Bifm Economic Review

4th Quarter 2012

Economic Review

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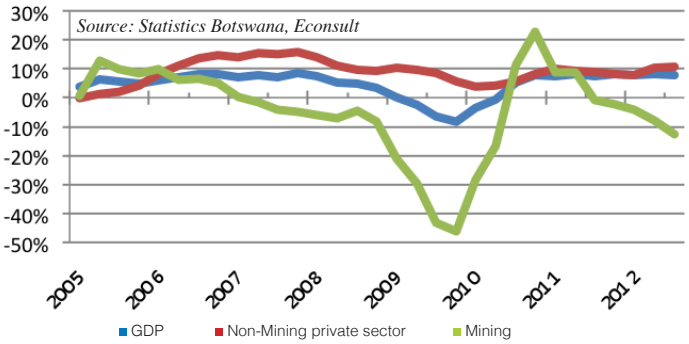
INTRODUCTION

The fourth quarter of 2012 was on balance characterised by negative economic developments, even though there is little hard data available beyond the end of the third quarter. Conditions in the global rough diamond market remained weak, and this impacted on exports and Debswana's production levels, and presumably on government revenues. Global economic conditions remained weak and uncertain, even if some of the most adverse scenarios relating to the Eurozone crisis and the US "fiscal cliff" were avoided, and the IMF revised downwards its projections of global economic growth in 2013.

ECONOMIC GROWTH

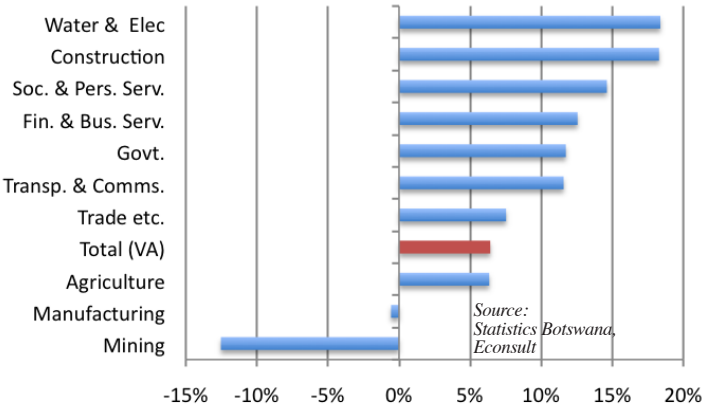
The latest economic growth figures for period to September 2012 were released by Statistics Botswana in late December. These show that year-on-year growth (over the 12 months to September) fell slightly to 7.7%, from 8.0% in Q2. This largely reflects reduced growth in the mining sector (down to minus 12.5% from minus 7.7% over the year to June 2012). The non-mining private sector is reported to show continued strong growth, of 10.5% over the period. Whether this is really the case is doubtful – growth of over 10% represents boom conditions, and this is not supported by perceptions of business or other indicators of activity. Given the otherwise weak conditions in the economy, with government spending restraint and declining real incomes for public sector employees, such rapid reported growth is unlikely. We remain of the view that the quality of some of the underlying data used in the GDP calculations by Statistics Botswana is doubtful. One of the problems is that response rates by businesses to requests for data by Statistics Botswana is low, and this makes the reported data less than fully representative.

Fig.1: Annual GDP Growth



At a sectoral level, the water & electricity and construction sectors are reported as being the fastest growing in the economy, with both recording growth of 18% over the year to September. The former seems to be something of a statistical quirk, while the construction figures are believed to be inaccurate and overstated. Other services sectors were relatively fast-growing. The contraction in mining largely reflects the scaling back of production at Debswana in response to weak market conditions.

