

ECONOMIC REVIEW

second quarter april - june 2017

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COMMENTARY

The Good, the Bad and the Uncertain

Economic news in the second quarter contained an intriguing mix of good and not so good developments. Macroeconomic developments are broadly positive, financial sector developments less so, while the way in which some policy issues is being handled gives rise to concern.

Economic Activity

Annual GDP growth came in at 3.9% in the year to March 2017, slightly below the 4.3% experienced in 2016, with the decline due mainly to the closure of the BCL copper-nickel mine and contraction of mining output. But the way in which the GDP data are presented makes it very difficult to disentangle mining-related developments from the non-mining economy. As we have pointed out earlier, downstream diamond activities are now spread throughout other sectors of the economy, and until Statistics Botswana separates out diamond and non-diamond activities from the trade and business services sectors, we (not to mention policymakers) will remain in the dark about what is really happening in the non-diamond part of the Botswana economy.

In other key developments, business confidence showed an improvement in the first half of 2017. De Beers reported increased diamond production at Debswana in the second quarter, with output up 14% in carat terms compared to Q2

2016 – an increase that will in due course show up in the GDP numbers for mining sector growth. The trade balance has improved to show a surplus in Q1. However, this is mainly due to a reported sharp decline in imports, which we believe is due to an error in the trade statistics following the introduction of a new customs reporting system, rather than a real economic event. Inflation ticked up slightly, to 3.5%, but this was expected. The medium term outlook for inflation looks positive, with few inflationary pressures in sight domestically, regionally or globally, so should not lead to any change in interest rates in the near future.

The Banking Sector

Worryingly, there are increasing signs of stress in the banking system, on a number of fronts. First, banking liquidity has been falling steadily for some time, but the decline has been particularly sharp since the beginning of 2017. Excess liquidity fell to 2.6% of banking assets in April, the lowest since the “liquidity crisis” of late 2014. The liquidity

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squeeze has been driven by stagnant deposits –there has been no growth in the deposit base of banks for at least two years. With little surplus liquidity, it is not surprising that bank lending has slowed – the banks (or some of them at least) are simply running out of loanable funds.

At the same time the level of bank loans in arrears has jumped sharply, to 8.3% - up from 6.4% a year earlier. Contrary to some perceptions that it is household borrowers that are debt stressed, the most striking increase in arrears has been on lending to businesses and – for the first time – on lending to parastatals.

The combination of these developments – lack of supply of loanable funds and concerns about credit risk – combined with much reduced borrowing by parastatals, have led to a sharp slowdown in annual bank credit growth, which is now at its lowest rate for 20 years. Perhaps in a further reflection of the lack of credit-worthiness of many parastatals, government's own direct lending has increased sharply.

Electricity supplies and new generation capacity

The electricity supply situation has improved markedly, with sufficient power available to meet national demand and no repeat of the load shedding which caused problems for businesses and households in 2014-15. Several factors have transformed the power supply situation, including the demise of BCL (whose smelter was by far the largest single consumer of electricity in the country), which has reduced national demand by around 15%, as well as the ready availability of power from South Africa, which now has a surplus to export (hence Botswana is now no longer using very expensive diesel power generation). The new Morupule B power station has been functioning reasonably well, although it is yet to fully deliver electricity at its design capacity, and is still undergoing rehabilitation work.

In order to increase domestic supply capacity, it is intended to add two more units (5 and 6) to Morupule B. This will be done through the private sector, on an IPP (Independent Power Producer) basis. To achieve this, the Ministry of Mineral Resources, Green Technology and Energy Security (MMRE) and the Botswana Power Corporation (BPC) have contracted a consortium of Marubeni (of Japan) and POSCO (South Korea) to build and operate the coal-fired power station for a period of 30 years.

However, the deal has run into problems with the financial guarantees required from Government, which has to underwrite BPC's commitment to buy the power produced, given BPC's weak financial position. Government's ability to borrow and provide guarantees is limited by the Stocks, Bonds and Treasury Bills Act, which limit each of domestic and foreign debt and guarantees to 20% of GDP. Botswana already has considerable foreign borrowing (mostly from the African Development Bank and the World Bank), and a large sovereign guarantee for BPC's loan from Stanbic/ICBC for Morupule B Units 1-4. Total foreign debt and guarantees totalled 16.1% of GDP at the time of the 2017 Budget.

If government wants to promote power generation by the private sector through IPPs, whether by coal, gas, solar or any other method, guarantees will always be needed, and an appropriate way to treat such guarantees under the law must be found, without undermining debt sustainability. A solution needs to be found urgently, as a failure to proceed with the Marubeni/POSCO IPP could have major financial costs for BPC and the Government, not to mention credibility costs.

In a related development, a request has just been issued for proposals to provide 100MW of electricity generated from solar power. This would help Botswana to meet the commitments made to the international community under COP21 to undertake mitigation measures to reduce CO2 greenhouse gas emissions.

There also needs to be better co-ordination between Ministries undertaking large projects with significant financial commitments, and the Ministry of Finance and Economic Development (MFED), which is the custodian of the public finances. A similar problem arose with the deal between BCL – another parastatal under the MMRE - and Norilsk Nickel, which involved a payment of over \$300 million from BCL to acquire regional nickel assets from Norilsk. In the event BCL did not have the funds to complete the deal, but it had not made formal arrangements to obtain sufficient finance from government. As a result, the deal was unable to proceed, and BCL had to be put into liquidation. A solution to this impasse is still being sought

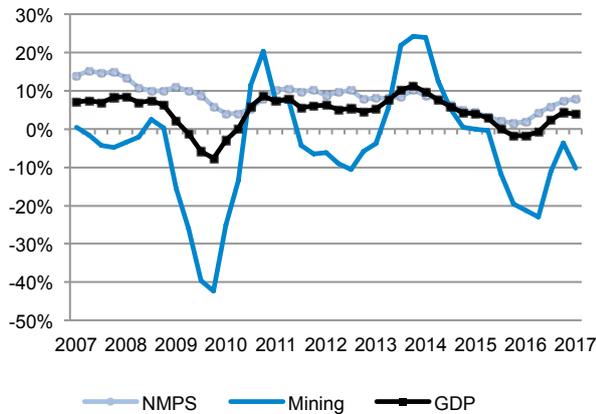
The on-off Air Botswana privatisation

The news earlier this year that Air Botswana was to be partially privatised through a share sale and management contract for a private sector partner was a welcome step in the implementation of Botswana's privatisation policy (which dates back to 2000). A number of proposals were received, some more credible than others, including one from Ethiopian Airlines. Ethiopian is probably the strongest airline in Africa, with a strategy of taking substantial minority stakes in African regional airlines, developing regional hubs, improving management and operations, and developing local technical expertise

However, the privatisation process now seems to have stalled. Initially, it was announced that the preferred bidder was Wilderness Safaris, a company that has a very good track record in running tourism operations and light aircraft charters, but no experience in running and managing a scheduled airline, and without the financial resources needed to develop it. In the event, Wilderness dropped out before the process had proceeded very far. The second short-listed bidder was Comair, a South African airline operating the British Airways franchise in the region, who would seem to have the right background and experience – i.e. running an airline is their core business. But there appears to be little political will to take this forward, and it appears that Government will (again) try and implement a turnaround strategy for Air Botswana on its own.

