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econsult

# ECONOMIC REVIEW

first quarter january-march 2018

## in this issue ...



## COMMENTARY

# Positive expectations for the economy under the new Presidency

The first quarter of 2018 has been marked by an upturn in business confidence, at least anecdotally, associated with the ascendancy to the Presidency by His Excellency Mokgweetsi Masisi on 1st April. Many in the private sector are anticipating the implementation of reforms that will improve the business climate and encourage investment and growth. We discuss some possible changes below.

Notwithstanding improved confidence, economic growth data for 2017 show a slowdown in GDP growth to 2.4% for the year. This was largely expected, and reflects the impact of the closure of the BCL copper-nickel mine in October 2016. To that extent, the slowdown is temporary, and we expect growth to recover to 4-5% in 2018. This will result from the BCL effect falling out of the GDP growth calculations during the year, an anticipated increase in diamond production, and the impact of fiscal expansion given the projected substantial growth in government spending in the 2018/19 financial year.

There are, however, some worrying signs in the economic data. Imports are reported to have fallen significantly, by 18.5%, in 2017. This would normally be indicative of an economy experiencing a major recession. However, we are concerned that the import data are unreliable, as we have pointed out in previous Reviews, and do not read too much into this (apart from the impact on the quality of the balance of payments statistics). Also worrying is the rise in arrears on bank lending, which has had an impact on bank profitability. The highest level of arrears is on bank lending to parastatals (state-owned enterprises), which reflects the poor state of financial and general management in many parastatals.

One interesting aspect of the 2017 GDP data is the result that, for the first time in almost four decades, mining is no longer the largest sector of the economy, having been surpassed by the trade, hotels and restaurants sector. This is a direct result of the significant contraction of mining in 2017, but is also a sign of the diversification of the economy.

On a positive note, inflation dropped to 2.8% in March 2018. However, we suspect that this will be short-lived, especially given the rise in international oil prices to the highest level in four years. Upward pressure on fuel prices will be exacerbated by the need to increase the fuel levy in order to restore the National Petroleum Fund.

In his Inaugural Address, H.E. President Masisi highlighted his determination to address the problem of unemployment, particularly youth unemployment. This, is indeed an important economic challenge, and dealing with it is fundamental to improving household incomes and living standards, and reducing poverty and inequality. There is no quick or easy answer to this, however; raising the rate of job creation sufficiently to reduce unemployment will be a long-term task.

Nevertheless, there are some changes that can, in principle, be made to get the process under way. Much could be achieved through the passage of an all-encompassing Business Environment Reform Act, as was done in Mauritius back in 2006. The crucial changes required in Botswana include reform of immigration regulations for foreign investors and workers, and visa regulations for tourists and other visitors; abolishing trade licences, except where there is a public health and safety justification; reducing the range of reserved economic activities (those that are closed to foreign investors); liberalising land and property ownership regulations; reform of zoning regulations to allow more mixed-use development; reducing the scope of environmental impact assessments (EIA) for developments in non-sensitive areas; legally establishing the "one government" principle (so that the public does not have to deal with multiple government departments on a single task); introducing legally binding time limits for the consideration of applications for permits or authorisations, failing which "silence is consent"; and introducing regulatory impact assessments, including a "bonfire" of existing regulations that are found to be unjustified, after review.

Such comprehensive "game-changing" reforms are necessary to achieve the Vision 2036 objective that Botswana will be a "destination of choice for investment", by "open[ing] up our economy and our country to the global world and to international expertise and know-how, and make[ing] foreign investors feel welcome". We are confident that private sector investment and job creation would respond well to such a reform package.

In pursuing the overriding objective of diversified, export-led growth, all policy initiatives should be viewed and assessed through the lens of whether they make Botswana more open and integrated into the regional and global economies, and whether they help the economy, and firms to become more (rather than less) competitive.

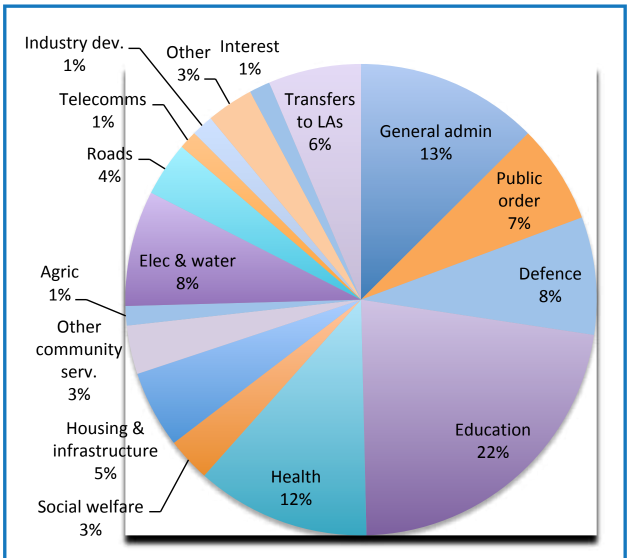
An example of how this should be applied relates to the proposed "tourism development levy", a USD30 tax to be levied on all non-SADC visitors to Botswana. It is obvious that this makes Botswana less attractive to tourists, business visitors and potential investors, and hence, is in conflict with the objectives of competitiveness and openness. Furthermore, it will establish a new, off-budget fund. Recent developments with the National Petroleum Fund have shown how such funds are subject to abuse and corruption, and do not have adequate levels of transparency, oversight and accountability. Hopefully, reason will prevail and the proposed levy will not see the light of day.

Overall, the first quarter of 2018 has seen a renewal of optimism in Botswana and more generally in Southern Africa. Four SADC countries – Botswana, South Africa, Zimbabwe and Angola – have had new presidents in recent months, and all show promise in improving the business environment, reducing corruption and introducing more rational policies that will be supportive of investment, job creation and growth.

## The 2018 Budget

The Budget for the 2018/19 Financial Year was presented in early February. Key features of the Budget were a large increase in spending (14%, or around 11% in real terms once inflation is taken into account), as well as a significant (12%) increase in projected revenues. A small budget deficit is projected, of P3.6 billion, or just under 2% of GDP. The pattern of expenditure is similar to that of previous years, with the largest shares going to education (22%), general administration (13%) and healthcare (12%). Much of the additional spending is going towards reducing infrastructure backlogs, improving maintenance, and raising the quality of public services. Hence, the largest increases go to roads (spending up 72%), public order (police, prisons, justice etc., up 21%) and education (up 19%).

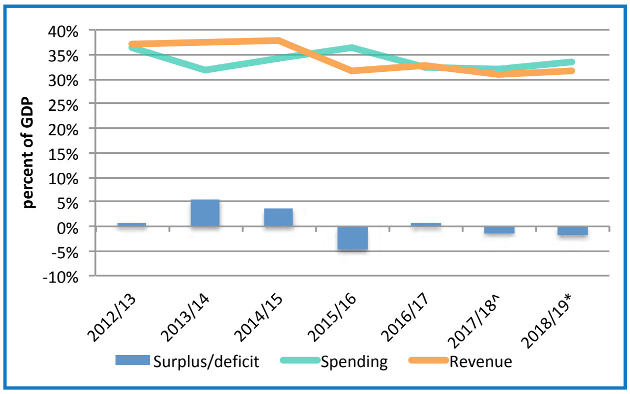
**Figure 1: Share of Budgeted Spending, 2018/19 (%)**




Source: calculations based on data from Ministry of Finance & Economic Development (MFED)

The upturn in spending represents a reversal of the trend of recent years, whereby government has tried to bring spending down to levels that are considered to be sustainable in the long-term, around 30% of GDP. Budgeted spending of P64.3 billion in 2018/19 amounts to 33.4% of GDP. Revenue is projected at 31.6% of GDP, due to a large increase – 51% - in anticipated mineral revenues to P24.6 billion, given the expected upturn in diamond exports.

