

ECONOMIC REVIEW

fourth quarter october - december 2017

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COMMENTARY

Diamonds performing well but the impact of the BCL closure is still being felt – and challenges facing the new President

Economic Summary

As we reach the end of 2017 and move into 2018, the economy presents a mixed picture of good, bad and important gaps in the data. Economic growth slowed over the 12 months to the end of September 2017, to an annual rate of only 1.8%, still weighed down by the impact of the closure of the BCL copper-nickel mine in October 2016. We do expect, however, that the final growth figure for the whole of 2017 will be higher than this, in the range of 2-3%. Inflation has picked up slightly, to 3.2% in December 2017, but this is still low by historical standards and within the expected range. As a result, interest rates have been cut again, to their lowest ever level since the Pula was introduced in 1976.

Also on a positive note, government revenues appear to be coming in ahead of forecast. The final budget data for the 2016/17 financial year show a more or less balanced budget (in fact a small surplus, of 0.6% of GDP), in contrast to earlier expectations of a substantial deficit.

This is mainly due to better than expected performance of diamond exports and government revenues. Data for the first half of the 2017/18 fiscal year (April – September 2018) indicates that this trend has continued, with a broadly balanced budget rather than the projected deficit. All this is positive and reduces some of the pressure for

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cutbacks in government spending and alleviates some concerns about the depletion of government savings.

The main data gap relates to international trade, i.e. imports and exports. Due to technical problems concerning the collection and analysis of trade data by BURS and Statistics Botswana, no accurate trade data has been published since the beginning of 2017. This marks a major gap in knowledge regarding economic developments, given the importance of exports and imports to the economy. We understand that the problem is close to being resolved, but nevertheless the length of time it has taken should be of concern to policymakers and the government principals of both parastatals. Nevertheless, the increase in the official foreign exchange reserves in the year to October indicates that the balance of payments was in surplus during that period, even if we do not know how different components of the external account performed.

Statistics Botswana has helpfully improved the frequency and timeliness of publishing data on formal employment, which is now being produced quarterly and runs to June 2017. Sadly, however, the results are discouraging, with a continued decline in formal employment, mainly in the mining sector. Of course, this largely reflects the closure of BCL, but it is also a reflection that the rest of the economy is failing to pick up the slack even nine months after the closure. The same developments may also lie behind the relatively weak business confidence reading for the second half of 2017.

At the beginning of January 2018, the Pula exchange rate mechanism was adjusted slightly. The basket weights were unchanged (55% SDR, 45% SA rand), but the rate of crawl was changed from an upward crawl at an annual rate of 0.26% in 2017 to a downward annual crawl of 0.30% in 2018. The basic mechanism of the pegged exchange rate remains unchanged, and the rate of crawl remains close to zero, but the small adjustment is a move in the right direction given our concerns about the overvaluation of the Pula (see the Economic Review, 2017 Q2) and the negative impact this may have on the potential for export-led growth.

Outlook

As we move into 2018, economic prospects for the year remain mixed, reflecting both international economic uncertainty as well as domestic issues. Economic growth for the year should be reasonable given the likelihood of increased diamond production, as long as the international market remains stable. However, as is well known in Botswana, diamond mining creates relatively few jobs directly, and the challenge remains to support other economic activities, notably those producing exports of goods and services, which is the only sustainable source of long-term job creation. Rising international fuel prices will put upward pressure on inflation, but we do not expect this to be serious enough to require an increase in interest rates. Global economic growth is picking up, with the IMF forecasting growth of 3.9% in 2018 and 2019, the highest for several years, which will generally provide a positive environment for exports.

Two major developments will take place in the coming weeks and months. The 2018 Budget Speech will be delivered in the first week of February. The outline of the budget message has already been presented in the Budget Strategy Paper in September 2017, so there will be no great surprises. However, the relatively beneficial budget data will give the Minister of Finance and Economic Development some breathing space.

At the end of March, the ten year term of His Excellency President Seretse Khama Ian Khama will come to an end, and the current Vice President, His Honour Mokgweetsi Masisi is expected to assume the Presidency under the automatic succession provision of the Constitution. A smooth transition is expected, with the next national elections due in late 2019. We do not anticipate any immediate major policy changes, although a Cabinet reshuffle is likely. Nevertheless, the incoming President will face some economic challenges that he will have to get to grips with pretty quickly, certainly prior to the 2019 election. We identify three major issues that, in our view, should preoccupy the new President and his economic advisors from the beginning.

First, the need to put the economy back on a path of economic openness, recognising that integration into regional and global markets for goods, services, capital and labour is essential for the long-term health and prosperity of the Botswana economy. This recognises that creeping protectionism against imports of goods and services, barriers to inward foreign investment, and immigration restrictions on foreign investors and skilled workers are counter-productive, and indeed have contributed to the lack of dynamism and job creation in the domestic economy in recent years.

Given the magnitude of the unemployment problem, large-scale job creation can only come from the growth of regionally and globally oriented, competitive producers of goods and services for export. The alternative of inward looking policies focusing on the small domestic market and import substitution cannot hope to address the unemployment problem. And export-led growth obviously requires integration into global markets and economic openness.

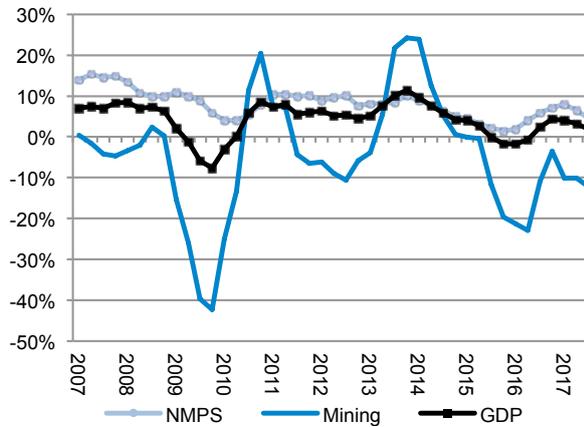
Second, we hope to see a more rational basis for policy-making, with policies based on evidence and analysis, rather than just being driven by political considerations. Policy decisions are often complex, with both predictable and unpredictable consequences. For policies to be effective, they need to be carefully considered, subject to analysis based on data, trialled through pilot programmes and refined accordingly. Policies need to be subject to regular evaluation using evidence to ascertain their impact; such evaluations should be published, and government should be accountable enough to accept and act on their results. If policies are not having the desired or anticipated impact, they should be

changed or wound up. Obviously government will always have to take into account both political and economic/technical considerations in making policy choices, but in our view, the balance needs to shift in the coming years, so as to improve the nature of policies being pursued.

Third, it will be essential to re-establish much better public finance discipline. This reflects a general problem in that the quality of public financial management has deteriorated over many years, with poor spending decisions and an increasing level of waste and inefficiency. However, the issue was brought home by the scandal over the diversion of monies from the National Petroleum Fund that blew up in December 2017. This resulted from a particular weakness in Botswana's public finances, which has been the tendency for a proliferation of "special funds" (there are now 33 in total). These funds are permitted under the Public Finance Management Act, but once the order establishing a fund has been approved by Parliament, they are then subject to relatively little scrutiny. Crucially, these funds are "off budget", in that they do not appear in the normal government budget documents that are presented for Parliamentary approval and are made available to the public. Inflows and outflows do not generally form part of recorded government revenues and spending. And in contrast to the detailed line-by-line reporting of authorised and actual expenditure for the government budget, virtually nothing is available regarding these special funds, where the funds come from and how they are used. Cleaning up these special funds and bringing them on-budget should form part of a more general reform and modernisation of public finance policies, laws and practices.

