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ECONOMIC REVIEW

second quarter april-june 2019

in this issue ...

COMMENTARY

Diamond market woes reinforce the need for export-led growth

Introduction

The second quarter of 2019 has been a very mixed one in terms of economic performance, with the main feature being a marked deterioration in conditions in the global diamond industry, and poor performance by exporters in general. On the domestic front, data releases for the first quarter show some improvements, with reasonably robust economic growth, continued low inflation and interest rates, and some easing of pressure in the financial sector. If the weakness of the global diamond market continues, however, this will show up in growth, export and government budget figures later in the year.

Economic growth

Real GDP growth in the year to March 2019 was 4.4%, very similar to the 4.5% recorded in 2018. Growth was reasonably broad-based, across both the mining and non-mining sectors of the economy, and was largely in line with expectations. The main weakness was in the wholesale sub-sector, which is dominated by diamond trading activities, and where negative growth reflects a lower level of activity compared to 2018. Our estimate of real non-diamond private sector growth was resilient at 5.2%, year-on-year.

Diamond markets

Sales of rough diamonds in the first quarter of 2019 were weaker than in 2018, and the trend appears to have intensified even further in the second quarter of the year. Sales of rough diamonds through De Beers Global Sightholder Sales (DBGSS) in Gaborone were 17.5% down, by value on the same period in 2018. This reflects a number of influences, including weak final demand for diamond jewellery in the major markets (the USA and China), overstocking in the midstream (diamond cutters and polishers) and a lack of profitability due to narrow margins between rough and polished prices, a lack of bank liquidity in India to finance diamond stocks, and the continued downward pressure on prices of lower-value diamonds due to competition from supplies of lab-grown diamonds. The weak market for rough diamonds will in turn have an impact on the mining sector, and hence on economic growth, as major diamond mining companies – including Debswana – adjust production levels in line with demand.

It also intensifies the fiscal challenges facing government. Revenues have been in structural decline for several years, relative to GDP, and weak diamond sales will make it difficult to achieve the 2019/20 revenue targets set out in the February 2019 Budget. Looking further ahead, some very large investments are required to extend the productive lives of the major diamond mines at Jwaneng (Cut 9) and Orapa (Cut 3). These investments will reduce government mineral revenues in the short-run, although by extending the period of diamond production will increase revenues over the longer term. But while the investments are being financed – during the second half of NDP 11 – budgetary constraints will be a major challenge, especially given the spending commitments made by all political parties in the run-up to this year's general election. Government will need to respond to this challenge by prioritising the competing demands on public spending, and cutting back spending on unproductive or low priority programmes, projects and institutions.

Monetary and Financial Conditions

Inflation has remained at very low levels by historical standards, and is still below the lower end of the BoB's inflation objective range of 3-6%, despite a slight increase during the quarter. Low inflation reflects a lack of price pressures, including low food price inflation, although this is now beginning to tick up due to low rainfall and poor harvests in Southern Africa. To some extent, however, low inflation may be artificial, as many regulated prices have not been increased as costs have risen, thereby requiring subsidies that may not be sustainable. Inflation is likely to rise modestly over the next 12 months, as food prices increase, some administered prices are adjusted, and as the impact of the recent 18% rise in minimum wages feeds through to costs. There may also be demand-side pressures if the proposed substantial increase in public sector salaries is implemented.

Alongside low inflation, policy interest rates have been kept low, and remain at the lowest ever levels in Botswana. In the banking sector, credit growth is weak, which may be an indicator of slowing activity in the non-mining business sector of the economy. More positively, arrears on outstanding loans are declining. Furthermore, banking liquidity is improving, but this mainly reflects the very slow growth of bank lending during recent months. If the rate of growth credit picks up, banking liquidity could soon become an issue, and this would in turn push interest rates up, independently of monetary policy rates.

External sector

Export performance was poor during the first quarter of 2019, with all categories of exports registering major declines, according to data from Statistics Botswana. For diamonds, this is in line with known developments in the global market, but it is surprising that export weakness has also been manifested across all other commodity groups; for instance, exports of beef, plastic products and vehicle parts were all down by 50% or more in Q1 2019 as compared to Q4 2018, as well as when compared to Q1 in 2018. This is of great concern, given the importance of export-led growth (see feature later in this Review). Closer monitoring of export performance over the coming months will be necessary to determine whether this is a short-term problem or reflective of a deeper export malaise that needs policy attention.

Outlook

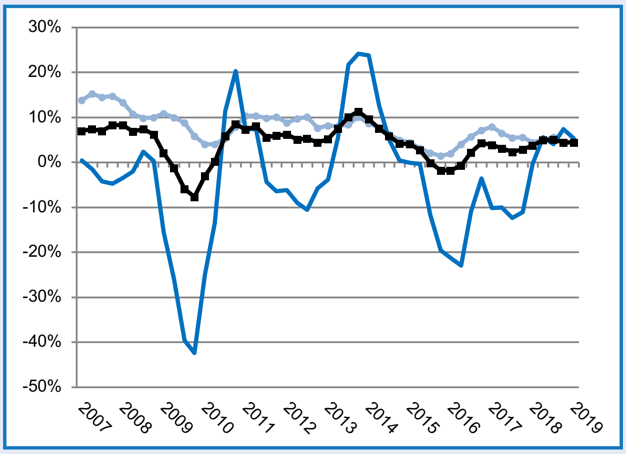
Although 2019 has started reasonably well in terms of economic growth performance, there are some worrying clouds on the horizon. Already, we have seen a weakening of the global diamond market during 2019, which is unlikely to be reversed in the second half of the year. Outside of diamonds, there are many risks in the global economy. Amongst the big, negative risks are the prospect of an escalating trade war between the USA and China; potential recession in the US – as indicated by the inverted US treasury yield curve – and growth slowdown in China, both of which would be made more likely by a trade war; a "no-deal" Brexit, which would be disastrous for the UK and bad for the European Union; and potential hostilities in the Persian Gulf, with escalating tensions between the USA and Iran, which could easily send global oil prices well over $100 a barrel and trigger global inflation, recession and tumbling financial markets.

A further concern, but this time a domestic one, is the government's decision – now approved by Parliament – to increase the rate of transfer duty on property purchases by non-citizens from 5% to 30%. This is likely to undermine the property market, with fewer transactions and lower prices, as well as negatively affect the banking system and reduce the availability of mortgages. To give the government credit, they have softened some of the more egregious elements of the original transfer duty proposals, following extensive consultations with the private sector. However, even though the proposed increase in the transfer duty rate for foreigners – including foreign-owned companies - is likely to have an adverse impact on the economy and deter much-needed inflows of foreign direct investment, the political environment of an election year made any further concessions impossible. The move emphasizes (adversely) the distinction between Botswana and Mauritius, where a new Property Development Scheme has been described as "the latest in a series of initiatives geared at opening up the economy to foreigners and providing them with the opportunity of becoming property owners in an enviable and stable country, if they so wish."[1]

[1] Intercontinental Trust Ltd, July 2019 Newsletter".

