Economic Review

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Introduction

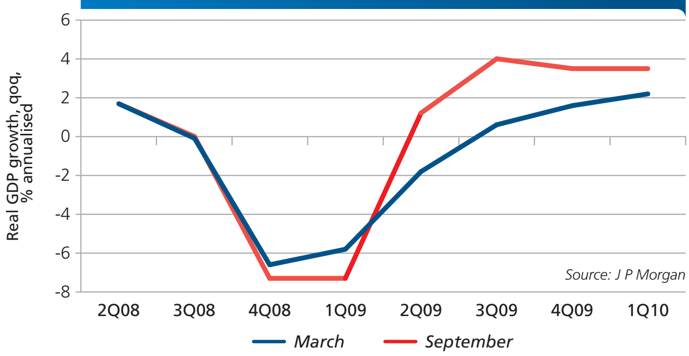
The third quarter of 2009 has seen a range of mixed, but broadly positive, economic developments and data releases. Globally, as economic recovery takes place, benefits are feeding through to Botswana's mining sector with improved exports and increases in production. This is expected to continue as global economic growth picks up and there is a slow recovery in consumer spending, especially in the USA. In the diamond market, however, retail sales of jewellery remain weak, and prospects for the next 24 months remain uncertain.

While the mining sector was badly hit by the global recession, the non-mining sector of the economy seems to have escaped relatively lightly, and new GDP data indicate that non-mining growth has remained robust, at least up until the middle of 2009. Nevertheless, there are some warning signs pointing to potential problems in coming months. First, the negative impact of the global downturn on mineral exports is now spreading to other exports, particularly of manufactured goods such as garments, and tourism. Second, industries dependent upon domestic consumption spending are coming under pressure as banks have restricted credit growth and household budgets are being increasingly squeezed.

Global Economy

Recent global economic news indicates that the world economy is recovering from recession at a reasonably healthy pace. Indeed, forecasts of the pace of recovery have been steadily revised upwards (see Figure 1), and suggest that global growth should rise to about 3.5% in the second half of 2009. While growth for 2009 as a whole is still likely to be negative, reflecting the depth of the recession in the first half of the year, the pace of recovery should be sustained into 2010. As has been apparent for some time, emerging economies are growing faster than the developed economies, and are likely to continue doing so for the foreseeable future. Just as there was a "vicious circle" in the rapidly deepening global recession in late 2008 and early 2009, as global economic and trade linkages reinforced the slowdown, there now appears to be a "virtuous circle" as a synchronised global recovery takes hold.

Figure 1: Global Growth Forecasts, March & September 2009



Nevertheless, the global economic situation is far from returning to normal, and many risks remain. In the major developed economies, consumer confidence and demand has improved from the low points reached earlier in 2009, but remain weak. One noticeable trend is a sharp rise in savings rates as households attempt to rebuild their assets, which in many cases have been decimated by collapsing house prices and stock market valuations. Higher savings make sense in the longer term, particularly in the USA where household savings rates had fallen to very low levels, but do not help the recovery which in the short term is dependent upon spending, not saving. Unemployment, which is a lagging indicator, continues to rise, and this will act as a drag on the broader process of recovery.

In addition, some of the global recovery is due to transient factors. Just as the recession was partly driven by the running down of inventories (so that output fell even more than sales), the recovery is being driven in part by the rebuilding of inventories as economic conditions improve, a process that will not be sustained indefinitely. In addition, fiscal stimulus packages have contributed to economic recovery, but are time-limited. Their immediate impact is clear – for example the scrapping allowances for old motor vehicles that have boosted new vehicle sales and contributed to recovery in the global motor industry – but the benefits may be short-lived as the scale of the stimulus has to be wound down.

There are also uncertainties regarding the global financial system, which should not be obscured by publicity over the recovery in bank profitability and the return of bonuses for bankers. Many banks still face problems of losses from bad investments, poor quality assets on their balance sheets, and dependence upon government support. These difficulties still have to be resolved, and many banks still face challenges of raising new capital and paying back loans from governments. In addition, while it is certain that the supervision and regulation of financial institutions will change, the likely form of these new supervisory arrangements remains uncertain.