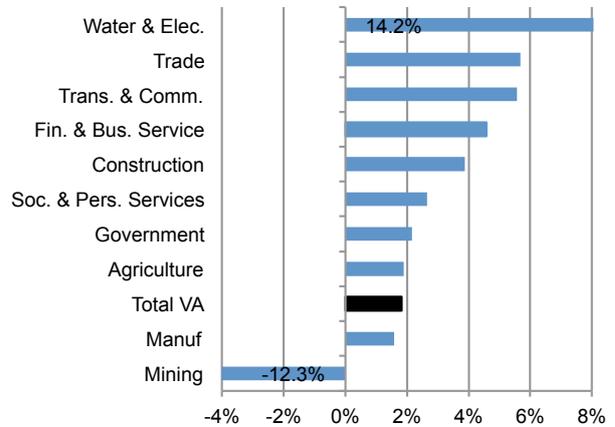
KEY ECONOMIC VARIABLES

Annual GDP Growth



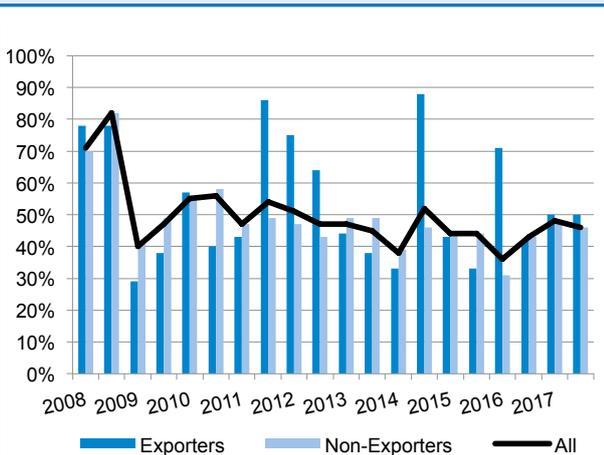
Annual real GDP growth fell further during the third quarter of 2017, recording year-on-year real growth of 1.8%, down from 3.1% in Q2 2017. The slowing of economic growth is attributable to the decline in both mining and non-mining private sector (NMPS) growth during the period. NMPS growth declined significantly from 6.5% y-o-y in Q2 2017 to 4.5% y-o-y in Q3. Mining has not improved and continues to record negative real growth, of minus 12.3% y-o-y in Q3 2017. This reflects the continued impact of the closure of BCL, whereby production of copper, nickel and cobalt ceased. Although diamond output increased, it has not been sufficient to offset the impact of the BCL closure on mining growth rates.

Sectoral GDP Growth



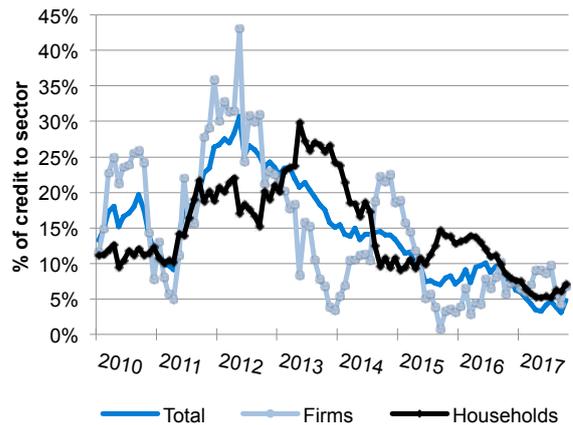
Overall economic activity was generally slow during Q3 2017 with several sectors recording lower growth rates than in the previous quarter. These include Mining, Transport & Communications, Agriculture, Trade, Construction, and Social & Personal Services. Manufacturing, Water & Electricity and Finance & Business Services were the only sectors with higher growth rates of 1.6%, 14.2% and 4.6% y-o-y in Q3 2017 from 1.4%, 13.9% and 4.0% y-o-y growth in Q2 2017 respectively. Trade, which fell significantly from 12.3% y-o-y growth in Q2 2017 to 5.7% in Q3 2017, was largely affected by the large fall in Wholesale subsector growth, from 48.1% in Q2 to 1.4% Q3.

Business Confidence



The Bank of Botswana's Business Expectations Survey (BES) for H2 2017 showed an overall decline in business confidence from 48% in H1 2017 to 46% in H2 2017. Business confidence decreased among domestic-oriented businesses to 46% in H1 from 48% in H2, while remaining the same for exporters at 50%. The survey revealed more optimism about business conditions in the first half of 2018, with expectations of improved domestic demand.

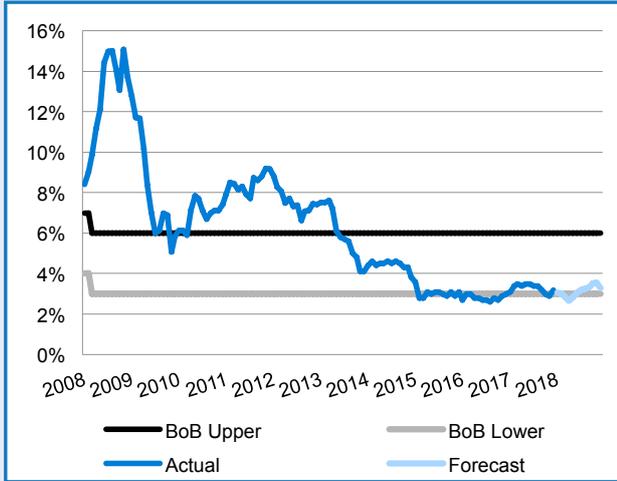
Annual Credit Growth



Annual bank credit growth increased marginally from 4.7% in July 2017 to 4.8% in October 2017. The increase is attributable to higher growth in lending to households, up from 5.1% in July 2017 to 7.1% in October 2017. However, the increase in household lending was partially offset by lower growth in bank credit to firms, from 9.8% to 6.8% during the period. The growth of bank credit to households was the result of the rise in the uptake of mortgage lending.

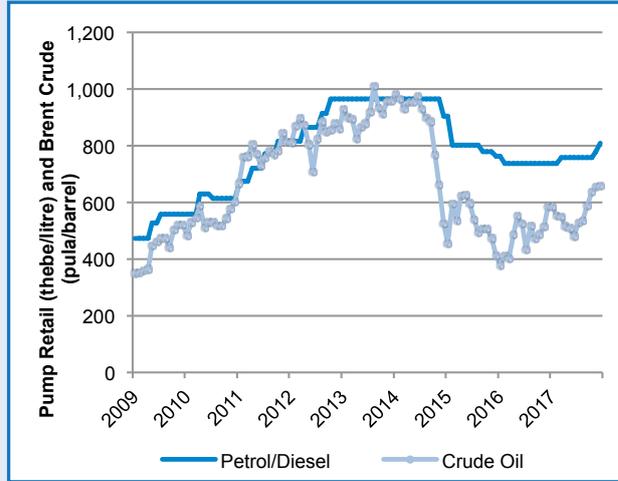
KEY ECONOMIC VARIABLES

Inflation and Forecast



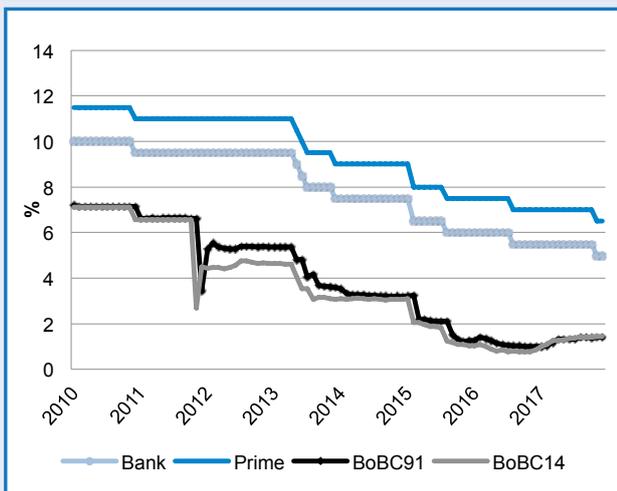
The annual inflation rate in December 2017 was 3.2%, the same as in September 2017 and 0.2% higher than inflation in December last year. Group indices were generally stable during Q4 2017 except for the Transport index group which registered an increase of 4.1% y-o-y as a result of changes in the Operation of Personal Transport following increased fuel prices. Core inflation (trimmed mean) was 2.9% in December, while the alternative measure of core inflation (excluding administered prices) was 2.3%. Inflation is forecast to fall below the the lower limit of the Bank of Botswana's inflation objective range of 3-6% in the first half of 2018 with small increases in the second half of the year.