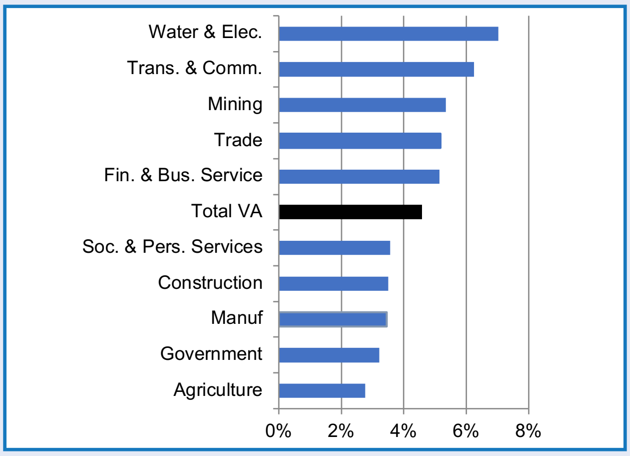
KEY ECONOMIC VARIABLES

Annual GDP Growth



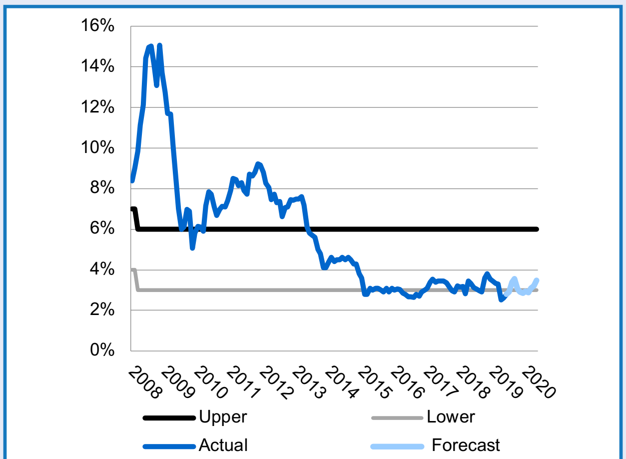
Real GDP growth has continued its relatively strong performance into the first quarter of 2019, recording year-on-year growth of 4.4%. This is marginally down from the 4.5% growth in Q4 2018, but significantly greater than the 3.8% growth registered during the same period last year. The mining sector has continued to recover in 2019, registering y-on-y growth of 5.3%; this is, however, lower than the 7.4% growth recorded in Q4 2018. The non-mining private sector (NMPS) recorded y-on-y growth of 4.7%, up from 4.3% in the previous quarter. The volatility of NMPS growth can be attributed to the fluctuations in the Wholesale sub-sector, which includes diamond trading activities.

Sectoral GDP Growth



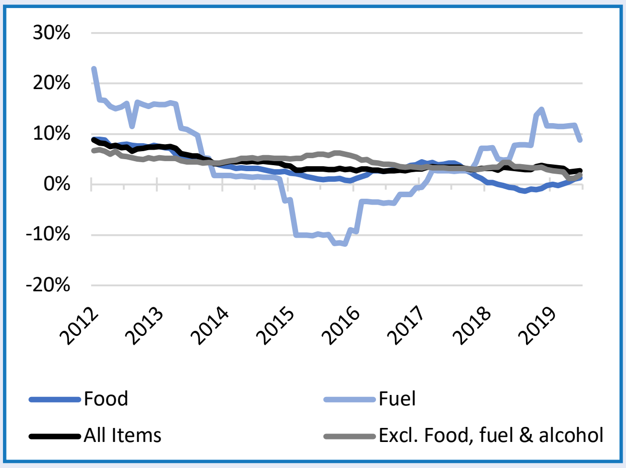
All sectors registered positive annual growth rates in the first quarter of 2019. Most sectors (excluding Trade and Water & Electricity) experienced small changes (+/-0.2%) in growth rates as compared to the previous quarter. Trade sector growth rose from 3.2% in Q4 2018, to 5.2% in Q1 2019. This was due to an increase in the growth of the Wholesale sub-sector which rose to minus 3.0% in Q1 2019, up from minus 11.6% in the previous quarter. Other sub-sectors that performed well (annual growth of 7% or above) were Soda Ash, Retail Trade, Hotels & Restaurants, Posts & Telecommunications, Real Estate and Business Services.

Inflation and Forecast



Annual headline inflation was 2.8% in June 2019, 0.5% lower than in March. This is lower than the Bank of Botswana's objective range of 3-6%. Inflation figures remain low, in part because, it is too early for them to reflect any upward pressure on prices from the recent 18% increase in the minimum wage. Inflation is also artificially low due to administered prices not being raised and key commodities being subsidized. The trimmed mean measure of core inflation declined from 3.5% to 2.5% during the quarter whilst inflation excluding administered prices increased from 1.6% to 2%. We expect inflation to rise above 3% in the coming months.

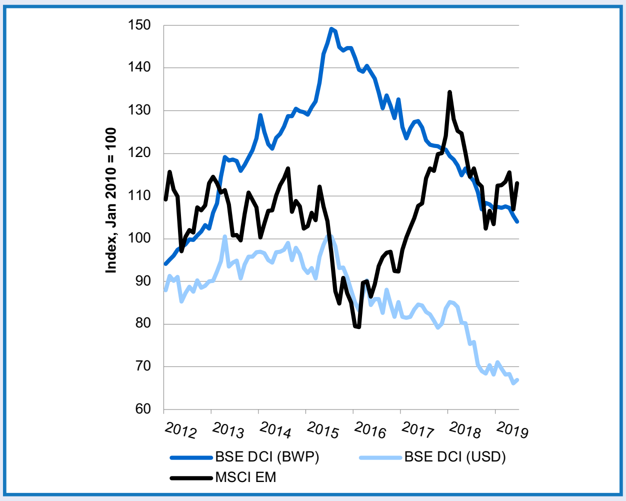
Inflation by Category



The main drivers of inflation vary over time. Fuel prices tend to be more variable than other components of the CPI basket, and their weight in the basket has been increasing. Fuel price inflation has been relatively high during 2018-19, even though fuel has been subsidised through the National Petroleum Fund and international cost increases have not been fully reflected in the domestic pump price. Fortunately, food price inflation has also been low, which has helped to keep overall inflation low, although with the regional drought in Southern Africa, food price inflation has started to increase. Other price increases have also been subdued, although this is partly artificial, as many regulated other prices (e.g., water, electricity, BHC rentals) have not been allowed to reflect higher costs of production and hence have been subsidised, in a way that is not sustainable in the long term.

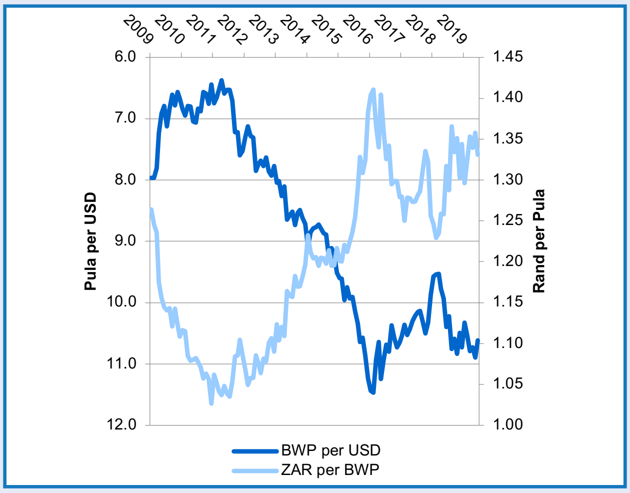
KEY ECONOMIC VARIABLES

Stock Markets



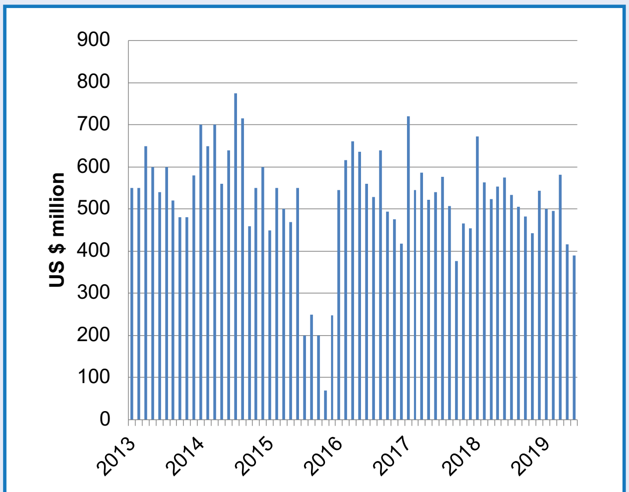
The Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) weakened during the second quarter of 2019. The DCI declined by 3.3% and 1.8% in Pula and USD terms respectively. The local market (BSE) was outperformed by international stock markets with the MSCI World Index appreciating by 3.3% and the MSCI Emerging Markets Index declining marginally by 0.3%.