Fig.2: Sectoral GDP Growth (VA)

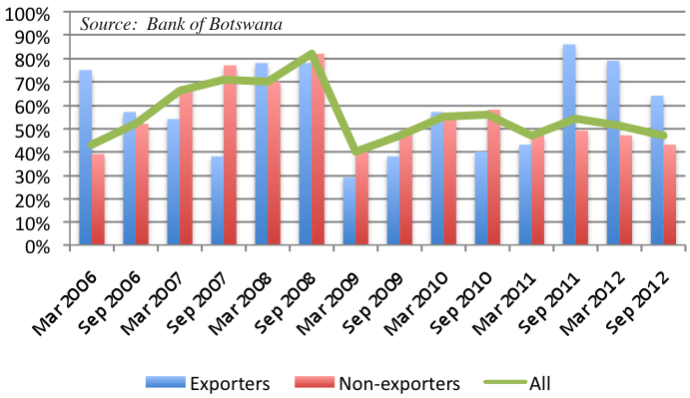


Business Expectations Survey

The results of the September 2012 Business Expectations Survey by the Bank of Botswana showed a deterioration in business confidence, with 47% of firms rating current business conditions as satisfactory, down from 51% in March. There was a decline in confidence levels amongst both exporters and firms selling into the domestic market. The former reflects uncertainty in the global economy, while the latter seems inconsistent with the reported GDP growth figures.

Fig.3: Business Confidence Index

(% of firms rating current business conditions satisfactory)



INTERNATIONAL TRADE

Diamonds

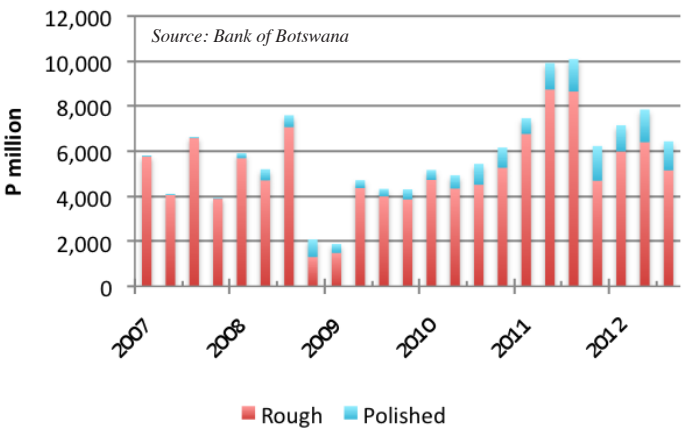
In the last issue of the Review we highlighted the discrepancies between the diamond export data provided by the Bank of Botswana (BoB) and Statistics Botswana (SB), and the problems that this led to in terms of interpreting what was happening in the economy, given the overwhelming importance of diamond exports. Getting consistent reporting is particularly important – and perhaps more difficult – given the relocation of DTCI's diamond aggregation operations from London to Gaborone. This increases the flow of diamonds through Botswana, with substantial rough diamond imports from De Beers group operations in Canada, South Africa and Namibia, as well as exports from aggregation.

One of our concerns was that there was inadequate distinction in the trade data between exports of rough and polished diamonds. A second concern was that there were discrepancies between the SB and BoB data, because of the different methodologies used by the two institutions. A third concern is that if aggregate flows of imports and exports are reported, it becomes impossible to distinguish trade related to Botswana's own diamond production from trade related to aggregation.

These concerns have been addressed, but only partially. The BoB has started to report exports of rough and polished separately, which is helpful. However, the BoB export data reports only trade related to Debswana and the various cutting and polishing operations, and not exports from aggregation or by the other diamond mining companies. The SB data relates only to gross imports and exports, and does not distinguish aggregation-related flows from Botswana-specific flows. So the situation remains unsatisfactory.