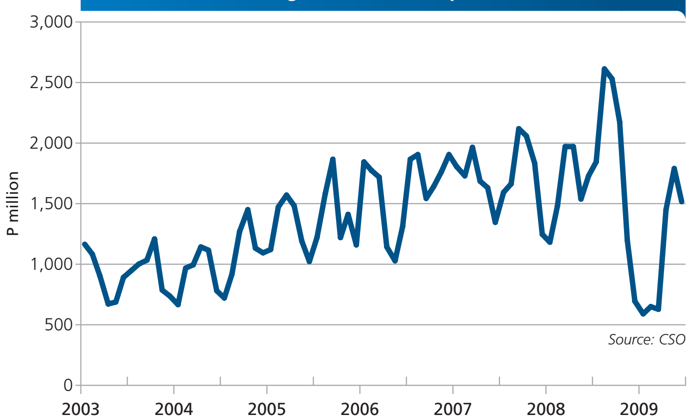
The most direct impact of these developments on Botswana is via the diamond market, and as economic recovery has gathered pace, the global diamond market has shown some improvement. This reflects a number of developments, including improved credit availability that has enabled diamond cutters, polishers, wholesalers and retailers to undertake some re-stocking. Activity in the retail jewellery market has also improved, but sales remain weak and are still well down on 2007-8 levels, especially in the USA which remains the world's largest market for diamonds. Much of the recovery in the demand for rough diamonds represents demand from re-stocking rather than buoyant retail demand, and may therefore be short-lived. Rough diamond prices have also recovered, driven by a combination of improved demand and reduced supply levels. However, as major producers such as Debswana (De Beers) and Alrosa return to the market, prices may soften again, especially if demand remains uncertain.

Botswana Economy

Exports

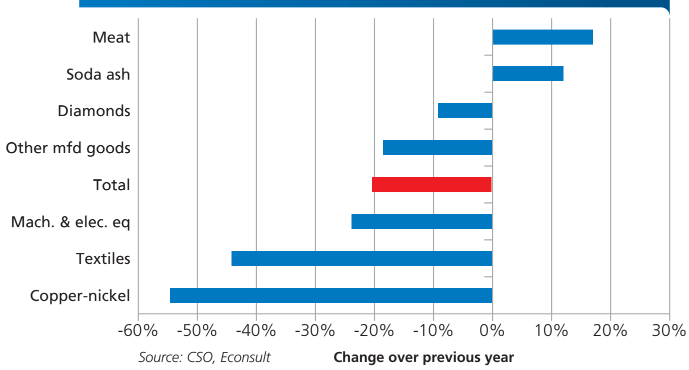
Developments in the global diamond industry have helped to boost Botswana's diamond exports, which have recovered strongly since April. During the three months from April to June, diamond exports averaged P1.58 billion a month, not far below the monthly average of P1.75 billion during the comparable period in 2008.

Figure 2: Diamond Exports



While diamond export performance has been improving, there is a more mixed picture overall. The second largest goods export, copper-nickel, continued to suffer, with exports down more than 50% compared to 2008 (although with much improved copper and nickel prices since July, performance in the third quarter is likely to be much better). Of more concern is the gradual spread of the export slowdown to non-mineral exports – textile/garment exports were down 44% in the second quarter of 2009 compared to 2008, and other manufactured exports were down by more than 20%. Data on tourism exports are not yet available, but anecdotal evidence suggests that visitor numbers are well down on 2008. While these non-traditional exports (tourism and manufactures) are still relatively small in revenue terms compared to mineral exports, they are very important from an employment perspective.

Figure 3: Export growth 2009Q2



Economic Growth

GDP data for the period to June 2009 provide evidence of the impact of the global recession on the economy as a whole. Real GDP over the year to June shrank by 2.1%, the same as in the year to March. The first half of 2009 was the first time that annual GDP has fallen since the current GDP series was introduced in 1994. However, while negative economic growth is obviously unwelcome, the impact of the global recession on GDP has been surprisingly modest so far. Expectations were that the negative impact on GDP would be substantially larger than this.