**Figure 2: Revenue, spending and budget balance (% of GDP)**




Source: calculations based on data from MFED

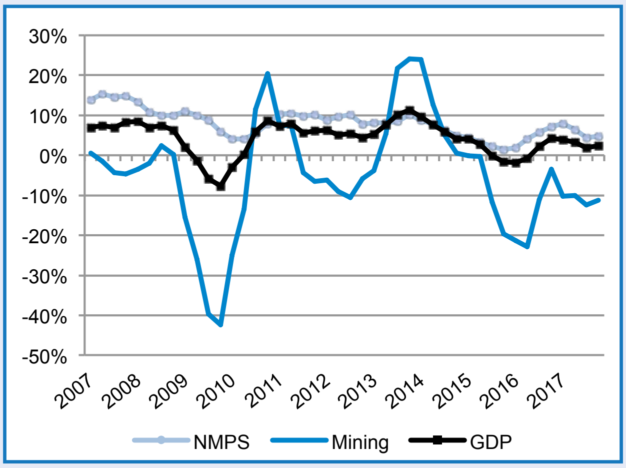
The budget deficit of P3.6 billion is projected to be financed largely by a drawdown of accumulated savings (P3.2 billion) combined with a small increase in internal borrowing (P0.9 billion of net new bond issuance), while external borrowing is set to fall slightly. It is not clear how this financing choice was arrived at - there is a shortage of government bonds in the market and demand for greater issuance. Our calculations suggest that it is cheaper for GoB to issue bonds than to use accumulated savings, so this financing mix should perhaps be revisited.

The budgeted increase in spending – if it can be realised in practice – will provide a boost to economic growth both directly and indirectly. Keeping the budget deficit at a manageable level with this increase in spending will of course be dependent upon achieving the projected increase in diamond revenues, for which there are reasonable prospects given the positive outlook for the industry.

One negative feature of the budget is the lack of transparency surrounding it. Apart from the budget speech itself, other budget documents are not readily available. There is no public access to soft copies of the detailed revenue and expenditure numbers, or of government accounts and audit reports, and hard copies only appear in the government bookshop after inordinately long delays, if at all. The MFED website, which is where budget documents should be posted, has not worked for the best part of a year. Hence, Botswana's very low score (8 out of 100) for transparency in the international Open Budget Index, 2017.

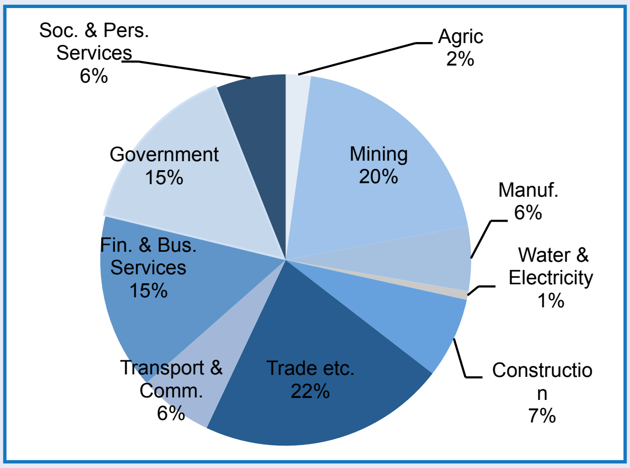
# KEY ECONOMIC VARIABLES

## Annual GDP Growth



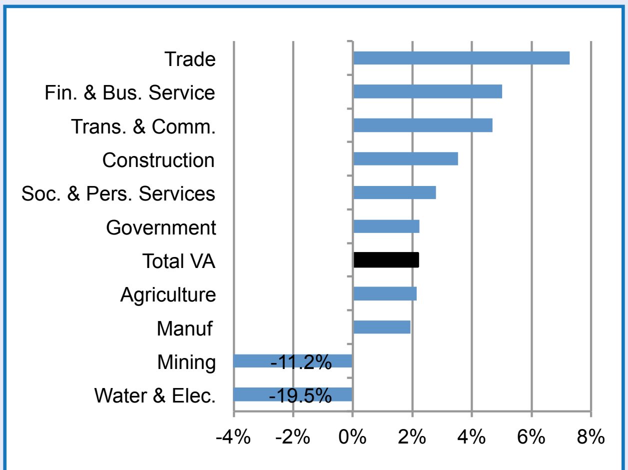

Annual GDP growth slowed in 2017 compared to 2016. Year-on-year real GDP growth declined to 2.4% in 2017 from 4.3% in 2016. Both mining and the non-mining private sector (NMPS) had slower growth during the twelve months to December 2017. Mining recorded y-o-y growth of minus 11.2%, significantly lower than minus 3.5% y-o-y growth in 2016. NMPS growth fell from 7.1% to 4.7% during the same period. The closure of the BCL mine in October 2016 continues to be felt, and was the main contributor to the contraction of the mining sector. Copper-nickel output fell by 99.4% y-o-y in 2017, from negative 21.2% growth in 2016.

## Sectoral Output Shares



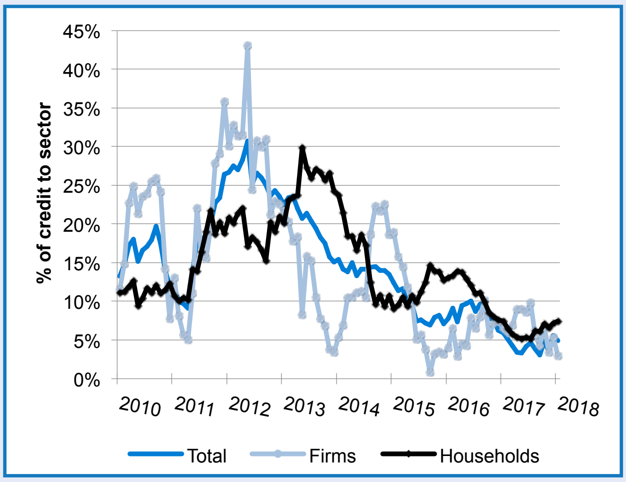

For the first time in four decades, Mining was not the largest sector of the economy in 2017. The Mining sector accounted for 20% of national output (value added), second after Trade with 22% of output (measured at current prices) in 2017. However, the structure of GDP in terms of the remaining economic sectors did not change in comparison to 2016. In contrast, when GDP is measured in constant prices, the shares of many economic sectors changes, with Mining coming fourth after Trade, Finance & Business Services and Government.

## Sectoral GDP Growth




Overall economic growth in 2017 was slow, with annual growth rates recorded in several sectors lower than in the previous year. These include Mining, Water & Electricity, Construction, Trade, Transport & Communications, Social & Personal Services and Government. Agriculture and Finance & Business Services are the only two sectors which recorded higher annual growth in 2017, of 2.1% and 4.6%, from 0.5% and 3.3% in 2016. The Agriculture sector had good rains during the 2016/17 ploughing season, which contributed positively to Crops and Other subsectors; these grew by 2.5% and 2.7% y-o-y in 2017 respectively.

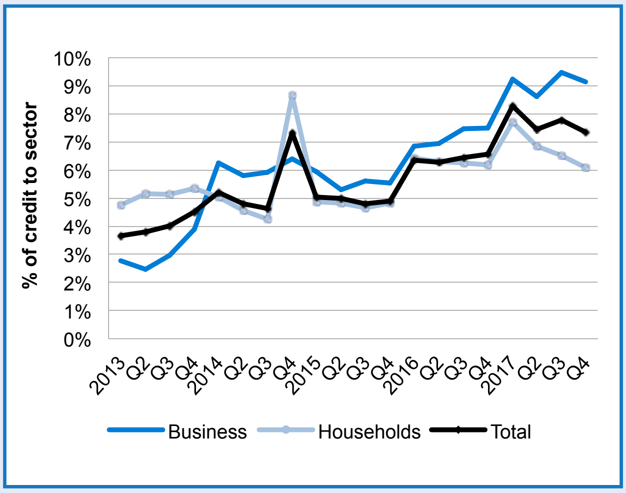
## Annual Credit Growth




Annual bank credit growth increased marginally to 4.9% in January 2018, from 4.8% in October 2017. The increase is attributable to the rise in household credit growth from 7.1% to 7.4% during the period. On the other hand, the growth of commercial bank lending to firms declined significantly to 3.0% in January 2018, down from 6.8% in October 2017. There was a high rate of credit defaults from firms, and commercial banks writing-off debts, which may have discouraged lending.

