

# ECONOMIC REVIEW

first quarter january - march 2016

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## COMMENTARY

# Economic woes deepen, but there are welcome signs of stability in the global diamond market

### Introduction

The first quarter of 2016 was generally a period of bad economic news, with the slowdown in the global commodities market taking its continued toll on production and jobs in the mining sector. But there was important positive news from the global diamond market, where the dismal performance of the second half of 2015 did not continue, and there was a sharp recovery in diamond sales in Q1 2016. However, the poor performance during 2015 had the expected impact on fiscal revenues and exports, with sharp widening of the balance of trade and fiscal deficits. And the long-overdue release of data on jobs showed what had long been suspected, that (net) job creation has ground to a halt over the past couple of years.

### Global Diamond Market

During the last quarter of 2015 the global rough diamond market was in a dismal state. The supply pipeline through trading, cutting, polishing, jewellery manufacturing and retail activities was overstocked; consumer demand was weak; and high rough prices relative to retail prices left little scope for profits. This all led to limited demand for rough and downward pressure on prices. However, efforts by De Beers and Alrosa, the two largest global suppliers of rough diamonds, to reduce supplies and prices seem to have had the desired effect. Whereas the last three De Beers diamond sights of 2015 averaged US\$173 million, the first three of 2016 averaged US\$607 million.

As a result of the difficulties in 2015, Debswana cut back production, and reduced production targets for 2016. However, while the improved performance in early 2016 is positive, it is being viewed very cautiously, given the weakening state of the

world economy. What is not yet clear is whether the improved diamond sales simply represent a restocking of the diamond pipeline following the Christmas 2015 season, or a fundamental change in market dynamics. Debswana is unlikely to increase production levels until there is more clarity on the performance of the market through the year.

### Other Mining

The depressed global commodities market has also had a severe impact elsewhere in Botswana's mining sector. Two copper mines – Boseto (Discovery Metals) and Mowana (African Copper) closed down last year. Since then, Tati Nickel has also halted production, and BCL – the country's largest base metals miner and a key producer of nickel – has been experiencing major difficulties. BCL made large financial losses in 2015, and is in need of a bailout from the government, which is the sole shareholder.

## COMMENTARY

These losses have several causes. First, BCL's costs of production are too high, and it cannot make a profit at the current low nickel prices. Second, the smelter was closed for refurbishment last year, and the closure lasted far longer than anticipated; this was apparently due, in part, to BCL's inability to secure short-term work permits for the specialised workers needed for the refurbishment. This delay is reported as costing BCL (and hence the government) P270 million – hopefully this painful experience will help to convince the government that its tightening of immigration regulations in recent years imposes huge costs on business, and on itself. Third, BCL has attempted to diversify in recent years, for instance, by venturing into steelmaking and exploration for iron ore and diamonds. This may have diverted management attention, instead of focusing on BCL's core business of mining and smelting nickel and ensuring that it is a competitive, efficient and low-cost producer.

### Macroeconomic Performance

As a result of the cutback in diamond production, real GDP growth in 2015 was marginally negative, at -0.3%, the first annual contraction since the global financial crisis of 2009. Poor diamond sales in 2015 also led to a sharp downturn in exports, a large balance of trade deficit, and a drawdown of the foreign exchange reserves in the second half of the year. Government revenues were also badly affected, and the resulting budget deficit amount to over 11% of GDP in the second half of 2015.

### Employment

Employment statistics generally inadequate in Botswana, and until recently the most recent data on formal employment dated back to 2013. However, it has long been suspected that the record on job creation was poor, with few companies starting up or expanding, and many closing down or contracting. The recent mining downturn has accentuated this trend; whereas Debswana has generally managed to maintain employment even when reducing production – in part because of its status as a profitable and cash-rich mining company – this has not been the case with other mining companies, which have been loss-making or marginal. Hence there have been hundreds of job losses at Boseto, Mowana and Tati, and there are likely to be one or two thousand more at BCL as it is forced to cut costs.

After a long period of radio silence from Statistics Botswana, newly released data on formal employment showed that only 2,207 jobs were created between 2013 and 2015, a growth rate of only 0.7% in two years. Over this time, there were probably 40,000 net new entrants to the labour force from school and college leavers. Given this dismal experience with job creation, it is surprising that government policy is not focused more on resolving the problems that lie behind the lack of job creation.

### Other Developments

#### BTCL IPO

One positive development during the early part of the year was the successful flotation of a minority stake in Botswana

Telecommunications Corporation Ltd (BTCL), which marked the first IPO of a state-owned enterprise. The IPO was oversubscribed by 68%. Applications for 900,000 shares or less were allocated in full, while others received the first 900,000 plus 11.45% of the balance. On listing, the share rose in value from the IPO price of P1.00 to P1.30, although it has since fallen back to P1.25.

The IPO received an enthusiastic response, and as a result the main achievement has been a dramatic expansion in the number of shareholders. Prior to the BTCL IPO, the number of individual accounts in the Central Securities Depository (CSD) was around 28,000. With 50,301 shareholders (excluding government and employees), BTCL now has by far the most widely dispersed shareholding of any company listed on the BSE, and has significantly extended share ownership by adding around 47,000 new shareholders.

We note, however, that the way in which the partial privatisation was conducted – which restricted participation to citizens, citizen-owned companies and local asset managers - was in conflict with the official Privatisation Policy. This states clearly that:

*Out-right exclusion of foreign investors or across-the-board fixed restrictions on foreign participation in privatised enterprises will be avoided and any restrictions will be considered on a case-by-case basis. Allowing foreign participation in privatisation activities is in line with Government's policy of promoting Botswana as an investor friendly location for international companies (Government Paper No. 1 of 2000, para.47).*

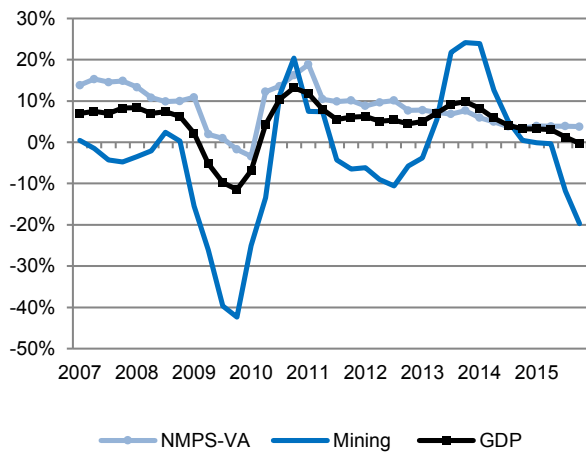
### Botswana's Greenhouse Gas Commitments

Botswana has, like most countries, made a commitment to reduce Greenhouse Gas (GHG) emissions in terms of the COP21 agreement under the UN Framework Convention on Climate Change (UNFCCC). Botswana's "Intended Nationally Determined Contribution" (INDC) is "to achieve an overall emissions reduction of 15% by 2030, taking 2010 as the base year." This is a worthy objective and in line with widely – although not universally – accepted international commitments to contain GHG emissions so as to reduce the impact of climate change.

There are several different contributors to Botswana's GHG emissions, the main ones being use of fuelwood for cooking by households, coal-fired power generation, and transport (petrol & diesel). Data on actual emissions is poor, and having made this commitment, more work is needed on quantifying GHG emissions. However, it is evident that plans to significantly scale-up coal-fired power generation, and to export electricity generated from coal, will make it virtually impossible to achieve the COP21 commitment. A determined shift towards solar-powered electricity generation will be essential to achieve the INDC and to reinforce Botswana's reputation as a globally responsible environmental steward.

