compiled by
SETHUNYA KEGAKGAMETSE
KITSO MOKHURUTSHE

econsult

ECONOMIC REVIEW

second quarter apr-jun 2022

in this issue ...

COMMENTARY

Economic Growth Continues into Early 2022, but uncertainties still persist

Introduction

Botswana continues to experience strong post COVID-19 economic recovery with the momentum realised throughout 2021 being carried forward into the early parts of 2022. At the same time, pressures emanating from the global economy are creating stresses for both households and firms. Economic developments during the second quarter of 2022 highlighted both the local economy's strengths and weaknesses in what can be described as a mixed bag performance. The key developments during the quarter are characterised by a strong diamond market, broad based growth, rising inflation and significant changes to monetary policy.

Growth

National accounts data for Q1 2022 report annual real GDP growth of 13.1%, significantly greater than the minus 4.4% growth recorded in Q1 2021 and higher than the 11.4% annual growth recorded during the previous quarter (Q4 2021). Despite the strong performance during the first quarter of the year, the International Monetary Fund (IMF) downgraded Botswana's growth projections for 2022 from 4.7% to 4.3% in their World Economic Outlook (WEO April 2022). The IMF cite increases in both prices and demand for diamonds, better harvests due to improved rainfall and an uptick in tourism activity as the main drivers of economic growth in Botswana for 2022. The downward revision in the growth projection mainly reflects slowing global growth.

Real GDP growth in Q1 2022 was mainly driven by the mining sector, which recorded year-on-year growth of 42.0%, spurred on by a 44.1% y-on-y increase in diamond mining. Nevertheless, the Non-Mining Private Sector (NMPS) also performed strongly

COMMENTARY

during the quarter, recording an annual growth rate of 8.3%, its fourth consecutive quarter of positive growth. The robust performance of the NMPS over the past 12 months has to some extent eased fears that Botswana's economic recovery would not be broad based but rather concentrated in a few sectors such as Mining and Diamond Trading. This is further evidenced by the fact that all sectors, barring Agriculture, recorded positive annual growth during Q1 2022. The Accommodation and Food Services sector, which is taken as a proxy for tourism activity, recorded positive growth for the first time since Q1 2020, suggesting that the tourism industry has begun to recover from the COVID-19 shock.

Diamond Market

The global market for rough diamonds performed very strongly during Q2 2022. De Beers' total sales for Q2 2022 were valued at USD1.8 billion, representing a 38.7% increase compared to Q1 2022 (albeit with an extra sales event) and a 32.9% increase compared to Q2 2021. Sales for the first half of 2022 were valued at USD3.1 billion, 32.2% greater than during the same period in 2021. Sales remained robust through Q2 2022 due to demand for diamonds remaining strong in key markets such the United States of America, and retail outlets in China gradually opening since experiencing COVID-19 related lockdowns. In April 2022, sanctions were imposed against Alrosa, Russia's leading diamond supplier, causing greater supply side shortages in the diamond market, pushing prices up and giving De Beers the opportunity to claim a much larger share of the market during Q2 2022. During H1 2022, the consolidated average realised price and the rough price index increased by 58% and 28% respectively when compared to H1 2021.

Despite strong sales results during Q2 2022, De Beers rough diamond production fell by 3.7% and 11.2% when compared to Q1 2022 and Q2 2021 respectively, reaching 7.9 million carats during the quarter. This was attributable to the treatment of lower grade ores at mines in Botswana and Canada. However, the production guidance for 2022 as a whole has been adjusted upwards to 32-34 million carats, from 30-33 million carats. In Botswana, diamond production fell to 5.5 million carats in Q2 2022, representing a 3.5% and 11.3% decline when compared to Q1 2022 and Q2 2021 respectively.

Banking Sector

The domestic banking sector continues to demonstrate considerable resilience, although some cracks are beginning to show. Annual bank credit growth reached 6.6% in April 2022, up from 4.7% in January 2022. As a reflection of improving economic activity, credit to firms rose to 8.4% in the year to April 2022, its highest level since January 2019. This increase was partially offset by a decline in the growth rate of credit to households, which fell to 5.6%, its lowest level since mid-2017; this could be indicative of growing uncertainties over consumer incomes as inflation continues to rise and adjustments that encourage saving are made to monetary policy. March 2022 was the first time that the growth rate of credit to firms surpassed the growth rate of credit to households since February 2019. Arrears on bank lending remained low by historical standards, although rising marginally from 5.2% in Q4 2021 to 5.4% in Q1 2022, further emphasising the market's resilience. Despite these positive developments, excess liquidity held by banks fell to 3.9% of total assets in April 2022, its lowest level since January 2015. The squeeze on liquidity is posing an increasing problem to banks and could result in restrictions on credit availability to both firms and households.

Inflation

The annual headline inflation rate reached 12.7% in June 2022, its highest level since January 2009. This has been driven by an increase in global food and energy prices during Q2 2022. As a result of the Russia-Ukraine war and the supply-side shortages of crude oil, international fuel prices continued to surge upwards during Q2 2022, with the spot price of Europe Brent crude oil rising by 20.8% during the quarter. Subsequently, the Botswana Energy Regulatory Authority (BERA) had to adjust fuel prices upwards twice during the quarter in order to align with international prices. In total, local retail pump prices were adjusted as follows: Unleaded 93 (341t per litre), Unleaded 95 (358t per litre), Diesel (402t per litre) and Paraffin (573t per litre). Local food prices, along with utility and rental prices, also continued to rise during the quarter. Inflation is projected to remain above 10% until Q2 2023, only reverting to within the BoB's 3-6% objective range towards the end of 2023.