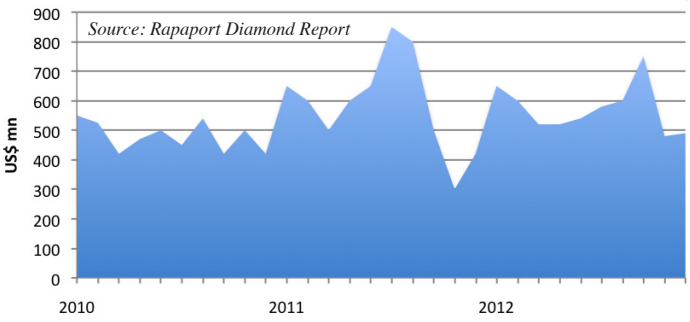
Below we report diamond exports using the BoB data, which as noted relates to exports from Debswana and from Botswana cutting and polishing operations (and not from aggregation or non-Debswana mines). According to these data diamond exports fell by 22% in the first three quarters of 2012 as compared to the same period in 2011. The decline was particularly strong for rough diamonds, with exports down 27%, while exports of polished were up 18%. In an encouraging development, the share of polished diamonds in total diamond exports rose from 12% of the total in the first 9 months of 2011 to 18% in 2012.

Fig.4: Diamond Exports



The decline in rough diamond exports reflects the gloomy conditions in the global diamond market. Overall diamond sales through De Beers DTC declined by an estimated 12% in 2012 compared to 2011, with relatively small sights towards the end of the year.

Fig.5: DTC Diamond Sales

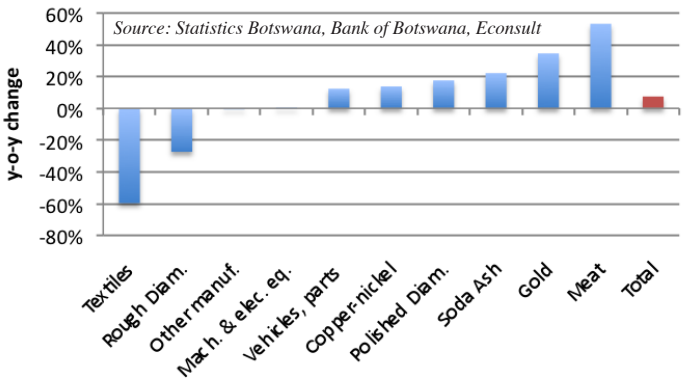


The rough market has been hit by a number of negative developments, including recession in the Euro zone, weak growth in the USA and concerns about the "fiscal cliff" and likely tax increases for higher income earners, which were expected to impact on spending on luxury commodities. In addition, economic growth has been slowing in China and India which, while still smaller than the US as a market for diamonds, have been responsible for a disproportionately large share of diamond market growth in recent years. Coupled with this, large increase in rough prices in 2011-12 had not been followed by commensurate price increases for polished diamonds and jewellery, hence squeezing margins for diamond cutters and polishers and jewellery manufacturers.

Exports

The overall export picture was mixed over the first nine months of 2012. Not only did exports of rough diamonds decline, but textile exports were 60% lower than in the same period in 2011. Exports of most other categories of manufactured goods were at best flat. There was some growth in exports of gold, soda ash and meat. Overall, goods exports increased by only 7% in pula terms over this period.

Fig.6: Exports, Jan-Sept



For a complete picture of export developments, data are also required on exports of services (tourism, finance and business services, transport etc.). Unfortunately there is no reliable reporting of trade in services. The Bank of Botswana is responsible for compiling these data, but reporting is both delayed (nothing is available beyond 2011) and the numbers are in any case unreliable (due to changes in methodology). It is regrettable that there is no reliable information on this important aspect of economic and export diversification.

