compiled by
KEITH JEFFERIS
SETHUNYA SEJOE

econsult

ECONOMIC REVIEW

third quarter july - september 2016

in this issue ...

COMMENTARY

Closure of BCL Mine overshadows BOT50 celebrations

Introduction

For much of the third quarter (Q3) of 2016, activity in Botswana was focused on the run-up to the 50th anniversary of Independence on September 30th. This gave rise to a wide spread feel-good factor, with many people focusing on Bot50 and its "United and Proud" theme. This was a special event, and widely celebrated for good reason.

On a macroeconomic level, some of the data released during Q3 painted a reasonably bright picture. While GDP growth for the year to June 2016 continued to hover around zero, this largely reflected the cutbacks in diamond production that took place in the second half of 2015. Elsewhere in the economy, in the non-mining private sector, growth appeared to be reasonably robust, with annual growth rising to 4.5%, the highest rate for two years. There was also a continuation of the recovery in diamond exports, and a large balance of trade surplus in Q2. Inflation and interest rates remained at the lowest rates for 40 years. There was a welcome rebalancing of bank credit growth, with a slowdown in the growth rate of credit to households, and an increase in credit to businesses.

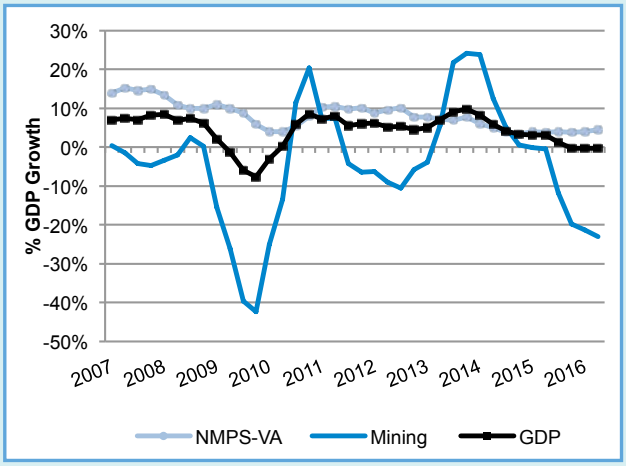
At the same time, there are some worrying signs of underlying economic stresses. The government budget is under pressure, with a large fiscal deficit in the year to June and rapid depletion of government savings. The Botswana Stock Exchange (BSE) has been on a year-long downward trend, and at the end of Q3 the Domestic Companies Index (DCI) was more than 10% below its 2015 peak, indicating that the profitability of large listed companies is under pressure. Reports from some sectors of the domestic economy suggest that trading conditions are extremely tough. And while there are no up-to-date employment statistics, there is a general feeling that the trend of virtually stagnating employment shown in the data to 2015 has continued.

Immediately after the end of the quarter came the announcement that the state-owned BCL copper-nickel mine was to be placed under provisional liquidation, with the loss of 5,000 jobs at BCL and its subsidiary Tati Nickel Mining Company (TNMC). We discuss this major development and its impact in more detail later in this Review. But in many ways this is a turning point in Botswana's economic trajectory. While many companies have closed in recent years, this one is by far the largest. There was a general expectation that when it came to the crunch, Government would be willing to bail out BCL, given its size and the potential political impact of its closure. The fact that it has declined to do so in part reflects the magnitude of the challenge – the amount of money required was just "too big, too late"; the bailout cost of well over P1 million per BCL/Tati employee simply could not be justified, especially when there are so many other demands on public spending. It also suggests that government has lost confidence in BCL management, and perhaps has also concluded that government itself just cannot run a large complex mining operation.

As we commented the last Economic Review, the next fifty years of Botswana's economic development will require a new approach, and that "business as usual" is not an option. Being willing to take tough decisions about where best to spend limited fiscal resources is part of the new realism that is required. But having taken one such decision, the real challenge now will be to make sure that when government does spend money, it is devoted to high return, productive and growth-enhancing purposes, and is backed up by other policies and reforms that are supportive of both local and foreign investment.

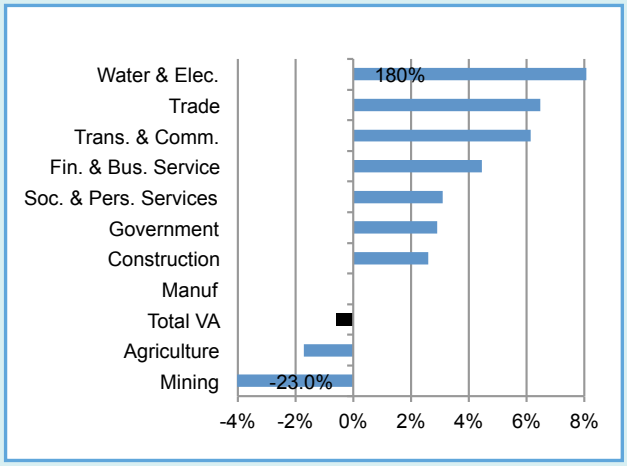
KEY ECONOMIC VARIABLES

Annual GDP Growth



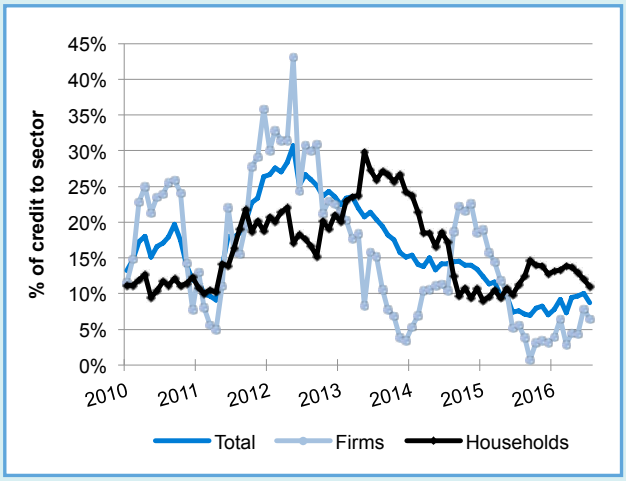
Overall GDP continued to stagnate in the first half of 2016, with close to zero growth. Year-on-year, real GDP contracted by 0.3% in Q2 2016, the same as in Q1, significantly lower than the 3.1% y-o-y growth recorded in Q2 2015. This is largely attributable to the decrease in mining output. Mining sector value added contracted by 23% y-o-y in Q2, the biggest decline since 2010. However, the non-mining private sector (NMPS) showed some resilience and expanded by 4.5% y-o-y in Q2 2016, up from 4.0% in Q1. Revisions were made to Q1 2016 GDP data due to availability of new sources.

Sectoral GDP Growth



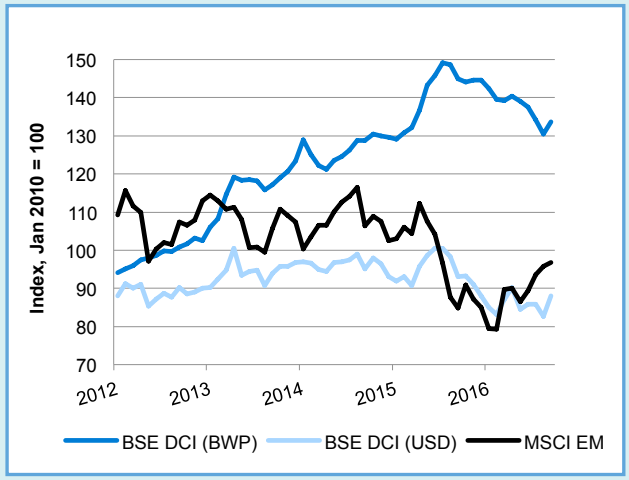
The services sectors continued to be the anchor of the economy during year to June 2016. Most sectors had positive y-o-y growth in Q2 2016, although the Mining and Agriculture sectors experienced negative growth of 23% and 1.7% respectively. The Water & Electricity sector recorded the fastest growth, at 180% y-o-y, but this is largely a statistical quirk driven by the large negative value added in the Electricity sub-sector. Nevertheless, real value added in the Water sub-sector grew by 15%, as a result of fewer interruptions the in water supply through the North-South carrier (NSC).