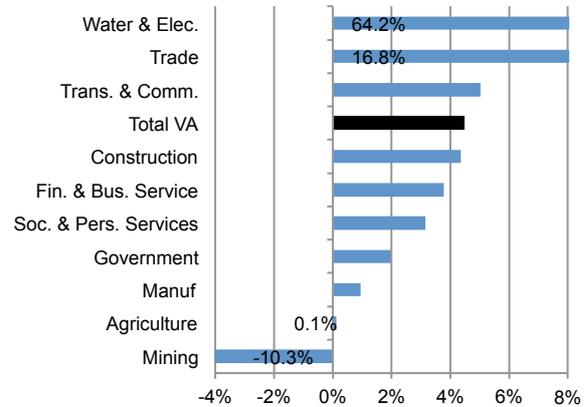
KEY ECONOMIC VARIABLES

Annual GDP Growth



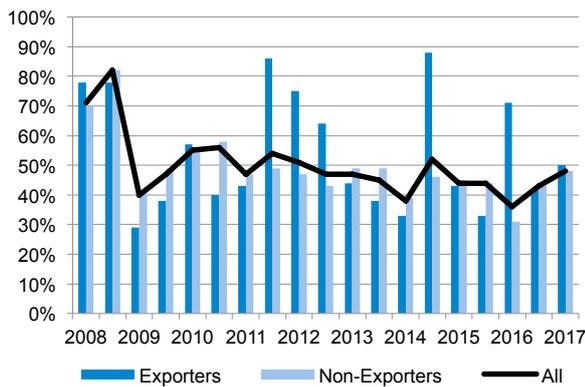
The Botswana economy slowed marginally during the first quarter of 2017, recording year-on-year growth of 3.9%. This compares to 4.3% y-o-y growth in Q4 2016. The decrease in real growth is attributable to a sharp decline in mining, from minus 3.7% y-o-y in Q4 2016 to minus 10.3% y-o-y in Q1 2017. The non-mining private sector (NMPS) continued to show resilience going into 2017, increasing to 7.9% y-o-y, driven by the continued improvement of diamond trading activities, which are included in the wholesale trade sub-sector.

Sectoral GDP Growth



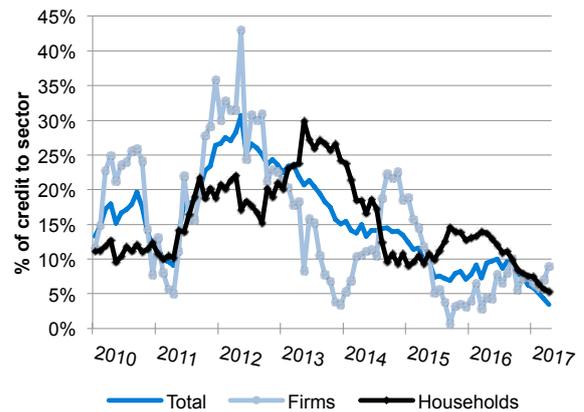
There was mixed performance across the economy during the 12 months to March 2017, with some sectors experiencing higher growth than in 2016 while others recorded marginal declines or no changes. The fastest growing sector was Water & Electricity, with annual growth of 64.2%, followed by the Trade sector which grew by 16.8% y-o-y. Mining contracted sharply, with minus 10.3% growth, following the closure of the BCL copper-nickel mine. The robust growth recorded by the Trade sector largely reflects a 99% increase in real output in the Wholesale sub-sector, due to improved diamond aggregation and trading conditions.

Business Confidence



The Bank of Botswana's Business Expectations Survey (BES) for the first half of 2017 showed that overall business confidence improved to 48%, from 43% in H2 2016. The survey revealed that confidence increased for both exporters and non-exporters, reflecting optimism about business conditions despite subdued demand in the domestic and international markets.

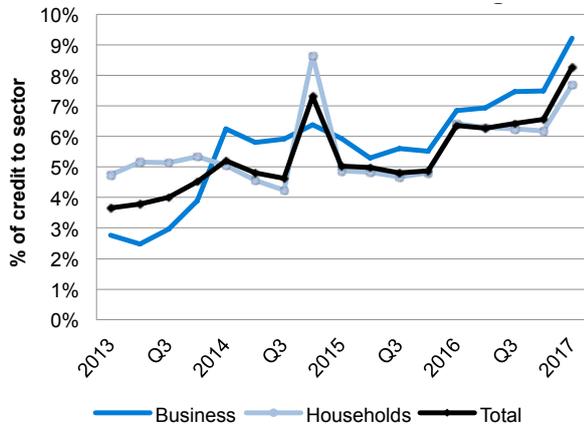
Annual Credit Growth



Annual bank credit growth continued to move downwards, decreasing from 5.9% in January 2017 to 3.4% in April 2017 – the lowest annual growth rate since early 1997. The slowdown in credit growth is attributable to slower growth in lending to households, down from 7.5% in January to 5.3% in April 2017. However, annual growth in bank credit to firms increased from 6.5% in January to 9% in April 2017. The decrease in household credit growth reflects slower growth across all of the main categories (mortgages, vehicles and unsecured loans). Credit to parastatals has also dropped sharply.

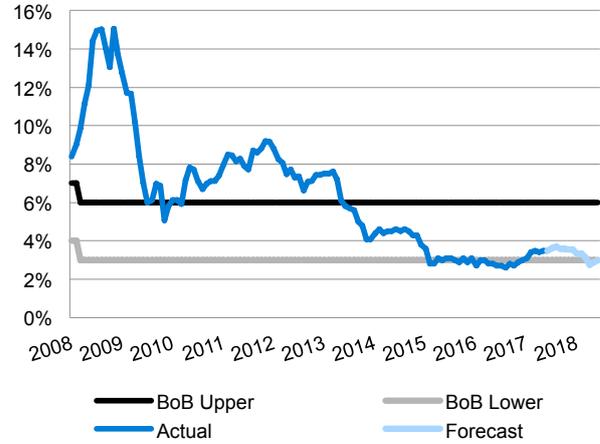
KEY ECONOMIC VARIABLES

Arrears on Bank Lending



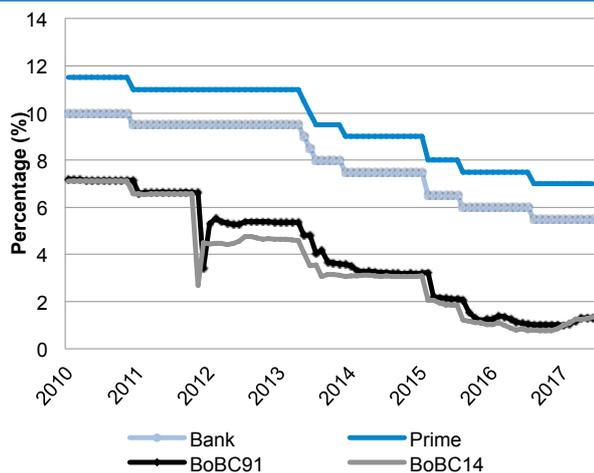
Total arrears as a proportion of outstanding bank credit increased further in the first quarter of 2017. Arrears increased from 6.6% in Q4 2016 to 8.3% in Q1 2017, and compares to 6.4% a year earlier. The increase is driven by both households and businesses; arrears on lending to households increased to 7.7% in Q1 2017 from 6.4% in Q1 2016, and on lending to businesses increased to 9.2% from 6.8% during the same period. There was also an increase in arrears on lending to government and parastatals in March 2017.