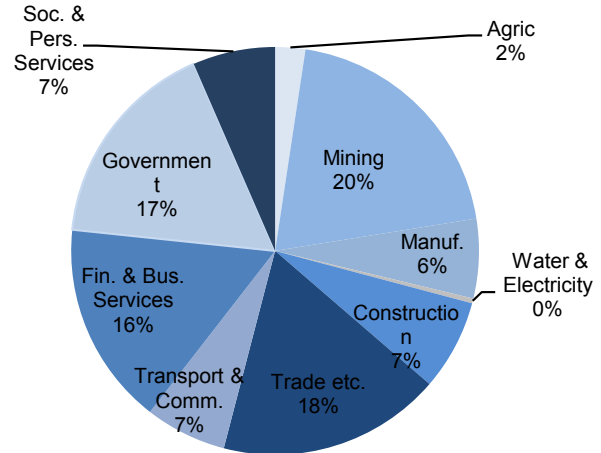
# KEY ECONOMIC VARIABLES

## Annual GDP Growth



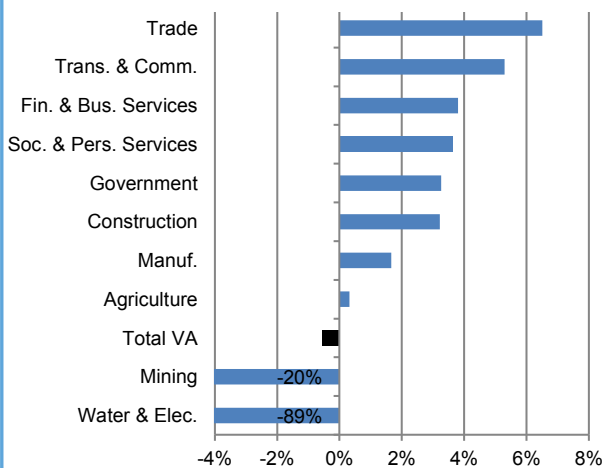
Weak global commodity demand for minerals dominated the economy in 2015, and had a major negative impact on GDP growth. In 2015 the economy contracted for the first time since 2009, recording GDP growth of negative 0.3%, compared to 3.2% growth realised in 2014. Mining contracted by 19.7% in 2015 compared to a slight increase of 0.5% in 2014, while in the non-mining private sector (NMPS), growth was resilient at 3.8% in 2015, slightly up from 3.4% realised in 2014.

## Sector GDP Shares



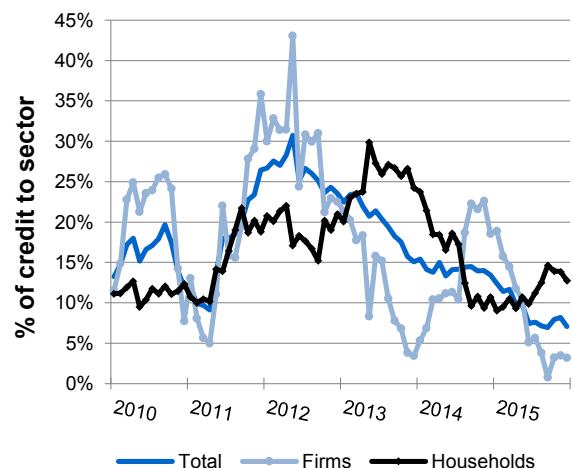
Despite contraction in 2015, mining continues to dominate the economy accounting for the largest share of GDP (20% at current prices) of any economic sector. Trade and Government are the second and third largest sectors. Compared to 2014, the share of mining to GDP fell by 6% while most other sectors' shares of GDP increased in 2015. However, when GDP is measured in constant prices, the shares of economic sectors change, with mining coming in third place after Trade and Finance & Business Services. The resilience of trade and service sectors shows that they are important especially when the economy is experiencing effects of external shocks.

## Sectoral GDP Growth



Overall economic growth performance in 2015 was poor, but there were small improvements in sectors such as Finance & Business Services and Construction. Mining was badly hit in 2015, recording the largest contraction since 2009, during the global financial crisis, when it shrank by 42%. Water & Electricity continued to experience negative growth, due to the huge negative value added in the electricity industry. Agriculture and manufacturing also performed poorly, with services sectors experiencing the fastest growth.

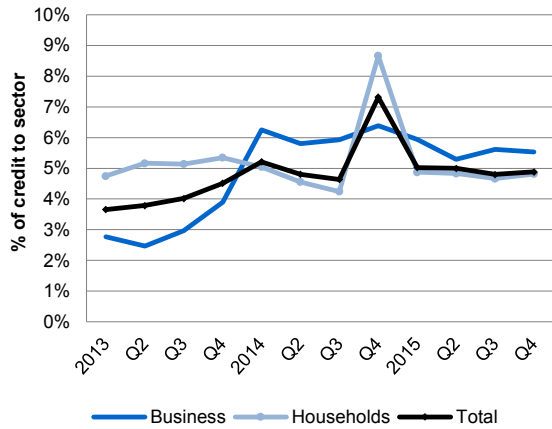
## Annual Credit Growth



Annual bank credit grew at a slower rate of 7.1%, in the year to December 2015, compared to 13.5% in 2014 – despite the lower interest rate environment. The subdued credit growth is attributable to declining annual growth in lending to businesses, which fell to 3.2% in 2015 from 18.9% in 2014. However, household credit growth was buoyant and increased from 10.7% in 2014 to 12.8% in 2015.

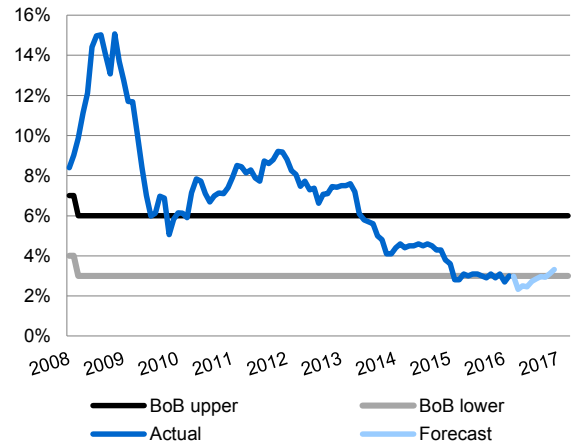
## KEY ECONOMIC VARIABLES

### Arrears on Bank Lending



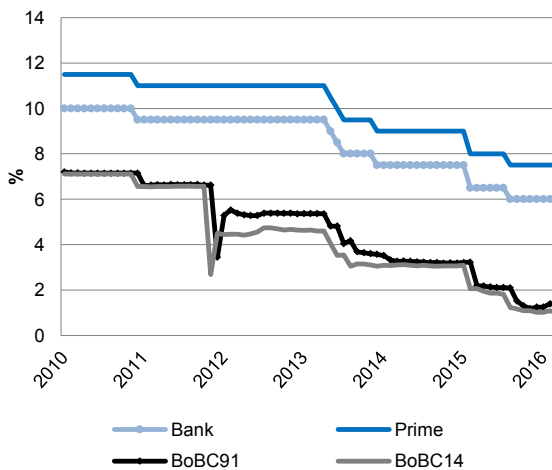
Total arrears as a proportion of outstanding bank credit decreased in 2015 contrast to a spike increase at the end of 2014; arrears fell from 7.3% in 2014 to 4.9% in 2015. Driven by both businesses and households, arrears on lending to businesses declined in 2015 to 5.5% from 6.4% in 2014 and arrears on lending to households decreased to 4.8% in 2015 from 8.7% in 2014. The overall decline in arrears eased the mood in 2014 over concerns of possible loan impairments.

