



MONETARY POLICY FRAMEWORK IN AFRICA IN CHANGING FINANCIAL LANDSCAPE

A CASE OF NAMIBIA

By

Mukela Mabakeng and Postrick Mushendami (PhD)

A PAPER PRESENTED AT CONTINENTAL SEMINAR OF THE ASSOCIATION OF AFRICAN CENTRAL BANKS

Nairobi, May 13-15, 2015

INTRODUCTION

1. This paper documents the monetary experience of Namibia in the changing financial landscape in particular the recent financial crisis of 2007 to 2009. A broad definition of changing financial landscape could include, among other things, the financial crisis, the increased innovation of the financial markets such as the emergence of securitisation etc., and the increased usage of information technology in the delivery of financial services.

2. The impact of the global financial crisis varied across countries in Africa. This was mainly due to poor integration of most African economies to the global economy. For instance, only 6 out of 51 African countries experienced a contraction in GDP in 2009. Generally, the groups that have been heavily hit in Africa are emerging and frontier markets, such as South Africa, Mauritius or the Seychelles; and resource-rich countries, such as Zambia, Angola and Botswana.

3. In Swaziland for instance, the SACU receipts which is a major source of government revenue accounting for over fifty percent of total revenue, fell precipitously by close to 70 percent in 2010. Consequently, the Government was being confronted with significant short-term liquidity constraints in financing its large fiscal deficit. The fiscal crisis emanated from structural imbalances in both Government expenditures and revenues. Significant weaknesses in the budget process led to off-budget expenditures in the past which were subsequently regularized by supplementary budgets. This culminated in the overall budget deficit of around 13 percent of GDP for 2010/2011. Swaziland, being an export-led country, also suffered as a result of the subsequent decline in aggregate demand from its major export destinations which resulted in a significant slump in global trade as well.

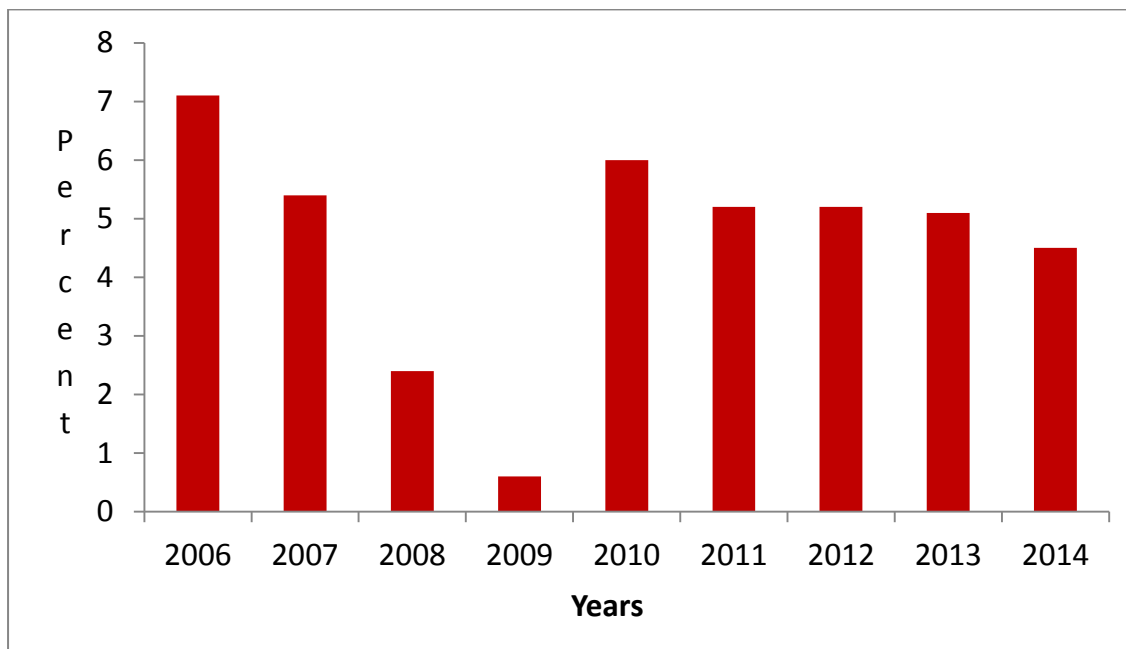
4. The Zambian economy on the other hand was impacted through both trade and financial flows. The precipitous decline in commodity (copper) prices in Q4, 2008 led to a sharp drop in export earnings, and lowered the profitability of large sections of the mining sector. As a result direct mining sector job losses estimated at between 10,000 and 12,000 were experienced, as some mining firms placed some of their mines on care and maintenance or opted to close down altogether. The trade balance deteriorated sharply in 2008 and remained in deficit in 2009, before recovering strongly thereafter. Whilst real GDP growth remained relatively robust, there was a sharp drop in fiscal revenues, with trade taxes falling by around 30%. However, a relatively strong fiscal position meant that the government had the fiscal space to expand the deficit in order to ensure that critical investment in infrastructure as well as education and health were maintained.