The second quarter GDP figures were good for a number of reasons. First, as expected, mining output recovered as the diamond mines re-opened. In fact the recovery in output was quite robust, so that mining sector output in the second quarter was only 19% lower than in the same period in 2008, whereas in the first quarter it had been 69% lower. Second, the non-mining portion of the economy has shown surprising resilience, and seems to have shrugged off adverse developments in the mining sector and elsewhere in the world. Value added in the non-mining private sector grew by a remarkable 9.3% in the year to June, up from 8.6% in the year to March. The steady growth of non-mining GDP contrasts with the slowdown in the mining sector, and indeed with declining growth elsewhere in the world. Growth has been particularly robust in agriculture, construction and transport and communications, although weak in manufacturing.

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Figure 4: Mining & Non-mining Output

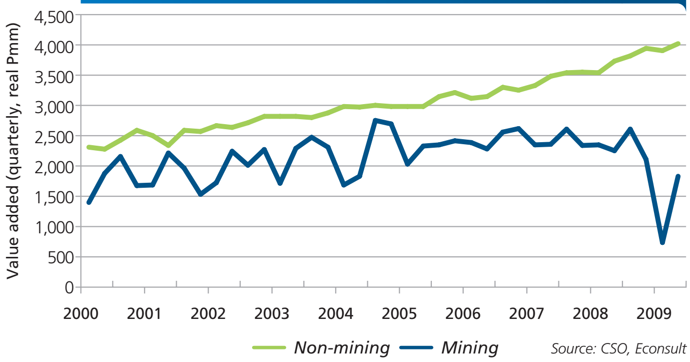
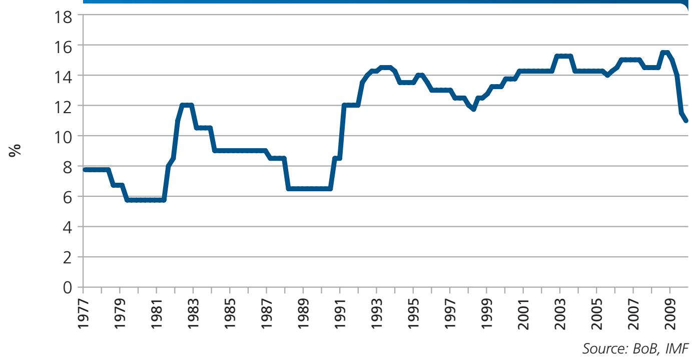


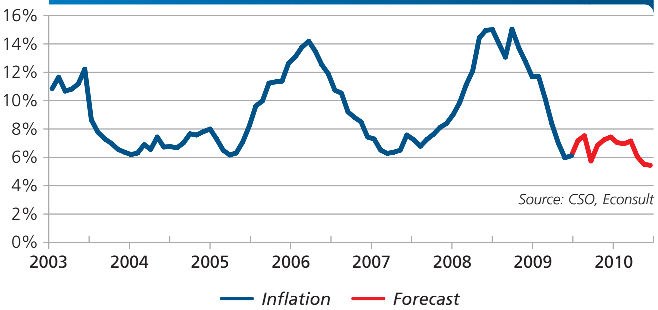
Figure 6: Bank Rate



Inflation and Monetary Policy

The sharp decline in inflation that has taken place during that first half of 2009 continued through to July, when inflation reached 6.0%, the lowest figure since early 2002. There was a small increase in August, to 6.1%, which was anticipated following an increase in fuel prices. Inflation is expected to increase in September and October, but should fall again in November when the impact of last year's alcohol levy falls away. As underlying inflationary pressures are low, both domestically and internationally, inflation is likely to remain around current levels for some time; our forecast is that inflation will fluctuate in a range between 5.5% and 7.5% over the next 12 months. The main uncertainty stems from international oil prices, and any sharp increase in oil prices from current levels would push Botswana inflation up again.