Exchange Rates



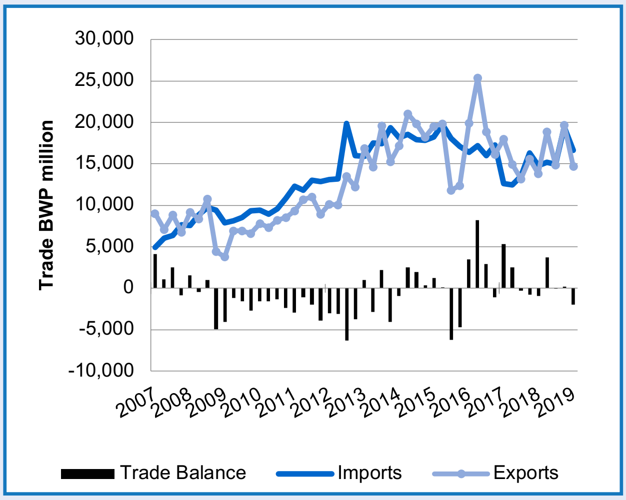
The Pula depreciated against the rand and strengthened against the US dollar during Q2 2019, reversing the trend that has been prevalent over previous quarters. The Pula depreciated by 1.6% against the rand, ending Q2 2019 at ZAR1.331, down from ZAR1.353 at the end of Q1 2019. The Pula-US dollar exchange rate was 10.62 at the end of Q2 2019, up from 10.79 at the end of Q1 2019, an appreciation of 1.6%.

De Beers Diamond Sales



The global market for diamonds continued to be subdued during the second quarter of 2019. This has been attributed to a challenging market environment in China and higher than usual polished diamond inventories in the midstream affecting the fifth sales cycle of the year. De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1,387 million during Q2 2019. This is 16.1% lower than the value of sales recorded in Q2 2018, but 39.3% higher than those reported during the previous quarter, which had one less sales cycle. These are the lowest second quarter sales registered by De Beers since before 2013.

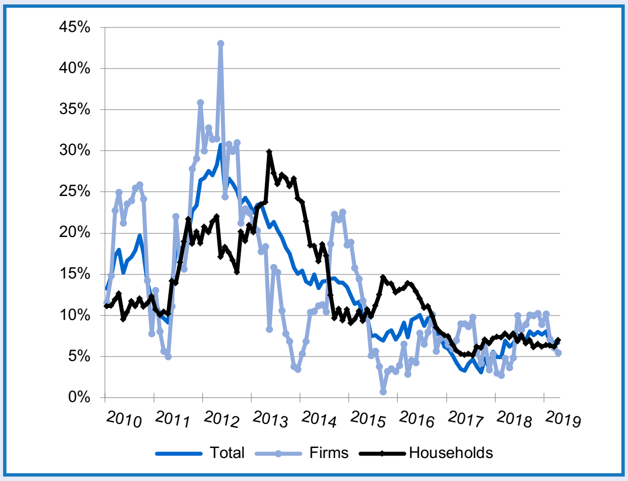
International Trade



Total International trade activity decreased during the first quarter of 2019, with both imports and exports declining across all categories. Total exports were valued at P14.7 billion in Q1 2019, down from P19.7 billion in Q4 2018, representing a decline of 25.4% in export value. This was driven by a 24% and 41% decline in the value of mineral and non-mineral exports respectively. The value of total imports declined by 14.4%, down from P19.4 billion in Q4 2018, to P16.7 billion in Q1 2019. The greater decline in exports over imports has resulted in a trade deficit of P1.99 billion, compared to a trade surplus of P0.22 billion in Q4 2018.

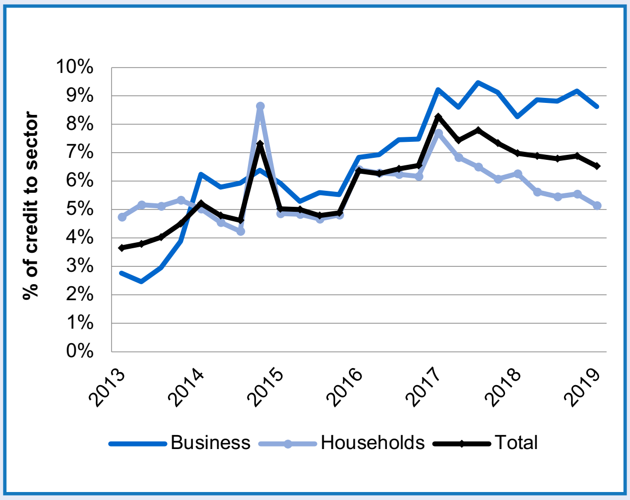
KEY ECONOMIC VARIABLES

Annual Credit Growth



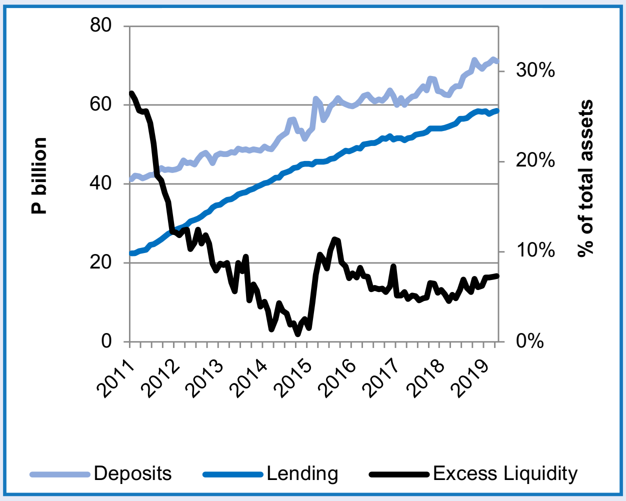
Annual bank credit growth declined significantly, from 8.1% in January 2019 to 6.7% in April. This was driven by a sharp decline in the growth of credit to firms, which fell from 10.2% in January to 5.5% in April. This was, however, partially mitigated by an increase in household credit growth from 6.4% to 7.0% during the same time period. The sharp decline in growth of credit to firms is concerning as it could be a sign of lower business activity and consequently lower private sector growth in the future.

