BANK OF NAMIBIA ANNUAL REPORT

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ANNUAL REPORT

1996

INFORMATION CENTRE
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ANNUAL REPORT

1996

Registered Office

10 Daniel Munamava Street
PO Box 2882
Windhoek
Namibia

MISSION STATEMENT

The objectives of the Bank are:

to promote and maintain internal and external monetary stability, an efficient payments mechanism, and the liquidity, solvency, and proper functioning of a soundly based monetary, credit, and financial system in Namibia;

to foster monetary, credit, and financial conditions conducive to the orderly, balanced, and sustained economic development of Namibia; and

to assist in the attainment of national economic goals.

In accordance with Section 53 (1) of the Bank of Namibia Act, 1990, the Bank has submitted to the Minister of Finance a copy of this Annual Report, which includes:

(i) a copy of its annual accounts certified by the auditors;

(ii) a report of its operations and affairs; and

(iii) a report on the state of the economy.

T.K. Alweendo
GOVERNOR

30 April 1997

MEMBERS OF THE BOARD

Mr T K Alweendo
Governor
Appointed - 01 January 1997

Dr J Ahmad
Former Governor
01 January 1994 -
31 December 1996

Mr L S Ipangelwa
Deputy Governor
Appointed - 01 January 1997

Ms P M Elago
Appointed - 16 July 1996

Mr A Botes
Appointed - 16 December 1992

Mr U Maamberua
Appointed - 11 December 1996

Mr P Damaseb
Appointed - 16 July 1990

BANK OF NAMIBIA MANAGEMENT

Governor	Mr T K Alweendo
Deputy Governor	Mr L S Ipangelwa
Chief Internal Auditor	Mr B Masule
Manager - Projects	Ms H Trossbach
Senior Manager - Corporate Services	Mr F S Hamunyela
Manager - Administration	Mr E Lehmann
Manager - Human Resources	Ms L Markus
Manager - Information Systems	Mr J vd Merwe
Senior Manager - Financial Institutions	Mr R Lawrence
Advisor - Financial Institutions	Mr J Rajakumar
Manager - Banking Examinations	Mr G Mate
Manager - Exchange Control	Mrs R Metzler
Manager - Regulations and Analysis	Mr W Mberirua
Senior Manager - Operations	Mr U Davids
Manager - Currency and Banking	Mr F Guiseb
Manager - Finance	Mr I H Theodore
Manager - Treasury	Mr P Mwangala
Senior Manager - Research	Mr E I Meroro
Manager - Balance of Payments	Mr H Scheun
Manager - Banking and Finance	Mr M Mwinga
Manager - Economics	Mr W I Shiimi

FOREWORD BY THE GOVERNOR

The overall economic growth was moderate during the year under review compared with stronger growth rates achieved in the previous two years. The relatively poor performance of the economy, which is well below the target rate set by NDP1, was mainly attributable to the drought and the reduced fish stocks. This demonstrates that economic growth patterns continue to be dictated by primary production and particularly by weather conditions. Thus government's efforts to diversify the economy in order to lessen dependence on the primary sector are steps in the right direction and should be encouraged. In this regard, the Bank fully supports the EPZ concept and has made several concessions with respect to exchange control regulations to facilitate the smooth implemention of this programme.

The balance of payments for the year 1996 continued to show a surplus of almost similar magnitude to that recorded in the previous year. This surplus was achieved on account of strong export earnings and the increase in transfers from SACU. The brisk performance in exports was largely underpinned by the rise in export prices and the depreciation of the Namibia dollar against the currencies of the country's major trading partners. However, transfers from SACU are likely to decline in the near future due to trade liberalization. This again underlines the importance of promoting an export-biased production in order to lessen the pressure on the balance of payments from the declining SACU transfers.

The intermediate monetary policy objective of the Bank has been to support the fixed exchange rate between the Namibia dollar and the South African rand. This policy has proven effective in attaining the Bank's overall monetary policy objective of price stability, as reflected in a single digit inflation rate in 1996. The Bank remains committed to this monetary arrangement and will direct monetary policy actions towards maintaining the fixed exchange rate.

Under the fixed exchange rate regime, the onus of demand management lies with fiscal policy and, to a lesser degree, with monetary policy. The government's efforts to curtail recurrent expenditure have already yielded some notable results, as the budget deficit has been brought down to just over 4 per cent of GDP. Fiscal operations for the year 1997/8 should result in a lower budget deficit, as the efforts to restraint recurrent expenditure have been stepped-up, and should therefore contribute towards a stable price environment.

However, more attention needs to focused on the non-implementation of budget targets. Although the revenue collected was more than estimated, the over-expenditure on the current account and under-expenditure on the capital account cannot continue without adversely affecting the productive capacity of the economy. The Bank strongly supports the public enterprise reform initiatives that the government is undertaking in the commercialization and privatization of 'non-core' functions.

The real savings ratio remained at around 7 per cent of GDP. This is far lower than the level required for sustainable economic development and cannot continue without putting undue pressure on the country's balance of payments position. The low savings ratio highlights the need for more concerted efforts to mobilize domestic savings. These are needed to finance the large volume of investment required to expand the productive capacity of the economy, thereby reducing the high level of unemployment in the country, over the medium to long-term. Of importance is to ensure real rates of return that will provide incentives to save and hence the need to contain inflation.

The average inflation rate, which was slightly above 10 per cent in 1995, slowed during 1996. Although monthly inflation has been accelerating during the last months of the year, the annual average inflation remained at a single-digit rate of about 8 per cent. This relatively stable price environment was largely due to the tight monetary policies pursued by the South African Reserve Bank (SARB), transmitted to Namibia mainly through the fixed exchange rate. Other factors such as the slower increase in labour costs in South Africa and the reduction in tariffs on imported goods also contributed to the lower inflation rate.

The high interest rates in the country could be construed not to be conducive to much needed investment to meet the targeted economic growth. However, amidst strong inflationary forces, the tight monetary policy needs to be continued until the risk of inflation is reduced.

The domestic capital market is increasingly becoming another source of funds, particularly for long term financing. This is evidenced by the growing number of companies listed on the NSE and the rising amount of funds raised through public offerings. The success of the national development strategy to achieve economic growth targets requires a dynamic and innovative capital market to meet new and large funding demands for capital investment.

The Bank is committed to the gradual relaxation of the remaining exchange control restrictions. This was demonstrated by Namibia's accession to Article VIII of the IMF, which precludes member countries from imposing restrictions on payments and transfers for current account transactions, or from engaging in discriminatory currency arrangements or multiple currency practices, without the approval of the IMF.

The year under review saw significant developments with regard to the supervisory role of the Bank. Substantive work was carried out in revising the Banking Institutions Act and the accompanying regulations and guidelines. The purpose is not only to give the Bank the necessary flexibility in executing its supervisory function, but also to bring the country's laws and regulations governing banking supervision in line with international norms and principles of banking supervision. The new Banking Institutions Bill is expected to be tabled in Parliament this year.

The Bank greatly supports regional integration initiatives in the context of SADC and other regional bodies. In this regard, the Bank in conjunction with other central banks in the region remained actively involved in strengthening financial and monetary co-operation.

The year 1997 is expected to show an improved performance in the overall economic growth, following the good rains and increased activities in the EPZ. Inflationary pressures are expected to remain strong, particularly during the first half of the year, as the full impact of the depreciation of the South African rand and hence the Namibia dollar is yet to work its way through the Namibian economy. However, the continuing tight monetary policy and a relatively low projected budget deficit in Namibia should help to ensure a reasonably stable price environment during the year.

30 April 1997

T K Alweendo
GOVERNOR

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PART A

STATE OF THE ECONOMY

1996

At the end of 1996, total outstanding debt stood at N$3.2 billion. As a ratio of GDP, total public debt was 29 per cent. External debt continued to fall, indicating the Government's determination to meet its financing needs on the domestic market. Public external debt fell from N$497 million in 1995 to N$488 million, or by 1.8 per cent, in 1996. Namibia's pre-independence debt is expected to be written-off during the fiscal year 1997/98.

The balance of payments recorded a surplus of N$98 million, or 0.7 per cent of GDP, similar to that in 1995. Despite the 1996 surplus, the level of official foreign reserves of N$906 million could cover only 5.9 weeks of imports, a marginal increase from 5.7 weeks in 1995. The current account grew from a surplus of N$113 million in 1995 to N$359 million in 1996, bolstered by a narrowing trade deficit and higher current transfers. The capital and financial account registered a net outflow of N$238 million in 1996, equivalent to 1.7 per cent of GDP, from a deficit of N$88 million in 1995. This deterioration was due to smaller capital transfer receipts, redemptions of maturing debt instruments, and short term flows between the banking sector and its parent companies. Namibia's international investment position moved into a net liability position of N$681 million in 1996, on the back of market value increases of direct inward investment, and the effect of the local asset requirement on institutional investor's stock of assets in South Africa.

During the first quarter of 1996, particularly mid-February, the value of the Namibia dollar, which is pegged to the rand, started to depreciate against major currencies. This depreciation was due to uncertainty regarding political stability in South Africa. Continued weakening of the Namibia dollar in the third and fourth quarters was a reflection of poor economic fundamentals in South Africa.

1.2 International Environment

1.2.1 The World Economy

Global real output growth, which slowed slightly in 1995, was projected by the International Monetary Fund (IMF) at 3.8 per cent for 1996, with developing countries showing higher growth rates than industrial and transition economies. The Organisation for Economic Co-operation and Development (OECD) estimated the real output growth of its member countries at 2.4 per cent.

World trade grew by more than 9 per cent in 1995, but slowed down significantly during the first half of 1996. The IMF estimated growth for 1996 at 6.7 per cent. Developing and transition economies were expected to lead world trade despite declines in commodity prices. The prices of non-fuel primary commodities have been declining since 1994, and are forecast to fall by a further 2.5 per cent in 1997.

Industrial Countries

The *United States* economy edged upward during the third quarter of 1996 to 2.2 per cent from the previous year's growth of 2.0 per cent. While inflation increased by 0.5 percentage points in the second half of 1996, from 2.5 per cent in 1995, unemployment declined from 5.6 per cent in 1995 to 5.2 per cent at the end of 1996. The annual broad money supply growth remained unchanged at 4.1 per cent from the year before.

The US trade deficit stood at US$179.4 billion for the twelve months to December 1996, while the current account deficit stood at US$141.8 billion in the second quarter. The current account deficit grew by 4.3 per cent, or US$6.4 billion. Meanwhile, the trade deficit worsened from its 1995 level, increasing by US$6.0 billion, or 3.5 per cent. This was due mainly to the dollar's depreciation and the larger import growth.

The recovering *Japanese* economy grew to 3.2 per cent in the second half of 1996 from 0.9 per cent in 1995. Japan had the highest industrial output growth in the developed world, almost double that of the US which had the second highest. Unemployment, however, grew from the previous year's 3.1 to 3.4 per cent. The negative inflation rate of 0.1 per cent in 1995 was reversed in October 1996 and stood at 0.5 per cent, the lowest level in the major industrial countries. Broad money supply growth recorded an increase of 0.4 percentage points to 3.7 per cent in 1996, in line with the inflation rate turnaround.

Japan recorded a trade surplus of US$90.7 billion and a current account surplus of US$72.6 billion. The current account surplus declined by 34.8 per cent, or US$38.8 billion. On the other hand, the trade surplus improved by US$20.4 billion, or 29.0 per cent, from 1995. This was mainly due to strong export demand.

GDP in *Germany* grew by 2.4 per cent during the third quarter of 1996. This was a remarkable performance given the country's growth rate of 1.9 per cent in 1995. While the Bundesbank maintained a lid on consumer price inflation, which stood at 1.5 per cent compared with 1.8 per cent in 1995, the unemployment rate soared to 10.7 per cent. This was an increase from the previous year's rate of 9.4 per cent. The growth in the broad measure of money more than doubled to 8.3 per cent in 1996.

Although Germany managed to record a trade surplus of US$63.1 billion, its current account reflected a deficit of US$21.7 billion. The deficit on the current account remained fairly stable, increasing by only US$0.7 billion, or 3.3 per cent, in 1996. This was despite the Deutsche mark's appreciation. On the other hand, the trade surplus improved from its 1995 level of US$61.5 billion.

The *French* economy experienced slower growth than the other major industrial countries. Output growth slowed to 1.2 per cent in the third quarter, after it grew by 2.2 per cent in 1995. As in Germany, unemployment remained a major problem and was at 12.6 per cent in October 1996, up from 11.6 per cent in 1995. However, inflation was contained, remaining unchanged at 1.8 per cent from the previous year. This was in line with the decline in broad money growth to 0.5 per cent from 4.8 per cent in 1995.

France recorded surpluses on both the trade balance and the current account. The trade balance stood at US$22.5 billion, while the current account showed a surplus of US$16.4 billion. However, the current account surplus dropped from US$18.6 billion in 1995. On the other hand, the trade balance improved by 7.7 per cent, or U$1.6 billion, from its 1995 level. This was due mainly to stronger export demand for French goods.

The *British* economy slowed from a growth rate of 2.5 per cent in 1995 to 2.3 per cent in the third quarter of 1996. Inflation was, however, contained and declined slightly from 2.8 per cent in 1995 to 2.7 per cent in October 1996. The unemployment rate declined by a percentage point to 7.2 per cent from a year earlier. The growth in the broad measure of money remained fairly unchanged at 10.3 per cent, as against 10.0 per cent in 1995.

Britain had both trade and current account deficits. The trade deficit was at US$20.3 billion for the year to December 1996, while the current account deficit was US$4.1 billion for the first half of the year. As a result of increased trade in services, the current account deficit improved by 53.9 per cent from US$8.9 billion in 1995. The trade deficit worsened from US$18.2 billion the previous year, because of slow export growth, while imports grew faster.

Developing and Transition Economies

Although developing countries continued to face macroeconomic imbalances and structural problems, real output growth was expected by the IMF to exceed 6 per cent during 1996. Inflation remained subdued throughout the year and could slow considerably during 1997, with Africa expected to experience the greatest decline. Foreign exchange markets were relatively stable during the first half of the year due to capital inflows and more appropriate policy measures.

Transition economies showed improved performance in gross domestic product from a decline of 1.3 per cent in 1995 to a growth of 0.4 per cent in 1996, boosted by increased domestic demand and exports. Despite some success in containing inflation, these economies still, according to the IMF, need to achieve and maintain greater macroeconomic stability. The balance on the capital and financial account improved significantly from US$1.9 billion in 1995 to US$14.4 billion in 1996. It is expected to almost double in 1997 and spur growth in the economies.

1.2.2 The South African Economy

According to the South African Reserve Bank (SARB), growth in the South African economy has remained above its long-term potential for some time. Domestic output grew by 3.1 per cent during 1996, despite a lower growth rate in the second half of the year. This slowdown was evidenced by a decrease in the utilisation of manufacturing capacity, smaller additions to inventories since mid-1995, production losses due mainly to strikes, and weakening capital inflows from abroad due largely to the rand's depreciation.

The growth in economic activity can be attributed mainly to improved agricultural production due to favourable weather. Secondary reasons were strong export demand for base minerals and coal as well as increases in non-gold mining productivity. Manufacturing was adversely affected by strikes, slowing domestic savings, inefficient production processes, and poor skills of the labour force. Therefore, the government's Macroeconomic Strategy for Growth, Employment and Redistribution (GEAR) announced on 14 June 1996, was aimed at promoting export-driven and cost-efficient manufacturing, and at keeping the real effective exchange rate at the current level.

Consumer price inflation started declining in 1995, but from March 1996 the monthly changes in the consumer price index were higher. During the year to December, consumer price inflation averaged 7.4 per cent per annum. Prices of imported goods increased during this period. The rise was, however, eased by lower import tariffs and increased competition. Efforts to contain inflation were hampered by the rand's depreciation, rising food and crude oil prices, and strong growth in money supply and domestic credit.

Broad money supply (M3) grew by R41.2 billion, or 15.2 per cent during 1996, exceeding by far the targeted upper limit of 10 per cent. This large increase in broad money supply was due to excessive credit extension to the private sector, reflecting increased domestic demand for goods and services and working capital. Total domestic credit extension grew at 17.0 per cent during the year.

The rand, which started depreciating in early 1996, continued this trend through to September when it stabilised. However, it depreciated further during the last quarter. This, along with other factors, was responsible for the widening current as well as capital and financial account deficits on the balance of payments. The result was a decline in foreign reserves until October, whereafter it started to recover. The current account deficit declined as a ratio of gross domestic product from 3.1 per cent in the second quarter to 2.0 per cent in the third quarter of 1996. This improvement was due mainly to increases in merchandise and net gold exports.

The overall balance of payments position, which had been improving since 1995, suffered a setback in the first half of 1996. This setback was mainly because the net capital inflow consisted largely of portfolio and short-term investments. Due to the depreciation of the rand, these inflows turned into large capital outflows during the first half of the year. This outflow drained liquidity from the domestic market and put pressure on money market interest rates. The result was a more restrictive monetary policy by the SARB, and hence the increase in the Bank rate. Net capital inflow was estimated at R3.5 billion in the last quarter of the year, but stood at R3.9 billion for 1996.

Prospects for 1997

Total government expenditure is expected to decline, in line with provisions of the GEAR. Although this cut in expenditure confirms and shows the government's commitment to gradually reducing the budget deficit before borrowing, it can have a dampening effect on consumption and hence on total demand and output. Due to this expenditure cut, the budget deficit is forecast at 4.0 per cent of GDP for the fiscal year 1997/98, down from 5.1 per cent in the previous fiscal year.

Consistent with the intention to retain a restrictive monetary policy during 1997, interest rates are expected to remain high and inflation to remain at around 10 per cent. Meanwhile, the remaining exchange controls, on both current and capital transactions, will be phased out gradually during the year. This could result in capital outflows that would put further pressure on foreign reserves and the balance of payments.

Given the above developments during 1997, real GDP is predicted to grow at below 3 per cent, from 3.1 per cent in 1996.

Regional Cooperation

The Southern African Development Community (SADC) countries entered into an important agreement in August, concluding the Trade Facilitation Protocol to pave way for the establishment of a free trade area in SADC. The free trade area, to be fully operational in 8 years, should ensure the removal of trade and non-trade barriers between the member states.

South Africa also entered into negotiations for a free trade area with the European Union (EU). An agreement is expected in 1997. An EU-South Africa free trade area will have tremendous implications for the Southern African Customs Union (SACU) member countries, including Namibia. It will affect customs revenue from the SACU pool, increase competition from EU companies establishing themselves in South Africa, and allow cheaper EU exports into South Africa.

Namibia is part of the Cross Border Initiative (CBI) established to support the objectives and programmes of regional organisations. The aim of the CBI is to ensure economic integration through the reduction of obstacles to economic activity between southern African countries. It is jointly sponsored by the IMF, World Bank, African Development Bank (ADB), and the Commission of the European Communities (CEC). As required, Namibia submitted the CBI Letter of Policy to the sponsors. This was officially accepted in August 1996.

The basic objectives of the CBI are the liberalisation of trade, the improvement of payments and exchange systems, development and harmonisation of investment policies or incentives, and the development of institutions to ensure southern African integration. The CBI is similar to the IMF's structural adjustment programmes being undertaken in many developing countries.

Namibia stands to benefit substantially, at least in the longer term, from the financial assistance as well as potential direct investment from the CBI sponsors. The benefits include, among others, balance of payments support, long term capital (mostly on a concessional basis), and support for intra-regional export promotion and tax reform efforts.

As a member of the Lomé Convention, Namibia enjoys preferential access to the EU markets for its exports. However, these benefits may end by the year 2000. One reason is that the EU is moving away from preferential to reciprocal trade arrangements. Another is the trend in global trade liberalisation, renewed by the General Agreement on Tariffs and Trade and now furthered by the World Trade Organisation. This will affect Namibia's exports to the EU since they will be subject to duties which were not applicable under Lomé.

1.2.3 World Economic Outlook for 1997

The IMF has forecast global real output growth at 4.1 per cent during 1997, while global trade continues to be strong at a growth rate of 7.2 per cent. Although many industrial countries are expected to continue facing structural and macroeconomic weaknesses in their economies, they could achieve an overall growth of 2.5 per cent. Japan is the only major industrial country expected to experience a lower growth rate.

Inflation in the industrial countries should be contained at 2.4 per cent, while the unemployment rate could improve somewhat, declining to 7.6 per cent in 1997. Meanwhile, final domestic demand is expected to decline, except in Britain, Canada, Italy, Germany and France where increases should occur. The demand in Japan and the US is expected to decline, more significantly in Japan.

According to IMF estimates, developing countries could achieve a growth of 6.2 per cent in real output. Africa is expected to achieve a 5.0 per cent growth compared with 7.5 per cent in Asia. Overall inflation is expected to slow down significantly to 10.8 per cent. On the other hand, countries in transition are expected to achieve a 4.0 per cent growth in real GDP, a significant improvement on the previous year's 0.4 per cent.

2. REAL SECTOR AND PRICE DEVELOPMENTS

2.1 Domestic Output and National Income

Real GDP expanded modestly by 2.6 per cent in 1996. This is well below the 5 per cent envisaged in the NDP1. The economy performed satisfactorily during 1994 and 1995, with real growth rates of 6.2 per cent and 5.2 per cent. The slower growth in 1996 was caused mainly by substantial declines in the secondary industries, particularly the manufacturing sector. Declines in the construction as well as the water and electricity sub-sectors of 9.0 and 11.7 per cent respectively, also contributed to the slower growth. The primary and tertiary sectors recorded growth rates of 5.5 and 3.7 per cent.

GNI, in real terms, grew by 9.9 per cent in 1996 compared with a marginal decline of 0.7 per cent in the previous year. This growth was due mainly to gains from improvements in the terms of trade.

Real GDP per capita fell marginally by 0.5 per cent in 1996, compared with modest improvements of 2.0 and 3.0 per cent in 1995 and 1994. In contrast, real GNI per capita increased by 6.6 per cent during the year under review.

2.2 Sectoral Review

During 1996, the performance of major sectors of the economy showed mixed results *(Table 2.1)*. This compares unfavourably with the growth achieved during the past two years when virtually all sectors recorded strong rates of expansion. Whilst agriculture, fishing, mining, and wholesale and retail trade registered robust growth rates in 1996, the performance in fish processing, electricity and water, construction and catering services was dismal. Output in the transport and communication sectors rose marginally. In terms of contribution to overall economic growth, primary production accounted for the highest percentage. Activities in the primary and tertiary industries expanded by 5.5 per cent and 3.7 per cent, respectively, while secondary industries registered a decline of 8.0 per cent.

2.2.1 Performance of the Primary Sector

The primary sector was relatively buoyant during 1996 as growth increased from 4.2 per cent in 1995 to 5.5 per cent, with all sub-sectors showing expansion in output, especially fishing. More than half of the growth in GDP was accounted for by the primary sector.

Output in the agricultural sector expanded by 6.1 per cent in 1996, compared with a decline of 2.4 per cent in 1995. This rebound is the result of an increase in commercial agricultural output of 7.4 per cent, combined with moderate growth in subsistence agriculture. The growth in output from commercial farmers was spurred by sales of livestock due to the drought. Although the effects of the drought are the same for both commercial and subsistence farmers, the latter are generally inclined to retain their stock during drought periods. Thus, the drought did not induce communal farmers to step-up the sales of their cattle as was the case with commercial farmers. In arable farming, poor rains reduced the areas planted and led to a poor harvest.

The *fishing sector* continued to expand at a double-digit rate for the sixth consecutive year. The sector's output expanded at almost 11 per cent, a percentage point below the rate recorded in the previous year. This output was above expectations, viewed against a substantial reduction in the *total allowable catch* (TAC) for pilchards, one of the major species. The 1996 TAC for pilchards was halved to allow for a faster recovery of the stock, reduced over the past years due to adverse oceanic conditions and over-fishing. However, the increase in output of other major species more than offset the decline in the output of pilchards.