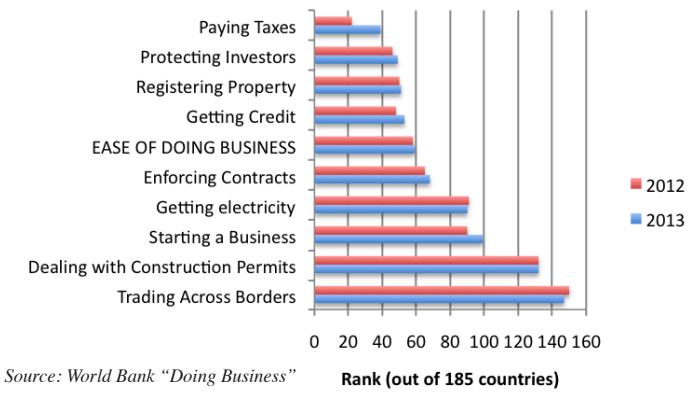
Box: World Bank "Doing Business" results

The World Bank's Doing Business assessment for 2013 was released in late October. The results do not make encouraging reading for Botswana, especially given the need for more dynamism in the private sector. The country's overall ranking fell to 59 out of 185 countries ranked globally, from (a revised) 58 in DB2012 (and 52 in DB2011). Of the ten sets of indicators used in compiling the overall ranking, Botswana's ranking fell on seven of them, was unchanged on one and rose on two. The biggest declines were on "Paying Taxes" and "Starting a Business". Other areas where Botswana does particularly badly are "Trading Across Borders", "Dealing with Construction Permits" and "Getting Electricity".

The deteriorating ranking does not necessarily show that business conditions have declined in absolute terms; instead, other countries are improving their business environment while Botswana has stood still.

As in the past, Botswana does well by the standards of Sub-Saharan Africa. Out of 46 countries ranked, Botswana comes fourth after ,Mauritius (ranked 19), South Africa (39) and Rwanda (52).

Fig.7: Doing Business Ranking 2012-2013



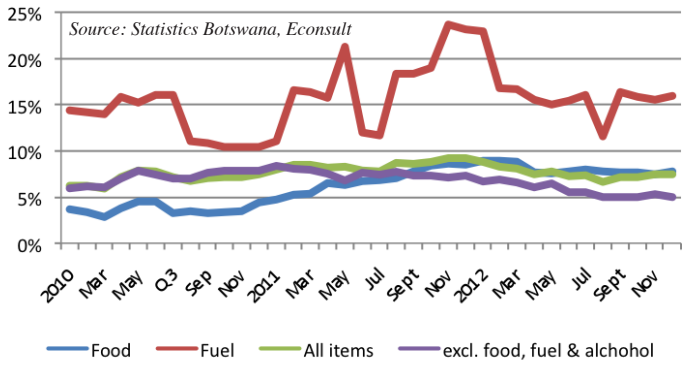
Source: World Bank "Doing Business"

Singapore remains the top ranked country globally, followed by Hong Kong and New Zealand.

INFLATION

Inflation finished the year at 7.4%, unchanged from November. This was somewhat disappointing given hopes at the beginning of the year that inflation would end the year much closer to the upper end of the BoB's inflation objective range of 6%. The main problem has come from increases in international fuel prices, which has slowed the drop in inflation. Nevertheless, on the positive side, inflation for 2012 was much lower than in 2011, when it was 9.2%, so the broad objective a significant reduction in inflation during 2012 was achieved. Underlying inflation (excluding food, fuel and alcohol) has continued to decline and ended the year at 5.0%.

Fig.8: Inflation by Category



Prospects for a continued decline in inflation are good, barring unfavourable developments with regard to international oil prices. As the impact of the change in exchange rate policy feeds through, imported inflation should fall further, and there is a good chance that inflation will fall to below 6% in the second half of the year.

