

## COMMENTARY ➤

## 2013 in Retrospect

As we reached the end of 2013, there was a widespread perception that the year had been a difficult one for the Botswana economy. This seems to have been mostly driven by concerns about reduced government spending, a lack of jobs, squeezed real incomes for some households, and a continued high level of inequality.

But on the macroeconomic front at least, things were not that bad. Inflation ended the year at 4.1%, the lowest end-of-year rate recorded in Botswana since the measurement of inflation in 1971. Interest rates were at their lowest for 23 years. Although figures for the whole year were not available for some of the indicators, the latest data showed encouraging signs. Overall GDP growth at the end of the third quarter was a respectable 5.9%, and will probably end the year around 5%.

Exports showed strong growth in the first three quarters of the year, even without the impact of the De Beers relocation. The balance of payments have improved and the foreign exchange reserves have been rising. There were other positive developments, including the relocation of De Beers Global Sightholder Operations from London to Gaborone, and the commencement of operations by the Okavango Diamond Company, confirming the emergence of Gaborone as a global diamond marketing hub. Internationally, there has been slow but steady recovery of the global economy, and the "worst case" scenarios of euro collapse and US debt default were avoided. So, despite some evident problems, there was much that was encouraging on the economic front in 2013.

The obvious question that many people are asking is, will 2014 be better than 2013? In our view, many positive aspects of the economy will continue. The world economy should show continued growth. The global market for rough diamonds will still face difficulties resulting from low margins and tight liquidity in

the cutting and polishing industry, but conditions should be supportive of a continued recovery in output, and perhaps higher prices later in the year. Botswana's economic growth in 2014 is expected to be around 5%, similar to that of 2013. Inflation should remain low, in the range of 4%-5%, which will support continued low interest rates.

But there are some negatives. Apart from diamonds, other minerals are in global oversupply with weak prices, including nickel, copper and coal, which is not encouraging for the diversification of Botswana's mining sector. Household debt levels are a major concern. And perhaps most worrying, is the shortage of water in the south of the country, and nationwide problems with electricity supply – these issues look set to continue holding back growth, and more generally contribute to a feeling of dissatisfaction and undermine business confidence.

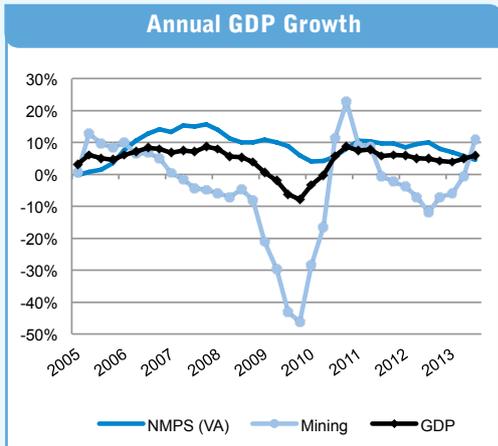
The major event of the first quarter of 2014 will, as always, be the Budget Speech, to be delivered on February 3rd. The Budget Strategy Paper (BSP) made available in October 2013 indicated that the budget outturn for the current fiscal year (2013/14) would be less favourable than originally anticipated at the time of the 2013 Budget. A budget deficit is now being projected for 2013/14, due largely to unanticipated spending on power supplies and drought relief. Although there were general perceptions of cutbacks in government spending in 2013, this was not the case, as spending actually increased by 10% over the previous year, and development spending increased by 48%.

For the coming financial year (2014/15), government is intending to get its "fiscal consolidation" programme back on track. Simply put, this means that spending will, in principle, be reduced – a cut in government spending of over 4% is being projected in the BSP. Combined with a modest increase in anticipated revenue, this should be enough to generate a small budget surplus. However, those who are seeking relief from fiscal austerity – whether actual or perceived – are likely to be disappointed.

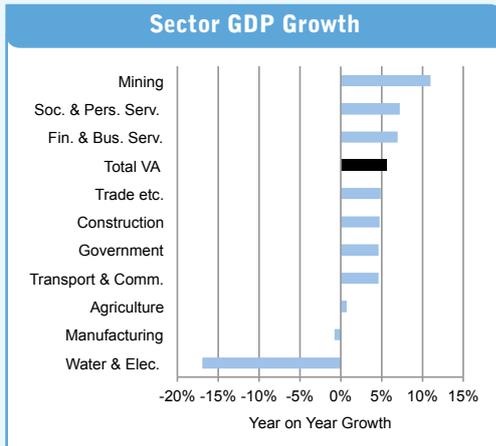
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## KEY ECONOMIC VARIABLES ↘



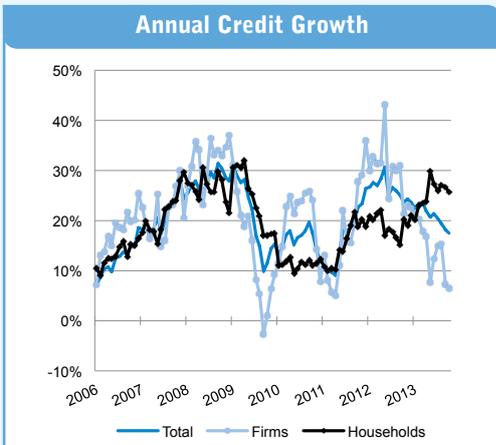
During the year to September 2013, the economy grew by 5.9%, an increase from the 4.9% growth realised during the year to June. This is attributable to the turnaround of the mining sector which grew by 11.0% during the four quarters to September 2013. However, the non-mining private sector continued to slow down, only growing by 4.6% during the year to September 2013.