Figure 5: Inflation



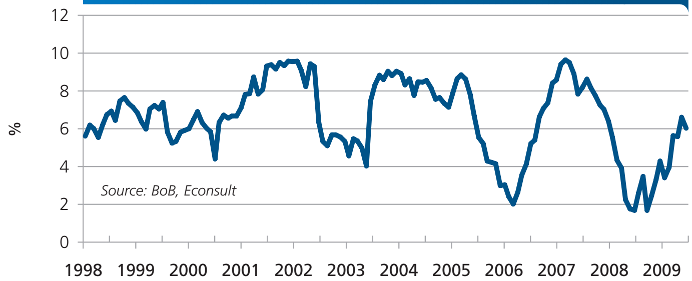
With inflation falling to 6.0% in July, it reached the upper end of the Bank of Botswana's inflation objective range (3-6%). This is the first time that inflation has met the BoB's objective since 2007, when it spent several months inside the range (which was then 4-7%).

Improved inflation performance coupled with a weak economic outlook has enabled the Bank of Botswana to cut interest rates dramatically, most recently by 0.5% on August 25th. In an aggressive easing of monetary policy, the Bank Rate has been cut by a total of 4.5% over the past year. At 11.0%, the Bank Rate is now at its lowest level since January 1991 – in other words the lowest since the current era of actively using monetary policy to control inflation began.

The reduction in the Bank Rate has fed through to other interest rates. The BoBC rate is now at just over 8%, the lowest since BoBCs were introduced in May 1991, and the long-term government bond yield at the latest auction in September was around 7.5%, down from 10% a year ago. While the reduction in interest rates is good news for borrowers, it is less good for savers, who struggle to get a positive real return.

What are the prospects for interest rates? With interest rates so low and inflation not yet firmly entrenched within the objective range, the BoB may now pause in its cutting cycle, waiting until the direction of inflation from the current low becomes clearer before undertaking any further reductions. However, real interest rates remain high, especially given concerns about economic weakness, and this would provide a motivation for further interest rate reductions.

Figure 7: Real Prime Lending Rate

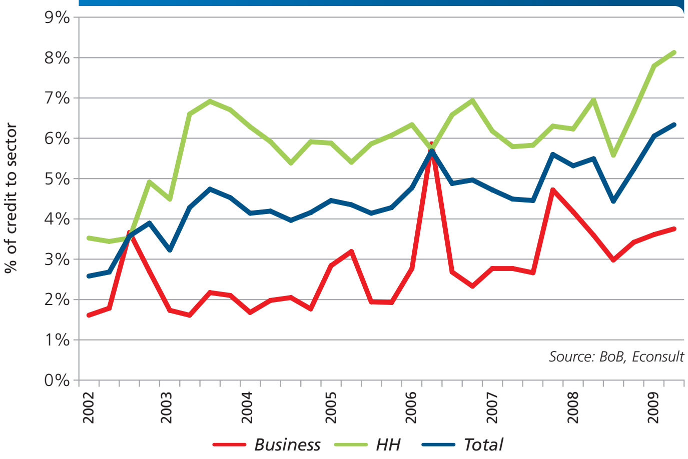


Bank Credit

Despite cuts in interest rates, bank credit growth has slowed dramatically during 2009. Between the first and second quarters of the year, total bank credit only grew at an annualised rate of 2%. The slowdown affected both household and business borrowing, with household credit growing at an annual rate of 4.4%, while credit to private businesses shrank, contracting at a rate of 9.5%. This is unprecedented in recent years, and reflects both a tightening of credit conditions by the banks and a reluctance by borrowers to take on further debt that they might have difficulty servicing.

