FOR INFORMATION

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To: Members of the Executive Board

From: The Acting Secretary

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***The authorities have not consented to the publication of this assessment by the AfDB.**

Namibia—Assessment Letter for the African Development Bank

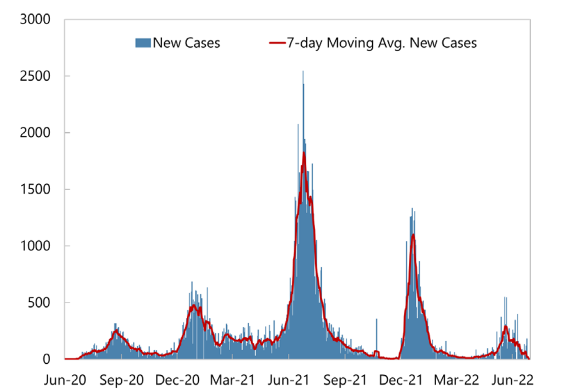
July 18, 2022

This assessment letter provides an update on the IMF's staff assessment of Namibia's recent economic developments, outlook, and economic policies since the Rapid Financing Instrument (RFI) was approved in March 2021. The assessment has been requested by the African Development Bank (AfDB).

Context and Background

1. **Namibia has been severely hit by the COVID-19 pandemic.** After the first case was reported in mid-March 2020, a national state of emergency was declared, land and aerial borders were closed, and a strict country-wide lockdown was introduced. As the economy started to gradually re-open, a more severe second and third wave hit Namibia in late 2020 and June 2021. In December 2021, the rapid spread of the omicron variant lead to a surge in new cases, with an international travel ban imposed on Namibia.[1] As the fourth wave eased, most COVID-19 restrictions were lifted in mid-March. A pick-up in new cases was recorded at end-May, but it has normalized. About 24 percent of the targeted population is fully vaccinated as of June 27. The vaccination campaign has recently slowed, mostly reflecting vaccine hesitancy.

Namibia: Daily Cases
(Number of people)



Sources: WHO Coronavirus Disease (COVID-19) Dashboard.

Recent Economic and Financial Developments

2. **After a sharp contraction, the Namibian economy has recovered modestly in 2021**. Real GDP contracted by about 8 percent in 2020, as economic activity was severely hit by the COVID-19 pandemic. Unemployment increased to about 22 percent at end-2020, reaching 40 percent among the youth, and poverty and income inequality increased. Real GDP growth strengthened to 2.1 percent in 2021, supported by a recovery in mining, notably diamonds and uranium, and tertiary sector activities. However, real output remained below its pre-pandemic level at end-2021. After reaching 3.6 percent (average, y-o-y) in 2021, headline inflation rose to 5.4 percent in May 2022 (y-o-y), as the pick-up in international oil and food prices started to be passed-through.[2] Food

[1] The international travel ban, also imposed on other Southern African countries, was lifted in early January 2022.

[2] Increases in international fuel prices were passed-through to pump prices, with a lag. In view of inflationary pressures, fuel levies were reduced by 50 percent for a period of three months (May to July). The associated loss in tax revenues (0.2 percent of GDP) is incorporated under staff's baseline scenario.

insecurity worsened, with more than a quarter of the population classified as food insecure, as of November 2021.[3, 4]

3. **Namibia's external position sharply deteriorated.** A current account deficit of 9.1 percent of GDP was recorded at end-2021, as Southern Africa Customs Union (SACU) receipts severely declined, imports rebounded from their 2020 contraction, and mining exports moderately strengthened. Net financial inflows surged, reflecting non-bank financial institutions' repatriation of assets and inter-company borrowing in the mining sector. Gross international reserves increased to about US$2.8 billion at end-2021 (about 4.9 months of import coverage), supported by IMF emergency assistance under the RFI and the IMF general SDR allocation (¶17), and AfDB budget support (US$100 million). After appreciating by 5.6 percent (average, y-o-y) in 2021, the real effective exchange rate further appreciated by 1.3 percent over the first five months of 2022.

