BON DISCUSSION NOTE: HAS NAMIBIA'S EXPORT BENEFITED FROM THE RECENT SURGE IN INTERNATIONAL COMMODITY[1] PRICES? NOVEMBER 2021

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1 BoN Economic Notes are articles by the Macroeconomic Statistics and Analysis division on relevant developments in macro and micro economic statistics. The Notes are aimed to stimulate economic debate as well as inform the public on current trends in the economy. The Notes are published semi-annually on the Bank's website and within the Research and Financial Stability Department as well as external experts on the subject matter. These notes are shorter and less technically oriented than BON working papers.

2 The views expressed in this note are those of the authors and do not necessarily reflect those of the Bank of Namibia. For helpful comments, the authors thank the colleagues from the Research and Financial Stability Departments, Editorial committee as well as Monetary Policy Committee Members. Published as part of the Bank of Namibia Quarterly Bulletin, December 2021.

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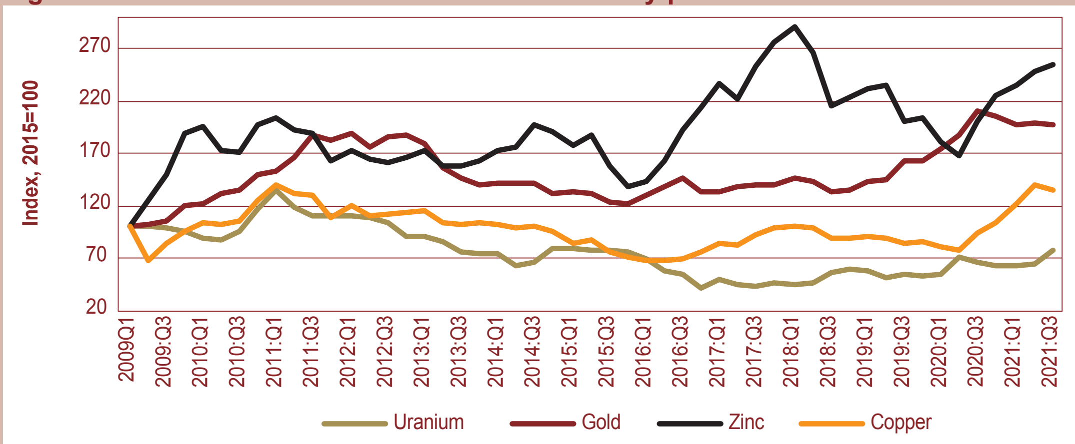
INTRODUCTION

The coronavirus outbreak has increased uncertainty, depressed demand and introduced excess volatility in markets across the globe, including commodity markets. The COVID-19 pandemic had a notable impact on commodity prices. Specifically, the pandemic was responsible for record high prices for gold, and record lows for oil, which fell by about 65 percent. Nonetheless, most of the commodities have recovered in the second half of 2021 from the record lows during the same period of 2020 (Figure 1). Specifically, crude oil prices have doubled since their April 2021 low, principally supported by sharp oil supply cuts. Similarly, metal prices recovered rapidly in response to a faster-than-expected pickup of China's industrial activity. While commodity prices have seen a recovery from the pandemic, this recovery has been uneven, amid concerns about renewed COVID-19 infections and variants and their impact on global economic recovery. Effects on some of the commodities such as oil are likely to be long-lasting, given the slow and uneven recovery in terms of demand and supply.

Figure 1: The evolution of international commodity prices



Source: World Bank, Cameco

The pandemic has severely impacted the global economy, but more so the commodity-dependent and developing countries as supply chains were severely affected and demand collapsed, which consequently dwindling revenues. Initial capital outflows resulted in massive exchange rate depreciation of most commodity-dependent and developing countries. During March 2020 alone, capital outflows from developing economies exceeded the total outflow of capital during the 2008 financial crisis. Notwithstanding this negative impact, the subsequent rally in commodity prices that ensued helped improve the external balances, triggering massive inflows of portfolio capital and exchange rate appreciations and thereby reversing the initial impact.