Globally, the volatile geo-political environment has led to instability in capital markets and potentially destabilising capital flows from international investors. Rising inflation is leading central banks to tighten monetary policies through higher policy interest rates. This, combined with fears of recession and slowing global demand, has caused global stock markets to decline sharply, led by price declines for assets that were arguably overvalued (e.g. shares such as Meta/Facebook, and crypto-currencies). Fortunately, the Botswana Stock Exchange (BSE) Domestic Companies Index (DCI) has resisted this trend, outperforming both the MSCI World Index and the MSCI Emerging Markets Index during Q2 2022. Furthermore, risk averse investors have been increasingly drawn towards US Dollar denoted assets given the currency's "safe haven" status, further propping up the US Dollar against most currencies such as the Rand; this effect is further exasperated by South Africa's structural deficiencies, such as electricity shortages, weakening the Rand.

Monetary Policy

The BoB made several changes to monetary policy during Q2 2022. The central bank changed its Monetary Operations Framework (MOF) from using the Bank Rate as the policy rate to setting a new Monetary Policy Rate (MPR). This change means that in place of the Bank Rate,

COMMENTARY

the 7-day BoBC rate will be set as the anchor policy interest rate, and BoBCs will be auctioned off using a fixed rate full allotment system. One of the problems with the old Bank Rate was that it had no operational significance for banks, and hence had no direct link to lending or deposit rates. The BoBC rate, by contrast, has stronger links to both. The BoB believes that the changes to the MOF will achieve three main objectives, namely enhanced policy transmission, affect liquidity management decisions, and influence commercial bank decisions & market responses. The changes to the MOF took effect from the end of April 2022.

Furthermore, the BoB took the decision to increase interest rates twice during Q2 2022, in April and June, the first interest rate hikes since March 2008. This was done in order to bear down on the high levels of inflation that the economy is experiencing, as well as to limit capital outflows by reflecting interest rate trends globally. The MPR was set at 1.65% in April 2022, representing a 51-basis point increase to the Prime Lending Rate (PLR), and a further 50-basis point increase was implemented in July, setting the new MPR at 2.15% and pushing the PLR to 4.76%.

Should inflation continue rising through the short-term and remain above the BoB's 3-6% objective range for longer than the current medium-term expectations, or if global rates continue to rise, further increases in interest rates would be expected from the central bank. This, however, would not be ideal as it would further hinder the domestic economy's post COVID-19 recovery efforts. Higher interest rates will also impact on Government's cost of borrowing, and short-term borrowing rates (Treasury Bills) have already increased along with BoBC rates. Longer-term bond rates are unchanged over recent months, but whether this is sustainable depends on the market's ongoing demand for bonds relative to Government's borrowing requirements.

Trade

International trade activity remained buoyant during Q1 2022. The value of imports rose by 1.7% quarter-on-quarter, reaching P25.56 billion. The value of exports rose sharply during Q1 2022, registering q-on-q growth of 35.9%, reaching a value of P25.74 billion. This resulted in a small trade surplus of P0.18 billion, the first quarterly trade surplus since Q1 2021 and only the second since Q4 2018.

Outlook and Conclusion

The second quarter of 2022 bore a mixed bag of results for Botswana. On the positive side, GDP data indicates that Botswana's strong economic recovery through 2021 has carried forward into 2022. The diamond market has also maintained its momentum throughout the first half of the year despite uncertainties caused by the Russia-Ukraine war. Furthermore, the quarter realised a significant increase in credit to firms, whilst total arrears on lending (to both firms and households) remained low by historical standards. However, on the negative side, the main driver of economic recovery remains diamond mining, leaving Botswana vulnerable to external shocks. There has been a squeeze on excess liquidity within the commercial bank sector which could, in the future affect access to lines of credit. Both local and global inflation rates continued to soar during the quarter, leading to monetary policy tightening around the world and disruptive capital flows.

Looking ahead, the domestic and global economic environments are marked by high levels of risk and uncertainty. The global macroeconomic environment is poor, with rising inflation and interest rates, and slowing growth, with risks of global recession. Asset markets are unstable, with sharp declines in value (and hence losses in wealth) for most. Living standards are under pressure almost everywhere, with increasing food and energy prices leading to reduced real incomes. However, there are a few winners in this environment, mainly commodity producers, especially energy (oil, gas and coal). To some extent Botswana falls into this category, with higher diamond prices and a changed supply-demand balance resulting in short-term gains for export earnings and government revenues. It has also led to gains for Botswana's copper and coal mining sectors. The price of South African export coal, for instance, surged to USD300 per tonne in Q2, compared to USD142 at the end of 2021 and an average of USD73 between 2015 and 2020. As a result, Botswana is now exporting coal to Europe, despite the very high costs of getting coal to ports on an old, slow and inefficient railway system.

High levels of risk cannot be ignored, however. The diamond market is highly dependent on economic growth, and notably the fortunes of US consumers. On the last two occasions that the global (and US) economy suffered from a major negative growth shock, during the global financial crisis of 2008-9 and the COVID-19 pandemic in 2020, the demand for diamonds collapsed. Hence the current gains may be short-lived.

On a positive note, there are signs that the surge in food and energy prices in recent months, which has had such a devastating impact on global and domestic inflation and living standards, is easing off. For global food prices, which surged in the first quarter of the year, there was a small decline in the second quarter. The UN FAO global food price index (covering meat, dairy, grains, oils and sugar) fell by 2.6% in Q2 2022, after increasing by 19.5% in Q1. The price of Brent crude oil declined to USD100 a barrel in mid-July, compared to over USD120 in early June. The price of copper – a bellwether for mineral commodity prices in general – fell by 31% between March and mid-July. This bodes well for a reduction in inflationary pressures both globally and in Botswana in the coming months, even though there may be some price pressures still in the pipeline in the short term.