Owing largely to the recovery in diamond production, mining was the fastest growing economic sector during the year to September 2013. Indeed, this is the first time for two years that mining has shown positive annual growth. Services sectors were also amongst the fastest growing sectors during the 12 month period. Two sectors contracted during the year to September, being manufacturing and water & electricity.

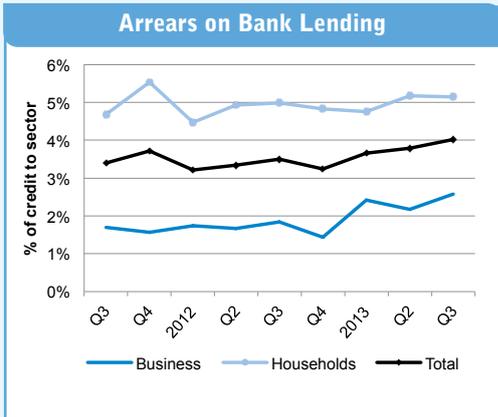


The Bank of Botswana's H2 2013 Business Expectations Survey (BES), conducted between September and November, show that overall business confidence fell from 47% in March 2013 to 45% in September. Confidence amongst exporting firms fell from 44% in H1 2013 to 38% in H2 2013, while that of non-exporting firms (i.e. those serving the domestic market) remained unchanged at 49%. The results are not entirely consistent with other economic data, given the continued recovery of the international economy and the slowing down of the growth of the domestic non-mining private sector.

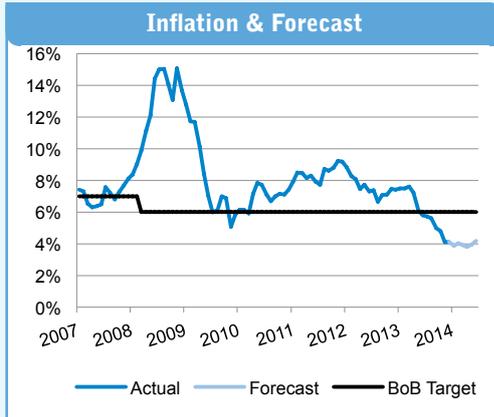


Q3 2013 was characterized by a slight slowing of credit growth. Annual bank credit growth stood at 18.2% in September 2013, compared to 21.4% in June. The annual growth rate of credit to households remained very high at 26.7% in September, while the growth of credit to firms fell to a very low 7.3%. Interestingly, the growth of credit to households is largely driven by property loans. Over this period, property loans (to households) increased by 44%, accounting for 41% of the growth in total bank credit to households.

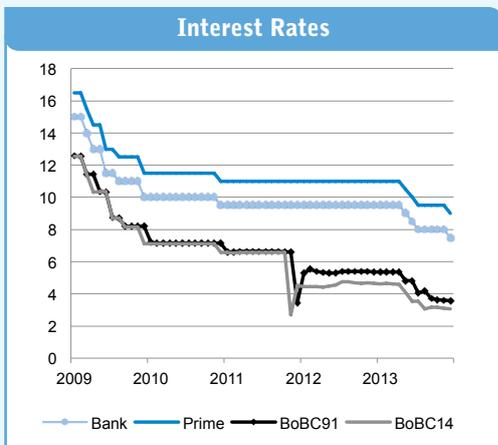
## KEY ECONOMIC VARIABLES ↘



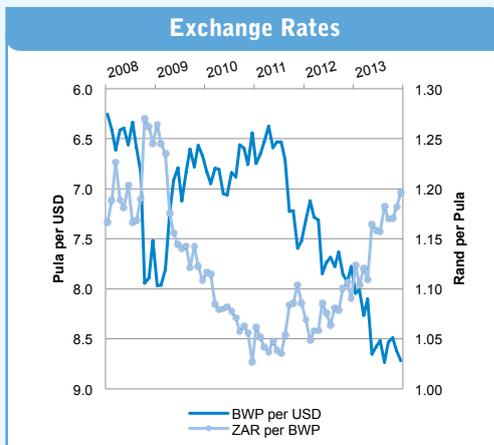
Total arrears on bank lending, as a percentage of total credit outstanding, increased marginally from 3.8% in Q2 2013 to 4.0% in Q3 2013. Similarly, arrears to firms increased from 2.2% to 2.6% between the two quarters. Interestingly, despite rapid credit growth, arrears on lending to households have decreased slightly from 5.2% in Q2 2013 to 5.1% Q3 2013.



Annual headline inflation continued to fall during Q4 2013, falling from 5.0% in September 2013 to 4.1% in December. This is largely attributable to base effects whereby the large price increases in 2012, particularly the fuel price increase effected in November 2012, fell out of the calculation. When compared to December 2012, inflation rate has lost 330 basis points, from 7.4%. We expect inflation to remain around current levels before rising slightly in mid-2014.