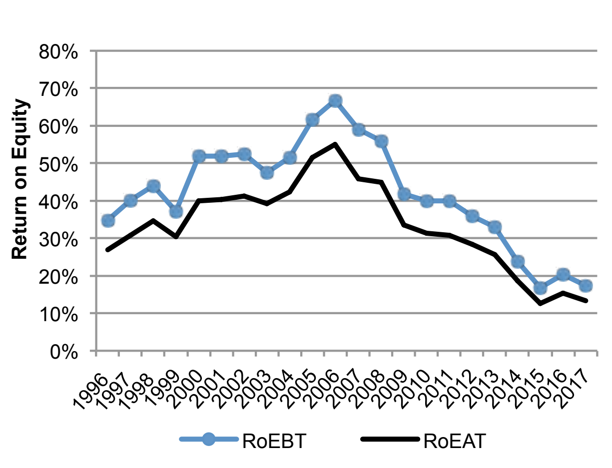
# KEY ECONOMIC VARIABLES

## Arrears on Bank Lending



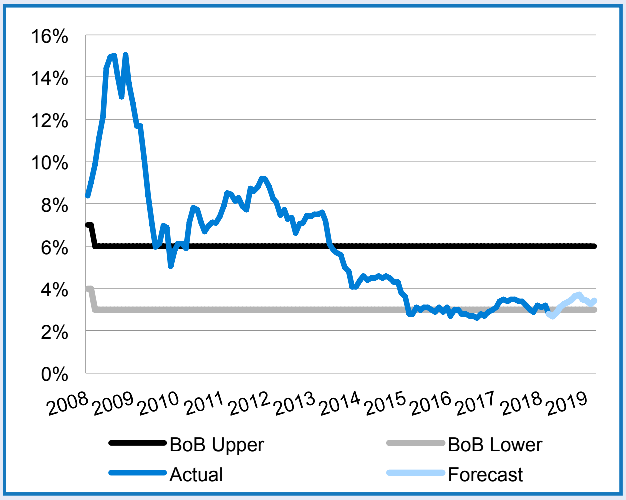

Total arrears as a proportion of outstanding bank credit increased during 2017. Arrears on lending increased from 6.6% at the end of 2016 to 7.3% in 2017. The increase was driven mainly by business arrears, rising from 7.5% in 2016 to 9.1% in 2017. Arrears on household lending fell marginally from 6.2% to 6.1% during the same period, after a spike in Q1 2017. The rise in total arrears is further compounded by a dramatic increase in arrears on lending to parastatals between 2016 and 2017. This is a further sign of the dismal state of parastatal finances, as discussed in the last eidition of the Review.

## Bank Profitability



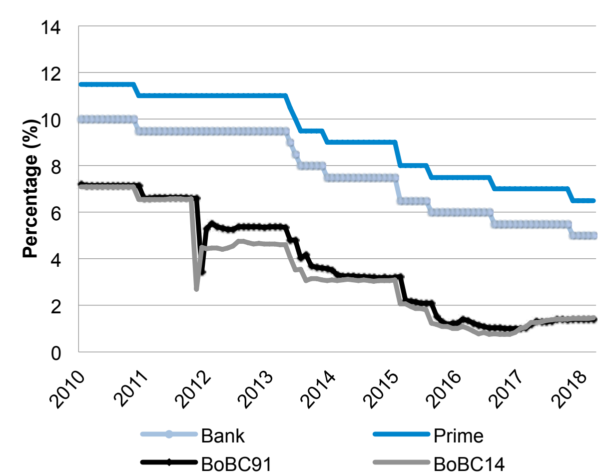

Bank profitability, as measured by the return on equity (RoE), fell in the year to December 2017, largely affected by the rise in non-performing loans (NPLs) during the period. Banks had to make increased provisions to cover actual and anticipated bad debts. Bank profitability post-tax (RoEAT) fell to 13.3% in 2017 from 15.3% in 2016. Although profitability was marginally higher than the low point of 12.6% in 2015, it still remains very low by historical standards.

## Inflation and Forecast




Annual inflation declined to 2.8% in the first quarter of 2018, 0.7% and 0.4% lower than inflation rate recorded in March and December 2017 respectively. The annual inflation rate fell for several commodity groups while increasing for Furnishing, Household Equipment & Routine Maintenance and Recreation & Culture. The inflation rate is forecast to increase maginally during the first half of the year, and remain within the Bank of Botswana's objective range of 3-6%. Higher international fuel prices and the need to increase the fuel levy to replenish the National Petroleum Fund are likley to push inflation upwards during 2018.

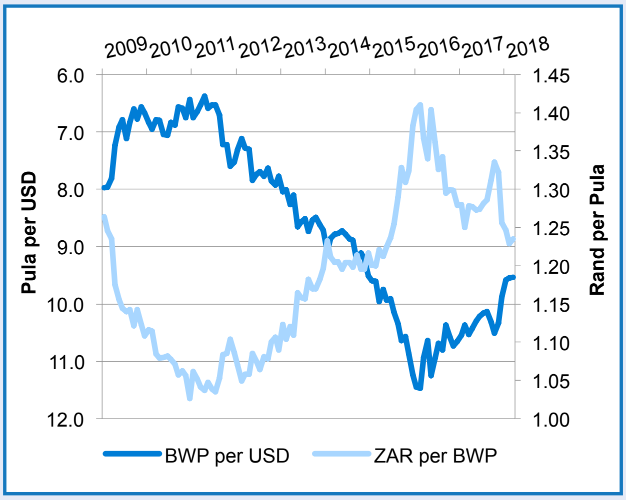
## Interest Rates




The Bank of Botswana's Monetary Policy Committee (MPC) maintained its monetary policy stance and held the Bank rate constant at 5.0% in February 2018, due to a positive inflation outlook. However, money market rates rose marginally with the 14-day BoBC increasing from 1.45% in Q4 2017 to 1.47% in Q1 2018 and the 91-day BoBC rate rising from 1.41% to 1.42% during the same period. The commercial bank Prime Lending Rate remained unchanged at 6.5%.

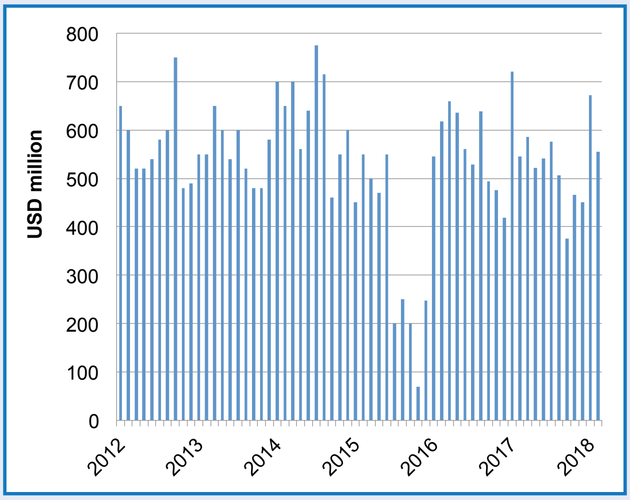
# KEY ECONOMIC VARIABLES

## Exchange Rates



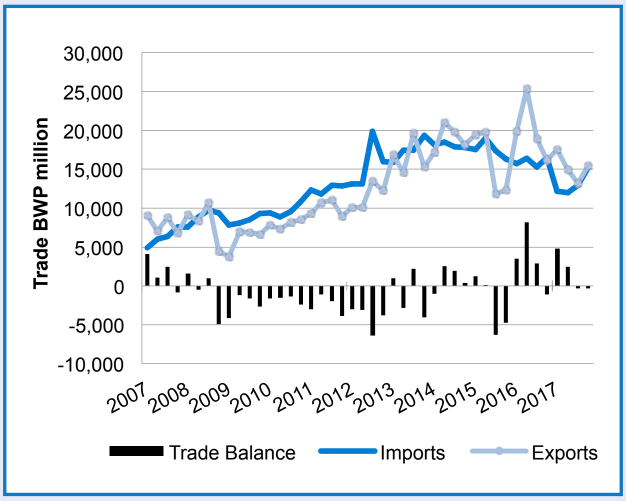

Exchange rate trends from 2017 continued during the first quarter of 2018, with the rand continuing to strengthen under the new South African presidency. As a result the Pula depreciated against the rand by 1.7% during the quarter, with an exchange rate of ZAR1.235 in March 2018, down from ZAR1.256 in December 2017. The Pula continued to appreciate against the US Dollar, ending the quarter with an exchange of USD9.53, up from USD9.87 in December 2017, reflecting an appreciation of 3.6%.

