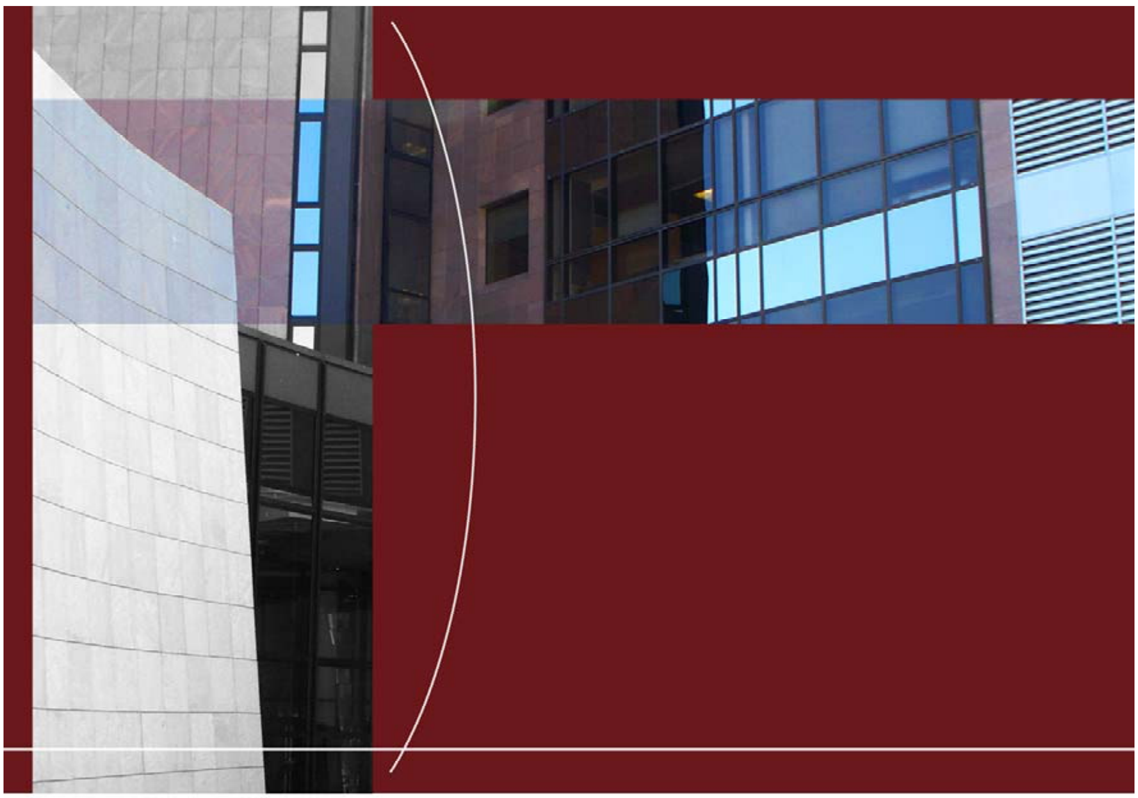
Bank of Namibia

Minutes of the Monetary Policy Deliberations at the Meeting of the Executive Committee of the Bank of Namibia

Windhoek, Monday, 16 February 2009



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"Our vision is to be a centre of excellence"

Publication date: 17 March 2009

Minutes of the Monetary Policy Deliberations at the Meeting of the Executive Committee of the Bank of Namibia held on 16 February 2009

EC Members present

Tom Alweendo (Chairperson and Governor), Paul Hartmann (Deputy Governor), Ipumbu Shiimi (Assistant Governor and Head of Financial Stability), John Steytler (Director of Research), Michael Mukete (Director of Banking Supervision), Ben Biwa (Director of Financial Markets)

Others present

Mally Likukela (Economist) and Fenny Shangula (Economist)

Golda Badmos (Secretary)

Background

1. The EC received a comprehensive briefing on recent developments in the international economy and financial markets, domestic demand and output conditions, inflation, money supply and credit demand.

International economic conditions

2. Since the last EC meeting on 17 December 2008, the outlook for the world economy had deteriorated considerably with most advanced economies facing negative growth. Moreover, the performance of international financial markets, especially equity markets, remained weak and volatile. Foreign exchange markets also exhibited extreme volatility amongst various currencies. Mainly prompted by weak global demand, commodity prices were put on a sharply descending trend, which brought about a favourable medium-term inflation outlook.

