FOR AGENDA

SM/09/43
Correction 1

February 26, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Namibia—Staff Report for the 2008 Article IV Consultation**

The attached corrections to SM/09/43 (2/13/09) have been provided by the staff:

Factual Error Not Affecting the Presentation of Staff's Analysis or Views

Page 20, para. 31, line 6: for "and veterans' allowances."
read "and war veterans' allowances."

Typographical Errors

Page 7, Figure 2, Chart 4, line 5: add "- - CPI Inflation excl. food and energy related items"

Page 16, Table, line 1: for "Nambia" read "Namibia"

Page 18, Chart 2, line 2: for "an improvement in the"
read "an improvement in the ranking"

Page 33, Table, column 1, line 9: for "Exchange rate (Namibia dollar"
read "Exchange rate (Namibian dollar"

Questions may be referred to Ms. Soonthornsima (ext. 37967) and Mr. Kpodar (ext. 36062) in AFR.

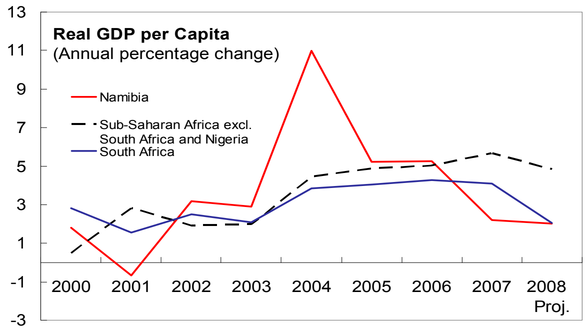
This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (5)

Other Distribution:
Department Heads

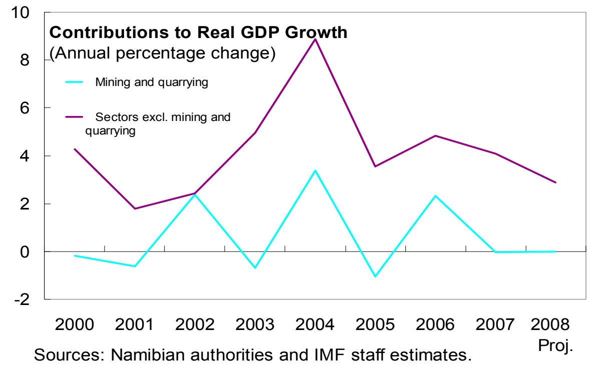
Figure 2. Namibia: Recent Macroeconomic Performance

Per capita income growth has weakened



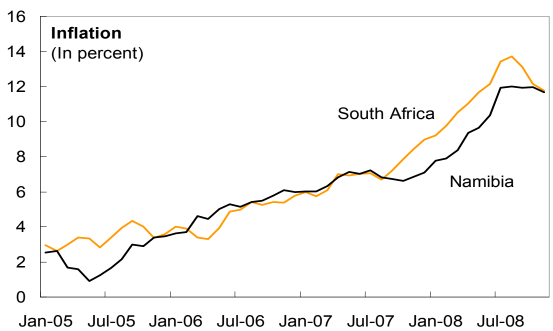
Sources: Namibian authorities; and World Economic Outlook.

… as growth slowed in both the mining and nonmining sectors.



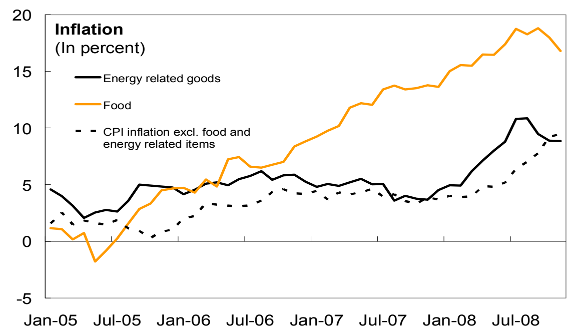
Sources: Namibian authorities and IMF staff estimates.

Namibia's inflation tracks South Africa's ...



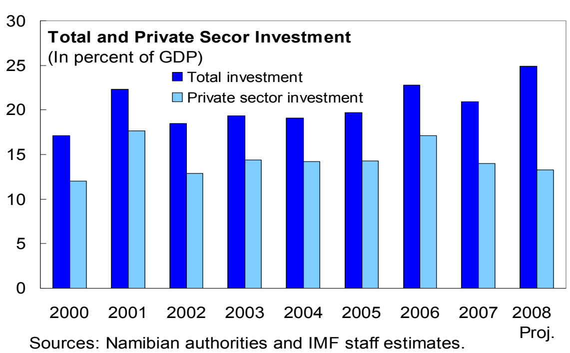
Sources: Namibian authorities and IMF staff estimates.