Annual Credit Growth



Annual growth in total bank credit decreased to 8.7% in July 2016 from 9.5% growth in April 2016, although higher than the 7.6% growth recorded in July 2015. Lending to firms grew by 6.5% y-o-y in July 2016, up from 4.5% in April. However, household credit growth fell to 10.9% y-o-y in July from 13.7% in April. This marks a welcome rebalancing of credit growth, which has been too dependent on borrowing by households, many of whom are over-indebted.

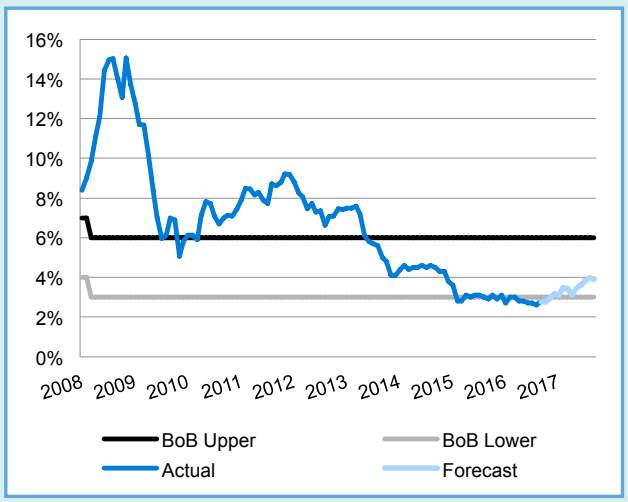
Stock Markets



The Domestic Companies Index (DCI) of the Botswana Stock Exchange (BSE) continued to move downward in Q3 2016, falling by 2.8% following a decline of 1.2% in Q2 2016 in Pula terms. However, in USD terms the DCI gained 2.5% in Q3 2016 compared to a decline of 1.1% in Q2 2016, mainly attributable to favourable exchange rate developments. Moreover, the MSCI Emerging Markets index came out strongly in the third quarter, rising by 8.3% while the MSCI World gained 4.4%.

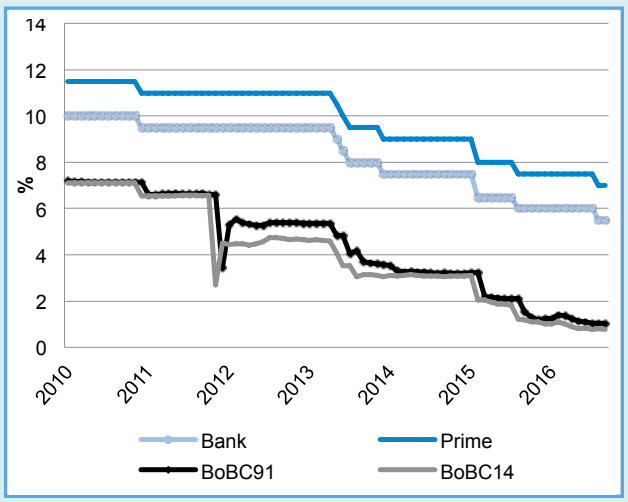
KEY ECONOMIC VARIABLES

Inflation and Forecast



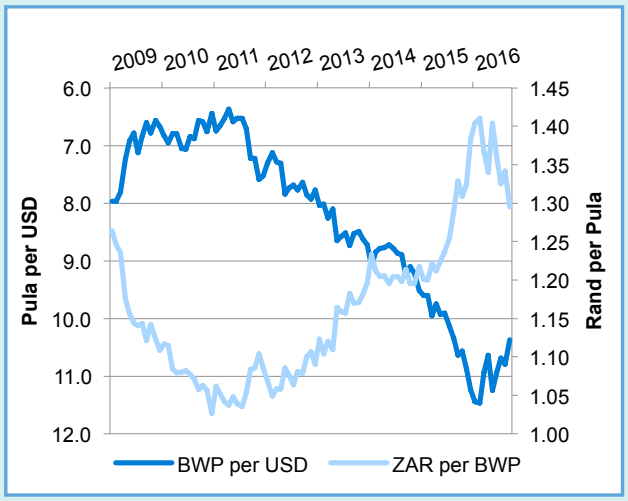
Annual inflation in Q3 2016 remained below the Bank of Botswana's lower limit of 3%, and recorded a new low of 2.6% in August before increasing to 2.8% in September. The Transport group index continued to move downwards, declining 1.7% year-on-year in Q3 mainly as a result of declining motor vehicle prices and low fuel prices. Fuel prices in Botswana are reviewed every month, based on the position of the National Petroleum Fund (NPF) and the trend of crude oil prices. Thus, any movement in international prices may be cushioned by the NPF.

Interest Rates



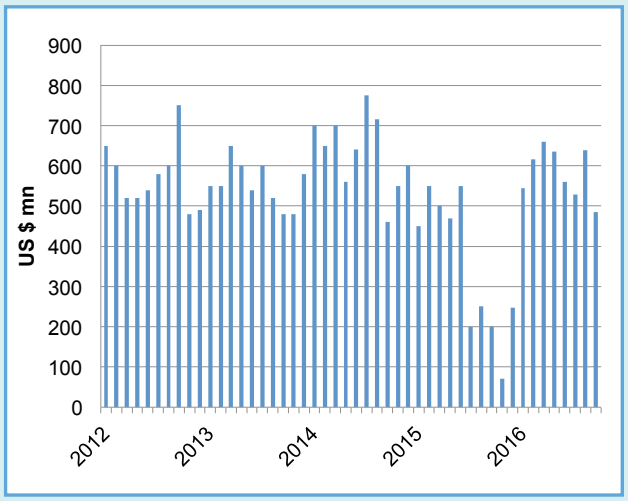
The Bank of Botswana Monetary Policy Committee (MPC) reduced the Bank Rate by 50 basis points in August 2016, to 5.5%, due to low inflation and prospects of continued price stability in the medium term. As a result, the Banks' Prime Rate was reduced from 7.5% to 7.0% in Q3. Also reflecting lower policy interest rates, the BoBC-14 and BoBC-91 yields continued to move slowly downward, with yields of 0.76% and 1.03% in Q3, from 0.84% and 1.09% in Q2, respectively.

Exchange Rates



The Pula gained against the US Dollar in the third quarter of 2016, as currency markets continued to be subject to uncertainties over the timing of interest rate increases by the US Federal Reserve. The Pula-US Dollar exchange rate was 10.37 at the end of September 2016, compared to 10.94 at the end of Q2. Conversely, the Pula depreciated against the South African Rand by 4.8%, closing the quarter at ZAR1.30 from ZAR1.36 in June. Although the RSA economy continues to be fragile with a possible credit rate downgrade, the Rand generally strengthened during Q3.