Table 2.1 Gross Domestic Product by Activity

Annual percentage changes: Constant 1990 Prices

Industry	1994	1995	1996
Agriculture	14.2	-2.4	6.1
Commercial	-0.8	-6.9	7.4
Subsistence	73.9	7.9	3.6
Fishery products	10.7	11.6	10.6
Mining and quarrying	10.5	5.8	4.0
Diamonds	10.8	8.1	2.9
Other mining and quarrying	9.9	0.8	6.7
Primary Industries	**11.6**	**4.2**	**5.5**
Manufacturing	5.0	3.3	-7.3
Meat processing	2.8	2.7	2.5
Fish processing	8.6	1.3	-43.0
Other manufacturing	4.0	4.0	4.0
Electricity and water	23.3	25.0	-11.7
Construction	11.9	4.8	-9.0
Secondary industries	**7.3**	**5.1**	**-8.0**
Wholesale and retail trade, repairs	2.2	4.6	6.4
Hotels and restaurants	24.3	13.7	-10.7
Transport and Communications	12.7	10.9	1.9
Transport and storage	19.4	13.1	1.0
Post and communications	4.4	7.0	3.1
Finance, real estate, business services	-0.1	3.6	8.3
Financial intermediation	-2.4	6.4	17.2
Financial intermediation indirectly measured	4.2	4.2	3.7
Real estate and business services	2.5	2.7	2.7
Owner-occupied dwellings	2.5	2.5	2.5
Other real estate and business services	2.5	3.0	3.0
Community, social and personal services	3.5	-2.8	-2.0
Producers of government services	1.6	1.1	3.3
Other producers	2.4	2.0	2.0
Tertiary industries	**3.2**	**3.3**	**3.7**
All industries at basic prices	**6.5**	**3.9**	**2.2**
Import duties	6.2	17.7	7.8
Other taxes on products	3.0	13.0	3.5
GDP at market prices	**6.2**	**5.2**	**2.6**

Source: Central Statistics Office

Mining output rose at a reduced rate of 4.0 per cent in 1996 from 5.8 per cent in the previous year. This growth was achieved because other mining and quarrying activity increased by 6.7 per cent, while diamond output rose by only 2.9 per cent. Although diamond prices increased modestly during the year, production was not flexible enough to respond to the favourable market conditions. Compared with the previous two years, growth in the mining industry slowed down considerably, declining from 10.5 per cent in 1994 to 4.0 per cent in 1996. Considering its relatively high contribution to GDP, this slack in the mining industry had a negative impact on overall economic performance.

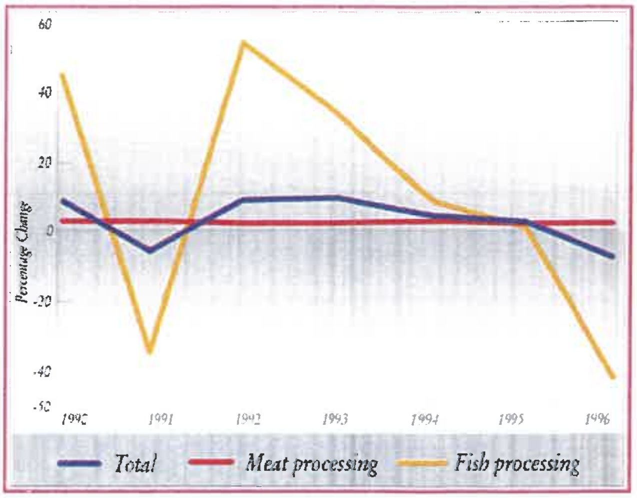
2.2.2 Performance of the Secondary Sector

The secondary sector, consisting of manufacturing, electricity and water, and construction, performed poorly in 1996, reversing the trend of positive growth recorded since 1992. Total production by this sector dropped by 8 per cent due to the dismal performance of the fish processing sub-sector.

As fish processing is directly dependent on quota allocations for pilchards, fish manufacturing output shrank by 43 per cent. On the other hand, meat processing and other manufacturing activity expanded by 3 and 4 per cent respectively, supported by the increase in the sale of cattle by commercial farmers.

The performance of the manufacturing sector has largely been dictated by the growth in

Chart 2.1 Growth in the Manufacturing Sector



fish processing output, as meat processing and other manufacturing activities have remained fairly stable since 1990 *(Chart 2.1)*. In 1991, when value added in fish processing fell by 34 per cent, total manufacturing output contracted by 6 per cent. When fish processing activity rose by 54 per cent in the following year, the overall manufacturing output increased by 16 per cent. Likewise, total manufacturing output declined markedly when fish processing output decreased sharply by 43 per cent in 1996.

The production of *water and electricity* declined by 11.7 per cent compared with a substantial increase of 25 per cent in 1995. This is in line with the water restrictions imposed because of the drought during the year. *Construction output* also declined by 9 per cent, reversing the positive trend recorded since 1992. The drop in construction activity was partly due to the slowdown in the construction of both housing and commercial buildings, largely because of higher interest rates in the market.

2.2.3 Performance of Tertiary Sector

The services sector, mainly dominated by government services, registered a moderate growth rate of 3.7 per cent in 1996, marginally higher than the 3.3 per cent recorded the previous year. In terms of contribution to GDP, the tertiary sector now accounts for 54.3 per cent, of which 26 per cent is from government services.

Output in the *wholesale and retail trade and repairs* increased by 6.4 per cent, compared with 4.6 per cent in the previous year. *Transport and communication services* rose by 2.0 per cent, compared with 10.6 per cent growth in 1995. During 1996, transport services grew marginally by 1.0 per cent, while post and telecommunication services grew modestly by 3.1 per cent.

Output in *finance, real estate and business services* improved by 8.3 per cent in 1996, compared with the increase of about 4 per cent in 1995. Responsible for the good performance of this sub-sector was financial intermediation which recorded a growth rate of 17.2 per cent. After growing by only 1.6 and 1.1 per cent in 1994 and 1995, respectively, government services grew substantially to 3.3 per cent in 1996. This rise reflects the additional burden that government had to carry as a result of drought relief programmes and the implementation of the Wages and Salary Commission recommendations.

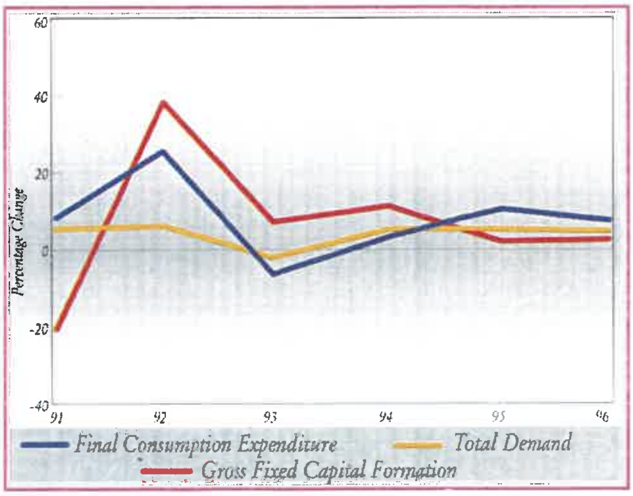
2.3 Supply of and Demand for Resources

There was an increase of 5 per cent in the supply of resources to the economy, even though it moderated slightly from the increase of 5.6 per cent recorded during the previous year (*Table 2.2, Chart 2.2*). Imports of goods and services accounted for roughly the same proportion of total supply of resources as at the previous year, increasing marginally to 37.6 per cent, compared with 36.2 per cent in 1995, with the rest of the resources being accounted for by GDP at market prices. Imports increased their share in total supply of resources despite the depreciation of the Namibia dollar against major currencies during 1996.

Gross domestic demand increased by 8.4 per cent in 1996 compared with the rise of 3.7 per cent recorded in the previous year. This increase in aggregate domestic demand was due mainly to consumption spending, despite its fall from 10.3 per cent in 1995 to 7.1 per cent in 1996. The increase in inventory build-up of 1 per cent in 1996, compared with a draw-down of about 6.4 per cent the previous year, had a marginal impact on domestic demand.

Real investment demand increased by 2.6 per cent in 1996, while it recorded an increase of 2.1

Chart 2.2 Growth in Domestic Demand



per cent in the preceding year. However, if mineral exploration is excluded, the rates of increase were 2.7 per cent and 1.7 per cent for 1995 and 1996, respectively. Capital formation in 1996 was driven mainly by investment outlays in buildings (11.8 per cent), machinery and equipment (9.4 per cent) and transport and equipment (5.6 per cent). Construction work, however, decreased substantially by 31 per cent.

Expenditure in the public sector rose by 5.7 in 1996 after a decline of 3.3 per cent in 1995. In nominal terms, expenditure increased by nearly 14 per cent. Accounting for this substantial rise was the 18.8 per cent increase in subsidies and the 64 per cent increase in current transfers to non-profit organisations. Further, increases in net transfers to the rest of the world were substantial, resulting in higher public sector expenditures for the year.

Private consumption expenditure remained strong, although its growth declined in 1996. In real terms, private consumption expenditure increased by 7.6 per cent in 1996 compared with a substantial increase of 16.5 per cent in the previous year. Private investment outlays, on the other hand, saw a decrease of 2.3 per cent in 1996, compared with a higher growth of 8.6 per cent recorded in previous year. This was the first decline recorded in private investment outlays since independence.

Table 2.2 Supply and Use of Resources
Constant 1990 Prices
N$ million

Supply of Resources	**1994**	**1995**	**1996(p)**	**94(%)***	**95(%)***	**96(%)***
GDP at Market Prices	7618	8013	8222	6.2	5.2	2.6
Imports of Goods and Services	-4269	-4544	-4962	4.7	6.4	9.2
Total Supply	**11887**	**12557**	**13184**	**5.6**	**5.6**	**5.0**
Use of Resources						
Final Consumption Expenditure	7233	7979	8545	3.4	10.3	7.1
Private	4981	5802	6243	4.7	16.5	7.6
Government	2252	2177	2302	0.6	3.3	5.7
Gross Fixed Capital Formation	1651	1685	1729	11.4	2.1	2.6
Buildings	658	713	797	16.3	8.4	11.8
Construction Work	350	350	243	7.7	0.0	-30.6
Transport Equipment	180	180	190	-23.3	0.0	5.6
Machinery & Other Equipment	423	414	453	33.7	2.1	9.4
Mineral Exploration	40	46	47	-4.8	15.0	2.2
Changes in Inventory**	-960	-1448	-1367	7.8	-6.4	1.0
Exports of Goods and Services	3963	4341	4277	-7.6	9.5	-1.5
Total Demand	**11887**	**12557**	**13184**	**5.6**	**5.6**	**5.0**

(p) Provisional
* Percentage Change
**Change in inventories is calculated as a percentage of GDP of the previous year.
Source: Central Statistics Office

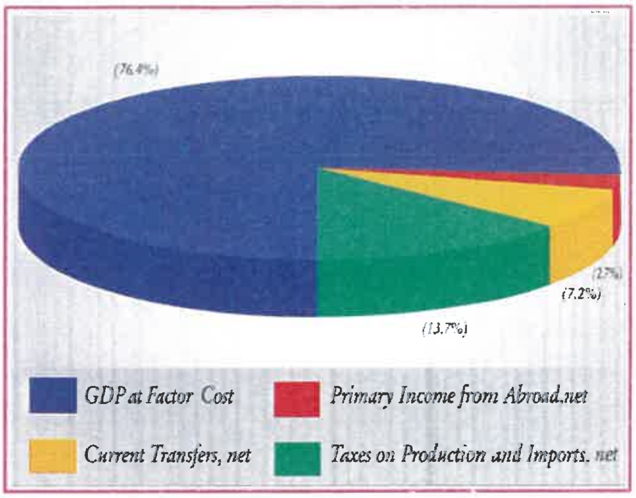
2.4 Gross National Disposable Income and Gross Saving

Gross domestic saving declined marginally by 0.6 per cent in 1996, an improvement on the substantial decrease of 29.4 per cent during the previous year. Nominal consumption expenditure increased by 19.7 per cent and 14.7 per cent for 1995 and 1996, respectively, while corresponding disposable income increased by 13.4 per cent and 13.5 per cent. Current gross saving represents a ratio of 7 per cent of GDP, down from 8.0 per cent in the preceding year (*Table 2.3*).

GDP at factor cost increased significantly by 14.8 per cent in 1996, compared with a 10.5 per cent growth realized during the previous year. As a share of national disposable income, factor income increased to 76.4 per cent in 1996, compared with 75.5 per cent for 1995 (*Chart 2.3*). The average proportion of factor income to gross national disposable income stood at 77 per cent since 1991.

Chart 2.3 National Income in 1996

As % of Disposable Income



NB: Percentages on Chart 2.3 and Table 2.3 may differ due to rounding.

The share of net primary income from abroad decreased slightly from 3.2 per cent in 1995 to 2.7 per cent in 1996. Accounting for the marginal decrease was a moderate reduction in net property income of 2.3 per cent in 1996. In contrast, the share of net current transfers from the rest of the world increased, mainly due to net increases in the SACU receipts. Net SACU revenues grew by

Table 2.3 Income and Outlay Account
Current Prices
N$ million

Income	1994	1995	1996(p)	94(%)*	95(%)*	96(%)*
GDP at Factor Cost	9 403	10 388	11 927	23.1	10.5	14.8
Plus: Taxes on Production and Imports, net	1 694	1 933	2 149	16.3	14.1	11.2
GDP at Market Prices	10 995	12 177	13 904	22.2	10.8	14.2
Plus: Primary Income from abroad, net	238	432	418	10.7	81.5	-3.2
GNI at Market Prices	11 233	12 609	14 322	22.0	12.2	13.6
Plus: Current Transfers, net	779	1 009	1 131	-0.8	29.5	12.1
Gross National Disposable Income	12 012	13 618	15 453	20.2	13.4	13.5
Less: Consumption Expenditure	10 463	12 522	14 364	13.9	19.7	14.7
Gross Saving	1 549	1 096	1 089	96.6	-29.4	-0.6
Saving Ratio (%)	**12.9**	**8.0**	**7.0**	**N/A**	**N/A**	**N/A**

(p) Provisional
* Percentage Change
Source: Central Statistics Office

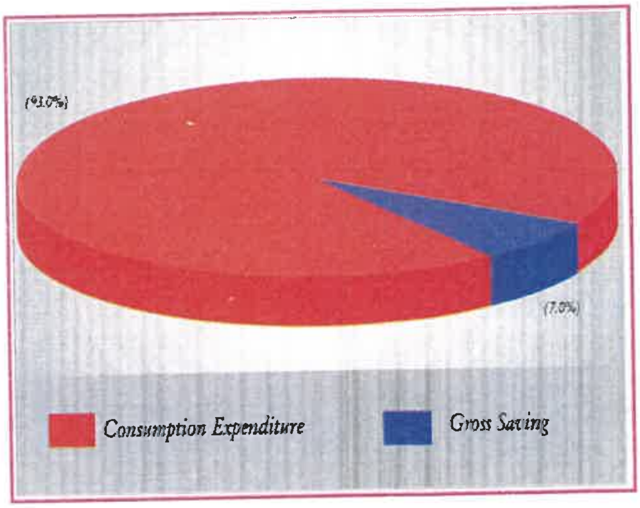
29 per cent in 1996 compared with an increase of 32 per cent in the previous year.

About 93 per cent of the gross national disposable income was spent on consumption in 1996, leaving only 7 per cent for saving (*Chart 2.4*). The ratio of consumption to gross national disposable income was 76.9 per cent in 1990.

2.4.1 Savings and Investment

Public sector saving improved significantly during the last three years. It increased from N$424 million in 1994 to N$638 million in 1996 (*Table 2.4*). Between 1995 and 1996, saving by this sector increased by 6.7 per cent from N$598 million. The negative gap between public savings and investment continues to fluctuate, although it has remained well below the N$690 million mark reached in 1992. This deficit deteriorated from N$313 million in 1995 to N$462 million in 1996.

Chart 2.4 Consumption and Gross Saving in 1996
As % of Disposable Income



Capital formation in the public sector increased by 20.7 per cent to N$1.1 billion in 1996, after remaining constant at N$911 million for 1994 and 1995. The relatively lower rate of increase in savings, combined with the steady increase in capital formation, led to the widening of the gap between savings and investment in the sector.

Table 2.4 Savings-Investment Gap
Current Prices
N$ million

	1994	1995	1996(p)	94(%)*	95(%)*	96(%)*
Public Gross Fixed Capital Formation	911	911	1 100	25.7	0.0	20.7
Public Gross Saving	424	598	638	151.8	41.0	6.7
Deficit\Surplus	**-487**	**-313**	**-462**	**N/A**	**N/A**	**N/A**
Private Gross Fixed Capital Formation	1 398	1 669	1 735	15.7	19.4	4.0
Private Gross Saving	1 125	498	451	8.9	-55.7	-9.4
Deficit\Surplus	**-273**	**-1 171**	**-1284**	**N/A**	**N/A**	**N/A**
Changes in Inventory	-1 233	-1 598	-2 103	-11.2	-13.1	-15.1
Gross Domestic Capital Formation	2 309	2 580	2 835	19.3	11.7	472
Gross Domestic Saving	1 549	1 096	1 089	96.6	-29.2	-0.6
Balance on Current Account **	**472**	**112**	**357**	**N/A**	**N/A**	**N/A**
Current Account/GDP (%)	**4.3**	**0.9**	**2.5**	**N/A**	**N/A**	**N/A**

(p) Provisional
* Percentage Change
** Balance on current account excludes net capital transfers.
Source: Central Statistics Office

Private sector savings declined further by 9.4 per cent in 1996, after the decrease of 55.7 per cent in the previous year. Private sector investment, on the other hand, recorded significant increases during the three years to 1996, increasing from N$1.4 billion in 1994 to N$1.7 billion in 1996. Private sector capital formation rose by 4 per cent in 1996 compared with a significant increase of 19.4 per in the previous year.

The national resource balance improved remarkably to N$357 million in 1996 from about N$112 million in 1995, despite the decline in overall gross national saving in the last two years. This increased the country's usage of foreign savings again, after a decline in 1995.

2.5 Price Developments

1996 saw slower increases in the main price indices. After declining from 10.01 per cent in 1995, the average annual rate of inflation, as measured by changes in the Interim Consumer Price Index of Windhoek, declined markedly to a single digit level of 8.01 per cent in 1996.

This trend was reflected in the rates of increases of both *domestic tradeables* and *non-tradeables* which dropped to an average of 7.04 per cent and 9.76 per cent, from 10.81 per cent and 11.02 per cent in the previous year. *Imported goods* also recorded a lower average annual increase of 7.26 per cent in 1996, compared with an increase of 8.88 per cent in the previous year.

Lower annual inflation was to a large extent also attributable to slower increases of 6.70 per cent in *food prices* during the year, compared with 11.58 per cent in 1995. This was evidenced by the higher average annual inflation excluding food, which rose by 8.58 per cent against the 8.01 per cent increase in the overall consumer inflation. Prices of several non-food indices declined, with the exception of most consumer services which rose from the previous year's level (*Table 2.5*).

Higher increases in the prices of consumer services were largely due to hikes in fuel prices, which led to increases in taxi fares and charges for municipal services. Higher imported prices (mainly from South Africa) were expected,

Table 2.5 Windhoek Consumer Price Index
December 1992 = 100

Item	1995	% Change from 1994	1996	% Change from 1995
All items	**127.93**	**10.01**	**138.17**	**8.01**
Food	129.20	11.58	137.84	6.70
Beverages & Tobacco	137.26	14.32	153.17	11.59
Housing, Fuel & Power	134.06	12.87	143.44	7.00
Clothing & Footwear	127.57	8.69	132.82	4.12
Household Goods Etc.	111.31	6.06	118.44	6.41
Transport & Communication	118.63	5.56	129.28	8.98
Recreation & Education	141.82	8.20	159.98	12.80
Medical Health Care	138.56	8.89	149.22	7.69
Miscellaneous	141.74	12.72	159.39	12.45

Source: Central Statistics Office

considering the depreciation of the rand that characterized almost the entire 1996. However, actual price increases seemed to differ from these expectations.

Price changes in South Africa were reflected in Namibia, with the rate of inflation decelerating in the first half of the year but accelerating later to reach 9.40 per cent by December 1996 (*Chart 2.5*). The average annual consumer price inflation rate decelerated to 7.4 per cent from 8.7 per cent in 1995 and 9.0 per cent in 1994. The slower growth in nominal labour cost per unit of production was one of the major contributing factors to this downward trend.

Prompted by, among other factors, volatility of the rand and an increase in money supply, the Bank rate was raised in April to curb inflationary pressures. This restrained an excessive expansion of the monetary aggregates and higher level of aggregate demand, and could have placed downward pressure on the price level.

Inflation, as measured by changes in the GDP price deflator, to a large extent reflected the Windhoek Interim Consumer Price Index (*Chart 2.6*). This trend was, however, disrupted during 1996 as the two variables displayed a divergent course.

Chart 2.5 Annual Inflation Rates in Namibia and South Africa

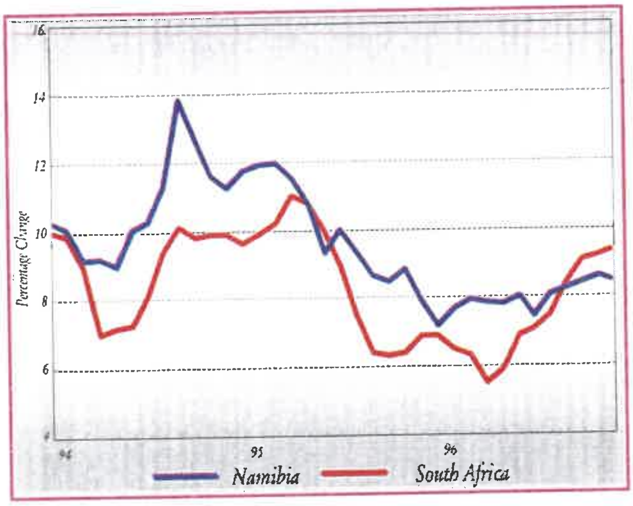
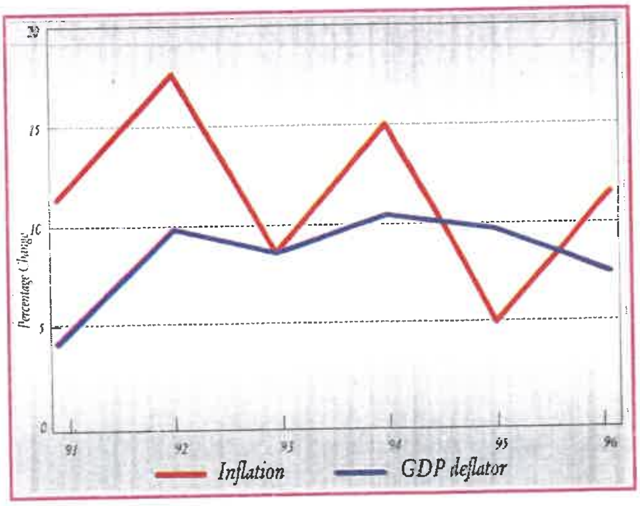


Chart 2.6 Inflation and Changes in GDP Price Deflator



3. MONETARY AND FINANCIAL DEVELOPMENTS

3.1 Money Supply

The Bank of Namibia (BON) uses two main monetary aggregates, M1 and M2, to track monetary developments. The measure for narrow money, M1, comprises currency in circulation and demand deposits. Broad money supply, M2, extends M1 by quasi-money, which consists of savings and time deposits with banking institutions.

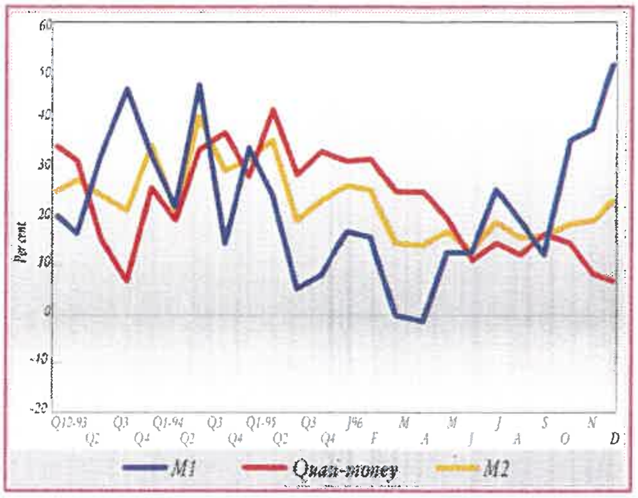
The growth in both monetary aggregates slowed during the first three quarters of 1996, before rising considerably in the last quarter. After reaching a high average growth rate of 22.2 per cent in the first quarter, the broadly defined measure of money supply (M2) slowed to 15.3 per cent in the second quarter, but started to accelerate again towards the end of the third quarter. Annually, the average growth rate declined significantly from 28.1 per cent in 1995 to 18.8 per cent in 1996. The decrease reflects the restrictive monetary policy as well as the downturn in general economic activity.