… and has declined slightly as food and fuel prices eased.



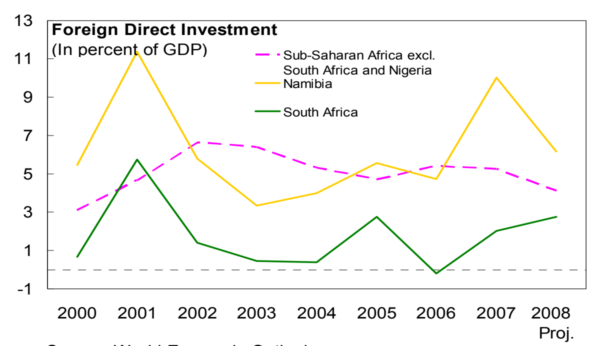
Sources: Namibian authorities and IMF staff estimates.

Private sector investment remains high, ...



Sources: Namibian authorities and IMF staff estimates.

… reflecting in part FDI inflows.



Source: World Economic Outlook.

5. **The 2007/08 (April–March) fiscal surplus, including extrabudgetary expenditure, was 4.5 percent of GDP, compared with the budgeted 0.2 percent.** Stronger revenue performance was driven by a significant improvement in tax administration, increased mineral export taxes due to high commodity prices, and strong SACU receipts. The large fiscal surplus was also partly due to lower than budgeted capital expenditure.

6. **The 2008/09 budget envisages a sharp swing in the fiscal balance to a deficit, with an unprecedented increase in expenditure (Figure 3).** The fiscal balance is projected to shift to a deficit of 5.7 percent of GDP, a swing of over 10 percent of GDP from the 2007/08 outturn. Budgeted current and capital expenditures are considerably higher than the average for the past three years, with externally financed capital expenditure projected at 3.7 percent of GDP compared to 0.6 percent in 2007/08. While revenue performance in the first two quarters of 2008/09 remained strong, the impact of falling global demand could dampen it for the rest of the fiscal year. Should the budget be fully implemented, public debt would rise to 24.8 percent of GDP, close to the authorities' target of 25 percent.

7. **The current account surplus is projected to fall to 2 percent of GDP in 2008, reflecting declining terms of trade and substantial imports for mineral exploration and public infrastructure projects (Figure 4).** The terms of trade decline mostly reflected the collapse in mineral export prices from historic peaks in recent years. Although capital outflows—mostly through pension funds—slowed, they remained large. Official international reserves increased to an equivalent of 3.7 months of imports of goods and services in December 2008, up from 3 months at end-2007. In line with the South African rand, the Namibian dollar depreciated by 26 percent against the U.S. dollar during 2008, roughly two-thirds of which took place during September–December.

8. **The BoN reduced its repo rate by 50 basis points in December 2008 in response to slowing economic activity and moderating inflation, in line with the move by the SARB.** This left the rate at 10 percent, still 150 basis points below the SARB repo rate, after the BoN opted not to follow three SARB rate increases in 2007–08 (Figure 5). The BoN also modified its operational framework in 2008, introducing a seven-day repo facility as the key monetary policy instrument and increasing issuance of BoN bills in order to manage liquidity and provide an alternative asset for banks to meet statutory asset requirements. Growth in credit to the private sector slowed drastically in 2008 as a result of monetary tightening in 2007,[2] falling to 5.6 percent in November (year on year) from 13 percent in December 2007.

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[2] The BoN increased the repo rate by 150 basis points in the second half of 2007.