5. Namibia was impacted by the financial crisis through decreased GDP growth rates, reduced export volumes for diamonds, equity prices and exchange depreciation. These effects are discussed here under.

IMPACT OF THE FINANCIAL CRISIS ON THE ECONOMY OF NAMIBIA

6. *Namibia was severely hit by the financial crisis with GDP expanding by only 2.4 percent and 0.6 percent during 2008 and 2009, respectively, from 5.4 percent in 2007.* This growth is attributed to the reduction in mining activity on account of the global economic crisis (Figure 1). The recovery of the global economy in 2010 led a recovery in the demand for Namibia's export and consequently GDP growth.

Figure 1: GDP growth rates 2006-2014



Source: NSA

7. *Certain real sectors of the Namibian economy felt the impact of the recent global crisis directly through weakened global consumer demand and high unemployment. Sectors that were mostly affected were such as diamond mining and tourism.* For instance the export volume of diamonds which is a major export product in Namibia declined by an average of 27 percent during the period 2007 to 2009 compared to the pre-crisis period. Nonetheless, the exported diamond volumes started to increase, albeit at a slow pace from the second quarter of 2009 and 2011 due to improved global demand.

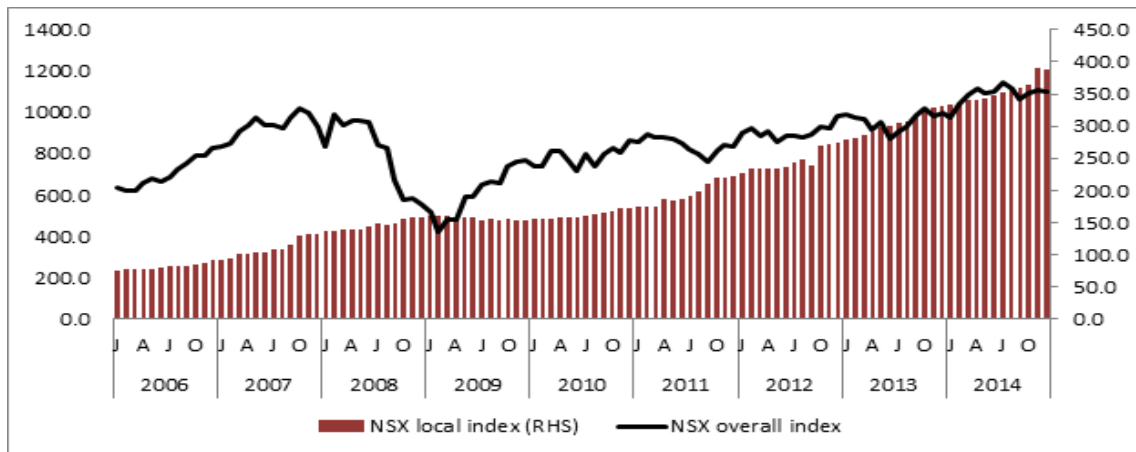
Figure 2: Diamond Exports, 2006-2014



Source: BoN

8. The impact of the crisis on the local financial system and specifically on local banks remained minimal during and after the crisis, due to the sector's insulation from the strain in the international financial market. Non-bank financial institutions were however hit severely by the crisis due to high investments in foreign equity markets especially in South Africa. For instance, equity prices as reflected by the NSX Overall Index, declined by 40.1 percent at the end of 2008, mainly due to a sharp decline of Anglo American which decreased by 50 percent during the year. At the end of 2009, however, the overall index increased by 38.8 percent and has been trending upwards since then. The increase in the overall index is similarly ascribed to the Anglo American plc which accounts for almost 42 percent of the total market capitalisation.