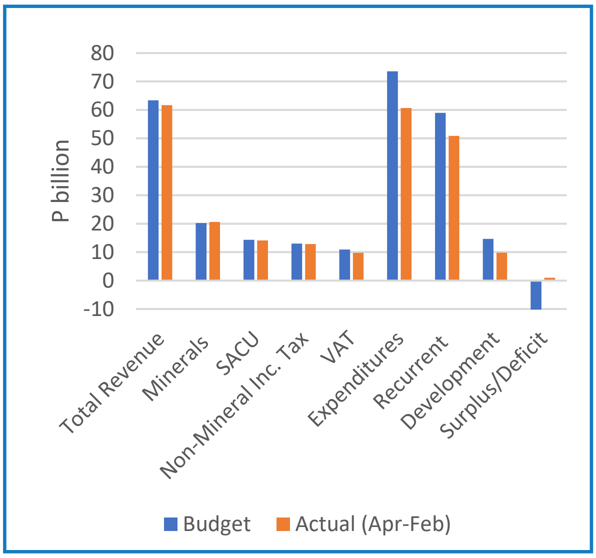
Fiscal Developments

The government budget has been subject to a lot of volatility in recent years, with long-term trends combining with the impact of COVID-19, resulting in large budget deficits and the depletion of government savings held in the Government Investment Account at the Bank of Botswana.

There are signs that the situation is improving, however. While final budget figures for the 2021/22 financial year have not yet been published, data are available for the first 11 months of the FY, and for government balances at the Bank of Botswana. Revenues are ahead of budget (for 11 months), due mainly to higher than expected mineral revenues. Expenditures are below budget, notably for the development budget, with only two-thirds of the budget actually spent after 11 months of the financial year. Whereas a significant budget deficit of P10.2 billion was budgeted for the year, the outturn after 11 months was a surplus of P1.0 billion. For the year as a whole, something close to a balanced budget is likely. While ministries have long complained that their ability to implement development projects has been hampered by a lack of funding, these figures suggest that the availability of funding is not the binding constraint on the roll-out of much-needed development projects.

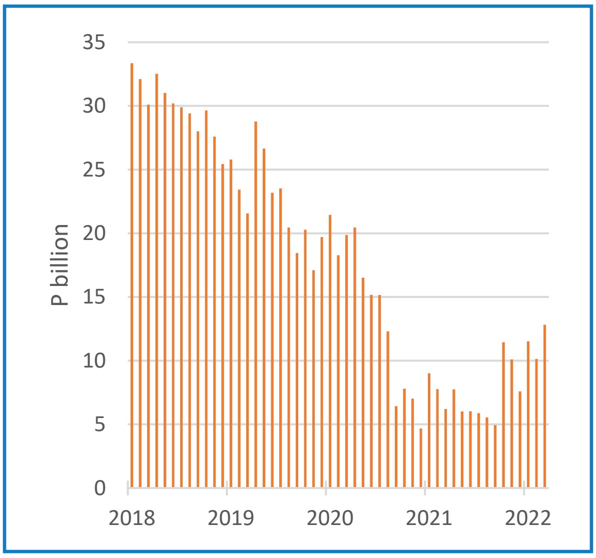
The combination of under-spending and some additional borrowing by government means that balances held at the Bank of Botswana have improved significantly. Compared to the low point of P4.7 billion reached in December 2020, government deposits at BoB had increased to P12.8 billion by the end of March 2022. The Government Investment Account (GIA) portion of these deposits increased from P3.3 billion to P11.4 billion over this period. Despite the recovery, government balances at BoB remain low by historical standards, and require to be rebuilt further in order to provide a useful buffer against shocks.

Figure 1: Budget 2021/22 (P billion)



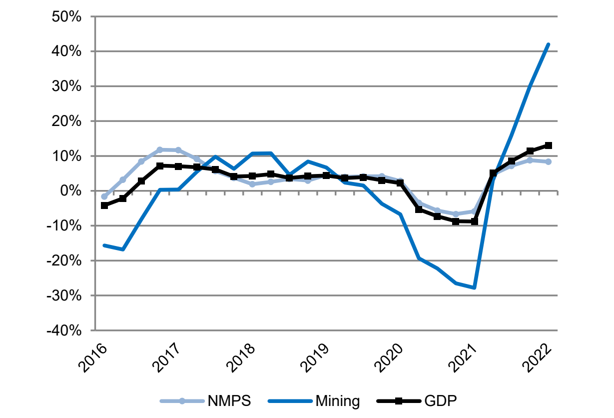
Source: Botswana Financial Statistics, May 2022

Figure 2: Government Balances at Bank of Botswana (P billion)