4. **Fiscal imbalances widened in FY21/22, despite the implementation of fiscal adjustment measures, owing to a sharp decline in SACU tax revenues.** The overall fiscal deficit is estimated to have widened to 9.2 percent of GDP in FY21/22, as SACU tax revenues contracted by about 5 percent of GDP. Non-SACU tax revenues strengthened, supported by the economic recovery and collection of tax arrears (1.4 percent of GDP). Public spending was reduced by about 4 percent of GDP by containing the wage bill on the back of a no-inflation adjustment of nominal wages and hiring freeze (excluding in priority sectors); re-prioritizing spending in goods and services and public investment and unwinding of the 2020 COVID-19 Economic Stimulus and Relief package. Large financing needs—deepened by the repayment of the US$500 million 2010 Eurobond—were covered by the IMF emergency assistance, the African Development Bank budget support, and a pick-up in domestic borrowing from the financial sector.

5. **Good progress was made in the implementation of governance commitments on COVID-19 spending under the RFI.** All COVID-19 spending was appropriately budgeted and an execution report was included in the FY21/22 budget. COVID-19 related procurement contracts were published, although the beneficial ownership information has not yet been made public. The Auditor General conducted a full audit of COVID-19 spending (including ex-post validation of goods and services procured), which was published online. The Public Financial Management Bill is expected to be presented to the Parliament in early 2023.

6. **The Bank of Namibia (BoN) has gradually raised its policy rate, following the South African Reserve Bank (SARB)'s monetary policy tightening.** In the context of the currency peg to the South African rand, the BoN had lowered its policy rate by cumulative 275 basis points in 2020 (to 3.75 percent), following the SARB's rate reduction. As the SARB started unwinding its

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[3] Integrated Food Security Phase Classification (IPC) analysis by the UN Office for the Coordination of Humanitarian Affairs (OCHA), December 2021.

[4] Namibia depends on imported food for more than half of consumed calories. About 90 percent of wheat is imported, of which 60 percent originates from Russia. So far, there have been no reports of food shortages but higher food prices have worsened food insecurity.

accommodative monetary policy stance in early 2022, the BoN gradually raised the policy rate by a cumulative 100 basis points (to 4.75 percent) during February-June 2022.

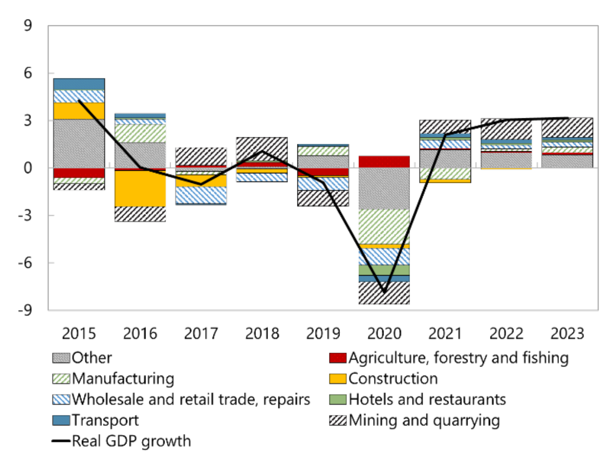
7. The financial system has remained stable, but risks have increased, and private sector credit growth was anemic. The banking sector has remained liquid, well-capitalized and profitable, with capital adequacy and liquidity ratios above prudential minima at end-2021. After increasing in 2020, the ratio of non-performing loans remained stable at 6.4 percent at end-2021.[5] Rising interest rates, coupled with a slower-than-anticipated recovery of the Namibian economy and a subdued real estate market, could represent a downside risk to NPLs. Depository corporations' net lending to the government picked-up by 51 percent (end-period, y-o-y) in 2021, reflecting large budgetary financing needs, increasing banks' exposure to sovereign risk. In parallel, credit to the private sector slowed to 1 percent at end-2021 (y-o-y). Furthermore, banks' exposure to the large non-bank financial sector (total assets of 187 percent of GDP at end-2021) increased, with wholesale funding representing more than a third of banks' deposits, heightening interconnectedness risks.