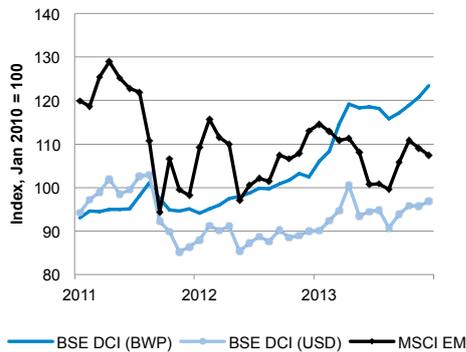
During Q4 2013 interest rates followed headline inflation downwards. The Bank of Botswana's Bank Rate was cut by 50 basis points from 8.0% to 7.5% on the 10th of December, thus effectively reducing the prime lending rate from 9.5% to 9.0%. This most recent bank rate cut was the fourth of the year, making it a total reduction of 200 basis points during 2013. We consider that Botswana is now at or close to the bottom of the interest rate cycle.



The South African rand continued to weaken against the USD during Q4 2013. Consequently, the Pula appreciated by 2.3% against the rand and depreciated by 2.1% against the USD during the quarter. Moreover, the Pula appreciated by 9.7% against the rand while it depreciated by 10.8% against the USD during 2013 as a whole.

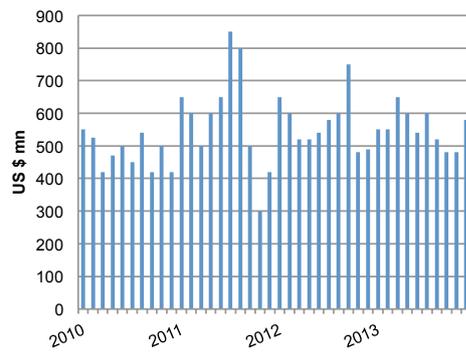
## KEY ECONOMIC VARIABLES

### Stock Markets



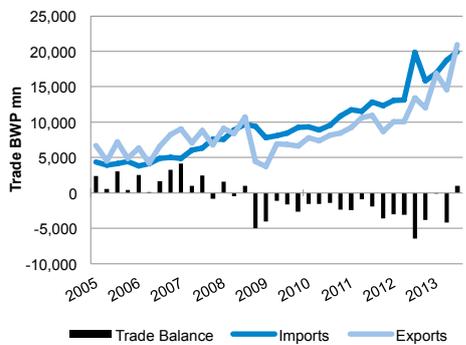
During Q4 2013 the BSE DCI gained in both USD and Pula, by 3.1% and 5.3%, respectively. Similarly, the DCI gained 7.5% and 20.5% during 2013 as a whole in USD terms and Pula terms, respectively. As a result, the BSE DCI outperformed its peers in 2013 as the MSCI EM Index (which is reported in USD terms) lost 5.0% during 2013. Sefalana, FSG and Choppies were the top domestic gainers on the BSE during 2013.

### DTC Rough Diamond Sales



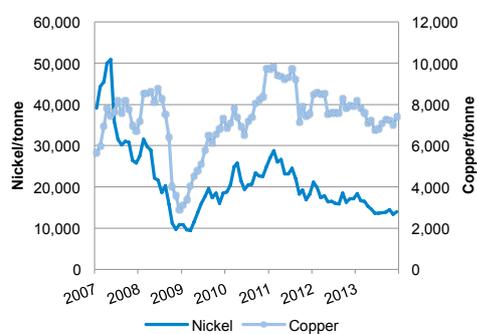
Q4 2013 saw DTCI's first diamond sales sight. During the quarter, there were two sights (November and December), both of which were characterized by a 3-5% reduction in price of rough diamonds by De Beers. Consequently, the take up of the goods by sight holders in Q4 was better than that in Q3. The November and December sights were estimated at USD480 million and USD580 million, respectively. The sale of rough diamonds by De Beers increased by 2% to an estimated USD5.59 billion in 2013.

### International Trade



The international trade position improved in Q3 2013, with a sharp increase (43.3%) in exports and a modest increase (6.2%) in imports. Exports stood at P20.9 bn while imports stood at P19.9 bn during the quarter. Consequently, Botswana realised a positive trade balance of P1.0 bn in Q3 2013, the first since Q3 2008. This was largely due to the P6.5 bn increase in exports of diamonds during the quarter.

### Copper & Nickel Prices



Commodity prices increased marginally during Q4 2013. Copper prices were up 1.4%, while nickel prices were up 0.8% during the quarter. However, 2013 as a whole was a particularly bad year for commodities. Copper and Nickel prices fell by 6.6% and 18.2%, respectively, between the end of 2012 and the end of 2013. Along with declining ore grades, this has contributed to the precarious status of Tati Nickel Mining Co.