Fuel Prices



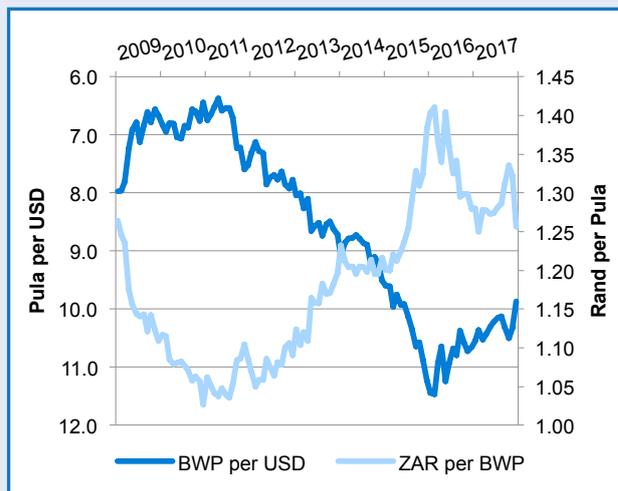
International fuel prices rose steadily during the second half of the year. The spot price of Brent crude increased by 21.4% and 12.5% in USD and Pula terms respectively in the 12 months to December 2017, with the increase in international prices partially offset by a weakening US dollar. Local retail prices for petrol and diesel were adjusted upwards three times during the year, in March, November and December 2017 by 20 thebe, 20 thebe and 30 thebe respectively, reflecting both higher international prices and increased domestic fuel levies. Retail fuel prices are regulated and reviewed every month by the Botswana Energy Regulatory Authority (BERA). Due to under-recovery relative to international prices, further increases in domestic prices are anticipated in the first half of 2018.

Interest Rates



The Bank of Botswana's Monetary Policy Committee (MPC) reduced the Bank Rate by 50 points basis in October 2017, to 5.0%, due to a positive price stability and low inflation outlook. As a result, the banks' Prime Rate was reduced from 7.0% to 6.5% in Q4 2017. However, money market interest rates continued to increase, with the 14-day BoBC rate rising from 1.42% in Q3 2017 to 1.45% in Q4 2017 and the 91-day BoBC rate rising from 1.40% to 1.41% over the same period.

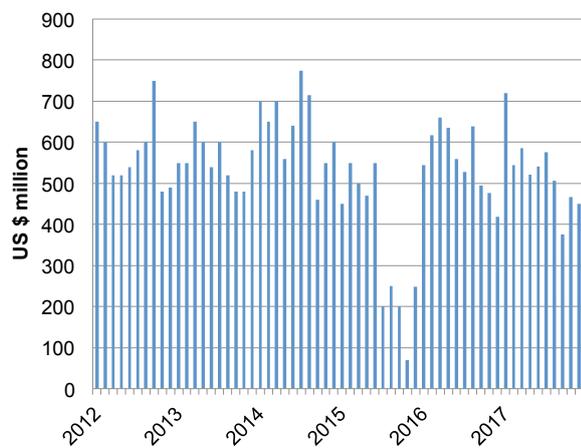
Exchange Rates



The Pula depreciated against the SA rand in the fourth quarter of 2017 as the rand strengthened in the light of change in the ruling party's leadership. The Pula weakened by 4.2% against the rand, closing the year with an exchange rate of ZAR1.256 from ZAR1.312 in Q3. On the other hand, the Pula-US Dollar exchange rate was 9.87 in December 2017 compared to 10.31 in September 2017, reflecting an appreciation of 4.4%. The Pula exchange rate policy was reviewed in December 2017, and the rate of crawl against the basket adjusted downwards to 0.30%, from and upward crawl of 0.26% in 2017. The Pula basket of weights was maintained at 45% for the South African Rand and 55% for the Special Drawing Right (SDR).

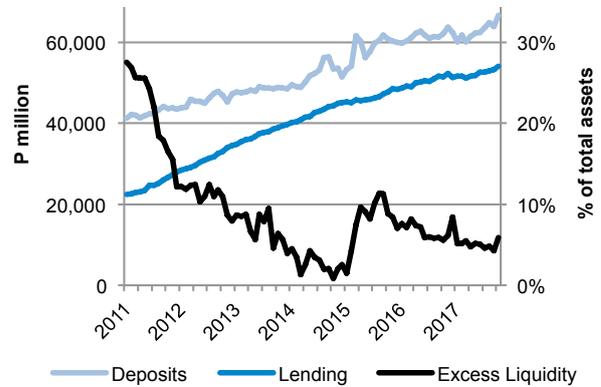
KEY ECONOMIC VARIABLES

De Beers Diamond Sales



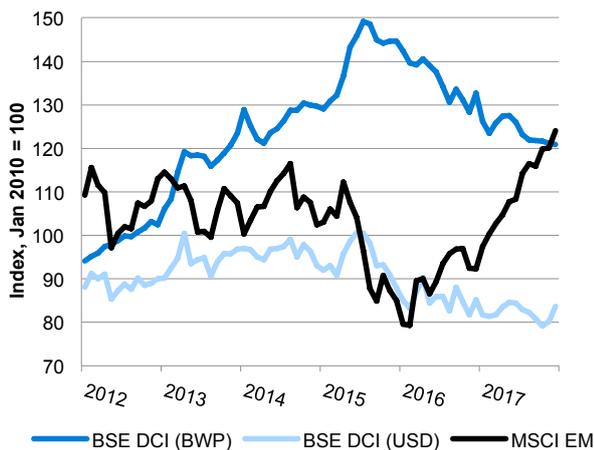
De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1,292 million from the three sights held in Q4 2017, 6.9% lower than the value of sales the same period last year. Moreover, De Beers recorded USD5,289 million in total sales of rough diamonds during 2017, which is 5.1% lower than USD5,573 million total sales in 2016. Global demand for rough diamonds was generally stable during the quarter going into the holiday season.

Bank Deposits & Excess Liquidity



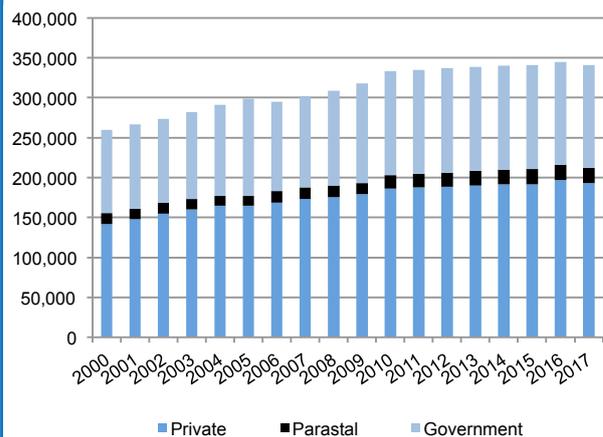
Bank liquidity further improved in October 2017 as a result of growth in the bank deposit base. Excess liquidity was 5.9% of total assets in October, up from 4.6% in July 2017. Total bank deposits grew by 5.7% y-o-y to P66.7 billion from P63.5 billion in July 2017. Bank deposits increased for high earning deposit accounts.

Stock Markets



The Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) performed poorly over 2017, losing 8.9% and 1.7% in Pula and USD terms respectively. On the other hand, both the MSCI World and MSCI Emerging Markets (EM) outperformed the DCI during the year: MSCI World and MSCI EM rose substantially, by 20.1% and 34.3% respectively, in USD terms. The BSE DCI performance was mostly weighed down by underperformance of local retailers.