Quasi-money recorded an average increase of 17.8 per cent in 1996, compared with 33.0 per cent in 1995. With an average growth rate of 20.2 per cent, M1 was the major driving force behind the increase in broad money supply during 1996.

The monetary base, consisting of bankers' reserves plus currency in circulation, increased significantly by 22.5 per cent in 1996, compared with an increase of 10.8 per cent in 1995. This growth reflects both the increase in currency in circulation and bankers' reserves at the BON. These components increased by N$43 million to N$283 million and N$49 million to N$214 million.

Chart 3.1 Monetary Aggregates

Twelve-Month % Changes



Developments in M1 corresponded with those of M2 *(Chart 3.1)*. The twelve-month growth rate of M1 declined significantly to 12.9 per cent in June from 17.1 per cent in January 1996. However, the growth rate in M1 rose significantly in the fourth quarter to reach 53.6 per cent in December. The rise was due mainly to the high liquidity preference of the private sector, as reflected in the rise in its demand deposits.

The main impetus to monetary expansion in the first half of 1996 came from credit to the private sector, which accounted, on average, for over 100 per cent of the growth *(Table 3.1)*. The situation changed in the second half of the year. At the end of the year, claims on the private sector contributed a mere 58.4 per cent to the growth in money supply. Net foreign assets, which had been contractionary over the previous years, turned expansionary in the last quarter of 1996, contributing 33.3 per cent to supply at the end of December. Of greater importance, however, was the impact of the budgetary operations of the central government on the expansion of money supply. The operations contributed 40.7 per cent to the growth in money supply in December 1996, an increase from 9.4 and 5.3 per cent in December 1995 and June 1996, respectively.

Total deposits with *commercial banks* increased by 28.1 per cent or N$1.3 billion over the twelve-month period to December 1996, slightly higher than the increase of 27.1 per cent in the previous year. Of significant importance was the increase in short-term deposits. Demand deposits rose by 59.5 per cent or N$976 million over the year, with the increases becoming larger in the second half of the year. Over the same period, time deposits increased by N$231 million, although the increases were recorded mainly in short and medium-term deposits. There was a decline in deposits of longer term maturity throughout 1996. After increasing by N$211 million in 1995, deposits with a maturity of longer than one year declined by N$72 million, year-on-year. The shift in deposit composition towards shorter term maturity could be ascribed to the increase in short term interest rates during the year, and the liquidity preference of the investors.

Analysis of deposits by holder reveals that the major increase in total deposits came from the non-financial private sector. Non-financial private sector deposits made up 73.4 per cent of total deposits at the end of December, slightly higher than the 70.4 per cent share in December 1995. Deposits from individuals increased by 30.9 per cent to N$2.6 billion in December 1996, while those of businesses rose by 37.8 per cent to N$1.8 billion. Deposits from the financial sector, comprising other banking institutions and non-bank financial institutions, increased by only N$19 million in 1996, after they had increased by N$417 million in 1995. The large increase in 1995 was a result of compliance with new government regulations on locally registered pension funds and insurance companies, stipulating that at least 35 per cent of their assets be invested in Namibia.

Table 3.1 Determinants of Broad Money Supply
N$ million

	Annual Changes		As at end	
	1994	1995	1995	1996
Net foreign assets	-75.7	-127.6	-335.6	99.6
Domestic Credit	1 116.2	1 443.1	7 049.2	8 345.1
To government	51.0	73.7	672.7	1 210.3
To private sectors	1 054.6	1 346.4	6 272.1	7 034.2
To statutory sector	10.6	22.9	104.4	100.6
Other items, net	45.0	296.8	1 341.7	1 768.7
Money supply	995.5	1 018.7	5 371.9	6 676.0

3.2 Liquid Assets and Reserve Requirements

The liquid asset ratio, which stands at 20 per cent of short-term liabilities, 15 per cent of medium-term liabilities, and 5 per cent of long-term liabilities, has not been changed since the 1965 Banking Act was enacted. The proposed Banking Act provides flexibility in determining the country's liquidity requirements by empowering the BON to alter the ratios as it sees fit. This will mean that liquidity requirements could be altered in line with prevailing economic conditions and in response to the needs of the banking sector. This will also allow for some flexibility in liquidity management in the domestic money market.

The reserve requirement has not been changed since 1986 and currently stands at 5 per cent of short-term liabilities and 2 per cent of medium-term liabilities. The proposed amendments to the Bank of Namibia Act will enable the BON to change the required ratio, to influence the level of liquidity in the banking system, and consequently the availability of loanable funds.

3.3 Monetary Policy

Namibia's monetary policy objective has been to support the fixed exchange rate between the Namibia dollar and the South African rand. This policy has been effective in attaining the ultimate monetary policy objective of price stability, as reflected in a single digit inflation recorded in Namibia over the year. Low inflation achieved in Namibia is a reflection of the restrictive monetary policy pursued by the SARB to achieve price stability, which is transmitted to Namibia via the fixed exchange rate.

In accordance with its mission to protect the value of the rand, the SARB continued its tight monetary policy in 1996. The South African Bank rate was raised twice during the year, from 15 per cent to 16 per cent in April and further to 17 per cent in November. This increase in the Bank rate was mainly in response to the depreciation of the rand and the money supply growth which continued to be higher than the targeted upper limit of 10 per cent. This high growth in money supply was mainly due to strong growth in private sector credit.

In the past, the BON followed the SARB's monetary policy, especially with respect to interest rates. In 1996 the BON diverged from this practice for the first time when, on two occasions, it did not adopt changes implemented by the SARB. This was basically due to the need to rectify some misalignment of interest rates between the two countries.

Namibia's membership of the Common Monetary Area (CMA), which has on the whole proved beneficial to the country, necessitates a monetary policy stance that supports the fixed exchange rate between the Namibia dollar and the South African rand. This relationship between the two countries has helped Namibia to achieve inflation rates that are low by regional standards, contributing to the Government's long-term objective of growth in a stable macroeconomic environment.

While the basic objective of monetary policy in Namibia has been to support the fixed exchange rate arrangement, there is nevertheless some room for the use of certain monetary policy instruments to achieve greater macroeconomic stability. While inflation is low by regional standards, it is still high at close to 10 per cent. Monetary aggregates have risen too rapidly in the past, although there was some moderation in 1996. There is need to keep monetary expansion under control. The adoption of monetary policy measures for this purpose, within the basic constraints imposed by the exchange rate arrangement, is being examined by the monetary authorities.

Although the BON did not follow the bank rate increase by the SARB in April and maintained its Bank rate at 17.50 per cent, commercial banks in Namibia followed the example of their counterparts in South Africa and increased their prime lending rate to 20 per cent. After SARB's second bank rate increase of one percentage point in November, the BON increased its Bank rate by only 0.25 percentage points to 17.75 per cent. Currently, the prime lending rate in South Africa is at 20.25 per cent, while the average in Namibia stands at 20.70 per cent.

3.4 Credit Extension

In line with the restrictive monetary policy, total domestic credit declined in 1996. The downward trend, that started in the third quarter of 1995, continued until the third quarter of 1996, while there was a rise in the fourth quarter. The twelve-month growth rate in total domestic credit extended by the banking sector, which had decelerated from 25.7 per cent in December 1995 to 16.5 per cent in September 1996, thus rose to 18.4 per cent in December.

The growth rate in credit extension to the domestic sector over the 12-months to December 1996 declined to 12 per cent from 27.4 per cent in December 1995 *(Chart 3.2)*. The average twelve month growth rate for the year was 19.1 per cent. This average was substantially lower than the average growth rate of 28.2 per cent in 1995. The weak growth in credit was reflected mainly in a deceleration in the growth of loans and advances, including mortgage loans of both commercial banks and other banking institutions.

The slow growth in total domestic credit in 1996, especially in credit extended to the private sector, was in line with a drop in economic activity, particularly in fishing and agriculture. As a share of total assets of the banking system, total credit extended to the private sector declined to 83.1 per cent in December 1996 from 93.4 per cent in 1995.

Year-on-year, net claims on the Central Government by banking institutions increased by 79.9 per cent to N$1.2 billion in December. This was the combined result of an increase of N$413 million in gross claims and a decline of N$124 million in government deposits with banking institutions. Treasury bills, the major form of claims on government by the banking institutions, increased from N$207 million in December 1995 to N$518 million in December 1996.

The twelve-month growth rate in credit extended by *commercial banks* to the private sector declined substantially during the year

Chart 3.2 Domestic Credit and Private Sector Credit
Twelve-Month % Changes

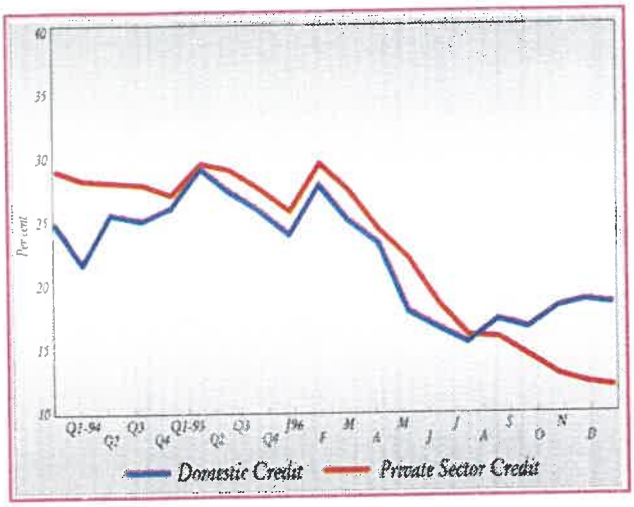
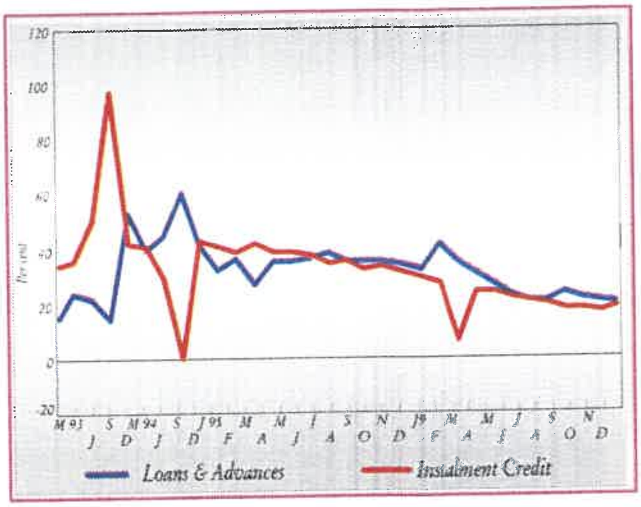


Chart 3.3 Claims on the Private Sector by Type
Twelve-Month % Changes



under review, from an average of 33.3 per cent in 1995 to an average of 25.2 per cent in 1996. The decline was more pronounced in the second half of the year with an average growth rate of 20.1 per cent compared with 30.3 per cent in the first half. At the end of the year, outstanding claims on this sector amounted to N$5.7 billion, an annual increase of 19.4 per cent. There was a steep deceleration in the growth rates of the two major categories of claims on the private sector, namely loans and advances (including mortgage loans) and instalment credit *(Chart 3.3)*. Total loans and advances accounted for 75.1 per cent of total claims on the private sector in December, while instalment sales made up 21.7 per cent.

Commercial banks' claims on the Central Government rose substantially in 1996, reflecting the amount of Treasury Bills and Internal Registered Stock (IRS) holdings which increased by 87 per cent to N$378 million and 54 per cent to N$78 million year-on-year.

The bulk of credit granted to the private sector during the year continued to be directed towards consumption rather than to productive sectors. Overdrafts and other loans and advances made up 48 per cent of total claims on the private sector in December 1996. The increase in funds channelled toward the purchase of property slowed down in 1996 owing largely to an increase in interest rates. This development resulted in the poor performance of the property market.

Credit extended to *individuals* increased by 22.9 per cent to N$3.4 billion in the year to December, compared with an increase of 23.1 per cent in the previous year *(Table 3.2)*. Mortgage loans to individuals grew by 34.4 per cent during the year, down from an increase of about 41.2 per cent in 1995. Instalment credit increased by 19.8 per cent in 1996 compared with an increase of 32.0 per cent during the previous year. The share of credit extended to individuals in total private sector credit remained at 60 per cent, as in 1995.

The twelve-month growth rate in credit to *businesses* decelerated even more than that to individuals. Credit extension to businesses increased by only 14.5 per cent to December 1996, while there was an increase of 53 per cent in 1995. Other loans and advances, mainly in the form of overdrafts, made up 75.1 per cent of total loans to businesses. Leasing increased by N$23 million to N$41 million during the year, while instalment credit increased by N$43 million to N$338 million.

Despite the drop in economic activity in 1996, year-on-year changes indicate an increase in credit extension to all sectors of the economy by commercial banks *(Table 3.3)*. As in the previous year, 43 per cent of loans outstanding was owed by individuals, and 27.6 per cent by the commercial and services sector. The share of credit extended to the agriculture and forestry sector declined from 5.3 per cent in 1995 to 4.9 per cent in 1996, while the share to manufacturing fell from 5.3 to 4.8 per cent.

Claims on the private sector by *other banking institutions*, which rose sharply between 1992 and mid-1995, grew very slowly in 1996. Twelve-month growth rates declined from a peak of 17 per cent in July 1995 to around 4 per cent in

Table 3.2 Commercial Banks' Claims on the Private Sector by Type of Credit
N$ million

	1994	% changes	1995	% changes	1996	% changes
1. Individuals	**2 254.3**	**14.5**	**2 775.7**	**23.1**	**3 411.1**	**22.9**
a) Loans and Advances	1 661.1	37.8	1 998.0	20.3	2 495.5	24.9
i) Mortgage loans	787.3	50.9	1 111.7	41.2	1 493.8	34.4
ii) Other loans and advances	874.8	27.8	886.3	1.4	1 001.7	13.0
b) Instalment credit	564.6	-13.8	742.5	31.7	889.8	19.8
c) Leasing transactions	28.0	-39.0	19.7	-29.8	21.0	6.6
d) Bills discounted or purchased	0.0	0.0	0.0	0.0	0.0	0.0
Other claims	1.5	-97.7	15.5	929.9	4.8	-69.0
2. Businesses	**1 288.3**	**74.9**	**1 967.1**	**52.7**	**2 252.0**	**14.5**
a) Loans and Advances	973.4	121.9	1 551.4	59.4	1 757.8	13.3
i) Mortgage loans	18.2	43.1	34.6	90.3	65.7	89.9
ii) Other loans and advances	955.2	124.2	1 516.8	58.8	1 692.1	11.6
b) Instalment credit	226.9	60.4	295.2	30.1	337.7	14.4
c) Leasing transactions	25.3	5.6	30.5	20.6	53.2	74.4
d) Bills discounted or purchased	35.0	-62.0	85.6	144.3	97.8	14.3
e) Other claims	27.7	-31.1	4.4	-84.1	5.5	25.0
3. (1+2) Total claims on private sector	**3 542.6**	**30.9**	**4 742.8**	**33.9**	**5 663.1**	**19.4**
a) Loans and Advances	2 634.5	60.3	3 549.4	34.7	4 253.3	19.8
i) Mortgage loans	805.5	50.7	1 146.3	42.3	1 559.5	36.0
ii) Other loans and advances	1 829.0	64.8	2 403.1	31.4	2 693.8	12.1
b) Instalment credit	790.6	-0.4	1 037.7	31.3	1 227.5	18.3
c) Leasing transactions	53.3	-23.7	50.2	-5.9	74.2	47.8
d) Bills discounted or purchased	35.0	-62.0	85.6	144.3	97.8	14.3
e) Other claims	29.2	-72.3	19.9	-31.8	10.3	-48.2

Table 3.3 Direction of Credit by Commercial Banks

N$ million

Industry	1995	% of total	1996	% of total
Agriculture and forestry	250.5	5.3	279.9	4.9
Fishing	266.8	5.6	275.3	4.9
Mining and quarrying	13.9	0.3	40.4	0.7
Manufacturing	253.0	5.3	273.3	4.8
Building and construction	674.0	14.2	798.0	14.1
Commercial and services	1 325.5	27.9	1 560.8	27.6
Individuals and other	1 959.1	41.3	2 435.4	43.0
Total	**4 742.8**		**5 663.2**	

August 1996. This was primarily a result of the tight monetary policy in place since the beginning of 1995. Mortgage rates were increased during the period on more than four occasions. Currently, the mortgage rate stands at 20.25 per cent. The increased interest rates left many house-owners, especially those in the lower income group, with increasing difficulties in repayment. This, in turn, resulted in a number of repossessions.

3.5 Commercial Banks' Sources and Uses Of Funds

In 1996, the large part of commercial banks' resources, which amounted to N$6.8 billion, was generated from deposits *(Table 3.4)*. As in the previous year, the private sector - individuals and businesses - contributed the bulk of the increase in deposits, accounting for 63.8 per cent of total liabilities at the end of 1996. The other major sources of funds comprised deposits from the government sector and own capital and reserves.

Deposits from the financial sector, which increased significantly in 1995, rose by only N$19 million in 1996 and accounted for 8.4 per cent of total available funds. Of significant importance is the decline in the reliance of Namibian banks on foreign borrowing.

Table 3.4 Commercial Banks' Sources and Uses of Funds

N$ million

	Annual Changes		Dec 1996
	1995	1996	
Sources			
Domestic	1 137.0	1 120.6	6 208.9
Capital and Reserves	138.8	211.5	644.0
Government deposits	268.0	-203.4	649.8
Deposits	313.1	1 093.4	4 345.8
Business	70.8	487.6	1 777.0
Individuals	242.3	605.8	2 568.8
Financial sector	417.5	19.1	569.3
Foreign sector	109.1	-152.8	347.8
Other	-51.9	359.3	251.3
Total	**1 194.4**	**1 327.2**	**6 808.1**
Uses			
Reserves	19.2	51.0	226.4
Government sector	49.3	204.3	551.7
Private sector	1 200.2	920.3	5 663.1
Business	678.7	284.9	2 252.0
Individuals	521.5	635.4	3 411.1
Financial sector	-20.5	-57.5	17.1
Foreign sector	-53.7	209.1	349.8

Out of the total resources mobilized during 1996, 69 per cent (N$920 million) were channelled to the private sector, with individuals taking up the larger part of N$635 million. The increase in claims on the government sector was N$204 million (15.4 per cent), while N$209 million was used to acquire foreign assets.

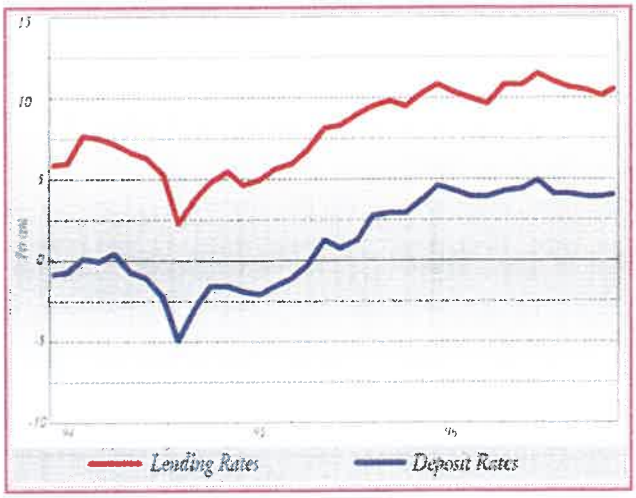
3.6 Interest Rates and Yields

Due to the close integration of the Namibian and South African financial markets, local interest rates are affected by developments in South Africa. Money market rates thus rose sharply in April and May in the wake of the first South African bank rate hike of 1996. They recorded another steep rise in December, registering only minor fluctuations during the other months.

The Namibian Bank rate was kept constant at 17.50 per cent in April 1996 but was adjusted to 17.75 per cent in November, in line with the change in the South African bank rate. Reacting to changes in the South African bank and prime rates, Namibian prime rates had risen to an average of 20.70 per cent at the end of 1996 from 19.00 per cent in December 1995.

The rise in Bank and prime rates had a strong effect on average lending and deposit rates. The weighted average lending rate rose from a nominal 1995 average of 18.5 per cent to 19.4 per cent in 1996 (*Chart 3.4*). Lower inflation rates during 1996 enhanced this rise, raising real lending rates from the 1995 average of 7.7 per cent to a 1996 average of 10.6 per cent. Deposit rates showed the same trend, rising from an average of 10.8 per cent in 1995 to 12.6 per cent in 1996, in nominal terms, and from 0.7 per cent to 4.2 per cent in real terms. As a result of the faster rise in deposit rates, the spread between lending and deposit rates was reduced from a nominal average of 7.7 percentage points in 1995 to 6.9 percentage points in 1996, and from a real average of 7.0 to 6.4 percentage points.

Chart 3.4 Real Interest Rates



Deposit rates on money market instruments also rose sharply in 1996. Average rates on negotiable certificates of deposit (NCDs) increased from 14.1 per cent in December 1995 to 16.7 per cent in December 1996 for the 3-month maturity, and from 14.9 to 16.4 per cent for the 12-month maturity.

In addition to fluctuations in the interest rates, there were also major changes in the term structure during the year. Interest rates showed an inverse term structure for the major part of the year. This was due to the fact that a reduction of key rates remained conceivable in the medium term. The inversed term structure was particularly visible in rates on NCDs and wholesale fixed deposits. The first inversion occurred in February when longer-term rates fell to levels below short-term rates. Even when the South African bank rate was raised in April, making it clear that a reduction in key interest rates was unlikely in the short run, interest rates kept the inverse term structure while increasing to higher levels across the maturity spectrum.

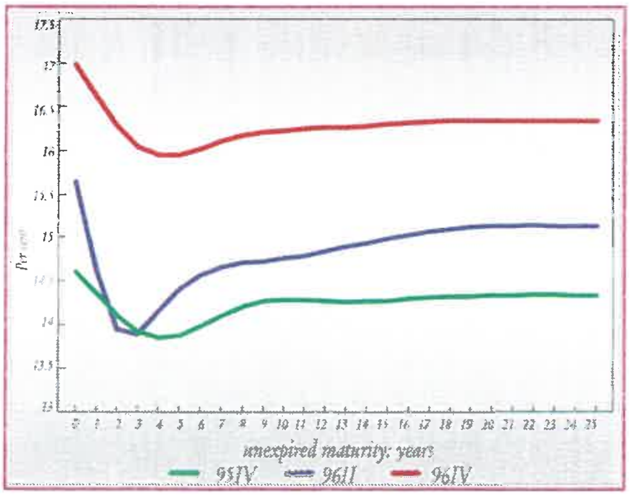
In the second half of the year, another interest rate hike became imminent due to increasing money market shortages and renewed pressure on the rand and on prices. NCD rates briefly returned to a normal term structure at the time. However, when it became clear that the interest rate hike had not substantially eased the money market shortage, or taken the pressure off the rand or off prices, short-term NCD rates recorded another strong rise and the term structure was inversed again.

The upward shift in interest rates, with various degrees of inversion in the short to medium-term, is clearly distinguishable in the Actuaries Yield Curve of the Johannesburg Stock Exchange (JSE) (*Chart 3.5*). Although such a yield curve is currently not available for Namibian debt securities, the rising trend can be observed in yields of domestic IRS at the time of issue. From 14.8 per cent during the December 1995 issue of a 5-year stock, the average yield to maturity rose to 16.9 per cent in May 1996 on 3-year stock and stood at 16.8 per cent in November. Weighted average tender rates for the monthly issues of 91-day treasury bills also rose from 14.1 per cent in December 1995 to 16.5 per cent in December 1996.

The yield gap, defined as the difference between the yield on long-term gilt-edged stock and the dividend yield of companies' shares, increased during the year. It rose from just under 12 percentage points in January to nearly 14 percentage points in December, despite the tendency of the two types of yield to move in a similar manner (*Chart 3.6*).