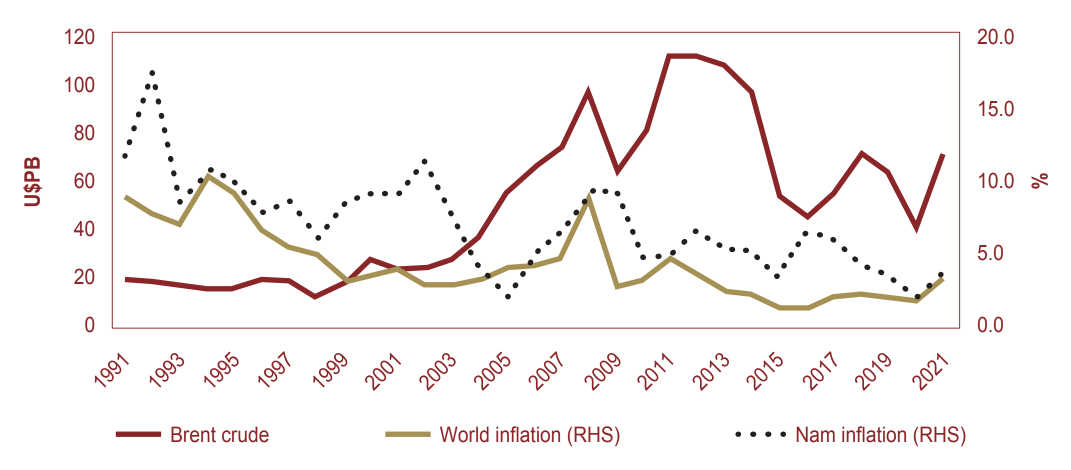
Namibia has not been spared from the impact of the pandemic, whether directly or indirectly, or whether positively or negatively. This impact includes commodity prices and its associated effects on the exchange rates, interest rates, capital flows, trade and other channels. The surge in commodity prices could be expected to have benefitted the Namibian economy as an exporting country. This note thus aims to examine the effects of the global developments, particularly in commodity prices, and the impact thereof on the Namibian economy. Specifically, the note aims to evaluate whether Namibia has benefited from the recent surge in commodity prices by evaluating the contributions to growth in nominal export receipts relative shares of growth contributions.

COMMODITY DEVELOPMENTS AND OUTLOOK

1.1 Brent crude prices

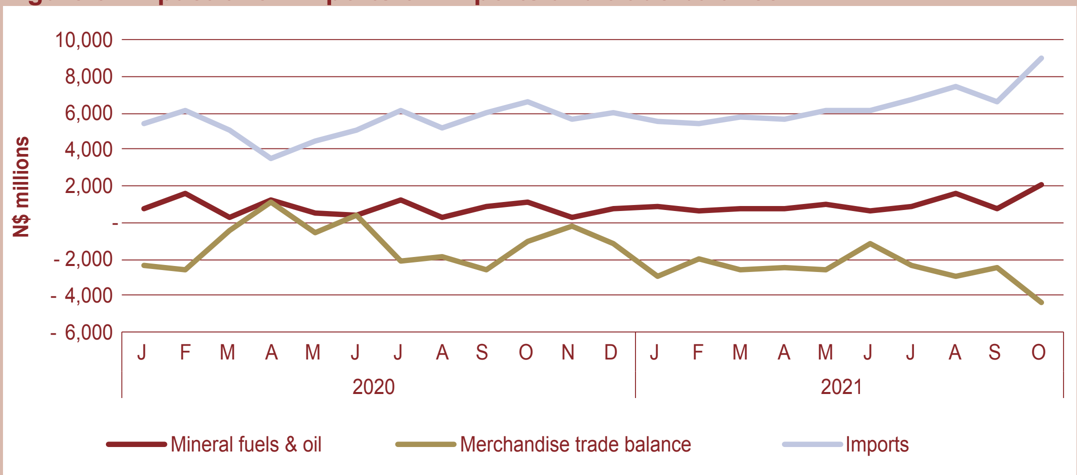
As a net oil importing country, the direct impact of changes in international oil prices on the Namibian economy, is typically via inflation as well as the current account. Brent crude oil prices and world inflation as well as Namibia's inflation rate are inherently correlated, albeit with a lag (Figure 2). The Brent crude oil price has recovered by 38 percent year-to-date in 2021 from its most recent slump last year. This is due to a recovery in global demand for fuel considering the COVID-19 induced travel restrictions that have been eased. To put this into context, mineral fuels imported into Namibia is on average 15.4 percent of total imports amounting to N$9.9 billion worth of mineral fuels, for the first ten months of 2021. This has partly contributed to the deterioration of Namibia's trade balance (Figure 3). In addition, the surge in Brent crude oil prices has exerted inflationary pressure on transport inflation in Namibia. Nonetheless, going forward, changes in oil prices are subject to new COVID-19 infections and variants and whether there will be new lockdowns. In addition, OPEC forecasts global oil demand to slow going forward into 2022.