Arrears on Bank Lending



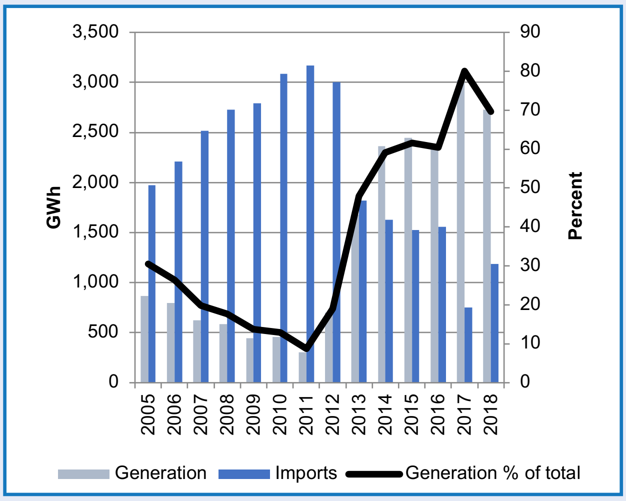
Total arrears as a proportion of outstanding credit declined during the first quarter of 2019, reaching their lowest level since 2016. Arrears fell from 6.9% of credit outstanding in Q4 2018 to 6.5% in Q1 2019. This was driven by a decline in both household and business arrears. Household arrears fell from 5.5% in Q4 2018 to 5.2% in Q1 2019. Business arrears experienced a more significant decline, falling from 9.2% to 8.6% during the same period. A rise in government & parastatal arrears partially offset the decline in total arrears during the quarter.

Bank Deposits, Lending & Liquidity



Bank liquidity improved marginally in April 2019. Excess liquidity rose from 7.2% of total assets in January to 7.3% in April. This was driven by a greater increase in bank deposits as compared to bank lending. Bank deposits in April were valued at P71.1 billion, up by 1.1%, from P70.3 billion in January while bank lending rose by 0.1%, from P58.5 billion to P58.6 billion during the same period.

Electricity



Total consumption of electricity increased by 3.9% in 2018, rising from 3,772GWh in 2017 to 3,919GWh. Electricity imports rose from 752GWh in 2017 to 1,189GWh in 2018, representing a significant increase of 58.1% in the importation of electricity. Simultaneously, there was a 9.6% decline in electricity generation during the year, as generated electricity fell from 3,020GWh to 2,730GWh. As a result, the contribution of generated electricity to total electricity consumption declined from 80.1% in 2017 to 69.7% in 2018. However, this trend did not continue into 2019 as the contribution of generated electricity rose to 80.4% during the first quarter.

NEWS HIGHLIGHTS

17/04/2019	Botswana Unveils 20ct. Okavango Blue Diamond (Rapaport News)	Okavango Diamond Company (ODC) has revealed a 20-carat polished stone, which is the largest blue diamond to be mined in Botswana. The diamond was graded as fancy deep blue, with VVS2 clarity by the Gemological Institute of America (GIA). The stone was recovered from the Orapa mine, which belongs to Debswana, a joint venture between De Beers and the Government of Botswana.
20/04/2019	Khoemacau Copper-Silver project gets multi-million-dollar cash injection (Mining review)	Cupric Canyon Capital and Khoemacau Copper Mines have announced the signing of a deal for funding worth USD565 million for the construction of the Khoemacau Copper-Silver Project. Cupric Canyon Capital states that the project funding package will be used for construction of the 3.6 million tonnes per annum (Mtpa) starter project at Khoemacau. The project is expected to cost USD397 million over a two-year construction period, with production expected to begin in the first half of 2021.
26/04/2019	XRT technology delivers another + 1 000 carat diamond (Mining review)	Lucara Diamond Corporation has recovered a 1,758 carat diamond from its Karowe mine located in Botswana. The diamond is the largest to be mined at Karowe to date and is also one of the largest diamonds in recorded history. The unbroken 1,7th58 carat stone was recovered through Lucara's XRT circuit, which was commissioned in April 2015.
26/04/2019	New 10m tonne coal railway construction set for 2021 (Mmegi)	Botswana Railways has announced that it intends to begin the construction of the Mmamabula-Lephalale railway line in the second half of 2021. The project is expected to directly create 3,000 jobs and provide a new export route to South Africa for the eastern Botswana coalfields.
20/05/2019	Lucara rakes in P487 million revenue in Q1 2019 (Weekend Post)	For the first quarter of 2019, Lucara generated over P487 million in revenue from its wholly-owned Botswana operation, Karowe mine. This represents an increase of well over 50 percent from the first quarter of 2018, which had registered just over P250 million. Lucara says 2019 Quarter 1 was characterized by a continuation of strong operating performance observed during the latter half of 2018.
20/05/2019	Income Tax amendment 2018: property companies feel the heat (Weekend Post)	The 2018 amendment of the income tax regime has had a negative impact on profits in the property industry. The Act imposes limits on the deduction of net interest expense in calculating taxable income and will result property companies suffering income tax on their profits prior to their distribution as debenture interest.
21/05/2019	Botswana to invest diamond wealth more widely (Bloomberg)	The Bank of Botswana has given its sovereign wealth fund a broader mandate. Previously, the Pula Fund could only invest in AA-rated issuers; the minimum credit rating has now been reduced to BBB. The Pula Fund, which currently holds about 70% of Botswana's USD6.8 billion in foreign reserves, has previously been confined to investing in dollars, pounds, yen and euros. The central bank's head of financial markets, Matthew Wright, has stated that the new guidelines have increased the number of eligible currencies to 17 and that, along with adding fixed-income assets, the central bank is also buying some stocks.
23/05/2019	Weaker Mining And Construction Prospects Weighing On Botswana's Growth (Fitch Solutions)	Fitch Solutions forecast a slow-down in Botswana's real GDP growth to 3.9% and 4.1% in 2019 and 2020 respectively, down from 4.5% in 2018. This is due to a projected decline in diamond production and below-trend construction sector growth. The firm expects stable growth in consumer-dependent sectors will help support economic growth. There are also risks of increased inflation due to the upward pressure on food prices caused by dry weather conditions across Southern Africa.