3. EC also noted the substantial monetary policy easing coupled with fiscal stimulus packages and liquidity injections that were introduced in most developed and emerging market economies. These policy responses were aimed at stimulating demand and, hence, production and employment, while liquidity injections into the financial systems were intended to reinforce the liquidity and solvency conditions of financial institutions and to restore confidence in the financial systems.

4. EC expected that the stabilization of commodity prices would help contain inflation in advanced economies during 2009. In emerging and developing economies, inflation was not projected to abate substantially mainly as a result of the weakness of their exchange rates against major currencies.

5. EC noted that the **US** economy grew by 1.1 percent in 2008 and its GDP was projected to contract by 1.6 percent in 2009. In response to the global financial crisis, the Fed reduced its policy rate to between 0 and 0.25 percent p.a., while the inflation rate stood at 1.0 percent in January.

6. In the **Euro Area** real GDP fell by 2.0 percent in 2008 and was expected to expand by 0.2 percent in 2009. The ECB lowered its Refinance rate to 2.0 percent p.a. in January with inflation standing at 1.6 percent.

7. Similarly, the **UK** recorded a negative growth rate of 2.8 percent in 2008, while the UK GDP was anticipated to expand by 0.2 percent in 2009. The Bank of England reduced its Base rate by 50 basis points to reach 1.5 percent p.a. in January 2009. Inflation in the UK stood at 3.1 percent in January 2009.

8. The **South African economy** continued to show signs of slowing, following the 0.2 per cent annualised growth recorded in the third quarter of 2008. Various indicators were pointing to a continuation of this trend. The physical volume of manufacturing production and mining output declined moderately in November 2008, while residential and non-residential building activity declined sharply over the same period. Household consumption expenditure also remained under pressure, with motor vehicle sales falling at a year-on-year rate of 35 per cent in January 2009. Similarly exports were expected to remain under pressure given the adverse global conditions. EC noted that the South African CPIX inflation has been moderating consistently since August 2008 when it measured 13.6 per cent to 10.3 per cent in December 2008. In view of these developments, the South African MPC has decided to reduce its Repo rate by 100 basis points to 10.5 per cent per annum with effect from 6 February 2009.

9. Similar developments in terms of low or negative growth with low inflation were experienced among other advanced, emerging and developing economies.

10. EC expressed concern about the poor growth performance of the major economies, originating mainly from demand constraints. This situation would lead to a direct and indirect contraction in output of export-orientated industries in Namibia. On the other hand, it was noted that sluggish consumer demand in major industrial countries was one of the factors responsible for decelerating global inflation, especially commodities.

International financial markets

11. **US** Treasury bills' prices fell throughout the month of December 2008 and January 2009, pushing yields higher, as the government began a slew of debt auctions. The yields for most government instruments rose relatively sharply. Bond markets became under pressure as actual and planned issuances surged, especially as foreign official buyers were less willing to invest in US debt.

12. The decline in interest rates in the **Euro Zone** that has characterized the Euro fixed income market since early European summer continued in December 2008 (75 basis point cut) and January 2009 (50 basis point cut) with the key factors driving the decline in rates being: global market dynamics, ongoing risk aversion, and a weakening growth backdrop.

13. EC expressed its uneasiness with the volatility currently experienced on international financial markets and insisted that the situation be monitored on a continuous basis.

Domestic demand and output conditions

14. The performance of the Namibian agriculture sector remained weak as reflected in the decline of 42 percent in the total number of cattle marketed between November and December 2008. Over the same period, however, the number of small-stock marketed expanded by 51 percent. On a year-on-year basis, a slight increase in total livestock marketing was recorded. Horticulture also performed weakly with harvests at a much

lower level during the third and fourth quarters of 2008 compared with the same periods in 2007.

15. Since the last EC meeting, diamond production declined by 3.9 percent between November and December 2008. The decline in diamond production directly emanated from the global financial crisis. As a result of the decline in demand for diamond, diamond mining companies have resorted to diamond stockpiling. EC expressed concern over the decline in diamond production that would have a further direct negative impact on employment.