Figure 2: Brent crude oil prices and inflation



Source: Investing.com, World Bank & NSA

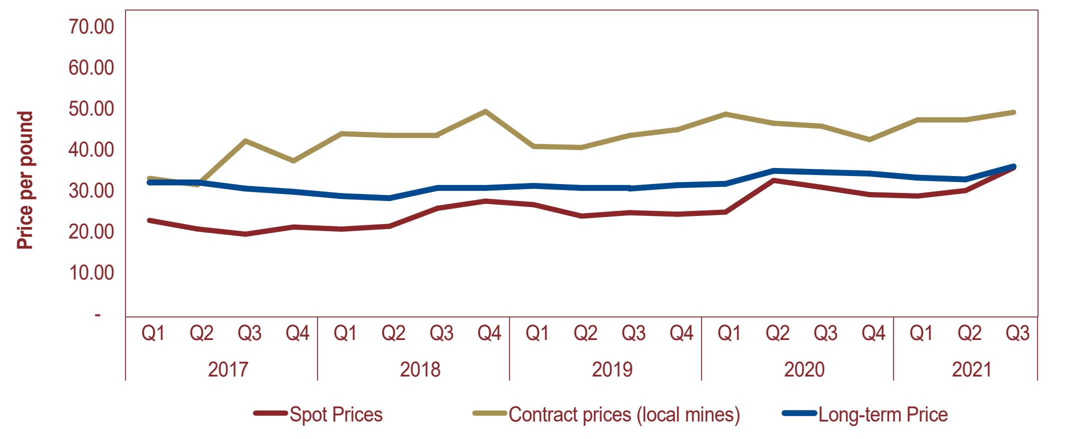
Figure 3: Impact of oil imports on imports and trade balance



1.2 Uranium

The two uranium mines currently in operation continued to benefit from contractual prices that remained above the prevailing spot prices. Year-to-date, the average international uranium spot price increased by 12.0 percent to US$33.56 per pound. The rise in spot prices was largely underpinned by binge buying of uranium in the spot market by developers and investment funds, particularly Sprott Physical Uranium Trust that began trading on the Toronto stock exchange during July 2021. In addition, the demand for nuclear energy as a clean and efficient power source has increased and that has pushed up the prices. At this level, the spot price was significantly below the subsidized average contract prices that the two local mines are getting from the foreign shareholders (Figure 4). Uranium production is not low cost and the average operating costs at the uranium mines has also exceeded the spot price in recent years. Thus, the differential between the spot and contract prices has largely allowed the currently operating mines to break even and has not been associated with profitability. This has been a key factor behind some of the mines remaining under care and maintenance in Namibia. Furthermore, most of the domestic uranium production is sold to China due to the vertical integration of local mines in the structures of the parent companies that have nuclear reactors. China's demand for uranium is strategic in nature and mainly focuses on security of supply.