### Inflation and Forecast



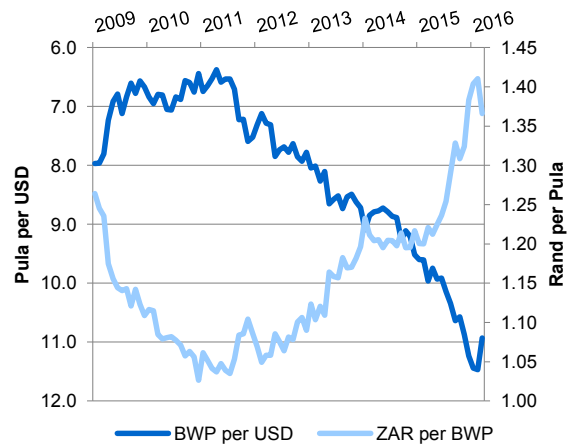
Headline inflation in the first quarter of the year has been positive ranging around the lower end of Bank of Botswana's medium-term objective range of 3-6%. This is mainly attributable to decline in the Transport Index group. For the rest of the year, the inflation outlook is positive; it may fall below 3% in the short term before rising towards 4% later in the year, but it is forecast to remain within the Bank of Botswana's medium-term objective range of 3-6% despite the expected hike in food prices (due to drought) and rising international oil prices.

### Interest Rates



The first sitting of Monetary Policy Committee (MPC) in 2016 maintained the Bank Rate at 6.0%, with the prime lending rate constant at 7.5%. Interest paid on 14-day and 91-day Bank of Botswana Certificates (BoBCs) was lower when compared to the same period last year, consistent with the Bank Rate reductions in February and August 2015.

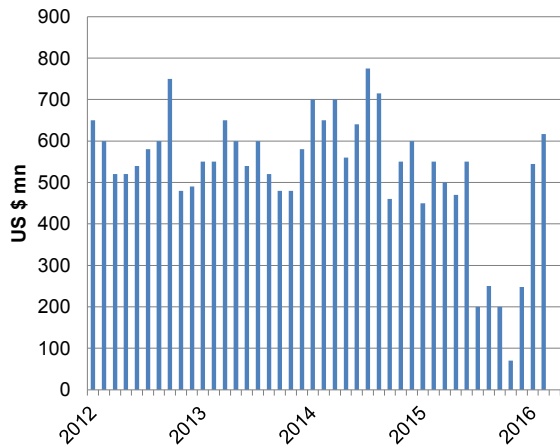
### Exchange rates



Exchange rate volatility continued in Q1 2016, but with some reversal of developments experienced in 2015. As at the end of Q1 2016 the Pula-US Dollar exchange rate was 10.93 from 11.23 in Q4 2015, an appreciation of 2.8%. Similarly, the Pula depreciated against the Rand by 1.2% in Q1 2016. The exchange rate policy was reviewed in January 2016 to allow for an upward crawl of 0.38% of the Nominal Effective Exchange Rate (NEER) from the zero rate of crawl in 2015. Currency weights in the Pula basket weight were maintained at 50% for the Rand and 50% for the Special Drawing Right (SDR).

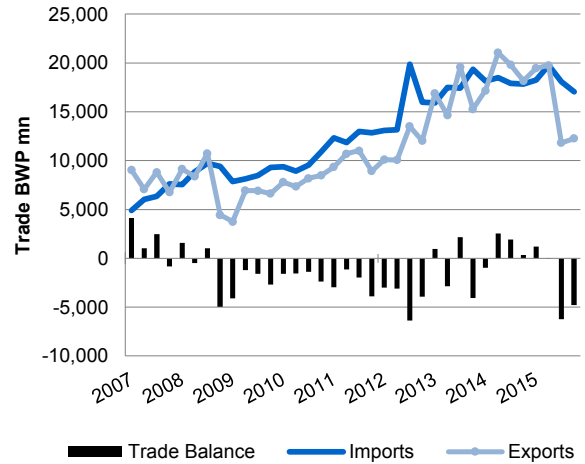
## KEY ECONOMIC VARIABLES

### De Beers Diamond Sales



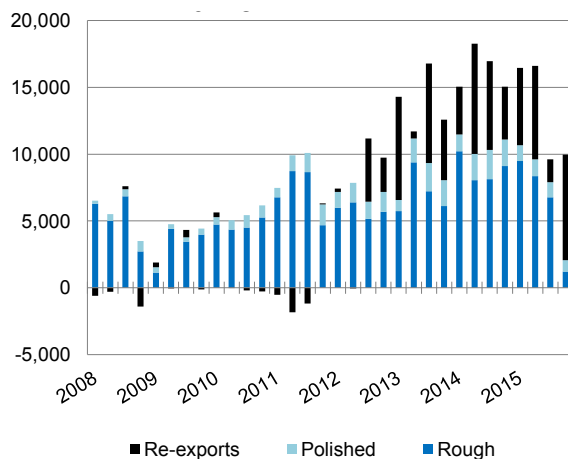
Demand for rough diamonds showed positive signs of recovery in the first cycle of sales in 2016. This is attributable to more rough demand from diamond manufacturers after the end of the holiday season. De Beers had successful sightholder and auction sales in January and February with rough diamond sales increasing to USD545 million and USD617 million respectively. At sightholder and auction sales, prices for rough diamond remained stable and De Beers sold all allocations in the February cycle. The industry remains cautious with developments in the global market.

### International Trade



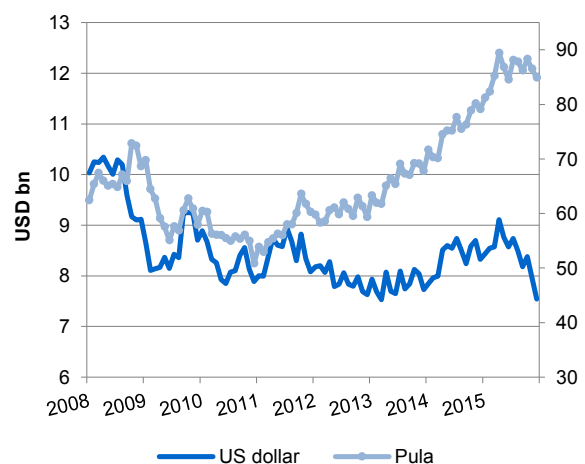
Trade performance in the last quarter of 2015 continued to be characterised by weakened demand for minerals, particularly diamonds but also copper-nickel. Compared to 2014, imports and exports in Q4 declined by 4% and 32% respectively. This resulted in a trade deficit of P4,777 million, compared to a surplus of P343 million in Q4 2014. Over the year as a whole, exports were down 17% on 2015, while imports were up 1%. The trade deficit deteriorated from a surplus of P3.8 billion in 2014 to a deficit of P9.8 billion in 2015.