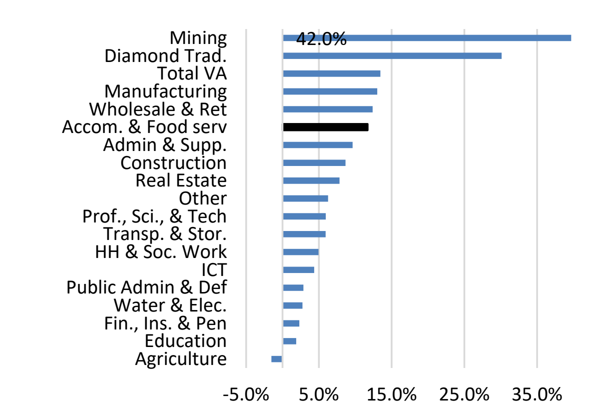


KEY ECONOMIC VARIABLES

Annual GDP Growth



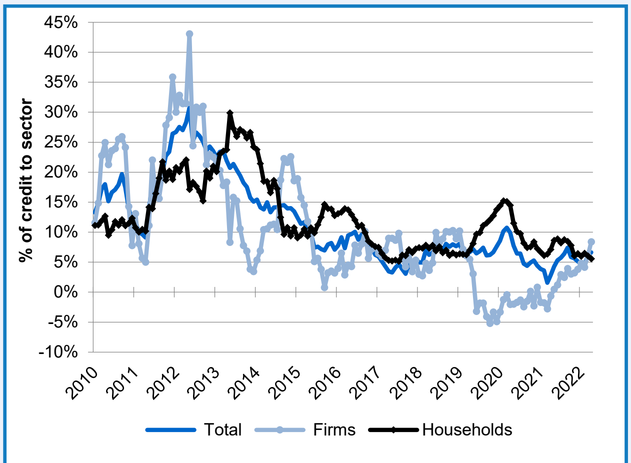
Sectoral GDP Growth



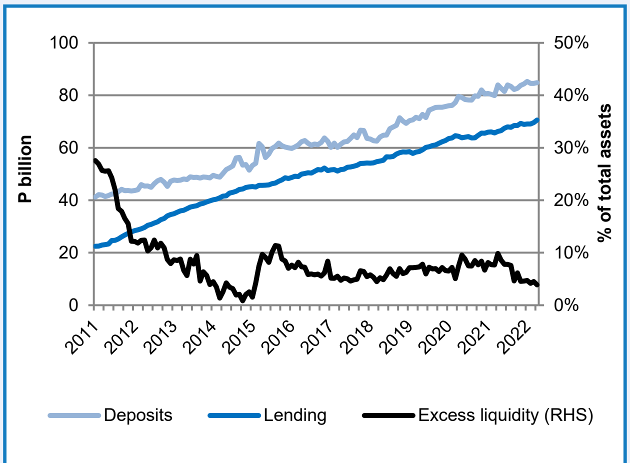
Overall economic growth continued its strong recovery during the first of quarter of 2022. Annual real GDP growth rose from 11.4% in Q4 2021, to 13.1% in Q1 2022, significantly greater than the minus 4.4% growth recorded 12 months prior (Q1 2021). Botswana's economic recovery has been spearheaded by the mining sector which recorded annual growth of 42.0% in Q1 2022, up from 29.9% in Q4 2021. The rise in mining sector growth was driven by a 44.1% y-on-y increase in the value of diamond mining. Non-mining private sector (NMPS) activity remained strong in Q1 2022, albeit marginally slower than the previous quarter, recording annual growth of 8.3%, down from 8.8% in Q4 2021.

In line with Botswana's continued economic recovery, all sectors except Agriculture recorded positive annual growth during Q1 2022. Most notably, the Accommodation & Food Services sector recorded annual growth of 11.7%, its first positive growth since Q1 2020. This could be interpreted as an indication that the tourism sector has begun to recover from the negative effects that the COVID-19 outbreak and its associated lockdowns & travel restrictions had on the industry. The best performing sectors during Q1 2022 were Mining (42.0%), Diamond Trading (30.1%) and Manufacturing (13.0%). Agriculture was the worst performing sector, recording annual growth of minus 1.5%.

Annual Credit Growth



Bank Deposits, Lending & Liquidity

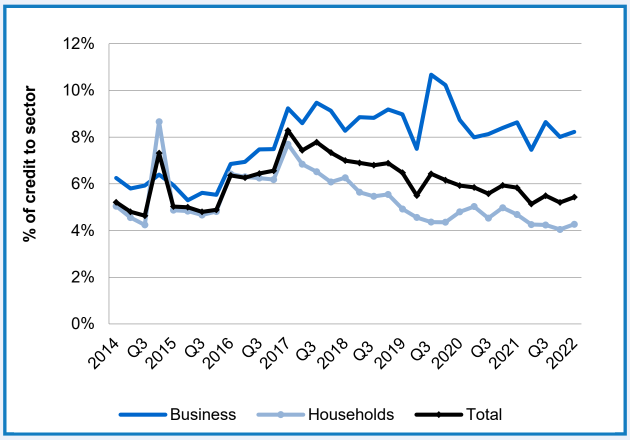


Annual bank credit growth in April 2022 was 6.6%, rising from 4.7% in January 2022. This was driven by a sharp increase in debt taken up by private firms, reflecting the increase in economic activity during Q1 2022. Annual bank credit to firms rose from 4.8% in January 2022 to 8.4% in April, reaching its highest level since January 2019. Annual credit growth to households slowed down to 5.6% in April, down from 6.0% in January 2022. This is the first time that the growth rate of credit to firms has exceeded the growth of credit to households since early 2019.

Bank liquidity decreased during the first months of 2022, reaching its lowest level since January 2015 in April. Excess liquidity fell to 3.9% of total assets in April 2022, down from 4.7% in January 2022. Bank lending was valued at P70.6 billion in April 2022, a 2.3% increase compared to January (P69.0 billion). Conversely, bank deposits declined by 0.6% during the same period, reaching a total of P85.8 billion in April 2022. Tight liquidity is increasingly posing a problem for banks and could potentially lead to restrictions on credit availability.

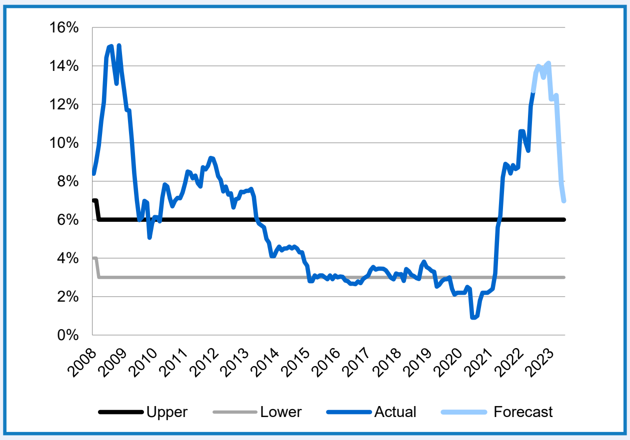
KEY ECONOMIC VARIABLES

Arrears on Bank Lending



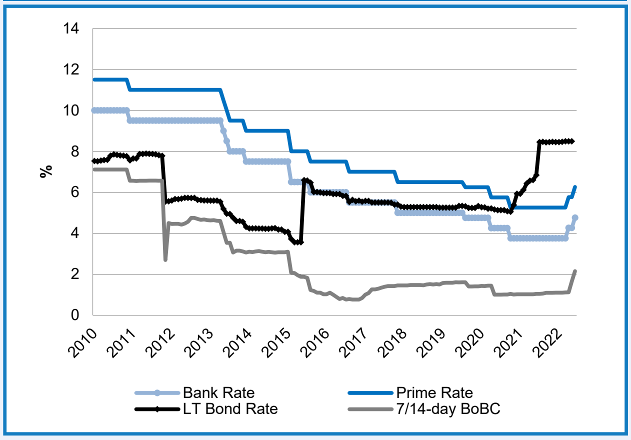
During the first quarter of 2022, total arrears on bank lending rose marginally as a proportion of total bank credit. Total arrears rose from 5.2% of lending in Q4 2021, to 5.4% in Q1 2022. This was driven by an increase in arrears on lending to both households and businesses. Arrears on lending to households rose from 4.0% in Q4 2021 to 4.3% in Q1 2022. This was compounded by an increase in arrears on lending to businesses which rose from 8.0% in Q4 2021 to 8.2% in Q1 2022. Although rising, arrears remain at historically low levels.