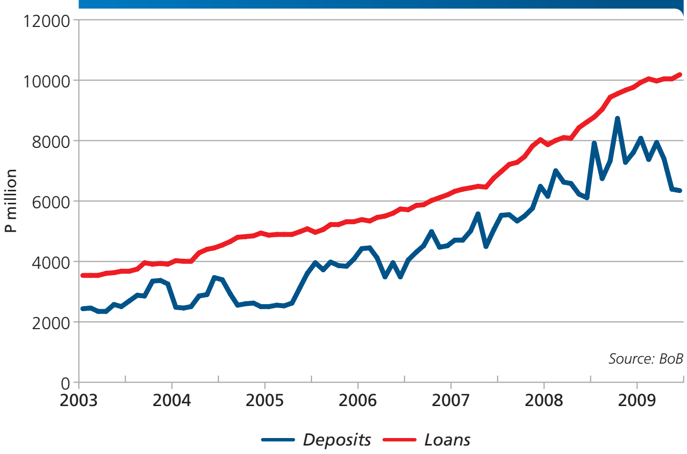
Difficulties in servicing debt are manifested in rising arrears levels, which have jumped in the first half of 2009, particularly for households for whom arrears are now at record levels. In these circumstances it is not surprising that the banks have become more cautious in granting loans.

Figure 8: Arrears on Bank Lending



The precarious situation of households can be seen in the widening gap between household borrowing from banks and household deposits. In recent years, household borrowing has consistently exceeded savings – making households net borrowers from the banking system – but both have grown at similar rates and the net debt position has been fairly constant. Since the beginning of 2009, however, even though credit growth has slowed, it appears that households have been drawing down their savings in order to maintain spending levels, and net household debt has increased sharply. This suggests that household incomes are under pressure. While this is a reasonable strategy to maintain living standards in the face of short-term economic difficulties, it is not sustainable in the longer term. Unless household incomes start to recover, it will eventually become necessary for spending to be cut back in order to prevent household indebtedness from becoming excessive.

Figure 9: Household Deposits and Loans



Economic Outlook

The economic outlook has improved during the third quarter of 2009, with brighter prospects for the global economy, which is now recovering faster than seemed likely six months ago. Botswana's mining sector has recovered along with the global economy. It is also encouraging that the non-mining segment of the economy has, so far at least, come through the global crisis relatively unscathed. In the light of these developments, we now forecast that Botswana's economy should contract by around 6% in 2009. This compares with earlier forecasts of negative GDP growth of 10% or more, and a recent projection from the Ministry of Finance and Development Planning that GDP would shrink by 12.8% in 2009/10, which we consider to be too pessimistic.

Of course many risks remain. Internationally, the recovery could easily be derailed in the short-term, and looking further ahead the growth of fiscal deficits in many developed countries is generating massive debt burdens that will eventually have to be dealt with – and themselves pose a risk to recovery by pushing up interest rates. Amongst Botswana's export markets, diamonds have recovered somewhat but remain very uncertain and volatile, due to weak demand in retail jewellery markets and low profitability throughout the industry. Copper-nickel should benefit in due course from a more steady recovery in global demand. For other exports – manufactured goods and tourism – recent performance has been poor. The prospects for recovery are uncertain at this point in time, especially as South Africa – one of the most important markets for non-mineral exports – is lagging other emerging markets in the pace of its economic recovery.

There are also risks from domestic demand. Over the past year, government spending has played an important role in supporting economic activity, but at some point the growth rate of government spending will have to slow down, especially with revenues under pressure, reserves declining and debt mounting. Household spending has also been an important contributor to the economy. In contrast to consumers in other countries who are saving more and spending less in response to the global recession, Botswana consumers have been saving less and spending more. This cannot go on for ever, and as savings decline and the debt burden mounts consumers will eventually have to cut back on their spending. These factors – weak non-mining exports, a slowdown in government spending and consumer demand – are likely to eventually lead to a weakening of activity in the non-mining segment of the economy. If this occurs as the mining sector is recovering then the overall impact on GDP will be limited; however, the main concern is the impact on employment growth, which has been weak even while the economy has been growing strongly.

Box: World Bank Doing Business Report 2010: How Does Botswana Fare?