## NEWS HIGHLIGHTS ↘

<b>6th October</b>	BIDPA calls for diversification indicators, monitoring (Sunday Standard)	Dr Grace Tabengwa, a research fellow at Botswana Institute for Development Policy Analysis (BIDPA), has called for timely monitoring and evaluation of economic diversification initiatives so as to bolster the performance the non-mining sectors.
<b>7th October</b>	North America reigns in World Risk Survey (MiningNews.net)	The United States and Canada have knocked off the Nordic countries to take the top two spots in the Resourcestocks' World Risk Survey 2013, while Botswana was ranked fourth.
<b>11th October</b>	Coal developer secures \$1m for development studies at Botswana project (Mining Weekly)	Coal developer, Hodges Resources, has secured up to USD1-million in funds to progress development studies at its 75%-owned Morupule South coal project.
<b>17th October</b>	Government to review scarce skill allowance (Botswana Gazette)	The Director of the Directorate of Public Service Management (DPSM), Carter Morupisi, has revealed that government is in the process of reviewing the Attraction and Retention allowance, commonly known as the "scarce skills allowance", to address concerns about its implementation and effectiveness.
<b>18th October</b>	Cash-strapped BPC awaits govt bailout (Mmegi)	The Ministry of Minerals Energy and Water Resources (MMEWR) is reportedly finalising a cash injection promised to the Botswana Power Corporation in March to help the utility cope with continued operating losses.
<b>22nd October</b>	African Energy Resources, ACWA Power sign Botswana power EOI (Proactive Investors)	African Energy Resources has executed a joint development agreement with ACWA Power International for the development of a 300 MW power station and integrated coal mine at the Sese coal deposit in Botswana.
<b>31st October</b>	Botswana's poultry prices too high – researchers (Mmegi)	A joint research project by Botswana, Kenya, Namibia, South Africa, Tanzania and Zambia examining competition issues and market dynamics in the cement, sugar and poultry industries, found that the prices of chicken in Botswana are higher than elsewhere in the region, largely due to high production costs.
<b>1st November</b>	Pangolin Diamonds discovers one of the world's largest kimberlites (Mining Weekly)	Pangolin diamonds announced that it had discovered a 270ha kimberlite at Tsabong North. Initial sampling had shown good concentrations of diamond indicator minerals. The next step would be to undertake a bulk-sampling programme that would provide indications of what diamond grades the giant kimberlite might hold.
<b>8th November</b>	Prime Time develops Kanye mall in PPP deal (Mmegi)	Prime Time has entered into a Private Public Partnership (PPP) deal with the Southern District Council (SDC) to develop the Mongala Mall in Kanye.
<b>13th November</b>	Bonyongo appointed new Debswana boss (Mmegi)	Debswana has appointed the Chief Operations officer, Balisi Bonyongo, as Managing Director effective January 2014. He replaces Canadian Jim Gowans, whose three-year contract expires at the end of December.
<b>13th November</b>	Walkabout eyes Botswana coal mine, coal-to-liquid plant (Mining Weekly)	Walkabout Resources signed a Memorandum of Understanding (MoU) with technology firm Coalswana to complete an integrated Prefeasibility Study (PFS) and Bankable Feasibility Study (BFS) for Takatokwane.

NEWS HIGHLIGHTS 

<b>19th November</b>	Firestone plots BSE exit (Mmegi)	British diamond producer, Firestone Diamonds, has unveiled plans to delist from the Botswana Stock Exchange (BSE), due to concerns about the cost-effectiveness of continued listing and a decision to reduce its exposure to Botswana.
<b>20th November</b>	CBD changing Gaborone rental market - Knight Frank (Mmegi)	The Knight Frank 2013 Africa report asserted that the development of the Central Business District has led to a significant decrease in rental values for other ageing and secondary grade commercial property.
<b>22nd November</b>	Botswana Diamonds to start Orapa fieldwork in January (Mining Weekly)	Botswana Diamonds will start the first ground phase of its joint venture (JV) with Russian diamond company Alrosa in January, with Russian geologists set to start fieldwork in the company's Orapa prospecting licence area.
<b>26th November</b>	Lucara reports revenue of \$20 280/ct from 3rd exceptional stone sale (Mining Weekly)	A special tender of 14 diamonds from Lucara Diamond Corp's Karowe mine, in Botswana, has sold for USD22.9-million, or USD20 280/ct.
<b>27th November</b>	RPC Data investors approve buy-out (Mmegi)	RPC Data shareholders have approved a 66 thebe management buy-out offer and associated Botswana Stock Exchange (BSE) de-listing, at their Extraordinary General Meeting.
<b>27th November</b>	State Bank of India shuns personal loans (Mmegi)	The CEO of the newly launched State Bank of India (SBI) Botswana, Sophy Mathew, said that they have decided to focus on lending financial support to the corporate sector, and not the already overly-indebted households. Therefore, the bank will not offer personal loans for the next three years.
<b>28th November</b>	Government increases livestock feed subsidy (Botswana Guardian)	In a bid to ease the effects of the severe drought on farmers Government has increased subsidises on livestock feeds, in the whole country, to 50 percent.
<b>4th December</b>	BTCL hands wholesale business to BoFiNet (Mmegi)	Botswana Telecommunications Corporation Limited (BTCL) handed over the wholesale business it has been handling for government to BoFiNet.
<b>4th December</b>	ODC follows De Beers into supply contracts (Mmegi)	Okavango Diamond Company (ODC) is planning to introduce fixed-term supply contracts in 2014 and become a direct competitor to De Beers. Currently, the fledgling state-owned diamond company only sells through auctions.
<b>6th December</b>	PPADB tightens screws on government tendering (Mmegi)	The Public Procurement and Asset Disposal Board (PPADB) has indicated that going forward it will prefer an open tender system, as opposed to selective tender system and direct appointments, as it promotes competition amongst contractors.
<b>6th December</b>	Australian junior eyes coalbed methane prospects in Botswana (Mining Weekly)	Energy exploration and development company, Magnum Gas & Power, which boasts project areas in the central and northern regions of Botswana, has lauded coalbed methane (CBM) as the energy source offering the best value proposition for the State and the region.
<b>10th December</b>	Govt buys out Norilsk in BCL Mine (Mmegi)	Government is buying out BCL Mine minority shareholder, Norilsk Nickel of Russia, in a restructuring exercise that includes a P2.3 billion equity injection into the mine that forms the economic nucleus of Selebi-Phikwe.