Namibia: Staff Alternative Medium Term Fiscal Outlook

(In percent of GDP)

	Est. 2007/08	Budget 2008/09	Staff Est. 2008/09	Projections 2009/10	2010/11	2011/12	2012/13	2013/14
Revenue and grants	32.4	29.3	30.4	29.9	29.1	29.0	28.7	28.5
Expenditures	27.9	35.0	33.0	32.3	31.4	31.1	30.8	30.5
Overall balance 1/	4.5	-5.7	-2.6	-2.3	-2.3	-2.0	-2.0	-2.0
Overall balance excluding extrabudgetary spending 1/	5.1	-2.0	0.0	-0.6	-0.6	-0.3	-0.3	-0.3
Memorandum items:								
Public and publicly guaranteed debt	24.3	33.1	28.3	29.4	29.0	28.2	28.3	28.3
Public debt	18.9	24.8	22.0	22.6	23.5	23.8	24.0	23.9
Domestic 2/	13.9	16.7	14.7	14.2	13.6	12.9	12.3	11.6
External	4.9	8.1	7.3	8.4	9.9	10.8	11.7	12.4
Publicly guaranteed debt	5.4	8.2	6.3	6.8	5.5	4.4	4.3	4.4
Government deposits	4.8	4.5	4.5	4.3	4.0	3.9	3.9	3.9
Net public and publicly guaranteed debt	19.4	28.6	23.8	25.1	25.0	24.3	24.4	24.4

Sources: Namibia authorities; and Fund staff estimates.

1/ "Overall balance" reflects externally financed project spending (except for roads) that is not channeled through the state account. "Overall balance excluding extrabudgetary spending" excludes such spending and thus corresponds directly with the authorities' budget balance.

2/ The change in domestic debt includes bonds issued for local capital market development.

17. **Staff's alternative scenario achieves a reduction of net public and publicly guaranteed debt to the 25 percent of GDP target through two main modifications.** First, the scenario assumes that the planned reforms of state-owned enterprises (SOEs) will result in a gradual decline in their need for budgetary support and debt guarantees starting in 2010/11. The anticipated reforms of SOEs include improvements in operational efficiency and in financial management by tightening the criteria on publicly guaranteed debt of SOEs, consistent with the public and publicly guaranteed debt target. Second, the scenario adjusts the planned level of capital expenditure to reflect historical implementation rates. Estimates of public debt sustainability confirm that the level of public debt is largely sustainable.[5] The simulations were sensitive, however, to declining SACU revenue, increases in publicly guaranteed debt, and a moderation of recent high GDP growth rates.

18. **The authorities have made considerable progress in reforming public financial management.** Revenue administration was strengthened through the introduction of comprehensive auditing of value added tax (VAT) refunds, and there are plans to expand the mineral tax to all minerals. The use of the Integrated Financial Management System has improved utilization of resources and prevented diversion of funds, while the first Annual Accountability Report on budget implementation prepared for 2006/07 will further strengthen budget execution and make the budgetary process more transparent. The authorities are also working to improve program budgeting and revenue forecasting, which is crucial for efficient fiscal management.

[5] See Debt Sustainability Analysis Annex.

19. **Staff recommended consolidating extrabudgetary project expenditure into regular budget reporting in order to provide more comprehensive coverage.** This would not only enhance transparency, but also allow for a more comprehensive assessment of the overall fiscal balance and the macroeconomic impact of fiscal policy.

20. **The authorities are moving forward with fiscal decentralization and exploring how best to effectively use public-private partnerships (PPP).** Staff commended recent progress on decentralization, but suggested a more comprehensive approach to fiscal relations between the central and lower tiers of government, with clear guidelines on revenue and expenditure assignments, transfers and subsidies, and financing and borrowing.[6] The authorities agreed with this recommendation, and noted that they were formulating a formula-based intergovernmental fiscal allocation mechanism with minimum standards for fiscal accountability. The authorities also agreed on the importance of establishing a clear legal and institutional framework for implementing PPP projects, clearly identifying and disclosing the fiscal risks associated with such projects.

Pursuing external stability

21. **The authorities stressed that the peg of the Namibian dollar to the rand has underpinned Namibia's deep economic and financial ties with South Africa.** Although the significant recent depreciation and prolonged current account surplus may suggest a possible undervaluation, staff's assessment suggests that the real effective exchange rate (REER) is not significantly different from the equilibrium level and is broadly consistent with external stability (Box 1). The REER depreciated by 9 percent in real terms from the end of 2007 through November 2008, but this follows an appreciation of more than 30 percent from 2001–07. In addition, the large current account surplus of 2006–07 appears to reflect a temporary boom in SACU receipts and export prices, while exports of nonrenewable mineral resources are expected to decline as these resources are depleted over the medium term.