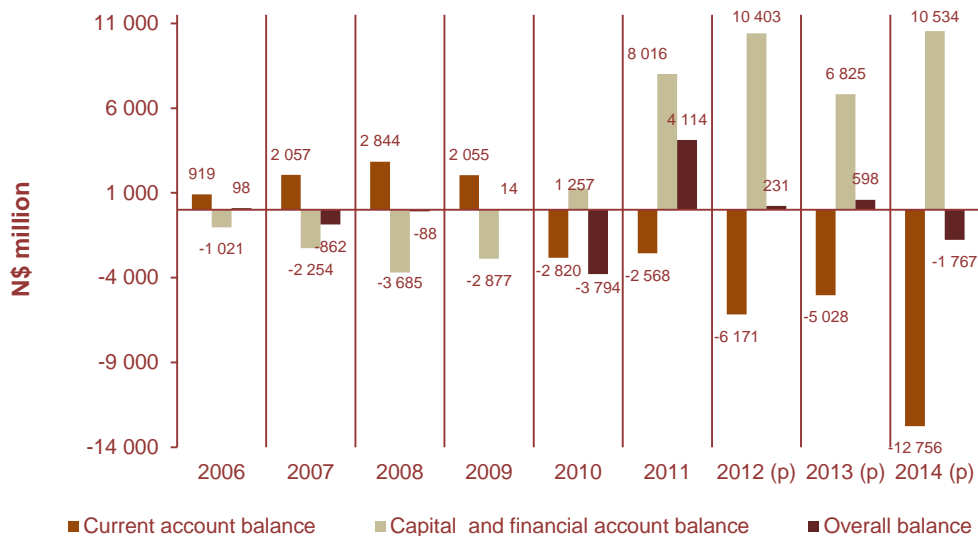
Figure 3: Namibia Stock Exchange Index 2006-2014



Source: BoN

9. The country's overall balance of payments which was in surplus since 2003 recorded a deficit on during the crisis period 2007 and 2008 except in 2009 when a smaller surplus of N\$14 million was registered (Figure 4).

Figure 4: Balance of Payments, Major Accounts 2006-2014

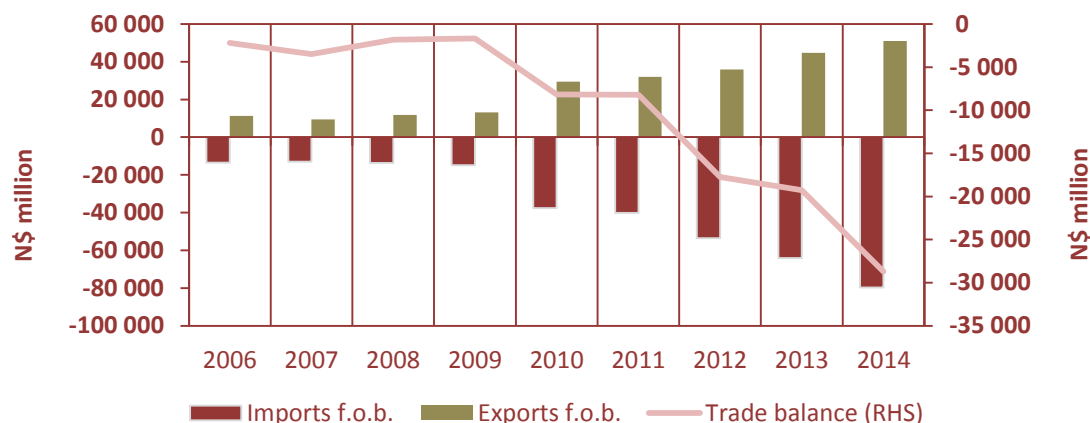


Source: BoN

The deterioration in the balance of payments was attributed to a significant increased deficit in the capital and financial account mainly due to large outflows in portfolio and other short term investments. The current account balance remained in surplus during the same period due to the South African Customs Union

(SACU) receipts which remained firm despite the deficit on the trade balance. From 2010 onwards however, the current account balance became negative, due to a sharp widening merchandise of trade deficit (Figure 5). The impact of the widening trade balance on the balance of payment has however been mitigated by the financial account which recorded a surplus from 2010.