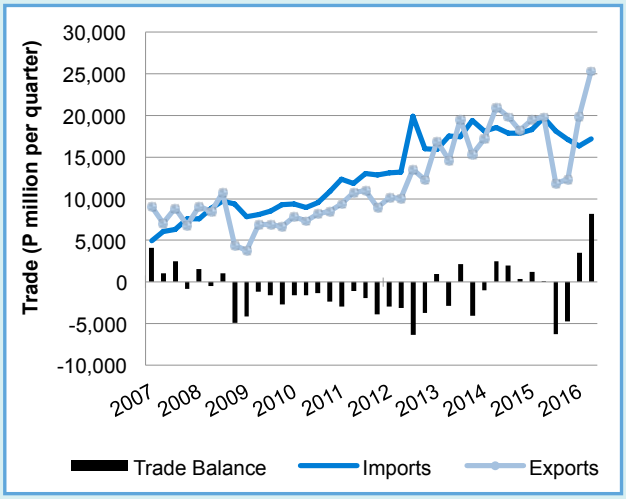
De Beers Diamond Sales



The global diamond market was generally stable through Q3, with demand for rough diamonds in line with the prevailing rough prices. De Beers Global Sightholder Sales (DBGSS) recorded higher than expected sales in cycle 7 of sightholder sales as jewellers increased their inventories ahead of the Christmas season, although the sight was smaller than those earlier in the year. De Beers sales in Q3 were valued at USD1,167 million compared to USD1,856 million sales in Q2. The company holds 10 sightholder sales each year, and is expected to maintain a cautious outlook into 2017.

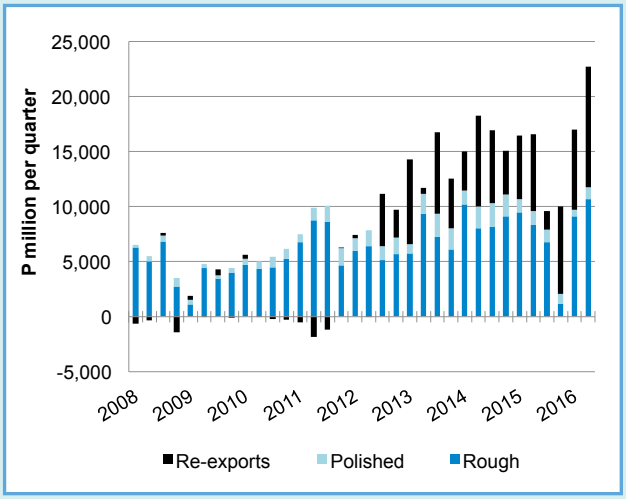
KEY ECONOMIC VARIABLES

International Trade



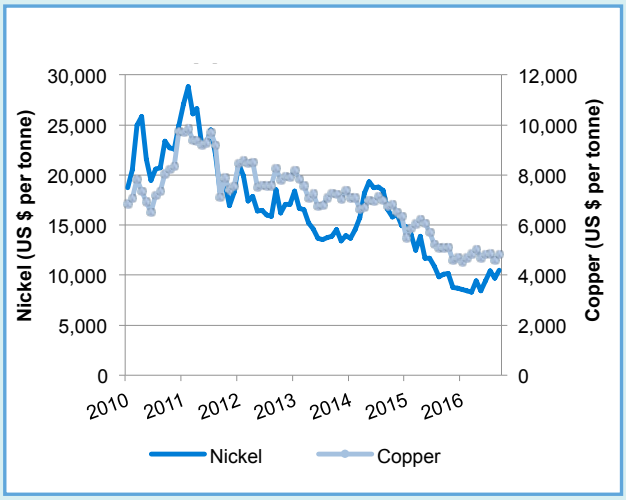
Total foreign trade continued to improve in the quarter to June 2016, with sharply increased diamond exports. Total exports grew 27.7% in Q2, to surpass P25 billion for the first time ever. Over the same period, imports contracted 13.1%. As a result, there was a trade surplus in Q2 2016 of P8,208.7 million, up from a revised figure of P3,502.7 million in Q1.

Diamond Exports



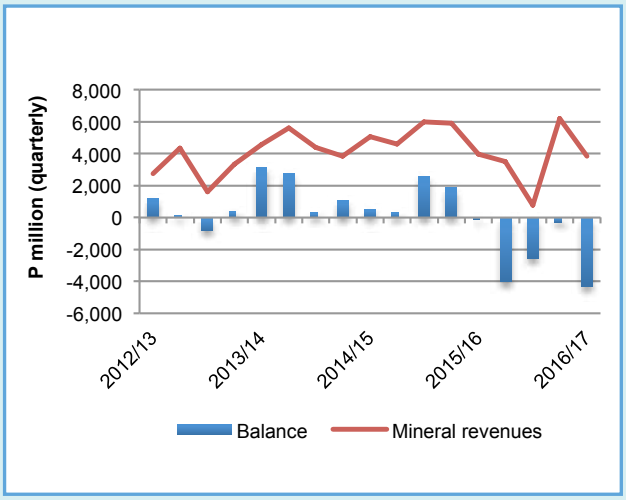
Total exports of Botswana diamonds improved significantly in H1 2016, in line with the recovery of global diamond market. Exports increased across all categories of rough, polished and re-exports (diamonds imported for aggregation purposes), by 31.7%, 91.6% and 17.2% respectively, compared to H1 2015.

Copper & Nickel Prices



International markets for base metals, copper and nickel were characterised by slow recovery through to September 2016 as demand from major consumers continued to improve. Although copper prices were little changed during the quarter, finishing Q3 at USD4,831 per tonne, nickel prices rose further during Q3, by 11.1%, to finish the quarter at USD10,457 per tonne. At the end of September, copper and nickel prices were, respectively, 12% and 36% higher than the 2016 lows experienced in January.

Budget Balance & Mineral Revenues



The budget balance has deteriorated over the past 12 months, with large deficits in three of the four quarters to June 2016. Over this period, the cumulative budget deficit was P11.2 billion, or 7.4% of GDP. This is smaller than the deficits incurred during the global financial crisis of 2008-10, but large enough to be of concern from a sustainability perspective. The main cause is lower mineral revenues, which were down by 30% over the year to June compared to the previous 12 months, combined with a 13% increase in total spending. The deficit has been financed by additional domestic bond issuance and a drawdown of government savings.