Figure 4: Uranium prices



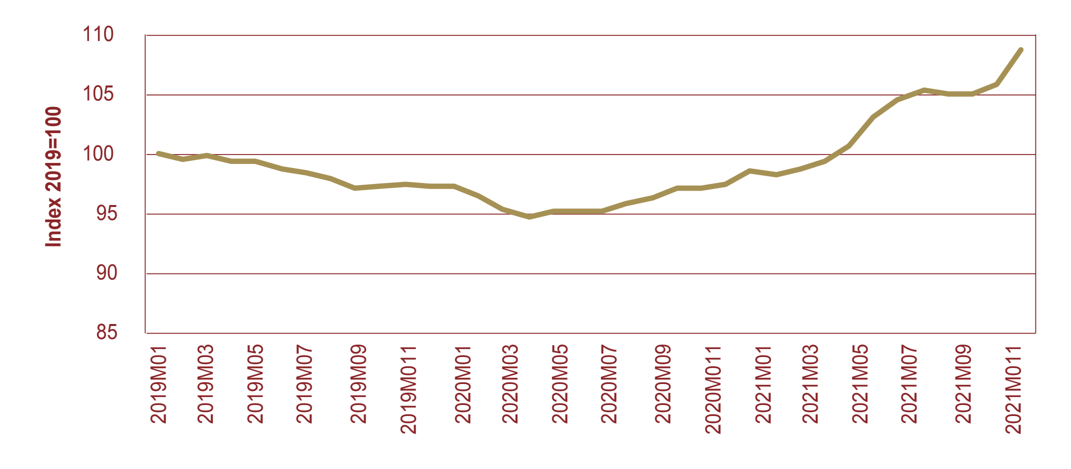
Source: Cameco, Bank of Namibia

Looking ten years ahead from October 2021, the long-term uranium prices have increased to around US$43.00 per pound, which is still not enough for the mines that are currently under care and maintenance to return to operation. While long-term uranium prices closely mirrored the developments in the spot prices in the past (Figure 4), uranium prices are expected to trend upwards as energy firms are set to phase down coal usage. In addition, China plans to build up to 150 new nuclear reactors over the next 15 years, while Japan plans to put 30 reactors back to activity to meet emission goals. In this regard, Namibia is well positioned to benefit from sustained higher prices as it has about four uranium mines that are currently under care and maintenance, namely the Orano's Trekkopje Mine, Paladin's Langer Heinrich, Etango mine and the Valencia Mine. These mines will remain under care and maintenance until the uranium price recovers to any price above US$55.00 per pound as these mines are very sensitive to changes in prices, due to their low-grade ore.

1.3 Diamonds

The diamond industry was severely impacted by the COVID-19 pandemic during 2020 but has recovered throughout 2021. De Beers International continues to report a recovery in demand for rough diamonds as well as prices on the back of a recovery in demand from key markets such as China and the United States. The holiday season celebrations as well as the Chinese New Year is expected to support the recovery in diamond demand going into the last months of 2021 as well as the first quarter of 2022. Thus, major diamond producers such as De Beers International and Alrosa PJSC have restricted supply amidst the recovery in demand, further contributing to the rise in rough diamond prices. Furthermore, demand for diamonds benefited from restrictions on rival luxuries such as travel, leading to a substitution effect, with the upper-middle class individuals opting to spend more on diamonds as opposed to travelling. For the domestic economy, the average implicit prices for diamonds rose by 23.5 percent to US$418 per carat, during the first ten months of 2021 relative to the same period last year (Figure 5 and 9b). Going forward, Namibia is expected to benefit from higher prices as production is expected to recover on the back of the new diamond recovery vessel which is expected to add an additional 500 000 carats to the annual output going forward.