## De Beers Diamond Sales



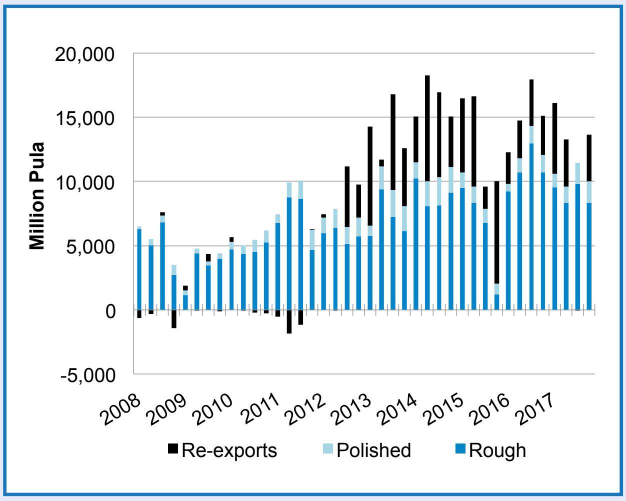

The global demand for rough diamonds was reasonably stable during the first quarter of 2018. De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1,227 million in Q1 2018, 5.0% lower than USD1,292 sales in Q4 2017 and 3.0% lower than sales recorded in the same period in the previous year. During the quarter, the global market for rough diamonds was characterised by manufacturers' restocking inventories from the christmas season, and rough prices were reported to be stable.

## International Trade




Total international trade slowed during the twelve months to December 2017, decreasing for all categories of imports and exports. Total exports fell by 24.0% to P61.1 billion in 2017 from P80.3 billion in 2016 while imports decreased by 18.3% to P52.3 billion from P64.0 billion. Although exports and imports decreased during the year, total exports exceeded total imports, resulting in a trade surplus of P6,602 million in 2017, which is 51% less than the surplus of P13,472 million in 2016. Trade performance during 2017 reflects the slowdown in overall economic growth during the year, although there is still some uncertainty about the impact on the data of a new trade recording system introduced in early 2017.

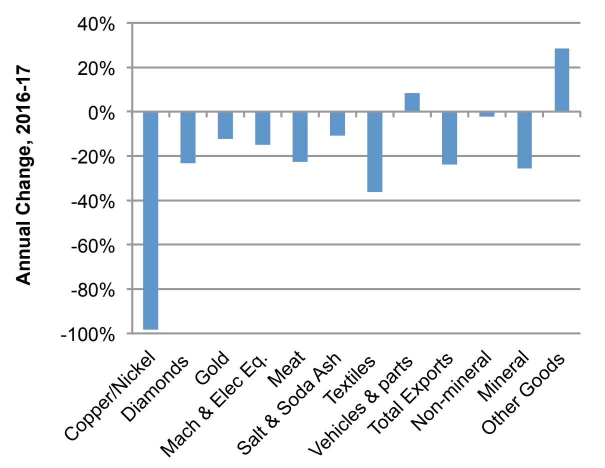
## Diamond Exports




The global market for diamonds was generally stable in 2017 with production in Botswana mines aligned with demand for diamonds. Compared to the previous quarter, total exports of diamonds increased by 19.8% between Q3 and Q4 2017; however, on a year-on-year basis exports fell by 23.2%. Botswana rough exports declined by 17.4% y-o-y in 2017, attributable to the decline in re-exports of rough (diamonds imported for aggregation purposes) which fell by 43.9% during the period. Polished diamond exports grew by 27.0% in 2017.

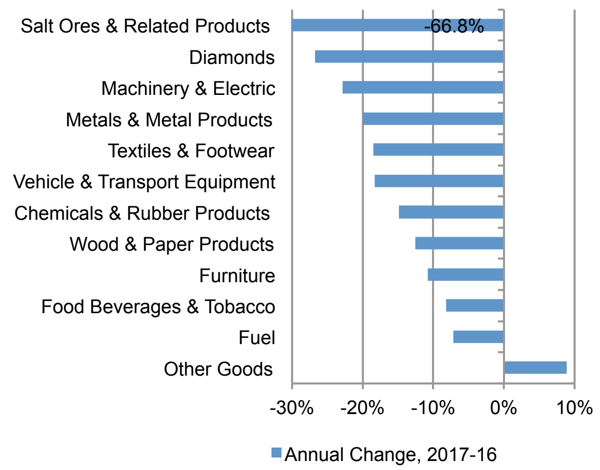
# KEY ECONOMIC VARIABLES

## Export Growth



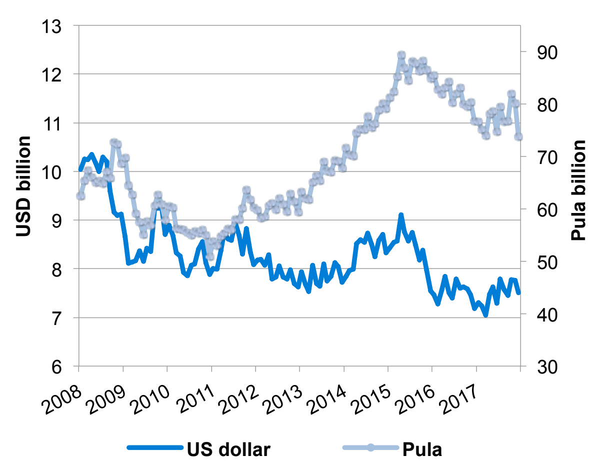

Overall export performance in 2017 was poor, decreasing for most categories except Vehicles and Vehicle Parts, which grew by 8.3%, and miscellaneous "Other Exports", which grew by 28.5%. The decline in total exports is attributable to poor performance in exports of mineral commodities. Exports of mineral commodities fell by 25.6% in 2017, weighed down by the 98.4% decline in copper and nickel exports, as lost exports from BCL could not be offset by exports from the re-opened Mowana and Thakadu copper mines. The generalised decline in exports is worrying, given the need for export-led diversified growth.

## Import Growth



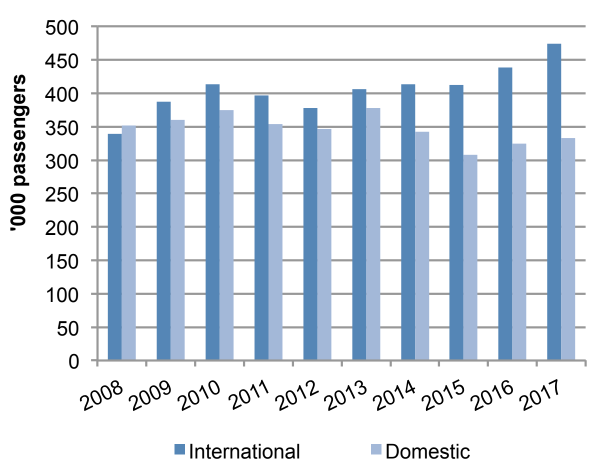

Imports are reported to have declined year-on-year for all sectors except for the "Other Goods" category. Total imports fell by 18.5%, with Chemicals & Rubber Products, Diamonds, Furniture, Machinery & Electric Equipment, Metals & Metal Products, Salt, Ores & Related Products, Textiles & Footwear, Vehicle & Transport Equipment, Wood & Paper Products all reporting double digit declines in their imports. Some of this is expected, with imports of copper-nickel concentrate ending due to the closure of the BCL smelter. However, the generalised large decline in imports is surprising, and would normally indicate an economy in severe recession. Given reported GDP growth rates, we remain concerned about the reliability of the reported trade data.

## Foreign Exchange Reserves




Foreign exchange reserves declined by 4.1% in 2017, closing the year at P73.7 billion compared to P76.8 billion in December 2016. The decrease can be largely attributed to exchange rate changes, with the appreciation of the Pula against the US dollar. The reserves appreciated by 4.4% in Dollar terms but declined by 1.6% in terms of the SDR.