NEWS HIGHLIGHTS

3rd July	BTCL swings to losses on high impairments. (Sunday Standard)	Botswana Telecommunications Corporation Limited (BTCL) recorded a loss of P371 million during the financial year (FY) ending 31 March 2016, compared to a profit of P147 million recorded in the 2015 FY. This was significantly higher than the anticipated P164 million loss estimated in BTCL's IPO prospectus. According to the company, the impairment exercise undertaken by BTCL resulted in impairment charges of P522 million, compared to the P306 million estimated in the prospectus.
5th July	First Lerala mine diamonds sold. (Mmegi)	Kimberly Diamonds Limited (KDL) has sold its first parcel of diamonds recovered from the Lerala diamond mine, which was re-opened in April 2016. The Lerala diamond deposit covers an area of 22 km^2 in the Central District and encompasses five diamond-bearing kimberlites. It has a mineral resource of approximately 4.9 million carats and its production target is 360,000 carats per year projected nine year lifespan.
5th July	Tlou Energy to expand Lesedi CBM project to 50MW. (Mining Weekly)	Tlou Energy, which is focused on the development of coalbed methane (CBM) projects, intends to fast-track development of the Lesedi CBM project and expand it to 50 MW of electricity generation capacity. Recently, the Botswana government announced an intention to procure up to 100 MW of CBM power, which will be incorporated into the national supply grid.
8th July	BTCL pays out big despite heavy loss. (Business Weekly & Review)	BTCL declared a P0.05 per share dividend payout despite having incurred losses in the 2016, FY attributable to impairment costs. The company's dividend payout will amount to P52.5 million, and will be paid to about 50,000 shareholders across Botswana. BTCL shares listed at P1.00 in March 2016 and rose to a peak of P1.25; however, the price has since declined to P0.85 per share.
8th July	Government green-lights 100 MW CBM power tender. (Mmegi)	The Ministry of Minerals, Energy and Water Resources (MMEWR) announced the approval of two companies short-listed to undertake the development of 100 MW Coal Bed Methane (CBM) power plants, to produce electricity from gas. If successful, the two companies, Tlou Energy and Sekaname, will each contribute up to 50 MW to Botswana's electricity supply.
8th July	Botswana's Okavango first-half diamond sales up 23%. (Reuters UK news)	The Okavango Diamond Company's (ODC) sales for the first-half of 2016 (H1 2016) increased by 23% to USD284 million, with volumes up 35% to 1.75 million carats, reflecting the improved diamond market in 2016 compared to 2015. ODC is allocated 15% of Debswana production, and had five tenders in H1 2016.
11th July	Khama receives Vision 2036 document. (Mmegi)	The Vision 2036 Presidential Task Team (PTT) handed over the Vision 2036 document to President Ian Khama after completing consultative meetings across the country, intended to get Batswana to define their long-term vision. Vision 2036 will start in January 2017, following the end of Vision 2016 in December 2016.
20th July	De Beers sales volume soars. (Rapaport News)	De Beers' sales volume soared in H1 2016 as diamond manufacturers restocked inventories that had been run-down towards the end of 2015. Sales volumes increased by 29% to 17.2 million carats, from 13.3 million carats, while average realised prices dropped 14%. De Beers will continue to be cautious about market developments and its production outlook for 2016 is maintained at 26 to 28 million carats.
24th July	Government sets up task force to study BCL business model. (Sunday Standard)	The Government has set up a task force of five ministers to study BCL's business model and operations and make recommendations as to whether to shut down the mine, place it on care and maintenance or fund the mine to continue operations. Already the Government has underwritten a USD100 million credit facility from Barclays Bank to save the company from collapse.

NEWS HIGHLIGHTS

24th July	Botswana barely passes in first SDG Index. (Sunday Standard)	The first look at the country-level Sustainable Development Goals (SDG) Index and SDG Dashboard placed Botswana at position 80 out of 149 United Nations member countries. Botswana scored 58.4 across the 17 SDG goals. In Africa, Botswana is placed in position 3 after Morocco (61.6) and Mauritius (60.7). The SDG Index ranks countries regarding their initial status (data as close to 2015 as available) on the 17 SDGs, thus, allowing each country to assess its progress towards achieving the goals relative to others.
25th July	Bank of Botswana (BoB) cracks whip. (The Patriot)	According to the annual Banking Supervision report released by the Bank of Botswana (BoB), in 2015 financial institutions were compliant with key prudential requirements as required and corrective measures were made where non-compliance incidences occurred. It is stated that all banks except two had occurrences of charging fees not approved by BoB and were to reimburse the affected customers. Furthermore, four banks fully complied with monetary policy decisions.
25th July	Big four dominate banking sector. (WeekendPost)	Botswana's four largest banks, out of ten commercial banks, dominate the banking sector, accounting for about 78% of total banking assets, deposits and loans and advances. Hence, the sector is characterised by an oligopolistic market. After adding one smaller rapidly growing bank, the market share for the five banks increases to about 90%. The Banking Supervision report concluded that the level of competitiveness in the sector as measured by the Herfindahl-Hirschman Index (HHI) was moderate in 2015, and it is expected to improve once newer banks fully employ their capital and expand their operations.
26th July	Barclays of Botswana gets P1.35 billion loan from U.S Government. (Mmegi)	The U.S Government finance institution, the Overseas Private Investment Corporation (OPIC), has channelled a USD125 million (P1.35 billion) loan to Barclays Bank of Botswana to help develop Botswana's diamond industry. The guaranteed agreement is part of a USD250 million (P2.7 billion) OPIC loan guarantee programme to Lazare Kaplan International (LKI) through its subsidiary Botswana Finance LLC, and Barclays Bank of Botswana is the first lender in the programme.
28th July	De Beers earnings gains from higher demand. (Rapaport News)	De Beers Diamond Company's revenue and earnings increased in H1 2016, as the miner benefited from strong rough diamond demand, tighter cost controls and favourable exchange rates. Revenues increased by 8% to USD3.27 billion in the six months to June, while earnings before taxation (EBIT) increased by 2% to USD585 million, from USD576 million in H1 2015, attributable to higher sales volumes during the period.
29th July	Pangolin Diamonds kicks off new kimberlite exploration project in Botswana. (Mining Weekly)	Pangolin Diamonds Corporation has announced the commencement of a two week long drilling programme targeting five potential kimberlite mineralisation areas within the Motloutse Diamond Project. The company intends to announce the result of the programme once all the material recovered have been tested and analysed.
30th July	Sefalana posts positive results. (The Voice)	Revenues for the Sefalana Group of Companies for the year ended 30 April 2016 grew by 10.4% year on year to P3.8 billion, up from P3.4 billion realised in 2015 FY. The Group's performance is attributable to growth in its core segments of Fast Moving Consumer Goods (FMCGs) businesses in both Botswana and Namibia. Profit before taxation increased by 8.4% to P202.1 million during the FY ended 30 April 2016, from P191.1 million in FY 2015.
1st August	Debswana cut 8 on schedule. (WeekendPost)	Debswana Diamond Company has reported that the Cut 8 project is on schedule to produce diamonds from 2017. The Cut 8 project entails expanding the Jwaneng open pit mine to uncover additional 105 million carats of high quality rough diamonds over 2017 to 2029.