Inflation & Forecast



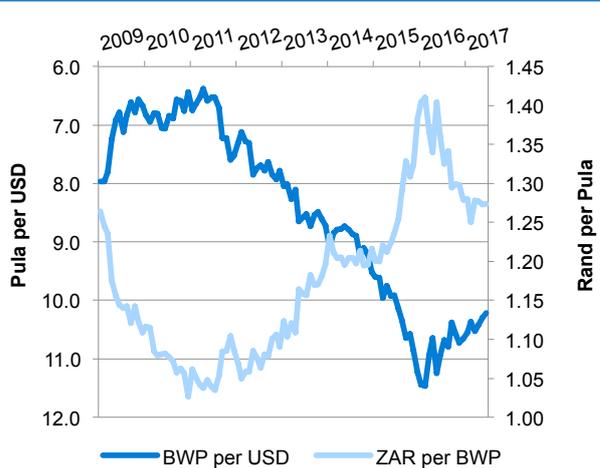
Annual inflation in June 2017 was 3.5%, the same as in March and 0.5% above the lower end of the Bank of Botswana's inflation objective range. Inflation is forecast to gradually increase in the second half of the year before falling back towards 3% in the first half of 2018. The introduction of a new fuel levy to meet strategic oil storage costs has not yet been reflected in fuel prices, but will do in due course. This will add around 0.2% to inflation.

Interest Rates



The Bank of Botswana's Monetary Policy Committee (MPC) maintained the Bank Rate at 5.5% in June 2017. The commercial bank Prime Lending Rate was also unchanged at 7.0%. Money market rates increased during the quarter, with the 14-day BoBC rate rising from 1.26% in Q1 2017 to 1.34% in Q2 and the 91-day BoBC rate rising from 1.18% to 1.31% over the same period. This may reflect the tightening of liquidity in the banking system, where excess liquidity fell to 2.6% of total assets, the lowest since the required reserve ratio was reduced in early 2015.

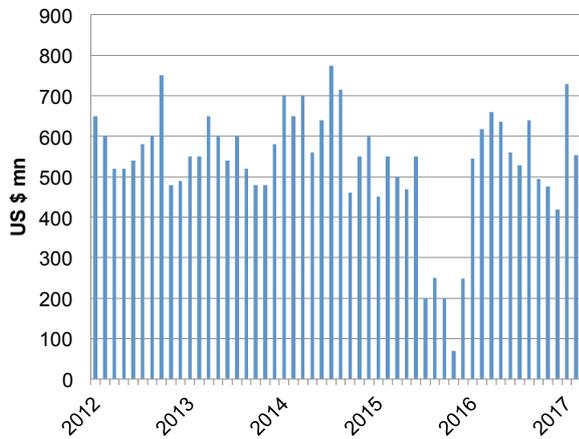
Exchange Rates



Foreign exchange rates were reasonably stable during the second quarter of 2017. The Pula-US Dollar exchange rate was 10.21 in June 2017, up from 10.53 in March, an appreciation of 3.1%. The Pula depreciated marginally against the Rand, by 0.3%, ending the quarter at ZAR1.274.

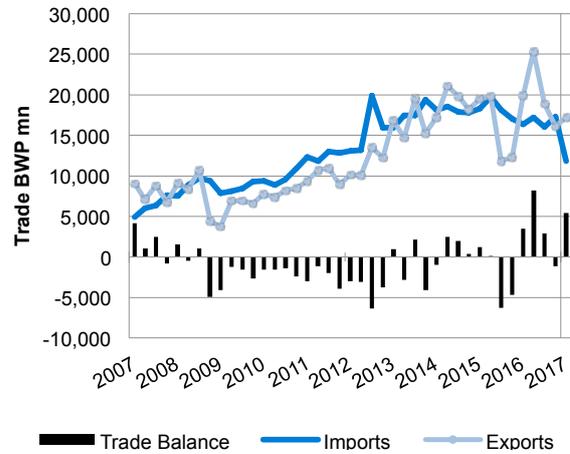
KEY ECONOMIC VARIABLES

De Beers Diamond Sales



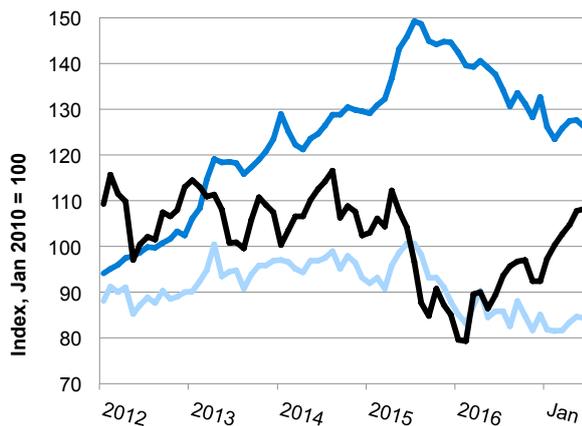
The global market for rough diamonds was generally stable in the first half of 2017. De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1.638 million in Q2 2017, 11.7% lower than sales recorded in the same period in the previous year. The June sight marked the end of existing sightholder contracts, to be replaced by new ones from July. However, allocations to sightholders for the new contracts are expected to be lower, due to commitments that De Beers has made to Botswana and Namibia state-owned diamond trading companies to sell a portion of the company's production.

International Trade



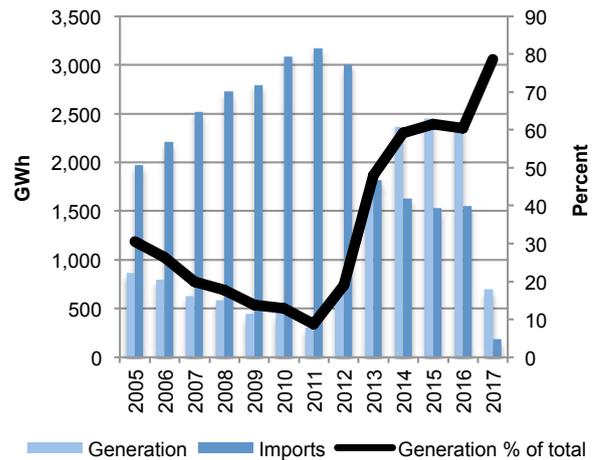
Statistics Botswana has reported a 32% decrease in imports and 7% increase in exports during Q1 2017, and as a result, the trade balance is reported to have improved from a deficit of P1,120 million in Q4 2016 to a surplus of P5,429 million. Total exports increased by P1,062 million to P17,213 million, while recorded total imports fell to P11,784 million during the same period. However, a closer look at the import data suggests that import figures for Q1 have been under-reported, most likely due to the introduction of a new trade recording system by BURS, and that a more accurate figure would show a much smaller drop in imports, and a smaller trade surplus.

Stock Markets



The Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) improved in the second quarter, gaining 0.2% and 3.3% in Pula and USD terms respectively, as market conditions show signs of recovery. Global stock markets generally performed well in Q2, with the MSCI Emerging Markets Index and the MSCI World index rising by 5.5% and 3.4% respectively.

Electricity



Total consumption of electricity in the year to March 2017 declined by 8.3%. Year-on-year domestic generation of electricity increased by 57.4%, to a total of 698GWh from 443GWh in the year to March 2016. Imports fell by 63.9% over the year, as a result of improved domestic electricity generation and reduced overall demand. The fall in electricity consumption was mainly due to the closure of the BCL mine and smelter, which had previously been the largest single consumer of electricity in the country.

