of the depth of damage done, but also the time taken to fully recover. A critical lesson exists in this. While this specific shock was largely unforeseeable, some external shock was, at some point, inevitable. Thus, a missed opportunity to make hay resulted in an empty hay barn when winter hit.

Real growth rates

Namibia clearly an outlier



Source: International Monetary Fund

However, past aside, a look to the future contains material uncertainty. While it is clear that COVID and related health measures will have caused extensive balance sheet and income damage to households, corporates and Government, it is yet unclear how this will be dealt with by policy makers going forward. This is an area of particular interest given the past five years.

Over this period the country has been flirting with a notable left swing in policy, with the balance of forces in policy-making circles leaning towards redistribution rather than growth. While no actual hard step in this direction has yet been seen, the talk of such a policy swing became a material contributor to slow divestment, reduced growth, reduced public revenue collection in real terms, and a deterioration in employment quality (similar levels of unemployment, but an increase in non-cash wage “employment” – particularly subsistence agriculture). However, the fact that this hard step has yet to be taken, and the now overwhelming evidence of the economic and livelihood damage that such a hard step would do (given the reaction to the mere discussion of such), is clearly indicative of a conflict of forces within policy making circles. The outcome of this conflict is yet to be seen, but will be highly deterministic of the country’s future.

It appears to us that this could go one of two ways. The first option is that the distributional impact of COVID (and more particularly, lockdown response measures) will drive policy makers towards taking the hard step to a more redistributive system. The “free markets have failed us” narrative may well gain the upper hand over the pro-investment and growth narrative, and piece after piece of nationalistic and redistributive policy could follow (including NEEEF, NIPA and increased taxes to plug budget deficits). The inevitable outcome of this is a further slow (or fast) bleed of investment, more business closures and a smaller pool of income and assets to redistribute. Ultimately, this would likely prevent a long-term recovery, and retrospect would show COVID as a catalyst for long-term collapse.

The alternative is that the COVID-19 shock could be the catalyst for a policy rethink. The hollowing out of household, corporate and Government balance sheets over the past five years, coupled with the COVID-19 shock, leaves the nation in a weak position for recovery without a meaningful injection of capital (investment) and entrepreneurship. Fortunately, bar some concerning policy proposals and (relatively) easy to address specific barriers to investment (work permits for skilled employees, time to open a business, relatively high corporate tax rates, overreach from regulators and excessive labour legislation), the country has a sound fundamental investment environment. This includes, but is not limited to, a world class financial system, an independent judiciary, high degrees of peace and stability, relatively little crime, good primary and secondary infrastructure and (some) fast-growing neighbours.

As a result, were COVID-19 to drive a pro-growth and investment policy change, much of the redistributive and nationalistic policy currently on the cards would need to be removed and re-worked in favour of inclusive growth, reduced regulation and investment impediments, and a generally more business-friendly environment. As the fundamental building blocks of investment remain sound, this policy change is far from impossible, and is generally achievable with the swipe of a pen.

At present, there appear to be camps within the political leadership pulling in both directions, thus making no major (net) change the most likely immediate outcome. However, this is an untenable situation. The frustration of the public has become palpable in recent months, exacerbated by extended periods of lockdown in response to COVID. Households with limited reserves and where breadwinners are unable to work from home are worst hit, and the livelihood damage done by health measures likely exceed any health benefits for these families. In addition, the very finite fiscal reserves of the nation mean that only limited government support can be provided as these periods of lockdown drag on.

As a result and given the extensive damage to public finances, employment, social fabric and political stability done over the past five years and further exacerbated by COVID, no clear net move towards investment-led recovery will likely bring about political realignment in the near future.