Fig.9: Inflation & Forecast

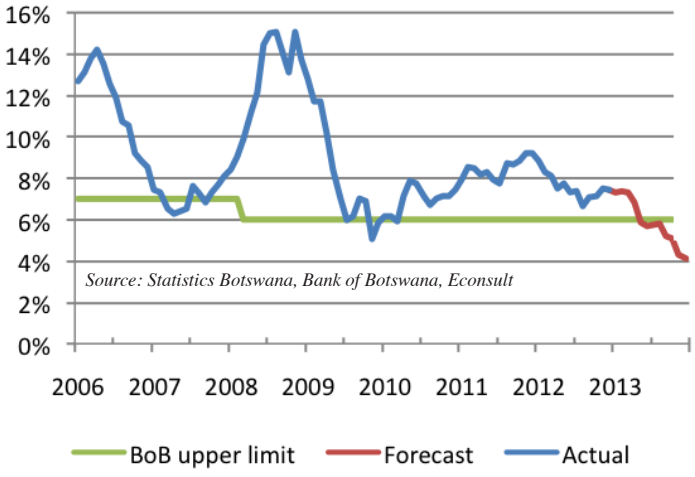
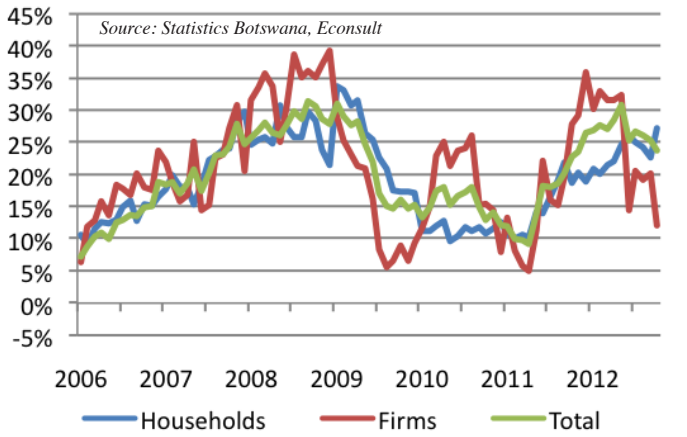


Fig.10: Credit Growth

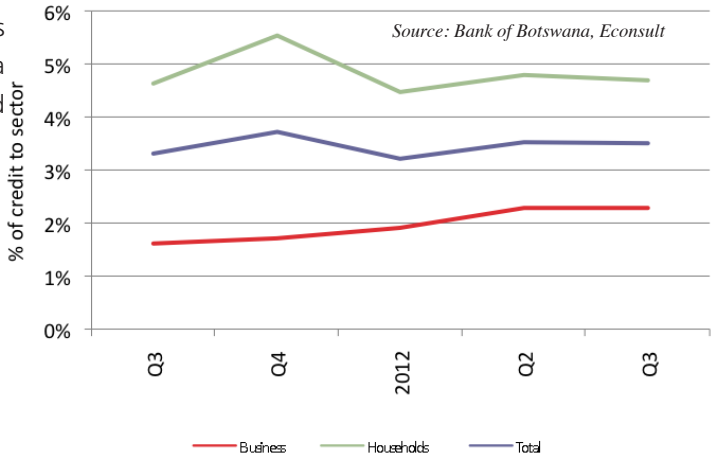


CREDIT GROWTH

Annualised credit growth remains relatively high at 24% in the year to October. The main drivers were credit to households (27% yoy) and parastatals (102%). Credit to the private sector has slowed, growing by only 12% over the 12 month period.

The slowdown in credit growth to the private business sector may be an indication of deteriorating business conditions, with firms either unwilling to take on more debt or less able to borrow. Faster growth in credit to households may also be a problem given concerns about over borrowing by some households (see Box).

Fig.11: Arrears on Bank Credit



Arrears

The Bank of Botswana has recently changed the reporting of arrears on bank credit, making it difficult to track trends over a long period of time. Arrears data covering the past 12 months (on the new definition) show that the overall level of arrears (as a percentage of borrowing) has been fairly stable over this short period, albeit with an increase in arrears on lending to businesses.