NEWS HIGHLIGHTS

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| 2nd April | Ghaghoo diamond mine stops production (Daily News) | Gem Diamond Botswana has placed its Ghaghoo diamond mine in the Central Kalahari Game Reserve (CKGR) on care and maintenance, and has halted production. Effective from 1 April 2017, only mine activities to preserve mine assets will be carried out, reducing the number of workers to 25 from 183 workers. According Mr Mphusu, the Managing Director of Gem Diamonds Botswana, the Ghaghoo mine experienced losses for two consecutive years due to lower diamond prices for small rough diamonds. Ghaghoo diamond mine started operations in 2014 and restructured in 2015 to reduce costs. |
| 4th April | De Beers sees strong demand at USD580 million sight. (Rapaport News) | Rough diamond sales grew by 5 percent at the De Beers' third sightholder and auction sales of 2017. Rough diamond sales increased from the revised USD553 million in February 2017 to USD580 million in March, amid positive market sentiment. Sightholders reported strong demand at the sight with allocations selling over the list price. |
| 6th April | BPC and Eskom sign new power import deal. (Mmegi) | The Botswana Power Corporation (BPC) has signed a three-year power supply agreement with South Africa's Eskom. According to BPC, the new power supply deal is important to ensure continued power supply in Botswana, especially at the time when Morupule B is undergoing remediation, and Morupule A is being refurbished. |
| 18th April | Morupule Mine expands to meet increasing coal demand. (Weekend Post) | Morupule Coal Mine (MCM) will commence expansion works to increase production and meet the demands of the growing local and regional coal market. The expansion project, MCM 3, will supply the planned units 5 and 6 of Morupule Power Station with coal. Botswana has the potential to be self-sufficient in electricity generation and even export power, and it is anticipated that the country will be self sufficient by 2019. |
| 26th April | Alrosa gets new Botswana exploration permits. (Rapaport News) | The Government has awarded Sunland Minerals with a six prospecting licenses in the CKGR and Orapa areas covering 3,135 square kilometers and 482 square kilometres respectively. Sunland Minerals is a diamond exploration partnership between Alrosa and Botswana Diamonds, and the licenses are valid until March 2020. |
| 28th April | Debswana saves P1 billion through cost-cutting. (Mmegi) | Through a range of measures to improve efficiency and reduce costs, Debswana Diamond Company has managed to save up to P1 billion in 2016. The company managed to improve on tyre lifespan, fuel consumption and productivity, hence, contributing to overall improvement in operational efficiencies. |
| 28th April | Norilsk seeks damages from Botswana Government over stalled sale of Nkomati and Tati mines. (Mining Weekly) | Norilsk Nickel intends to resume legal proceedings against the Botswana Government in relation to a stalled 2014 deal that would have resulted in Botswana copper and nickel producer BCL acquiring Norilsk's African assets. BCL agreed to purchase Norilsk's 50% shares in Nkomati mine and 85% shares in Tati nickel mine in 2014. However, in 2016 BCL was placed under provisional liquidation by the Government and could not complete the transaction as it has no funds. |
| 28th April | Sese power project granted tax breaks. (Mmegi) | The Government has granted Sese power project a 5 year tax holiday and a preferential 15 percent company tax rate thereafter, as a way of encouraging private investment in the coal and energy sector. The proposed Sese power project is a joint venture between First Quantum Minerals and African Energy to develop a coal mine and build a 450 megawatt coal-fired power plant. |
| 28th April | Botswana introduces USD30 per visitor tourism levy. (Mmegi) | The Government has introduced the Tourism Development Levy (TDL) to raise funds for conservation and national tourism development effective from June 2017. The new TDL will affect non-SADC citizens who will be required to pay USD30 tourism levy upon entry. |

NEWS HIGHLIGHTS

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| 30th April | S&P: Botswana Vulnerable to Weak Diamond Market. (Rapaport News) | The rating agency, Standard & Poor's (S&P) has maintained a negative outlook for Botswana, given the country's continued heavy reliance on diamonds and vulnerability to external shocks in the sector. According to S&P, Botswana's ratings are constrained by the country's narrow economic base, and economic growth performance and fiscal outcomes could be weaker in the near future. Diamonds account for about 80 percent of total exports and a quarter of gross domestic product (GDP). |
| 2nd May | Debswana spends P2.1 billion to keep Lethakane mine going. (Sunday Standard) | Debswana Mining Company is set to commission the Lethakane Mine tailings project at the end of the second quarter (Q2) of 2017, increasing the lifespan of the mine by at least 20 years. According to the company, Lethakane diamond mine has reached its depth limit for conventional open pit mining and the initiation of the tailings project will unearth more rough diamonds at the same time preventing job losses and ensuring future sustainability. New technology will be employed at the tailings plant and annual production is estimated at 800,000 carats of rough diamonds. |
| 7th May | Botswana's secrecy in mining contracts under World Bank spotlight. (Sunday Standard) | The Mining Investment and Governance review compiled by the World Bank has highlighted Botswana's lack of disclosure on mining contracts, singling out diamonds as one of the minerals whose business dealings are conducted under heavy secrecy. |
| 12th May | Lucara's high-grade Karowe continues to impress with latest exceptional stone tender. (Mining Weekly) | Lucara Diamond Corp has completed the first exceptional stone tender (EST) for 2017, and has achieved revenues of USD54.8million from the sale of 1,765.72 carats of precious gems larger than 10.8 carats. The 2017 EST marked Lucara's 11th EST since mining started in 2012 and consisted of 15 single stone lots ranging from 29.9 carats to 373.73 carats in size. According to the President and CEO of Lucara, Mr William Lamb, Karowe continues to deliver strong and consistent results from its exceptional tenders. |
| 12th May | Alecto's Mowana now producing full-time. (Mining Weekly) | Alecto Minerals announced that its Mowana copper mine has reached full-time operation in copper concentrate production. The first blast was done in April 2017, and the trial was successful producing over 1,900 tonnes of concentrate. Mowana mine is forecast to hold 172 million tonnes of resource at 0.84% copper. Moreover, Alecto Minerals will undertake additional test work to decide on the installation of the dense media separation (DMS) unit which is expected to increase annual throughput to 2.6 million tonnes with output of 23,000 tonnes of copper per year. |
| 12th May | World Bank sees Botswana poverty levels dropping. (Mmegi) | The World Bank has forecast poverty levels in Botswana to decline by 0.5 percentage point annually to 11 percent in 2019, from an estimated 13 percent in 2016. The poverty rate, as measured by the number of people living on USD1.90 or less a day, remains high in Botswana, particularly given that Botswana is an upper middle-income country. The World Bank acknowledges that achieving further poverty reduction will be constrained by limited private sector job creation and reliance on low productivity agricultural jobs in rural areas. |
| 14th May | Botswana's mining revenue sharing formula needs revision – World Bank. (Sunday Standard) | The Mining Investment and Governance Report by the World Bank has noted with concern that Botswana lacks a legislated mineral revenue sharing formula or mechanism from the national level to mining affected areas. The report recommended allocation of a share of mining revenues to communities that are negatively affected by mineral development. According to the World Bank, the distribution of mineral revenue does not reach the poorest segments of the society, thus resulting in high level of rural poverty and high income disparities between the wealthy and the poor. Therefore, Botswana should consider the recommendation of the Africa Mining Vision to return a portion of mineral revenues to local government. |