National Accounts Forecast

Real GDP Growth Rates

Industry	2018	2019	2020	2021	2022	2023
Agriculture, forestry and fishing	-1.9	-2.6	-7.9	2.1	1.9	2.6
Livestock farming	-0.5	-6.7	-18.0	3.0	1.9	4.0
Crop farming and forestry	-6.9	-13.5	6.8	2.8	2.6	2.3
Fishing and fish processing on board	0.1	6.1	-8.9	1.3	1.5	2.0
Mining and quarrying	16.1	-11.1	-14.8	5.1	19.1	9.4
Diamond mining	15.1	-17.7	-19.0	3.7	32.1	13.5
Uranium	33.4	-4.4	-23.0	14.0	7.6	4.5
Metal Ores	0.7	-0.1	6.7	2.9	3.3	4.8
Other mining and quarrying	13.6	2.5	-4.2	2.9	2.6	1.8
Primary industries	8.5	-7.8	-12.0	3.9	11.9	6.8
Manufacturing	1.0	3.5	-10.4	0.4	1.6	3.0
Meat processing	14.8	18.1	-14.2	0.5	2.1	4.2
Grain Mill products	1.9	-2.6	4.2	3.1	2.4	2.9
Other food products	1.1	1.0	3.3	-0.9	1.4	2.5
Beverages	5.0	12.5	-23.0	19.1	5.1	3.8
Textile and wearing apparel	0.9	-2.2	1.3	-1.9	-1.0	0.5
Leather and related products	4.5	-2.3	-2.2	1.6	2.1	4.4
Wood and wood products	-12.4	1.3	-3.8	-0.2	-2.0	7.2
Publishing and Printing	-13.2	-7.0	-1.2	-3.6	-2.5	7.0
Chemical and related products	-7.1	-1.5	53.1	-1.1	3.2	4.1
Rubber and Plastics products	7.0	-2.3	-5.6	-3.2	-1.0	3.0
Non-metallic minerals products	-5.1	3.9	-16.5	-0.7	1.9	8.3
Basic non-ferrous metals	-4.0	12.3	-28.0	-16.1	0.3	0.6
Fabricated Metals	5.3	1.1	-11.2	0.7	-2.2	-0.8
Diamond processing	6.5	-7.0	-43.0	-4.5	-1.2	3.2
Other manufacturing	0.2	9.1	-0.1	3.4	-0.1	1.3
Electricity and water	13.2	-5.4	3.8	2.3	1.8	3.5
Construction	-8.7	-7.9	-5.8	10.4	4.0	11.4
Secondary industries	0.9	0.9	-8.3	1.9	2.0	4.3
Wholesale and retail trade, repairs	-6.2	-4.6	-11.2	1.9	0.8	2.2
Hotels and restaurants	4.9	2.7	-83.8	173.0	69.2	20.4
Transport	-3.5	-3.4	-25.0	1.2	1.7	-10.2
Transport	-5.0	-33.5	-33.5	1.2	2.3	-15.9
Storage	2.6	5.4	5.4	1.1	0.4	3.0
Information Communication	-2.2	8.6	15.5	1.9	2.3	3.3
Financial and insurance service activities	0.0	6.0	-9.0	2.1	-0.2	2.6
Real estate activities	2.7	2.7	-3.8	2.0	2.5	2.8
Professional, scientific and technical services	-1.1	-7.1	1.0	-2.4	-2.9	0.5
Administrative and support services	0.8	-6.1	0.6	-1.1	0.8	2.5
Arts, Entertainment & Other Service activities	-1.1	-1.9	-20.7	12.5	1.2	2.3
Public administration and defence	-8.9	2.2	-0.7	1.6	2.6	2.4
Education	-2.4	2.7	2.7	1.7	3.4	2.0
Health	0.5	-4.8	6.1	-1.0	1.2	2.8
Private household with employed persons	-2.4	-2.6	0.6	1.2	2.2	2.5
Tertiary industries	-1.4	0.6	-7.1	2.8	2.9	2.4
All industries at basic prices	0.7	-0.9	0.7	0.4	0.7	0.6
Taxes less subsidies on products	0.5	-4.0	-12.2	5.9	6.4	6.7
GDP at market prices	0.7	-1.1	-8.5	3.0	4.4	3.8