OUTLOOK

The economic outlook in the short-term is for not much change – the first half of 2013 is likely to be similar to the second half of 2012. Global economic uncertainty is likely to persist in the early months of the year, with the US economy impacted by the likely imposition of automatic ("sequestered") spending cuts in March and possibly prolonged arguments over the lifting of the government debt ceiling. Conditions in the global diamond market are likely to remain uncertain, and Debswana has already announced that 2013 production is planned to be at similar levels to 2012, which was reduced in response to adverse market conditions. However, there are indications that prospects may improve in the second half of the year, with an upturn in global growth.

Domestically, there should be a similar pattern of uncertainty in the first half of the year and improvements in the second half. Inflation should continue to decline, although on the downside, substantial increases in electricity tariffs will be introduced sooner or later, which will have both direct and indirect inflationary impacts. The electricity shortages that have plagued the country at the beginning of 2013 due to the inability of Botswana Power Corporation to secure supplies should be alleviated once Morupule B power station is fully commissioned, which is expected by mid-year. If inflation declines as expected, notwithstanding electricity tariff increases, this will open up the possibility of lower interest rates in the second half of the year. Economic growth forecasts are becoming increasingly difficult because of the disconnect between reported GDP growth figures and other indicators and sentiment on economic activity. We expect growth in 2013 to be around 4-5%, although how this will relate to the growth that is reported in due course by Statistics Botswana is anyone's guess.

Box: Household Borrowing in Botswana

Many people have expressed concerns about the level of household borrowing in Botswana, which has been increasing steadily over a number of years. There is anecdotal evidence that some households are over-borrowed, borrowing from microlenders and other non-bank lenders when their capacity to borrow from banks is exhausted. But what is the true situation? Official data (published in the BoB's Botswana Financial Statistics) only covers borrowing from banks. It shows that more than half of bank lending – around 57% - is to households, which is high by the standards of most African countries. The rate of bad debts on lending to households is higher than on lending to private sector – although at just under 5%, the household arrears rate is still not particularly high.

Does this indicate a problem? Excessive household credit can indeed be a problem, as was graphically illustrated when the sub-prime crisis erupted in the USA. This caused huge losses for many financial institutions, undermined the financial system as a whole, and was a major contributor to the global financial crisis of 2007-9. This resulted from banks and other financial institutions lending too much to borrowers who did not have the capacity to repay, combined with failures in assessments of credit quality, regulation and governance. This experience illustrated that while over-indebtedness is initially a problem for the individual borrower or household, if it becomes widespread it can cause problems for the broader financial sector and the macro-economy.

Households have access to credit from various sources, including banks, other financial institutions, insurance companies, microlenders, retail stores etc. They can also borrow in various forms, including secured (asset-backed) loans for property (mortgages) or vehicles, unsecured personal loans, and credit cards etc.

In Botswana, data are not available on overall credit to households. There is good reporting on lending to households by banks, but nothing is published in official data sources on lending by Letshego, insurance companies, microlenders or retail stores. However, data on lending by Letshego can be derived from the company's annual report. For BBS, BSB and NDB, aggregate lending data are published, and estimates of lending to households can be made.

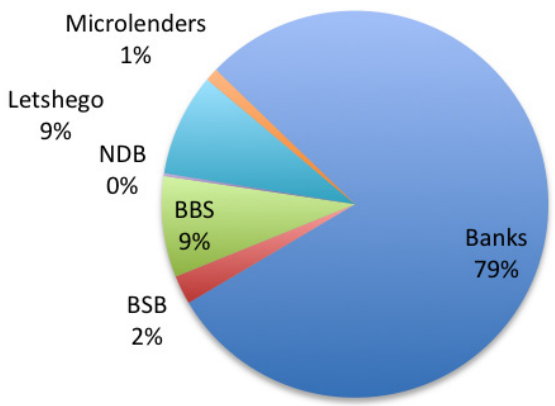
There are various ways to look at borrowing by households:

- comparing household borrowing from banks with deposits

(to determine net borrowing from banks)
- the debt service burden (what proportion of household income is devoted to interest payments and repayment of capital)
- the ratio of debt to disposable income (a commonly used measure of household debt exposure) or to GDP
- the composition of household borrowing.