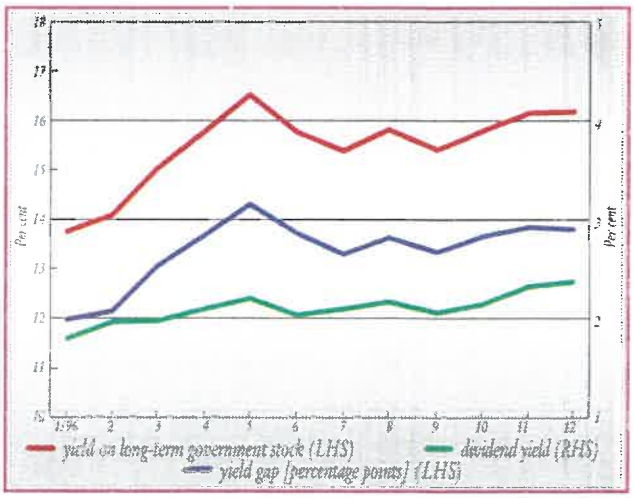
Dividend yield as the ratio of 12-month dividends to current share prices can be misleading. The ratio would increase when dividend payments rise or when share prices fall, or both. On the other hand, a combination of rising company profits and

Chart 3.5 JSE Actuaries Yield Curve



Source: Johannesburg Stock Exchange

Chart 3.6 Yield Gap



dividend payments together with rising share prices may cause the ratio to fall, if rising share prices prove to be the stronger of the two factors. However, this would actually be a welcome development for an investor. The upward trend in the yield gap in 1996 could therefore be interpreted as an indication that capital gains in an environment of rising interest rates would have to increase relative to the previous year in order to compensate for lower income from shares.

3.7 The Namibian Stock Exchange

Since its establishment in October 1992, the NSE has grown from 6 listings in December 1992, with a combined market capitalization of N$15.1 billion, to 27 listings worth N$76.0 billion at the end of 1996. Turnover reflects the same impressive development, rising from N$1 million in 1993 to N$660 million in 1996.

Recent year-end figures for the NSE reveal a shift within the sectoral composition of market capitalization and turnover (*Chart 3.7*). At the end of 1995, *overall market capitalization* of N$69.6 billion comprised financials with a share of 80.4 per cent, industrials with 18.5 per cent, retail with 0.5 per cent and mining and fishing with 0.3 per cent each. In 1996, three listings in the industrial sector caused a reduction in the weight of financial shares, so that financials made up 68.5 per cent, industrials 29.3 per cent, mining 1.3 per cent, retail 0.8 per cent and fishing 0.1 per cent of overall market capitalization of N$76.0 billion. *Overall turnover*, which rose from N$240 million in 1995 to N$660 million in 1996, reflected the same shift. The share of financials fell from 80 to 54 per cent, while that of industrials increased from 16 to 36 per cent.

Two of the five listings in 1996 were part of the local market segment, so that composition of local market capitalization and turnover also recorded substantial changes (*Chart 3.8*). However, the rise in industrials' share affected only the share of the fishing and retail sectors because the local market segment does not comprise financial companies. In December 1995, *local market capitalization* of N$689 million was made up of fishing with 31.4 per cent, mining with 28.3 per cent, retail with 27.8 per cent and industrials with the

Chart 3.7 NSE Overall Market Capitalization by Sector

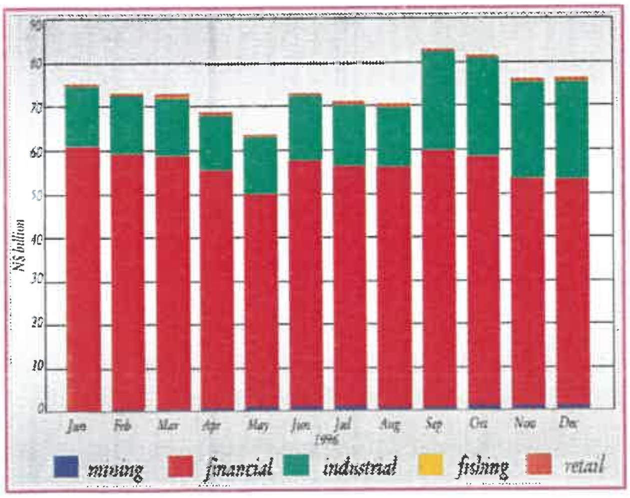
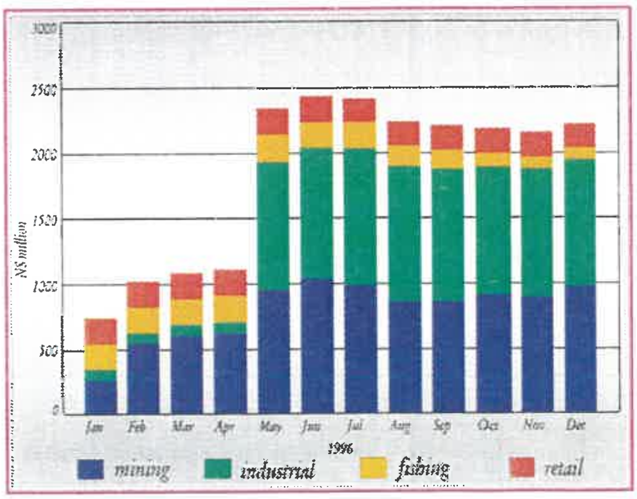


Chart 3.8 NSE Local Market Capitalization by Sector



smallest share of 12.4 per cent. Industrials' share was pushed up to first place by the new listings while mining's weight rose with increasing share prices. At the end of 1996, local market capitalisation of N$2.2 billion was composed of industrials with 43.9 per cent, mining with 43.8 per cent, retail with 8.4 per cent, and fishing with 4.0 per cent. Similar changes were recorded for *local turnover*, particularly with regard to the industrial and retail sectors. Of the local turnover of N$11 million in 1995, only 8 per cent was in industrial shares and 55 per cent in retail. In 1996, industrials made up 63 per cent and retail only 7 per cent of the local turnover of N$176 million.

Comparing local market capitalization and turnover with the corresponding figures for the overall stock market, one can clearly establish the boost that the Namibian stock market enjoys through dual listings. The opposite effect occurs in terms of liquidity, defined as the ratio of turnover to market capitalization, because a dual listing increases turnover far less than it raises market capitalization. It could, therefore, be argued that the grouping of local companies might be a more accurate representation of the Namibian equity market in terms of its development and potential. However, using the local market segment as a reflection of the Namibian economy and its underlying fundamentals and market sentiment could be misleading. Whereas market capitalization, turnover and liquidity figures may be a good approximation, the local index in contrast is a rather warped indicator of market sentiments about share prices. This is a result of fewer companies being listed in the local market segment, with a single company accordingly having a bigger weight. Developments in the share price of a highly capitalised company would therefore move the local index to a larger extent than it would influence the overall index.

Options, which entail the right to buy shares of the issuing company at a predetermined price, traded for the first time on the NSE in December. The options had already been listed on the NSE since December 1995. Previously listed letters of allocation did not record any trading on the NSE. More companies have issued options, but these are not listed on the NSE as they are traded internally through schemes for directors and employees of the respective companies. The increasing number of ordinary shares listed on the NSE can partly be attributed to the conversion of options into shares by the beneficiaries of these incentive schemes.

3.8 Sources of Finance

Sources of funds for investment in productive capital include reserves generated internally in the form of retained earnings, capital raised from shareholders, and loans from external creditors.

An overview of sources of financing of companies listed on the NSE reveals that equity financing, short-term loans and issues of debentures and bonds are the most popular sources of funding. Moreover, the share of equity financing increased substantially over the past year, while that of bank overdrafts and long-term loans was reduced drastically. This indicates that corporate management is becoming more conscious of the benefits of equity financing, as against debt financing, when interest rates are rising.

A growing awareness by companies of alternative financing sources could have important implications for the Namibian financial markets. The wider range of financing alternatives could facilitate a shift of resources from less productive to more productive uses, thus increasing allocation efficiency in the financial markets. Borrowing costs could be reduced as competition in the financial sector is intensified with the emergence of financial innovations. Additional listings of local equities and debt securities on the NSE could also attract more local and foreign investors as market capitalization and liquidity increase. This should encourage local institutional investors to invest more domestic funds in Namibia as productive investment opportunities become available, making local asset requirements for institutional investors more effective than at present. Ultimately, these effects should spill over into the real sector as companies are able and forced to operate on a more cost-efficient basis.

3.9 Unit Trusts

Total funds absorbed by unit trusts at the end of 1996 amounted to N$86 million, having grown by 65 per cent since the fourth quarter of 1995. This growth was composed of a 78 per cent increase in the assets of growth funds to N$70 million and a 25 per cent rise in the assets managed by income funds to N$16 million.

Unit trusts are a relatively new form of saving in Namibia, but have enjoyed growing popularity due to the promise of higher returns. A comparison between the yield on unit trusts and on conventional savings accounts shows the distinct advantage of the former, but also demonstrates the different returns from growth and income funds. Calculated over one year, for 1996, without taking the initial administration fee into account, growth funds yielded about 10 per cent per annum more than savings accounts, whereas the return from income funds was only 6 per cent higher. However, the margins are reduced when unit trusts are compared with fixed deposits. The advantage was a mere 1 per cent per annum in the case of growth funds, while income funds yielded about 3 per cent less than fixed deposits.

The yield on unit trusts is based on distributed income plus the change in unit prices over the investment period. Much like a direct investment in equity, investment in unit trusts will only deliver its full potential in the medium term. A comparison would therefore have to take into account factors like risk and the flexibility of the investment. Much of the investment decision will ultimately depend on risk and time preference of every individual.

4. PUBLIC FINANCE

4.1 Government Budget 1996/97

Fiscal policy is Namibia's key instrument for the successful implementation of the development objectives as outlined in the NDP1. The Namibian government has consistently sought to use fiscal policy to ensure that its development plan is sustainable and will promote economic growth with a high degree of stability, and thus contribute to employment creation and poverty alleviation. Stimulating business development by promoting small and medium-sized enterprises is another objective. During the 1996/97 budget, the then Minister of Finance strongly emphasised the need for fiscal discipline, through effective expenditure management. The Minister also introduced measures aimed at reducing recurrent expenditure. These include downsizing the civil service through rationalisation and early retirement, as recommended by the Wage and Salary Commission (Wascom). Furthermore a number of revenue enhancing measures were announced. They include the renegotiation of the SACU revenue sharing formula, the possibility of introducing Value Added Tax (VAT), improvement in the tax administration, and the computerisation of the Inland Revenue Department.

4.1.1 Revenue

The revised budget estimates for 1996/97 provided for total revenue, including grants, of N$4.8 billion (*Table 4.1*), representing a remarkable increase of 17 per cent compared with the increase of 11 per cent in 1995/96. The increased growth in

Table 4.1 Government Revenue

N$ million

	95/96	% of total	96/97*	% of total	97/98**	% of total
Total revenue and grants	**4 069.7**		**4 770.6**		**5 198.2**	
Tax revenue	3 548.2	87.2	4 206.1	88.2	4 542.3	87.4
Direct taxes	1 080.7	26.6	1 320.6	27.7	1 365.6	26.3
Personal taxes	625.0	15.4	750.0	15.7	790.0	15.2
Company taxes	427.0	10.5	510.0	10.7	510.0	9.8
Other taxes on income and profits	28.7	0.7	60.6	1.3	65.6	1.3
Indirect taxes	2 467.5	60.63	2 885.5	60.5	3 176.7	61.1
Domestic tax on goods and services	1 234.8	30.3	1 448.5	30.4	1 520.7	29.3
Tax on property	40.0	1.0	47.0	1.0	50.0	1.0
Tax on int. trade and transactions	1 156.7	28.4	1 348.0	28.3	1 564.0	30.1
Others	36.0	0.9	42.0	0.9	42.0	0.8
Non-tax revenue	469.5	11.5	485.6	10.2	532.2	10.2
Entrepreneurial and property income	220.2	5.4	282.9	5.9	308.7	5.9
Fines and forfeitures	6.0	0.1	7.5	0.2	10.0	0.2
Administrative fees and charges	243.3	6.0	195.2	4.1	213.5	4.1
Return on capital	9.6	0.2	11.0	0.2	59.7	1.1
Grants	42.4	1.0	67.9	1.4	64.0	1.2

Source: Ministry of Finance
* Revised figures ** Budget figures

revenue is a reflection of improved efficiency in tax administration, including the collection of taxes. Total revenue, including grants, for the past four years in relation to GDP has been, on average, 35 per cent.

Tax revenue, including direct and indirect taxes, registered a double digit growth rate for the fourth successive year, increasing by 19 per cent to N$4.2 billion in fiscal year 1996/97. At this level, tax revenue is equal to 31 per cent of nominal GDP and accounts for 88 per cent of total revenue, including grants, representing one percentage point more than in the preceding financial year.

Receipts from direct taxes grew by 22 per cent to N$1.3 billion in fiscal year 1996/97, compared with an increase of 6 per cent in the preceding financial year. In relation to GDP, direct taxes accounted for 10 per cent compared with 9 per cent in the previous fiscal year. The high growth in direct taxes was achieved despite a reduction in tax rates. Receipts from personal taxes, the largest component of direct taxes, increased by 20 per cent, compared with the increase of 11 per cent in 1995/96. Collections from corporate income tax increased by 19 per cent to N$510 million. They were the second largest contributor to direct taxes, a trend that has continued over the last six years.

Revenue from indirect taxes increased by 17 per cent to N$2.9 billion, compared with an increase of 18 per cent in the previous fiscal year. Indirect taxes remained at 60 per cent of total revenue, and accounted for 21 per cent of nominal GDP. The increase in receipts from indirect taxes stemmed from increases in revenue from domestic taxes on goods and services by 18 per cent. This reflected higher receipts from General Sales Tax and the fuel levy as well as motor vehicle licences and related fees. These increases were moderated by a slower growth in revenue from international trade and transactions of 16 per cent compared with 27 per cent in the previous year. However, this sub-category accounts for 28 per cent of total revenue and represents 10 per cent of the GDP.

After a decline of 8 per cent in the preceding fiscal year, total non-tax revenue increased by 3 per cent to N$486 million in fiscal year 1996/97. Entrepreneurial and property income increased by 29 per cent, while administration fees and charges declined by 20 per cent.

4.1.2 Expenditure

Total government expenditure rose strongly by 24 per cent to N$5.4 billion in fiscal year 1996/97, compared with 17 per cent in fiscal year 1995/96 (*Table 4.2*). Expenditure was about 40 per cent of GDP, compared with 38 per cent in the previous fiscal year.

Current expenditure continued to be a major part of total expenditure, accounting for 85 per cent in fiscal year 1996/97 *(Chart 4.1)*. The wage bill, the largest component of current expenditure (52 per cent), increased by 20 per cent to N$2.4 billion in fiscal year 1996/97. This was two percentage points higher than in the previous fiscal year. The increase was mainly to meet the cost of restructuring the civil service in line with Wascom's recommendation to downsize the public service.

Table 4.2. Government Expenditure

N$ million

	95/96	% of total	96/97*	% of total	97/98**	% of total
Total expenditure and net lending	**4 339.8**		**5 420.5**		**5 754.0**	
Current expenditure	3 659.8	84.3	4 614.8	85.1	4 755.4	82.6
Personnel expenditure	2 027.2	46.7	2 424.6	44.7	2 633.9	45.8
Goods and other services	984.6	22.7	1 322.4	24.4	1 186.3	20.6
Subsidies and current transfers	527.5	12.2	640.1	11.8	725.4	12.6
Domestic interest payments	103.8	2.4	207.4	3.8	204.3	3.6
Foreign interest payments	15.9	0.4	19.5	0.4	3.3	0.1
Other	0.8	0.0	0.8	0.0	2.2	0.0
Capital expenditure	645.8	14.9	805.7	14.9	846.8	14.7
Lending and equity participation	34.2	0.8	0	0.0	151.8	2.6

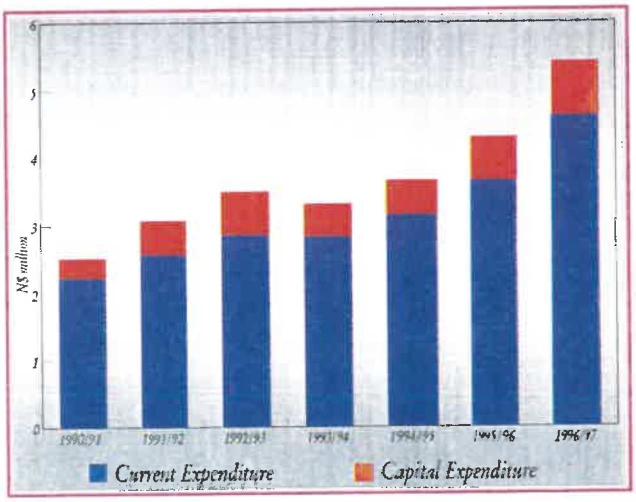
Source: Ministry of Finance
*Revised figures ** Budget figures

Expenditure on goods and other services amounted to N$1.3 billion in fiscal year 1996/97, representing an annual increase of 34 per cent, compared with an increase of 19 per cent for fiscal year 1995/96. This increase was due to higher government expenditure on materials and supplies as well as other government services. Subsidies and current transfers grew by 21 per cent to N$640 million in fiscal year 1996/97, compared with an increase of 11 per cent during the previous fiscal year, reflecting greater government subsidies to government organisations and non-profit organisations.

Total interest payments on domestic and external debt in fiscal year 1996/97 amounted to N$227 million, almost double the amount in the previous fiscal year. Interest payments accounted for 4 per cent of the total current expenditure, of which domestic interest payments were a dominant component and accounted for 83 per cent on average for the past three years. This reflects increased domestic borrowing to finance budget deficits and the higher interest rates prevailing in the country.

Capital expenditure for fiscal year 1996/97 was N$806 million, which in real terms amounted to N$596 million. Government development expenditure increased by 9 per cent in real terms over fiscal year 1995/96, more than the 6 per cent projected in the NDP1. The share of development expenditure in total capital expenditure was 87 per cent, compared with 82 per cent in fiscal year 1995/96.

Chart 4.1 Government Expenditure



Over the past four fiscal years, capital expenditure increased by a nominal average of 20 per cent per year *(Chart 4.2)*. In real terms, this was an average growth of 10 per cent, while in fiscal year 1994/95, the real growth rate was negative at 9 per cent, compared with a nominal rate of 1 per cent. The past fiscal year saw a capital expenditure increase in both nominal and real terms of 18 and 9 per cent, respectively.

Outlays on *community and social services* continued to absorb the largest share of total expenditure in fiscal year 1996/97, amounting to N$2.8 billion, or 47 per cent of total expenditure *(Table 4.3, Chart 4.3 & 4.4)*. Education received 51 per cent of this, reflecting the importance that the Government attaches to the sector. Growth in education spending is directed towards rural primary school construction which was neglected in the past. Health care received 21 per cent with the balance allocated to housing, social security and recreation.

Chart 4.2 Capital Expenditure

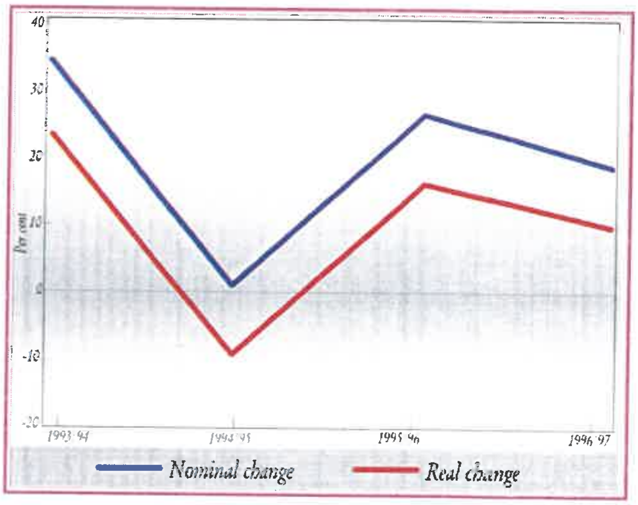


Table 4.3 Government Expenditure by Functional Classification
N$ million

	95/96	% of total	96/97*	% of total	97/98**	% of total
General government services	**1 254.1**	**28.9**	**1 894.1**	**32.3**	**1 636.6**	**28.4**
General public services	724.2		1162.4		849.6	
Defence	232.15		377.2		415.6	
Public order and safety	297.8		354.5		371.4	
Community and social services	**2 292.9**	**52.8**	**2 759.1**	**47.1**	**2 931.2**	**50.9**
Education	1 049.9		1431.7		1 523.6	
Health	480.6		570.7		611.6	
Social security and welfare	248.3		276.1		280.7	
Housing and community amenities	402.8		347.5		366.2	
Recreations and cultural affairs	111.3		133.1		149.1	
Economic services	**671.9**	**15.5**	**988.1**	**16.9**	**976.5**	**17.1**
Fuel and energy	21.3		16.8		33.9	
Agriculture, forestry, fishing, hunting	271.8		491.5		420.6	
Mining and mineral resources	18.0		35.5		30.5	
Transport and communications	270.8		319.4		409.1	
Other economic affairs	90.0		124.9		82.4	
Unclassified Expenditure	**121.0**	**2.8**	**215.8**	**3.7**	**209.6**	**3.6**
Total expenditure	**4 339.9**	**100**	**5 857.1**	**100**	**5 753.9**	**100**

Source: Ministry of Finance
*Revised figures **Budget figures

Chart 4.3 Functional Expenditure for 1995/96

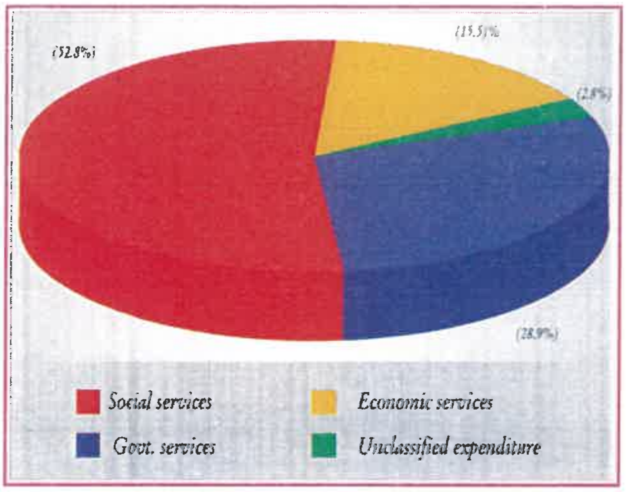
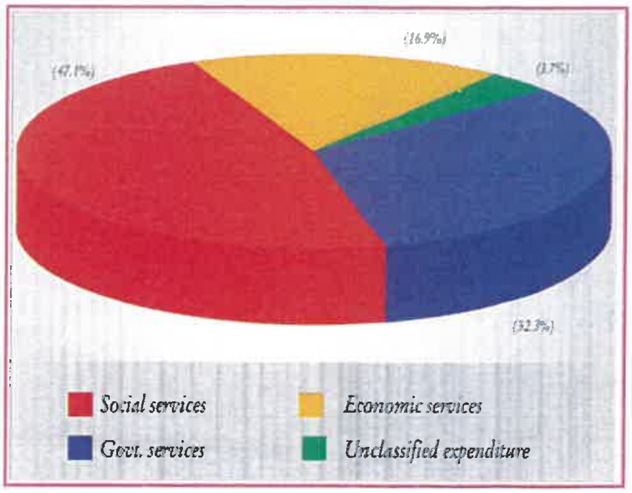


Chart 4.4 Functional Expenditure for 1996/97



After increasing by 17 per cent in fiscal year 1995/96, the budget allocations to housing and community amenities declined by 14 per cent to N$348 million in 1996/97.

Expenditure on *general government services* amounted to N$1.9 billion for fiscal year 1996/97, or 32 per cent of the total expenditure. This compared with 28 per cent in the previous fiscal year. Expenditure on general public services increased by 61 per cent, while that on defence and public order increased by 63 and 19 per cent, respectively.

The allocation to *economic services* amounted to N$988 million, accounting for 17 per cent of total expenditure in fiscal year 1996/97. This marked an increase of 22 per cent, compared with 25 per cent in the previous fiscal year.