NEWS HIGHLIGHTS

3rd August	Global slump in commodity demand weakens asset quality of Botswana banking sector. (Mining Weekly)	According to the BoB Banking Supervision Report, the banking sector weakened marginally in 2015 against the backdrop of sluggish global and domestic activity. The ratio of non-performing loans (NPLs) to total loans and advances rose to 3.9% in December 2015, from 3.6% in December 2014, attributable to the closing of businesses and job losses, especially in the mining sector. Moreover, profitability decreased as a result of a combination of narrowing interest margins and increased operating expenses. In 2015, the Bank Rate was reduced by 150 basis points, while regulatory changes released additional funding resources of about P2.3 billion in order to bolster economic activity.
7th August	Letshego enters commercial banking in Namibia. (Business Weekly & Review)	Following the granting of a provisional banking license in 2014, the Bank of Namibia has confirmed the decision to award Letshego Holdings Limited a commercial banking license for Letshego Bank of Namibia. The approval marks Letshego's fifth lending and deposit license as the company has been successfully expanding outside Botswana, and has operations in nine African countries.
7th August	Lucara's sales lifted by record 813 carat rough diamond. (Rapaport News)	Lucara Diamond Corporation's revenue and profit soared in the first half of the year due to a record sale of a rough diamond for USD63.1 million. Revenues increased to USD191.4 million in the six months to June 2016, compared to USD67.8 million realised the same period last year. Revenues were also boosted by the exceptional stone tender the company held in April 2016, which sold 10 rough diamonds for USD51.3 million, as well as the improved rough diamonds prices in 2016.
8th August	Lucara leaves door open to another auction for whopper diamond. (Mining Weekly)	According to Lucara's Chief Executive Officer, William Lamb, Lucara has not ruled out the possibility of selling the 1,109 carat Lesedi La Rona rough diamond through another auction process. This comes after the second largest rough diamond ever discovered failed to sell at a public auction in London.
12th August	Morupule Coal mine plans Botswana's biggest coal mine. (Mmegi)	Morupule Coal Mine's (MCM) open cast mine near Palapye plans to produce about 10 million tonnes of coal per annum, significantly higher than historical production levels of around one million tonnes. MCM plans to ramp up supplies to Botswana Power Corporation's Morupule Power Station, given the latter's plans to double output to 1200 MW by adding four additional generating units (five to eight). MCM also intends to secure supply contracts to the regional and international markets.
16th August	Francistown BMC re-opens for slaughter. (The Voice)	The Botswana Meat Commission's (BMC) Francistown abattoir re-opened in August 2016 for slaughter to the European Union (EU) market.
17th August	Gem Diamonds makes losses in H1 2016. (Rapaport News)	Gem Diamonds swung to a loss of USD15.9 million in the year to 30 June 2016 compared to USD25.6 million profit realised in June 2015 due to an impairment charge related to downsizing at the Ghaghoo mine in Botswana. Earlier this year, the mine halved its production target to 300,000 tonnes per year from 720,000, amid soft diamond prices. As a result, the miner incurred USD40 million in charges negatively impacting its financial position.
21st August	Standard Chartered Bank Botswana's earnings improve in H1 2016. (Daily News)	Standard Chartered Bank Botswana saw a recovery in earnings in the first half of 2016 compared to the previous year. During the half year operating expenses were reduced by 1% to P335.0 million from P339.1 million, reflecting cost efficiencies realised in 2016. The bank further strengthened its capital position, tightened risk tolerance and established robust controls to achieve its goals.

NEWS HIGHLIGHTS

26th August	Selkirk Mine to open in 2017. (Mmegi)	Tati Nickel Mining Company (TNMC), a 100% subsidiary of BCL, revealed that operations at the Selkirk Mine will start early next year, subject to the availability of funds. TNMC owns a mining lease at Selkirk mine, which is expected to have a lifespan of 15 years.
28th August	FNBB profits plummet. (Daily News)	First National Bank Botswana (FNBB) delivered its financial results for the year ending 30 June 2016. Profits before tax declined by 13 per cent to P659.0 million, down from P756.5 million recorded in the year ended June 2015. The bank attributed the decline to investments in infrastructure, increased depreciation of assets and regulatory process enhancements, which resulted in increased operating expenses of 31%.
1st September	Choppies earnings per share drop 52%. (The Botswana Gazette)	Choppies Enterprise Limited cautioned shareholders that earnings per share (EPS) for the period are expected to fall between 32% and 52%, compared to the year ended 30 June 2015. The retailer reported lower profits before taxation during the period from P243.2 million in 2015 to P127.4 million in 2016.
6th September	Letshego profits flat on weak economic growth. (Mmegi)	Profit before taxation for Botswana's leading non-bank lending group, Letshego Holdings Limited, for the first half of 2016 was P489.1 million, representing a 6% drop from P592.9 million realised the same period in 2015. Staff and operational expenses increased by 51% during the period as the company continue to expand into other African markets.
7th September	Mod hopeful of PFS at Botswana copper project by year-end. (Mining Weekly)	Mod Resources aims to start its pre-feasibility study (PFS) on its T3 copper deposit in Botswana by the end of 2016. The first preliminary pit, processing, environmental and social studies are expected to be available by November 2016 and completion of the study in December 2016.
9th September	Botswana Diamonds JV to begin exploration in Orapa and Gope. (Mining Weekly)	Exploration for diamonds is scheduled to commence at the end of September at the two licensed sites of the joined-venture between Botswana Diamonds and Alrosa. An intensive 12 week exploration programme is planned.
9th September	BDC to pump P4.5 billion into new projects. (Mmegi)	The Botswana Development Corporation (BDC) plans to invest approximately P4.5 billion into new projects and in turn create thousands of jobs under its new strategy. BDC's strategy for the period running from 2014 to 2019 aims to double its business in five years.
12th September	Sale of Firestone Diamonds' Botswana asset to Tango lapses. (Mining Weekly)	Following consecutive extensions to allow Tango Mining to raise funds for the purchase of Firestone Diamond's Botswana assets, the latter will continue to seek for a buyer for its assets as Tango has been unable to meet the conditions of the sales agreement. In the period from July 2016 to September 2016 alone, two extensions were made to Tango Mining.
13th September	Government issues first uranium mining license. (Mmegi)	Government has issued Australian mining company, A-Cap Resources with a mining licence, paving way for construction of what would be the country's first uranium mine. In a statement, A-Cap said it has been granted a 22 year mining licence for its Letlhakane Uranium Project and construction of the mine is expected to start in 2018. It area is estimated to hold around 1.04 billion tonnes of uranium ore reserves.

NEWS HIGHLIGHTS

16th September	Rolling P24 billion budget deficits until 2020. (Mmegi)	Botswana will incur rolling budget deficits amounting to P24.7 billion for the next three financial years to boost growth through fiscal stimulus. However, economists are sceptical about the sustainability of a mineral-led economy spending its way out of an economic downturn. Botswana's budget is forecast to record a deficit of P6.8 billion for the 2017/18 financial year and similar deficits for the next three years to 2020. According to Dr Keith Jefferis, fiscal expansion is not sustainable as key issues lay with implementing fundamental economic reforms to boost growth.
16th September	BPC seeks P2 billion government support. (Mmegi)	Botswana Power Corporation (BPC) is seeking P2 billion as support from government to cushion its operational deficit due to uneconomic tariffs. The corporation has also stated that it is challenged with collecting money owned to it, with Government and some mining companies being its biggest debtors.
14th September	Trust among partners key – Dr Jefferis. (Mmegi)	Dr Keith Jefferis, Managing Director of Econsult Botswana, described trust as an important component to successful economic partnerships, including between the public and private sectors. He further urged the government to implement business reforms which could increase foreign direct investment flowing into Botswana, as this has fallen by half in the past ten years.
19th September	Barclays doubles profits. (WeekendPost)	Barclays Bank of Botswana delivered strong half year results for the period ended June 2016. Profit after tax increased by 139% compared to H1 2015, from P86.9 million to P207.6 million. According to the bank, strong performance in the period was driven by sustained revenue growth in Retail and Banking Business and Corporate and Investment Banking segments. The bank managed to contain operating costs and reduced impairment losses from 2.5% year-on-year in H1 2015 to 1.8% in H1 2016, attributable to improved debt collection activities.
20th September	National Development Bank needs P1 billion. (Botswana Guardian)	The National Development Bank (NDB) has extended a request to the Government for cash injection of P1 billion over the next three years, in order to keep the bank alive amid non-performing loans. During the 2014/15 financial year, the bank managed to improve losses from P87.8 million to P48.4 million and reduced impairment losses by 48%. NDB will continue with its strategy adopted in 2015 to generate additional income, contain costs and reduce non-performing loans, so as to improve performance.
23rd September	Liquidator handpicks Mowana mine buyer. (Mmegi)	The liquidator for the Mowana Copper mine has stated that they have found a buyer for the mine. An announcement of the successful bidder is scheduled for October 2016 when buying processes have been completed.
28th September	Botswana improves in Global Competitiveness Rankings. (World Economic Forum)	The Global Competitiveness Report 2016/17 by the World Economic Forum (WEF) showed Botswana has improved in Global Competitiveness Index (GCI) having moved 7 up places, from a world ranking of 71 out of 140 countries in 2015 to 64 out 138 countries. The country's score has also increased slightly from 4.2 in 2015 to 4.3 on a score scale of 1-7 (highest = better). Botswana's GCI ranking improvement is attributable to better performance in infrastructure, higher education and goods market efficiency. Botswana continues to do well in the macroeconomic environment indicators but struggles in the doing business indicators.