### Diamond Exports



The global demand for diamonds, especially rough diamonds, was depressed in 2015, and prices were reduced to try and balance supply with demand. Overall diamond exports from Botswana decreased in the year to December 2015 across all export categories (rough, polished and re-exports) compared to 2014. However, total rough diamond exports increased by 7% in the last quarter of the year going into the holiday season, after a 45% decline in Q3 2015 – attributable to surge in re-exports during this period.

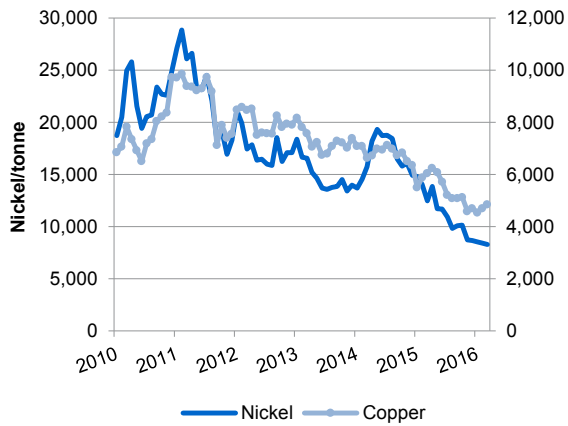
### Foreign Exchange Reserves



Foreign Exchange Reserves in Q4 2015 were P84.9 billion representing an increase of 7.3% from P79.1 billion in Q4 2014. However, the increase was largely driven by exchange rate changes, and in US dollar terms the reserves fell by 9.4% in 2015 to USD7.5 billion. At the end of the year the reserves were equivalent to 19 months of import cover of non-diamond goods and services.

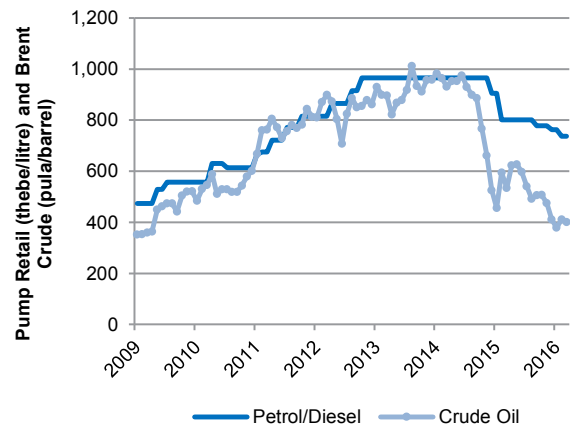
## KEY ECONOMIC VARIABLES

### Copper & Nickel Prices



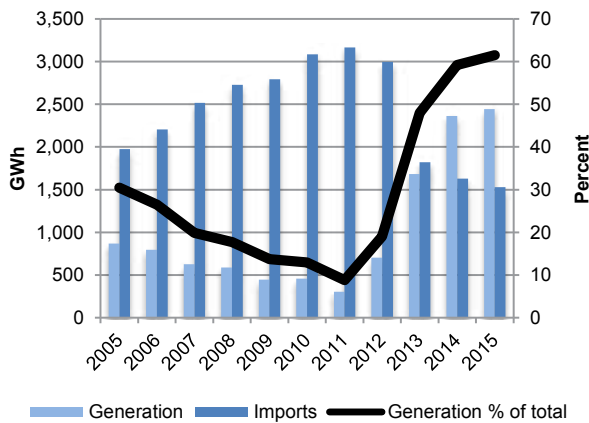
While nickel prices continued to move downward, copper prices in the first quarter of 2016 improved by 3.3% from USD4,701 to USD4,855 per tonne in Q4 2015 and Q1 2016 respectively. Nickel prices decreased to USD8,275 in Q1 2016 down from USD8,662 in Q4 2015. Rising copper prices followed an increase in Chinese imports – the country is responsible for nearly half of the world’s copper demand.

### Fuel Prices



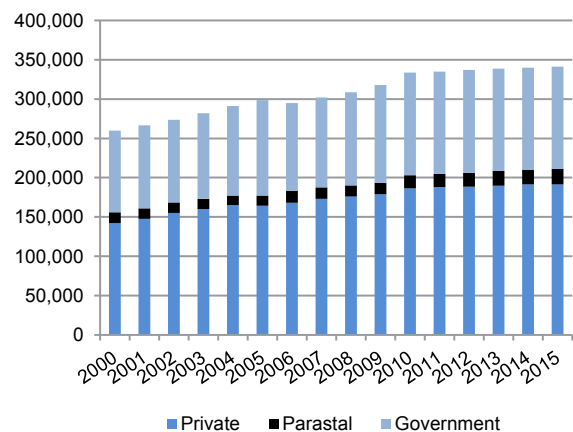
International fuel prices fell to record low levels in 2015 as the market continued to be oversupplied, creating a mismatch between demand and supply. Importers of oil benefited and domestic retail pump prices, which are administered, were reduced twice in the second half of 2015 and again in February 2016. In Q1 2016 the spot price for Brent crude decreased by 2.4% in Pula terms as exchange rate changes offset a 0.4% increase in USD terms. International oil prices are expected to recover this year.

### Electricity



Total consumption of electricity fell by 0.4% in 2015, reflecting reduced mineral production. However, domestic generation of electricity increased by 3.6% compared to 2014, to a total of 2,456GWh, as production at the troubled Morupule B power station stabilised to some extent. As a result, imports fell by 6.2%, and the proportion of total consumption produced domestically reached 62%. However, domestic production is still to some extent dependent on very expensive diesel generating capacity.

### Formal Sector Employment



A recent statistical release on formal employment – after a two-year gap - showed an overall increase in the number of formally employed persons in Botswana. However, the rate of increase is very low. Between September 2014 and September 2015 there were only 1,008 new jobs created in all sectors, growth of only 0.3%. Most of these were from parastatals, while private sector job creation was disappointing, with only 85 net new jobs in the year to September 2015. This compares with 20,000 or more net new entrants to the labour market each year. In this situation, policy needs to focus on job creation – and preventing job losses – above all else.