16. Uranium output rose month-on-month by 27.3 percent between November and December 2008. Uranium production continued to increase, mainly on account of existing ample scope to meet contractual-export requirements. Similarly, gold output also recorded a substantial increase of 33.6 percent from 292 kg in November to 390 kg in December 2009. The rise in gold production was attributed to high demand for gold driven by the need to diversify against falling equity markets. However, for other minerals, especially copper, the situation looked gloomier with output losses being recorded.

17. The construction industry also showed signs of slowing down. The number of building plans approved for January 2009 decreased by 25.9 percent to 157 units compared to December 2008. The number of buildings completed declined 65.8 percent to 92 units over the same time period.

18. Since the last EC meeting, vehicles sales continued indicating easing demand pressures. This was reflected in the total number of vehicles sold, which declined by 20.4 percent, month-on-month, to 686 units in December 2008 from 862 units in November 2008. The decline was more reflected in the number of commercial vehicles sold that decelerated by 22.3 percent to 422 units from 543 units over the same period. This decline was further supported by the decline in passenger vehicles, which decreased by 17.2 percent from 319 units in November. The continued decline in the number of vehicle sales was caused by weakening demand condition for vehicles.

19. EC expressed satisfaction with the performance of the Namibia economy under an unfavourable external environment, but cautioned that the short-term growth outlook would be negatively affected by the recessionary conditions in the world economy. The sectors that would be hardest hit were diamond and base metal mining, tourism and transport.

Inflation, money supply and credit demand

20. In line with moderating demand pressure, such as that from car sales, the annual rate of inflation started to abate. In this connection, the annual rate of inflation remained unchanged at 12.0 percent since August 2008, and then decline to 11.7 percent in November and to 10.9 percent in December. However, in January 2009, a sudden and unexpected increase of 12.5 percent was recorded. In January 2009 all major categories rose: Transport (9.9 percent), Housing (9.0 percent), Education (11.7 percent), except food which fell by 16.0 percent. The EC commented on the January 2009 CPI figure with some members noting that it did not reflect the reality and it may have to be followed up with the Central Bureau of Statistics to assess the origin of the increase.

21. Growth in credit extension by banks to the private sector accelerated by 11.4 percent in December 2008 compared to 9.4 percent in November 2008. EC noted that the increase in demand for credit was partly influenced by the Namibianization of credit card

transactions in December 2008. The increase in credit extended to the private sector would have been 10.6 percent if credit card transactions were excluded.

22. The rise in credit extended to the private sector was prevalent with both individuals and businesses. Growth in credit to individuals accelerated from 9.4 percent in November to 10.7 percent in December 2008. For businesses, the respective growth rates were 9.3 percent and 12.4 percent.

23. Development in respect of asset-backed credit reflected a further upward movement since the last EC meeting. In December 2008, the annual growth in asset-backed credit rose to 11.6 percent from 11.3 percent in November. Responsible for this development was mainly the general growth in “instalment sales” and “overdrafts”. On the other hand, the growth in mortgage loans has been fairly constant since October 2008, while that of “other loans and advances” moderated in December 2008.

24. It was also noted that the rate of growth in credit extension to the private sector was not excessive and would, therefore, not fuel domestically induced inflation.

Inflation outlook

25. The current outlook for crude oil price has improved since the last EC meeting of December 2008. The decline is attributable to the current financial crisis and its ensuing effect on demand. As a result of the financial crisis and worldwide recessions, demand for oil is expected to remain lacklustre, but might pick up after the first quarter of 2009 as economies are stimulated by their governments through low interest rates and stimulus packages.

26. Spot and forward prices for wheat and corn (maize) in the US have increased since the last EC meeting. The increase in the future prices of the two commodities could be seasonal, with future prices tending to be higher in the first quarter of a year as this was the beginning of the planting season. The FAO (Food and Agriculture Organization of the UN) Food Price Index was gauging the international prices of six food commodities. The index was pointing towards a general decline. However, due to the lagged effect, the local food prices were expected to slightly decrease only into the second quarter of 2009.

27. The N$/USD exchange rate continued to be driven by global investor sentiment. Following the rand’s sharp depreciation early in the second quarter of 2008 when it broke above 8.25 to the US dollar to settle as high as 11.60, the currency has since then pulled back to trade in a range between 9.30 and 10.70. High levels of risk aversion continue to drive the rand’s direction as the global economy was sliding deeper into a recession led by the US and followed by the UK, Euro Zone and Japan.