MACRO-ECONOMIC DATA

Key Economic Data	unit	2012	2013	2014	2015	2016Q1	2016Q2	2016Q3
Annual Economic Growth								
GDP	%	*4.5%*	*9.9%*	3.2%	-0.3%	*-0.3*	-0.3	..
Mining	%	*-5.8%*	*24.2%*	0.5%	-19.7%	-21.4	-23.0	..
Non-mining private sector	%	*7.7%*	*7.6%*	3.4%	3.8%	*4.0*	4.5	..
GDP current prices	*P mn*	111,896	124,311	142,466	145,715	*39,234*	40,694	..
GDP 2006 prices	*P mn*	75,515	82,961	85,619	85,401	*22,087*	21,792	..
Money & Prices								
Inflation	%	7.4	4.1	3.8	3.1	3.0	2.7	2.8
Prime lending rate	%	11.0	9.0	9.0	7.5	7.5	7.5	7.0
BoBC 14-day	%	4.6	3.1	3.1	0.97	1.0	0.84	0.76
Trade & Balance of Payments								
Exports - total goods	*P mn*	45,915	66,404	76,233	63,467	19,875	25,378	..
Exports - diamonds	*P mn*	36,143	55,367	65,328	52,730	17,003	22,732	..
Imports - total goods	*P mn*	62,114	70,218	72,418	73,168	16,373	17,169	..
Balance of visible trade	*P mn*	-16,199	-3,814	*3,816*	*-9,701*	3,503	8,209	..
Balance of payments	*P mn*	-862	1,340	11,404	- 57	- 261	..	..
Foreign Exchange								
Exchange rate BWP per USD	*end*	7.776	8.718	9.515	11.236	10.929	10.941	10.373
Exchange rate ZAR per BWP	*end*	1.090	1.196	1.217	1.383	1.366	1.361	1.295
FX reserves	*$ mn*	7,628	7,726	8,323	7,546	7,559	7,402	..
FX reserves	*P mn*	59,317	67,772	79,111	84,881	81,891	80,283	..
Financial Sector								
Deposits in banks	*P mn*	47,216	48,512	51,492	59,961	61,078	61,700	..
Bank credit	*P mn*	34,555	39,763	45,116	48,307	49,040	50,476	..
BSE index		7,510.2	9,053.4	9,501.6	10,602.3	10,202.6	10,081.3	9,797
Business Indicators								
Diamond production *(a)*	*'000 cts*	20,619	23,134	24,658	20,732	5,429	*5,305*	..
Copper production (c)	*tonnes*	57,916	49,448	46,721	23,050	5,777	*4,464*	..
Nickel production	*tonnes*	17,942	22,848	14,958	16,789	7,303	*5,801*	..
Business confidence index		47%	45%	52%	44%	36%	..	..
No. of companies formed		16,561	14,190	16,300	19,134	4,592	..	..
Electricity consumption	*GWh*	3,703	3,502	3,990	3,974	967	955	..
Crude oil (Brent)	*$/bar*	110.80	109.95	55.27	36.61	36.75	48.05	48.24
Employment (formal)								
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	..	..	..

Govt Budget		2013/14	2014/15	2015/16 Outturn	2016/17 Budget
Revenues	*P mn*	48,951	55,904	48,291	48,062
Spending	*P mn*	41,730	50,564	54,923	54,445
Balance	*P mn*	7,222	5,340	-6,632	-6,382
Public debt & guarantees	*P mn*	*29,481*	32,991	33,670	34,459
Govt deposits at BoB	*P mn*	*31,745*	38,406	36,752	35,322
GDP	*P mn*	124,311	142,466	*145,715*	159,888
Spending	*%GDP*	*33.6%*	*35.5%*	37.7%	34.1%
Balance	*%GDP*	*5.8%*	*3.7%*	-4.6%	-4.0%
Public debt & guarantees	*%GDP*	*23.7%*	*23.2%*	23.1%	21.6%
Govt deposits at BoB	*%GDP*	*25.5%*	*27.0%*	25.2%	22.1%

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

Notes: (a) 2013 figures include production from Boteti Diamond and Debswana

(b) 2016 figures include production from Gem Diamonds and Lerala mines

(c) Numbers in Italics reflect revisions from the previous review

SPECIAL FEATURE

Economic Aspects of the BCL Liquidation

Introduction

The announcement in early October that BCL, Botswana's major copper-nickel mining and smelting operation, was to be placed in provisional liquidation came as a major shock to many people. In part the shock was due to the anticipated impact on Selebi-Phikwe, the town where BCL is located, and on the company's employees and suppliers. With around 5,000 workers, state-owned BCL is (was) the second-largest corporate employer in the country (after Debswana).

The shock was also due to surprise that the Government was willing to take this decision, which marks a major turnaround from previous approaches, despite the potential short-term political costs. Because of both of these factors, the closure of BCL is one of the most significant economic events to have taken place in Botswana in recent years. It has some parallels with the diamond market collapse at the time of the global financial crisis in 2008-10, but its impact may be longer lasting, in that BCL may never recover, at least not in its present form. In this feature, we explore the background to the collapse, its likely economic impact, and prospects for resolution.

History / Background

BCL Ltd was established following the discovery of copper in North-east Botswana in 1967. Originally named Bamangwato Concessions Ltd, it was established as a joint venture between two foreign investors – American Metal Climax (Amax) of the USA and Anglo American Corporation of South Africa - and the Botswana Government. The mine, and the associated infrastructure developments of the Shashe Dam, rail, roads and the new township, were shortly after independence seen as the key to diversifying the economy away from the historical dependence on cattle and beef.

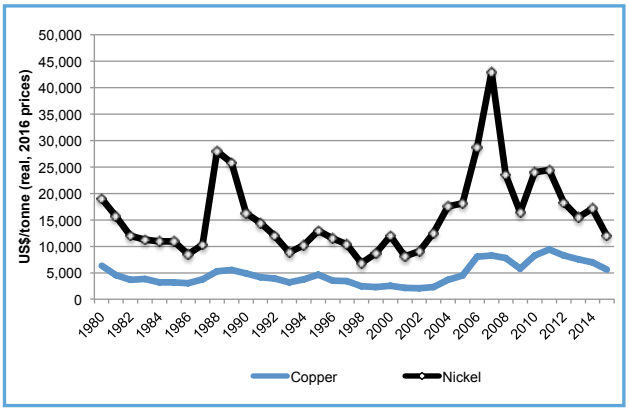
However, the project has never lived up to those early expectations. From the beginning, it was plagued by technical problems and huge cost overruns, such that the capital cost of the mine and smelter was more than twice the initial estimates, and from the beginning BCL was burdened by high levels of debt. This was compounded by volatile metals prices in the 1970s, and the company struggled to make a profit ever since. A commentary in 1978 noted:

"It seems likely that the mining operation will remain marginal: it will be able to meet its costs only when world metal prices are close to cyclical highs. More efficient management, however, could compensate for some of the high cost of operation. Most important in determining the future profitability of the mine is the world price of nickel"[1].