## NEWS HIGHLIGHTS

6th January	IMF trims Botswana growth prospects. (Mmegi)	In a Press Release marking the completion of the 2015 Article IV Mission to Botswana, the International Monetary Fund (IMF) estimated that real Gross Domestic Product (GDP) growth for Botswana in 2015 was 2.3%, slightly lower than the government's projection of 2.6% announced in September. This reflected weak global demand for diamonds. However, growth was expected to recover as a result of the gradual pickup in demand for diamonds, supported by low interest rates and the government's Economic Stimulus Package (ESP).
11th January	Cash flow crisis cripples BCL. (Sunday Standard)	Government-owned copper-nickel mining company BCL is struggling to pay its obligations to creditors due to cash-flow problems. These are in turn due to low commodity prices and poor management decisions. BCL is seeking recapitalisation by the shareholder, but government has instead instructed the company to raise finance through a bond issue. In the meantime, Government has issued a "Letter of Comfort", assuring creditors that BCL will be supported as a going concern.
21st January	Letshego completes acquisition of Nigerian Bank. (Mmegi)	The proposed acquisition by Letshego Holdings to acquire a 100% stake in a bank in Nigeria- FBN Microfinance Bank - from its parent FBN Holdings plc has been completed. According to the company, this acquisition is part of a strategy to expand into African markets thus bringing Letshego's footprint to 10 countries in south, east and west Africa.
2nd February	Reform to avoid middle-income trap, IMF advises. (Mmegi)	Botswana and other Small Middle Income Countries (SMICs) have been advised to rethink their growth strategies to advance to the next development stage of an upper-income country. According to the IMF, the SMICs are among the slowest growing group in the region and face significant downside risks to their outlook, which requires a new growth plan.
3rd February	Gem Diamonds ups cash, stops Ghaghoo cash bleed. (Mining Weekly)	Gem Diamonds, which owns diamond mines in Botswana and Lesotho, ended the year with net cash of USD55.3 million and cites the first quarter of 2016 as "encouraging". Viability has been a concern since average prices for Q4 2015 at Gem Diamonds' Ghaghoo underground mine in Botswana hit USD150 per carat.
4th February	Rough Market Enthusiasm. (Diamonds Net)	Demand for rough diamonds improved significantly in January, leaving many to wonder if the sudden upturn is sustainable. Manufacturers demanded more rough than was available as miners - De Beers and ALROSA - limited their respective supplies amid continued uncertainty in consumer demand. Rough diamond sales at both companies surged in January compared to late 2015.
10th February	Lucara's biggest diamond named. (The Patriot)	The world's second largest diamond - discovered last year at Lucara Diamond Corporation's Karowe mine - has been named. The 1,111 carat diamond was named 'Lesedi La Rona' following a competition that was open to all Batswana to come up with a name for the stone.

## NEWS HIGHLIGHTS

13th February	Botswana diamond exports fall 38% to seven-year low. (The Diamond Loupe)	According to data published by Bank of Botswana, the value of exports from Botswana's big diamond mines fell 38% to a seven-year low of USD2.4 billion in 2015, from USD3.9 billion the previous year. Botswana exports were last recorded lower during the 2009 global financial crisis, exports were worth USD1.8 billion.
15th February	Botswana too dependent. (Daily News)	According to Dr. Jefferis at Econsult Botswana, approximately 540,000 adults, out of an the adult population of just over 1 million in Botswana, depend directly on the government for economic survival. This figure includes government and parastatal employees and recipients of old age pensions, destitute allowances, Ipelegeng payments and various government economic support programmes. .
22nd February	Lending Rate left unchanged at 6%. (Sunday Standard)	At the meeting of the Monetary Policy Committee (MPC) held on the 17 February 2016, a decision was made to keep the Bank Rate unchanged at 6%, due to the positive outlook for price stability. Inflation is expected to remain within the Bank of Botswana objective range of 3-6% in the medium term, while credit growth is also considered to be at a sustainable level.
25th February	FNBB deposits increase 13%. (The Patriot)	First National Bank Botswana's (FNBB) unaudited financial results for half of their financial year, ended December 2015, revealed an improvement in the bank's financial position (balance sheet) when compared to the same period last year, from P17.9 billion to P20.5 billion, driven by advanced customer deposits of 13%. Profit before tax contracted by 15%, from P440 million to P372.1 million in H1 2014 and H1 2015 respectively.
29th February	BOB forecasts economy to grow 4.2%. (Sunday Standard)	Bank of Botswana forecast the economy to grow by 4.2% in 2016, an advance on the estimated 1.0% growth in 2015. These positive growth rates are attributable to modest gains in the global economy, where the market for diamonds is improving.
6th March	Botswana's mining industry facing layoffs. (DIB Online)	Thousands of jobs might be lost as a result from the persistent global slump in commodity prices, forcing Botswana mines to make adjustments to their workforce. According to the Department of Mines, BCL may layoff as many as 2,000 workers from its Selebi-Phikwe copper-nickel mine, while Gem Diamonds may also retrench 100 workers at its Ghaghoo mine.
7th March	Local banks record decline in mortgage lending. (Sunday Standard)	The Monetary Policy Statement (MPS) by Bank of Botswana revealed that annual growth in mortgage lending to households decreased significantly, from 18.4% in 2014 to 7.4% in 2015. According to the MPS, this contraction is consistent with market indicators that the residential property market is weakening, especially for high-value properties and associated use of property refinancing to augment spending in other areas.
8th March	BIHL profit jumps 18%. (The Patriot)	Financial results for the year ended 31 December 2015 revealed that Botswana Insurance Holdings Limited (BIHL) performed very well, with profit after tax recording an 18% increase, from P505.6 million in 2014 to P597.7 million in 2015. The life insurance business was the major contributor to BIHL profits.



## NEWS HIGHLIGHTS

11th March	Botswana's budget lacks transparency – Survey. (Mmegi)	The International Budget Partnership's Open Budget Index survey (OBI) scored Botswana 47 out 100 in 2015 (where 100 represents extensive budget openness). The results indicate that the government provides the public with limited budget information and is weak in providing the public with opportunities to engage in budget processes. Thus, budget transparency is weak. To improve transparency it is recommended that the government publish In-Year reports and Mid-Year reviews.
14th March	Botswana Oil to list on the Stock Exchange. (Sunday Standard)	The Chief Executive Officer of Botswana Oil Limited revealed plans to list the company on Botswana Stock Exchange to generate funds to finance the company's expansion and infrastructure development, and to increase citizen participation in the petroleum industry. The company also plans to promote economic diversification through a project to convert coal to liquid petroleum.
14th March	Sotheby's to auction the world's second-largest rough diamond. (Rapaport News)	Lucara Diamond Corporation, which discovered the world's second-largest rough diamond from its Karowe mine in Botswana, has appointed Sotheby's to auction the 1,111 carat stone. "Lesedi La Rona" is expected to be sold in the first half of the year following completion of scheduled road shows around the world.
17th March	More than 40 000 buy BTCL shares. (Daily News)	The Botswana Telecommunications Ltd (BTCL) IPO was a success with applications for shares exceeding the number on offer. The Managing Director of BTCL revealed that more than 40,000 submissions were made for purchase of the 462 million shares available. The allocations committee is still to decide how the shares will be allocated to applicants given the over-subscription. The BTCL IPO was open to all Botswana from 11 January 2016, and ended on the 4 March 2016.
16th March	Inflation expected to remain low and stable – BOB. (Business Weekly & Review)	The Bank of Botswana forecast the economy's inflation to remain within the Bank's medium-term objective range of 3-6% for the rest of 2016. Informed by the positive inflation outlook relative to trading partners, the Pula will crawl upwards by 0.38% against the basket in 2016 (Monetary Policy Statement).
17th March	De Beers diamond reserves +28% to 480M carats. (Rapaport News)	Diamond reserves at De Beers increased by 28% in 2015 as the company increased its resource estimate from its main Debswana mines, Jwaneng and Orapa. It is stated that reserves increased from 375.4 million carats in 2014 to 479.7 million carats in 2015. Most of the increase is attributable to arise in reserves at Debswana which advanced from 212 million carats in 2014 to 313.8 million carats in 2015.
18th March	Debswana cautiously optimistic in 2016. (Mmegi)	Debswana Mining Company intends to keep production at 20 million carats in 2016, largely unchanged to 2015 production, as the company remains cautiously optimistic about the global diamond market despite signs of market recovery. The decision to reduce production target from 23 million carats in 2015 was informed by the challenging environment in the diamond market.
21st March	IMF forecasts 3.7% GDP growth in 2016. (Sunday Standard)	In a Press Release regarding the just-completed 2015 Article IV Report on Botswana, the IMF forecast that the economy will grow by 3.7% in 2016, as the global diamond markets continue to show signs of recovery, with improving diamond prices, as well as the positive impact of the fiscal stimulus.