NEWS HIGHLIGHTS 

<b>11th December</b>	Government throws a lifeline to Air Botswana (Mmegi)	Minister of Transport and Communications, Nonofa Molefhi, has revealed that his ministry has approved a bail-out package for Air Botswana, and is waiting for Parliament's approval.
<b>11th December</b>	Troubled Blue extends BSE hiatus (Mmegi)	Blue Financial Services, plans to extend its self-imposed suspension from the Botswana Stock Exchange (BSE) after pushing forward the publication of its 2013 financials.
<b>12th December</b>	Pangolin Diamonds intersects 59 m of kimberlite, shares rise (Mining Weekly)	Shares of Pangolin Diamonds closed up 10.42% after it announced that it had intersected 59m of kimberlite at its Magi kimberlite pipe at the Tsabong North project.
<b>12th December</b>	Moody's upgrades Letshego outlook (Mmegi)	Moody's Investors Service affirmed Letshego Holdings' credit ratings and upgraded the company's outlook from negative to stable on the back of reduced risk exposure and the micro-lender's geographical expansion.
<b>13th December</b>	Botswana Diamonds raises cash to fund exploration (Mining Weekly)	Botswana Diamonds on Friday announced that it had raised cash proceeds of GBP540,000 through the issue of 21.6-million new ordinary shares in order to finance exploration in Botswana.
<b>13th December</b>	Government to establish roads authority (Mmegi)	Government is set to establish a roads authority to finance and manage roads infrastructure and maintenance.
<b>13th December</b>	BPC costs drive P2bn supplementary budget (Mmegi)	A P1.98 billion supplementary 2013/14 budget was due before legislators in December, with the Minerals, Energy and Water Resources Ministry seeking the lion's share, mainly as a result of the delayed Morupule B project.
<b>15th December</b>	Khama shocks consumers over uncollected plastic bag levy (Sunday Standard)	Minister of Environment, Wildlife and Tourism Tshekedi Khama revealed that since the introduction of the plastic bag levy in 2007, the Government has not been collecting any of the money from store owners.
<b>17th December</b>	ABC shareholders reject buyout offer (Mmegi)	African Development Corporation's (ADC) bid to take over the Pan African focused banking group, ABC Holdings, through buying out minority shareholders hit a brick wall after the offer was rejected last week.
<b>18th December</b>	Botswana Oil, PetroSA ink cooperation deal (Mmegi)	The new state owned oil company, Botswana Oil, has kicked off efforts to enhance stability and diversity of fuel supplies with the signing of a cooperation agreement with South Africa's PetroSA.
<b>18th December</b>	Great Quest to develop Botswana's Sua Pan brownfield potash project (Canadian Mining Journal)	Great Quest Metals Ltd has entered into an exclusive arrangement with Botswana Ash (Pty) Ltd (BotAsh), to develop the potash brine potential of Sua Pan.
<b>23rd December</b>	Discovery flies high on resumed talks (MiningNews.net)	Discovery Metals stock soared by 43% the morning after the company announced it had restarted discussions regarding a USD100 million recapitalisation plan.