Formal Sector Employment



Data on formal employment for June 2017 showed an overall decrease in the number of formally employed persons in Botswana. Between June 2016 and June 2017, the total number of jobs lost was 1,724 across all sectors resulting in a negative growth of 0.5%. This is attributable to 2,810 jobs lost in the private sector as a result of 34.3%, 0.1% and 0.7% negative growth in Mining & Quarrying, Manufacturing and Construction respectively during the same period. Government and parastatals had growth 0.8% and 0.5% (983 and 103 new jobs respectively) of new jobs created between June 2016 and June 2017.

NEWS HIGHLIGHTS

6th October	BDC borrows P131 million to finance new projects. (Mmegi)	The Botswana Development Corporation (BDC) has secured P131 million in funding from the issuance of bonds on the local bourse. The funds acquired will be used to finance new projects and a loan refinancing facility. The targeted projects are in manufacturing, infrastructure development, solar power plant and agriculture. The BDC loan requirements are in line with their strategy to assist in economic diversification.
8th October	Government adjusts minimum wage rates. (Daily News)	The Botswana government has adjusted the minimum wage rates for 2017/2018 by 6% across the board and P80.00 for the agricultural sector, effective from 1 November 2017.
11th October	Shumba Energy receives first revenues from its coal trading division. (Mining Review Africa)	Shumba Energy has announced the first sales revenue from its trading division, Shumba Coal Trading (SCT). The miner has sold over 1,000 tonnes of coal to the regional market. SCT was established in 2015 to manage the company's trade of coal, and also other Botswana coal producers.
17th October	Bank Gaborone's recovery firms as profits double. (Mmegi)	Bank Gaborone's financial results for the year ended 30 June 2017 showed an impressive performance during the financial year, recording 97.6% increase in profit after tax to P35.6 million in 2016/17 FY from P18.0 million in 2015/16 FY. Net interest income grew by 36.9% to P183.3 million during the same period. The bank's impairment charges were 62% higher than in the previous year. During the 2016/17 FY, the bank exercised caution in providing credit facilities and benefitted from a stronger capital adequacy ratio.
17th October	Waste mining revives Letlhakane mine. (Mmegi)	Debswana Diamond Company's Letlhakane Diamond Mine is set to reopen after transitioning to a tailings plant that will re-treat the accumulated waste materials at the mine. The tailings plant was built in 2014 following the end of the mine's lifespan, at an estimated cost of P2.1 billion. It is expected that the plant will treat about 3.6 million tonnes per year of waste material with an estimated annual production of 800,000 carats.
23rd October	Diamond fund donates USD130,000 to Botswana program. (Rapaport News)	The Diamond Empowerment Fund (DEF) has awarded the Botswana Top Achievers program with USD130,000, for outstanding scholars. It is envisioned that the grant will assist in funding outstanding scholars with higher education. The Botswana Top achievers program is run by the Ministry of Tertiary Education, Research, Science and Technology (MoTERST) and the DEF has been supporting the program since 2011.
24th October	BoB cuts interest rates to record low. (Mmegi)	Bank of Botswana's Monetary Policy Committee (MPC) has reduced the Bank Rate by 50 points basis to 5%, due to a positive outlook for growth and inflation in the medium term. As a result, the banks' prime lending rate was reduced from 7% to 6.5%, thus, reducing interest costs for borrowers.
25th October	De Beers Sees Sales Volume Rise. (Rapaport News)	De Beers' sales volume and production increased in the third quarter of 2017 as the market for rough diamonds stabilized. According to the company, demand for lower-value goods returned to normal in 2017 when compared to 2016. De Beers production increased across its mines with output increasing by 33% to 6.1 million carats from 4.1 million carats at Debswana mines and 46% to 9.2 million carats at its Gacho Kue mine in Canada. De Beers expects production for 2018 to be 33 million carats of rough diamonds.
6th November	National Petroleum Fund is running dry. (Sunday Standard)	According to the Botswana Energy Regulatory Authority (BERA), the National Petroleum Fund - from which the government pays petroleum retailers the difference between the administered and prevailing fuel prices - had come under pressure from rising crude oil prices. The spot price of Brent crude rose by 26.5% in November 2017, from USD47.95 in November 2016 to USD63.53. As a result of the rise in international fuel prices, local retail prices were adjusted upwards by 20 thebe for all grades. The NPF is funded by the fuel levy and is also used to finance construction of government fuel storage facilities, procurement of strategic stocks for the economy, financing insurance premiums as well as providing for price stabilisation.

NEWS HIGHLIGHTS

11th November	World Bank injects P1.5 billion into water projects. (Weekend Post)	The Ministry of Land Management, Water and Sanitation Services announced a P1.5 billion loan facility from the World Bank Group to finance various water projects around the country. The Ministry launched the Botswana Emergency Water Security and Efficiency (BEWSE) project to address the increasing water demand in the country. The BEWSE projects will be divided into three components; improving water supply services, improving wastewater and sludge management systems and strengthening Water Sector Reforms and Institutions.
13th November	Three foreign contractors snatch BPC's P2.4 billion power grid project. (Sunday Standard)	The Botswana Power Corporation (BPC) plans to commission the construction of the North West Transmission grid connection project in 2018. The project, which is expected to be completed in 2020, will be undertaken in two phases at an estimated total cost of P2.1 billion. The first phase of the project entails the construction of a 400,000V backbone transmission line from Morupule B to Maun, 400 Kv substations and a 132 Kv line and substations connecting Maun to Shakawe and Ghanzi. In turn, the second phase will extend the 400 Kv grid from Phokoje. Once complete, the project is envisioned to support large projects in the Ngamiland area.
13th November	SONA: Economic outlook. (Weekend Post)	The State of the Nation Address (SONA) has forecast the economy will grow by 4.7% in 2017 and 5.3% in 2018, higher than the 4.3% growth recorded in 2016. The forecasted growth is expected to be supported by high growth in Mining, Trade, Hotels & Restaurants, Transport & Communication and Water & Electricity sectors. The continued improvement in the global demand for diamonds is expected to bolster growth in mining as production increases. Moreover, the restoration of Morupule A and the additional unit at Morupule B power stations will improve the electricity supply in the country.
20th November	Environmental rehabilitation liability of BCL deters buyers. (Business Live)	BCL's environmental rehabilitation liability has made the sale of the mine and the smelter difficult to parties who had expressed interest in acquiring the mine and/or its assets. The environmental liability of the miner is estimated to be more than P3 billion. According to the liquidator's report, the liability accumulated over the years and was made worse by drawing down on the rehabilitation fund, used to finance operating costs. The BCL mine was placed under final liquidation in June 2017.
29th November	BoB introduces new P10 bank note. (Daily News)	The Bank of Botswana has introduced a new P10 bank note, which will start to circulate in February 2018. The new bank note has new security features and improved quality for longer duration compared to the outgoing bank note. When held up against the light, consumers should be able to see a rampant zebra, figure 10 in the shield besides the zebra and a shiny golden diamond in the middle of the note. Other features are also visible under the ultra-violet light.
30th November	Karowe to produce up to 290,000 carat in 2018. (Engineering News)	Lucara Diamond's Karowe mine expects to process between 2.4 million and 2.7 million tonnes of ore and produce between 270,000 carat and 290,000 carat of diamonds in 2018. According to the company, production at the mine has improved with the engagement of the new contractor, and mined ore increased from 1.4 million tonnes to 1.6 million tonnes of ore in 2017. In line with mining production, Lucara expects to generate sales revenue between USD170 million and USD200 million in 2018. The company will further advance its exploration work on its prospecting licences.
3rd December	Orapa Diamond Mine expansion slated for 2030. (Sunday Standard)	The Orapa Diamond Mine's expansion project, Cut 2, is said to be at a pre-feasibility study stage, and it is hoped to be complete by 2030. The scope of Cut 2 include the expansion of the mine's open pit which will require relocating some buildings, services and waste stockpiles, as well as the construction of social infrastructure and other services in the township.