Inflation and Forecast



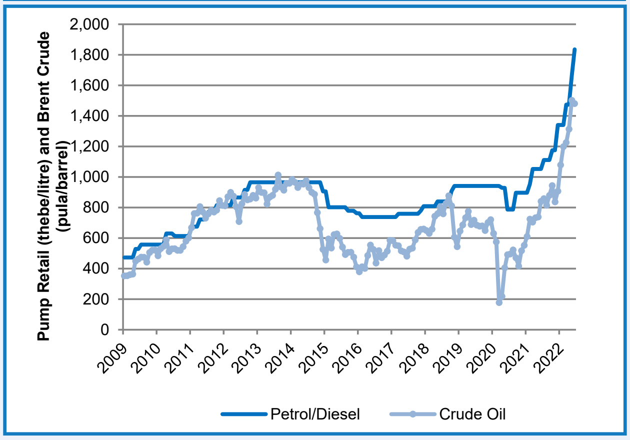
Headline inflation rose to 12.7% in June 2022, up from 10.0% in March, reaching its highest level since January 2009. The increase in inflation was driven by two upward adjustments to fuel prices during the quarter, rising utility & rent prices and uptick in local food prices. Inflation is projected to remain above 10% until Q2 2023 and to fall within the BoB's objective range of 3-6% by the end of 2023.

Interest Rates



The Bank of Botswana's (BoB) Monetary Policy Committee (MPC) took the decision to raise interest rates twice during Q2 2022. The first increase, a 51-basis point hike, took effect in April, and was followed by another 50-basis point increase in June. Subsequently, the Prime Lending Rate rose by 101-basis points during the quarter, reaching 6.26% in June 2022. Interest rates were raised in order to rein in the persistently high levels of inflation. Furthermore, BoB made a policy change in April 2022, moving away from the Bank Rate to a new Monetary Policy Rate (MPR) as the main monetary policy instrument used to target inflation. The MPR is tied to the BoBC rate. Money market rates continued to rise in Q2 2022. The 7/14-day BoBC rate rose from 1.11% in March 2022, to 2.15% in June 2022. The long-term government bond rate (BW012) rose marginally from 8.47% in February 2022 to 8.49% in May 2022.

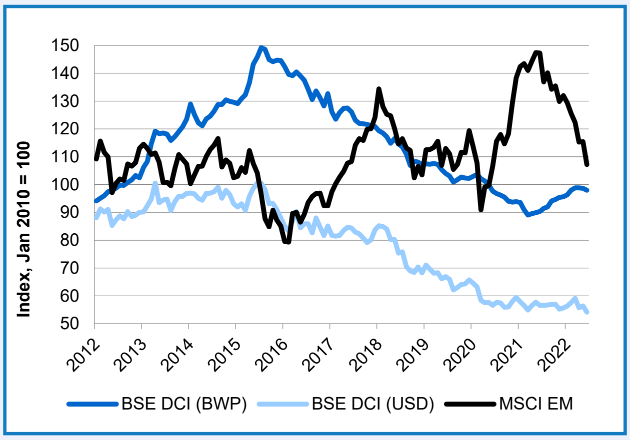
Fuel prices



International fuel prices continued to rise during Q2 2022 due to the ongoing conflict between Ukraine and Russia. Supply-side shortages of crude oil persist because of international trade sanctions imposed on Russian oil exports. Subsequently, the Europe Brent Spot Price for crude oil rose by 20.9% between the end March and June 2022. As a result, local fuel prices were adjusted upwards twice during Q2 2022 (May and June 2022) in order to align with international crude oil prices. In total, unleaded 93, unleaded 95, diesel and paraffin prices were raised by 341t, 358t, 402t and 573t per litre respectively during Q2 2022.

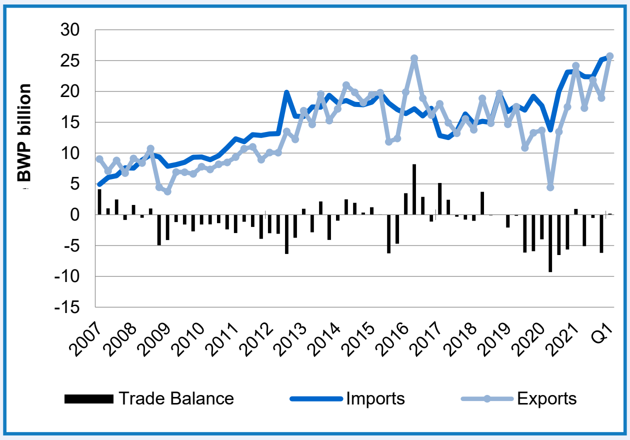
KEY ECONOMIC VARIABLES

Stock Markets



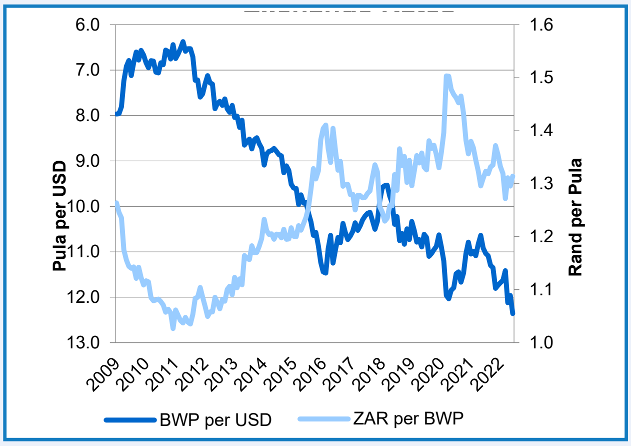
The Botswana Stock Exchange (BSE)'s Domestic Companies Index declined by 0.8% and 8.4% in Pula and Dollar terms respectively during Q2 2022. However, the BSE managed to outperform global markets which suffered major losses due to fears over a slowdown in global demand as various central banks were anticipated to increase interest rates during the quarter. The MSCI World Index declined by 16.6%, whilst the MSCI Emerging Markets Index depreciated by 12.4% during Q2 2022.