Agriculture had the largest increase of 34 per cent. Agriculture is seen as a priority sector for employment creation and poverty alleviation in the rural areas, where most of the Namibian people live. Although expenditure on transport increased by 17 per cent, it is expected to decline towards the end of the NDP1 period due to the completion of Trans-Caprivi and Trans-Kalahari highways.

4.1.3 Financing

Revised budgetary transactions for fiscal year 1996/97 resulted in an overall budget deficit of N$649 million. As a ratio of GDP, the revised budget deficit was 4.8 per cent. The government used N$200 million in cash reserves to finance the budget deficit while the balance was financed by issuing Treasury Bills and medium term government securities.

4.2 Budget Speech 1997/98

The Budget statement for 1997/98 re-emphasized the Government's basic policy objective of attaining growth and equity within a stable macroeconomic framework. Highlighting unemployment, sluggish economic growth, and skewed income distribution as the major problems facing the economy, the budget seeks to achieve accelerated economic growth to bring about a meaningful improvement in the welfare of the Namibian people.

Amongst other factors, the Budget statement attributed the recent slowdown in the economy to a sluggish increase in fixed capital investment in recent years. It stressed the importance of fiscal prudence and the need to bring Government expenditures more closely in line with revenues, to ensure that the resulting deficits are consistent with the other macroeconomic policies and objectives of the Government.

The specific areas of importance addressed in the Budget include:

- stimulating and diversifying the economy;
- lessening the impact of recurring droughts;
- ensuring fiscal and budgetary discipline;
- reassessing the government's income distribution programmes;
- reviewing Namibia's financial system and institutions;
- reducing the share of personnel expenditure in the budget;
- the design of a prudent and transparent public borrowing policy; and
- reform of the tax system and its administration.

Total revenue in fiscal 1997/98 is expected to increase by nearly 15 per cent over the previous year's original budget. Total expenditure is expected to rise by over 13 percent. The planned reduction in expenditure growth is a desirable shift from the previous fiscal year. The budgeted increase in both total revenue and expenditure was the same, at 17 per cent, in fiscal 1996/97.

More importantly, the Budget restrained the increase in current expenditure to about 11 percent over the previous year's allocation, which is slightly higher than the current rate of inflation. This increase is significantly lower than the growth of 17 percent provided for in the previous fiscal year's budget. In its efforts to restrain current expenditure, the Government put the "second phase" of salary adjustments, which were to be implemented in April 1997, on hold. This is until measurable and commensurate progress in down-sizing the civil service has been made.

Capital and development expenditures, on the other hand, are expected to record an increase of 21 percent over the original budget provision for the previous fiscal year. Their share in total expenditure is to go up from 16.2 percent in 1996/97 to 17.4 percent in 1997/98. This shift in Government expenditure should address concern about the sluggishness in fixed capital formation and contribute to economic growth. It is important to note that the budgeted-for overall deficit remains unchanged in nominal terms. In fact, it declines from 4.1 percent of projected nominal GDP for 1996/97 to 3.7 percent.

The Budget for 1997/98, as presented, clearly has a greater development orientation, although constrained by limited financial resources and the difficulties of rolling back current expenditures in the shorter term. For the longer term, however, the Minister has announced measures such as commercialisation, outsourcing, and eventual privatisation of Government enterprises to "down-size or right-size" the civil service. Privatisation, however, tends to be generally slow in developing economies due, for example, to a lack of domestic entrepreneurship and capital and unwillingness on the part of Governments to permit foreign ownership in the economy. A dedicated pursuit of privatisation, however, would be highly conducive to more rapid economic growth.

It is necessary to examine whether the budget targets could actually be achieved over the fiscal year. Past experience has shown significant divergences between the original budget and the actual outturn. A comparison of the original estimates and the currently available revised estimates for 1996/97 is quite revealing. On the revenue side, the Government did better than the original estimate, the revised figure exceeding the original by nearly N$250 million, or 5.5 percent. Revised total expenditure, on the other hand, overshot the original estimate by almost N$350 million. The increase in revenue thus could not cover the increase in expenditure, resulting in the revised overall deficit going up by N$100 million over the original estimate. This brings it to 4.8 percent of GDP as against the original forecast of 4.1 percent.

A more adverse outcome was the increase in current expenditure as revised, which rose by nearly N$350 million, or 8.6 percent, over the original estimate. There was also under-expenditure on the capital account, though the decline from the original provision was somewhat marginal, of nearly N$20 million.

Should over-expenditure on the current account and under-expenditure on the capital account occur again in 1997/98, the Minister's objective of increasing capital formation in the economy may not be realized. Moreover, the resultant budget deficit, at least to the extent it is financed by drawing down Government's cash balances, will add to domestic pressures on the price level as well as on the balance of payments, and could contribute to macroeconomic instability in the economy. It is thus vital that Government lives within the Budget.

In respect of revenue collection, the Minister announced a project aimed at modernising tax administration to strengthen collections and enhance tax compliance. It is hoped the project will be implemented effectively. The need to mobilize domestic resources to finance the Government's development projects was deemed equally important.

The Budget for 1997/98, as presented, has a stronger development orientation. It is hoped that the various Ministries and Departments will exercise the utmost financial discipline to ensure that the final outcome of the Budget does not diverge significantly from the original estimates, especially on current expenditure.

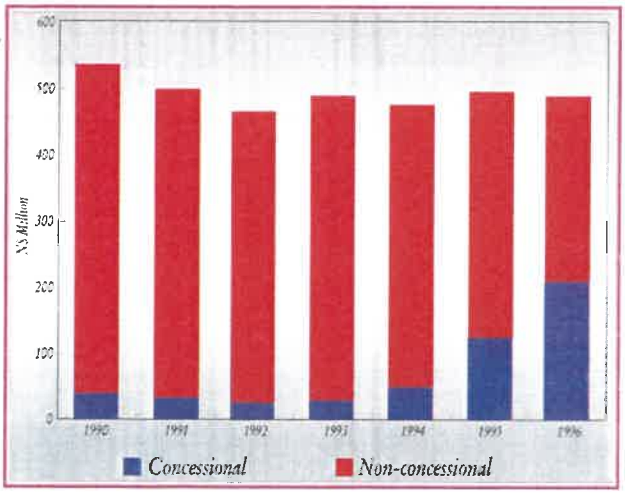
4.3 Debt

At the end of 1996, total outstanding public debt stood at N$3.2 billion, representing a 26.7 per cent growth, compared with 26.1 per cent in the previous year. As a percentage of GDP, total public debt increased from 21.0 per cent in 1995 to 23.3 per cent in 1996. The share of public external debt in total public debt continued to decline. It decreased from 19.4 per cent in 1995 to 15.0 per cent in 1996. In 1990 it stood at 94.9 per cent. This clearly illustrates the Government's determination to increasingly meet its financing requirements on the domestic market.

Total public external debt was N$487.8 million at the end of 1996, in comparison with N$496.6 million in the previous year (*Table 4.4, Chart 4.5*). This represented an annual decrease of 1.8 per cent against the 4.5 per cent rise in 1995. At the end of 1996, concessional debt accounted for 43 per cent of total public external debt, compared with 25 per cent in the previous year.

Debt contracted on bilateral terms decreased by 3.7 per cent compared with the 5.4 per cent decrease in the previous year. Bilateral loans are contracted on concessional terms and accounted for about 27 per cent of total public external debt. Multilateral debt accounted for 18 per cent of total public external debt in 1996. It increased by 48 per cent in 1996 compared with the 168 per cent rise the previous year. About 88 per cent of the total multilateral debt is contracted on concessional terms. The growth of public concessional debt continued to accelerate, rising from 25 per cent in 1995 to 43 per cent in 1996.

Chart 4.5 Public External Debt Outstanding



Namibia's pre-independence debt, guaranteed by South Africa and currently serviced by the South African Reserve Bank under an agreement with the Bank of Namibia, is expected to be written off in 1997/98. The Government's external debt is thus expected to decline by 55 per cent and Namibia's total external debt by 78 per cent. The pre-independence debt at the end of 1996 stood at N$268.6 million in the books of the Namibian government and N$856.9 million at the BON.

Domestic public debt, which accounted for 85 per cent of total public debt, continued to grow. It grew by 34 per cent to N$2.8 billion during 1996, compared with 33 per cent in the previous year. The government's indebtedness on the domestic market is in the form of Treasury Bills and IRS, accounting for 34 and 33 per cent, respectively. The Government facility with BON, which is the domestic arrangement for the settlement of the pre-independence debt, accounted for 32 per cent of total domestic debt. This facility will be written off by BON as part of an internal arrangement concerning the pre-independence debt.

External private debt, which accounts for 6.6 per cent of total external debt, decreased further by 5.9 per cent to N$95.1 million, compared with the 1.6 per cent decrease in 1995. At the end of 1996, the concessional portion accounted for 70 per cent of total private external debt. The reason for this high degree of concessionality was that most private sector borrowers reverted to foreign shareholders.

On average, between 1990 and 1996, 90 per cent of the debt was denominated in South African rand. Significant changes were observed in respect of the share which declined from 92 per cent in 1990 to 81 per cent in 1996. It is expected to decline further to 21 per cent with the write-off of Namibia's pre-independence debt.

Table 4.4 Disbursed Outstanding Debt

N$ million

	1991	1992	1993	1994	1995	1996(p)
A.1. Public External Debt	**499.5**	**465.6**	**490.0**	**475.0**	**496.6**	**487.8**
2. Bilateral	75.0	75.0	135.4	146.9	138.9	133.8
- Concessional	0.0	0.0	4.7	16.1	68	133.8
- Non-concessional	75.0	75.0	130.7	130.8	70.9	0.0
3. Multilateral	0.0	0.0	6.5	21.5	57.6	85.4
- Concessional	0.0	0.0	6.5	21.5	50.4	75.3
- Non-concessional	0.0	0.0	0.0	0.0	7.2	10.1
4. Financial Institutions	0.5	0.0	0.0	0.0	0.0	0.0
- Concessional	0.0	0.0	0.0	0.0	0.0	0.0
- Non-concessional	0.5	0.0	0.0	0.0	0.0	0.0
5. Other	424.0	390.6	348.1	306.6	300.1	268.6
- Concessional	32.5	26.6	19.5	13.0	6.5	0.0
- Non-concessional	391.5	364.6	328.6	293.6	293.6	268.6
B.6. Domestic Debt	**35.9**	**757.4**	**1285.5**	**1551.5**	**2059.4**	**2755.4**
7. T-bills	19.2	139.5	254.0	254.7	405.2	946.9
8. I.R.S.	0.0	97.6	406.4	574.4	869.8	931.6
9. Banks (BON)	0.0	510.3	619.6	721.6	783.7	876.5
10.Other	16.7	10.0	5.5	0.8	0.7	0.4
C.11. Private External Debt	**186.0**	**189.9**	**121.2**	**102.7**	**101.1**	**95.1**
12.Financial Institutions	54.6	58.9	22.0	37.1	43.7	45.7
- Concessional	46.9	52.0	15.8	17.1	17.9	21.5
- Non-concessional	7.7	6.9	6.2	20.0	25.8	24.2
13.Other	131.4	131.0	99.2	65.6	57.4	49.4
- Concessional	83.5	77.4	68.9	60.5	52.3	45.1
- Non-concessional	47.9	53.6	30.3	5.1	5.1	4.3
D. 14. BON	**0.0**	**543.7**	**618.4**	**720.0**	**783.7**	**856.9**
Total Public Debt (1+6)	**535.4**	**1,223.0**	**1,775.5**	**2,026.5**	**2,556.0**	**3,243.2**
Total External Debt (1+11+14)	**685.5**	**1,199.2**	**1,229.6**	**1,297.7**	**1,381.4**	**1,439.8**
E: Memorandum Items						
Debt Service Ratio	3.1%	2.7%	4.0%	2.5%	2.5%	1.8%
External Debt Service (N$ Million)	116.8	114.6	198.2	141.1	152.7	121.9
External Debt as % of GDP	9.7%	14.3%	13.7%	11.8%	11.3%	10.4%

(p) Provisional

5. FOREIGN TRADE AND PAYMENTS

Namibia's balance of payments recorded a surplus of N$98 million or 0.7 per cent of GDP in 1996, a magnitude similar to that in 1995 (*Table 5.1*). This followed the larger surpluses of 1993 and 1994, of N$298 million and N$266 million. These were mainly on account of the introduction of the Namibia dollar in September 1993. Despite the surplus recorded in 1996, the level of official foreign reserves of N$906 million could cover only 5.9 weeks of imports, a marginal increase from 5.7 weeks in 1995.

According to preliminary estimates, the current account strengthened from a surplus of N$113 million in 1995 to N$359 million in 1996, or 2.6 per cent of GDP, bolstered by a narrowing trade deficit and higher current transfers. The trade balance was in deficit in 1995, but due to robust exports and a slow increase in imports, it narrowed substantially to only N$107 million in 1996. Exports had their best year since 1991. Compared with 1995, diamond exports increased by 30 per cent, other mineral products by 20 per cent, and food and live animals by 20 per cent. Current transfers rose by 12 per cent due to substantial SACU receipts, thereby boosting the recovery of the current account.

The capital and financial account registered a net outflow of N$238 million in 1996, equivalent to 1.7 per cent of GDP, from a deficit of N$88 million in 1995. The imbalance on the capital and financial account has been a constant feature of Namibia's balance of payments since 1990. The deterioration in 1996 was due to smaller capital transfer receipts, redemptions of maturing debt instruments, and short term flows between the banking sector and its parent companies. The local asset requirement legislation affected net outflows on pension fund and life assurance businesses which declined from N$1.4 billion in 1995 to N$1.2 billion in 1996.

Namibia's international investment position (IIP) changed dramatically in 1993, when it moved from a net liability to a net asset position of N$1.3 billion, due to ownership changes in the mining sector. However, increases in the market value of direct investment in Namibia of around 10 per cent per annum, and the effect of the local asset requirement on institutional investor's stock of assets in South Africa, combined to move the IIP to a net liability position of N$681 million by 31 December 1996.

5.1 Current Account

Namibia's *trade balance* reversed to a substantial deficit in 1995, after four years of consistent surpluses (*Chart 5.1*). The sharp deterioration was due to a 20 per cent increase in imports, surpassing exports which grew by only 6 per cent. In 1996, however, the growth in exports exceeded the growth in imports significantly, improving the net merchandise trade position from a deficit of N$405 million in 1995 to a deficit of N$107 million in 1996.

Namibia's *merchandise exports* registered another year of double digit growth in 1996. During the year, export value increased by 14 per cent to reach N$5.8 billion on account of an increase of 15 per cent in prices and a decrease of 2 per cent in volume.

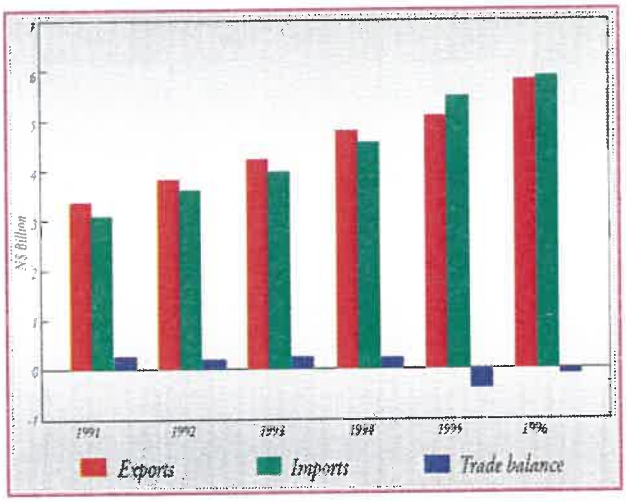
Table 5.1 Balance of Payments Main Aggregates (a)

N$ million

	CALENDAR YEARS					
	1991	1992	1993	1994	1995	1996 (b)
Balance on current account	**372**	**247**	**424**	**472**	**113**	**359**
Balance on merchandise trade	284	210	246	230	-405	-107
Merchandise exports fob	3 376	3 825	4 221	4 794	5 076	5 801
Merchandise imports fob	-3 092	-3 615	-3 975	-4 564	-5 481	-5 908
Net services	-938	-976	-823	-774	-922	-1 084
Net income	268	47	216	237	432	419
Net current transfers	758	966	785	779	1 008	1 131
Balance on capital and financial account, excluding reserves (c)	**-468**	**-169**	**-40**	**-282**	**-88**	**-238**
Net capital transfers	80	91	88	154	146	85
Direct investment, net	315	342	152	369	429	584
Portfolio investment, net	-70	45	255	157	393	108
Other long term investment, net	-712	-801	-774	-1 224	-1 267	-955
Pension funds	-404	-578	-659	-645	-904	-748
Life assurance	-433	-270	-105	-488	-479	-439
Other	125	47	-10	-91	116	232
Other short term investment, net	-81	154	239	262	211	-60
Balancing item (net errors & omissions) (d)	***62***	***-97***	***-86***	***76***	***62***	***-23***
Overall balance (e)	***-34***	***-19***	***298***	***266***	***87***	***98***
Change in reserves (f)	***34***	***19***	***-298***	***-266***	***-87***	***-98***
			(In per cent of GDP)			
Current account balance	***5.2***	***2.9***	***4.7***	***4.3***	***0.9***	***2.6***
Overall balance	***-0.5***	***-0.2***	***3.3***	***2.4***	***0.7***	***0.7***

(a) For the current account, a minus sign (debit) means a deficit, or imports of goods and services, or income and transfers payable. A plus sign (credit) means a surplus, or exports of goods and services, or income and transfers receivable. For the capital and financial account (including reserves), a minus sign (debit) means a capital outflow (deficit), or an increase in foreign financial assets, or a decrease in foreign liabilities. A plus sign (credit) means a capital inflow (surplus), or an increase in foreign liabilities, or a decrease in foreign financial assets. b) Provisional (c) Represents net identified capital and financial transactions; other than in reserves. (d) Represents the net errors and omissions in the current and capital and financial account. (e) Overall balance is equal to the current account balance, plus all identified capital and financial transactions, excluding changes in reserves, plus net errors and omissions. (f) For changes in reserves, a minus sign means an increase and a plus sign a decrease. (g) In conformity with the new IMF 5th edition manual, transfer items are split between current (of a current nature) and capital (linked to fixed assets) transfers, with the latter moved to the new capital and financial account. (h) The entries for pension and life assurance transactions are reclassified as other investment. These transactions were classified previously as portfolio investment.

Chart 5.1 Trade Balance



A breakdown of exports according to products showed that almost all major categories had a strong performance in 1996, except manufactured goods which declined sharply. The most robust growth was in fish, lobster and crabs, followed strongly by diamonds and other mineral products. No electricity was exported to South Africa in 1996 (*Table 5.2*).

Diamonds continued to be the mainstay of Namibia's exports. Diamond export earnings improved due to increases in prices, which, on average, went up by 6 per cent. The industry gained another 24 per cent due to exchange rate changes, while volumes remained stable. During the year under review, diamond exports increased by 30 per cent to N$2.3 billion, maintaining the position as Namibia's leading foreign exchange earner, with an increased share of 39 per cent of total exports, compared with 35 per cent in 1995.

Other minerals, particularly copper and silver, saw a decrease in export volume after a strike in the non-diamond mining industry. Exports of these minerals fell by 35 per cent and 24 per cent, respectively. However, the overall export of other minerals did well, with zinc recording a rise of 62 per cent after a decrease of 10 per cent in 1995. Gold also performed well in 1996, on the back of price increases of 38 per cent.

The export of food and live animals continued its strong growth, increasing by 20 per cent in 1996. The performance of this component was supported by the export of unprocessed fish which increased by 34 per cent and accounted for 20 per cent of total exports in 1996, compared with 17 per cent in 1995. Food and live animals constituted about 36 per cent of Namibia's total exports in 1996. The export of live animals continued its upward trend since 1990, increasing by 13 per cent in 1996. Meat and meat preparations remained stable during the year under review, while hides, skins and wool exports (including karakul) increased by 11 per cent in 1996 to N$83 million.

Exports of unprocessed fish rose by 34 per cent to N$1.2 billion. The exports of hake continued to rise, accounting for 61 per cent of the export earnings of unprocessed fish. This was followed by horse mackerel exports which grew by 6 per cent. Fish, lobster and crab exports continued to increase, becoming the second largest export earner with a 20 per cent share of total exports in 1996 (17 per cent in 1995). Exports of deep water fish, particularly the newly discovered Orange Roughy, grew substantially.

Exports of manufactured products fell sharply by 55 per cent to N$265 million in 1996, continuing to decline for the second consecutive year. The drop in 1996 was due largely to the depletion in volumes of pelagic fish, particularly

Table 5.2 Merchandise Exports Fob by Commodity Group

N$ million

	1991	1992	1993	1994	1995	1996 (a)
FOOD AND LIVE ANIMALS	**964**	**1 131**	**1 139**	**1 672**	**1 753**	**2 096**
Live animals	214	269	279	420	483	548
Meat and meat preparations	272	293	294	380	367	352
Fish, lobster, and crabs	450	539	536	842	873	1 166
Other food products	28	30	30	30	30	30
HIDES, SKINS AND WOOL	**42**	**43**	**53**	**74**	**75**	**83**
MINERAL PRODUCTS	**2 014**	**2 107**	**2 374**	**2 392**	**2 655**	**3 357**
Diamonds	1 222	1 350	1 515	1 486	1 765	2 287
Other	792	757	859	906	890	1 070
MANUFACTURED PRODUCTS	**352**	**538**	**655**	**655**	**589**	**265**
Canned fish, fish meal and fish oil	219	311	488	509	472	144
Other	133	227	167	146	117	121
ELECTRICITY	**4**	**6**	**0**	**1**	**4**	**0**
TOTAL MERCHANDISE	**3 376**	**3 825**	**4 221**	**4 794**	**5 076**	**5 801**

0: indicates nil or less than N$500 000
(a) Provisional

pilchards, resulting from adverse oceanic conditions. The total allowable catch was halved to encourage the recovery of pilchard stocks. Exports of other non-fish manufactured products remained relatively stable.

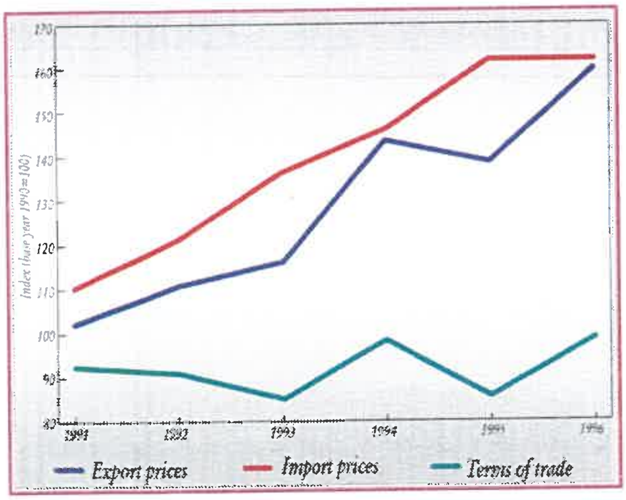
Namibia's major export markets remained virtually unchanged for the years 1994 to 1996. This trend is expected to continue in 1997. The most important customers for merchandise exports are the United Kingdom, South Africa, Japan, Spain and Germany. The United Kingdom maintained its position as Namibia's leading export market.

A moderate expansion in *merchandise imports*, coupled with a strong export performance, was responsible for the significant increase in trade in 1996. The value of merchandise imports rose by 8 per cent to N$5.9 billion after a sharp rise of 20 per cent in 1995. Imports increased by 12 per cent in the first quarter of 1996, compared with the corresponding period in 1995. Disruptions in the foreign exchange markets, particularly during the first half of 1996, saw the South African rand/ Namibia dollar plummet by 24.3 and 22.7 per cent against the British pound and the US dollar, respectively. These developments had a profound effect on Namibia's trade position. The effect was seen later in 1996, as the volume of imports decreased. Preliminary import data for the end of 1996 suggest nominal declines compared with corresponding periods in 1995.

South Africa still remained the leading supplier of Namibia's imports, although other countries such as Russia, Germany and Zimbabwe are increasing their exports to Namibia.