NEWS HIGHLIGHTS

8th December	Botswana cancels USD30 tourist levy. (Southern Times)	The Government has withdrawn plans to introduce a Tourism Development Levy that was intended to raise funds for the industry. The decision to withdraw was to allow the Ministry of Environment, Natural Resources and Conservation and the Botswana Tourism Organisation (BTO) time to engage with the various stakeholders in the industry.
10th December	Fuel prices up. (Daily News)	The Botswana Energy Regulatory Authority (BERA) announced an increase in retail pump prices for petrol, diesel and illuminating paraffin. Local fuel prices increased by 30 thebe for all types of fuel effective from 5th December 2017. The increase in local prices for fuel is the third in 2017 as the international prices for oil continue to increase.
11th December	BHC to deliver 3,300 houses every year. (The Patriot)	The Botswana Housing Corporation (BHC)'s 2018-2023 strategic focus intends to deliver on the corporation's mandate on social housing aspect. During the strategy period, the BHC plans to deliver 1,500 social housing units and 1,800 commercial housing units, making a total of 3,300 housing units annually.
11th December	The money trail. (Mmegi)	The former Managing Director of Kgori Capital is being investigated in a case involving suspicious transactions of funds from the National Petroleum Fund (NPF). The P250 million funds was availed to the Directorate of Intelligence and Security (DIS) and managed by Khulaco Pty Ltd, for use in the construction of petroleum storage facilities, but was diverted to purchase anti-poaching equipment. The NPF was established to cushion against fluctuating international fuel prices and to finance the construction of fuel storage facilities.
14th December	Moody's affirms the "A2" stable outlook sovereign credit rating for Botswana. (Bank of Botswana)	Moody's Investor Service has affirmed Botswana's sovereign credit rating of A2 for long and short term bonds denominated in both domestic and foreign currency. Moody's also gave Botswana a stable outlook based on prospects for continued fiscal prudence and the achievement of a balanced budget in the medium term. The agency states that the country has a strong fiscal position, low debt burden, sizeable sovereign wealth fund, strong institutions, well designed macroeconomic frameworks and a stable political environment.
18th December	Moody cautions Botswana against slow structural reforms. (Sunday Standard)	Moody's Investment Service has warned Botswana against the slow progress in the implementation of structural reforms as well as limited economic diversification indicating that it would undermine the country's fiscal position. According to the agency, substantial depletion of fiscal reserves and/or a rapid increase in public debt in the near term could lead to a downgrade. However, this can be offset by accelerating diamond beneficiation, economic diversification and implementing efficiency-enhancing public and private sector reforms.
22nd December	BPOPF terminates Kgori Capital contract. (Botswana Public Officers Pension Fund)	Botswana Public Officers Pension Fund (BPOPF) has terminated all of its asset management contracts with the investment management firm Kgori Capital. The decision comes after consideration of the involvement of the then Managing Director of Kgori Capital in a money laundering scandal involving funds from the National Petroleum Fund (NPF).

MACRO-ECONOMIC DATA

Key Economic Data										
	unit	2012	2013	2014	2015	2016	2017Q1	2017Q2	2017Q3	2017Q4
Annual Economic Growth										
GDP	%	4.5	11.3	4.1	-1.7	4.3	3.9	3.1	1.8	..
Mining	%	-5.8	24.2	0.5	-19.6	-3.7	-10.3	-10.1	-12.3	..
Non-mining private sector	%	7.7	10.1	4.9	1.4	7.2	7.9	6.5	4.5	..
GDP current prices	P mn	109,870	125,158	145,868	146,066	170,589	43,857	43,148	43,068	..
GDP 2006 prices	P mn	75,515	84,081	87,569	86,083	89,797	22,467	22,884	22,689	..
Money & Prices										
Inflation	%	7.4	4.1	3.8	3.1	3.0	3.5	3.5	3.2	3.2
Prime lending rate	%	11.0	9.0	9.0	7.5	7.0	7.0	7.0	7.0	6.5
BoBC 14-day	%	4.64	3.06	3.07	0.97	0.84	1.26	1.34	1.42	1.45
Trade & Balance of Payments										
Exports - total goods	P mn	45,915	66,404	76,261	63,484	80,336	17,214	14,821	..	..
Exports - diamonds	P mn	36,143	55,367	65,328	52,730	70,781	16,084	13,709	..	..
Balance of payments	P mn	-862	1,340	11,404	-57	2,843	-3,386	619	..	..
Foreign Exchange										
Exchange rate BWP per USD	end	7.776	8.718	9.515	11.236	10.650	10.526	10.215	10.309	9.872
Exchange rate ZAR per BWP	end	1.090	1.196	1.217	1.383	1.279	1.278	1.274	1.312	1.256
FX reserves	\$ mn	7,628	7,726	8,323	7,546	7,189	7,041	7,288	7,454	..
FX reserves	P mn	59,317	67,772	79,111	84,881	76,804	73,957	74,734	76,763	..
Financial Sector										
Deposits in banks	P mn	47,216	48,512	51,492	59,961	62,438	60,120	62,380	63,842	..
Bank credit	P mn	34,555	39,763	45,116	48,307	51,316	51,141	52,555	53,290	..
BSE index		7,510.2	9,053.4	9,501.6	10,602.3	9,727.7	9,225.2	9,244.2	8,930.4	8,860.1
Business Indicators										
Diamond production (a)	'000 cts	20,619	23,134	24,658	20,732	20,880	8,553	5,992	6,117	5,568
Copper production (c)	tonnes	57,916	49,448	46,721	23,050	16,878	0	0	0	0
Nickel production	tonnes	17,942	22,848	14,958	16,789	13,120	0	0	0	0
Business confidence index		47%	45%	52%	44%	43%	48%	..	46%	..
No. of companies formed		16,561	14,190	16,300	19,134	17,133	4,604	5,661	..	..
Electricity consumption	GWh	3,703	3,502	3,990	3,974	3,929	888	899	1,018	..
Crude oil (Brent)	\$/bar	110.80	109.95	55.27	36.61	54.96	52.20	47.08	57.02	58.02
Employment (formal)										
Government		131,033	130,175	129,918	130,220	129,216	129,078	128,520		
Parastatals		17,484	18,838	18,790	19,411	19,008	19,314	19,579		
Private sector		188,531	189,894	191,399	191,484	194,202	193,582	192,937		
Total		337,048	338,907	340,107	341,115	342,426	341,974	341,036		
Govt Budget										
		2013/14	2014/15	2015/16	2016/17 Outturn	2017/18 Revised	2018/19 Proposed			
Revenues	P mn	48,951	55,904	47,420	56,828	57,187	58,811			
Spending	P mn	41,730	50,564	54,411	57,364	62,425	66,873			
Balance	P mn	7,222	5,340	-6,991	-536	-5,238	-8,062			
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	147,920	149,111	174,836	186,363	201,543			
Revenues	%GDP	37.3%	37.8%	31.8%	32.5%	30.7%	29.2%			
Spending	%GDP	31.8%	34.2%	36.5%	32.8%	33.5%	33.2%			
Balance	%GDP	5.5%	3.6%	-4.7%	-0.3%	-2.8%	-4.0%			
Public debt & guarantees	%GDP	23.5%	22.6%	22.8%	19.9%	18.7%	..			
Govt deposits at BoB	%GDP	24.2%	28.2%	22.7%	17.1%	..	..	