## Air Passenger Traffic




Air passenger traffic had a robust growth for the second consecutive year. The number of air passenger movements at all Botswana airports rose by 5.6% in 2017 when compared to 2016. International air passenger traffic recorded the highest number of air passenger movements, increasing by 7.9% during the year, while increasing by 2.5% for domestic air passenger traffic. For all airports, Sir Seretse Khama International Airport (SSKIA) accounts for 52.6% of the total number of air passenger movements in Botswana.

# NEWS HIGHLIGHTS

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|---|---|---|
| 1st January | Pula exchange rate reviewed. (Bank of Botswana) | The Ministry of Finance and Economic Development and the Bank of Botswana have reviewed the exchange rate policy effective from 1 January 2018. The Pula basket of currencies was maintained at 45% South African rand and 55% IMF's Special Drawing Rights (SDR). The SDR consists of the US dollar, Japanese yen, Chinese renminbi, euro and UK pound. The crawling peg rate has been changed to a downward crawl of 0.30% per annum in 2018 from an upward crawl of 0.26% per annum in 2017. The Pula exchange rate is reviewed every year with the view to maintaining a stable and competitive real effective exchange rate. |
| 12th January | World Bank upgrades Botswana growth forecast. (Mmegi) | The latest World Bank Global Economic Prospects report anticipates improved growth in the global economy. The World Bank has forecast the Botswana economy to grow by 4.5% in 2017 and 4.7% in 2018, marginally lower than the Ministry of Finance and Economic Development growth forecasts of 4.7% and 5.3% in 2017 and 2018 respectively. The global and regional economic rebound is expected to be positive for the Botswana economy. |
| 12th January | Botswana's Okavango posts record diamond sales at USD567 million. (Mining Engineering) | Okavango Diamond Company (ODC) recorded a 4.0% increase in diamond sales to USD567 million in 2017, from USD547 million in 2016, the highest annual sales since the company's establishment in 2013. The company sold 3.41 million carats of diamonds in 2017 compared to 3.44 million carats in 2018. ODC is a state-owned company and sells 15% of Debswana's diamond production. |
| 14th January | BBS records 8.8% growth in H1 2017. (Sunday Standard) | The Botswana Building Society's (BBS) financial results for the six months ended September 2017 revealed an increase in profit to P26.2 million, from P24.1 million in the six months to September 2016. During the period, BBS managed to reduce interest expense costs by raising lower priced loans. BBS's main product is long-term housing mortgages. |
| 19th January | African Energy to delist from Botswana Stock Exchange (BSE). (Mining Weekly) | African Energy Resources (AER) announced its intention to delist from the Botswana Stock Exchange (BSE), as it currently has only 22 shareholders and has 0.3% of its shares listed with the local bourse. African Energy listed on the BSE in 2011 and is currently developing the Sese coal and power project, a Joint Venture (JV) project with First Quantum Minerals Ltd. Its primary listing is in Australia. |
| 23rd January | Poverty declines at decreasing rate. (Weekend Post) | Poverty preliminary results from the Botswana Multi-Topic Household Survey (BMTHS) 2015/16 have shown a general decrease in poverty levels over the years. The proportion of people living below the poverty datum line at national level was 16.3% in 2015/16, down from 19.3% and 30.6% in 2009/10 and 2002/03 respectively. The BMTHS 2015/16 also revealed that poverty is more prevalent in female headed households than male headed households. Furthermore, poverty incidence by locality showed that poverty in cities/towns had risen to 9.4% (from 8.0% in 2009/10), compared to urban villages and rural areas, where poverty had fallen to 13.4% and 24.2% in 2015/16 from 19.9% and 24.3% in 2009/10 respectively. The BMTHS 2015/16 follows the Botswana Core Welfare Indicators Survey (BCWIS) of 2009/10. |
| 5th February | Botswana's economy is projected to expand at a faster pace. (CNBC Africa) | The Ministry of Finance and Economic Development (MFED) has forecast that the economy will expand at a faster pace in 2018 compared to 2017, attributable to improved growth in the mineral sector as a result of the global recovery of the diamond industry. The economy is projected to record real GDP growth of 5.3% year-on-year in 2018 from 4.7% year-on-year growth estimated for 2017. The non-mining private sector is also expected to record improved growth due to a favourable domestic business environment. |

# NEWS HIGHLIGHTS

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| 6th February | Matambo pegs 2018/19 hopes on global recovery. (Mmegi) | According to the Minister of Finance and Economic Development, mineral revenues are estimated to increase by 50.5% to P24.59 billion in 2018/19 from the revised expected mineral revenue of P16.33 billion in 2017/18. Diamond exports are expected to significantly increase, underpinned by recovery of the global economy. Government revenues from other sources are also expected to increase, reflecting the projected growth in the non-mining sector. |
| 6th February | Matambo maintains sustainable fiscal policy. (Daily News) | The Minister of Finance and Economic Development, Mr Kenneth Matambo, has noted the slow growth in government revenues compared to expenditure pressures arising from unlimited societal needs. During the 2018/19 budget speech, it was stated that it is important to continue with judicial management of public resources to maintain fiscal sustainability, which will in turn lead to macroeconomic stability. The government intends to increase efficiency in collecting revenues and expand the revenue base by identifying potential new sources, while managing expenditure to ensure value for money. Hence, the government will achieve fiscal stability in the medium to long term and be guided by the fiscal rule restricting government expenditure to 30% of GDP. |
| 14th February | Bank of Botswana maintains policy rate at 5%. (Bank of Botswana) | The Bank of Botswana (BoB) has maintained the Bank Rate of 5% following the Monetary Policy Committee meeting (MPC), due to a positive outlook for price stability as inflation is forecast to remain within the Bank's objective range of 3-6% in the medium term. |
| 22nd February | De Beers sets higher output target for 2018. (Mining Weekly) | De Beers has set a production target of 36 million carats for 2018, up from the 33.8 million carats produced in 2017. According to the company, the improving global macroeconomic conditions remain supportive growth in consumer demand for polished diamonds. Production at Debswana mines increased by 11% to 22.7 million carats in 2017 with the Orapa mine accounting for a larger proportion, driven by improved plant performance. |
| 2nd March | Botswana's food deficit widens. (CNBC Africa) | Botswana is likely to face a larger food deficit after drought slashed the acreage of planted crops by 75% in the 2017/18 ploughing season. According the Minister of Agriculture and Food Security, a total of 42,800 hectares were planted at the end of 2017/18 compared to 167,562 hectares planted in the previous season. |
| 4th March | Abattoirs face remodelling. (Daily News) | Plans are underway to remodel Botswana Meat Commission's (BMC) Francistown and Lobatse abattoirs as the BMC is set to be privatised. According to the Ministry of Agricultural Development and Food Security, the Maun abattoir will be retained as a government entity to retain the Ngamiland market and control of Foot and Mouth Disease (FMD). The decision to privatise BMC will ensure that the entity achieves operational efficiency and profitability. |
| 4th March | Barclays Africa confirms change of name to ABSA. (Sunday Standard) | Barclays Africa Group Limited (BAGL) intends to change its name to ABSA Group Limited by May 2018, subject to regulatory and shareholders' approval. The change follows the successful selling of shares by Barclays PLC, in 2017 in which its stake in BAGL was reduced to 14.9%. The proposed change is set to take place two years before the deadline imposed by the transitional trade agreement between the BAGL and Barclays PLC as part of their separation agreement. |
| 5th March | Inside the SPEDU investor package. (Weekend Post) | The Government of Botswana has passed the Selibe Phikwe Economic Development Unit (SPEDU) Region Development Approval Order (DAO). Under the order, approved new businesses will have a reduced profits tax rate of 5% over their first five years of operation and 10% thereafter. The tax incentive is intended to make Selibe Phikwe attractive for investment, to promote growth and create employment opportunities. |