A large deficit on *net services* has been a consistent feature of Namibia's balance of payments since 1990. This is attributable mainly to an average net transport deficit of N$675 million from 1991 to 1996. From 1993, this deficit has been increasingly offset by growing net travel receipts. The net services deficit widened to N$1.1 billion in 1996, showing a deterioration of 18 per cent (19 per cent in 1995). Net travel receipts increased by 11 per cent during the same period. Smaller receipts on net communications, financial and other government services were recorded during the year under review. The deficit on net transportation services declined by 15 per cent, due to a 23 per cent increase in payments of charter fees.

Chart 5.2 Terms of Trade



Since 1991, Namibia's *terms of trade* (TOT) has been on the decline (*Chart 5.2*). This trend was reversed in 1994 and 1996 when the TOT improved as a consequence of a price rise in exports. Export commodity prices rose by 15 per cent during the year under review, while import prices remained stable. The improvement of export prices strongly influenced the narrowing of the trade deficit and therefore the increase in the surplus of the current account.

Namibia's *resource gap* has been widening since 1991, but narrowed in 1993/94 and again in 1996 (*Table 5.3*). As Namibia grew as a tourist destination, increasing travel receipts influenced the resource gap heavily in 1993 and 1994. The resource gap widened in 1995 as a result of a 20 per cent surge in merchandise imports. Although non-factor service imports increased by 13 per cent in 1996, the subdued increase in merchandise imports allowed increases in total exports to dominate, thereby narrowing the resource gap to N$1.2 billion.

Net investment income was N$432 million in 1995, and remained relatively stable the following year. In 1996, gross income received was N$1.2 billion while income paid was N$811 million, bringing the net balance to a surplus of N$419 million. Income paid on direct investment decreased from N$707 million to N$634 million in 1996, representing a 10 per cent decrease. Income received on direct investment was only N$13 million. Receipts on portfolio investment increased substantially in 1995, but remained stable in 1996. Payments of dividends and retained earnings to foreign direct investors constituted the biggest components in income payments, N$348 million and N$276 million, respectively, for 1996.

After a marginal decline in 1994, *net current transfers* in cash and kind increased substantially by 29 per cent in 1995 and 12 per cent in 1996, to N$1.1 billion. In 1995, both SACU and foreign aid receipts did well. SACU receipts continued to rise in 1996, in line with increases in imports, and recorded a substantial increase of 19 per cent. This

Table 5.3 Namibia's Resource Gap
N$ million

	1991	1992	1993	1994	1995	1996(a)
Exports fob						
Merchandise goods	3 376	3 825	4 221	4 794	5 076	5 801
Non-factor services	399	484	761	898	952	1 039
Exports of goods and non-factor services	**3 775**	**4 309**	**4 982**	**5 692**	**6 028**	**6 840**
Imports fob						
Merchandise goods	-3 092	-3 615	-3 975	-4 564	-5 481	-5 908
Non-factor services	-1 338	-1 460	-1 582	-1 672	-1 874	-2 125
Imports of goods and non-factor services	**-4 430**	**-5 075**	**-5 557**	**-6 236**	**-7 355**	**-8 033**
Resource gap	***-655***	***-766***	***-575***	***-544***	***-1 327***	***-1 193***

(a) Provisional

improvement was partially offset by a decline of 12 per cent in foreign development assistance, particularly to non-governmental organisations. Current transfer debits increased by 8 per cent.

The net effect of these transactions resulted in a current account surplus of N$359 million in 1996, up from N$113 million in 1995. In short, this good performance was the result of a significant increase in exports as opposed to sluggish imports, an increasing net services deficit, a stable net income surplus, and a rise in current transfers, particularly SACU receipts.

5.2 Capital and Financial Account, and Foreign Reserves

The capital and financial account remained significantly in deficit in the post-independence era, except for 1993 and 1995. In 1993, increased portfolio investment in Namibia, as well as short term investment inflows into sectors such as mining and retailing, resulted in a smaller deficit. In 1995, more portfolio investment in long term government stock, and higher direct investment in Namibia in the form of retained earnings of the banking and mining sectors were responsible for the narrowing of the deficit. The capital and financial deficit has averaged N$247 million per annum, equivalent to 2.6 per cent of GDP. Outflows of pension funds and life assurance assets heavily influenced these deficits, although short term transactions between local banks and their foreign parent companies were also significant.

The deficit widened substantially from N$88 million in 1995 to a provisional N$238 million in 1996. Redemption of maturing long term government stock, and, particularly, short term investment transactions with parent companies by banks and other sectors, created higher outflows. These developments, coupled with declining capital transfers, more than offset the contraction of other long term investment transactions in accordance with the amended Pension Fund and Life Assurance Acts, and the larger inflows of direct investment, mostly in oil exploration.

Table 5.4 International Reserves of the Monetary Authorities and Namibia's Import Cover

	1991	1992	1993	1994	1995	1996 (a)
LEVEL OF RESERVES IN N$ MILLION (as at 31 December of each period)	171	152	454	719	808	906
IMPORT COVER IN WEEKS (of merchandise goods and non-factor services)	2.0	1.6	4.3	6.0	5.7	5.9

(a) Provisional

Net capital transfers declined sharply in 1996, as existing capital projects were close to completion. The surplus therefore fell from N$146 million in 1995 to N$85 million in 1996.

Net direct investment increased substantially in 1996, by 36 per cent to N$584 million. Investments in mining, retailing and especially oil exploration caused this good performance. New equity capital of N$290 million was invested and profits of N$276 million reinvested by foreign direct investors. Inter-company transactions netted an inflow of N$25 million. Direct investment abroad was N$7 million in 1996, a level similar to 1995.

There was a sharp decline in *net portfolio investment*, from N$393 million in 1995 to N$108 million in 1996. Although investment on tradeable equity securities, mostly on the NSE, increased from N$166 million in 1995 to N$220 million in 1996, it was developments in debt instruments which largely influenced the above performance. Sales of long term government stock to non-residents peaked in 1995, at N$269 million, and continued in 1996 at N$225 million. Those investments made in 1992 and 1993 are beginning to mature. Redemptions were only N$5 million in 1994, but increased to N$42 million in 1995 and jumped to N$226 million in 1996.

The deficit on *other long term investment net* narrowed to N$955 million during 1996 from N$1.3 billion in 1995. The major driving force behind this improvement were pension and life assurance transactions, which were affected by the local asset requirement. Combined, these transactions contracted from N$1.4 billion in 1995 to N$1.2 billion in 1996. A secondary reason for the narrowing deficit was an increase in foreign non-rand borrowing by Government, and an increase in the foreign liabilities of other sectors.

For the first time since 1991, the balance on *other short term investment net* transactions were in deficit in 1996, by N$60 million. As liquidity conditions eased in 1996, banks reversed funding demands on their parent companies to such an extent that they registered an outflow of N$56 million (1995: an inflow of N$86 million). Similarly, other sectors switched from a net inflow of N$125 million in 1995 to a net outflow of N$4 million in 1996.

The net effect of all the external transactions of the balance of payments caused the overall balance to increase by N$87 million in 1995, and by N$98 million in 1996. The level of the monetary authorities' reserves rose, therefore, by the same amount to N$808 million as at the end of 1995, and N$906 million by end 1996 (*Table 5.4*).

5.3 International Investment Position

Namibia's foreign assets declined marginally by 0.1 per cent from the end of 1995 to N$9.8 billion at the end of 1996, while foreign liabilities increased by 11 per cent to N$10.5 billion over the same period (*Table 5.5*).

The category *other assets* within foreign assets, especially pension fund and life assurance assets held in South Africa, make up more than 80 per cent of the total. It is the significant increases in the market value of these investments that led to the strong growth in nominal value of Namibia's external assets, up to 1994. After the introduction of the local asset requirement, the value of other assets declined to a level of N$8.2 billion by the end of 1996. These developments have kept the overall level of Namibia's foreign assets at around N$9.8 billion, both in 1995 and 1996.

Two-thirds of Namibia's foreign liabilities consist of direct investment. The value of this type of liability has increased slowly over time, from N$5.8 billion in 1991 to N$7.0 billion in 1996. The reduction in the market value of Namibia's foreign liabilities in 1993 is explained by the acquisition of half of the equity shares of Namibia Diamond Corporation (Pty) Ltd by the Namibian Government.

The ownership change in the mining sector led to Namibia moving into a net foreign asset position from 1993 onwards. This trend held for three years but changed in 1996 when Namibia reversed to a net foreign liability position of N$0.7 billion, as the build-up of foreign assets declined due to the local asset requirement, while foreign liabilities increased by 11 per cent.

5.4 Exchange Rate Developments

Since February 1996, the value of the Namibia dollar, which is pegged to the rand, depreciated against major currencies. The Namibia dollar, which averaged N$3.66 against the United States dollar (USD) during the last quarter of 1995, depreciated to N$4.35 in June of 1996 and weakened further to N$4.68 at the end of the fourth quarter of 1996.

Table 5.5 Investment Position Main Aggregates
N$ million

	1991	1992	1993	1994	1995	1996(a)
Foreign assets at end of year	**6 441**	**6 914**	**8 765**	**9 878**	**9 821**	**9 814**
Direct investment abroad	269	249	269	56	54	61
Portfolio investment	459	443	399	585	601	603
Other assets	5 542	6 070	7 643	8 519	8 358	8 244
Reserve assets	171	152	454	718	808	906
Foreign liabilities at end of year	**7 747**	**8 582**	**7 478**	**8 424**	**9 461**	**10 495**
Direct investment in Namibia	5 801	6 539	5 065	5 674	6 229	6 987
Portfolio investment	501	561	752	876	1 091	1 035
Other liabilities	1 445	1 482	1 661	1 874	2 141	2 473
Net foreign position at end of year	***-1 306***	***-1 668***	***1 287***	***1 454***	***360***	***-679***

(a) Provisional

The depreciation of the Namibia dollar against most major currencies was due to uncertainty regarding political stability in South Africa. However, continued weakening of the Namibia dollar in the second half of 1996 was a reflection of poor economic fundamentals in South Africa, as indicated in the worsening of the current account deficit, and uncertainty over exchange control liberalisation. Against the British pound, the Namibia dollar weakened from N$6.00 in the first quarter to N$7.79 in the fourth quarter.

The nominal effective exchange rate (NEER) of the rand against a trade-weighted basket of the USD, the British pound, the German mark and the Japanese yen declined by more than 20 per cent over the first 10 months of 1996. Between the end of 1995 and end 1996 the decline in the rand's NEER was 21.9 per cent. The rand's real effective exchange rate (REER) decreased by 5.9 per cent over the first quarter of 1996, as against the NEER's 7.8 per cent over the same period. The SARB's tight monetary stance led to relatively lower inflation levels. This caused a smaller inflation differential between South Africa and its major trading partners. During the first ten months of 1996, the REER declined by 14.1 per cent and by a provisional 16 per cent between December 1995 and December 1996.

Due to different trade patterns, Namibia's trade-weighted basket is not exactly similar to South Africa's. However, broad inferences can be made from the above trends. It is clear that Namibia's NEER and REER follow fairly similar trends to those of the Republic of South Africa. A declining REER implies that Namibia's producers have gained in external competitiveness, meaning that eventually, because of the effects of the J-curve, the trade balance will be affected positively, contributing to an improvement in the overall balance of payments.

BOX 1: PRIVATE SECTOR GLOBAL LOAN SCHEME

The Government of Namibia entered into an agreement with the European Investment Bank (EIB) under which the EIB will fund the Private Sector Global Loan Scheme (PSGL). The PSGL will complement existing loan facilities by providing yet another source of financing to small and medium size enterprises in the agro-industry, manufacturing, fishing and fish processing, hotels and tourism, mining and quarrying, and productive infrastructure sectors of the Namibian economy.

The availability of the funds will allow qualifying enterprises to secure fixed interest rate loans for a minimum period of five years. The interest rates are competitive and based on the long term bond yields in the CMA. A project should have a minimum investment of N$260 000 and a maximum of N$5.2 million. The PSGL finances up to 50% of the project cost. However, these amounts will fluctuate with changes in the exchange rate of the Namibia dollar against the European Currency Unit.

The Bank of Namibia (BON) views this facility as an attractive source of financing. Firstly, the PSGL will give entrepreneurs access to long term funding at competitive fixed interest rates. Secondly, it will help in stimulating important sectors of the economy that will, in turn, contribute to employment and wealth creation. The initial grace period of one year is an added advantage of this scheme. The BON, therefore, encourages Namibians to make optimal use of the PSGL.

As the implementing agent of the PSGL for the Government, the BON will channel the funds for projects through approved commercial banks. The banks are responsible for project selection and appraisal. Loan applications will be forwarded by BON to the EIB for approval, after ensuring that projects conform with the scheme's objectives.

Some of the requirements that projects should meet for eligibility under the PSGL include technical and financial viability, good management, market potential, and environmental friendliness. Further, enterprises should contribute capital to the projects for amounts not covered by the loans. They should also offer appropriate security to the banks.

PART B

BANKING SUPERVISION AND EXCHANGE CONTROL

1996

6 BANKING SUPERVISION AND EXCHANGE CONTROL

I. DEVELOPMENTS IN BANKING SUPERVISION AND EXCHANGE CONTROL

6.1 Introduction

The year under review was characterised by significant developments in the banking supervision function. In carrying out its role to develop and promote a sound, stable and progressive banking system, the Bank of Namibia concentrated its efforts on expediting progress on the legal framework, that is, the country's Banking Institutions Act and accompanying regulations and guidelines. Similarly, substantive work was carried out to enhance the structures upon which effective supervision could be performed and to strengthen the skills and technical capacity of banking supervisors.

While speculation on the lifting of exchange control continued to create volatility in the forex markets, the subject of exchange control and its impact on the Namibian economy became a focal point of debate. Meanwhile, initiatives have been taken, within the context of exchange control, to examine and review the restrictions to the free flow of trade and cross border investment in the SADC region. Namibia acceded to Article VIII of the IMF that commits it to abolishing most, if not all, restrictions on current account transactions.

To facilitate the operations of the country's Export Processing Zone (EPZ), concessions were granted to EPZ companies to operate foreign currency accounts which are exempted from exchange control restrictions. The exchange control function has shifted somewhat to facilitate flows of foreign capital, without impeding the overall economic development of the country.

As liberalization of exchange control becomes more of a reality, money laundering is likely to increase. The Bank has begun to address this issue, in a national as well as a regional context, by becoming involved in the National Task Force whose objective it is to create effective legislation and measures to combat money laundering.

II. ANNUAL REPORT OF THE REGISTRAR OF BANKS AND BUILDING SOCIETIES

This report is submitted in terms of section 47 of the Banks Act, 23 of 1965 and section 77 of the Building Societies Act 2 of 1986 for the year ended 31 December 1996.

6.2 Industry Developments

During the year, both the building societies (Namib Building Society and SWABOU) and Bank Windhoek submitted an application to the Registrar to enter into an amalgamation. However, the amalgamation was called off after further negotiations between the relevant parties failed. The failure of the merger caused some adverse publicity and speculation.

The role of the Bank in this matter has been to remain constantly vigilant against potential repercussions from possible loss of depositor confidence and to ensure that the smooth functioning of the banking system is not compromised. In this respect, measures were taken to ensure continuing negotiations in an orderly environment, without undue pressures from adverse publicity and the potential erosion of depositor confidence. The active involvement of the supervisory authority in such matters is regarded as crucial since even the strongest of financial institutions can fail if subjected to a sustained loss of depositor confidence.

An amalgamation did eventually take place between Namib Building Society and Bank Windhoek while the other building society opted to continue operating on its own.

In anticipation of the passage of Namibia's Banking Institutions Act, the industry is in a transitional phase as it prepares itself for the implementation of new banking regulations and guidelines. In this respect, the Bankers Association of Namibia and the Institute of Chartered Accountants of Namibia have demonstrated their commitment by providing valued input to the drafting process.

6.3 Developments in the Regulatory Framework

Considerable progress was made on the proposed Banking Institutions Act which is expected to be tabled in 1997. The Act will result in a complete overhaul of the legal framework which governs the activities of banking institutions in Namibia. It will eventually replace the outmoded 1965 Banks Act.

The proposed Act incorporates the latest standards in banking, and is designed to be flexible and responsive to changes that take place within the domestic and international financial environments.

Among others, the Act recognises the importance of auditors in a banking institution. The Act embraces the principles of corporate governance, as generally accepted in the Cadbury and King Reports, and the functions of Audit Committees. It clearly sets out the role, duties and responsibilities of the directors, management, internal and external auditors, as well as those of the Audit Committee. It also obliges the auditors to report directly to the supervisory authority, at any time, on issues which pose a threat to a banking institution as a going concern. The Act also spells out the additional responsibilities of directors and management, and compels them to act responsibly and diligently in the conduct of the affairs of a banking institution.

The success of banking institutions primarily depends on prudent risk management. Prudential requirements based on international supervisory standards advocated by the Bank for International Settlements (BIS) have been adopted into the Act. These requirements, designed to strengthen the prudential standards of banking institutions, determine mainly market entry, risk-weighted capital adequacy, liquidity, limits on the concentration of credit risk, provisioning for bad debts, and standards of disclosure of financial information.

Following implementation of the above directives and guidelines, it is conceivable that local institutions meeting the minimum requirements should be able to obtain better ratings from international rating agencies which could lead to favourable terms for external loans.

6.4 On-Site Examination Activities

During the year under review, the Bank Examinations Division carried out a series of limited scope examinations to provide supervisory assurance on the financial condition and soundness of the banking system. These examinations, which were carried out in collaboration with off-site surveillance operations, were focused mainly on appraisal of lending portfolios, non-performing loans, deposit concentrations, capital adequacy, management quality and compliance with statutory requirements.

With the enactment of the proposed Act and the issuance of regulatory guidelines and directives, it is expected that the on-site examination division of the Financial Institutions Department will be more active in 1997. This is in line with the Bank's supervisory policy of building technical capacity in this area and carrying out more regular on-site examinations to complement the off-site surveillance which was solely relied upon in the past. In addition, these examinations are widely acknowledged, in the global context, as being highly effective tools for banking supervisors to satisfactorily discharge their responsibilities as regulators of the banking system.

BOX 2: The Changing Role of Banking Supervision in Namibia

During the last decade, global financial markets and intermediaries experienced one crisis after another. These crises have ranged from the traditional banking problems caused by poor lending practices to a proliferation of new types of risk exposure associated with derivatives and other complex financial instruments. Significant volatilities were recorded in the international foreign exchange and money markets. In these turbulent times, several countries around the world have not been spared the costly problem of having to deal with failed banks. Of greater concern has been that some of these ailing institutions, such as Barings Bank and Credit Lyonnaise, were once considered premium names in the market, and were under the supervision of well regarded G10 Central Banks. Subsequently, pressures have been exerted on banking supervisors to review and update their regulatory frameworks in response to the ever increasing diversity, magnitude and complexity of banking risks.

In the pursuit of its statutory objectives, the Bank stands firmly committed to ensuring the integrity, soundness and stability of the Namibian banking system. The serious financial, political and economic repercussions caused by ailing or failed banks have strengthened the argument that banking business should not be left solely in the hands of bankers. Banking institutions play a crucial role in the economy through the mobilisation of public savings, the allocation of credit and in the operations of the national payments system. Consequently, the soundness and stability of the banking system is in the national interest. Furthermore, a safe and sound banking system is essential to the conduct of effective monetary policy to sustain non-inflationary economic growth.

Several significant developments have been taking place in the Namibian context as the Bank prepares itself for the challenges ahead. At the heart of these changes is the comprehensive review and proposed amendment of the laws governing, amongst others, the scope, powers and role of banking supervision in Namibia.

Prior to this, the supervision framework had been based on the outdated 1965 Act, which was subjected to ad-hoc amendments from time to time. The proposed Banking Institutions Act, on the other hand, incorporates the very latest and best in banking supervision and regulatory practices. The provisions contained are the result of an in-depth review and based on information sourced from reputable international banking supervision authorities.

A major departure from past supervision practices will be in terms of the flexibility provided to the Bank to alter, amend or adapt prudential banking requirements through the issuance of guidelines or determinations. Previously, such requirements had been cast in concrete through legal provisions. Consequently, the ability of banking supervisors to react effectively to frequent changes in the banking and financial world, was rather limited. A case in point is in the area of capital adequacy. Since the introduction of uniform capital adequacy standards in 1988, various pronouncements on the risk-weighted capital framework have been and are still being made by the Basle Committee on Banking Supervision. Without the required flexibility to amend or adapt the prudential capital adequacy requirements in keeping with changes occurring in the global banking environment, the Bank would not be in a position to promptly respond to these changes by updating its supervisory framework. For example, the present capital adequacy requirement specifies a fixed minimum requirement without due regard to the assets and risk profile of the banking institutions.

The proposed legislative framework is also expected to nurture a more pro-active type of regulation and supervision by the Bank. The stage has therefore been set for a clear departure from fire-fighting to fire-prevention.

A further improvement of banking supervision will be the streamlining of banking disclosure and reporting. Although, overall banking disclosure and reporting has improved over the years, there is a need to further enhance the quality, timeliness and accuracy of reported information. In addition, financial evaluations of and comparisons between banking institutions can often be misleading due to differences in accounting standards. As is the case with international convergence in the measurement of capital adequacy, efforts are under way to eventually converge accounting practices and financial reporting of banking institutions in Namibia, in line with international principles. The move towards standardisation in accounting treatment will be, for example, through the proposed introduction of minimum standards on the classification of non-performing loans, bad debt provisioning, and the accounting treatment of interest-in-suspense.

While the monitoring of the Namibian banking system has largely been confined to off-site supervision and reliance on reports from external auditors, there has been a significant shift towards the establishment of an on-site surveillance capacity. Measures are being taken, therefore, to develop and promote the required skills and knowledge capacity for an effective on-site examination function. Essentially the objectives of these bank examinations are to conduct on-site verification of a bank's financial condition and performance, to provide assurance that the financial reporting is accurate and reliable, and to ensure that the bank is operating in compliance with Namibia's laws and regulations.

Other expected changes include the adoption of standards on the supervision of cross-border banking establishments and the acknowledgement of home and host supervisory obligations. The reporting obligation of external auditors will also be defined more clearly and banks will be required to establish Audit Committees and observe high standards of corporate governance. These and other changes augur well for a new and exciting era in the Namibian banking industry.

6.5 International Supervisory Cooperation

Namibia's banking supervisors have played a role in developing measures within SADC to combat money laundering and were represented on the National Task Force dealing with this issue. While the Bank has sensitised the banking industry to money laundering practices, certain banking institutions had already initiated counter measures of their own in the absence of appropriate laws.

International supervisory relations and cooperation were strengthened with counterparts in the region and overseas. These concerned cross-border supervision by home officials in the region and technical support offered by international supervisory agencies as well as authorities in the region. In particular, technical assistance and cooperation was forthcoming from the Central Bank of Malaysia and the Reserve Bank of South Africa. Other instances of the Bank's involvement in international supervisory cooperation include the following:-

East and Southern Africa Banking Supervisors (ESAF)

The Bank's role as Secretariat for the ESAF group was extended for another year at the Fifth Annual Meeting held in Stockholm, Sweden, during June 1996. At the meeting, all ESAF member countries reiterated their commitment to the improvement of the supervisory systems in their respective countries and agreed on an action plan to ensure minimum standards for the supervision of international banking groups and their cross-border operations as recommended by the BIS. These minimum standards comprise four main principles:-

1. All international banking groups and international banks should be supervised by a home-country authority that capably performs consolidated supervision;

2. The creation of cross-border banking establishments should receive the prior consent of both the host-country supervisory authority and the home-supervisory authority;

3. Supervisory authorities should have the right to gather information from the cross-border banking establishment of the banks or banking groups for which they are the home-country supervisor; and

4. If a host-country authority determines that any one of the foregoing minimum standards is not met to its satisfaction, that authority could impose restrictive measures necessary to satisfy its prudential concerns consistent with these minimum standards, including the prohibition of the creation of banking establishments.

Bank for International Settlements

As in the past, in 1996, the Bank was able, on several occasions, to contribute and to participate in the work of the BIS on a wide range of supervisory issues. These included written contributions to the Basle Committee on guidelines for effective banking supervision and the usefulness of quantitative limits in supervision. The Bank also actively participated in debates and the eventual adoption of a formal

Basle position on the improvement of supervision of cross-border banking pertaining to determining the effectiveness of home-country supervision, supervisory standards in host countries, information flow between host and home supervisors, and gaps in supervision.