NEWS HIGHLIGHTS

27/05/2019	De Beers sales decline as uncertainty creeps in (Weekend Post)	De Beers has cut its production target for the year. The company projects to produce to 31 - 33 million carats this year, subject to trading conditions, down from last year's 35 – 36 million carats. "Rough diamond sales during the first sales cycle of 2019 were lower than those for the equivalent period last year, reflecting higher than normal sales in the previous cycle (cycle 10 2018) and the slow movement of lower value rough diamonds through the pipeline," according to Bruce Cleaver, De Beers Chief Executive Officer.
27/05/2019	Botswana cancels 100 MW PV tender, plans new procurement exercise for June (PV – Magazine)	Botswana Power Corporation (BPC) has cancelled the tender for 100 MW of solar capacity that it had previously launched in May 2017. The now-cancelled tender had sought investors for the construction of two 50 MW photovoltaic plants, as part of a joint venture (JV) with BPC. It will be replaced by a new tender, which will be structured for independent power producers (IPPs) rather than a JV with BPC.
29/05/2019	Kalahari Energy Botswana awarded preferred bidder status for the construction of a 97MW Coal Bed Methane (CBM) fuelled IPP-owned power station (Weekend Post)	Kalahari Energy Botswana, through its subsidiary Sekaname (Pty) Ltd, has been granted Preferred Bidder Status by the Ministry of Mineral Resources, Green Technology and Energy Security for the construction of a coal-bed methane (CBM)- fuelled, IPP-owned power plant.
7/06/2019	PEEPA privatising BMC. (Sunday Standard)	The Chief Executive Officer of the Public Enterprises Evaluation and Privatisation Authority (PEEPA) has revealed that the government has started the process of privatising the Botswana Meat Commission (BMC) along with the Lobatse and Francistown abattoirs. Local law firm Minchin and Kelly, along with Deloitte Consulting, have been appointed as advisors to PEEPA for the BMC privatisation process, with a total advisory budget estimated at P8.7 million.
10/06/2019	Botswana gets P31.7 million facility. (Weekend Post)	Botswana is among the Southern African Development Community (SADC) countries set to benefit from the European Union-funded Trade Related Facility to capacitate the implementation of the Southern African Development Community (SADC) Trade Protocol and the EU-SADC EPA. According to the Minister of Investment Trade and Industry (MITI), Ms Bogolo Kenewendo, Botswana has received approximately P31.7 million to improve the implementation of the various trade facilitation interventions aimed at improving the ease of doing business in the country. The facility comes at a time when Botswana is increasing efforts to diversify the economy and promote export-led growth.
20/06/2019	Gem Diamonds drops Ghaghoo and exits Botswana. (Mining Review)	Gem Diamonds has entered into a binding agreement with Pro Civil for the sale of its 100% shareholding in the Ghaghoo diamond mine. The purchase of the mine is expected to be complete before the end of 2019 subject to regulatory approval. Ghaghoo mine has been closed, under care and maintenance, since March 2017.
24/06/2019	Botswana proposes Lucara Investment. (Rapaport News)	The government of Botswana have expressed interest in buying shares in Lucara Diamond Corp which owns and operates the Karowe mine in Botswana. The diamond mine has been successful in extracting large rough stones including the 813 carat Constellation, the 1,109 carat Lesedi la Rona and the 1,758 carat Sewelo.
24/06/2019	Central Bank root for an expanded Pula debt market. (Sunday Standard)	The Bank of Botswana has encouraged the government to develop the domestic capital market, in particular, the deepening of the Pula debt market, to reduce the risks that come with external borrowing in different currencies. According to the Bank's 2018 Annual Report, total outstanding government debt stood at P25 billion, of which 58 percent is held by external creditors. The Bank notes that large holdings of external debt are associated with high risks, making the Government vulnerable to volatile and potentially increasing debt service costs.

NEWS HIGHLIGHTS

24/06/2019	Tlou Energy gassed up. (Sunday Standard)	Tlou Energy Limited has reached yet another milestone in its gas-to-power project, after reaching the critical stage of extracting gas from coal seams, a development that points to commercial viability of the gas project. According to the company, production testing has been successful with the Lesedi 3 well, reaching Critical Desorption Pressure (CDP), and progress with Lesedi 4 continues to be carefully monitored. Tlou Energy is focused on delivering gas-to-power solutions in Botswana by tapping CBM natural gas.
25/06/2019	Botswana Stock Exchange to list, State to cede control. (Bloomberg)	The Botswana Stock Exchange (BSE) plans to list its own stock on the BSE within two years, a move that will see the government ceding control of the institution to private investors. The Chief Executive Officer of BSE, Mr Tsheole, stated that by listing on the stock exchange it would help the company improve on governance and transparency. The BSE is owned 80 percent by government with the remaining shareholding divided among four stockbroking firms.
25/06/2019	Government could hike P15 billion bond limit, move to monthly auctions. (Mmegi)	The Bank of Botswana (BoB) has advised the Government to raise the P15 billion ceiling on the note issuance programme for domestic bonds, and increase the frequency of auctions from quarterly to monthly as a way of triggering local capital market growth. It is stated that the government's traditional approach to raising debt, especially domestic debt, limits opportunities for enhanced infrastructure growth and creation of employment opportunities. Furthermore, the investment requirements as the country moves towards high-income status can be funded by tapping into the domestic capital market.

MACRO-ECONOMIC DATA

Key Economic Data	unit	2013	2014	2015	2016	2017	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2
Annual Economic Growth												
GDP	%	11.3	4.1	-1.7	4.3	*2.9*	*3.8*	*4.9*	5.0	4.5	4.4	..
Mining	%	24.2	0.5	-19.6	-3.7	-11.1	-0.3	5.6	4.0	7.4	5.3	..
Non-mining private sector	%	10.1	4.9	1.4	*7.1*	*5.6*	*4.5*	*5.1*	5.6	4.3	4.7	..
GDP current prices	P mn	125,158	145,868	146,066	*170,564*	*180,102*	*45,768*	*46,910*	48,699	48,492	48,729	..
GDP 2006 prices	P mn	84,081	87,569	86,083	89,787	*92,398*	*23,478*	*24,058*	24,126	24,851	24,485	..
Money & Prices												
Inflation	%	4.1	3.8	3.1	3.0	3.2	2.8	3.1	2.9	3.5	3.3	2.8
Prime lending rate	%	9.0	9.0	7.5	7.0	6.5	6.5	6.5	6.5	6.5	6.5	6.5
BoBC 14-day	%	3.06	3.07	0.97	0.84	1.45	1.47	1.47	1.52	1.52	1.60	1.60
Trade & Balance of Payments												
Exports - total goods	P mn	66,404	76,261	63,484	80,336	61,093	13,795	18,900	14,833	19,667	14,672	..
Exports - diamonds	P mn	55,367	65,328	52,730	70,781	54,384	*12,345*	*17,253*	12,991	17,822	13,519	..
Balance of payments	P mn	1,340	11,404	- 57	2 843	61	*- 958*	3 742	-90	216	-1,986	..
Foreign Exchange												
Exchange rate BWP per USD	end	8.718	9.515	11.236	10.650	9.872	9.533	10.395	10.593	10.730	10.787	10.616
Exchange rate ZAR per BWP	end	1.196	1.217	1.383	1.279	1.256	1.235	1.317	1.334	1.344	1.353	1.331
FX reserves	$ mn	7,726	8,323	7,546	7,189	7,502	7,383	7,147	7,146	6,657	6,843	..
FX reserves	P mn	67,772	79,111	84,881	76,804	73,693	70,582	74,297	75,781	71,427	73,505	..
Financial Sector												
Deposits in banks	P mn	48,512	51,492	59,961	62,438	63,581	62,495	64,838	68,517	69,271	71,640	..
Bank credit	P mn	39,763	45,116	48,307	51,316	54,181	54,695	56,531	57,582	58,332	58,362	..
BSE index		9,053.4	9,501.6	10,602.3	9,727.7	8,860.1	8,589.6	8,402.7	7,837.3	7,853.5	7,885.6	7,622.5
Business Indicators												
Diamond production *(a)*	'000 cts	23,134	24,658	20,732	20,880	22,961	5,885	6,360	5,825	6,307	6,081	..
Copper production (b)	tonnes	49,448	46,721	23,050	16,878	1,239	135	547	625	155	..	..
Nickel production	tonnes	22,848	14,958	16,789	13,120	0	0	0	0	0	..	..
Business confidence index		45%	52%	44%	43%	46%	58%	..	..	..	..	..
No. of companies formed		14,190	16,300	19,134	17,133	20,707	5,327	..	..	..	..	..
Electricity consumption	GWh	3,502	3,990	3,974	3,929	3,772	960	992	1,004	963	966	..
Crude oil (Brent)	$/bar	109.95	55.27	36.61	54.96	66.73	69.02	77.44	82.72	50.57	67.93	67.52
Employment (formal)												
Government		130,175	129,918	130,220	129,216	129,009	129,118	130,817	132,386	133,238	..	
Parastatals		18,838	18,790	19,411	19,008	19,444	19,491	19,566	19,773	19,830	..	
Private sector		189,894	191,399	191,484	194,202	193,745	194,162	194,564	195,198	195,681	..	
Total		338,907	340,107	341,115	342,426	342,198	342,771	344,947	347,357	348,749	..	