The Short-Term Outlook and Risks

8. The economic recovery is expected to continue. Real GDP growth is projected at 3 percent in 2022 and 3.2 percent in 2023. The recovery is expected to be supported by a pick-up in diamond mining activity, as external demand strengthens and prices pick-up following the repercussions of the war in Ukraine, and a new mining vessel becomes operational, and a recovery in manufacturing and tourism activities. Headline inflation is expected to rise to 6.2 percent (average, y-o-y) in 2022, as higher international oil and food prices, due to the repercussions of the war in Ukraine, are passed-through. The current account deficit would slightly narrow but remain large at 8.2 percent of GDP in 2022. This would reflect a further decline in SACU receipts and a pick-up in oil and food imports,[6] only in part mitigated by a robust recovery in mining exports, supported by a significant terms of trade

Namibia: Contribution to Real GDP Growth

(Percent)



Sources: Bank of Namibia, and IMF staff calculation.

[5] Financial sector indicators at end-2021 reflect the implementation of the 2020 COVID-19 relief measures, easing regulatory requirements for banks. As this may delay the recognition of asset quality deterioration, data on banks' NPLs, profitability and capital ratios may not fully reflect the impact of the COVID-19 crisis.

[6] Food and oil imports represent 16.9 and 15.2 percent of overall imports, respectively.

improvement.[7] Despite anticipated financial net inflows and IFIs budget support, international reserves are expected to decline to 2.5 billion (4.2 months of imports coverage) at end-2022, slightly below the IMF reserve adequacy metrics. Over the medium term, real GDP growth is expected at 2.5 percent, as mining output stabilizes. The external position would gradually strengthen, supported by sustained mining production and prices, recovering SACU receipts, and lower international oil and food prices.

9. Fiscal imbalances are expected to narrow, on the back of fiscal adjustment measures articulated in the FY2022/23 National Budget approved by the Parliament. The overall fiscal deficit is expected at 7.9 percent of GDP in FY2022/23. Public expenditures would be reduced by about 1.5 percent of GDP on the back of: i) containing the wage bill by allowing for natural attrition, except in priority sectors, ii) reducing non-priority spending in goods and services; iii) re-prioritizing capital expenditures; iv) lowering transfers to state-owned enterprises (SOEs) thanks to the liquidation of the public airline.[8] Against declining SACU tax revenues, mobilizing sizable one-off dividends from SOEs, increasing taxes on alcoholic beverages and tobacco, and higher mineral export prices will support revenues.

10. Risks are tilted on the downside. Stronger-than-anticipated spillovers from the war in Ukraine could weaken Namibia's short-term outlook: higher-than-expected fuel and food prices could exacerbate inflation, worsen the external position, and undermine the domestic recovery. Furthermore, a prolonged impact of the pandemic and resumption of lock-down measures, weaker-than-expected growth in South Africa, a worsening of the global outlook, and supply chain disruptions could weigh on the recovery. In parallel, delays in the implementation of the planned fiscal consolidation would worsen the fiscal and external positions and increase financing needs. On the positive side, stronger-than-expected non-oil commodities prices and a faster-than-anticipated pace of planned investments in green hydrogen and oil extraction could boost growth. Higher-than-anticipated SACU revenues would support the fiscal position and reduce financing needs.

Macroeconomic Policies

11. Advancing the planned medium-term fiscal consolidation strategy is needed to preserve debt sustainability. The authorities are moving ahead with the implementation of the medium-term fiscal consolidation strategy approved by the Parliament in October 2020 while preserving social spending and provision of services to the population. Moving forward, advancing the planned public sector early retirement scheme will be key to contain the wage bill. Furthermore, advancing the SOEs reform to strengthen performance and management will support reducing budgetary transfers. To this end, a swift ratification of the Public Asset Ownership Policy will be

[7] The SACU revenue sharing formula adjusts for forecast errors with a two-years lag. A large negative adjustment is expected in FY22/23 to reflect lower-than-anticipated SACU revenues in FY20/21 due to the impact of the pandemic.