As noted above, household borrowing from banks has been increasing steadily. Little is known about what has been happening to overall household debt levels, given the lack of data on non-bank lending. However, it is likely that the banks account for the vast majority of household credit from financial institutions – probably 80% of the total, with Letshego accounting for nearly 10% and the remainder spread between BSB, BBS and NDB. While there are many microlenders, and they have many borrowers, the amounts they lend are very small and do not add to a great deal in aggregate. Total estimated household borrowing from financial institutions as at September 2012 was approximately P23 billion, equivalent to P11 200 for each person in Botswana.

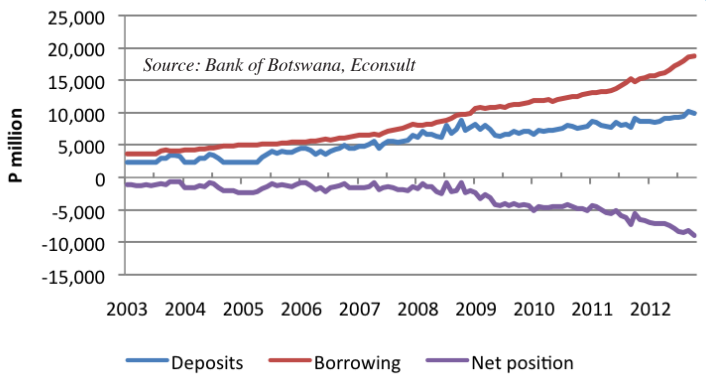
Fig.12: Composition of Household Borrowings



Source: Bank of Botswana, Econsult

With regard to the banks, households borrow much more than they keep on deposit – in September, 2012 households had borrowed P18.5 billion from banks while they had P10.2 billion on deposit, resulting in net debt of P8.3 billion.

Fig.13: Household Borrowing and Deposits

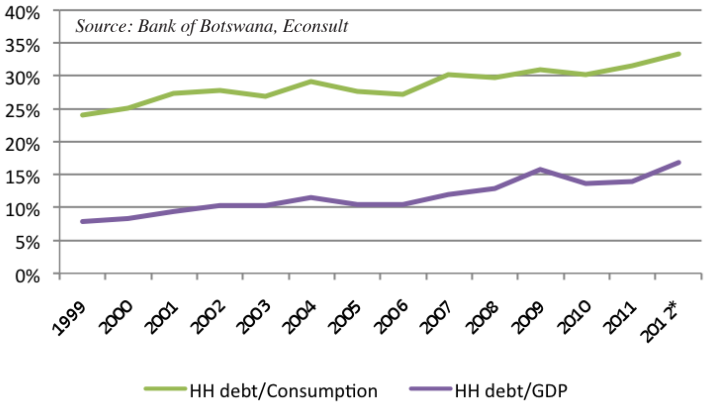


Some concern has been expressed about this level of indebtedness, on the basis that it means that households are not saving sufficiently. This would be incorrect, however, because households have financial savings in other forms. In particular, they have large holdings of pension fund assets – these totalled P45.7 billion in September 2012. So these assets – which form part of household savings – far exceed households' net borrowing from the banks. In financial terms, households as a whole are substantial net savers.

Borrowing has, nevertheless, been increasing steadily. The usual measure of household debt – relative to disposable income – cannot be calculated because data on GDP by income are not produced in Botswana. However, data are available on household consumption expenditure, which can be used as a proxy for disposable income.

This shows that the "burden" of household borrowing has indeed been rising, with the ratio of debt to disposable income (proxied by consumption) increasing from 24% in 1999 to 33% in 2012., and from 8% to 17% of GDP over the same period.