NEWS HIGHLIGHTS

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| 16th May | IMF staff concludes 2017 Article IV visit to Botswana. (IMF) | The International Monetary Fund (IMF) concluded its 2017 Article IV Consultations with Botswana, and focused on recent developments and prospects as well as on policies to support economic stability and promote inclusive growth. Positive prospects for the diamond sector could lead to high GDP growth rates in 2017 to 2019, and Botswana need to focus on activities with economy-wide benefits. According to the IMF, economic diversification could be achieved by developing sectors with growth and employment creation potential (e.g tourism). Botswana needs to also proceed with privatisation efforts and reforms to improve the efficiency and financial viability of state enterprises, reduce bureaucracy and improve education outcomes and the skills of the labour force. It is stated that delivering on these policies and reforms, the economy could achieve economic stability and private sector-led growth and employment creation. |
| 25th May | Firestone Diamonds enters agreement for disposal of Botswana operations. (Mining Review) | Firestone Diamonds has entered a conditional option agreement for the potential disposal of its Botswana operations. The agreement includes the disposal of Firestone Diamonds' interest in the BK11 mine to Amulet Diamond Corporation. However, completion of the disposal is subject to agreed conditions including an approval from the Botswana Competition Authority. In the past, Firestone has not been successful in selling its Botswana assets. |
| 31st May | Tlou Energy set to start seismic collection at Botswana coal bed gas project. (Proactive Investors) | Tlou Energy Limited has chosen Australian company Velseis to acquire the seismic data for its Lesedi coal bed methane project and the adjacent Mamba permit. The seismic programme should start in the next quarter, with the aim of boosting gas reserves at both projects. The seismic survey will also assist to gain enhanced knowledge of the sub-surface of the project as the company prepares to drill more wells. |
| 1st June | Botswana Lerala Diamond Mine shuts down – newspaper. (Reuters Africa) | Kimberley Diamonds Ltd (KDL) has decided to shut operations its Lerala Diamond Mine in Botswana attributable to weak market conditions, leaving 130 workers unemployed. Lerala mine was opened in 2008 and has been closed twice before as a result of weak sales. It had previously targeted to produce 360,000 carats of rough diamonds every year for seven years. |
| 12th June | South Africa recession could negatively affect Botswana's economy. (The Patriot) | Dr Keith Jefferis, Managing Director of Econsult Botswana, has warned of negative spill-over effects after South Africa economy entered into a technical recession in the second half of the year. Notwithstanding technical recession is not a big issue, prolonged poor performance of South Africa economy could hurt other small economies in the region given that the country's economy is the biggest in the SADC region, According to him, manufacturing and exports could be negatively affected. |
| 12th June | BHC too expensive for Batswana – PAC. (Business Weekly and Review) | Botswana Housing Corporation (BHC) has been criticized for high housing pricing structures hence losing touch with its core objective of 'affordable housing'. The Public Accounts Committee (PAC) argues that many Batswana are being priced out of the property market as BHC houses are expensive for many. BHC was established with a core objective to provide affordable housing to Batswana. |
| 12th June | Wilderness withdraws interest in Air Botswana. (Weekend Post) | Wilderness Safaris has withdrawn its Expression of Interest (EOI) Air Botswana. The Government had previously opened an EOI, inviting interested companies to bid to operate the Airline and acquire a partial shareholding. Two companies were preferred bidders, including Wilderness Safari. |

NEWS HIGHLIGHTS

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| 16th June | Kimberley Diamonds goes into administration. (Mining Weekly) | Kimberley Diamonds has reportedly entered into a voluntary administration, a few days after its Lerala diamond mine was closed as a result of weak sales. Lerala is the second diamond mine to close in 2017 after Gem Diamond's Ghaghoo diamond mine was placed under care and maintenance in April 2017. |
| 16th June | Botswana's BCL to be sold off piecemeal after sale talks fail. (Reuters Africa) | BCL could be sold at a much lower price after the company could not find a buyer. BCL mine was placed under provisional liquidation in September 2016 after the government could not afford to keep the mine operating. According to the liquidator, options to sell BCL include selling the mine as a going concern or selling its assets which include the smelter and mine shafts separately. BCL owes its creditors over P1 billion coupled with the P3 billion Norilsk lawsuit deal to acquire Nkomati mine in South Africa. |
| 19th June | Shumba Energy partners with Basil Read Mining for coal projects in Botswana. (Mining Review) | Shumba Energy has signed a Memorandum of Understanding (MoU) with Basil Read Mining for technical mining operations to provide contract mining solutions for coal projects in Botswana. Under the MoU, Basil Read Mining will provide services for opencast mining, and inputs for mine design, scheduling, planning, infrastructure development, operations and project management. |
| 19th June | Cupric Canyon Capital – Building a copper hot spot in Botswana. (Mining Review) | Cupric Canyon Capital, through its subsidiary Khoemacau Copper Mining, plans to deliver its first copper and silver concentrate in 2019 from its Zone 5 Starter project in the Kalahari Copper Belt. Khoemacau intends to upgrade the concentrator plant it acquired from Discovery Metals to 10,000 tpd/3.6 Mtpa to produce 50,000 tpa of copper and 1.4 Moz of silver concentrates. The mine is estimated to be capable of producing more than 80,000 tpa of copper and silver for approximately 27 years. At present, the mine is focused on pre-construction engineering and procurement activities as well as installing a new power line to connect into the national grid line. |
| 21 June | Tlou generates first electricity from gas in Botswana. (Mmegi) | Tlou Energy Limited has reported that it has started generating power at its Selemo pilot project in Mmashoro using coal bed methane (CBM). The CBM project is the first gas-fired power station in Botswana and would connect to the national grid line. Compared to diesel and coal fired power generation, the CBM gas is a cheaper and cleaner alternative way of producing electricity. |
| 23rd June | BCL liquidation poses for Botswana diamond exploration JV. (Mining Weekly) | Botswana Diamonds is weighing its options in resolving the corporate governance issues relating to its Maibwe joint venture (JV) exploration project, in the emerging diamond province of Gope in Botswana. Works at Maibe JV are suspended as BCL which is the major shareholder (51%) and operator in the JV is on provisional liquidation. According to Botswana Diamonds, it is in the interest of the JV that corporate issues relating to BCL's holding be resolved for progression of the project, through the proposed sale of BCL shares. |
| 23rd June | Stanbic taps bond market for P200 million. (Mmegi) | The Botswana Stock Exchange (BSE) has approved Stanbic Bank Botswana's listing of two tranches of notes to raise P200 million from the capital market. The bank will first raise P140 million followed by the remaining P60 million through a subordinated unsecured floating rate note. The funds raised through the capital market will be used to fund loans and advances to customers and cover liquidity and capital management. |