28. Emerging market risk aversion and declining South African growth prospects have reversed the sentiment towards South Africa as an attractive and high growth investment destination. Thus, going forward, the rand should remain under pressure as the wide current account deficit, declining commodity prices, low capital inflows have put pressure on the currency.

29. EC noted that inflation forecasts using historical time series of the NCPI to produce forecasts for two quarters ahead have shown that the rate of inflation would decelerate from 11.5 percent in the fourth quarter of 2008 to 10.4 percent in the first quarter of 2009 and to a single digit in the second quarter.

Foreign exchange reserves

30. EC noted that the country's total stock of foreign reserves (including the external manager's funds) since the last EC meeting increased, month-on-month, by 14.2 percent. At the end of January 2009, the stock of reserves rose to N$14.5 billion from N$12.7 billion at the end of December 2008. The level remained noticeably high and on the increasing trend, which largely reflects the Government's commitment to fiscal prudence. The high level of reserves indicates that there has been no threatening pressure to honour foreign liabilities.

31. EC expressed its satisfaction with the comfortable reserves position as this provided a significant support to the currency peg.

Money and capital market developments

32. Responding to the cut in the BoN Repo rate, commercial banks adjusted their lending rate downward. In December, average lending rate declined by 58 basis points to 13.74 percent from 14.32 percent in November 2008. Average deposit rate also declined marginally by 2 basis points to 8.60 percent from 8.62 percent in November 2008.

33. In December 2008, real average rates improved noticeably in line with improving money market conditions. The negative real average deposit rate narrowed to 1.81 percent from 2.76 percent in November 2008. The average for real lending rate increased, rising to 2.84 percent in December 2008 from 2.35 percent in November 2008. As a result, the spread between the two rates narrowed to 4.65 percent from 5.11 percent.

34. The revived confidence in emerging markets towards the end of 2008 was short lived. As a result of dual listing at JSE, the NSX overall index fell sharply in December 2008. The overall index fell due to weak performances by dual listed companies as the global financial turmoil persist and worsen. As a result, overall market capitalization was weak in line with the respective price indices.

35. After gaining 6.4 points to close at 582.4 points in November, the overall index of the NSX plunged to 556.3 points in December losing 26.1 points. Although the local companies remained cushioned from the international shocks, the crisis that has spilled over to all sectors have dampened demand and as a result, affecting domestic companies negatively. The local index, however, remained virtually constant at 158 points since November 2008.

36. Developments in stock prices were mirrored in the market capitalization. Overall market capitalization decreased to N$736.5 billion, with strongest losses recorded in the mining sector. Local market capitalization remained unchanged at N$5.71 billion.

37. Namibian Government bond yields declined rather sharply between November and December, with the exception of the GC10 and GC24 moderated. At the end of December 2008, the yields for the GC12, GC15 and GC18 declined month-on-month to 9.6 percent, 8.7 percent and 7.8 percent, respectively, while that of GC10 and GC24 was only to 6.6 percent and 6.9 percent, respectively. The fall in yields can be partly ascribed to the decline in the interest rates in December.

Exchange rate developments

38. The domestic currency depreciated against the US dollar and the Euro since the last EC meeting. The ZAR weakened against the dollar as the country's stocks fell with the prices of gold and platinum, its biggest exports, reducing the revenue prospects for

South Africa. The Namibia dollar depreciated by 5.1 percent in September 2008 to stand at N$8.047 per US dollar.

39. EC expressed concern that the recent strong depreciation may have an inflationary impact, and may also further suppress domestic demand.

Conclusions and considerations for monetary policy

40. Taking into consideration both the international and domestic economic conditions, the EC was of the view that a further round of monetary policy easing was necessary to support the local economy by providing a stimulus for consumer and investment demand expansion. Against this background, the EC viewed a further easing in the monetary conditions as necessary under current circumstances. The EC observed that the desired expansionary effect of the more accommodative monetary policy stance could be enhanced by a simultaneous fiscal stimulus.

41. The EC stressed that it was essential to closely monitor domestic and international economic developments and, if it would become necessary, that required actions should be taken to defend the peg and ensure price stability.

The decision

42. Against this background, the EC decided to reduce the Repo Rate by 100 basis points to 9.0 per cent with effect from 18 February 2009.