## NEWS HIGHLIGHTS

21st March	Barclays rebounds in H2:2015. (Sunday Standard)	Barclays Bank Botswana rebounded in the second half of 2015 to improve performance from the first six months of 2015 financial year. Profit before tax (PBT) increased to P332 million in H2 from P222 million in H1 2015. However, when compared to the previous financial year, PBT in H2 2015 was 22% below that recorded in H2 2014, from P424 million to P332 million in 2014 and 2015 respectively.
24th March	Debswana reports positive trend in rough diamonds sales. (Sunday Standard)	De Beers announced positive rough diamond sales at the start of the year, with total sales to global sightholders and at auction increasing slightly in February to USD617 million, up from USD545 million in January. However, the company continues to face market pressures due to subdued demand for diamond, and production is capped at 20 million carats in 2016.
28th March	Botswana Diamonds kick-off Orapa exploration. (Rapaport News)	A joint venture between Botswana Diamonds and ALROSA has started exploration in the Orapa area, with drilling expected to commence in April this year. Botswana Diamonds will cover half of the USD700,000 budget while ALROSA will manage and cover the remaining budget.
29th March	IMF Executive Board concludes Article IV consultation with Botswana. (Sunday Standard)	The IMF Article IV consultations with Botswana have been completed. Botswana was commended for its prudent economic policies and for the government's fiscal stimulus to boost the economy. The IMF stated that it expects Botswana's economy to gradually recover over a period of three years, amidst positive signs of recovery in global prices of diamonds, although a budget deficit is estimated for 2015. The IMF noted that structural reforms are still necessary to improve efficiency in all sectors, diversify the economy and create employment.
29th March	Botswana to attain self-sufficiency in power generation by 2019. (Mining Weekly)	According to the International Business Monitor (IBM), Botswana should achieve power self sufficiency in 2019, following optimisation of power generation at the currently underperforming coal-fired thermal power stations. Furthermore, power generation capacity is expected to increase in the next five years, driven by three new power projects that have been proposed to supply the national grid between 2018 and 2019.
30th March	Tango hoping for USD30 million loan to complete Botswana mine deal. (Rapaport News)	Tango Mining is hoping to finalise a USD30 million loan to fund the delayed acquisition of Firestone Diamonds' BK11 diamond mine in Botswana, after being granted an extension to raise funds for the purchase. Tango was given until 8 April to have raised USD7.65 million balance of the consideration.

## MACRO-ECONOMIC DATA

Key Economic Data									
	unit	2012	2013	2014	2015 Q1	2015 Q2	2015Q3	2015Q4	2016Q1
<b>Annual Economic Growth</b>									
GDP	%	4.8	9.3	4.4	3.2	3.1	1.2	-0.3	..
Mining	%	-4.6	23.9	4.5	-0.1	-0.4	-11.8	-19.7	..
Non-mining private sector	%	8.0	6.8	4.1	3.9	3.8	3.9	3.8	..
GDP current prices	P mn	112,705	125,810	142,466	36,217	37,279	37,327	34,904	..
GDP 2006 prices	P mn	75,786	82,961	85,619	21,514	21,450	20,707	21,730	..
<b>Money &amp; Prices</b>									
Inflation	%	7.4	4.1	3.8	2.8	3.1	2.9	3.1	3.0
Prime lending rate	%	11.0	9.0	9.0	8.0	8.0	7.5	7.5	7.5
BoBC 14-day	%	4.6	3.1	3.1	2.1	1.9	1.18	0.97	1.0
<b>Trade &amp; Balance of Payments</b>									
Exports - total goods	P mn	45,719	66,402	76,208	19,465	19,767	11,830	12,281	..
Exports - diamonds	P mn	36,143	55,367	65,328	16,466	16,618	9,609	9,969	..
Imports - total goods	P mn	62,112	70,210	72,394	18,265	19,756	18,076	17,058	..
Balance of visible trade	P mn	-16,393	-3,808	3,814	1,200	12	-6,246	-4,777	..
Balance of payments	P mn	-862	1,340	11,404	4,998	942	-468	..	..
<b>Foreign Exchange</b>									
Exchange rate BWP per USD	end	7.776	8.718	9.515	9.960	9.911	10.638	11.236	10.929
Exchange rate ZAR per BWP	end	1.090	1.196	1.217	1.221	1.237	1.329	1.383	1.366
FX reserves	\$ mn	7,628	7,726	8,323	8,571	8,572	8,179	7,546	..
FX reserves	P mn	59,317	67,772	79,111	85,194	84,536	86,190	84,881	..
<b>Financial Sector</b>									
Deposits in banks	P mn	47,216	48,512	53,231	61,342	57,357	61,485	59,650	..
Bank credit	P mn	34,555	39,763	45,116	45,694	45,866	47,209	48,307	..
BSE index		7,510.2	9,053.4	9,501.6	9,693.9	10,690.1	10,624.3	10,602.3	10,202.6
<b>Business Indicators</b>									
Diamond production (a)	'000 cts	20,619	23,134	24,658	5,722	5,999	4,176	4,836	..
Copper production	tonnes	57,916	49,448	46,721	9,653	7,530	2,518	3,349	..
Nickel production	tonnes	17,942	22,848	14,958	5,169	6,439	1,194	3,987	..
Business confidence index	%	47%	45%	52%	44%	..	44%	..	..
No. of companies formed		16,561	14,190	16,300	5,238	4,904	5,071	..	..
Electricity consumption	GWh	3,703	3,502	3,990	970	1,006	956	1,041	..
Crude oil (Brent)	\$/bar	110.80	109.95	55.27	53.69	60.31	47.29	36.61	36.75
<b>Employment (formal)</b>									
Government		131,033	130,175	129,918	..	..	130,220	..	..
Parastatals		17,484	18,838	18,790	..	..	19,411	..	..
Private sector		188,531	189,894	191,399	..	..	191,484	..	..
Total		337,048	338,907	340,107	..	..	341,115	..	..
<b>Govt Budget</b>									
		2013/14	2014/15 Outturn	2015/16 Revised	2016/17 Budget				
Revenues	P mn	48,951	55,904	51,764	48,398				
Spending	P mn	41,730	50,564	55,961	54,445				
Balance	P mn	7,222	5,340	-4,197	-6,046				
Public debt & guarantees	P mn	29,481	32,991	33,670	34,459				
Govt deposits at BoB	P mn	31,745	41,680	36,752	..				
GDP	P mn	129,425	145,435	153,844	159,888				
Revenues	%GDP	37.8%	38.4%	33.6%	30.3%				
Spending	%GDP	32.2%	34.8%	36.4%	34.1%				
Balance	%GDP	5.6%	3.7%	-2.7%	-3.8%				
Public debt & guarantees	%GDP	22.8%	22.7%	21.9%	21.6%				
Govt deposits at BoB	%GDP	24.5%	28.7%	23.9%	..				