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

Notes:

- (a) 2013 figures include production from Boteti Diamonds (Karowe mine) and Debswana
 (b) 2016 figures include production from Gem Diamonds (Ghagoo) and Lerala mines as well as Boteti and Debswana
 (c) Copper and Nickel production for Q3 2016 are for July and August only
 (d) Numbers in Italics reflect revisions from the previous review

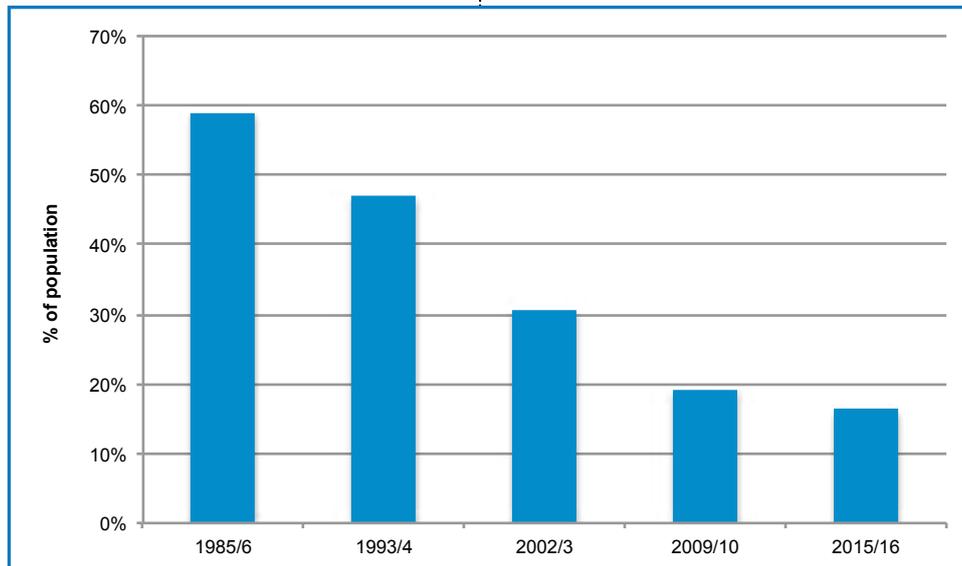
SPECIAL FEATURES

2015/16 Poverty Statistics

Introduction

Statistics Botswana released poverty statistics from the 2015/16 Botswana Multi-topic Household Survey (BMHTS) in January 2018. As expected, the results showed a welcome decline in the poverty headcount rate, from 19.3% at the time of the previous survey in 2009/10, to 16.3% in 2015/16. This marks a continuation of a long-term trend in Botswana of poverty steadily declining as economic growth and policy interventions have led to rising incomes.

Figure 1: National Headcount Poverty Rates, 1985 – 2015



Source: Statistics Botswana, Poverty Stats Brief

The poverty headcount rate measures the proportion of the population living in households with consumption levels below the relevant poverty datum line (PDL). As poor households tend to be larger than the average, the proportion of households that are poor is less than the headcount rate, at 9.0% nationally.

Key results

As noted above, the decline in the national poverty headcount rate is both welcome and expected. However, digging deeper into the results, there are some less encouraging findings as well as some surprising ones.

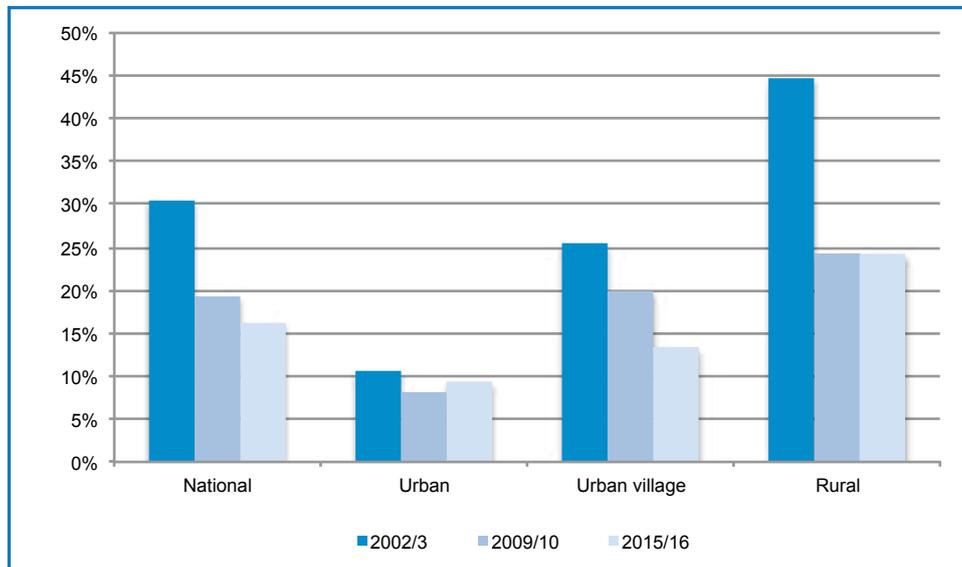
The pace of poverty reduction is falling. Between 2002/3 and 2009/10, the poverty rate fell from 31% to 19% - a dramatic reduction over 7 years. This meant that every year during this period, on average, 6.4% of households who were poor at the start of the year moved out of poverty during the year. However, the much smaller decline in poverty (to 16.3%) in the six years between 2009/10 and 2015/16 meant that over this period, only 2.8% of

households who were poor at the start of the year moved out of poverty during the year. Hence the rate of poverty reduction (by this measure) has fallen by more than half in the more recent period.

The geographical incidence of poverty is changing. A second striking change is where the decline in poverty is being felt. Between 2002/3 and 2009/10, the reduction in poverty was felt in all settlement types - urban areas, urban villages and rural areas - with the latter experiencing the largest decline. But between 2009/10 and 2015/16, the pattern was quite different, with poverty increasing marginally in urban areas, unchanged in rural areas, and declining only in urban villages. On the positive side, this benefits the largest settlement group, as more Botswana live in urban villages than in either cities/towns or in rural areas. But it does raise questions about why both urban and rural areas have not experienced a continued decline in poverty. Much of it may be to do with the dynamics of population migration, which requires detailed demographic analysis.

SPECIAL FEATURES

Figure 2: Headcount poverty by settlement type



Source: Statistics Botswana

Inequality is increasing. Many people will not be surprised by the conclusion of the BHMTS that inequality is increasing. The Gini coefficient for consumption – a commonly-used measure of inequality – increased between 2009/10 and 2015/16. This is a troubling, if not an unexpected finding, given that Botswana has one of the highest levels of inequality in the world. However, there is some uncertainty about the accuracy of the data presented; when the World Bank calculated the Gini coefficient from the 2009/10 survey data, they got quite different results to Statistics Botswana. It seems that this discrepancy remains unresolved.

Major changes in spending patterns. The BHMTS data indicates large changes in spending patterns compared to 2009/10. In particular, there are significant increases in the proportion of expenditure devoted to transport, housing, education, and communications, all of which would be expected as incomes rise. There are decreases in the proportion of expenditure devoted to food, household goods & services, clothing & footwear, alcohol & tobacco, and recreation & culture, some of which would be expected, but others are surprising. These results require further analysis, particularly with regard to the patterns of expenditure by households in different income groups.

Fall in household consumption levels in real terms. Average (mean) household consumption spending rose by 29% from P3046 per month in 2009/10 to P3927 per month. Although this is a significant increase, it is not so impressive once inflation of 40% over the period is taken into account. Therefore, average real consumption level per household fell by 8.1% over the seven year period, indicating a general squeeze on living standards. Again, this is something that needs further analysis to determine which parts of the income distribution spectrum have been most affected by this.

Slowdown in employment creation. Why has the decline in poverty slowed? It seems likely that it is closely related to the rate of employment creation, given that wages & salaries are the main source of household income. Between 2002/3 and 2009/10, when poverty fell rapidly, around 6600 new formal sector jobs were created each year, an annual growth

of 2.2%. But between 2009/10 and 2015/16 the rate of formal job creation fell to 2000 jobs a year, reflecting an annual growth of 0.6%. This illustrates the crucial role that employment creation plays in bringing poverty down, and the urgent need to address the barriers to business activity.

Need for welfare reform. Although job creation is paramount in bringing poverty down in the long-term, an important role is also played by social safety net welfare measures that provide support to vulnerable and low-income households. The BHMTS data indicate that poverty would be 8 percentage points higher, at 24.3%, without existing government welfare programmes. However, it is widely acknowledged (e.g. by the World Bank, various UN agencies, some government departments as well as Econsult) that Botswana's social safety net (SSN) is not very efficient, and does not target support for poor households very effectively. This is in part because it is out-dated and comprised of piecemeal programmes that are not integrated with each other. A thorough overhaul of SSNs is long overdue, to reduce waste and ensure that welfare spending is more effective in bringing poverty down further.