Source: Cirrus Securities

Real GDP (N\$ Million) Forecast

Industry	2018	2019	2020	2021	2022	2023
Agriculture, forestry and fishing	9 474	9 232	8 505	8 685	8 849	9 076
Livestock farming	2 713	2 531	2 075	2 137	2 178	2 265
Crop farming and forestry	2 403	2 078	2 219	2 282	2 342	2 396
Fishing and fish processing on board	4 358	4 623	4 211	4 265	4 329	4 416
Mining and quarrying	15 349	13 649	11 632	12 229	14 561	15 925
Diamond mining	9 283	7 643	6 191	6 420	8 484	9 630
Uranium	2 559	2 447	1 884	2 149	2 312	2 415
Metal Ores	1 352	1 351	1 442	1 484	1 533	1 606
Other mining and quarrying	2 155	2 208	2 115	2 176	2 233	2 274
Primary industries	24 823	22 881	20 138	20 914	23 410	25 001
Manufacturing	18 212	18 852	16 885	16 957	17 233	17 753
Meat processing	767	906	778	782	798	831
Grain Mill products	2 156	2 100	2 188	2 256	2 310	2 377
Other food products	3 753	3 791	3 916	3 881	3 936	4 035
Beverages	2 639	2 968	2 285	2 722	2 860	2 969
Textile and wearing apparel	459	449	455	446	442	444
Leather and related products	300	293	286	291	297	310
Wood and wood products	453	459	442	441	432	463
Publishing and Printing	316	294	290	280	273	292
Chemical and related products	845	832	1 274	1 259	1 299	1 352
Rubber and Plastics products	350	342	323	312	309	318
Non-metallic minerals products	517	537	449	445	454	492
Basic non-ferrous metals	2 553	2 867	2 064	1 732	1 737	1 747
Fabricated Metals	532	538	478	481	470	467
Diamond processing	2 045	1 901	1 084	1 035	1 022	1 055
Other manufacturing	527	575	574	594	593	601
Electricity and water	2 933	2 774	2 879	2 946	2 999	3 104
Construction	3 333	3 069	2 891	3 193	3 322	3 700
Secondary industries	24 478	24 695	22 656	23 096	23 553	24 557
Wholesale and retail trade, repairs	14 526	13 851	12 300	12 533	12 639	12 917
Hotels and restaurants	2 983	3 063	496	1 355	2 292	2 761
Transport	4 430	4 278	3 207	3 245	3 300	2 965
Transport	3 537	3 346	2 225	2 252	2 304	1 938
Storage	893	932	982	992	996	1 026
Information Communication	2 315	2 513	2 903	2 958	3 026	3 126
Financial and insurance service activities	10 653	11 295	10 278	10 491	10 467	10 734
Real estate activities	8 015	8 228	7 915	8 077	8 276	8 508
Professional, scientific and technical services	1 093	1 015	1 025	1 000	972	976
Administrative and support services	1 599	1 501	1 510	1 494	1 506	1 544
Arts, Entertainment & Other Service activities	2 453	2 406	1 908	2 146	2 172	2 222
Public administration and defence	17 160	17 537	17 414	17 687	18 152	18 586
Education	13 089	13 443	13 806	14 046	14 525	14 812
Health	5 412	5 154	5 466	5 409	5 474	5 626
Private household with employed persons	1 006	980	986	998	1 021	1 046
Tertiary industries	84 734	85 264	79 215	81 440	83 822	85 823
All industries at basic prices	134 035	132 840	122 008	125 450	130 786	135 381
Taxes less subsidies on products	11 401	10 946	9 611	10 177	10 833	11 561
GDP at market prices	145 436	143 786	131 619	135 627	141 619	146 942

Source: Cirrus Securities