Sources: Bank of Botswana; MFDP; Statistics Botswana; Department of Mines; Registrar of Companies; Econsult

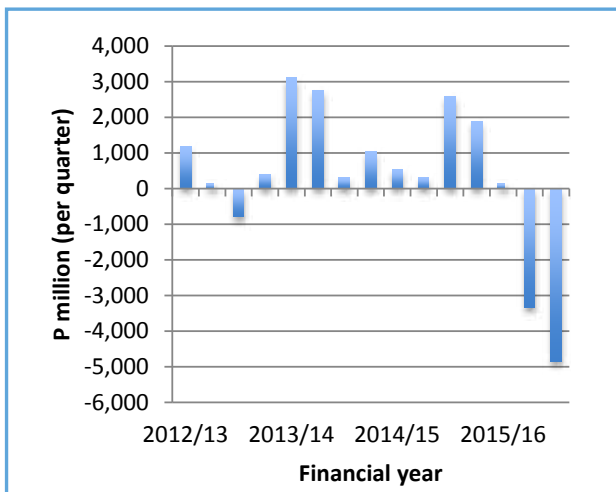
Notes: (a) 2013 figures include production from Boteti Diamond and Debswana  
(b) Numbers in Italics reflect revisions from the previous review

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## The 2016 Budget

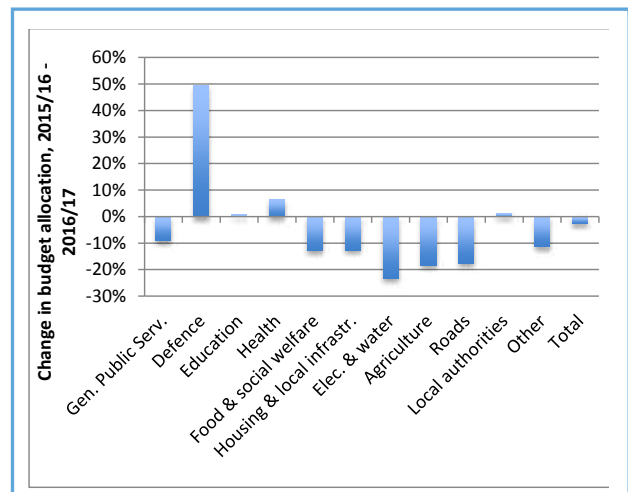
The 2016 Budget was presented by the Minister of Finance and Development Planning, Hon. O K Matambo, on February 1st, 2016. The Budget was delivered at a very difficult time, with poor diamond sales in the second half of 2015 leading to sharply reduced exports and fiscal revenues. Economic growth had come to a halt, with the contraction of diamond production. The fiscal balance had deteriorated, with the previously forecast surplus transformed into a large deficit by the end of 2015. At the same time, a political commitment to a fiscal stimulus package had to be accommodated. Nevertheless, the Ministry of Finance and Development Planning was unwilling to draw down fiscal buffers excessively – indeed these were still being rebuilt following the earlier drawdown during the Global Financial crisis of 2008-9. The Government also faced high spending demands for the subsidy of loss-making parastatals and subventions to a proliferation of new parastatals.

Figure 1: Quarterly Budget Balance



In the even the Budget presented by the Minister showed considerable restraint, with total spending of P54.5 billion in the 2016/17 financial year (FY), a small (2.7%) reduction when compared to the revised budget of P56.0 billion for FY 2015/16. The budget therefore provides little in the way of fiscal stimulus, at least on paper. With the overall decline in expenditure, most areas of spending are due to have their budget allocations cut back in the 2016/17 FY (see Figure 2). The main exceptions are defence (up 50%) and health (up 7%).

Figure 2: Changes in Budget Allocation by Functional Area



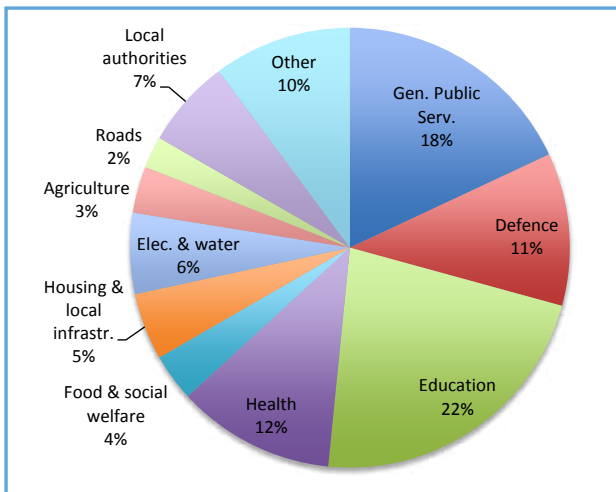
There are other surprises in the budget allocations. One is the relatively small allocation to investment in water projects, given the needs for new pipelines and other water treatment and distribution infrastructure. Of the P3.1 billion allocated for investment in water and electricity projects, the majority is devoted to electricity, and of this the bulk is for subsidies to the loss-making Botswana Power Corporation (BPC), given the reluctance of government to raise electricity tariffs to cost-covering levels. The allocation for investment in core water infrastructure and development has been cut by more than half, from P1.1 billion in 2015/16 to P484 million in 2016/17. The Budget also makes no provision for expenditure on rail transport, which is a puzzle given the recent re-introduction of passenger rail services, which required the purchase of new rolling stock by Botswana Railways and will undoubtedly need on-going subsidies in order to keep the service running.

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It is also striking that there is no financial provision for the loss-making nickel mining company BCL, another parastatal, which is sorely in need of recapitalisation and restructuring if it is to have any hope of survival. BCL is also committed to the purchase of Tati Nickel and a share in the Nkomati nickel mine in South Africa from Norilsk Nickel. Government has agreed to guarantee a very large bond issue by BCL, which will not appear in the budget but does count against the statutory limits on government borrowing. But debt is not a suitable method of recapitalisation, and sooner or later government will need to make an equity contribution, through the budget, in order to put BCL on a firmer financial footing.

Despite these changes, education remains the largest single recipient of government spending, followed by general public services and healthcare.

Figure 3: Functional Allocation of Public Spending, 2016/17



Expenditure on the much-anticipated Economic Stimulus Programme (ESP) is not separately identified in the budget documents. However, government officials have elsewhere commented that the total ESP allocation over the two financial years is around P3.6bn, equivalent to just over 3% of total spending over this period. Taking fiscal multipliers into account, this could add an estimated 2% to GDP in 2016.

It is believed that most, but not all, public spending goes through the official budget. There are some off-budget funds, including for the alcohol levy, electricity levy, and tertiary education, but as the accounts for these funds are not included in the official budget documents their magnitude is difficult to identify precisely. But their omission means that total tax revenues and public spending are higher than the figures in the budget.

As noted above, the 2016 Budget aspires to present a fiscally responsible budget in a difficult situation. Inevitably, the previously anticipated budget surplus for 2015/16 has turned into a deficit, with a further deficit projected for 2016/17, given the sharp decline in mineral revenues. The budgeted deficits are manageable, at P4.2 bn (2.7% of GDP) and P6.0 bn (3.8% of GDP) respectively.

The danger is of course that the budget may prove to be over-optimistic. Already, the actual deficit for the first three quarters of the 2015/16 financial year (i.e. April-December 2015) came in at P8.0 billion, almost twice the size of the deficit for the whole year projected in the 2016 Budget. So the starting point for the 2016/17 budget is likely to be considerably worse than the official estimates. And as noted above, it is likely that there will be additional spending demands for rail transport and mining subsidies. Having said that, the good performance of the global diamond market in the first few months of 2016 suggests that there should be some recovery in mineral revenues.