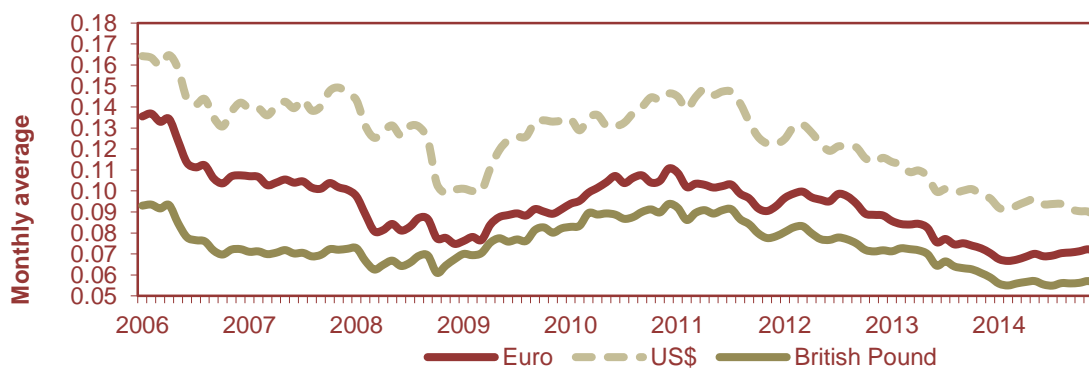
Figure 5: Trade balance, 2006-2014



Source: BoN

10. The exchange rate remained volatile against major international currencies such as the US Dollar, Euro and Pound Sterling. The exchange rate depreciated from 2006 to 2008 due to a host of factors both international and domestic. Domestic factors, included decline in gold and platinum prices, sharp fall in the growth of property prices in South Africa. The exchange rate appreciated against major currencies from 2009 to 2011 due to high interest rates in South Africa, supported by a rebound in prices of commodities such as gold, diamond, platinum and other metals for which South Africa is a main exporter (Figure 6). The exchange rate however depreciated from 2011 to 2014 on account of capital outflows from emerging markets and negative economic conditions in South Africa.

Figure 6: Exchange Rates 2006 to 2014



Source: BoN

MONETARY AND FISCAL POLICY DURING THE FINANCIAL CRISIS

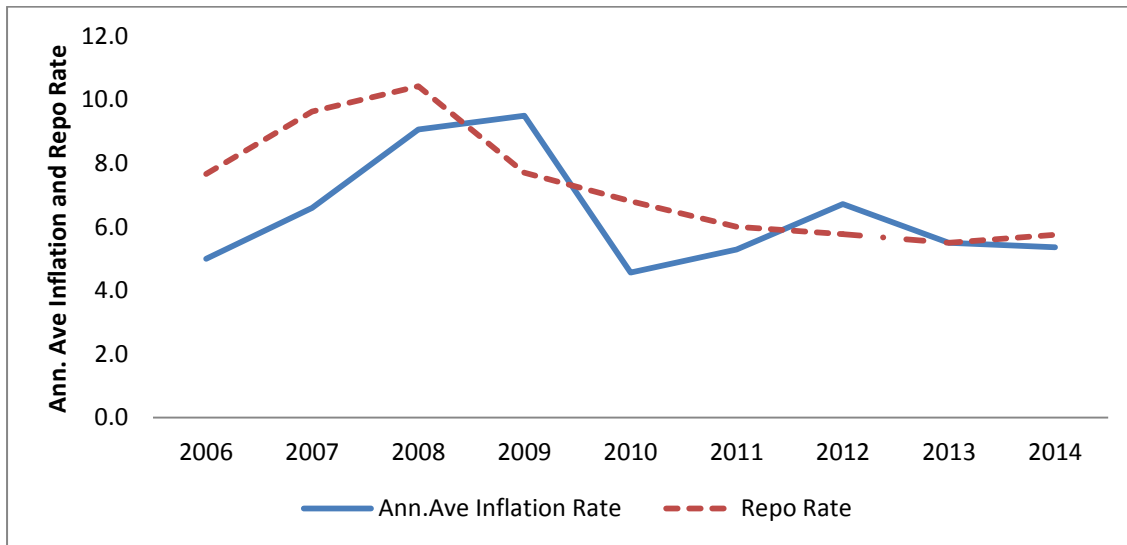
11. Namibia embarked on an accommodative monetary policy to mitigate the impact of the crisis on the economy. This policy was supported by an expansionary fiscal policy which was implemented since 2005/06 fiscal year. Before explaining in detail the monetary policy reaction of the central bank, the monetary policy framework of the country is briefly explained below.

THE MONETARY POLICY FRAMEWORK IN NAMIBIA

12. Namibia's monetary policy framework is underpinned by the fixed exchange rate system where the Namibia Dollar is fixed to the South African Rand at one is to one under the Common Monetary Area (CMA). This arrangement requires that Namibia's currency in circulation is backed by international reserves. Under a fixed exchange rate regime, Namibia monetary policy remains submissive to maintaining the fixed exchange rate peg. The Bank of Namibia uses the Repo rate as the tool for monetary policy. The country has some level of monetary policy discretion because of capital controls and other prudential requirements. These discretionary powers confer liberty upon the Bank of Namibia to maintain its Repo rate at a different level from the Repo rate of the South African Reserve Bank, when required. The ultimate aim of monetary policy in Namibia is to ensure price stability in the interest of sustainable economic growth.