[8] Air Namibia was liquidated in February 2021, as a key component of the authorities' fiscal consolidation strategy.

important. Staff welcomes the operationalization of the Namibia Revenue Agency to support strengthening tax administration and fostering revenue mobilization. Under staff's baseline scenario, underpinned by the planned medium-term fiscal consolidation,[9] Namibia's public debt would peak at 70.9 percent of GDP in FY2023/24 and then gradually decline.

12. Maintaining the policy rate broadly in line with the SARB's rate will be key to anchor inflation. The currency peg to the South Africa rand has provided an anchor to monetary policy and inflation expectations. As inflationary pressures build-up and the SARB continues to unwind its accommodative monetary policy stance, tightening the BoN's policy stance will support the peg and containing inflation. In parallel, maintaining an adequate level of international reserves will support the credibility of the currency peg and provide buffers, in view of downside risks.

13. Strengthening the macroprudential framework will support financial stability. Staff welcomes progress in the setting-up of a macroprudential framework, with the establishment of the Financial Stability and Macroprudential Oversight Department at the BoN. Moving ahead, developing targeted macroprudential tools, notably to monitor bank's exposure to wholesale funding risks and capital adequacy, and reviewing early warning indicators and stress testing, with the support of IMF technical assistance, will be important. As the recovery strengthens, lifting the COVID-19 relief measures, recently extended to April 2023, would support financial stability.

14. Advancing structural reforms will be key to foster economic diversification and support medium-term growth and inclusion. Reducing policy uncertainty, strengthening the business environment and governance, facilitating firms' access to credit, and reducing skills mismatch in the labor market would foster private sector development, inclusive growth, and job creation.

Relations with the Fund

15. The 2021 RFI was Namibia's first financial engagement with the Fund. On March 31, 2021, the Executive Board approved emergency financial assistance under the RFI for SDR 191.1 million (about US$270.8 million) to address urgent balance of payments and fiscal needs stemming from the COVID-19 pandemic. The RFI purchase was made in the form of budget support. Namibia received a general SDR allocation of SDR 183.2 million on August 23, 2021.

16. The IMF Executive Board concluded the 2019 Article IV consultation on August 30, 2019. The 2022 Article IV consultation mission is expected to take place in September, with Executive Board discussion in November 2022. IMF capacity development has focused on public financial management, tax and customs administration, financial sector oversight, and macroeconomic statistics.

[9] A package of fiscal adjustment measures of 5.3 percent of GDP (cumulative) over FY2021/22–23/24 underpins staff's baseline scenario. This builds on spending rationalization measures (3.6 percent of GDP) and revenue mobilization measures (1.7 percent of GDP), reflecting the authorities' medium-term fiscal consolidation strategy