NEWS HIGHLIGHTS

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| 24th June | Sir Ketumile Masire, Botswana president known as leader of model African nation, dies at 91. (Washington Post) | Botswana's second president, Sir Ketumile Q. J. Masire, has died at the age of 91. Sir Ketumile became Vice President at Independence in 1966, and served the country as President from 1980 to 1998. He led Botswana through a drought that dragged on for much of the 1980s, and in 1989 shared the African Prize for Leadership from the Hunger Project in recognition of the food distribution efforts that helped Botswana avoid starvation during the drought period. He is widely acknowledged to have contributed immensely to Botswana's economic and political development. He helped transform the country from least developed to middle income status and made strides in the provision of education, health and social welfare, and was the pioneer of Botswana's long-term 'Vision 2016'. During his tenure, he continued to establish good relations with other countries, and opposed the apartheid regime in South Africa. Sir Ketumile continued work after his presidency and advised other African leaders and chaired the international panel that probed the Rwandan Genocide of 1994. |
| 25th June | Banking Act 1995 set for amendment – BOB. (Sunday Standard) | Bank of Botswana has confirmed the amendment of the Banking Act, which was enacted in 1995. The decision to amend the act was necessary to be aligned with new regulatory developments in both domestic and global financial systems. The BoB Governor further noted the need to enhance the legal framework and central bank powers for handling problem bank resolution and a systemic banking crisis; and providing for the sharing of relevant information among internal and external regulators and oversight authorities. |
| 25th June | BDC get Moody's first rating. (Sunday Standard) | The rating agency Moody's has assigned first-time Baa2/Prime-2 issuer ratings to Botswana Development Corporation (BDC), with a stable outlook on the Baa2 long-term ratings. Moody's confirmed the rating in June 2017 and it is the first rating for BDC. BDC is an investment parastatal organisation and is owned 100 percent by the government. However, BDC is independently managed even though it has two government representatives on the board of directors. |
| 27th June | Shareholders asked to inject P28 million into Pula Steel. (Mmegi) | Shareholders of the troubled Pula Steel have been asked to inject P28 million into the company to restart operations and to pay off a portion of the debt owed to its creditors. Pula Steel which is owned by BCL, the Verma Family, the Citizen Entrepreneurial Development Agency (CEDA) and Wealth Creations owes creditors an amount equivalent to P100 million. Nevertheless, BCL may not be able to participate in the capital injection as it is under liquidation, and will have to cede its shares to the other shareholders for the capital raising to proceed. |
| 28th June | Giyani reports multiple manganese occurrences at Kgwakgwe hill project, Botswana. (Marketwired) | A regional mapping and sampling program by Giyani Gold Corporation has confirmed multiple occurrences of visible manganese in the Kanye Basin. The company has collected 80 samples for lab analysis. Geological surveys also discovered several old small scale manganese mines in the area, and these historical mines have no documented record of their existence in government records in the area. |
| 30th June | New fuel tax introduced. (Mmegi) | Cabinet has approved the implementation of the new 17.5 thebe per litre fuel tax aimed at raising funds for Botswana Oil to build storage infrastructure and buy petroleum products stock. Effective from 1 July 2017, the new levy is an addition to the existing 13.5 thebe per litre tax. The new tax may not be immediately felt by consumers as the National Petroleum Fund (NPF) provides a buffer to any price change in the short term. |

MACRO-ECONOMIC DATA

| Key Economic Data | | | | | | | | | | | |
|--|----------|---------|---------|--------------------|--------------------|-------------------|----------|---------|---------|--------|--------|
| | unit | 2012 | 2013 | 2014 | 2015 | 2016Q1 | 2016Q2 | 2016Q3 | 2016Q4 | 2017Q1 | 2017Q2 |
| Annual Economic Growth | | | | | | | | | | | |
| GDP | % | 4.5 | 11.3 | 4.1 | -1.7 | -1.8 | 0.7 | 2.3 | 4.3 | 3.9 | .. |
| Mining | % | -5.8 | 24.2 | 0.5 | -19.6 | -21.3 | -22.9 | -11.1 | -3.7 | -10.3 | .. |
| Non-mining private sector | % | 7.7 | 10.1 | 4.9 | 1.4 | 2.0 | 4.1 | 5.9 | 7.2 | 7.9 | .. |
| GDP current prices | P mn | 109,870 | 125,158 | 145,868 | 145,924 | 39,499 | 42,441 | 44,091 | 43,657 | 43,647 | .. |
| GDP 2006 prices | P mn | 75,515 | 84,081 | 87,569 | 86,081 | 22,277 | 22,667 | 22,410 | 22,422 | 22,466 | .. |
| Money & Prices | | | | | | | | | | | |
| Inflation | % | 7.4 | 4.1 | 3.8 | 3.1 | 3.0 | 2.7 | 2.8 | 3.0 | 3.5 | 3.5 |
| Prime lending rate | % | 11.0 | 9.0 | 9.0 | 7.5 | 7.5 | 7.5 | 7.0 | 7.0 | 7.0 | 7.0 |
| BoBC 14-day | % | 4.6 | 3.1 | 3.1 | 0.97 | 1.0 | 0.84 | 0.76 | 0.84 | 1.26 | 1.34 |
| Trade & Balance of Payments | | | | | | | | | | | |
| Exports - total goods | P mn | 45,915 | 66,404 | 76,261 | 63,484 | 19,885 | 25,389 | 18,911 | 16,151 | 17,214 | .. |
| Exports - diamonds | P mn | 36,143 | 55,367 | 65,328 | 52,730 | 17,003 | 22,741 | 16,581 | 14,456 | 16,084 | .. |
| Imports - total goods | P mn | 62,114 | 70,218 | 72,427 | 73,192 | 16,380 | 17,194 | 16,018 | 17,272 | 11,785 | .. |
| Balance of visible trade | P mn | -16,199 | -3,814 | 3,834 | -9,707 | 3,505 | 8,195 | 2,893 | -1,120 | 5,429 | .. |
| Balance of payments | P mn | -862 | 1,340 | 11,404 | -57 | -261 | 2,432 | 1,545 | -873 | .. | .. |
| Foreign Exchange | | | | | | | | | | | |
| Exchange rate BWP per USD | end | 7.776 | 8.718 | 9.515 | 11.236 | 10.929 | 10.941 | 10.373 | 10.650 | 10.526 | 10.215 |
| Exchange rate ZAR per BWP | end | 1.090 | 1.196 | 1.217 | 1.383 | 1.366 | 1.361 | 1.295 | 1.279 | 1.278 | 1.274 |
| FX reserves | \$ mn | 7,628 | 7,726 | 8,323 | 7,546 | 7,559 | 7,402 | 7,631 | 7,189 | 7,041 | .. |
| FX reserves | P mn | 59,317 | 67,772 | 79,111 | 84,881 | 81,891 | 80,283 | 79,990 | 76,804 | 73,957 | .. |
| Financial Sector | | | | | | | | | | | |
| Deposits in banks | P mn | 47,216 | 48,512 | 51,492 | 59,961 | 61,078 | 61,700 | 61,198 | 62,438 | 60,120 | .. |
| Bank credit | P mn | 34,555 | 39,763 | 45,116 | 48,307 | 49,040 | 50,476 | 51,703 | 51,316 | 51,141 | .. |
| BSE index | | 7,510.2 | 9,053.4 | 9,501.6 | 10,602.3 | 10,202.6 | 10,081.3 | 9,797 | 9,728 | 9,225 | 9,244 |
| Business Indicators | | | | | | | | | | | |
| Diamond production (a) | '000 cts | 20,619 | 23,134 | 24,658 | 20,732 | 5,429 | 5,305 | 4,601 | 5,557 | 8,553 | .. |
| Copper production (c) | tonnes | 57,916 | 49,448 | 46,721 | 23,050 | 5,777 | 4,464 | 2,879 | 0 | 0 | .. |
| Nickel production | tonnes | 17,942 | 22,848 | 14,958 | 16,789 | 7,303 | 5,801 | 3,774 | 0 | 0 | .. |
| Business confidence index | | 47% | 45% | 52% | 44% | 36% | .. | 43% | .. | 48% | .. |
| No. of companies formed | | 16,561 | 14,190 | 16,300 | 19,134 | 4,592 | 4,666 | 4,137 | 3,726 | 4,604 | 5,661 |
| Electricity consumption | GWh | 3,703 | 3,502 | 3,990 | 3,974 | 967 | 955 | 995 | 1,012 | 888 | .. |
| Crude oil (Brent) | \$/bar | 110.80 | 109.95 | 55.27 | 36.61 | 36.75 | 48.05 | 48.24 | 54.96 | 52.20 | 47.08 |
| Employment (formal) | | | | | | | | | | | |
| Government | | 131,033 | 130,175 | 129,918 | 130,220 | 126,737 | 127,537 | 128,279 | 129,216 | .. | .. |
| Parastatals | | 17,484 | 18,838 | 18,790 | 19,411 | 19,999 | 19,476 | 19,101 | 19,008 | .. | .. |
| Private sector | | 188,531 | 189,894 | 191,399 | 191,484 | 193,460 | 195,747 | 197,107 | 194,202 | .. | .. |
| Total | | 337,048 | 338,907 | 340,107 | 341,115 | 340,196 | 342,760 | 344,487 | 342,426 | .. | .. |
| Govt Budget | | | | | | | | | | | |
| | | 2013/14 | 2014/15 | 2015/16 Outturn | 2016/17 Revised | 2017/18 Budget | | | | | |
| Revenues | P mn | 48,951 | 55,904 | 47,420 | 55,926 | 57,187 | | | | | |
| Spending | P mn | 41,730 | 50,564 | 54,411 | 57,031 | 59,544 | | | | | |
| Balance | P mn | 7,222 | 5,340 | -6,991 | -1,106 | -2,357 | | | | | |
| Public debt & guarantees | P mn | 30,791 | 33,399 | 34,058 | 34,827 | 34,788 | | | | | |
| Govt deposits at BoB | P mn | 31,745 | 41,680 | 33,916 | 29,819 | .. | | | | | |
| GDP | P mn | 131,241 | 147,930 | 148,853 | 156,094 | 167,374 | | | | | |
| Revenues | %GDP | 37.3% | 37.8% | 31.9% | 35.8% | 34.2% | | | | | |
| Spending | %GDP | 31.8% | 34.2% | 36.6% | 36.5% | 35.6% | | | | | |
| Balance | %GDP | 5.5% | 3.6% | -4.7% | -0.7% | -1.4% | | | | | |
| Public debt & guarantees | %GDP | 23.5% | 22.6% | 22.9% | 22.3% | 20.8% | | | | | |
| Govt deposits at BoB | %GDP | 24.2% | 28.2% | 22.8% | 19.1% | .. | | | | | |