Figure 5: International diamond price index Jan-19 to Nov-21



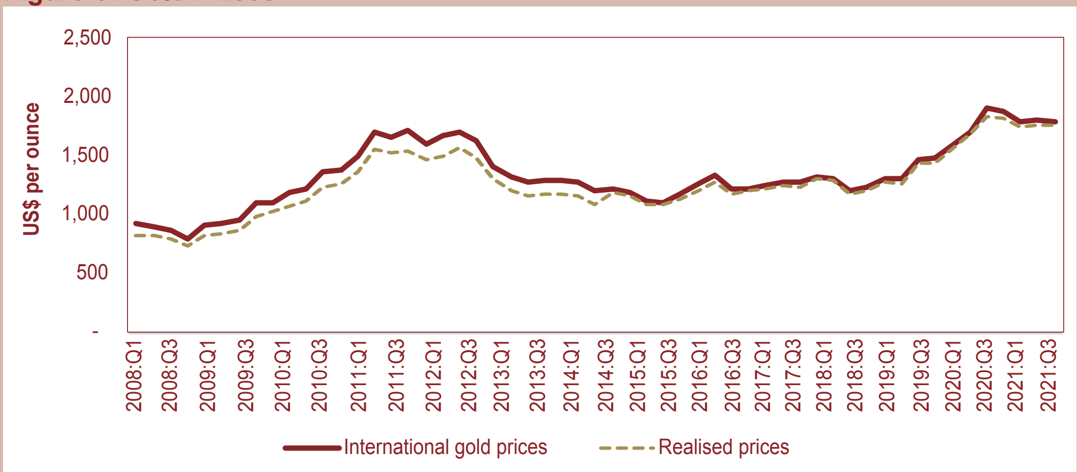
Source: Index online

1.4 Gold

Gold prices rose during the spread of coronavirus mainly attributable to the fact that gold is viewed as the safest form of investment in times of pandemics. In response to the coronavirus pandemic, central banks slashed interest rates and flooded markets with cash. This has fuelled fears of inflation, which would typically devalue other assets, and has also lowered returns on government bonds, making gold more attractive.

Namibian gold mines benefited from the surge in gold prices as the prices closely tracked the international gold prices. Gold prices began to rise during the first quarter of 2020, with the highest price (since 2009) recorded during the third quarter of 2020. In this regard, gold prices rose by 2.7 percent to US$1789 per fine ounce during the first 10 months of 2021 relative to the same period last year (Figure 6). In addition to higher gold prices, gold production also rose by 4.0 percent during the first 10 months of 2021 relative to the same period last year. It is worth noting that the surge in gold prices have stabilised and have begun to fall since the record highs observed during third quarter of 2020. This was as result of lower demand for gold as a safe haven coupled with the appreciation of the US Dollar since the third quarter of 2020. Going forward, changes in international gold prices are subject to the global vaccination rate as well as the potential benefit from the negative impact that the Omicron variant might have on the global economy and the associated uncertainty.

Figure 6: Gold Prices



1.5 Zinc

Zinc is one of the most consumed metals after iron, aluminium and copper, whose market prices are influenced by the state of the global economy. The price of zinc has been subdued in general and highly volatile but started to increase between 2017 and 2018 (Figure 7). However, the prices declined during 2020 due to the pandemic and rose during 2021 due to global economic recovery. In 2020, prices declined significantly due to lower demand for commodities on the back of global lockdowns and containment measures. Prices recovered in the first ten months of 2021 from their lows in 2020, supported by the weaker US dollar, and huge fiscal stimulus in advanced economies. Furthermore, the disruptions of zinc concentrate supply supported the recovery of zinc prices coupled with the recovery of zinc consumption levels in China, the US, and other countries given the recent COVID-19 vaccine roll-out.

The international and implicit prices averaged US$1 995 and US$679 per metric tons, respectively, between 2010-2015. The implicit prices of the locally produced zinc are much lower than international prices (Figure 7). This could be attributable to the fact that the international spot prices are likely to be for refined zinc while Namibia exports zinc concentrates. Namibia's zinc concentrates are sold at contract price for three months on the London Metal Exchange. Furthermore, the local mine is also subject to penalty from the receiving smelters in the global market if their zinc concentrates contain other minerals, which impacts the earnings negatively.