Namibia: Tradeable Sector Performance, 2004–08

(Percentage changes one year earlier; unless otherwise noted)

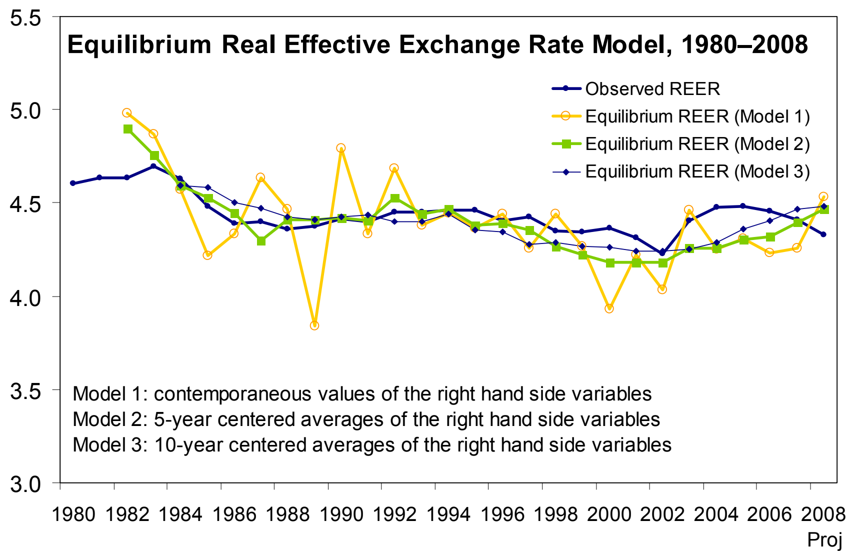
	2004	2005	2006	2007	Proj. 2008
Export growth (Namibian dollars)	24.3	11.8	36.5	14.6	24.7
Mineral goods	29.3	5.3	47.6	14.7	33.4
Nonmineral goods	18.0	20.6	23.3	14.4	12.4
Of which: Manufactured goods	2.8	13.6	59.3	26.1	...
Manufacturing value added (real terms)	0.4	7.5	2.7	7.2	3.4
Share of exports in world trade (percent	0.020	0.020	0.022	0.021	0.018

Sources: Namibian authorities; and IMF staff estimates.

[6] Staff gave a presentation on *Fiscal Decentralization: General Principles, International Evidence, and Lessons for Namibia.*

Box 1. An Assessment of External Stability

The equilibrium real exchange rate approach suggests that Namibia's REER may be undervalued. An econometric analysis of behavioral determinants of the equilibrium REER[1]—trade openness, investment rate, broad money, and relative productivity against main trading partners—indicates that Namibia's REER is undervalued. However, these estimates are highly volatile, depending on the assumption about the smoothing factor for the fundamentals, an important consideration for a commodity exporting country like Namibia. The magnitude of the undervaluation ranges from 13 to 20 percent, depending on the period considered.



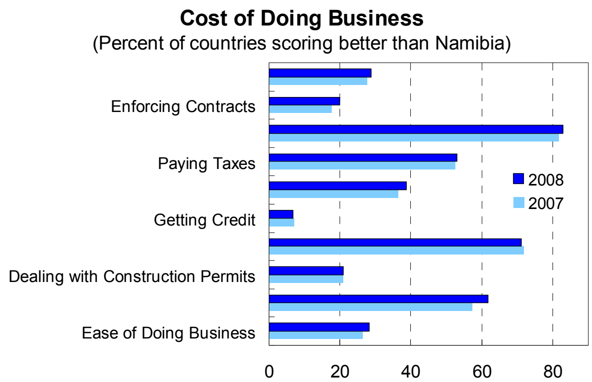
Source: IMF staff estimates.

However, the macroeconomic balance approach finds the current REER to be overvalued. The underlying current account deficit is estimated to about 4.5 percent of GDP, while the current account norm stands at 4 percent. This results in an overvaluation of 11 percent assuming that current account elasticity with respect to the REER is about 0.8.

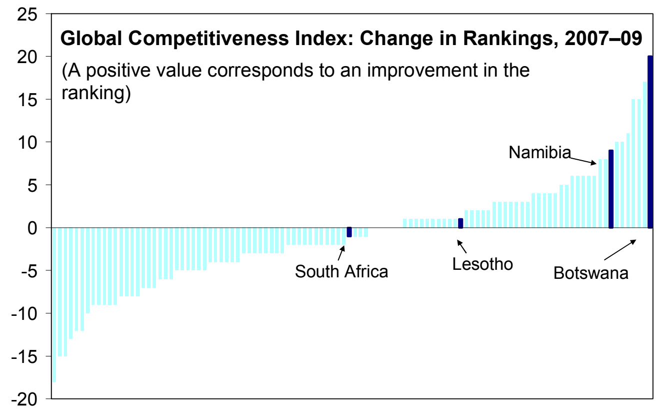
Overall, these results do not provide conclusive evidence that the REER was not aligned with its equilibrium value at the end of 2008 and the findings do not indicate substantial risks to external stability.