Conclusions

So what does this all mean? There are some conflicting results. Poverty has fallen, Average real consumption expenditure has fallen, indicating declining living standards for households in general, but at the same time poverty has fallen, and inequality has risen. This suggests that those at the upper end and the lower end of the income distribution spectrum have done better than the average. This in turn suggests that the squeeze on living standards has mostly been felt by those in the middle of the income distribution spectrum, who make up the bulk of the population. Further analysis of income and consumption patterns across the income distribution spectrum will help to determine exactly where the squeeze is being felt. More work is also needed to reconcile household spending data from the BHMTS and the national accounts (GDP data). The latter show much higher levels of average household consumption, as well as rising, rather than declining, real consumption levels.

SPECIAL FEATURES

The Evolution of Botswana's Parastatals – Part 2

In the last issue of the Economic Review we wrote about Botswana's parastatal sector and its evolution over past years. One of the key messages was that the number of parastatals has grown rapidly, despite a supposed commitment to privatisation. A second message was that there is a huge variation in the transparency surrounding parastatal governance and operations. Some parastatals reach high standards with regard to disclosure, while others fall well short of minimum acceptable standards with regard to publication of audited financial statements and annual reports. Amongst the best performers regarding transparency and efficiency were BoB, BHC, BTCL and the BSE, while the worst performers were BMC, ODC, CEDA, PEEPA, SPEDU and MCM (see Table 1 for acronyms).

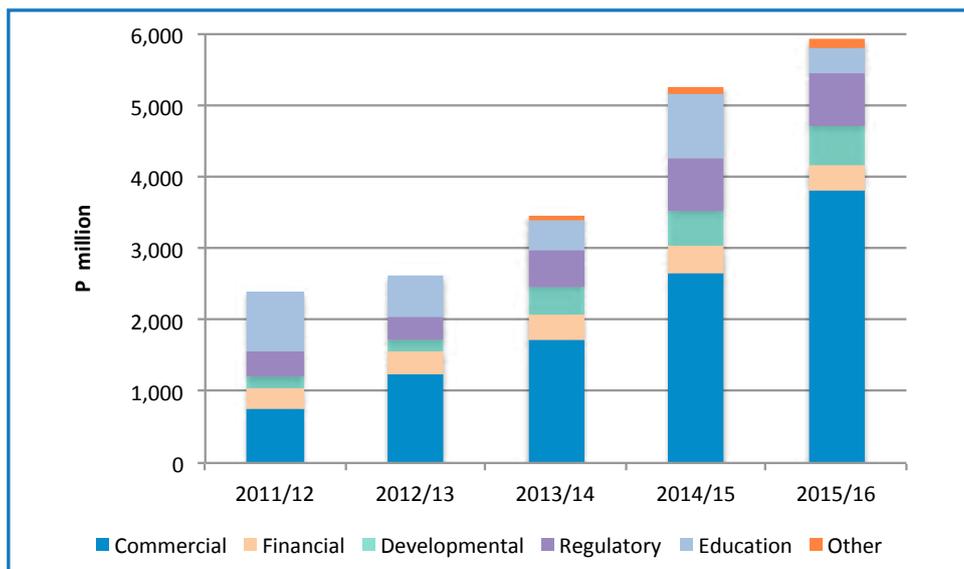
We continue this discussion by looking at the financial performance of parastatals. This involves several elements. First, we review the dependence of parastatals on government subsidies, i.e., how much parastatals are costing the taxpayer. Second, we consider financial efficiency, at least for those parastatals that are broadly commercial in their operations and which should be expected to generate a return on the capital that government has invested in them. For these parastatals, we consider profitability and return on assets.

A note of caution is in order, however; as we reported in our last issue, there is a great deal of inconsistency in the quality of reporting by parastatals and several do not make their annual reports or financial statements readily available, the main offenders being Botswana Railways, Air Botswana and CEDA. Hence, there are some gaps in the numbers, which we highlight where relevant.

Parastatal Subventions from Government

It is striking how fast the level of parastatal subventions from government has risen in recent years, from P2.4 billion in 2011/12 to P5.9 billion in 2015/16. There are two main reasons for this. First, the dramatic increase in subsidies to Botswana Power Corporation (BPC), from P508 million in 2011/12 to P2.3 billion in 2015/16. BPC received a total of P7.5 billion in subsidies over the five-year period. Second, the steady increase in the number of parastatals, notably developmental and regulatory parastatals, most of which are dependent on subventions from government. These include the BEC, CAAB, BTO, BITC and BITRI.

Figure 1: Total subventions from government to parastatals



Source: Annual Reports, Government Budget documents

SPECIAL FEATURES

Over the five-year period, total subventions to parastatals were just under P20 billion. The major recipients were BPC (P7.5 bn), UB (P1.9 bn), CEDA (P1.6 bn), BAMB (P1.2 bn), BEC (P949 million), LEA (P750 mn), CAAB (P683 mn), BIUST (P677 mn), BMC (P623 mn) and WUC (P613 mn).

These figures just refer to operational subsidies, and do not include capital injections or subsidised loans (including these would make subsidies significantly higher). The also exclude BR and AB, which have failed to make financial statements publicly available.

Table 1: Subventions by parastatal, total, 2011/12 – 2015/16

Commercial Parastatal	
Air Botswana (AB)	n/a
Botswana Agric. Marketing Board (BAMB)	1,179,054
BCL Ltd	n/a
Botswana Couriers & Logistics (BC&L)	n/a
Botswana Fibre Networks (BoFINET)	135,010
Botswana Housing Corporation (BHC)	0
Botswana Meat Commission (BMC)	622,900
Botswana Oil (BOL)	0
Botswana Post (Bots Post)	102,853
Botswana Power Corporation (BPC)	7,515,160
Botswana Railways (BR)	n/a
Botswana Telecomms Limited (BTCL)	0
Botswana Vaccine Institute (BVI)	0
Morupule Coal Mine (MCM)	n/a
Minerals Development Company Botswana (MDCB)	88,101
Okavango Diamond Company (ODC)	n/a
Water Utilities Corporation (WUC)	612,956
TOTAL	10,256,034

Regulatory	
Botswana Accountancy Oversight Authority (BAOA)	24,966
Botswana Bureau of Standards (BOBS)	269,369
Botswana Communications Regulatory Auth. (BOCRA)	0
Botswana Examinations Council (BEC)	943,009
Botswana Institute of Chartered Accountants (BICA)	25,029
Botswana Qualification Authority (BQA)	123,232
Civil Aviation Auth. of Botswana (CAAB)	682,522
Companies and Intellectual Property Authority (CIPA)	28,187
Competition Authority (CA)	108,158
Copyright Society of Botswana (COSBOTS)	5,656
Gambling Authority (GA)	12,200
Public Enterprises Evaluation and Privatization Agency (PEEPA)	192,038
Public Procurement & Asset Disposal Board (PPDAB)	249,663
Non-Bank Financial Institutions Regulatory Authority (NBFIRA)	70,357
TOTAL	2,734,387

Total

19,933,502

Commercial Financial	
Botswana Savings Bank (BSB)	0
Botswana Development Corporation (BDC)	0
Citizen Entrepreneurial Development Agency (CEDA)	1,586,016
Motor Vehicle Accident Fund (MVAFF)	0
National Development Bank (NDB)	23,198
Botswana Stock Exchange (BSE)	42,304
TOTAL	1,651,518

Developmental	
Botswana Innovation Hub (BIH)	125,157
Botswana Tourism Organisation (BTO)	346,967
Botswana Nat. Productivity Centre (BNPC)	108,644
Botswana Nat. Sports Council (BNSC)	n/a
Botswana Inv. & Trade Centre (BITC)	322,670
Botswana Institute for Technology Research and Innovation (BITRI)	123,286
Human Resources Dev. Council (HRDC)	118,518
Local Enterprise Authority (LEA)	750,661
Selibe Phikwe Economic Diversification Unit (SPEDU)	32,259
TOTAL	1,928,161