The future price of zinc will be influenced by the demand for galvanized steel and global supply. The slowdown in the property sector in China and a government cap on steel production could curtail demand for zinc, which is a key input for galvanizing steel. The recent increase in zinc prices was also due to supply disruptions and power shortages at zinc mining and smelting in China, which resulted in the authorities releasing state stockpiles to shore up supply. Supplemented by recovery in Peru and Bolivia, and supply increase expected in 2022 from Brazil, China, India, Kazakhstan and Mexico, global supply of zinc will increase in 2022. The World Bank is projecting that the average spot price for zinc will fall to US$2,400 per metric ton in 2022, down from the estimated US$2,700/t at the end of 2021.

Figure 7: Zinc prices

Source: World Bank, Bank of Namibia

HAS NAMIBIA'S COMMODITY EXPORTS BENEFITED THUS FAR?

Despite the rise in most commodity prices, the export values declined during the first ten months of 2021, chiefly on account of a decline in export volumes followed by the exchange rate appreciation. During the first ten months of 2021, the exchange rate strengthened by 12.7 percent to N$14.60 per US Dollar, negatively affecting exports receipts and volumes of all Namibia's commodity exports. Uranium export value declined by 33.6 percent year-to-date as volumes exported declined by 21.0 percent (Figure 8 and Figure 9a). The main challenge experienced by the uranium exporting mines was the unavailability of suitable vessels which impacted the transportation and delivery of the product on time. Despite this, uranium mines have gained about 2.1 percent from their contractual agreements during the first ten months of 2021. In terms of gold, despite prices increasing year-to-date with a growth rate of 3.8 percent, export earnings of gold declined by 12.9 percent due to exchange rate revaluation losses and lower export volumes (Figure 8 and 9c). Export receipts from diamonds rose by 9.2 percent during the first ten months of 2021 supported by the increase both prices and volumes (Figure 8 and 9b). Similarly, export volume for zinc rose substantially by 41.8 percent due to favourable international zinc prices and the lower treatment cost by processors abroad (Figure 8 and 9d).

Figure 8: Growth contributions to export value for first ten months of 2021 compared the same period last year