International Trade



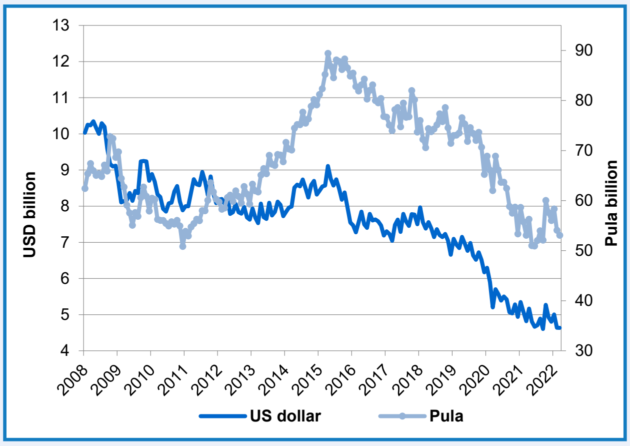
International trade activity gathered pace during the first quarter of 2022. Total exports were P25.74 billion in Q1 2022, up from P18.94 billion in Q4 2021, representing a 35.9% increase. The rise in exports was driven by a broad-based increase in the value of exports across most sectors, including diamonds which rose by 38.8%. The value of imports reached P25.56 billion in Q1 2022, rising by 1.7% compared to Q4 2021. The significantly larger increase in the value of exports against the value of imports resulted in trade a surplus of P0.18 billion during the quarter.

Exchange Rates



The Pula strengthened against the Rand and weakened against the US Dollar during the second quarter of 2022. The Pula appreciated by 3.3% against the Rand, closing the month of June 2022 with an exchange rate of ZAR1.3142, from ZAR1.2717 in March. The Pula-US Dollar exchange rate depreciated by 7.6% during the same period, falling from 11.42 to 12.36. The changes were mainly driven by the strength of the US dollar due to its "safe haven" status in a time of heightened global risk, while the Rand was weighed down by continued structural weaknesses in the South African economy.

Foreign Exchange Reserves



Foreign exchange reserves decreased across all measurement currencies, namely, the Pula, SDR and US Dollar during Q1 2022. Foreign exchange reserves fell from P56.1 billion in December 2021, to P53.1 billion in March 2022, reflecting a 5.3% decrease in Pula terms. Reserves declined by 3.6% in US Dollar terms and 2.8% in SDR terms reaching USD4.6 billion and SDR3.3 billion, respectively, during the same period.

NEWS HIGHLIGHTS

10th April	US Imposes Further Sanctions on Alrosa. (Rapaport News)	The United States has blocked assets belonging to Alrosa in the government's latest action against the Russian diamond miner. Alrosa joins the list of companies with which business is prohibited, in efforts to cut off funding for Russia's war in Ukraine.
11th April	African countries fare poorly in latest Fraser Institute investment attractiveness rankings. (Mining Weekly)	According to the Fraser Institute's Annual Survey of Mining Companies for 2021, African countries have scored low on the survey's Investment Attractiveness Index (IAI) when compared to the 2020 survey's IAI. Among the countries that dropped significantly are the DRC, Botswana, Mali, South Africa and Zimbabwe from 58.12, 81.48, 76.27, 56.33 and 49.52 in 2020 to 29.67, 48.61, 33.05, 37.88 and 26.55 in 2021, respectively. Botswana lost its ranking as the top African jurisdiction in terms of policy and ranked 31 globally in 2021 from a ranking of 15 in 2020. Botswana's Policy Perception Index (PPI) score decreased significantly by 22% in 2021, reflecting increased concerns over the uncertainty relating to protected areas, political stability, labour regulations and employment conditions and tax regime. The survey aims to assess how mineral endowments and public policy factors, such as taxation and regulatory uncertainty, affect exploration investment. Thus, the IAI is derived from combining a Best Practices Mineral Potential Index, which rates regions based on their geological attractiveness, and a Policy Perception Index (PPI), a composite index that measures the effects of government policy on attitudes toward exploration investment.
20th April	Mobile money transactions continue to grow. (Sunday Standard)	Mobile money service providers have reached multimillions of Pula yearly in transactions since inception. Orange money's value of transaction since inception has reached P4.5 billion, Mascom's MyZaka is currently at P295.8 million while BTC's Smega value transacted is P50 million. The transactions include cash-in and cash-out by subscribers at an agent, cash-in deposits through bank to wallet, withdrawals by registered and unregistered subscribers, and withdrawals by payroll. They also include withdrawals at automated teller machines (ATM), point-of-sale payments, online VISA payments, transfers to registered and unregistered subscribers, bulk payments (B2C), transfer to international recipients, airtime purchases, bill payments and prepaid electricity purchases.
24th April	De Beers Output Rises in Strong Market. (Rapaport News)	De Beers' production grew by 25% year-on-year to 8.9 million carats in the first quarter of 2022 as the company responded to strong demand and benefited from improved conditions at its mines. The increase in production partly reflects favourable mining conditions in comparison with a period of operational difficulties in 2021, when high rainfall in Botswana and at the Venetia mine in South Africa restricted output. Production in Botswana jumped 25% to 6.2 million carats from the Orapa and Jwaneng mines.