Education	
Botswana University of Agriculture and Natural Resources (BUAN)	466,661
Botswana International University of Science and Technology (BIUST)	676,750
BOCODOL	n/a
Botswana Accountancy College	n/a
Univ. of Botswana (UB)	1,926,078
TOTAL	3,069,490

Other	
Bank Of Botswana (BOB)	0
Botswana Unified Revenue Service (BURS)	0
Legal Aid Botswana (LAB)	n/a
Statistics Botswana (StB)	293,913
TOTAL	293,913

Parastatal Profitability

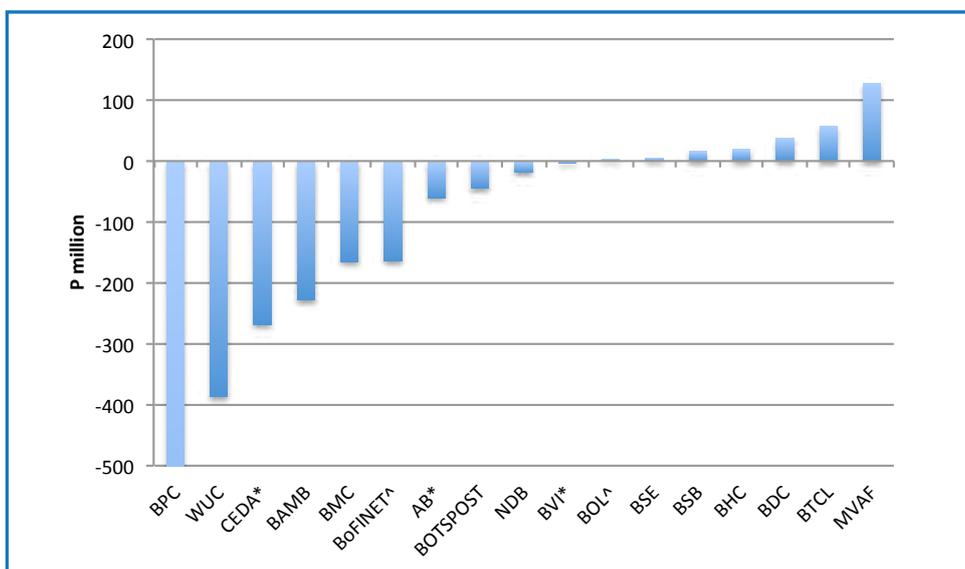
Some parastatals are set to operate as commercial entities, whereby they primarily derive income from the sale of goods or services. In many cases the Acts of Parliament establishing such parastatals require that they operate in a commercially sustainable manner and generate a reasonable return on capital. For instance, the BPC and WUC Acts require “that its revenues are sufficient to produce on the fair value of its assets a reasonable return measured by taking its net operating income as a percentage of the fair value of its fixed assets in operation plus an appropriate allowance for its working capital”. There are similar provisions for Air Botswana and Botswana Railways. BHC’s Act is slightly different, only requiring that “its revenue is sufficient for meeting all expenditure properly chargeable to revenue and sufficient provision is made for depreciation of assets”, but apart from this it does not have to make a profit. Indeed, BHC is one of the few parastatals to meet its statutory financial objectives.

Of the nineteen broadly commercial parastatals (including financial institutions), only seven have made a profit over the past five years. The major loss maker is BPC, followed by WUC, while the most profitable parastatal in terms of absolute values is the MVA Fund, followed by BTCL. (We do not include regulatory or developmental parastatals here, which cannot generally sell services to cover their costs, as they are providing public goods).

Most parastatals have therefore failed to meet their statutory financial objectives, or to operate in a commercially viable manner under the Companies Act. The widespread lossmaking means that for many parastatals, the shareholder – government – is breaking its own law.

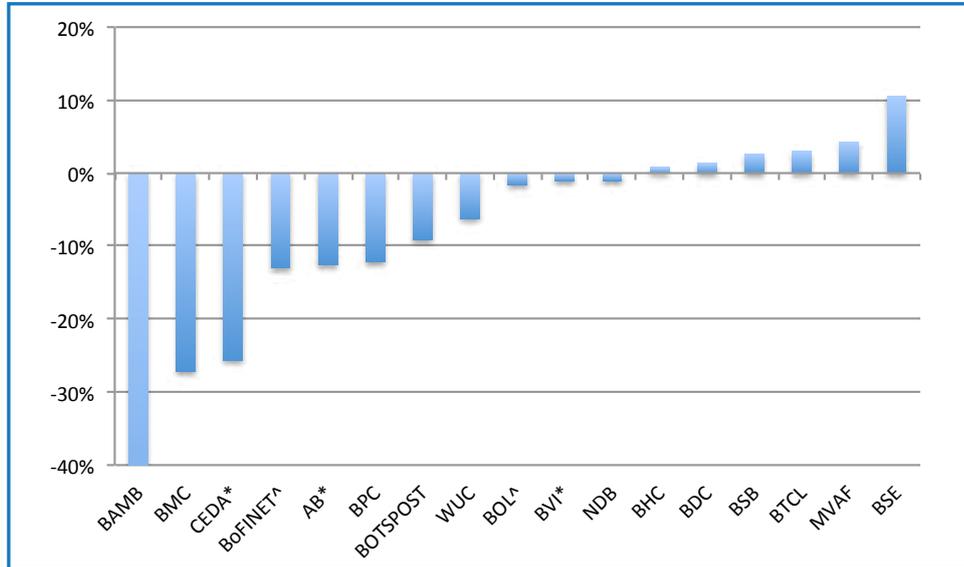
The absolute value of profits depends on the absolute size of an organisation as well as how efficiently it is run. Hence, another way to measure profitability is by return on assets, which adjusts profits for size. This gives a somewhat different ranking of parastatal performance. By this measure, the worst performing entity is BAMB with an average annual return on assets of minus 91%, followed by BMC at minus 27%. BPC is no longer the worst performer; although its losses are huge, so are its assets, so its RoA is “only” minus 12%. At the other extreme are the BSE (RoA of 11%) and the MVA Fund again (RoA 4%). However, it should be noted that even the profitable parastatals are not very profitable, with RoAs that are meagre by the standards of the private sector.

Figure 2: Average annual profits, 2011/12 – 2015/16 (P million)



Note: * indicates missing information for one or more years; ^ indicates new organisation. In both cases the figures are based on available data.
Source: Annual Reports

Figure 3: Average profitability (return on assets), 2011/12 – 2015/16 (%)



Conclusions

Why are Botswana’s “commercial” parastatals generally unprofitable? The reasons are a mixture of policy and mismanagement. BPC, for instance, has made major losses due to the incompetently handled Morupule B power station project (leading to high costs), as well as government’s refusal to allow it to raise electricity tariffs to realistic levels. WUC’s losses are due to the transfer of decrepit village water infrastructure to it from the Department of Water Affairs, as well as its inability to charge cost-recovery tariffs. Air Botswana has been hampered by management instability, compounded by excessive government interference in its operations. Others are highly politicised. With some parastatals, there are strong suspicions of corruption leading to losses, although unfortunately the law enforcement authorities have been unable to bring any successful prosecutions for this. Fortunately both BPC and WUC are under new management and are trying to address historical problems, although in other cases government seems to be resistant to making the required changes.

Commercial parastatals need not be loss-makers, indeed they should not be, on a sustained basis. They should be required to operate commercially and efficiently. Any subsidies to achieve broader socio-economic objectives should be clearly justified on a cost-benefit basis, and explicitly budgeted by the government (rather than paid as an emergency bail-out). It should also be recognised that many social objectives are best pursued by other means. For instance, keeping water and electricity tariffs generally “low” to help poor households largely benefits the rich, while also provides misleading incentives to both households and businesses (for instance by encouraging over-consumption and discouraging investment in more efficient ways producing or conserving these resources). Helping poor households can be more effectively done by direct welfare measures, or by keeping water and electricity tariffs low only for a restricted initial consumption amount, and then charging full-cost tariffs on the remainder.

This feature was prepared with the assistance of Sekgwa Mark Teleki.