# NEWS HIGHLIGHTS

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|---|---|---|
| 9th March | Botswana pays Russia's Norilsk Nickel USD45 million to settle mine sale dispute. (Reuters News) | The Botswana Government has paid Norilsk Nickel USD45 million to settle a dispute after BCL pulled out of buying a stake in Norilsk Nickel's Nkomati mine in South Africa. BCL had initially agreed to buy 50% shares in Nkomati but collapsed into liquidation in 2017. |
| 9th March | Morupule A 90% complete and returns in June. (Mmegi) | Morupule A power station is set to return to full operations in June, six years after its operations were suspended due to plant availability of less than 30%. According to the Minister of Minerals, Green Technology and Energy Resources, Morupule A, which has capacity to produce 132MW of electricity, will add 116MW (net) to the national grid, thereby contributing to Botswana's self-sufficiency in electricity. The national demand of 520MW will be met from combined 892MW electricity production capacity from Morupule A, Morupule B, and Orapa and Matshelagabedi diesel power plants, supplemented by imports where necessary. Morupule A is expected to operate for 15 years at 80% plant availability. |
| 19th March | Botswana Railways endorses Minergy's rail line plan. (Weekend Post) | Botswana Railways (BR) has endorsed a plan to construct a rail link to connect the Botswana coal fields with the South Africa rail network. A Memorandu of Understanding is due to be signed between BR and South Africa's Transnet by mid-2018. The development of the rail line is expected to reduce the current rail route distance to South African ports by an estimated 500 kilometres, significantly reducing transport costs for Botswana coal producers. |
| 21st March | Africa signs Free-Trade to replace existing agreements. (CBNC Africa) | African member states have signed the African Continental Free Trade Area agreement (AfcFTA) to remove tariffs on 90% of goods, in an effort to boost intra-regional trade. The agreement awaits ratification by individual country governments and will come into effect when at least 22 countries have ratified. So far, 44 out of 55 members of the African Union have signed the AfcFTA, excluding the largest two African economies, Nigeria and South Africa. |
| 21st March | Botswana ranks third on social protection, poverty eradication. (Daily News) | Botswana spends 4.4% of its GDP on social protection initiatives to improve the livelihoods of the poor. According to the World Bank senior economist, Mr. Victor Sulla, Botswana is amongst the top three African countries with the highest spending on social protection and poverty alleviation. |
| 23rd March | Air Botswana gets P290 million for new aircraft. (Mmegi) | The national airline, Air Botswana, is to receive funds amounting to P290 million to acquire new aircraft and enhance the airline's value, thereby making it more attractive for privatisation. |
| 23rd March | Ministries unfazed as revenue arrears top P460 million. (Mmegi) | The Public Accounts Committee (PAC) has accused ministries for being ineffective in collecting revenue, as figures show that at least P461 million was owed in arrears, with no recoveries in 2015/16. The PAC has also revealed in their report that revenue arrears in 2014/15 amounted to P457.6 million and P3.8 million revenues was collected, while a sum of P527,245 was written off. The PAC has advised ministries to improve record management and ultimately revenue collection. The PAC consists of members of Parliament and reviews public accounts every year. |
| 27th March | Botswana's Debswana says it expects further rise in diamond output. (Reuter Africa) | Debswana Diamond Mining has reported that production jumped 11% to 22.2 million carats, representing a three-year high, in 2017. According to the company, sales jumped 16% and contributed 20% to increased earnings before interest, tax and amortisation. The company expects increased growth in 2018 attributable to high consumer spending from the USA and increased production. |

# MACRO-ECONOMIC DATA

| Key Economic Data | unit | 2013 | 2014 | 2015 | 2016 | 2017 | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Annual Economic Growth** | | | | | | | | | | | |
| GDP | % | 11.3 | 4.1 | -1.7 | 4.3 | 2.4 | 4.0 | *3.2* | 1.8 | 2.4 | .. |
| Mining | % | 24.2 | 0.5 | -19.6 | -3.7 | -11.2 | -10.2 | *-10.0* | *-12.4* | -11.2 | .. |
| Non-mining private sector | % | 10.1 | 4.9 | 1.4 | 7.2 | 4.7 | 7.9 | 6.5 | 4.5 | 4.7 | .. |
| GDP current prices | P mn | 125,158 | 145,868 | 146,066 | 170,589 | 180,113 | 43,857 | *44,639* | *44,963* | 46,654 | .. |
| GDP 2006 prices | P mn | 84,081 | 87,569 | 86,083 | 89,797 | 91,917 | 22,467 | *22,893* | *22,660* | 23,897 | .. |
| **Money & Prices** | | | | | | | | | | | |
| Inflation | % | 4.1 | 3.8 | 3.1 | 3.0 | 3.2 | 3.5 | 3.5 | 3.2 | 3.2 | 2.8 |
| Prime lending rate | % | 9.0 | 9.0 | 7.5 | 7.0 | 6.5 | 7.0 | 7.0 | 7.0 | 6.5 | 6.5 |
| BoBC 14-day | % | 3.06 | 3.07 | 0.97 | 0.84 | 1.45 | 1.26 | 1.34 | 1.42 | 1.45 | 1.47 |
| **Trade & Balance of Payments** | | | | | | | | | | | |
| Exports - total goods | P mn | 66,404 | 76,261 | 63,484 | 80,336 | 61,093 | *17,507* | *14,931* | *13,201* | 15,453 | .. |
| Exports - diamonds | P mn | 55,367 | 65,328 | 52,730 | 70,781 | 54,384 | 16,084 | *13,246* | *11,400* | 13,654 | .. |
| Balance of payments | P mn | 1,340 | 11,404 | - 57 | 2 843 | .. | -3 386 | 619 | 61 | .. | .. |
| **Foreign Exchange** | | | | | | | | | | | |
| Exchange rate BWP per USD | end | 8.718 | 9.515 | 11.236 | 10.650 | 9.872 | 10.526 | 10.215 | 10.309 | 9.872 | 9.533 |
| Exchange rate ZAR per BWP | end | 1.196 | 1.217 | 1.383 | 1.279 | 1.256 | 1.278 | 1.274 | 1.312 | 1.256 | 1.235 |
| FX reserves | $ mn | 7,726 | 8,323 | 7,546 | 7,189 | 7,502 | 7,041 | 7,288 | 7,454 | 7,502 | .. |
| FX reserves | P mn | 67,772 | 79,111 | 84,881 | 76,804 | 73,693 | 73,957 | 74,734 | 76,763 | 73,693 | .. |
| **Financial Sector** | | | | | | | | | | | |
| Deposits in banks | P mn | 48,512 | 51,492 | 59,961 | 62,438 | 63,581 | 60,120 | 62,380 | 63,842 | 63,581 | .. |
| Bank credit | P mn | 39,763 | 45,116 | 48,307 | 51,316 | 54,181 | 51,141 | 52,555 | 53,290 | 54,181 | .. |
| BSE index | | 9,053.4 | 9,501.6 | 10,602.3 | 9,727.7 | 8,860.1 | 9,225.2 | 9,244.2 | 8,930.4 | 8,860.1 | 8,589.6 |
| **Business Indicators** | | | | | | | | | | | |
| Diamond production *(a)* | '000 cts | 23,134 | 24,658 | 20,732 | 20,880 | 22,961 | 8,553 | 5,992 | 6,117 | 5,568 | .. |
| Copper production *(b)* | tonnes | 49,448 | 46,721 | 23,050 | 16,878 | 1,239 | 0 | *689* | *340* | *210* | .. |
| Nickel production | tonnes | 22,848 | 14,958 | 16,789 | 13,120 | 0 | 0 | 0 | 0 | 0 | .. |
| Business confidence index | | 45% | 52% | 44% | 43% | 46% | 48% | .. | 46% | .. | .. |
| No. of companies formed | | 14,190 | 16,300 | 19,134 | 17,133 | 20,707 | 5,661 | 4,913 | 5,350 | 4,783 | 5,327 |
| Electricity consumption | GWh | 3,502 | 3,990 | 3,974 | 3,929 | 3,772 | 888 | 899 | 1,018 | 967 | .. |
| Crude oil (Brent) | $/bar | 109.95 | 55.27 | 36.61 | 54.96 | 66.73 | 52.20 | 47.08 | 57.02 | 66.73 | 69.02 |
| **Employment (formal)** | | | | | | | | | | | |
| Government | | 130,175 | 129,918 | 130,220 | 129,216 | 128,950 | 129,078 | 128,520 | 128,950 | | |
| Parastatals | | 18,838 | 18,790 | 19,411 | 19,008 | 19,469 | 19,314 | 19,579 | 19,469 | | |
| Private sector | | 189,894 | 191,399 | 191,484 | 194,202 | 193,480 | 193,582 | 192,937 | 193,480 | | |
| Total | | 338,907 | 340,107 | 341,115 | 342,426 | 341,899 | 341,974 | 341,036 | 341,899 | | |