NEWS HIGHLIGHTS

26th April	Pula Fund muscles up, but still a long way to go. (Sunday Standard)	The dwindling Botswana foreign reserves had a reprieve last year, marked by slight growth and improvement to the national buffers. Total foreign assets were valued at P56 billion in December 2021, up from P53.3 billion in December 2020, reflecting a 5% growth after two years of steady decline. The Pula fund, which accounts for a large portion of foreign reserves, was resilient as it increased its holdings to P49.2 billion in December 2021, compared to a balance of P46 billion in December 2020. The improved performance in the fund was attributable to an increase in the Government Investment Account (GIA), which represents the government's share of funds in the Pula Fund and Liquidity Portfolio. After two years of rapid decline in the GIA, the Pula fund component ended 2021 with an enhanced balance of P5.6 billion compared to the record low balance of P2.8 billion in December 2021. Botswana's fiscal position was compromised in 2020 after the COVID-19 pandemic forced the government to finance the pandemic from the GIA, leading to a massive decline, from P18.3 billion in 2019 to P3.3 billion by end of December 2020. It is expected that the GIA will be partially replenished in the next two years as the economy is projected to recover.
26th April	GNRI considers sale of $1.5 billion Botswana copper mine. (Bloomberg News)	Global Natural Resource Investments (GNRI) is considering options for its Khoemacau copper mine in Botswana including a possible sale of the mine. The company is working to identify potential buyers for the mine which has an estimated value USD1.5 billion. The Khoemacau mine started production in June 2021, with planned annual production level of 60,000 metric tons of copper and 2 million ounces of silver.
9th May	Botswana invites bids to build 200 MW solar plant. (Reuters)	Botswana has invited bids from independent power producers (IPPs) to build a 200-megawatt (MW) power plant as the country looks to boost power generation and increase the proportion of renewable energy. This includes financing, construction, operation, and maintenance as well as decommissioning the plant at the end of its economic life. It is expected that the project will be commercially online by 2026/27 and will sell all the energy produced and capacity to the Botswana Power Corporation (BPC) through a Power Purchase Agreement.
11th May	Botswana Diamonds sees deal to buy Ghaghoo mine lapse. (Irish Times)	Botswana Diamonds announced that it has not been able to secure a joint venture partner to acquire the Ghaghoo diamond mine. Botswana Diamonds entered a non-binding agreement with Gem Diamonds Limited to acquire the mine and could not find a partner for the venture before the extended deadline of May 2022. Gem Diamonds has indicated their willingness to re-engage if Botswana Diamonds and partner finalise their agreement.

NEWS HIGHLIGHTS

11th May	No more free land as Gov't introduces application fees, hikes services levies. (Sunday Standard)	In 2020, the cabinet approved the revision of service fees across all ministries and state-owned entities. Plans to increase user fees for some government services gained traction in 2019, pressured by the widening budget deficits caused by large expenditures against dwindling revenues. The situation was made worse by the Covid 19 pandemic in 2020. In May 2022, the Ministry of Land Management, Water and Sanitation Services through Land Boards announced the implementation of revised fees, increasing costs for some services and introducing charges for previously free services. Services charged include the transfer of land rights either through sale or donation, plot applications, loss of title, sketch plan, survey and application for wayleaves and servitudes.
11th May	Europe looking to get 1Mt/y of coal from Botswana, says President Masisi. (Mining Weekly)	According to the President of Botswana, Mr Mokgweetsi Masisi, there has been a high number of inquiries for Botswana to supply coal to Europe region. This comes after Russia invaded Ukraine at the beginning of this year and many European countries which relied on Russia's fuel are looking for alternative supplies after sanctioning Russia's exports, including coal. Hence, new opportunities have emerged for African suppliers, investment has also increased, and prices has rose sharply. Botswana's coal production and exports have been limited, and plans are underway to increase production and export to the rest of the world.
13th May	Sandfire Resources' Motheo – It's all systems go. (Mining Review Africa)	Sandfire Resources has noted significant progress on the development of its Motheo open-pit copper/silver mine in the Kalahari Copperbelt and has about 1,000 on-site employees. The company stated that it has completed the 670-bed construction camp and building a 750-room mine village. The miner is also readying to deploy a mining fleet to Motheo and aims to build up a significant ore stockpile and ready it for commissioning of the plant in March 2023.
16th May	Demand for Diamond Traceability Spikes. (Rapaport News)	The diamond and jewellery industry is seeing a surge of interest in traceability programs as companies throughout the pipeline seek to avoid Russian supply. Several companies have announced new traceability initiatives or fast-tracked existing programs since the Russia-Ukraine war began. De Beers has scaled up its Tracr platform while the Gemological Institute of America (GIA) plan to launch a consumer-facing service called GIA Source Verify that would validate the country of origin for diamonds.
17th May	Botswana plans USD2.5 billion coal-to-liquids plant to cut fuel imports. (Zawya)	Botswana plans to build a USD2.5 billion plant to convert coal into liquid fuels and reduce reliance on imported fuel. The coal-to-liquids plant will operate under a public-private partnership model and is expected to produce 12,000 barrels of diesel and gasoline a day, with a planned lifespan of 30 years. Botswana is seeking to maximise usage of its abundant coal reserves and at the same time adhering to the environmental considerations that it has signed up to.