13. Although Namibia has forgone the option of having a fully independent monetary system, the stance of monetary policy can deviate to a certain degree from that of the anchor currency by using capital controls and prudential requirements imposed on banking and other financial institutions. The discretion to maintain a different Repo rate from that of the anchor country, South Africa, enables Namibia to control the domestically induced inflation of about 35 percent (Namibia's Monetary Framework). In response to the financial crisis which was also characterised by declining inflation, Namibia maintained a fairly accommodative monetary policy stance. For instance, the Bank of Namibia reduced the repo rate from 10.42 percent at the beginning of the financial crisis to the lowest of 5.50 percent in 2013. The repo however was increased from 2014 mainly to discourage rising import bill.

Figure 7: Namibia's Average Inflation and Repo Rates, 2006-2014



Source: BoN

14. Despite for the decrease in the repo rate, the ratio of non-performing loans increased slightly during the financial crisis. Through the use of interest rates, it is clear that Namibia has been able to manage the credit levels in the economy, such that it has remained steady before, during and after the financial crisis (Table 1).

Table 1: Household Debt GDP Ratio

	Pre-Crisis					Crisis Period			Post Crisis					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Feb-15
Credit To Households	9 756	10 648	12 822	15 515	18 044	19 770	21 899	23 256	24 856	27 916	31 832	36 621	41 517	41 705
GDP	35 430	37 304	42 678	46 177	54 028	61 583	70 109	75 212	82 598	90 128	107 037	126 608	143 144	163 870
Ratio	27.5	28.5	30.0	33.6	33.4	32.1	31.2	30.9	30.1	31.0	29.7	28.9	29.0	25.5
Average	30.6					31.4			29.0					

Source: BoN

15. In addition, the crisis has taught us that countercyclical fiscal policy is an important tool. Given the limitations of monetary policy, including quantitative easing, policy makers had little choice but to rely on fiscal policy. Moreover, the recession was expected to last long, and evidently fiscal stimulus would have ample time to yield beneficial impact despite implementation lags.

16. The Namibian Government fiscal policy framework has been geared towards providing support to the economy, safeguarding macroeconomic stability, enhancing job creation, improving social welfare and ensuring long-term fiscal sustainability. The financial crisis coincided with the period of fiscal

expansion in Namibia. This was on the back of stronger collection on income tax on individuals and corporate tax which from the fiscal year 2006/2007. For instance during 2007/2008 fiscal year total revenue exceeded the budget estimates by 7.3 percent.

Accordingly, Government expenditure was increased by 16.1 percent during the MTEF period 2005/06 to 2007/08 to address the country's developmental needs. These was due to implementations of social welfare programmes such as extension of the Orphan and Vulnerable Children (OVC), social safety nets, education training sector improvement programme(ETSIP), rural electrification programmes, infrastructure development programmes etc. Consequently, total government expenditure as a percentage of GDP increased from 28 percent in 2006/07 to 32.9 percent in 2009/10. Moreover, during 2009/10 there was a reduction in individual taxpayers and non-mining corporations, while the tax threshold was increased from N\$24,000 to N\$36,000 during the 2007/08 financial year.

17. This fiscal policy framework has served the economy relatively well since the onset of the global financial and economic crisis through sustained fiscal expansion and other countercyclical measures. It has virtually shielded the domestic economy from the severe impacts of the crisis. The Government has increasingly been able to maintain and even frequently expand the provision of services to a growing population through investment in infrastructure. In addition, the Government has also realised an improvement in the fiscal position, having achieved a near balance budget in 2012/13, mainly due to the strong economic performance and a mix of revenue-raising measures (MTEF, 2014).

18. Conclusions

Namibia was affected by the financial crisis through reduced GDP growth rates and diamond exports volumes, decrease in equity prices, increase in non performing loans and exchange depreciation. The country reacted to the financial crisis by reducing the repo rate in tandem with the overall decline in international interest rates and by including financial stability as an additional mandate of the central bank. Moreover, the impact of the crisis was mitigated by the expansionary fiscal policy.

References

Bank of Namibia Annual Report, Various editions.

Bank of Namibia (2008). Namibia's Monetary Policy Framework. Namibia

Namibia Statistical Agency (NSA), Preliminary National Accounts, 2015.

Republic of Namibia. (2014). Medium Term Expenditure Framework 2013/14 to 2015/16.

International Monetary Fund. (2014). Regional Economic Outlook: Sub-Saharan Africa: Fostering Durable and Inclusive Growth.