The 2016 Budget documents also include three-year forecasts, in the Medium Term Expenditure Framework (MTEF). While these forecasts are preliminary and subject to change, they show that the difficult fiscal situation is unlikely to ease anytime soon, with deficit budgets projected through to 2018/19.

Despite several years of actual/projected deficits, they can be financed relatively easily through a combination of domestic debt issuance and drawdowns of cash balances from the Government Investment Account (GIA). Both domestic and foreign debt (including guarantees) are subject to (individual) statutory ceilings of 20% of GDP. Foreign debt is currently estimated at just over 16% of GDP, and the BCL bond guarantee (which is for a US dollar facility) will take this close to the statutory limit. However domestic debt is only around 6% of GDP, so there is scope for Pula bond issuance. As at December 2015 the GIA totalled P37 billion. But obviously, the more that government savings are used to finance near-term budget deficits, the less that is available to help with the longer-term adjustment to the depletion of diamond deposits.

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# Botswana - 2015 IMF Assessment

As a member of the International Monetary Fund (IMF), Botswana is subject to regular economic assessments. This assessment, carried out under Article IV of the IMF's membership conditions, is done for all members at regular intervals, usually annually. The most recent Article IV consultation with Botswana was carried out in late 2015, and the report was published in April 2016.

The Article IV Consultation report comprises a standard set of components, including a review of the economy and economic performance, an assessment of policy in various areas, medium-term economic forecasts, recommendations for policy reforms, and a discussion of areas of agreement (or not) between the IMF and the country's government. The reports also typically include assessments of a country's debt sustainability, real exchange rate alignment (a measure of competitiveness) and statistical capacity.

It should be understood that the Article IV process is purely one of consultation and discussion. The recommendations that are produced are just that, and are not conditions, and there is no obligation on a government to accept or implement the recommendations. It is therefore quite different to the conditionality that may be imposed on countries participating IMF lending programmes, or the more formal assessments under programmes such as the Policy Support Instrument. Article IV reports are generally quite diplomatic in tone, and do not usually highlight major disagreements between the Fund and the government, and economic forecasts are typically quite close to those of government; as a result it is sometimes necessary to "read between the lines" to fully understand where there may be issues or problems.

The 2015 Botswana Article IV Report is generally quite positive about the economy, although noting the short-term difficulties resulting from the slowdown in diamond exports in 2015. However, it does provide information on the IMF's assessment of priorities that policymakers need to attend to given the long-standing need for more effective economic diversification. The following are some of the areas that the IMF has highlighted.

## Fiscal Policy and Government Spending

This is always a key area for the IMF, and remains one of the main topics of relevance to Botswana in the long term. The Fund notes the need to improve the efficiency of public investment, and to be more selective in the choice of development projects to minimise the risks of poor execution and waste of public resources. It proposes that Botswana undertakes a Public Investment Management Assessment to identify investment capacity constraints in the investment planning, allocating and implementing processes. The government agrees with the need to increase efficiency and

the quality of public spending, at least in principle, although the continued allocation of funds to expensive projects that clearly do not meet any kind of rational cost-benefit analysis criteria shows that achieving this in practice will be challenging.

The IMF also notes that more effort is needed to mobilise domestic revenues given constrained mineral and SACU revenues. This could include improved VAT collections, fewer exemptions, and raising more revenue from property taxes.

The Fund also advises that reforms are needed to the management of mineral revenues, and suggest that a new fiscal rule is needed to ensure long-term budget sustainability, and to strengthen the rules regarding the saving of a share of mineral revenues in the Pula Fund and the ability of government to withdraw and spend money that has been saved in the Pula Fund. NDP11 will be a key test of whether government is prepared to follow this advice, as well as recommendations for a clear prioritisation of public investment projects based on cost-benefit analysis.

## Business Environment

The Fund highlights the negative impact that water and electricity shortages has had on the growth of the private sector and on job creation, and the need to urgently address these issues. A related issue is the need to improve the efficiency of state-owned enterprises (parastatals), to restore them to profitability (and hence reduce the burden they impose on the budget and on the private sector), through restructuring and bringing in private sector management. This will help to create more jobs and boost diversification. The Fund also urged government to reduce red tape and restrictions on work permits for skilled foreign workers, as this would raise productivity, facilitate the expansion of the private sector, and promote transfer of skills and know-how. However, this is one area where the government is not in agreement – unlike most of the points and recommendations made by the IMF - and made no commitments to reform.

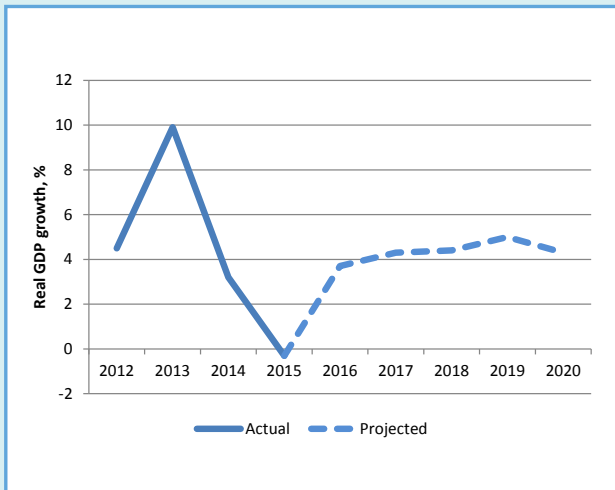
The IMF also urged caution in proceeding too rapidly with establishing Special Economic Zones (SEZs), noting that internationally many SEZs have failed, and that they should avoid unduly generous tax incentives and expensive in-



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infrastructure investments with uncertain payoffs. Instead, the focus should be on providing a substantially improved business environment in SEZs, and that lessons should be learned from an initial one or two SEZs before rolling out the full programme of up to eight SEZs.

Figure 4: IMF GDP Growth Forecasts



### Economic Forecasts

The IMF forecasts in its base case that Botswana's real GDP growth will recover from the mild contraction in 2015 to average 4.3% a year from 2016-2020. However, in an alternative, enhanced reform scenario, non-mining growth could be 1.2% a year higher in the long-term. This would require improved efficiency in the public sector investment programme.

### Statistics

The IMF's assessment of Botswana's economic statistics capacity is that it is "adequate" for surveillance purposes. We consider this finding to be overly optimistic, however, given that the report continues to note that "there are some data shortcomings in national accounts, fiscal, monetary, and external sector statistics in terms of accuracy and reliability of the source data and the statistical techniques used in the compilation of national accounts, government finance, and balance of payments statistics".

We also note that a recent World Bank assessment of national statistical capacity concludes that Botswana's capacity has deteriorated sharply in recent years and is now below the average for sub-Saharan Africa.

### Other Assessments

The IMF concludes that Botswana's international (foreign) reserves "far exceed their adequate level" according to IMF metrics. However, they note that more clarity is needed as to what portion of the reserves (especially the Pula Fund) is for stabilisation purposes and how much represents a store of savings for future generations. In terms of external stability, the IMF concludes that the real effective exchange rate (REER) is broadly in line with the country's needs and fundamentals.

However, we disagree with this conclusion, given the gradual appreciation of the Pula over the past decade, especially against the SA Rand, the lack of competitiveness of many non-mining exporters, and the sluggish rate of job creation by those exporters. Finally, the IMF concludes that in terms of public debt, Botswana faces minimal risks of medium term debt problems or stress.

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