The World Bank "Doing Business" (DB) report is published annually and investigates regulations that enhance or constrain business activity. It presents quantitative indicators compared across 183 countries. A focus is placed on regulations affecting 10 stages of a business life: starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business.

Botswana has traditionally fared quite well in the DB index, at least by African standards. In DB2010, Botswana is ranked 43rd in the world, and is the 3rd best ranked country in SADC (after Mauritius and South Africa).

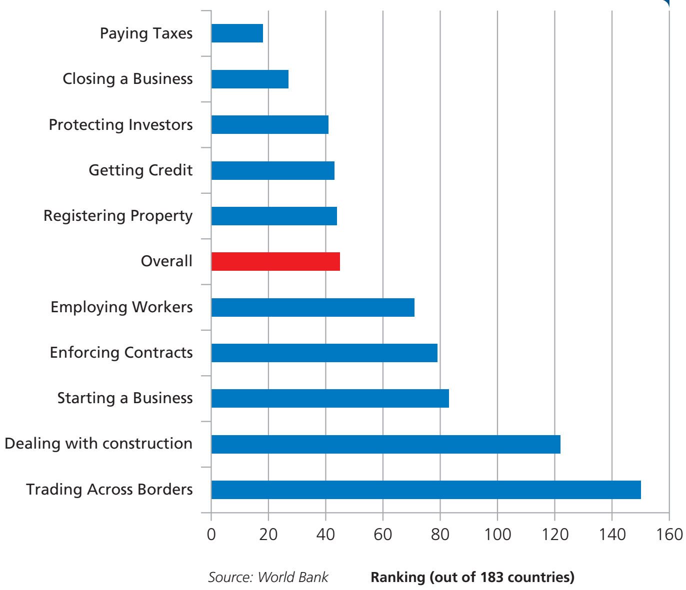
Figure 10 shows how Botswana is ranked globally according to the ten categories that make up the overall DB index. Botswana's best ranking is in terms of paying taxes, where it is ranked 18th in the world. What this means is that Botswana is not only competitive when it comes to tax rates but also that the number of tax payments, frequency of payments and the time taken to process such payments are relatively low. Botswana also does well in terms of closing a business, protecting investors, getting credit and registering property. By and large these reflect the rule of law, a relatively efficient legal process, and good access to information.

On the downside, Botswana has received a very low ranking for trading across borders (150). This is due to the cumbersome procedures, delays and costs associated with importing and exporting. Since it looks at requirements for exporting and importing a standardized cargo of goods by ocean transport, Botswana is unsurprisingly disadvantaged because of its inland location, but this illustrates the important of doing well on other indicators that can be controlled. Botswana also does badly on dealing with construction permits (122). This considers the procedures required for a business to build a standardized warehouse. These procedures include submitting all relevant project-specific documents (for example, building plans and site maps) to the authorities, obtaining all utility connections and registering the property so that it can be used as collateral or transferred, obtaining all necessary clearances, licenses, permits and certificates, completing all required notifications, and receiving all necessary inspections. The low ranking on this measure suggests that the process is unnecessarily bureaucratic and slow. Botswana also does badly on starting a business, again due to bureaucracy and delays.

Botswana has fallen in the rankings from 39th in DB09 to 45th in DB10. This is notably due to deterioration in the rankings for registering property (down 17), protecting investors (-3) and getting credit (-2), while only enforcing commercial contracts (+15) has improved.

There was much celebration in 2008 when Botswana's Doing Business rankings improved. This year's reversal should prompt a determined effort to do away with unnecessary bureaucracy and impediments to doing business. In principle, this has been accepted by Government. In practice, however, the story is different. The Trade Act, for instance, has introduced a new "miscellaneous" licensing category that is being applied indiscriminately to all sort of businesses that have never needed to have licenses in the past. Business license renewals have become more difficult rather than easier. Such changes need to be carefully considered from a business rather than a bureaucratic point of view before being introduced – and scrapped if they do not contribute positively to the business environment.

Figure 10: Doing Business 2010 Ranking



Source: World Bank