REF. 9/6/2 **07 June 2007**

PRESS STATEMENT

Monetary Policy Statement by the Bank of Namibia

1. Introduction

Since the last Monetary Policy meeting in April this year, the outlook on inflation has deteriorated considerably. The less favourable outlook was primarily reflected in sharp increases in transport and food inflation. However, even if transport and food inflation are omitted from the consumer price index, the underlying inflation also shows a significant upward trend, raising concerns of second round effects of transport and food inflation. At the same time, there are encouraging signs of a cooling down of domestic demand conditions, as reflected in the latest vehicle sales and credit figures.

2. Developments in the Real Sector

On the international front, it is noted that the global economy continued to expand at a healthy rate during the first quarter of 2007 due to the strengthening of economic activities in major economies in the world. Despite a sharp downturn in the housing market, economic activity in the US remained relatively strong, with consumption growth supported by employment gains in the services sector. Activity in the Euro-zone and Japan continues to be strongly supported by robust domestic demand, while developing and emerging market economies continue to show solid growth on the back of the ongoing strong performance of China and India. Equally, performance of the South African economy continued to be robust, with real GDP growth expanding by 4.7 percent in the first quarter of 2007. Overall in Africa, the short-term economic outlook remains positive against the backdrop of strong global growth, with the region's GDP growth expected to accelerate to 6.2 percent in 2007, according to the latest IMF projections.

Revised quarterly growth estimates for Namibia suggest that, despite tighter monetary conditions since the latter half of 2006, economic activities in Namibia have been stronger than estimated at the previous meeting. Growth was relatively broad-based during the fourth quarter of 2006, with most of the sub-sectors gaining stronger growth momentum compared to previous quarters. The agriculture, hunting and forestry; construction and wholesale and retail trade sectors, in particular, performed exceptionally well during the fourth quarter of 2006 compared to their performance in the preceding quarters. Some other sectors such as hotels and restaurants, transport and communication; and financial intermediation also displayed robust growth, albeit at lower rates than in the preceding quarter, while the fishing; electricity and water; and manufacturing sector performed weakly.

3. Credit Extension to the Private Sector

Although growth in banks' credit to the non-government sector continued to expand, there are signs of a slowdown since the last quarter of 2006. For instance, the annual growth rate in credit extension to the non-government sector slowed from 15.0 percent in December 2006 to 14.3 percent in April 2007.

The downward movement in the growth of credit extension was reflected in credit extended to both businesses and individuals. The annual growth in credit to businesses in April was 12.8 percent, while that for individuals stood at 15.2 percent. The corresponding rates for March 2007 were 15.7 percent and 16.1 percent, respectively. It is also encouraging to note that the bulk of the increase in credit extension occurred in the mortgage category sub-sector, while the growth in instalment credit has decelerated. Growth in mortgage credit expanded at a healthy rate of 26.2 percent during April 2007 albeit slower than the 27.1 percent recorded in March 2007. In line with the decelerated growth in credit extension, there are also signs of slowdown in other demand indicators, such as the moderation in new vehicles sales, which declined by a monthly rate of 29 percent and an annual rate of 16 percent during April 2007. Commercial vehicle sales, in particular, displayed a sharp decline of 31.7 percent and 12 percent, respectively during the same period.

4. Inflation Developments

Since the last Monetary Policy meeting in April this year, the outlook on inflation has deteriorated further. Despite tighter domestic monetary conditions, inflation picked up to 6.9 percent in April from 6.3 percent in March 2007. This has been the highest level of inflation since July 2003 when the annual rate of inflation was 6.6 per cent.

The factors that continue to contribute to the relatively high inflation rate are increases in food prices and transport inflation. However, even if the effect of higher food and transport prices are excluded the underlying rate of inflation remains disturbingly high at 4.8 percent in April. This suggests that second round forces are at work, which now start to drive inflationary pressures in Namibia.

Regarding food price inflation, there has been an upward trend in maize and wheat prices due to the persistent regional drought and sharp increases in international prices due to the increased global demand for bio-diesel. It was noted that international prices for maize and wheat on an annual basis increased by 54 percent and 52 percent, respectively in the month of April. However, on a monthly basis, prices of maize and wheat declined between March and April 2007. These declines are, however, expected to be short-lived. Higher maize prices are also expected to influence meat prices significantly due to its impact on the price of fodder. Nevertheless, meat price inflation could moderate somewhat as more livestock would be marketed during drought periods. This could, however, again be relatively short-lived as meat prices are expected to increase during the second half of 2007, due to the general increase in demand and the feedback effect from high food prices.

The persistent high and volatile international oil prices continues to be a worrying factor that drives inflation in a number of net oil importing countries, Namibia included. Due to heightened geopolitical tensions and supply disruptions in major oil producing countries, such as Nigeria, the international price of crude oil increased to around US$70 per barrel in recent weeks. As a result, the domestic fuel prices increased twice in a short period of time and further price increases are not excluded. Thus, more price pressure could come from this component going forward.

The South African Production Price Index (PPI), being a leading indicator for consumer price inflation in both South Africa and Namibia, showed an annual increase of 11.1 percent during April 2007 compared with the 10.3 per cent during the preceding month. This increase was mainly triggered by the rise in the price indices for South African produced commodities. The PPI, and its concomitant impact on CPI, is expected to increase further due to volatile oil prices and an expected increase in food prices coupled with substantial increases in maize prices. Rising production prices are expected to filter through to consumer inflation in due course.

Having considered the latest inflation developments, forecasts and expectations, the Bank of Namibia considers the risks to the outlook for inflation in the medium term to remain tilted to the upside, as inflationary pressures are expected to persist, mainly on account of volatile crude oil prices and expected increases in administered prices in the second half of the year. There is therefore a need for public utilities to exercise some restraint when considering increases in administered prices in order to contain further inflationary pressures.

5. Monetary Policy Stance

From the review of the recent economic developments, the Bank of Namibia noticed with concern the increase in the inflation rate since the last monetary policy meeting. At this stage, the growth in domestic demand seems to be abating as witnessed by the slowing growth in private sector credit extension and the number of vehicles sold. Nevertheless, rising food prices and uncertainties about regional weather conditions that could reduce agricultural output, the volatile exchange rate and international oil prices continue to pose major risks to the domestic inflation outlook. At this stage the Bank of Namibia is also concerned about the risks of second round effects of food and oil price inflation on the overall level of inflation. The risks to inflation, therefore, remain on the upside. Considering the aforementioned economic developments, the Bank of Namibia is of the opinion that an increase in the Bank rate is necessary to lessen the risks posed by these factors on inflation. In light of these developments the Bank decided to increase the Bank rate by 50 basis points to 9.50 percent per annum, with effect from 8 June 2007. While tighter monetary conditions could moderate economic growth, the Bank believes that contained inflation is a more serious consideration at this stage than a situation of high economic growth with high inflation. Moreover, current economic performance is robust enough to be able to absorb tighter monetary conditions without significant negative impact.

As usual, the Bank of Namibia will continue to closely monitor price developments and factors that induce price changes, and will adjust its policy stance should monetary conditions so demand in the interest of price stability.

Tom K. Alweendo
Governor