6.6 Performance of Commercial Banks

6.6.1 Asset Growth

During 1996, total assets of the banking system grew by 22.1 per cent to N$7.4 billion from N$6.0 billion as at the previous year end *(Chart 6.1, 6.2).*

This represented a slight decrease over the corresponding growth rate of 29.3 per cent recorded in 1995 *(Table 6.1).* Loans and advances, which constituted 75.0 per cent of total assets, continued to grow significantly in 1996, albeit at a lower rate of 18.1 per cent. Significant increases of 87.1 per cent and 113.4 per cent were also recorded in the holdings of Treasury Bills and inter-bank deposits, respectively. They together accounted for 9.7 per cent of total assets. However, aggregate investments in NCDs declined by 35.3 per cent over the same period to N$238.9 million and constituted 3.2 per cent of total assets as at 31 December 1996.

Chart 6.1 Growth in Assets

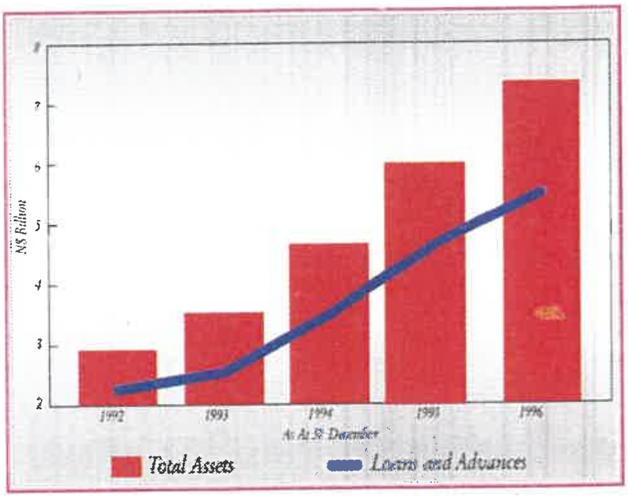


Chart 6.2 Composition of Assets

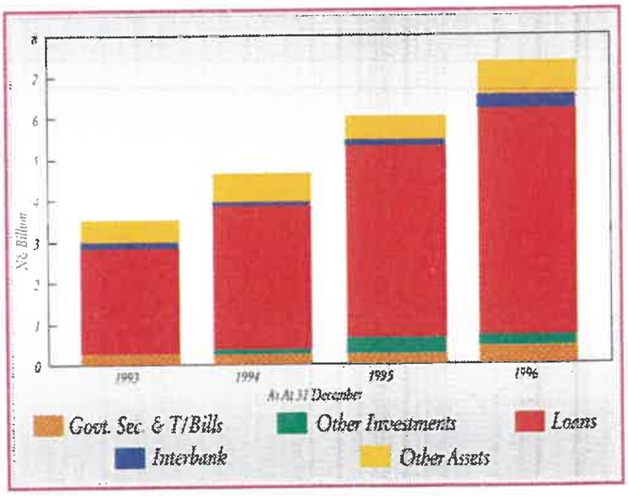


Table 6.1 Key Balance Sheet Data

As at 31 December

	1994 N$ Million	% Change	1995 N$ Million	% Change	1996 N$ Million	% Change
Total Assets	4 664.6	32.2	6 030.2	29.3	7 363.6	22.1
Total Loans & Advances	3 499.3	37.4	4 679.3	33.7	5 525.6	18.1
Total Deposits	4 170.6	34.0	5 457.2	30.8	6 408.4	17.4
Govt Securities & T/Bills	233.2	-12.1	252.0	8.1	445.0	76.6
Other Investments	144.4	1 212.7	390.8	170.6	255.3	-34.8
Total Capital & Reserves	312.0	41.2	446.7	43.2	579.3	29.7

While growth of the banking system's loans and advances eased somewhat in 1996, increases in credit extension by banks continued.

Growth in aggregate deposits in 1996 was down to 17.4 per cent from 30.8 per cent in the preceding year. Deposits, however, continued to represent the major source of funding, accounting for over 87.0 per cent of total liabilities as at 31 December 1996. This compared with 90.5 per cent a year earlier. Funds generated internally accounted for an increasing share of the funding base, as indicated by the significant growth in the banks' capital and unimpaired reserves. These funds increased by N$132.6 million, or 29.7 per cent, in 1996.

Demand and fixed deposits formed the major components of deposits by type, together constituting 83.6 per cent of the total. Demand deposits, in particular, grew significantly by N$989.9 million, or 58.6 per cent, during 1996, thus building in higher liquidity pressure within the total funding base. As in previous years, funding mobilisation through savings deposits remained marginal, constituting a mere 8.7 per cent of total deposits as at 31 December 1996 *(Table 6.2)*.

6.6.2 Loan Quality

Non-performing loans (NPL) in the banking system amounted to N$253.9 million as at end 1996 as compared with N$164.4 million a year earlier. This represents a steep annual increase of 54.4 per cent and reflects pressures exerted by rising interest rates and factors such as the slight downturn in the real property market on the overall quality of the loan book. The industry NPL ratio stood at 4.6 per cent as at 31 December 1996, representing an increase of 1.3 percentage points over the corresponding level in 1995 *(Chart 6.3)*.

Chart 6.3 NPL Ratio and Provision Cover

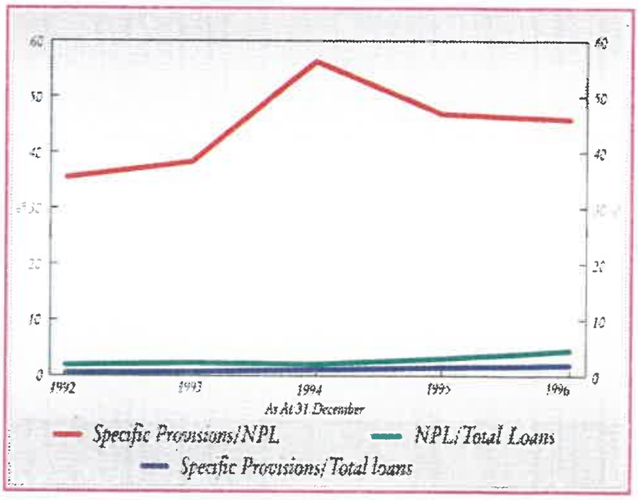


Table 6.2 Deposits by Type
As at 31 December

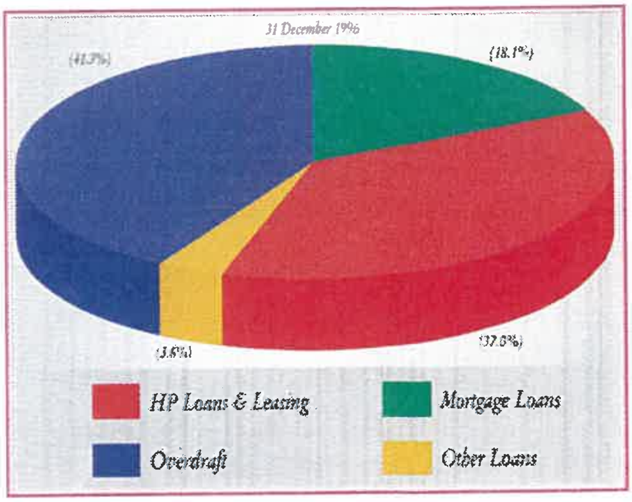
	1994 N$ Million	% Change	1995 N$ Million	% Change	1996 N$ Million	% Change
Demand	1 631.3	28.0	1 690.0	3.6	2 679.9	58.6
Fixed	1 706.6	25.5	2 421.0	41.9	2 678.5	10.6
Savings	426.0	23.0	461.5	8.3	558.0	20.9
Others	406.7	210.7	884.7	117.5	492.0	-44.4
Total	4 170.6	34.0	5 457.2	30.8	6 408.4	17.4

Although the current level of NPL is not near alarming proportions, the adverse trend noted over the past few years is a matter that the banking system will have to increasingly focus upon. Properly conceived and effective credit management and control measures will have to be put in place to prevent any further deterioration of the credit portfolio and to ensure that the overall quality of the book is maintained.

Consistent with the trend in NPL, the banking system's specific provision for bad and doubtful debts has risen over the years, registering an increase of N$39.9 million, or 51.9 per cent, during 1996. Specific provision cover remained fairly unchanged at 46.1 per cent of non-performing loans as at 31 December 1996, compared with 46.9 per cent a year earlier.

Overdraft facilities and hire purchase and leasing loans accounted for the major portions of NPL at 41.3 per cent and 37.0 per cent, respectively *(Chart 6.4)*. Non-performing mortgage loans, on the other hand, constituted 18.1 per cent of total NPL as at 31 December 1996.

Chart 6.4 NPL by Loan Type



6.6.3 Profitability and Earnings

During 1996, the banking system continued to post strong income growth. Income before taxation was N$223.6 million, representing an increase of N$36.4 million or 19.4 per cent, over 1995 results.

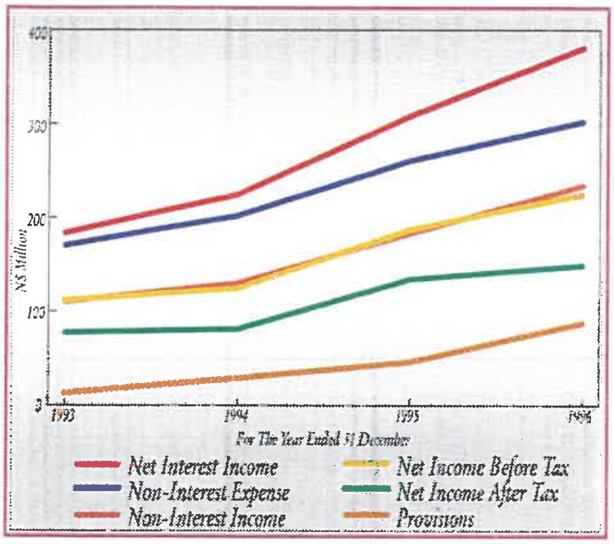
Net interest income increased by N$71.4 million, or 23.2 per cent, during 1996 *(Table 6.3, Chart 6.5)*. This compared favourably with the growth rates in total assets and loans of 22.1 per cent and 18.1 per cent, respectively.

Table 6.3 Key Earnings Indicators
Year Ended 31 December

	1994 N$ Million	% Change	1995 N$ Million	% Change	1996 N$ Million	% Change
Interest Income	528.4	13.9	848.2	60.5	1 136.8	34.0
Interest Expense	304.6	8.6	540.0	77.3	757.3	40.2
Net Interest Income	223.8	22.0	308.2	37.7	379.6	23.2
Non-Interest Income	129.5	18.2	183.1	41.4	233.5	27.5
Non-Interest Expense	201.0	18.4	259.5	29.1	301.8	16.3
Net Provision Charges	27.9	127.2	44.6	59.9	87.7	96.6
Income Before Taxation	124.4	12.2	187.2	50.5	223.6	19.4

The banking system managed to maintain a strong interest spread despite rising interest rates in 1996. The high net interest margin in Namibia, which averaged 5.6 per cent over the past three years, represents a key factor contributing to the high overall profitability of Namibian banks. Conversely, it could be argued that ample scope remains for the development and growth of competition in the sector to enhance the quality and depth of financial intermediation.

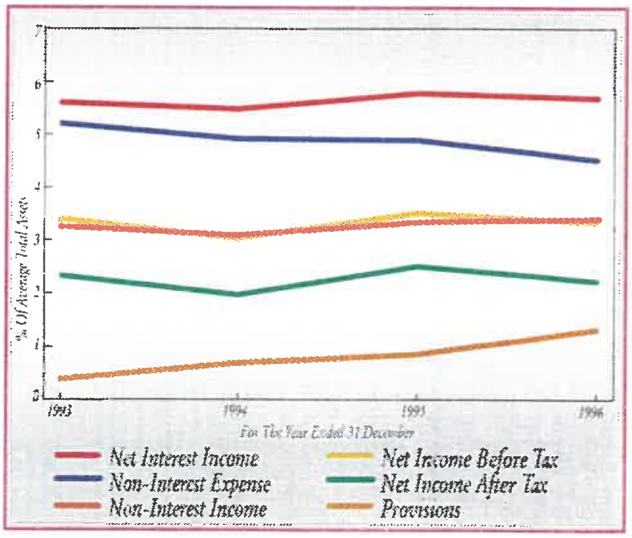
Chart 6.5 Key Earnings Indicators



Other operating income, predominantly commissions and fees, increased by N$50.4 million, or 27.5 per cent, to N$233.5 million during 1996 and accounted for 17.0 per cent of total income. Non-interest expenses, comprising personnel, occupancy, furniture and general administrative charges, increased by N$42.3 million, or 16.3 per cent, to N$301.8 million. On the basis of this trend, both non-interest income and non-interest expense appeared to be moving in tandem over the past four years with the net difference (net overhead expense) averaging about N$73.2 million.

The banking system's after tax return on assets (ROA) and return on equity (ROE) for the year ended 31 December 1996 stood at 2.2 per cent and 25.6 per cent, respectively. These strong profitability indicators would nevertheless have been higher had it not been for a sharp increase in provisioning for bad and doubtful debts. The banking system's net bad debt provisions surged during the year by N$43.2 million, or 96.6 per cent, to N$87.8 million as at 31 December 1996. In proportion to average total assets, net provisioning charges increased from 0.8 per cent in 1995 to 1.3 per cent in 1996. The sharp increase in bad debt provisioning was, as mentioned previously, understandable in the light of the deterioration in the level of non-performing loans. It is an area in which banking institutions will have to increasingly focus on in the years ahead *(Chart 6.6)*.

Chart 6.6 Key Earnings Ratios

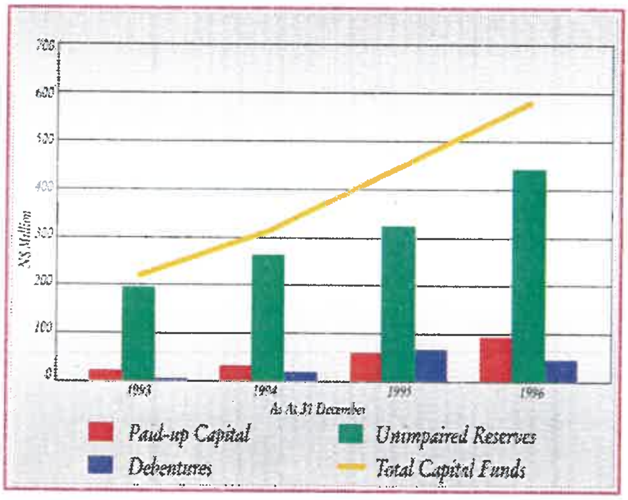


6.6.4 Capital Adequacy

The total capital funds of the banking system as at 31 December 1996 amounted to N$579.3 million *(Chart 6.7)*, representing an increase of

N$132.6 million, or 29.7 per cent, over the previous year . Unimpaired reserves, which accounted for 76.1 per cent of the total, registered a robust increase of N$117.4 million, or 36.3 per cent, during the year. Similarly, total paid-up capital grew significantly by N$34.7 million, or 59.8 per cent, in 1996. However, debt equity (mainly debentures issued in terms of the provisions of Section 14(2) of the Banks Act, 1965) decreased by 30.0 per cent over the same period.

Chart 6.7 Composition of Capital Funds



In relation to total assets, the banking system's capital funds ratio improved by 0.5 percentage points in 1996 to 7.9 per cent as at 31 December 1996. Although the capitalization of Namibian banks is considered adequate, efforts are under way to review and standardize the measurement of capital adequacy through the adoption of the risk-based capital adequacy framework. When implemented, this should provide a uniform measurement of capital adequacy that is in line with international banking standards.

6.6.5 Liquidity

Despite the discontinuation of bankers acceptances as eligible liquid assets in terms of the requirements of the Banks Act, 1965, liquid assets maintained by the banking system in 1996 were consistently above the minimum statutory requirement by an average of N$38.5 million. As at 31 December 1996, total liquid assets amounted to N$1.3 billion, representing an increase of N$318.4 million, or 32.9 per cent, over the previous year. Charts 6.8 and 6.9 indicate the composition and trend of liquid assets over the past two years, respectively.

Chart 6.8 Composition of Liquid Assets

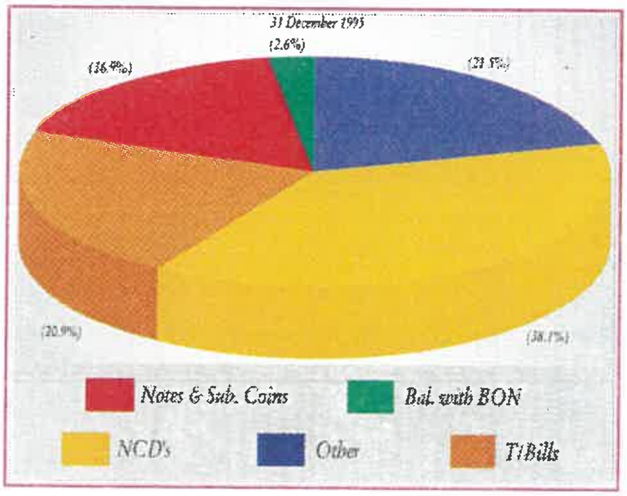
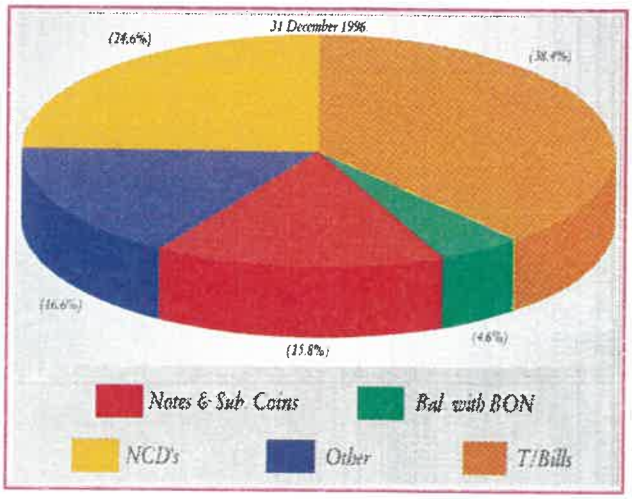


Chart 6.9 Composition of Liquid Assets



6.7 Performance of Building Society

Following the amalgamation of Namib Building Society with Bank Windhoek in the later half of 1996, only one building society, SWABOU, remained by the end of the year. Given that the industry report would reflect the financials of a single building society, only certain key data have been selected for analytical review in this report.

6.7.1 Asset Growth

The building society's total assets increased by N$23.4 million, or 2.5 per cent, to N$950.0 million as at the end of 1996 *(Table 6.4)*. The low growth rate registered in 1996 was in contrast with that of the preceding year which saw its total assets increase by 9.2 per cent. This was attributed mainly to the reduction in the building society's loans and advances portfolio, which fell by N$27.3 million, or 3.7 per cent, in 1996 to N$717.4 million. As at 31 December 1996, loans and advances constituted 75.5 per cent of total assets, 4.9 percentage points lower than the corresponding level recorded a year earlier.

On aggregate, funding through deposits increased slightly by 1.2 per cent to N$577.5 million in 1996, compared with a growth rate of 22.7 per cent in 1995. This low growth was, in turn, attributable mainly to significant decreases in fixed and savings deposits. These deposits decreased by 23.2 and 30.4 per cent, respectively, during the period under review *(Table 6.5)*.

Table 6.4 Key Balance Sheet Data
As at 31 December

	1994 N$ Million	% Change	1995 N$ Million	% Change	1996 N$ Million	% Change
Total Assets	848.4	18.6	926.6	9.2	950.0	2.5
Total Loans & Advances	691.8	20.5	744.7	7.6	717.4	-3.7
Total Deposits	465.0	50.4	570.8	22.8	577.5	1.2
Average Total Assets	781.7	17.8	887.5	13.5	938.3	5.7
Total Capital & Reserves	242.3	52.3	245.0	1.1	225.1	-8.1

Table 6.5 Deposits by Type
As at 31 December

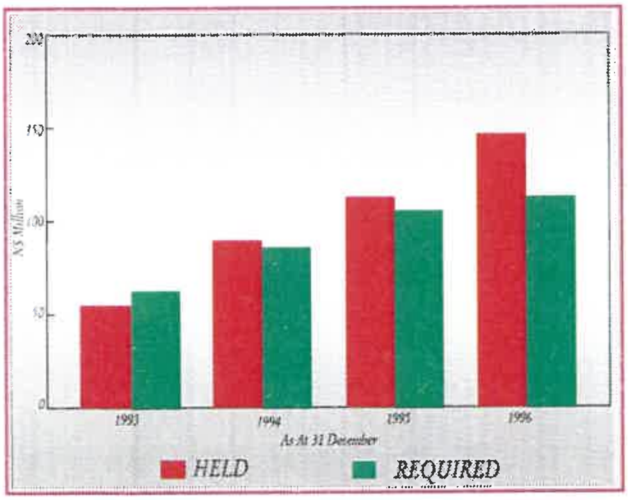
	1994 N$ Million	% Change	1995 N$ Million	% Change	1996 N$ Million	% Change
Fixed	147.3	-39.1	178.6	21.2	137.1	-23.2
Savings	49.9	-14.1	36.9	-26.1	25.7	-30.4
Transmission	262.5	4 584.0	349.3	33.1	408.0	16.8
Collateral	5.4	43.5	6.0	10.9	6.7	11.7
Total	465.1	50.4	570.8	22.7	577.5	1.2

Although a decrease was recorded in the loans and advances portfolio of the building society, collateral deposits increased by 11.7 per cent to N$6.7 million as at the end of 1996. This could be attributed to a more conservative lending policy on the part of the institution requiring higher collateral for loans granted.

6.7.2 Liquidity

After taking a sharp decline towards the middle of 1996, as a result of the aborted amalgamation with the other two institutions and the negative publicity that followed, the total liquid assets of the building society improved remarkably and was comfortably above the statutory requirement at the end of 1996 *(Chart 6.10)*.

Chart 6.10 Liquid Assets Compliance



The loan-to-deposit ratio dropped from 130.5 per cent as at the end of 1995 to 124.2 per cent as at 31 December 1996, indicating that loan growth was outstripped by deposit growth. Although this is a positive indication which generally reflects an improvement in the overall funding situation, the building society should restructure the profile of its deposits in favour of longer maturities.

6.7.3 Capital and Earnings

As at 31 December 1996, the building society's capital funds amounted to N$225.1 million. It remained one of the most capitalised financial institutions in Namibia. During 1996, the institution maintained its capital and reserves well above the statutory requirement, exceeding it by N$80.0 million as at the end of 1996.

Although the building society experienced a setback in the previous financial year, its earnings improved during the current financial year due to prudent credit management. Given current earnings statistics, there are clear indications that the building society should post a turnaround operating profit in its current financial year.

BOX 3: REVIEW OF EXCHANGE CONTROL IN NAMIBIA

Introduction and Regulatory Framework

Exchange Control within Namibia is regulated by the Currency and Exchanges Act No. 9 of 1933. The Regulations made in terms of the Act are contained in the Exchange Control Regulations, as amended. The Bank of Namibia, which has been delegated by the Minister of Finance with all the powers, functions and duties assigned to the Treasury under the Exchange Control Regulations has, in turn, delegated several of these powers to Authorised Dealers. These are commercial banks authorised to deal in foreign currency. A major function of Authorised Dealers is to assist the Bank in administering exchange control.

The latest developments with regard to policies and procedures are regularly communicated to Authorised Dealers by the issuance of Exchange Control Circulars.

There are no trade and exchange control restrictions on residents of member countries of the CMA[1] as they form a single exchange control territory. There are, however, exchange control restrictions on the dealings of residents of the CMA with non-residents. Non-residents, on the other hand, are subjected to very limited exchange controls.

Recent Developments

The Bank is moving towards a gradual relaxation of remaining exchange control restrictions. This commitment has again been emphasized with Namibia's accession to Article VIII, Sections 2, 3 and 4 of the IMF Articles of Agreement, with effect from 20 September 1996. IMF members that accept the obligations of Article VIII undertake to refrain from imposing restrictions on payments and transfers for current international transactions, or from engaging in discriminatory currency arrangements or multiple currency practices, without IMF approval.