## MACROECONOMIC DATA

Key Economic Data								
	unit	2010	2011	2012	2013 Q1	2013 Q2	2012 Q3	2013 Q4
<b>Annual Economic Growth</b>								
GDP	%	8.6	6.1	4.2	3.9	4.9	5.9	..
Mining	%	22.7	-2.3	-7.0	-6.1	-0.5	11.0	..
Non-mining private sector	%	8.1	9.7	8.0	6.9	5.7	4.6	..
GDP current prices	<i>P mn</i>	93,390	104,573	110,737	28,460	32,730	32,378	..
GDP 2006 prices	<i>P mn</i>	66,549	70,610	73,564	18,920	19,388	19,463	..
<b>Money &amp; Prices</b>								
Inflation	%	7.2	9.2	7.4	7.6	5.8	5.0	4.1
Prime lending rate	%	11.0	11.0	11.0	11.0	10.0	9.5	9.0
BoBC 14-day	%	6.6	4.5	4.6	4.6	3.5	3.2	3.1
<b>Trade &amp; Balance of Payments</b>								
Exports - total goods	<i>P mn</i>	31,822	39,542	45,608	16,870	14,596	20,918	..
Exports - diamonds	<i>P mn</i>	21,780	29,910	36,143	14,274	11,694	18,149	..
Imports - total goods	<i>P mn</i>	38,651	48,412	61,962	16,916	18,751	19,911	..
Balance of visible trade	<i>P mn</i>	-6,830	-8,870	-16,354	-46	-4,155	1,007	..
Balance of payments	<i>P mn</i>	-6,511	3,430	-862	75	-4,496	..	..
<b>Foreign Exchange</b>								
Exchange rate BWP per USD	<i>end</i>	6.439	7.524	7.776	8.264	8.576	8.532	8.718
Exchange rate ZAR per BWP	<i>end</i>	1.027	1.086	1.090	1.121	1.159	1.170	1.196
FX reserves	<i>\$ mn</i>	7,886	8,082	7,628	7,531	7,647	7,842	..
FX reserves	<i>P mn</i>	50,847	60,271	59,317	61,728	65,362	67,024	..
<b>Financial Sector</b>								
Deposits in banks	<i>P mn</i>	40,423	43,505	47,216	47,650	48,941	48,458	..
Bank credit	<i>P mn</i>	22,122	27,968	34,555	35,966	37,409	38,544	..
BSE index		6,412.9	6,970.9	7,510.2	8,400.0	8,688.5	8,594.9	9053.4
<b>Business Indicators</b>								
Diamond production (a)	<i>'000 cts</i>	22,019	22,903	20,619	4,658	6,462	5,541	6,475
Copper production	<i>tonnes</i>	25,981	22,319	26,736	9,212	11,776	10,999	9,760
Nickel production	<i>tonnes</i>	24,931	15,675	17,942	5,203	6,358	6,000	5,287
Business confidence index		56%	54%	47%	47%		45%	..
No. of companies formed		11,458	11,788	16,561	3,404	2,773	4,071	3,942
Crude oil (Brent)	<i>\$/bar</i>	93.23	108.09	110.80	108.45	102.49	109.45	109.95
<b>Employment (formal)</b>								
Government		130,709	130,196	..	..	..	..	..
Parastatals		16,749	16,992	..	..	..	..	..
Private sector		186,234	187,986	..	..	..	..	..
Total		333,692	335,174	..	..	..	..	..
<b>Govt Budget</b>								
		2011/12	2012/13 Revised	2013/14 Budget				
Revenues	<i>P mn</i>	38,486	41,911	44,022				
Spending	<i>P mn</i>	38,667	41,076	43,242				
Balance	<i>P mn</i>	-181	835	779				
Public debt & guarantees	<i>P mn</i>	28,464	28,737	28,575				
Govt deposits at BoB	<i>P mn</i>	20,553	20,611	..				
GDP	<i>P mn</i>	107,042	112,622	..				
Revenues	<i>%GDP</i>	36.0%	37.2%	..				
Spending	<i>%GDP</i>	36.1%	36.5%	..				
Balance	<i>%GDP</i>	-0.2%	0.7%	..				
Public debt & guarantees	<i>%GDP</i>	26.6%	25.5%	..				
Govt deposits at BoB	<i>%GDP</i>	19.2%	18.3%	..				

## I Drivers of Growth

Consideration of economic growth typically focuses on the contributions of different economic sectors – mining, manufacturing, agriculture, services etc. Data on the output of the different economic sectors is one of the two main sets of GDP data that are regularly reported. The second main set of GDP data relate to expenditure, reflecting the fact that all of the output produced in an economy is purchased as a result of spending by domestic entities (government, firms, or households) or by non-residents.

Many people will be aware of the core identity of Keynesian aggregate demand, as follows:

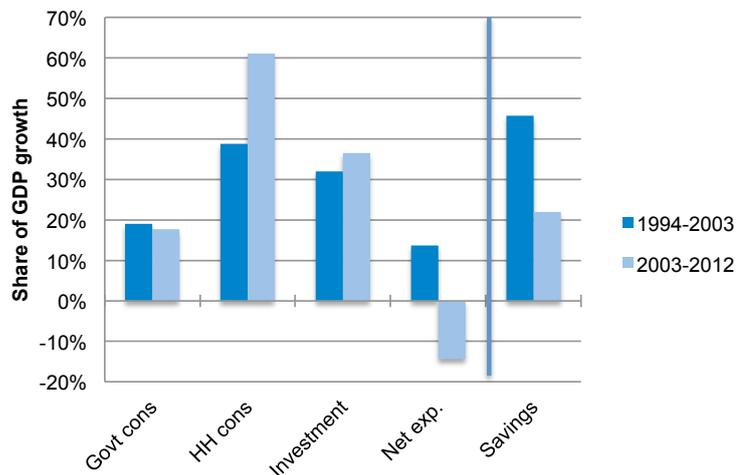
$$\text{Output} = \text{Income} (Y) = \text{Consumption} (C) + \text{Investment} (I) + \text{Net Exports} (X-M)$$

Economic growth (output) is therefore driven by a change in demand, which must result from consumption spending, investment spending or net exports (exports less imports).

Using data published by Statistics Botswana, it is possible to disaggregate the sources of expenditure driving economic growth in Botswana. While these sources may vary from year to year, it is probably more helpful to consider longer-term trends, as annual figures are highly volatile.