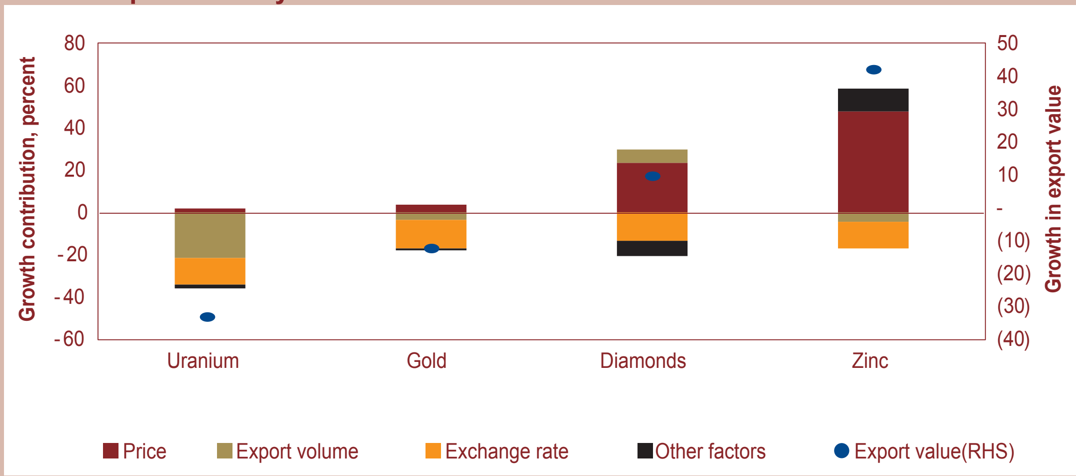
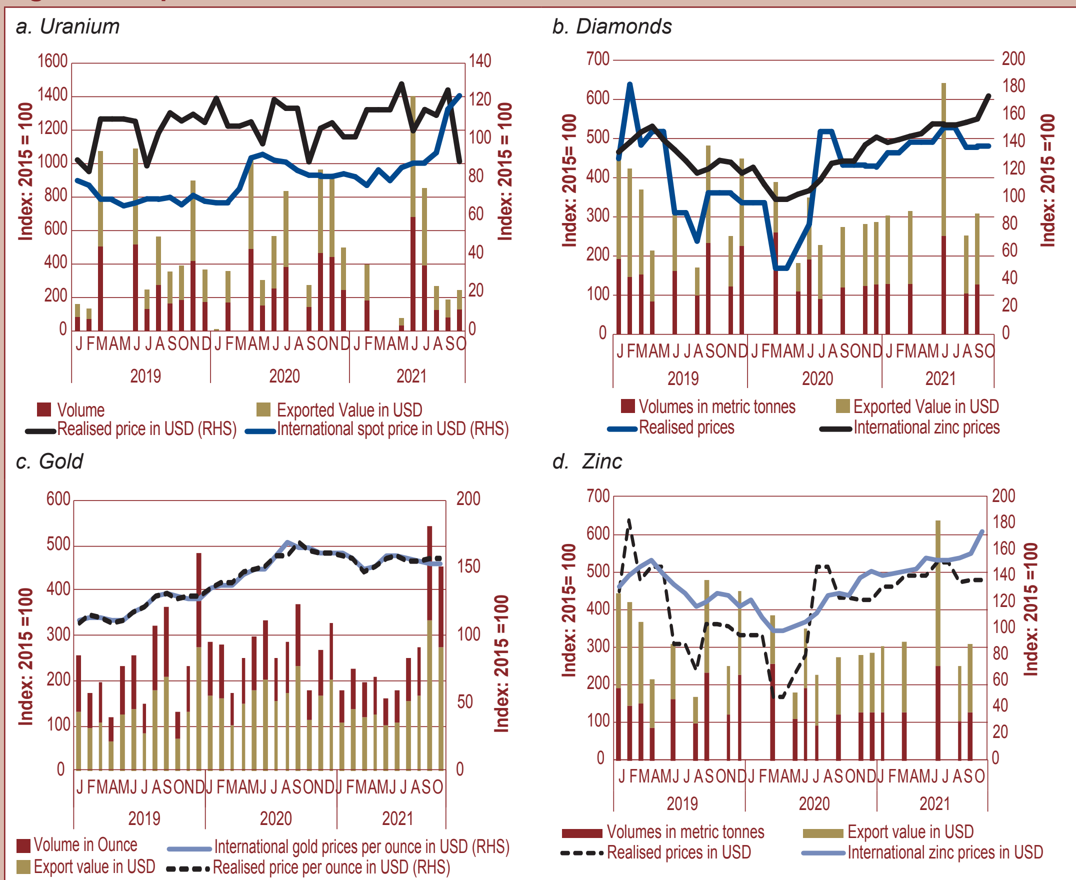


Figure 9: Exported volumes and values for commodities



CONCLUSION

The recovery in global demand during the first 10 months of 2021 has resulted in a recovery in international commodity prices. Specifically, higher prices were recorded in zinc, gold and to a lower extent uranium. Namibia's gain from the recent surge in commodity prices was offset by the strengthening of the exchange rate which led to low export volumes particularly for uranium and gold. Moreover, the recent increase in oil prices has led to a rise in the import bill and ultimately a worsening trade deficit. Going forward, the newly identified Omicron variant has already triggered the imposition of new restrictions by some countries and will have an adverse impact on domestic commodity production, supply and economic recovery.