Govt Budget		2015/16	2016/17	2017/18	2018/19 Revised	2019/20 Proposed
Revenues	P mn	47,420	57,398	*56,411.05*	*58,229.40*	*60,198.63*
Spending	P mn	54,411	56,275	*58,392.94*	*65,308.34*	*67,537.96*
Balance	P mn	-6,991	1,123	*-1,981.89*	*-7,078.94*	*-7,339.33*
Public debt & guarantees	P mn	35,058	36,954	*34,339*	*35,920*	
Govt deposits at BoB	P mn	33,916	29,819	*30,094*	*21,559*	
GDP	P mn	149,140	174,600	*182,195*	*192,829.4*	*207,568*
Revenues	%GDP	*31.8%*	32.9%	*31.0%*	*30.2%*	*29.0%*
Spending	%GDP	*36.5%*	32.2%	*32.0%*	*33.9%*	*32.5%*
Balance	%GDP	*-4.7%*	0.6%	*-1.1%*	*-3.7%*	*-3.5%*
Public debt & guarantees	%GDP	*23.5%*	21.2%	*18.8%*	*18.6%*	
Govt deposits at BoB	%GDP	*22.7%*	*17.1%*	*16.5%*	*11.2%*	

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

Notes:

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

(b) Copper production starting Q2 2017 for Mowana mine

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

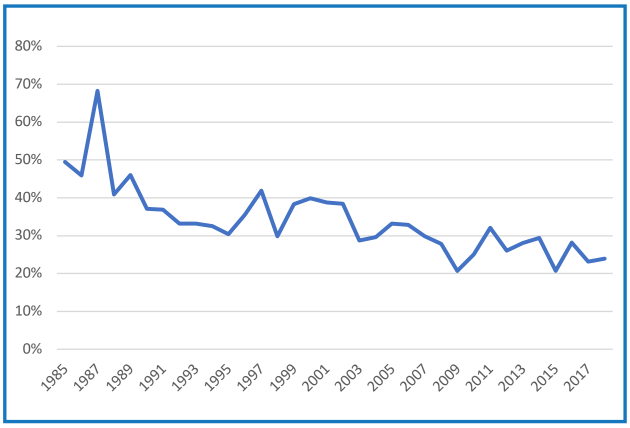
The Challenge of Export-Led Growth

Introduction
Much has been said about the need for Botswana to pursue export-led growth. This objective is a key part of Vision 2036, and is also central to National Development Plan 11 (NDP 11). In this article we discuss why export-led growth is so important, and how the challenges entailed in this strategy can be addressed.

The Importance of Export-Led Growth
Botswana's economic growth has been led by exports throughout much of the country's post-independence history, particularly during the period from the early 1970s to the mid-2000s as the diamond industry expanded steadily. Indeed, the growth of diamond mining and exports was one of the main factors behind the rapid increase in incomes and expansion of public services over this period. Diamond exports underpinned budget and balance of payments surpluses, and the accumulation of significant financial savings (in the Government Investment Account and the foreign exchange reserves, respectively).

However, diamond exports have been declining in relative terms over the past two decades, and in 2018 were equivalent to 24% of GDP, compared to over 50% in the mid-1980s and 40% of GDP in the early 2000s. This is one reason for lower economic growth rates, a shift towards balance of payments deficits over the past decade, and hence declining foreign exchange reserves.

Figure 1:
Diamond exports as a percentage of GDP



Source: Statistics Botswana

Exports are necessary for a number of reasons. Most obviously, exports are required in order to generate the foreign (exchange) currency earnings that are required to pay for imports. A country that doesn't export sufficiently will eventually experience a balance of payments and/or a debt crisis.

But the benefits of exporting go far beyond this. Exporting (and importing) provides opportunities for countries to specialise in the production of goods and services in which they have a comparative advantage. These "gains from trade" are widely acknowledged as one of the most important drivers of economic growth and higher real incomes over the long term. In addition, trade enables countries to benefit from economies of scale – especially important for small economies where the size of the domestic market offers limited potential for this. Furthermore, exports provide a key driver for innovation and productivity gains, which are the most important long-term determinants of real incomes.

The challenge for Botswana is particularly acute because our main export – diamonds – has not been growing. While the economy has been diversifying steadily – diamond mining accounted for only 16 % of value added (GDP at basic prices) in 2018, compared to 25% in 1994 – exports have not; Botswana rough and polished diamonds accounted for 73% of total exports of goods and services in 2018, little different to the figure 25 years earlier. But as the economy grows, the need for imports will also grow, and hence new export products must be developed. One of the main structural problems facing the Botswana economy is that the economic diversification that has occurred has been into non-tradeable sectors, mostly services, that serve the domestic economy rather than exports.

SPECIAL FEATURE

Figure 2a:
Composition of GDP, 2018

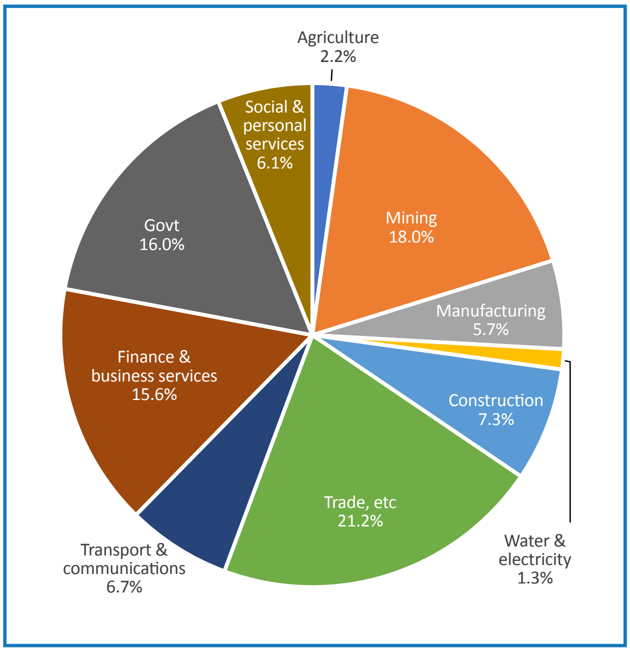
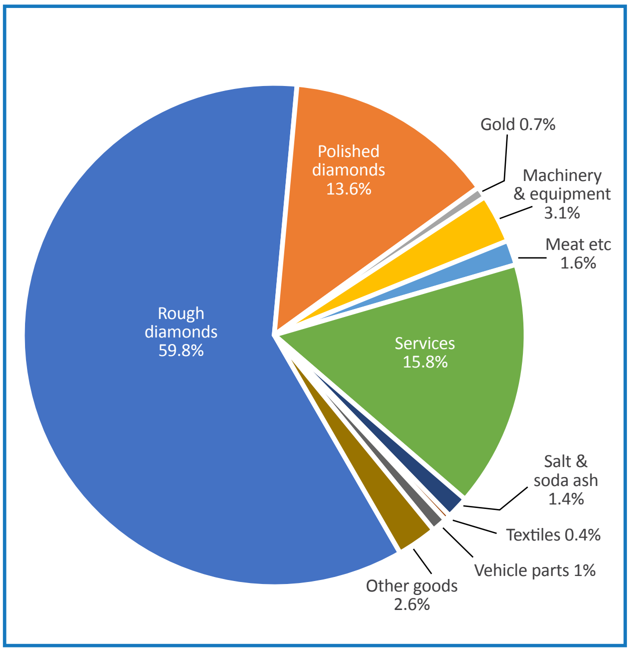