[1] The model, documented in "What Do We Know About Namibia's Competitiveness?" WP/07/191, is based on data for 1980–2007.

22. **Improving competitiveness is essential to stimulate Namibia's growth and reduce high unemployment**. The country's main strengths remain its strong institutions and good infrastructure. However, labor skill shortages and complicated business registration and licensing procedures continue to undermine firms' competitiveness. With the support of the World Bank and the EU, Namibia's Strategic Plan for Education and Training Sector Improvement Program (2005–20) aims to make the education system more effective. To promote investment and trade, a "one stop-shop" has been established to facilitate fast-track processing of regulatory requirements.



Source: World Bank's Doing Business (2009).



Source: Global Competitiveness Report 2008–09.

Monetary policy and financial stability

Monetary policy

23. **The BoN did not follow the SARB interest rate hikes from December 2007 through June 2008, considering that further monetary tightening was not necessary given moderating inflation.** The authorities maintain that capital controls allow them to retain some scope for independent monetary policy within the CMA. The BoN requires that domestic assets of commercial banks be equal to or greater than their domestic liabilities, and limits their foreign assets to one-half their level of equity capital. While the exchange rate peg to the rand remains the monetary policy anchor, the BoN considers that these constraints on capital movement provide some discretion to deviate from the SARB repo rate without significantly affecting capital flows. Also, to ensure the stability of the fixed peg, the BoN maintains foreign exchange reserves well above the level necessary to cover currency in circulation and monthly average capital outflows.

24. Staff agreed that the current deviation from the SARB repo rate poses little risk at present, provided that the BoN maintains sufficient international reserves. Staff noted, however, that as a small, open economy with a fixed exchange rate as a member of CMA, Namibia has limited scope for an effective independent monetary policy. Although the

current capital controls constrain banks to some extent, there remain a wide range of other possible channels for capital to move back and forth from South Africa, which keeps money market and deposit rates closely linked to rates in South Africa.

Financial stability

25. **The global financial crisis has had little direct impact on the Namibian financial sector, which has benefited from continued prudent supervision by the BoN.** Banks in Namibia appear to have been well-protected by conservative lending practices and little direct overseas exposure, and remain well-provisioned and profitable. The expected entrance of a fifth bank in 2009 is expected to increase competition within the sector. Nonperforming loans are at very low levels despite a modest increase in 2008, but can be expected to increase as the real economy continues to slow. Given that banks have relatively high concentration to real estate and consumer lending, the banking system may be exposed to higher risks.

26. **The BoN has acted quickly to curb pyramid schemes.** It closed down one such scheme in 2008, and has initiated a public awareness campaign to deter others. The authorities plan to increase consultation within the CMA on the issue, given similar problems elsewhere in the region and will participate in an IMF workshop on the issue in early 2009. The BoN has also continued to strengthen its stress-testing framework and will move forward with implementation of Basel II in 2009.

27. **The capacity of the Namibia Financial Institutions Supervisory Authority (NAMFISA) is increasing, but the authorities recognize the need for further improvement.** A new law to consolidate regulation of nonbank institutions and clearly define NAMFISA's supervisory authority is expected to be approved by the end of 2009. NAMFISA has also introduced regular standardized reporting for pension funds and insurance companies that should help address deficiencies in data collection and monitoring and is implementing a risk-based auditing system.

28. **The government is considering modifications to the tighter domestic investment requirements introduced for pension funds and life insurance companies in 2008 to address market uncertainty about their interpretation.** The new regulation, which was to be phased-in over five years beginning in 2009, limits dual-listed companies (largely traded in South Africa) to a maximum of 10 percent of local assets and requires a minimum of 5 percent of total assets to be invested in unlisted Namibian companies. The previous regulation permitted investment in dual-listed companies to be counted toward the 35 percent domestic investment requirement, with no required minimum investment in unlisted companies.