| Govt Budget | | 2014/15 | 2015/16 | 2016/17 Outturn | 2017/18 Revised | 2018/19 Proposed |
|---|---|---|---|---|---|---|
| Revenues | P mn | 55,904 | 47,420 | 57,398 | 57,187 | *64,277* |
| Spending | P mn | 50,564 | 54,411 | 56,275 | *59,606* | *67,867* |
| Balance | P mn | 5,340 | -6,991 | 1,123 | *-2,419* | *-3,590* |
| Public debt & guarantees | P mn | 33,131 | 35,342 | 36,864 | 38,000 | 38,539 |
| Govt deposits at BoB | P mn | 41,680 | 33,916 | 30,451 | 30,596 | .. |
| GDP | P mn | 147,920 | 149,111 | 174,836 | 185,931 | 203,175 |
| Revenues | %GDP | *37.8%* | *31.8%* | 32.8% | *30.8%* | 31.6% |
| Spending | %GDP | *34.2%* | *36.5%* | 32.2% | *32.1%* | 33.4% |
| Balance | %GDP | *3.6%* | *-4.7%* | 0.6% | *-1.3%* | -1.8% |
| Public debt & guarantees | %GDP | *22.4%* | *23.7%* | 21.1% | 20.4% | 19.0% |
| Govt deposits at BoB | %GDP | *28.2%* | *22.7%* | *17.4%* | *16.5%* | .. |

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

Notes:

(a) 2013 figures include production from Boteti Diamonds (Karowe mine) and Debswana. Also, 2016 figures include production from Gem Diamonds (Ghagoo) and Lerala mines which ceased production in February and April 2017 respectively.

(b) Copper production starting Q2 2017 for Leboam Holdings' Mowana and Thakadu mines

Numbers in Italics reflect revisions from the previous review

SPECIAL FEATURE

# The Wage Share of National Income

## Introduction

One of the most pressing development issues in Botswana is the high level of inequality. The Gini coefficient, a widely-used measure of inequality, is one of the highest in the world, and was 60.5 in 2009/10 (for per capita consumption). Over time, it is important that inequality is reduced, and this requires that the benefits of economic growth are widely shared.

There are various ways of achieving this objective of "shared prosperity". Perhaps the most important is ensuring that there are sufficient jobs or other income-generating opportunities for all households in the country, and that the incomes generated from employment or self-employment increase over time.

The degree of inequality (and poverty) is strongly influenced by the way in which the income generated in an economy is divided between wages (return to labour) and profits (return to capital). In principle, the overall income generated (GDP) can be divided up as follows:

| | |
|---|---|
| Labour share | Wages (and associated benefits) |
| Capital share | Consumption of fixed capital (depreciation) |
| | Profits (return on capital) |
| Unattributable share | Mixed income (from self-employment, agriculture etc.) |

Hence, an important indicator of how the incomes generated from economic activity are distributed is the Labour Share of Income (LSI). This represents the share of overall national income (GDP) paid to employees in the form of wages or related social contributions or benefits financed by employers. The remainder of GDP either accrues to capital (consumption of fixed capital or profits) or is classified as "mixed income". The latter relates to activities such as self-employment, where it is difficult to distinguish wages from profits.

The LSI is an important macroeconomic variable because it is related to a wide range of other variables such as household consumption/expenditure, the potential tax base and fiscal revenue. It is also closely related to inequality; given that the suppliers of labour (employees) are more widely distributed than the suppliers of capital, a higher LSI is generally associated with a more equal income distribution, and vice versa.

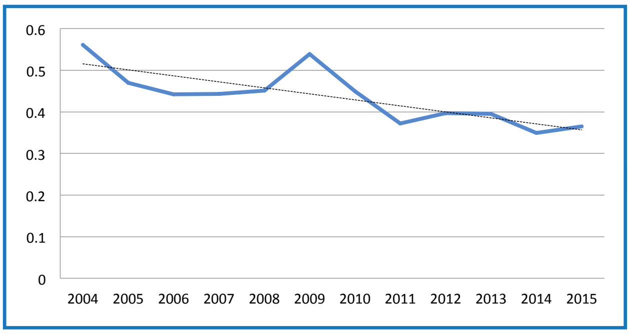
The LSI may change (increase or decrease) for many reasons. It could be indicative of a change in the structure of the labour market. For instance, an increase in the LSI could be the result of individuals moving from informal employment with erratic and often undocumented wages to formal employment with standardized pay structures and benefits. It could also be the result of rapid employment growth, or an increase in real wages for those who are employed, or some combination of these.

A decline in the LSI may have a negative effect on income inequality and poverty reduction, as it implies that a smaller share of national income is going to employees, while a greater share is going to firms (employers). As capital tends to be disproportionately owned by the rich rather than the poor, an increase in returns to capital tends to lead to greater inequality.

### Trends in the Labour Share of Income in Botswana

The LSI can be calculated for Botswana from the national accounts data, adjusted for the portion of national income that is derived from mineral rents (which is attributable to neither capital nor labour).

**Figure 1. Labour Share of Income in Botswana, 2004-2015.**




Source: Authors' own calculation, based on data from Statistics Botswana and the Botswana Geo-Science Institute.

Note: income is defined as adjusted Net Domestic Product (Total Value Added minus consumption of fixed capital minus mineral rents).

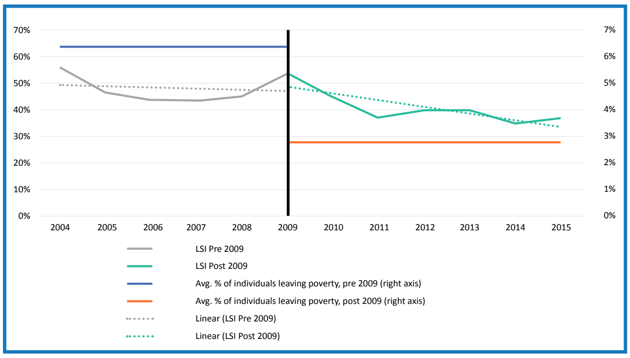
On this basis, the labour share of income in Botswana has declined from 56.1% in 2004 to 36.4% in 2015, with the lowest share of 34.9% in 2014. This represents an average annual decline of approximately 3%. What this means is that between 2004 and 2015, adjusted net domestic product (NDP) grew at an average annual rate of 13.3%, while total compensation of employees grew on average by only 9.0% (in nominal terms).

The LSI in Botswana has an acyclical relationship with GDP. This type of relationship is observed for most countries in the world, and is because profits are more volatile than wages. As a country enters a recession and GDP growth slows down, there tends to be greater decline in firms' profits than in the wages they pay out; as a result, the LSI rises. The inverse applies during periods of economic recovery. This effect is further accentuated in Botswana since mining, which has a high capital share, was the hardest hit during the recession of 2009; hence the rise in the LSI during the global financial crisis in 2009.

# SPECIAL FEATURE

The relationship between LSI and poverty levels is also of importance to Botswana. Between 2002 and 2009, the headcount poverty rate declined from 30.6% to 19.3%. The fall of 11.3 percentage points over a 7-year period meant that on average, annually, 6.4% of individuals who had been living in poverty at the beginning of each year had managed to move out of it by the end. However, the average annual rate of poverty alleviation dropped between the years of 2009 and 2015. The poverty rate fell to 16.3% in 2015, representing an average annual reduction of only 2.8%. Hence, the average annual poverty reduction rate fell by more than half. This coincides with a faster decline in the LSI in the second period. Between 2004 and 2009 the LSI had a very slight downward trend, compared a much steeper declining trend from 2009 until 2015. This is not surprising, as most research finds links between falling a labour share of income and rising inequality, which in turn has been found to retard poverty reduction rates in developing countries. In conclusion, a faster rate of decline in the labour share of income is associated with a slower rate of poverty reduction.