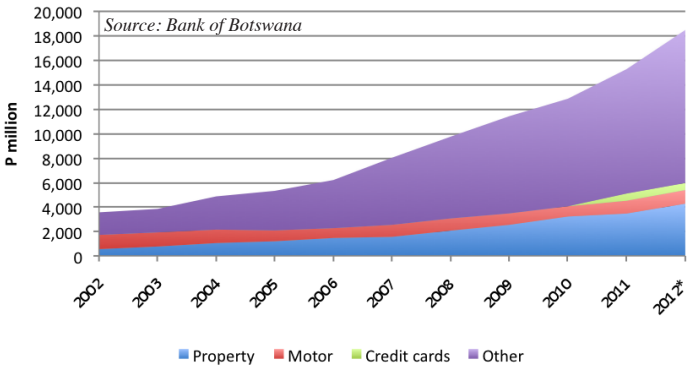
Fig.14: Household Borrowing and Deposits



Although the level of household debt is increasing relative to income and GDP, this is not of any great concern – indeed it is to be expected as an economy develops and the financial sector deepens. In developed economies the ratio of consumer borrowing to disposable income is typically well over 100%, and in some countries (such as the Netherlands) over 200%. In South Africa it is around 75%. So a ratio of 33% in Botswana is not of any immediate macroeconomic concern.

What is striking about household debt in Botswana is that it is very short-term. This is in contrast with more developed countries (and South Africa) where the majority of consumer borrowing is for mortgages. As at September 2012, only 23% of bank lending to households was for mortgages, and the vast majority – 71% was for short-term unsecured personal borrowing and credit card debt. Over the past decade, mortgage lending has grown slowly, but the real change has been the drop in asset financing for purchase of vehicles – down from 33% of bank lending in 2002 to only 6% in 2012 – although of course consumers may be using short-term personal loans for vehicles instead.

Fig.15: Composition of Household Borrowing



This could be problematic for two reasons. First, short-term unsecured loans tend to have higher interest rates than longer-term secured loans (for vehicles and property), and hence cost consumers more (but are more profitable for the banks). They are also more likely to be used for financing consumption – perhaps unsustainably financing expenditures that are in excess of incomes.

Going back to our starting point relating to the level of housing loans, and the potential dangers that this can pose to an economy, it seems that Botswana's problem is not that there is too much housing finance, but too little. Access to housing is a crucial component of rising living standards, and for most people this requires borrowing. An increase in the size of mortgage lending relative to GDP almost always accompanies economic growth (although as we have seen, there are limits).

The size of mortgage lending relative to GDP is often taken as an indicator of the general level of financial sector development. While this figure can vary a great deal across economies, it would typically be 70% or more in a "mortgage friendly" developed country such as the UK, USA or Australia. Data for Africa shows a wide variation, ranging from over 30% in South Africa and Namibia, to less than 1% in Nigeria and Tanzania.

Mortgage Finance as % of GDP, Selected African Countries	
South Africa	32%
Namibia	32%
Kenya	3.3%
Rwanda	2.6%
Ghana	2.4%
Tanzania	<1%
Nigeria	<1%

Source: FinMark Trust (2010) Housing Finance in Africa, 2010 Yearbook

In Botswana, mortgage finance (provided by the banks and BBS) amounted to approximately P6.4bn, or just under 6% of GDP in 2012. Although this is reasonable by the standards of Africa, it is much lower than in relevant comparator nations. Hence the concern is that Batswana are borrowing too little from banks for housing purposes – which most likely reflects a range of factors including consumer preferences and the nature of housing and land markets, rather than specifically financial sector issues.

Lower interest rates in Botswana have probably helped households to increase borrowing even with stagnant real incomes in recent years. Many households are, as a result, vulnerable to an increase in interest rates, which could in turn cause problems for the banking system. More generally there is a need for a national system of credit information, with a central record of borrowing, repayments and bad debts. This would help financial institutions better assess credit risks and make it more difficult for households to become over-indebted.