

PRESS STATEMENT

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Statement of the Monetary Policy Management Committee (MMC)

1. Introduction

Following a thorough review of and intensive deliberations about the recent domestic and international economic developments, the Monetary Management Committee of the Bank of Namibia at its meeting held on 2 August 2006 has decided to increase the Bank rate by 50 basis points from **7.50** percent to **8.00** percent with effect from Friday, 4 August 2006.

This decision is based on the following considerations.

2. Developments in the real sector

Available indicators show that the Namibian economy portrayed positive signs of economic developments which is in line with the recovery in the global economy during the second quarter of 2006, notably the US and China. Some key economic indicators in the mining sector improved, spurred by the prevailing high commodity prices and favorable exchange rates, although indicators in some other sectors, such as fishing and agriculture indicated slowdown in activities. Further, consumption expenditure continued to increase, an indication that the economy might have performed better in the second quarter of 2006.

3. Inflationary developments

The inflation during the first half of 2006 has generally been rising. It started at 3.6 percent in January 2006, increased to 4.6 percent in March and reached 5.3 percent in June 2006. This resulted in an average of 5.0 percent for the second quarter of 2006, the highest quarterly rate recorded for the past three years, after 4.0 percent recorded during the preceding quarter. The rate during the second quarter is also significantly higher when compared to 1.3 percent recorded at the same time in 2005. The increase in the average annual inflation during the second quarter was mainly attributed to the rise in the inflation rates of the food and transport categories, which is heavily influenced by the increase in fuel prices. The trend in inflation is expected to continue, given the continuing increasing international oil prices caused by geopolitical factors.

Another factor confirming the current and expected inflationary pressures are the continuous increase in the South African Producer Price Index (PPI), a measure of factory gate prices, during June 2006. The South African PPI soared by 7.5 percent during June 2006 compared to 5.9 percent during May. This developments, whose effect have started translating into higher inflation in South Africa, is also believed to have had and will continue to have an impact on Namibia's CPI since about 80 percent of the goods consumed in Namibia are imported from South Africa.

4. Exchange Rates

During the second quarter of 2006, the Namibia Dollar continued to depreciate, on a month-on-month basis against all the major currencies, such as the US Dollar, Euro and Pound Sterling. The external value of the NAD, depreciated against the €, to trade at N\$8.1102 during the second quarter of 2006 from N\$7.4038 during the first quarter. On average the US dollar traded at N\$6.4489, while the pound sterling was exchanged at N\$11.7852, during the second quarter, compared to N\$6.1537 and N\$10.7849 during the first quarter of 2006, respectively. At the same time, last year, the US Dollar, Pound and Euro stood at N\$6.4112, N\$11.8944 and N\$8.0733,

respectively. The depreciation of the Namibian dollar is expected to boost exports on one hand, while on the other hand could further compound inflationary effects.

5. Money Supply

The monetary development during May 2006 continued to point towards an acceleration in the growth of money supply (M2). Year-on-year M2 increased by 18.0 percent during May 2006 from 11.7 percent in May of 2005. The acceleration is attributed to increases in the net foreign assets of the depository corporations and domestic credit extension. The same trend in M2 was observed on a month-on-month basis, though at a slower pace of 3.1 percent during May 2006 compared to April 2006. An expansion in domestic credit extension has also been the reason for the increase in money supply on a month-on-month basis.

6. Credit extension by other depository corporations to private sector

Year-on-year, growth in credit extension to the private sector remained strong at 18.5 percent during May 2006, reflecting an environment of generally low interest rates during 2006. Credit extended to the business sector increased by 11.9 percent, year-on-year, and by a slower growth of 2.4 percent on a month-on-month basis. Credit extended to individual households also increased by 22.6 percent, year-on-year and 1.3 percent on a month-on-month basis during May 2006. The month-on-month growth for both categories are slower than those registered in April which could be a reflection of expectations of increasing interest rates.

7. Monetary Policy Stance

Based on the above economic indicators and trends, the MMC expressed concern about the current inflationary pressures. The MMC is particularly concerned about the impact the inflationary spiral could have on the performance of the real sector, the erosion of the purchase power of consumers, business and consumer confidence, future inflation expectations and the competitiveness of the Namibian economy.

Although a major cause of the current upward spiral in inflation is caused by the unabated increase in crude oil prices and by geo-political disturbances, strong domestic demand and rising food prices also have an added upward impact on domestic prices. Moreover, the recent weakness in the external value of the Namibia Dollar may also put further pressure on local price levels.

The MMC felt it necessary to moderate domestic demand by making access to bank credit less inexpensive by raising its Bank Rate by 50 basis points to 8.00 per cent per annum. This decision is expected to lead to upward adjustments in the commercial banks' lending rates by a similar margin.

Given the rapid upward movement of domestic inflation and many adverse exogenous developments that could further fuel the inflation spiral, the Bank of Namibia will closely monitor domestic and international developments and their inflationary impact. Should it be necessary, the Bank would be obliged to respond even earlier than the next MMC meeting scheduled for 11 October 2006.

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