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 Lerela mines

(c) Copper and Nickel production for Q3 2016 are for July and August only

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

SPECIAL FEATURE

The Exchange Rate and Economic Diversification

Diversification and Dutch Disease

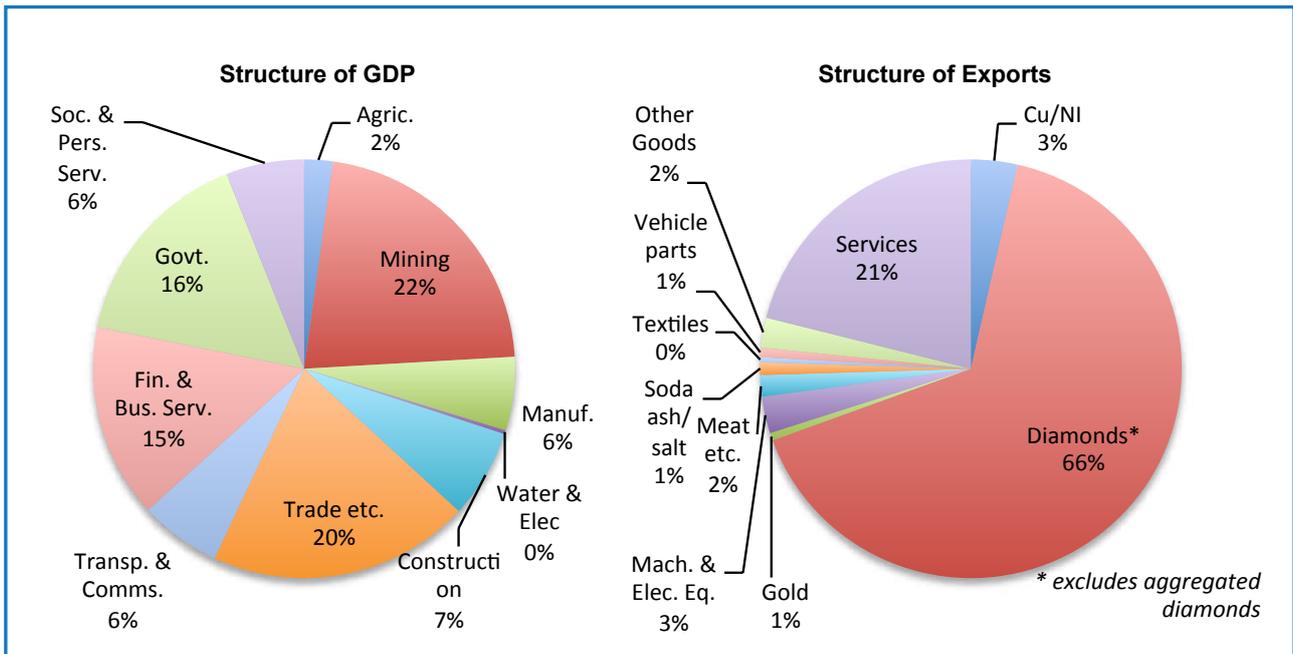
There has been much discussion of the need to diversify the economy away from its dependence on diamonds, and this has formed the basis of successive National Development Plans (NDPs). The emphasis has generally been on the diversification of GDP, i.e. the development of new economic activities to help move beyond dependence on diamond mining.

Evidence shows that the economy has become much more diversified over the past two decades, and that from a GDP perspective, Botswana is much less dependent upon mining now than it was two or three decades ago. In 2016, mining accounted for 22% of GDP, compared with over 50% in the late 1980s. So to this extent, diversification has been successful.

But this has been accompanied by a slowdown in overall growth rates; average annual real GDP growth over the first 25 years of after independence was 12.7%, while over the second 25 years it was only 4.6%. And although the econo-

my has diversified, exports have not, or at least not to anything like the same extent. At the same time, FDI has fallen sharply. So although the economy has diversified, it has mainly been through the growth of services sectors, serving the domestic economy, which explains the phenomenon of economic diversification without export diversification. In other words, Botswana, like most mineral economies, has suffered from the Dutch Disease, whereby the growth of the resources sector and domestic services (and other non-tradeables) squeezes out non-resource tradeables production (such as manufacturing, agriculture, and exportable services).

Figure 1: Composition of GDP and Exports, 2016



Source: Statistics Botswana, Bank of Botswana, Econsult

SPECIAL FEATURE

The explanation is that non-mining export sectors are generally uncompetitive, or at least not competitive enough for Botswana's producers of goods and services to penetrate regional and global export markets. There are many reasons for this, including low productivity and high labour costs, as well as a range of factors that make the investment climate unattractive, such as the problems in getting work permits for foreign investors and skilled workers. But the lack of export diversification raises a fundamental question of whether the (real) exchange rate is overvalued.