In the event, the two private investors eventually exited from the project, at a considerable financial loss, leaving the Government with a 93% stake, and as the major source of finance for the company through loans and guarantees.

The 1978 comment quoted above proved very prophetic. During the 2000s, when nickel prices spiked to record highs, BCL was profitable and accumulated considerable cash reserves. But apart from that period, the company has struggled to operate profitably, which continues to be the case. In recent years, BCL has been haemorrhaging cash, at an unsustainable rate.

Figure 1: Long-term nickel and copper prices (real 2006 US dollars), 1980-2016



Source: Econsult, based on IMF World Economic Outlook database.

BCL's recent problems

BCL's recent problems have been brought about by a combination of events that have put the company's finances under further pressure and led to demands for injections of substantial additional capital from the shareholder, i.e. government.

[1]*Source: Hartland – Thunberg, P. (1978). Botswana: An African Growth Economy.*

Declining ore grades

BCL operates four shafts in two mines, at Selebi and Phikwe, with some very deep mining operations. Two of these shafts in particular have very low ore grades and cannot operate profitably. There has been a lack of investment in mining operations in recent years, i.e. in the company's core business. Overall, BCL's reserves were reported as containing 0.67% nickel and 0.87% copper in 2014.

Low commodity prices

Nickel and copper prices have weakened over the past five years, falling by around 50%. In real terms, the prices of the two metals are no higher now than they were in the early 1980s. Compared to the peak prices of $50,000/tonne for nickel and almost $9,000/tonne for copper in 2007-8, prior to the global financial crisis, prices had dropped to $8,500 and $4,500 for nickel and copper respectively in early 2016.

Questionable decision-making

BCL has been implementing a turnaround strategy over the past two years (Polaris II), which was intended to move the company on to a sustainable long-term path. However, it has not achieved this objective. In part this is because it allowed inefficiencies in the core mining and smelting operations to grow as management attention was distracted. Unrelated ventures such as steelmaking, and prospecting for iron ore and diamonds, proved to be a waste of time and money.

The Norilsk deal

An important component of the turnaround strategy was the 2014 agreement with the Russian firm Norilsk Nickel to buy its assets in Southern Africa, which Norilsk was seeking to sell. These included 7% of BCL itself; 85% of Tati Nickel Mining Company (TNMC) (the other 15% owned by the Government of Botswana); and 50% of the Nkomati Nickel mine in South Africa (the other 50% owned by JSE-listed African Rainbow Minerals).

The logic behind this deal was that it would secure flows of concentrate from TNMC and Nkomati for processing in the BCL smelter. This was important not just to bring in a new revenue stream but also to optimise the use of the smelter, which needs to operate on a continuous basis, but which has insufficient supplies of copper-nickel concentrate from BCL's own mines. Of course, ownership of these companies is not necessary for concentrate supplies, and TNMC concentrate has been smelted by BCL for years. But the thinking was that ownership stakes in TNMC and Nkomati would make those supplies more secure.

It was agreed that BCL would pay US$337 million for these assets, approximately P3.5 billion. Our view at the time was, and remains, that the deal made sense from a business perspective, but only if BCL was not overpaying for the Norilsk assets. And of course, BCL had to find some way of raising the P3.5 billion necessary to pay for it.

By August 2016, the various conditions precedent for the Norilsk deal to be completed had been fulfilled, notably permission from the South African government for the transfer of Nkomati shares from Norilsk to BCL. Hence the payment to Norilsk became due.

BCL's financial crisis

By early 2016, the combination of declining ore grades, low metals prices, and an expensive smelter refurbishment – largely prompted by the need to accommodate the Nkomati concentrate – that interrupted production for many months, had depleted BCL finances. Indeed, in order to keep going, BCL had requested to defer mineral royalty payments to the Government, accumulating a debt of nearly half a billion Pula in the process. It had also depleted funds of over P1 billion that had been specifically put aside for end-of-life rehabilitation expenses. Furthermore, it had borrowed USD100 million (almost P1.1 billion) from Barclays Bank, which was made available on the basis of a Government guarantee. It had also accumulated debts to suppliers. BCL had therefore accumulated debts of nearly P3 billion.

On top of this, BCL needed to spend more money in order to stay in business. The acquisition of TNMC may have been at a low cost, but the company was in a parlous state. The operational Phoenix open cast pit near Francistown was approaching the end of its economic life. TNMC also owns the nearby Selkirk deposit, which had previously operated as an underground mine but had been mothballed since 2006. TNMC intended to re-open the Selkirk mine as an open-cast operation, but this required considerable investment. And in both cases ore grades were low: in its last published report, Norilsk stated ore grades of 0.22% nickel and 0.18% copper at Phoenix, and 0.27% Ni/0.3% Cu at Selkirk. Despite mining at Selkirk being economically marginal, its development and re-opening was seen by BCL management as the mainstay of a restructured BCL, and crucial to securing a sustained concentrate flow to the BCL smelter. BCL therefore required additional funds of at least P2 billion for expenditure on mining development at Selebi-Phikwe and TNMC.

We understand that in total, BCL needed some P4.6 billion to clear existing debts and invest in production. And on top of that, with the completion of the conditions precedent for the Norilsk deal, that bill became due. It is not clear quite how much this amounted to. The original contract specified a price of US$337 million (P3.5 billion), but some reports say that this had been negotiated down substantially in view of the deteriorating values of copper and nickel deposits, or that Nkomati portion of the deal had been removed. But in total, BCL needed to raise somewhere between P5.5 billion and P7.5 billion to be put on a firm footing.

Where could this money come from? The company had already sought recapitalisation through a cash injection from the shareholder, which was declined. During 2015 the company had been canvassing the capital market to ascertain the appetite for a bond issuance of US$325 million (P3.5 billion). The response was that BCL itself was not credit-worthy, and that there would only be purchasers for the bond with a 100% government guarantee, and that even with this, the amount was far in excess of what the domestic market could absorb.

In view of BCL's financial position, all of its funding would have to come from Government, through a mixture of direct finance (as a subvention to provide additional capital) and indirectly through guarantees. In the latter case, the proposed bond issue would virtually exhaust government's ability to borrow or guarantee foreign currency debt, taking it up to the statutory ceiling of 20% of GDP, and restricting government's ability to borrow externally for other projects. Any capital subvention or government lending to BCL would have to come directly from the budget.

With the Norilsk payment due imminently, a decision had to be made. BCL's failure to pay Norilsk under the binding contract they had entered into would have most likely led to a petition to wind up the company and sell its assets to pay the debt.

Given the many other demands on the budget, including from other parastatals such as BPC and WUC, as well as ongoing priority expenditures such as on anti-retroviral drugs, government decided that it could not afford to bail out BCL. Rather than waiting for Norilsk or another creditor to initiate proceedings against BCL, government took a decision to enter voluntary provisional liquidation, which gave it a bit more control over the process and a possibility that BCL could be sold as a going concern.

In some respects, the collapse of BCL should not be a surprise. It has long been known that eventually, BCL would close due to declining ore grades and rising production costs. And Botswana's two other copper mines – Boseto near Maun and Mowana near Dukwe – have both closed down in the past 18 months due to high costs and low metal prices.

Economic impact of closure

What is the economic impact of the BCL closure likely to be? The brief answer is, at a national, macroeconomic level – significant, but not too serious, but at a regional level, in north-east Botswana – a major, negative and potentially long-lasting impact.