The main objective of the IMF in urging member countries to accept the obligations of Article VIII is to promote a multilateral system of payments for current transactions between member states in the interest of achieving balanced growth in world trade and finance. When Namibia joined the IMF in 1990, the country was automatically classified by the Fund as an Article XIV country. The Article is intended to allow developing countries, especially those with weak balance of payments positions, to impose controls on international transfers until their external positions are sustainable.

Since Article XIV serves as a disincentive to investment, most countries have switched to Article VIII status which promotes confidence within international financial markets and provides some assurance to investors. In this regard, it is of interest to note that there have not been any real obstacles to Namibia acceding to Article VIII status as the country has no balance of payments problems and has recorded a surplus on the current account since 1990. It is believed that Namibia's Article VIII status will facilitate the flow of capital between the country and the rest of the world and will help in accumulating foreign reserves.

Another move toward exchange control relaxation is the ongoing process to divest more authority to Authorised Dealers. In this regard, the limits in the Exchange Control Rulings have been subjected to continuous review and adjustment. Further, policies have been formulated to make domestic credit more accessible to foreign controlled companies. Such companies can now borrow on the domestic market. Loans may not, however, exceed 100 per cent of shareholders' investments. Such borrowings were previously limited to 50 per cent.

Requests by Namibian institutional investors to invest abroad are now sanctioned by the Bank.[2] Such arrangements provide for the exchange of part of their existing asset portfolios for foreign assets.[3] The limit has now been revised to 10 per cent, an increase of 5 percentage points over the previous limit of 5 per cent. In addition, the Bank has introduced policies directed towards the off-setting of foreign liabilities against foreign accruals. This was prohibited in the past.

During 1996, the Bank also approved direct investment by corporates in countries outside the CMA. When reviewing such applications for investment abroad, potential long term benefits to Namibia are taken into consideration. Currently, the level of funds that may be transferred from Namibia for investment abroad is restricted to N$20 million. Any additional balance should be financed from foreign sources with no guarantee from or recourse to Namibia. In addition, income/dividends earned by the foreign subsidiary must be repatriated to Namibia in terms of Exchange Control Regulation 6.

It is worth noting that non-resident investors in Namibia are not subjected to exchange control restrictions. The proceeds from their sale of locally owned investments are freely transferable. Dividends and income earned on their local investments may also be transferred abroad, provided an auditor's certificate, confirming that such monies come from normal trading profits of the local concern, is obtained.

Apart from new policy measures, the Bank is also reviewing its operational procedures. In this regard, the Bank is introducing administrative reforms to allow Authorised Dealers to approve certain requests. These reforms are a further effort by Namibia's Exchange Control Authorities to cut down on tedious and time-consuming procedures and to enable Authorised Dealers to provide a more prompt and efficient service to their clients.

EPZ Enterprises

The EPZ Act was promulgated in 1995. However, in the absence of an Off-shore Banking Act, which should govern off-shore banking services for business enterprises in the EPZ, the Bank, with the cooperation of the banking system, made allowance for special banking facilities to be provided to EPZ Enterprises. Two types of banking accounts have been tailored to the needs of EPZ Enterprises.

(a) **EPZ Customer Foreign Currency Account**

This account will facilitate the foreign currency disbursements of EPZ enterprises and will be kept in foreign currency. Transactions through this account must conform to normal banking practices and be carried out with the full cognisance and approval of the Authorised Dealer concerned.

(b) **EPZ - Non-Resident Account**

This is a Namibia dollar account, funded with foreign currency, and used for the normal operational requirements/expenditure of the EPZ Enterprise and to facilitate local investments. Balances remaining in this account are freely convertible.

The future of exchange control in Namibia

Namibia is in the process of gradually phasing out remaining exchange control. This commitment was emphasised with Namibia's accession to Article VIII. To this end, the recent policy announcement regarding further exchange control liberalisation made by South Africa is welcomed by Namibia. Consequently, virtually all remaining current account restrictions will be abolished.

The current measures do not restrict the non-residents' flow of capital, but only apply to residents. To abolish capital restrictions on residents within the CMA, concerted efforts will have to be made to liberalise capital account transactions. In this regard, CMA countries continue to deliberate.

<u>**Notes:**</u>

[1] The Common Monetary Area consists of Namibia, South Africa, Lesotho and Swaziland

[2] Qualifying institutional investors are pension funds, insurance companies and unit trusts

[3] This arrangement is often referred to as "Asset Swaps"

PART C

OPERATIONS AND AFFAIRS OF THE BANK

1996

7. OPERATIONS AND AFFAIRS OF THE BANK

7.1 THE BOARD

The Board, comprising of six members as required by the Bank of Namibia Act, met from time to time to deliberate on issues of concern to the Bank.

Dr. Jafaar Ahmad served as the Governor of the Bank from January 1, 1994 until December 31, 1996. His contributions to the Bank were numerous and very valuable. Mr. Tom K. Alweendo, who has been serving as the Deputy Governor since January 1, 1993, succeeded Dr. Ahmad as the Governor of the Bank on January 1, 1997.

Mr. Lazarus S. Ipangelwa, previously Manager of Banking and Finance in the Research Department, was appointed Deputy Governor on January 1, 1997.

Mr. Petrus Damaseb and Mr. Anthony Botes continued to serve as Board members, positions they have held since July 1990 and December 1992, respectively. Mrs. Bience Gawanas-Minney and Mr. Paul W. Hartmann, who had served as Board members since July 1990, were succeeded by Ms. Paulina M Elago and Mr. Usituaije Maamberua from July 1996 and December 1996, respectively.

7.2 DEPARTMENTAL REPORTS

7.2.1 CORPORATE SERVICES DEPARTMENT

The Department comprises Human Resources, Administration and Information Systems. During 1996, the Human Resources Division, on behalf of the Bank, introduced changes to improve its staff relations and enhance transparency in its administrative procedures. A Communications Policy was put in place by the Public Relations Section to facilitate communication between staff and management and to contribute to a culture of participative management. To underscore the importance of transparency, staff must now be consulted on changes in policy or design of new policies. Communication within the Bank has been facilitated partly through the quarterly In-house Journal.

As part of the Bank's commitment to fair labour practices and the need to attract, retain and motivate quality employees, management conducted a comprehensive review of staff salary and benefit packages. The review was accompanied by the introduction of a new performance management system, which ensures high productivity and remuneration to staff, commensurate with contribution to work. The Bank's total staff compliment for 1996 was 160, comprising 73 females and 87 males.

1996 saw the Bank's continued commitment to human resources development and capacity building. During this period, one employee completed full-time study for a Master's degree in economics, two completed Bachelors degrees in Banking and Economics, and three completed post-graduate diploma courses in economics and finance. In addition, 66 short courses, seminars, workshops and conferences, held locally and abroad, were attended by staff members, while a large number of staff were trained in various in-house courses. In recognition of its social responsibilities, the Bank also awarded bursaries to two Namibian students, for the first time.

The Administration Division streamlined the Bank's asset management and procurement systems procedure. A number of policies, including the Assets Disposal Policy, were designed and various procedures, such as the Acquisition of Assets, were introduced or reviewed. The Division's organisational structure was also revised to include the Building Management unit and the Information and Documentation centre. This restructuring will enable the Division to manage the new Bank building effectively, as well as to meet increasing information and research needs.

As a support unit, the Information Systems Division's strategy is based on the Bank's needs and developments in Information Technology. The Division has strengthened its technical capacity to install and maintain systems as well as to provide effective support on networking and software applications.

7.2.2 FINANCIAL INSTITUTIONS DEPARTMENT

The Financial Institutions Department is organised into Regulations and Analysis, Bank Examinations, and Exchange Control divisions. To cope with the demands and challenges of a new legal framework and to establish the necessary administrative support structures, the Department was restructured to accommodate additional staff. The Department is responsible for banking supervision as well as the Bank's exchange control function. Provision has also been made to acquire much-needed legal expertise.

A detailed description of the activities performed by the Department during 1996 is given in the Statutory Report of the Registrar of Banks and Building Societies in Part B of this report.

7.2.3 INTERNAL AUDIT DIVISION

The Internal Audit Division is charged with the responsibility of reporting on the adequacy and effectiveness of the Bank's systems of internal accounting and operating controls and on compliance with relevant laws and regulations.

To enable it to accomplish its audit responsibilities more effectively, the Internal Audit Division was attached to the Governor's office. The Division is headed by the Chief Internal Auditor who reports functionally to the Chairperson of the Audit Committee. During the year under review, the Division assisted in establishing an audit committee, the compilation of the fixed assets register, and the establishment of the Institute of Internal Auditors - Namibia, a regional chapter of the Institute of Internal Auditors - South Africa.

The approval of the Internal Audit Charter by the Board of Directors in 1996 gave the Division an unrestricted scope of work and authority to access all of the Bank's activities, records and assets.

In the past, the Division experienced a high staff turnover and difficulty in recruiting due to the shortage of suitably qualified auditing professionals in Namibia. The Division will address this shortcoming through training and the Institute of Internal Auditors - Namibia.

The Division uses the Business Approach to Internal Auditing, a pro-active, risk-based method that helps it comply with the Standards for the Professional Practice of Internal Auditing. Training in the use of this approach was provided by a local auditing firm.

7.2.4 OPERATIONS DEPARTMENT

The Operations Department, in line with the Bank's restructuring process, now has three divisions which include Currency and Banking, Treasury, and Finance. The Currency and Banking Division is responsible for the issue of the National Currency and the provision of Banking Services to commercial banks and the Government. In December 1996, it issued two additional banknotes in N$20 and N$200 denominations, to complement the existing N$10, N$50 and N$100 notes in circulation. The issue of these additional notes will contribute towards operational efficiency in the financial system.

The Treasury Division is responsible for treasury management. This includes Reserve Management, Foreign Exchange Dealings, and Money Market Operations. Capacity building has been the Division's main focus. Recruitment of additional staff to enhance the capacity within the Division is considered a priority.

The Finance Division executes the financial accounting and reporting function but has also provided support services to treasury operations and facilitated various loans entered into by Namibia with foreign governments. The "Private Sector Global Loan Facility" is one such arrangement in which the Division will act as an agent for the Government and facilitate the on-lending of funds. See Box article 1 in this report for details.

7.2.5 RESEARCH DEPARTMENT

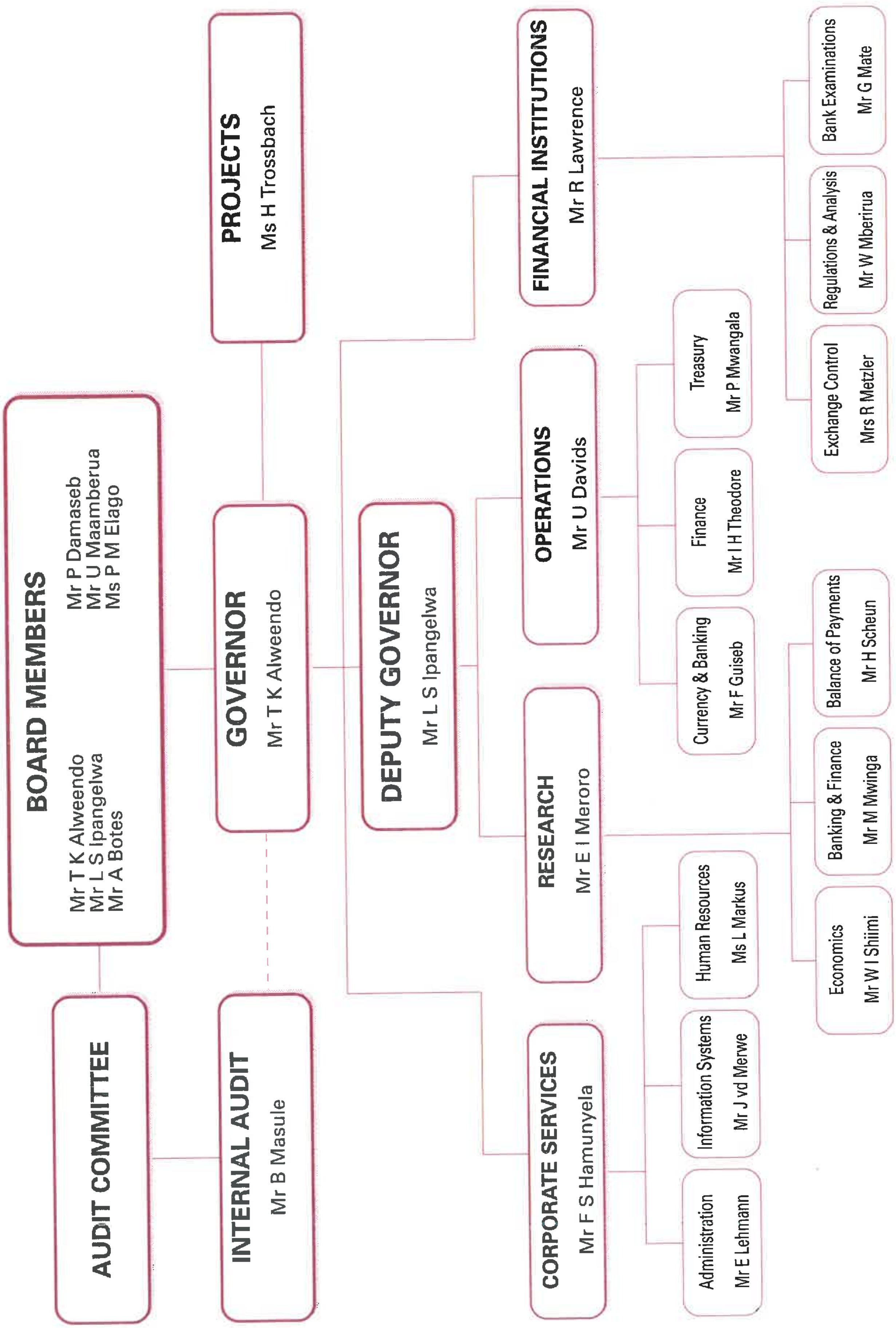
The Department has undergone restructuring in concert with the rest of the Bank. The new structure of the Department consists of the Economics, Banking and Finance, and Balance of Payments divisions. The head of the Department reports directly to the Deputy Governor. The new structure has allowed the Department to execute its duties efficiently.

During 1996, the Department produced the annual report, quarterly bulletins, and the monthly monetary and price developments report. In addition, it presented a bi-weekly economic report to management. The report covers the financial market and other economic issues. The collection and compilation of money and banking statistics, real sector statistics, and balance of payments statistics, has now become routine. Money and banking statistics are released on a monthly basis, while the real sector and balance of payments statistics are published on a quarterly and yearly basis, respectively.

Several research papers were undertaken during 1996. One dealt with the impact of South African bank rate changes on the Namibian economy. Another analysed the problems faced by small and medium sized enterprises in borrowing from the commercial banks.

The Department sent researchers to courses relating to monetary policy in developing countries and on financial programming and policy at the International Monetary Fund. To address the new challenges facing the Department, a new section for forecasting and modelling was added.

7.3 ORGANISATIONAL CHART



PART D

ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 JANUARY 1997

8. ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 JANUARY 1997

GOVERNOR'S STATEMENT

Pursuant to Section 9(5) of the Bank of Namibia Act, 1990, I confirm that:

1. I am responsible for the preparation of the annual financial statements and for the judgements used therein;

2. I am responsible for establishing and maintaining the systems of internal control designed to provide assurance as to the integrity and reliability of the Bank's financial reporting;

3. In my opinion, the attached annual financial statements for the year ended 31 January 1997 fairly present the financial position of the Bank and the results of its operations.

GOVERNOR

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBER OF THE BANK OF NAMIBIA

We have audited the annual financial statements set out on pages 84 to 88. These annual financial statements are the responsibility of the Board of Directors of the Bank. Our responsibility is to report on these annual financial statements.

We conducted our audit in accordance with generally accepted auditing standards. These standards require that we plan and perform the audit to obtain reasonable assurance that, in all material respects, fair presentation is achieved in the annual financial statements. An audit includes an evaluation of the appropriateness of the accounting policies, an examination, on a test basis, of evidence supporting the amounts and disclosures included in the annual financial statements, an assessment of the reasonableness of significant estimates and a consideration of the appropriateness of the overall financial statement presentation. We consider that our audit procedures were appropriate in the circumstances to express our opinion presented below.

In our opinion these annual financial statements fairly present the financial position of the Bank at 31 January 1997 and the results of its operations for the year then ended in the manner required by the Bank of Namibia Act, 1990.

Deloitte & Touche
Chartered Accountants
WINDHOEK

Deloitte & Touche

30 April 1997

BANK OF NAMIBIA

APPROPRIATION ACCOUNT FOR THE YEAR ENDED 31 JANUARY 1997

	NOTES	1997 N$	1996 N$
Net profit from operations after meeting all current expenditure and making provisions as required by Section 6 of the Bank of Namibia Act, 1990. ('the Act')		39 579 723	44 319 957
Less: Transfer to Reserves:			
General Reserve under Section 7(1) of the Act	3	9 894 931	11 079 989
Building Reserve under Section 7(2) of the Act	6	14 842 396	23 239 968
Surplus paid to Government under Section 7(3) of the Act		14 842 396	10 000 000

BANK OF NAMIBIA

BALANCE SHEET AT 31 JANUARY 1997

	NOTES	1997 N$	1996 N$
CAPITAL EMPLOYED			
Share Capital	2	40 000 000	40 000 000
General Reserve	3	42 350 455	32 455 524
Revaluation Reserve	4	157 961 731	34 746 240
Special Reserve	5	2 535 000	2 535 000
Building Reserve	6	50 926 292	36 083 896
Capital and Reserves		293 773 478	145 820 660
Currency in Circulation		395 651 206	356 118 850
Deposits	7	437 758 332	553 208 386
Long Term Loan Facility	9	844 049 910	758 083 342
Other Liabilities		17 207 288	13 372 706
		1 988 440 214	1 826 603 944
EMPLOYMENT OF CAPITAL			
Rand Cash		3 877 379	3 668 083
Investments	10	1 034 620 358	1 014 533 287
Loans and Advances			
Government	9	844 049 910	766 959 273
Other		36 245 856	2 552 238
Other Assets	8	69 646 711	38 891 063
		1 988 440 214	1 826 603 944

TOM K. ALWEENDO
GOVERNOR
30 April 1997

UBAIDULLAH DAVIDS
CHIEF FINANCIAL OFFICER
30 April 1997

BANK OF NAMIBIA

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
31 JANUARY 1997

1. ACCOUNTING POLICIES

The Bank's annual financial statements are prepared on the historical cost basis. The annual financial statements have also been prepared to comply with the requirements of the Bank of Namibia Act, 1990. The principal accounting policies, which have been consistently applied in all material respects, are set out below.

1.1 Fixed assets

Immovable fixed property is stated at cost and is not depreciated. Computer software expenditure incurred after 1 February 1994 is written off in the year of acquisition. All other movable fixed assets are depreciated to write off their costs over their estimated useful lives on the straight line basis.

1.2 Investments

Investments are adjusted to take account of discounts earned or premiums paid, over their remaining life, so that book value at maturity equals the redemption value.

Some investments include realised and unrealised capital appreciation, or depreciation, which are taken into account to reflect the change in market value, particularly for those financial instruments which are not necessarily held to maturity date.

Interest from investments is accounted for on the accruals basis.

1.3 Foreign Assets and Liabilities

In terms of Section 32 of the Bank of Namibia Act, 1990, foreign assets and liabilities are translated at year end exchange rates and any gains or losses are transferred to the Revaluation Reserve Account.

1.4 Currency Inventory Account

The costs of new Namibia bank notes and coins purchased by the Bank are capitalised in the Currency Inventory Account and expensed on issue of the currency for a period not exceeding five years from date of acquisition.

2. SHARE CAPITAL

	1997 N$	1996 N$
Authorised Capital		
40 000 000 ordinary shares of N$1 each	40 000 000	40 000 000
Issued Capital		
40 000 000 ordinary shares of N$1 each	40 000 000	40 000 000

BANK OF NAMIBIA

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
31 JANUARY 1997

		1997 N$	1996 N$
3.	**GENERAL RESERVE**		
	Opening Balance	32 455 524	21 375 535
	Transfer from Appropriation Account	9 894 931	11 079 989
	Closing Balance	42 350 455	32 455 524
4.	**REVALUATION RESERVE**		
	Opening Balance	34 746 240	25 064 928
	Revaluation of Foreign Assets	123 215 491	9 681 312
	Closing Balance	157 961 731	34 746 240
5.	**SPECIAL RESERVE**		
	This reserve has been created to meet the costs of replacing and producing the national currency.	2 535 000	2 535 000
6.	**BUILDING RESERVE**		
	Opening Balance	36 083 896	12 843 928
	Transfer from Appropriation Account	14 842 396	23 239 968
	Closing Balance	50 926 292	36 083 896

This reserve has been created to meet the cost of building the new headquarters for the Bank.

BANK OF NAMIBIA

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued) 31 JANUARY 1997

		1997 N$	1996 N$
7.	**DEPOSITS**		
	Government	362 553 984	498 487 996
	Domestic Bankers' Current	1 000 394	0
	Bankers' Reserve	36 538 000	26 042 000
	Other	37 665 954	28 678 390
		437 758 332	553 208 386
8.	**OTHER ASSETS**		
	Fixed Assets		
	Movable Assets		
	Cost	10 824 879	11 870 796
	Accumulated Depreciation	7 347 435	7 365 998
	Net Book Value	3 477 444	4 504 798
	Immovable Property - at cost	40 437 468	11 013 077
		43 914 912	15 517 875
	Currency Inventory Account	9 012 505	7 429 269
	Accounts Receivable	16 639 175	15 879 202
	IMF - Special Drawing Rights	80 119	64 371
	Bankers Current	0	346
		69 646 711	38 891 063

9. **LONG TERM LOAN FACILITY AND LOAN TO GOVERNMENT**

9.1 A bilateral agreement was entered into on the 24th March 1997 between the governments of Namibia and South Africa for the transfer of the current debt facility commitment to the government of South Africa. It now remains for the respective parliaments to ratify the agreement to allow for the finalization of the legal arrangements.

9.2 An amount of N$16 103 167 in respect of an interest rate differential was written off in order to bring the two loans in line with each other.

BANK OF NAMIBIA

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued) 31 JANUARY 1997

		1997 N$	1996 N$
10.	**INVESTMENTS**		
	Investments are made up as follow:		
	Rand Currency	309 310 200	466 224 821
	Other Currencies	722 390 718	539 995 864
	Interest Accrued	2 919 440	8 312 602
		1 034 620 358	1 014 533 287

11. COMMITMENTS

11.1 Capital Expenditure

Contracted:

	1997 N$	1996 N$
New Bank Headquarters	77 720 876	104 730 920
	77 720 876	104 730 920

These commitments are to be financed from both internal and external sources.

11.2 Commemorative Coins

A contingent liability of N$156 584 (1996: N$ 94 319) exists at 31 January 1997 in respect of commemorative coins issued.

11.3 Forward Exchange

The Bank has entered into a forward exchange arrangement whereby an amount of YEN 158 017 427 (1996: YEN 269 020 507) inclusive of interest, is outstanding and repayable at exchange rates estimated by the Bank.

11.4 Guarantees

The Bank guarantees a percentage of housing loans granted to employees by certain financial institutions. Half of the guarantee is given by way of collateral security in the form of deposits at the respective financial institutions and the balance by way of a written obligation from the bank.

BANK OF NAMIBIA

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued) 31 JANUARY 1997

12. PENSION FUND

Pensions are provided for employees by a separate Pension Fund to which the Bank contributes. The Pension Fund is governed by the Pension Fund Act. The Pension Fund is in the nature of a defined benefit plan where the retirement benefits are determined with reference to the employee's pensionable remuneration and years of service. All employees contribute to the Pension Fund.

The Fund is subject to an actuarial valuation every three years. Any shortfall will be made good by the Bank as recommended by the actuaries. A valuation was undertaken in March 1996 and no adjustments were recommended.

13. COINS WRITE OFF

An amount of N$975 000 has been written off against income in respect of coins stolen during October 1996. It is estimated that approximately N$100 000 will be recoverable.