The role of the exchange rate

The exchange rate plays a key role in determining export competitiveness, as well as the ability of Botswana firms to compete domestically with imports. Ever since the Pula was introduced in 1976, Botswana has had a pegged (i.e. managed) exchange rate, rather than a floating (market determined) exchange rate. Therefore the choice over the level of the exchange rate, and how it is managed, is – within some fairly broad constraints – a policy choice.

As is well known (thanks to much more disclosure regarding exchange rate policy in recent years), the Pula is pegged to a basket of currencies via an adjustable/crawling peg arrangement. Once the fundamental policy choice has been made (a floating or managed/fixed rate), the main policy parameters – which can be varied by policymakers – become the nature of the peg, the weights of different currencies in the pula basket, and the rate of crawl (upward, downward, and how fast).

In the past, exchange rate policy was strongly focused on supporting competitiveness and export diversification. This meant trying to prevent the real exchange rate from appreciating (as often happens in mineral economies), and in particular preventing it from appreciating too much against the South African rand (ZAR)¹. The choice of the rand as a key reference point reflected the fact that a high proportion of Botswana's non-mineral exports were destined for South Africa, and Botswana firms selling locally were mostly competing against imports from South Africa. Excessive real appreciation against the rand would mean that these exporters and import competitors would become increasingly uncompetitive, with negative impacts for export diver-

sification and employment creation. Concerns about real exchange rate appreciation lay behind the devaluations of the Pula in 2004 and 2005.

Twenty years back, the currency weights in the pula basket were 65% ZAR and 35% SDR (itself a basket of major hard currencies, mainly the USD). This largely reflected the weights of the various currencies in Botswana's non-diamond trade. Over time the rand weight in the Pula basket has been progressively reduced, so much so that since early 2017, the weight of the ZAR in the basket has been reduced to 45%, with 55% SDR. But this is not just a mechanical change in weights, it represents a change in policy; instead of having an exchange rate policy focused on export diversification and supporting the competitiveness of non-traditional (or non-diamond) exporters, we have moved towards a "strong pula" policy, with more of a peg to hard currencies such as the USD than the main regional currency, the ZAR.

The result of the reduced rand weight in the basket is to progressively de-link the Pula from the rand. Depending on the movements in other exchange rates, but particularly the ZAR-USD rate, the Pula can appreciate sharply against the rand, as it did back in early 2016, when it reached 1.44, which made life very difficult for exporters and those competing with imports; major local companies such as the brewery and cement producers struggled to compete with imports, with negative implications for jobs.

The reduced weight for the rand in the basket is based on the argument that it reflects the actual currency composition of Botswana's trade. This is more or less true, if one looks at total trade (which is split roughly equally between SACU and non-SACU trade). But this in turn reflects the dominant position of diamonds in Botswana's overall trade; if the objective is to diversify the economy (and particularly exports) away from diamonds, then the appropriate benchmark for Pula basket weights is the currency composition of trade excluding diamonds.

On this basis, the Pula basket weights should be much closer to the 65% ZAR and 35% SDR structure that prevailed from 1997 to 2007.

¹While policymakers can influence the nominal exchange rate, the key variable from a competitiveness perspective is the real exchange rate, which is the nominal exchange rate adjusted for relative inflation. The real exchange rate can appreciate (become less competitive) either if the nominal exchange rate appreciates, or if a country has higher inflation than its trading partners (or some combination of the two channels).

Table 1: Direction of Trade [SACU] as % of total

| | 2013 | | 2014 | | 2015 | | 2016 | |
|----------------|------|----------------|------|----------------|------|----------------|------|----------------|
| | All | Excl. diamonds |
| Exports | 27% | 47% | 23% | 44% | 27% | 43% | 25% | 54% |
| Imports | 75% | 85% | 75% | 86% | 78% | 84% | 75% | 80% |
| Average | 51% | 66% | 49% | 65% | 53% | 63% | 50% | 67% |

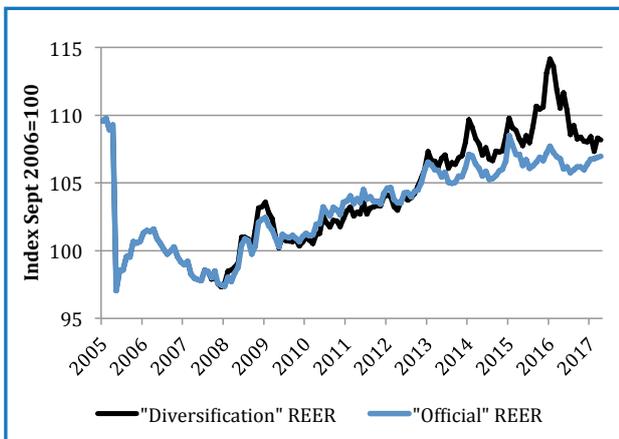
SPECIAL FEATURE

A key measure of competitiveness is the Real Effective Exchange Rate (REER), which measures the Botswana's real exchange rate against key trading partners, weighted by trade proportions. The real exchange rate reflects the actual (nominal) exchange rate, adjusted for relative inflation rates. Changes in the REER show whether competitiveness (by this measure) is increasing or decreasing.

The Bank of Botswana publishes an "official" REER measure, calculated using the Pula basket weights. This has shown some appreciation since the 2005 devaluation, with an increase of just over 10% over the 12 years to April 2017. This is not a huge appreciation, but is nonetheless unhelpful to export-led diversification.

We can also calculate the REER using currency weights that reflect non-diamond trade – in other words, weights that are more in line with diversification objectives. This alternative REER measure shows a slightly larger appreciation of 11.5% over the same period. However, it is much more volatile, and in early 2016 had appreciated by almost 18% above the post-devaluation level – a much more serious loss of competitiveness for non-diamond exporters.

Figure 2: Real Exchange Rate Measures



Source: Bank of Botswana, Econsult

Implications

What does all this mean? It is likely that keeping the current "strong Pula" policy will cause renewed problems for exports and employment if the rand weakens against the US dollar, which many commentators expect to happen in the medium-term. This would lead the Pula to appreciate against the rand, making life difficult for many firms.

There is a strong case to consider a reversion to the old policy of determining the Pula exchange rate basket weights on the basis on diversification and job creation objectives, not some other objectives (such as the interests of importers). This would require an increase in the rand weight in the basket, say to 60%, from the current 45%. And there may be a case to consider a modest downward crawl against the basket, rather than the current upward crawl.

Old-timers may well recall Margaret Thatcher's "strong pound" policy in the UK in 1980, when the pound strengthened to \$2.40 (it is currently \$1.30). This was one reason for the decimation of much of British manufacturing industry, and a sharp rise in unemployment in the early 1980s. From a more academic perspective, a leading development economist notes that "Avoiding significant overvaluation of the currency is one of the most robust imperatives that can be gleaned from the diverse experience with economic growth around the world, and one that appears to be strongly supported by cross-country statistical evidence undervaluation of the currency stimulates economic growth." (Dani Rodrik, Harvard University²).

This does not mean that a currency should be aggressively undervalued, as this can have other costs such as higher inflation. But overvaluation is something to be avoided if at all possible.

The exchange rate is clearly not the only issue that matters in driving export-led diversification – there are other critical factors that can make firms uncompetitive and the investment climate unattractive, with productivity levels being one of the most important. But it is counterproductive to provide struggling producers with added headwind from an overvalued exchange rate.

²Rodrik, D (2008) The Real Exchange Rate and Economic Growth, Brookings Papers on Economic Activity, Fall

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