29. **The authorities consider the revision an important step to help channel high domestic savings to support economic growth.** They indicated that the previous regulation was not working as envisaged, given that the domestic investment requirement was mostly

met through investment in dual-listed companies that also trade in South Africa, and that they considered the revision a relatively modest change with a sufficient phase-in period. The authorities maintained that it would not create undue risk for these funds and cited the example of many other emerging market economies with similar requirements.

30. **Staff encouraged the authorities to consider a more moderate change to the requirements on domestic investment.** Staff agreed that a modest revision to direct a larger share of investment into local assets rather than dual-listed shares could be appropriate, but cautioned that there are insufficient instruments to absorb efficiently the significant volume of capital inflows that the new regulation would require. The limited number of domestically listed companies and corporate and government bonds are mostly held by buy-and-hold investors and do not trade in sufficient volume or size to absorb the capital inflow. In addition, staff noted the higher risk associated with the required allocation in unlisted companies and the implications for insurance reserves and pension savings. Experience with investment in unlisted domestic companies by the government pension fund in the mid-1990s raises significant concerns about excessive risk associated with these investments.

C. Poverty Reduction and Structural Reforms

31. **The authorities have taken several measures to address poverty and alleviate the temporary impact of high food and fuel prices.** These include a zero-rate value-added tax on selected food items, rebate facilities for food importers, and a food distribution program to feed the most vulnerable. The authorities restated their commitment to combating poverty and expanding the social safety net and noted that the 2008/09 budget increased payments to the elderly, orphans and vulnerable children, and war veterans' allowances. The mission supported additional but targeted social safety support and recommended that any increase should be accommodated by reallocation of resources within the existing budget envelope.

32. **The National Development Plan 3 (NDP3) (2007/08–2011/12) aims to achieve sustainable economic growth and reduce poverty**. Under NDP3, the authorities plan to focus resources on the poorest and the most vulnerable, improve the social safety net to alleviate poverty and inequality, and foster competitiveness to promote growth and employment. Each ministry is required to develop a strategic plan consistent with the MTEF, with a firm focus on monitoring and evaluation of outputs.

33. **Unemployment and HIV/AIDS remain the major challenges to overcoming poverty**. The Labor Act of 2007, enacted in 2008, aims to provide greater protection to workers while acknowledging that the business sector needs flexibility and cost competitiveness in staffing. Under the National Strategic Plan on HIV/AIDS, Namibia has made good progress in expanding the availability of anti-retroviral treatment (ART), with about 80 percent of those in need currently receiving treatment. Progress on prevention remains a priority, however, and reliance on external funding could jeopardize the long-term provision of ART.

year and remained at 10.9 percent in December, compared with 7 percent a year before. In line with the South African Reserve Bank (SARB) rate cut, the Bank of Namibia (BoN) reduced its repo rate by 50 basis points in December 2008. This left the rate at 10 percent, still 150 basis points below the SARB repo rate, after the BoN opted not to follow three SARB rate increases in 2007–08. Mirroring the weakening of the South African rand, the Namibian dollar depreciated by 26 percent against the U.S. dollar during 2008, roughly two-thirds of which took place during September-December.

The 2007/08 fiscal balance recorded a much higher surplus than budgeted, reflecting stronger revenue performance driven by high commodity prices and an improvement in tax administration. Accordingly the 2008/09 budget envisages a large swing in the fiscal balance to a deficit, which would raise public debt close to the authorities' target level of 25 percent of GDP.

Executive Board Assessment

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Namibia: Selected Economic Indicators

	2005	**2006**	**2007**	**2008 Proj.**
	(Percent)			
Change in real GDP	2.5	7.2	4.1	2.9
Change in CPI (end of period)	3.5	6.0	7.1	10.9
	(Percent of GDP)			
Overall fiscal deficit/surplus[1]	-0.4	2.8	4.5	-2.6
Public debt [1]	26.0	24.4	18.9	22.0
	(End of period; percent change)			
Broad money	9.7	29.8	18.8	15.5
Credit to the private sector	20.1	14.8	12.9	6.1
	(Percent of GDP, unless stated otherwise)			
Current account balance	4.7	13.8	9.2	2.0
International reserves (months of imports)	1.4	2.1	3.0	3.7
Exchange rate (Namibian dollar/U.S. dollar, end of period)	6.3	7.0	6.8	9.3

Sources: Namibian authorities; and IMF staff estimates.

[1] Figures are for fiscal year, which begins April 1.