The current annual GDP data series covers the period from 1994 to 2012. We have divided the pe-

FIGURE 1: Expenditure drivers of GDP growth



Source: Econsult calculations based on data from Statistics Botswana

riod into two halves – 1994-2003 and 2003-2012 – and considered the main drivers of growth in each period:

- Government consumption
- Household consumption
- Investment
- Net exports

Although all of these sources of demand can drive growth, they are not all “equal” in terms of their economic impact. For instance, investment spending contributes to increased capital stock and hence higher future production – and higher future growth – assuming of course that the investment spending is productive. Consumption spending contributes to current living standards, but does not build productive capacity.

It is also important to know how spending is being financed, whether by saving or borrowing, as this has implications for sustainability. The same GDP expenditure data can be used to calculate national savings rates (from the identity  $S = I + X - M$ ).

The results are summarised in Figure 1.

In some respects there are many similarities between the two periods. The relative magnitudes of

## SPECIAL FEATURE

the sources of growth remain the same: household consumption spending is the largest, followed by investment, government consumption and net exports. However, there are also some striking changes. The dependence of the economy on household consumption has dramatically increased, with its share of GDP growth increasing from 39% to 61% between the two periods. The counterpart to this is the drop in the contribution of net exports, from plus 14% to minus 14% of GDP growth. This means that rather than driving growth, as in the past, exports have fallen (in relative terms) and imports have risen, making the external sector a drag on growth.

Interestingly, the share of government consumption has fallen slightly, while the share of investment – which includes both private and public spending – has risen. This may indicate an increased dependence on government projects – development spending – to drive growth. Although a high rate of investment is good, there are concerns about the efficiency of several recent public sector investments and hence their impact on future growth.

A further striking result is the sharp drop in the contribution of national savings. The decline in savings is the counterpart of increased (household) consumption and decreased net exports. Historically, one of Botswana's strengths has been a very high savings rate, but this may now be changing. It is not an immediate problem, as the overall savings rate (as a share of GDP) is still reasonable, although well below historic peaks. But it is consistent with other evidence of increased household indebtedness (and reduced net savings), and the downward trend in savings is a concern.

What do these results say about the sustainability of growth? They suggest a shift from a savings-and-export led model in the first period to one based on consumption, imports and debt in the second. This is not very encouraging; the savings-and-export model is typical of fast-growing developing countries, especially those in Asia, and can deliver sustained increases in living standards over a prolonged period of time. The model based on domestic (household) demand and debt is likely to reach its limits much more quickly, and is clearly much less sustainable.

# I Diversification

Botswana has for a long time aimed to diversify its economy, exports and government revenue stream away from dependence upon diamonds. There has been a series of policies aimed at boosting the non-mining sector, including subsidy schemes such as the Financial Assistance Policy and the Citizen Entrepreneurial Development Agency, and various sectoral Hubs etc. In the 1980s and 1990s these efforts were largely focused on the manufacturing sector. However, there has been no long-term increase in the share of manufacturing in GDP. Perhaps as a result of this, it is widely thought that attempts at diversification have been unsuccessful.

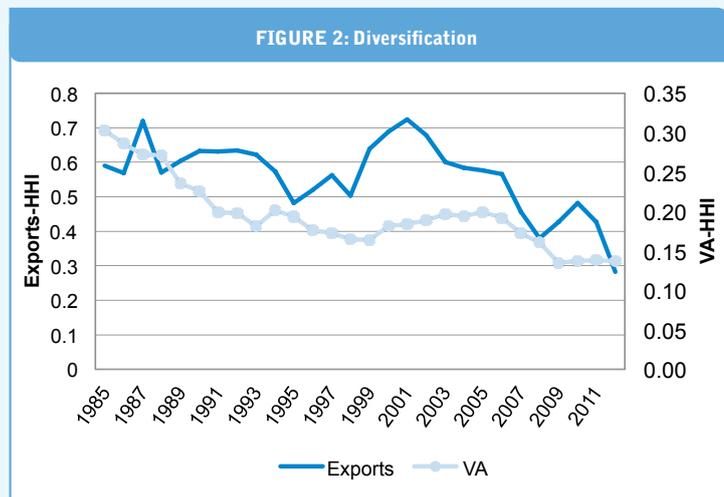
Certainly, the nature of Botswana's resource rich and landlocked economy may be an obstacle to diversification. Resource rich economies are often uncompetitive (due to appreciation of the real exchange rate), and being landlocked can increase costs even further. However, it has often been argued that Botswana has escaped the "Dutch Disease" and the resource curse, in part due to the quality of institutions, good governance and real exchange rate stability.

While we often talk about the failure of diversification efforts, what does the economic data say about what has really been happening? One way to measure the extent of concentration of an economy (or the inverse, i.e. diversification) is to use the Herschmann-Herfindahl Index (HHI). The HHI varies between 0 (denoting high diversification) and 1 (denoting a high level of concentration, or low diversification). The HHI is typically used to measure the degree of competition in an industry, but can also be applied to measure the diversification of an economy (based on sectoral shares in GDP) or of exports.

HHI data shows that, contrary to common perceptions, there has been some improvement in the degree of economic diversification. There is evidence that since the late 1980s, the HHI index

applied to output (sectoral GDP or value added) has been steadily declining, showing reduced dependence on mining, and the growth of other sectors in GDP.