**Figure 2: Poverty Reduction and the LSI**




Source: calculations based on data from Statistics Botswana

## The impact of changing economic structure

As a country develops through industrialization, individuals are expected to move from more labour-intensive sectors such as agriculture to more capital-intensive industries with greater returns to capital. This movement should result in a decline in the LSI (although in practice it may be difficult to measure due to uncertainty over income levels in informal agriculture). However, Botswana did not take the conventional path towards economic development. After independence, Botswana experienced a rapid transition from agriculture to capital-intensive mining as the main source of GDP growth. Since that time, one of the main goals of the country's economic development strategy has been to diversify the economy and move away from mining to other sectors that are more labour intensive than mining. We would therefore expect a rise in the LSI for Botswana as diversification has occurred; however, this has not happened.

We can investigate this further by looking at the contributions to the decline in the aggregate LSI from (i) changes in the LSI within individual industries, and (ii) changes in the share of total output produced between industries. The results are that changes in income shares (declines in the LSI) within individual sectors are the greatest contributor to declines in aggregate LSI. Changes in the composition of total output between economic sectors have had a positive effect on the aggregate LSI (i.e. a relative shift in output from low LSI sectors to higher LSI sectors, mainly mining to non-mining), but not enough to offset the decline in (i) above.

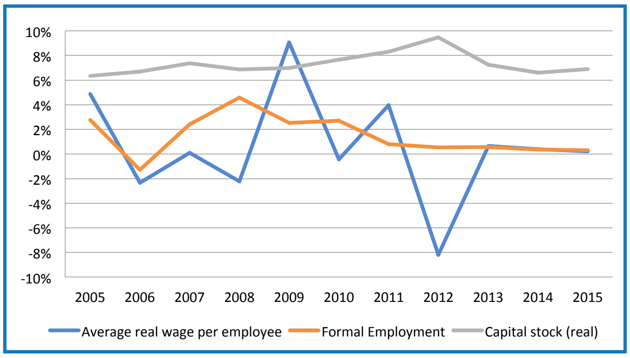
To better understand the decline in the overall national LSI we must focus on changes in income shares within individual industries, given that shifts in GDP production from mining to other more labour-intensive industries (economic diversification) *ceteris paribus* leads to an increase in LSI.

## High level trends

In explaining the declining labour share of income in Botswana, we can focus on three high level trends:

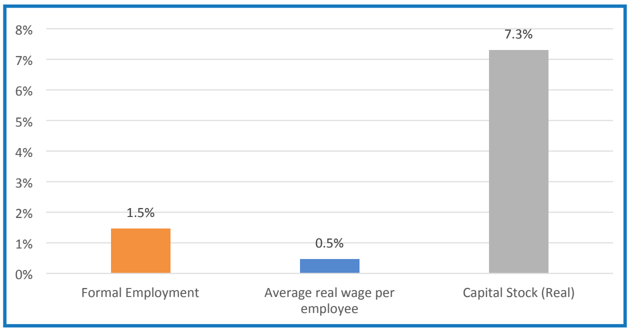
- a high level of investment, leading to an increase in capital-labour ratios;
- slow growth of average real wages;
- slow growth of formal employment.

**Figure 3a: Annual growth rates of capital stock, real wages and employment 2005-2015**




Source: calculations based on data from Statistics Botswana

**Figure 3b: Average growth rates of capital stock, real wages and employment 2004-2015'**




Source: calculations based on data from Statistics Botswana

Real wages have remained almost stagnant, experiencing an annual average growth rate of just 0.5% between 2004 and 2015. Over the same period the annual average growth rate of formal employment was 1.5%, compared to the 7.3% real growth rate of capital stock. A more alarming figure is that since 2011, formal employment has not had an annual real growth rate greater than 1% in any year. The annual real growth rate of capital stock has been steady and positive between 6-10% from 2005 to 2015, whilst real wage growth has fluctuated but remained below that of capital stock for all but one year. These trends imply that even with a constant rate of return to capital, the rise in the relative quantity of capital to labour will result in the

## SPECIAL FEATURE

capital share of income rising and that of labour declining. Reversing this requires faster growth in employment and/or real wage rates.

### Policy Recommendations

Given the importance of the LSI in household consumption and poverty alleviation it is vital that the economic policy work towards reversing the current trend, which has seen the LSI decline over recent years.

### Employment

The main problem facing the new administration is that of jobless growth. While economic activity has grown at reasonable, if unspectacular rates in recent years, job creation has not followed. This may be both a demand side problem and a supply side problem. Firms seem to have chosen to invest more in capital than in labour, perhaps due to supply side constraints of skills availability.

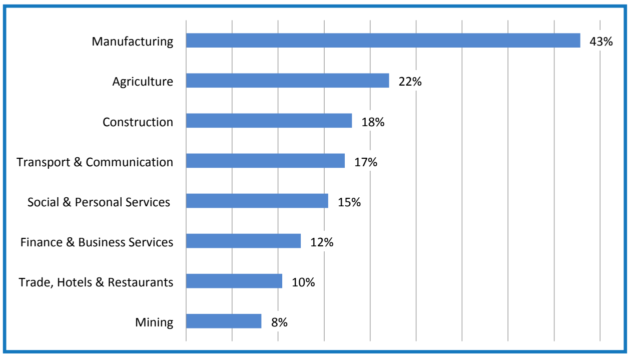
It may also be a pricing issue. Although real wages have largely stagnated, interest rates have fallen dramatically since 2009, and hence the price of capital has fallen relative to the price of labour, which may be one factor explaining the faster growth in capital stock.

While it may be tempting to argue for higher wages to address the problem of declining labour share of income, this would probably be counterproductive from the perspective of employment creation. Instead, the focus should be on encouraging employment growth, and then when labour markets are tighter and the excess supply of labour has been reduced, market forces will tend to push wages upwards.

### Is manufacturing the future?

The results of this analysis also have implications for the type of economic diversification that should be pursued. As noted above, a shift away from mining should increase the overall labour share of income. But what kind of sectoral shift would be most effective?

**Figure 4: Labour share of income by economic sector, 2016**




Source: Statistics Botswana National Accounts

As Figure 4 shows, manufacturing has the highest labour share of income of any economic sector. It is also one of the few sectors that has experienced growth in the LSI over the period 2004 to 2016. A policy push to boost the growth of the manufacturing sector would therefore help to address the problem of the falling labour share of income in Botswana. It is reasonably labour intensive – and helps contribute towards job creation – and pays higher average wages than many other sectors.

However, the manufacturing sector has not performed well, and has grown more slowly than most other non-mining sectors of the economy over this period. Its contribution to national output remains low, at just over 5% in 2016.

The cause of this decline could be due to Dutch Disease, with increases in mining exports driving up the real effective exchange rate, which would make all non-mining exports, such as manufactured goods, more expensive to sell and possibly uncompetitive in international markets. Trade agreements can help, but may not be enough to boost the industry if it remains uncompetitive; for instance, textile exports have dropped significantly in recent years, despite duty-free access to the USA under the AGOA free trade agreement. Nevertheless, manufacturing is a fundamentally export-orientated sector, and should play a central role in export-led growth in Botswana, which is the key to sustainable economic development.

Manufacturing also carries a distinct advantage over service led industries such as tourism in that it provides a clear and well-defined pathway towards taking a country like Botswana from middle-income to high-income status. This is through the ladder of productivity. As a country develops the goods they manufacture change from products that require a low skill base, such as textiles and garments, to more complex products such as computer chips, which require a more skilled work force. As the average worker in a country moves from low to high skill, their productivity rises, which is then reflected in the form of higher wages. This internal path of development is not readily available or clear in the services sector, or at least in some parts of it, where employee roles do not evolve in the same way over time.

In conclusion, increased investment in manufacturing industry would have a positive effect on the aggregate labour share of income in Botswana. Furthermore, it strengthens the export-led growth that is necessary for sustainable economic development along with providing a tried and tested development pathway.

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