Table 1. Namibia: Selected Economic Indicators, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj	Proj	Proj	Proj	Proj	Proj
	(percentage change, unless otherwise indicated)									
National account and prices										
GDP at constant prices	1.1	-0.9	-7.9	2.1	3.0	3.2	2.6	2.5	2.5	2.5
GDP deflator	4.4	1.0	4.1	1.8	6.6	5.5	4.6	4.5	4.3	4.4
GDP at market prices (N$ billions)	181	181	174	181	199	216	232	248	266	284
GDP at market prices (Fiscal Year) (N$ billions)	181	179	176	185	203	220	236	253	270	289
GDP per capita (US$, constant 2000 exchange rate)	10,817	10,627	10,012	10,221	11,030	11,787	12,422	13,068	13,724	14,419
Consumer prices (average)	4.3	3.7	2.2	3.6	6.2	4.9	4.5	4.5	4.5	4.5
External sector										
Exports (US$)	12.1	-7.6	-19.0	13.0	24.6	10.5	3.7	3.3	4.5	4.1
Imports (US$)	3.4	-9.8	-21.0	33.5	12.9	3.5	4.3	2.6	3.2	3.5
Terms of trade (deterioration = -)	-0.9	2.3	7.0	-10.8	11.8	3.6	-0.3	-1.7	11.8	13.9
Real effective exchange rate (period average)	98.3	96.3	89.1	94.1	...	...	...	...	...	...
Exchange rate (N$/US$, period average)	13.2	14.5	16.5	14.8						
Exchange rate (N$/US$, end of period)	14.4	14.0	14.7	15.9	...	...	...	...	...	...
Money and credit										
Domestic credit to the private sector	7.2	7.1	2.4	1.0	5.0	6.8	7.6	7.5	7.5	7.5
Base money	5.7	5.0	16.1	0.2	8.1	7.8	7.8	7.6	7.7	7.7
M2	6.4	10.5	8.1	4.2	8.1	7.8	7.8	7.6	7.7	7.7
Interest rate (percent)	6.8	6.5	3.8	...	...	...	...	...	...	...
	(percent of GDP)									
Investment and Savings										
Investment	14.9	15.0	13.1	13.9	15.2	15.1	15.2	15.1	15.1	15.1
Public	4.7	3.7	3.0	2.5	2.2	2.2	2.2	2.2	2.2	2.2
Private	12.2	12.1	10.5	11.5	13.0	13.0	13.0	13.0	13.0	13.0
Change Inventories	-2.0	-0.8	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings	11.5	13.3	16.0	4.8	6.9	11.0	11.1	11.4	11.8	11.9
Public	-2.0	-2.2	-4.3	-5.9	-5.3	-3.3	-1.7	-1.1	-0.7	-0.5
Private	13.5	15.5	20.3	10.8	12.2	14.4	12.8	12.5	12.4	12.4
Central government budget 1/										
Revenue and grants	30.8	32.6	32.9	28.9	28.6	29.7	30.8	30.8	31.1	31.2
Of which: SACU receipts	9.6	10.5	12.7	8.0	7.0	8.6	9.4	9.2	9.2	9.2
Expenditure and net lending	36.4	38.2	41.9	38.1	36.5	35.5	35.1	34.8	34.6	34.6
Primary balance (deficit = -)	-2.3	-1.8	-4.8	-4.9	-3.3	-0.8	1.1	1.4	2.3	2.4
Overall balance	-5.6	-5.6	-8.9	-9.2	-7.9	-5.7	-4.2	-4.0	-3.4	-3.3
Primary balance: Non-SACU	-11.9	-12.3	-17.5	-12.8	-10.3	-9.4	-8.3	-7.8	-6.9	-6.7
Public debt/GDP	50.4	60.0	66.1	70.7	70.4	70.9	70.5	70.0	68.8	67.7
Of which: domestic	32.6	39.5	44.8	52.4	53.1	54.6	55.2	56.4	56.5	56.3
Gross public and publicly guaranteed debt/GDP	56.5	66.7	72.5	76.2	76.4	76.9	76.5	76.0	74.8	73.7
External sector										
Current account balance										
(including official grants)	-3.3	-1.7	2.9	-9.1	-8.2	-4.1	-4.0	-3.8	-3.4	-3.2
External public debt (including IMF)	17.8	20.4	21.3	18.3	17.3	16.4	15.2	13.6	12.3	11.4
Gross official reserves										
US$ millions	2,155	2,071	2,158	2,766	2,491	2,705	2,914	3,116	3,374	3,647
Percent of GDP	17.1	16.0	18.2	24.3	19.1	19.6	19.9	20.3	21.0	21.7
Months of imports of goods and services	4.5	5.4	4.3	4.9	4.2	4.4	4.6	4.8	5.0	5.1
External debt/GDP 2/	61.7	66.4	77.5	66.5	60.4	53.4	47.9	42.7	37.7	33.3
Memorandum item:										
Population (in million)	2.4	2.5	2.5	2.6	2.6	2.6	2.7	2.7	2.8	2.8

Sources: Namibian authorities and Fund staff estimates and projections.

1/ Figures are for fiscal year, which begins April 1.

2/ Public and private external debt.