Figure 2b:
Composition of Exports, 2018



Source: Statistics Botswana, Bank of Botswana

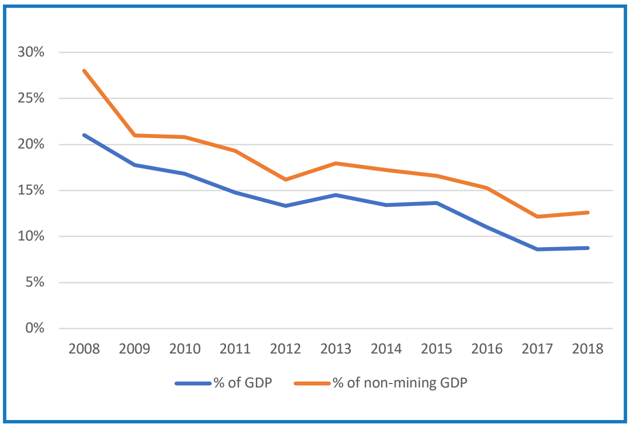
In recent years there has been a lot of emphasis on import substitution as a source of growth, with many references to Botswana's "P70 billion import bill", which could or should be replaced with domestically produced goods and services.

While there may be some scope for import substitution, in our view the potential is limited, and it would be unwise to frame an economic development strategy around this approach, and the entire P70 billion import bill for goods and services is a misleading reference point. For example, over P18 billion of this represents diamond imports, which are integral to the country's strategy of developing as a diamond trading hub, and hence cannot be substituted by domestic production. Many remaining imports represent commodities that cannot physically be produced in Botswana, or could only be produced at a much higher cost than importing. In reality, the true potential for imports that can be substituted by domestic production is a small fraction of the quoted P70 billion figure – probably no more than ten percent – which would add only two percent to the total output of the economy if produced locally rather than imported, i.e. it would be insignificant. The small size of the domestic economy will always provide a constraint on the potential for import-substitution led growth. By contrast, the potential for export-led growth is effectively unlimited, given the size of the regional and international economies. This applies to both the potential foreign exchange earning impact, as well as the employment impact.

International experience also shows that an export-led growth strategy is likely to be more successful than an inward-looking, import substituting one. The examples of North and South Korea provide an extreme example of the contrasts, but more generally the experiences of (export-led) East Asian economies compared to those in (import-substituting) Latin America provide clear evidence of this conclusion. Or alternatively, consider Singapore, which is arguably the single most successful economy in the world over the past 50 years. As a thought experiment, imagine how rich (or poor) Singapore would have been if it had insisted on being self-sufficient in food production, rather than developing specialisations in increasingly complex segments of manufacturing and services value chains, and importing things (like food) that other countries had a comparative advantage in and could produce much more cheaply.

Having said that, achieving successful export-led growth will not be easy. Botswana has struggled to develop dynamic export sectors outside of diamonds, with the only major success being the tourism sector. Most other non-diamond goods exports - copper-nickel, beef and other manufactured goods – have experienced only slow growth, or even declined.

Figure 3:
Exports of Non-diamond goods & services



Source: Statistics Botswana

Achieving modern export-led growth in Botswana

As noted above, Botswana has experienced export-led growth in the past, but in the most recent one or two decades the economy has not been led by diamond sector, as production has plateaued (and hence declined in relative terms), and GDP growth has slowed markedly. Achieving future export-led growth will be quite different to that experienced in the past, however, and poses very new challenges that Botswana will need to address.

The past era of export-led growth through diamonds was in some respects easy to achieve. Botswana was fortunate enough to be blessed with very large, low cost diamond deposits, and put in place governance to ensure that this good fortune was not wasted, as happened in many other mineral-rich countries. With De Beers dominating and managing the global trade in rough diamonds, and Botswana being the largest diamond producer in the world, by value, for many years, it was not difficult to find export markets. Export success was not dependent upon being highly competitive.

Future export-led growth will be different. It will be based on selling goods and services to customers in different countries – in the region and elsewhere – who have a choice as to where they buy those goods and services. Hence Botswana products will have to be competitive, and chosen by international consumers because they are the best value – in terms of price, design and quality – available. This in turn requires a focus on competitiveness, efficiency and productivity that has not generally been central to either the public or private sectors in Botswana – not by design, but simply because has it not been necessary for survival.

There are several key components necessary for successful export-led growth in Botswana.

Attracting Foreign Direct Investment (FDI)

It is a well-established finding globally that foreign-owned firms tend to be more active exporters than locally-owned firms. In Botswana, locally-owned firms are more dependent on government procurement and less likely to be involved in exports than foreign-owned firms. In recent years, Botswana's efforts to attract FDI have largely failed, with FDI inflows dropping to 0.6% of GDP in 2018, compared to an average of around 5% of GDP in the 2000s. Foreign firms typically bring access to markets and supply chains, expertise in product design, technology and skills – i.e., addressing many of the factors that are likely to act as binding constraints to export growth. They are also likely to be larger in terms of employment and output.

Trade agreements

Botswana has access to a range of regional and international trade agreements, including the Southern African Customs Union (SACU), Botswana-Zimbabwe Bilateral Trade Agreement, the SADC Free Trade Area (FTA), the SADC-COMESA-EAC Tripartite Free Trade Area (TFTA), the new African Continental Free Trade Area (AfCFTA), the SADC-EU Economic Partnership Agreement (EPA), and the US Africa Growth and Opportunity Act (AGOA). These trade agreements offer varying degrees of market access, on different conditions. Most FTAs include tariff liberalisation with the objective of zero tariffs on "substantially all trade" (as per WTO rules). However, it is often the case that tariffs are not the main barrier to trade, and other factors such as product competitiveness, transport costs, standards, and non-tariff barriers (NTBs) can be more important. Also, these agreements typically refer only to trade in goods, not services. Hence it will be wise for Botswana to ensure that these other issues are addressed in negotiating and implementing these and other agreements. Also, it is important to remember that most trade agreements (the main exception is AGOA) are reciprocal, and if Botswana expects improved access to other countries' markets, the same access to Botswana must be granted to those countries. Protectionist trade policy, therefore, is not consistent with participation in regional and international trade agreements, or with export-led growth.

Product and market development

Success in exporting requires an understanding of external market demand, the characteristics of the products that will sell in those markets, meeting appropriate standards, as well as being able to produce those products competitively. It also requires access to the sales and marketing channels that enable consumers to acquire those goods and services. This includes both final demand for finished products and intermediate demand for components in value chains. Examples of the former would include beef, clothing and tourism services, while the latter would include soda ash, vehicle wiring harnesses and back-office business services. Understanding markets enables the right products with the right characteristics to be produced at the right price; with-out such an understanding, and the willingness to incorporate market requirements into product design and quality, exporting will be very difficult. It also provides opportunities to move up the value chain, providing more specialised products for higher value market segments. Successfully penetrating external markets often also requires meeting appropriate market or product standards, whether technical standards (typically where there are health and safety issues), Good Manufacturing Practice (for food & beverages, cosmetics, pharmaceuticals etc.), HACCP (foodstuffs), Organic standards (foodstuffs), and Fairtrade (food and other products).