GDP

In the first half of 2016, copper-nickel mining accounted for 2.4% of Botswana's total economic output (GDP). The BCL closure will reduce GDP by this amount. If the mine remains closed, over a full year it would reduce GDP growth from an estimated 3.5-4% to 1.0-1.5% in terms of the direct impact, and perhaps to zero once indirect impacts are taken into account. This would be a one-off impact and would not necessarily reduce future growth.

Exports

In the first half of 2016, exports of copper-nickel amounted to P2.03 billion, or 4.5% of total goods exports. While copper-nickel used to be Botswana's second largest export, after diamonds, this is no longer the case as it has been substantially overtaken by tourism. Although the loss of copper-nickel export earnings would harm the balance of payments, the impact can be accommodated given that in the first half of 2016 there was a total balance of trade surplus of P11.7 billion. Reduced copper–nickel exports would also be offset to some extend by reduced imports, particularly of electricity.

Employment

With just over 5,000 employees at BCL and Tati Nickel, this amounts to around 1.5% of total formal sector employment. Total monthly payroll of P68.7 million amounts to an estimated 3% of total wage income in Botswana.

Financial Sector

The Botswana banking system has substantial exposure to BCL group, to both the company and its employees, although there is no reliable figure for the total amount. Some of this is secured by a GoB guarantee, e.g. the loan of $100 million (approx. P1.07 billion) from Barclays. Of the remainder, some is secured against other assets, such as receivables or assets owned by employees including houses and vehicles.

It is likely that a proportion of the outstanding credit (apart from the Barclays loan) will not be recoverable. Although some of it will be secured, the banks are likely to be in the same queue as other creditors, and it is likely that a substantial proportion of this credit could be lost and hence written off. The impact of this on bank profits could be substantial. However, it is likely these losses can be absorbed by the banking system's capital base without major disruption.

Regional impact

BCL/Tati is the largest single employer outside of government in north-east Botswana. Its closure will have a major impact on the households affected, both directly and indirectly.

BCL/Tati employs just over 5,000 workers directly, and injects P68 million a month into the local and regional economy through wages. Therefore, in addition, some workers will be employed as a result of spending by BCL employees. There are no reliable figures available on the indirect, multiplier effect of such spending, although in general spending multipliers in Botswana tend to be quite small given the tendency to spend wages on imported items (vehicles, clothing, food etc.). Nevertheless, it is probably reasonable to assume that an equal number of people would be employed nationally (not necessarily regionally) as a result of spending by BCL/Tati employees, hence an additional 5,000 jobs.

Selebi-Phikwe and the surrounding region (Central-Bobonong) had a total of 35,000 households at the time of the 2011 population and housing census, and a total population of 121,000 of this, Selebi-Phikwe has 16,000 households and a population of 49,000. Hence BCL directly supports a substantial proportion of the households in Selebi-Phikwe and the surrounding region through employment – perhaps 15% of the total. TNMC has a smaller, but still significant effect on the Francistown regional economy. Although there are no accurate figures, our estimate is that BCL is directly responsible for around 20% to 25% of spending by households in the region (although not all of this is spent locally).

The impact of the BCL liquidation/closure on the economy of Selebi-Phikwe and the surrounding region is therefore likely to be substantial, through the impact on employment and household spending. There will also be a smaller impact on the Francistown regional economy, both from the closure of TNMC and money that would previously have been spent by BCL employees in Francistown.

Beside the impact on household incomes and spending, and hence on the firms that supply goods and services to households in the region, there will also be an impact on the private sector through the BCL supply chain. Various entities are suppliers to BCL and Tati, including BPC (electricity), MCM (coal), BR (rail freight services) and road haulage firms. Other affected firms include those providing engineering and maintenance services, accommodation/hotels, vehicles, consumables etc.

There is no information readily available to estimate the magnitude of the impact on these suppliers. However, in some cases it is no doubt a significant proportion of their business. On a positive note, the closure of BCL will relieve pressure on the national electricity grid, and make it less likely that other consumers and business will experience load-shedding in future.

Options for the future

Many commentators have said that government should have made more effort to save BCL from liquidation, because of the impact on the 5,000 employees of BCL and TNMC, and the region more broadly. While government could, in principle, have contributed the necessary funds, should it have done so?

As noted above, the total cost to government of bailing out BCL would be in the region of P5.5 – P7.5 billion. This is a large sum, equivalent to nearly half of annual government development spending. It is also equivalent to P11,000-P13,500 per household in Botswana. Perhaps most importantly, the rescue plan would have cost government between P1.1 million and P1.5 million per job saved at BCL and TNMC. With this magnitude of funds required, it is not surprising that the government said, "enough".

BCL management have claimed that their turnaround plan would pay off eventually, and that some or all of the capital injection requested would be repaid. But this is based on some ambitious expectations for recovery in nickel prices, as well as confidence in their ability to successfully implement an extensive restructuring process.

Of course nobody knows what level prices will be in the future, but various estimates are available, and these vary a great deal. If the most optimistic of the sources below is correct, then much of BCL's production would be profitable by 2019. However, these are only forecasts. The only actual price is the one from the futures market, i.e. the price that would be realised today for a contract to sell nickel at a specified date in the future. At present, the futures market is not pricing in a recovery, with the price only 1.8% higher in December 2019 than it is today.

Table 1: Nickel prices and forecasts

Source	US$/tonne	USc/lb	% increase
Current (Sept. 2016)	10,458	4.74	--
2019 forecasts			
IMF	10,650	4.83	1.8%
World Bank	12,004	5.45	14.8%
EIU	16,310	7.40	56.0%
Futures market	10,645	4.83	1.8%

Source: IMF; www.barchart.com; www.knoema.com

Given that some of BCL's Selibe-Phikwe deposits are close to exhaustion, the management's turnaround plan also involved developing the Selkirk mine (near Francistown) as the main source of ore within the BCL group. It also involved renegotiating the contract with Norilsk to reverse the commitment to buy 50% of Nkomati, while keeping the agreement to buy the Botswana assets. At the same time, it required securing a long-term contract with Nkomati to process its ore in the BCL smelter. All of which entailed considerable risk.

Now that BCL is in provisional liquidation, one of the liquidator's tasks is to try and find a buyer for BCL as a going concern. This will be challenging, but not impossible. If other mining companies share the optimistic view of future price rises for nickel, then it could be a worthwhile investment to take over BCL and TNMC. However, government may still have to write off some of the money it is owed, and it should not expect to receive any significant monetary value from any sale. Somewhat ironically, the government had a chance to sell its stake in BCL back in 2006, when the previous owners of Tati Nickel, Lion Ore, wanted to buy BCL. Lion Ore was subsequently taken over by Norilsk. Whether BCL would have been in a different position in 2016 if this option had been pursued is impossible to know, but clearly it would have been much better for government to have sold out at a time of booming metals prices.

One of the positive outcomes from the BCL saga is that government has finally made a choice about where it should devote its limited resources. As we have been arguing for some time, government cannot continue to throw money at problems, and given the many demands on fiscal resources, choices are necessary about where money is best spent. Having made such a choice, the challenge now is to make sure that the spending decisions that it makes in future do indeed lead to money being well spent, and not wasted on unproductive projects. It will also be necessary to aggressively support private sector development in Selebi-Phikwe and the surrounding region, particularly by accelerating long-overdue regulatory reform and removing barriers to local and foreign investment.

PO Box 45016, Gaborone, Botswana

tel [+267] 390 0575
fax [+267] 390 0585

email keith@econsult.co.bw
sethunya@econsult.co.bw
www.econsult.co.bw