A similar trend applies to exports, although not as consistently as with output. Although exports have become more diversified, they remain very dominated by diamonds, and the degree of export diversification tends to be strongly affected by the performance of the diamond industry. Exports have become more diversified during the past decade as diamond growth has slowed. It is also important to note that over the last decade the government has shifted the diversification objective from "diversification away from mining" to include "diversification within mining", and an emphasis on minerals beneficiation. One of the major drivers of export diversification in recent years has been the growth of polished diamond exports.



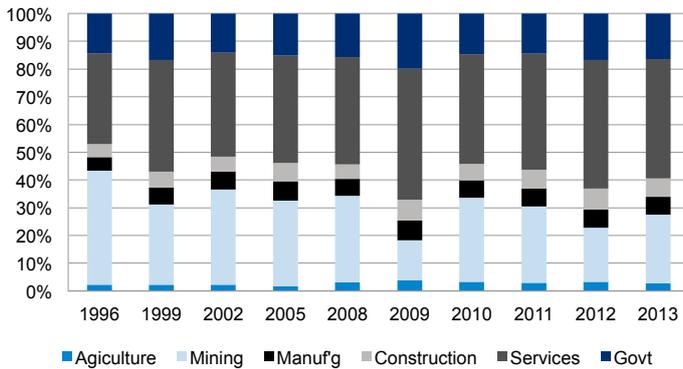
Source: Statistics Botswana, Econsult Botswana

The focus on diversification within mining is part of a broader readjustment of policy towards diversification, away from an emphasis on manufacturing. Based on the Industrial Development Policy of 1998, incentives were provided to the manufacturing sector, but not services. Despite this, the services sector has experienced robust growth: between 1998 and 2012, services grew at an average annual rate of 7.0%, compared to 4.4% for manufacturing and 4.2% for GDP as a whole. The services sector's contribution to GDP is now around 42%.

Although the growth in services has been accompanied by a fall in mining growth, there are important links between the two sectors. An important driver of services growth has been activities such as diamond sorting, valuation and trading, as well as financial and other services related to mining and beneficiation activities (transport, freight, security, IT etc.).

SPECIAL FEATURE

FIGURE 3: Composition of Output (Value Added)



Source: Statistics Botswana, Econsult Botswana

As noted above, diversification efforts have not fared as well in exports, and the growth of non-diamond exports has been sluggish. This is problematic, given that Botswana’s future economic growth has to be export driven. Manufactured goods accounted for only around 10% of goods exports in 2012, similar to the share in the 1980s. Exports of beef and related products have fallen to only 1% of goods exports, after a long period of relative decline. Sluggish performance of non-mining exports is consistent with the effects of the “resource curse”.

While the objective of diversification of exports away from mineral products is not being met, there is some evidence that the objective of diversification within mining is working. As illustrated in Figure 4, mining dominates exports accounting for nearly 90% of the total. However, exports of rough diamonds have declined as a share of the total, from an average of 75% in the 1990s to 60% in 2012. Other minerals have risen from 7% in the 1990s to 12% in 2012, and most importantly polished diamonds, which contributed 14% of total exports in 2012 from being non-existent in the 1990s. This is encouraging, and suggests that the expansion of other mining activities along with beneficiation could contribute to achieving a more diversified export base and an export-led economy.

There is however a clear gap in the data for exports, in that there are no consistent data se-

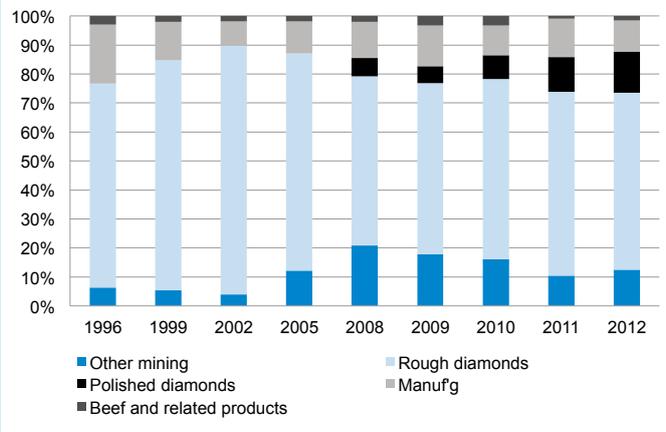
ries on exports of services (such as tourism). Hence export diversification that may be driven by services exports cannot be readily tracked. This shows the lack of attention services is getting from policy makers and statisticians alike. As the IMF and others have noted, service sectors can play a potentially important role in diversification; inadequate data will, however, make it more difficult to formulate appropriate policies to pursue this objective.

In conclusion, Botswana has actually made some strides towards achieving a diversified economy. The degrees of diversification of GDP (value added) and of exports are quite different, perhaps reflecting a more vibrant domestic economy perceived to be largely supported by government expenditures.

Though exports have not fared as well as GDP, mining exports have at least become more diversified in the last decade.

That said, there still remains a dichotomy between the story given by the above data and public perceptions about Botswana progress with diversification. The main issue here could be that growth

FIGURE 4: Composition of Goods Export



Source: Statistics Botswana, Econsult Botswana

of exports or GDP has not been able to stimulate adequate growth in employment. According to the Botswana Core Welfare Indicator Survey, overall unemployment in 2009 was at 17.8% with much higher rates amongst the youth. Moving forward there is a need for policies that will help translate progress in diversification into both economic growth and job creation.