Problem-solving and Non-Tariff Barriers

Discussions with existing exporters indicate that they face a number of problems that constrain their growth and/or raise costs unnecessarily. These problems cover a broad range of issues both inside and outside of Botswana. Domestic examples include well-known concerns such as the availability of work permits for employees with scarce skills, slow approval of Environmental Impact Assessments (EIAs) and other regulatory requirements, inefficiency in the provision of services that are essential for trade by government departments and parastatals, as well as delays at borders (partly due to the fact that none of Botswana's borders are open 24 hours).

There are also concerns about Non-Tariff Barriers (NTBs) imposed by countries that are destinations or transit routes for Botswana's goods exports. Many of these NTBs (at least as reported by exporters) appear to be inconsistent with the spirit, if not the letter, of various regional and bilateral trade agreements, and appear to be deliberately constructed (or passively allowed) to disadvantage Botswana exporters. And yet mechanisms for resolving NTB problems under SACU and the SADC FTA do not appear to be effective. As noted above, trade agreements need to include effective mechanisms for dealing with NTBs, and this is one thing that Botswana should be pushing for in trade negotiations. As an example, the East African Community (EAC) has a number of mechanisms for reporting NTBs (even including real-time reporting by SMS of NTBs encountered en route by transport operators), as well as follow up and accountability mechanisms to improve the efficiency of dealing with NTBs.

Given the importance of domestic barriers and external NTBs as a barrier to exporting, government and the private sector need to establish forums ("exporters clubs") where these can be raised and resolved, if necessary through official, government-to-government channels. Relevant entities need to be held accountable for resolving or responding to the problems raised, in a timely manner.

Exporter Training and Awareness

Although it is important to attract more FDI to increase exports, it is also important to support more locally-owned firms to enter and grow in export markets. There are already some local firms that are export successes, but as noted above, most local firms are dependent upon the domestic market. However, with the small size of the Botswana market, it is important that if firms wish to keep growing, they develop the capacity to export. But this is not easy or straightforward; firms need training in export production, cross-border trading issues and trade finance, as well as understanding markets and product requirements. Besides formal short training courses, emerging exporters could benefit from mentoring by larger, established exporting firms.

Incentives

The government offers Botswana firms various support and incentives, some of which are available only to citizen-owned firms while others are for any firm based in Botswana. Such initiatives include subsidised finance from Citizen Entrepreneurial Development Agency (CEDA), business support from Local Enterprise Authority (LEA), and price preferences for government procurement under the Economic Diversification Drive (EDD) scheme. The structure of such preferences is not well focused on encouraging exports, and may often discourage exporting. EDD price preferences are a good example, which reward Botswana-based firms for supplying government, with additional price incentives for smaller firms and those owned by disadvantaged groups (the youth, women, disabled). There can be very high profit margins involved in supplying Government. Furthermore, procurement processes are often perceived as not being particularly competitive or concerned about product quality, where sub-standard performance is tolerated.

Although EDD was intended in the short-term to provide firms with a platform to achieve scale and then graduate to export markets, there is no evidence of this being achieved; instead EDD has become a "procurement trap" with no incentive to move beyond an undemanding and profitable domestic (public sector) market to a highly competitive and demanding – albeit much larger – export market. Perhaps the structure of EDD benefits need to be revised to incentivise the desired shift towards exporting. Similarly, CEDA and LEA support should be more focused on supporting and encouraging graduation into exporting.

Many firms have argued for a specific package of incentives for exporters, in addition to concessions that many already benefit from, such as a reduced corporate tax rate of 15% for manufacturing firms or IFSC companies. Some further concessions will be made available to exporters once the Special Economic Zones Authority (SEZA) incentives are finalised. Caution is required, however, as direct subsidies for exporters may be inconsistent with WTO rules. There is also a risk that too much may be given away in incentives relative to the economic benefits that result, or that subsidies encourage excessive consumption of scarce resources, such as water. Direct subsidies are also costly for government. In our view, any incentives should be targeted on encouraging labour-intensive export production.

SPECIAL FEATURE

Infrastructure

Exports can be supported by the provision of appropriate public infrastructure. This includes:

- making key border posts more efficient, through 24-hour opening and establishing "one-stop border posts", where freight traffic has to only be cleared once in each direction (at present it has to be cleared twice);
- developing an airfreight transport hub, in collaboration with a major international airline, to improve inward and outward airfreight capacity and, hopefully, reduce costs;
- improving cross-border rail links, with a new east-west link (through the Mmamabula coal fields to Lephalale in South Africa) and north-south link across the new Kazungula bridge over the Zambezi river to Zambia probably the most promising;
- improving the reliability of internet services, especially the Government Data Network, so that transport documents (e.g. for customs clearance) can be reliably filed and transmitted electronically; more generally, Botswana could consider attracting all types of investors by providing and guaranteeing access to "the fastest, cheapest, internet in Africa", which would be a great selling point for the country and an effective tool to support new types of businesses.
- utilities are constantly an issue for firms, in terms of reliability and/or cost. Water will always be expensive in an arid, water-stressed country like Botswana. For electricity, many firms complain that power is expensive by regional standards; there would be merit in conducting a detailed comparative study on electricity tariffs to determine the facts, and in particular to examine whether there is a need to rebalance the way the power tariffs are applied to households and firms.

Exchange Rate

Exchange rate policy is the most important macro-economic policy with regard to export development, as it is a key determinant of Botswana's overall competitiveness. We have commented earlier (Economic Review, 2017Q2) that exchange rate policy needs to be reviewed with respect to how well it supports export diversification. In particular, the weights of the different components of the Pula currency basket (ZAR and SDR) are not appropriate for the development of non-diamond exports (specifically, the weight of the ZAR is too low, given the importance of regional export markets).

Current exchange rate policy aims at keeping the real effective exchange rate (REER) of the Pula stable. The REER is a key overall measure of competitiveness, and stability in the REER may help to promote exports. The problem, however, is that the deterioration in export performance in recent years, along with persistently high unemployment, indicates that the real exchange rate of the Pula is overvalued, and therefore a policy of maintaining stability – at an overvalued level – does not help export development at all. The conclusion, therefore, is that exchange rate policy should revert to a modest downward crawl of the Pula against the basket, and certainly that an upward crawl should be avoided at all costs, in addition to adopting more appropriate basket weights.

Conclusion

The successful achievement of export-led (non-diamond) growth is essential for Botswana's continued economic prosperity – it is not an optional or "nice to have" strategy. The implications of failure to achieve export-led growth are severe – an eventual balance of payments crisis, the likelihood of mounting debt and possible debt distress, downward pressure on the value of the Pula, and continued high unemployment. As the new National Employment Policy makes clear, export-led growth is of fundamental important in sustainable, large-scale job creation. Therefore, it requires a concerted effort to make it work.

As noted above, ensuring that exports can expand requires several elements to be put in place – the right firms, products, policies, market access, and minimal trade barriers. A common thread is the need for competitiveness, which can be addressed at both the firm level and the policy level. A key challenge for government is to deal with factors under its control that may reduce Botswana's competitiveness, and its actions should be viewed through the lens of whether they improve or reduce competitiveness. Competitiveness should be the overriding criteria to gauge all government policies and measures; "will this policy and/or measure enhance or hinder the country's competitiveness?". This question should be applied systematically to all government decisions; and all major policy frameworks and systems and procedures in the economic, labour and social areas, from macroeconomic policy to trade and sectoral policies, skills and labour market policies, should be reviewed in the light of this one central criterion. By doing this, costs of production can be reduced, barriers to achieving competitiveness can be removed, and Botswana firms will be supported to successfully penetrate regional and international export markets.

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