NEWS HIGHLIGHTS

18th May	Grindrod and partners create new export route for Botswana coal. (Engineering news)	Grindrod's Matola terminal at the Port of Maputo welcomed its second coal train from Botswana and successfully managed to discharge the 50 wagons using the terminal's tippers. The first train with a consignment of 40 wagons arrived in April 2022. The rail network includes Botswana, Zimbabwe and Mozambique, and it is a collaboration between African Railway Company, Botswana Rail, National Railways of Zimbabwe, Mozambican Railway Company (Caminhos de Ferro de Mozambique) and Grindrod. It is envisaged that the corridor could realise a yearly export volume of 350,000 tonnes to 400,000 tonnes of coal from Botswana. Botswana is attempting to develop new coal mines and the corridor has created a new export route for coal producers.
31st May	IMF Staff Completes 2022 Article IV Mission to Botswana. (Mirage)	The International Monetary Fund (IMF) Staff has completed the 2022 Article IV Mission to Botswana. The economy is expected to continue to recover in 2022 attributable to robust demand for diamonds and higher prices, good rainfall in most parts of the country, and increased international tourism activity. As a result, growth is forecast at 4.3% year-on-year in 2022 and will depend heavily on the path of commodity prices, the length of the Russia-Ukraine war and possible outbreaks of contagious Covid-19 variants. The depleted national savings and buffers are also expected to recover as the economy improves coupled with strong fiscal adjustments and the improvement in the current account. However, Botswana continues to face structural challenges such as reliance on the mining sector, slow progress in diversifying exports and high unemployment. Inflation is also on the rise and would require further monetary policy tightening to reduce inflationary pressures. The staff notes progress made with diversification, digitalisation, and achieving a fiscal surplus over the medium-term is on track. However, Botswana has been advised to avoid inward-looking policies including those which restrict imports as these could slow down growth. Instead, the country should accelerate the pace of implementing reforms to increase economic diversification, deepen international trade and create employment opportunities.
21st June	Tax Amnesty extension 'BURS' fruits. (Sunday Standard)	Local companies owing tax have responded positively to the Botswana Unified Revenue Service (BURS)'s tax amnesty scheme, following its extension to June 2022. The scheme seeks to grant delinquent taxpayers an opportunity to clear the total principal tax owed in exchange for write-off of interest and penalties charged during tax periods prior to 1st July 2021. There was a low uptake by companies in the initial months, however, there has been growth in the number of applications approved, increasing by 77% from 4,109 to 7,927, since the extension on the scheme deadline. As of 31 May 2022, 58% of taxpayers in arrears had applied for tax amnesty and 35% of those who have applied had been approved.
21st June	Civil society group flays diamond watchdog over Russia stalemate. (Rapaport News)	The Kimberley Process Civil Society Coalition has criticised the global diamond watchdog for resisting efforts to discuss Russia's invasion of Ukraine, at its international conflict diamond meeting hosted in Botswana. Several governments are urging a broadening of the KP's definition of conflict diamonds to include state actors using diamonds to fund acts of aggression. However, this is only possible with the approval of all member governments and the KP alone cannot change the definition.

NEWS HIGHLIGHTS

22nd June	De Beers sales accelerate following price rise. (Rapaport News)	De Beers' sales soared to USD650 million in June 2022 as demand increased attributable to supply shortages and high prices for rough diamonds. Total sales for the fifth cycle of 2022 were 36% higher than in the same cycle in 2021, and increased by 8% when compared with sales in cycle four. Supply shortages have been caused by Western sanctions on Russia's rough diamond exports from Alrosa, the world's largest diamond producer.
22nd June	Food imports surge to P2.9bn in Q1. (Mmegi)	The international merchandise trade statistics from Statistics Botswana revealed that the value of Food, Beverages & Tobacco imported into the country reached P2.9 billion in the first three months of the year, up from P2.4 billion over the same period in 2021. Food, Beverages & Tobacco imports increased between January and March 2022 from P845.7 million to P1.2 billion. For both periods, cereals such as wheat, maize and rice dominated food imports, followed by beverages such as spirits and vinegar, and fruits and nuts.
27th June	WDC president says there seems to be movement towards KP reform. (Mining Engineering)	The President of the World Diamond Council (WDC) has noted member's support for reforming the Kimberly Process (KP). This includes a change in the definition of 'conflict diamonds', which is loosely defined as rough diamonds used to finance rebel movements or wars against governments around the world. The issue with the current definition is that it is limited to rough diamond exports used by rebel groups to finance conflict and excludes violence by ruling authorities. However, the KP itself lacks the authority to re-define 'conflict diamonds' and this is only possible through the approval of all participating member states. Botswana is the current KP chair and has been requested to add the reform and review cycle to the draft agenda of the scheduled KP Plenary in November 2022 to enable the start of the discussions. The KP serves to certify rough diamond exports and reduce the flow of conflict diamonds.
29th June	De Beers, Botswana extend diamond sales deal by a year. (Reuters)	De Beers and the Government of Botswana have agreed to extend the sale agreement for rough diamonds from their joint venture Debswana by one year, to enable both parties to finalise the discussions towards a new agreement. This is the third time it has been extended, following the end of the 2011 sale agreement in 2020.
30th June	Debswana targets P4bn citizen spend in 2022. (Mmegi)	Debswana's Citizen Economic Empowerment Programme (CEEP) aims to spend P20 billion on citizen enterprises by 2024, with a cumulative P7.8 billion having already been procured between 2019 when the programme began and 2021. The CEEP represents the largest citizen economic empowerment spend by a private company in Botswana and supports the government's Economic Diversification Drive (EDD).

MACRO-ECONOMIC DATA

KEY ECONOMIC DATA	unit	2015	2016	2017	2018	2019	2020	2021	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2
Annual Economic Growth													
GDP	%	-4.9%	7.2%	4.1%	4.2%	3.0%	-8.7%	11.4%	5.1%	8.5%	11.4%	13.1%	..
Mining	%	-15.3%	0.3%	6.3%	8.4%	-3.7%	-26.5%	29.9%	3.0%	15.8%	29.9%	42.0%	..
Non-mining private sector	%	-3.5%	11.8%	3.7%	2.9%	4.2%	-6.7%	8.8%	4.7%	7.2%	8.8%	8.3%	..
GDP current prices	P bn	137.05	164.42	166.65	173.73	179.58	171.04	195.30	48.68	49.29	50.40	53.83	..
GDP 2016 prices	P bn	153.37	164.42	171.18	178.35	183.76	167.73	186.80	46.25	47.82	46.49	49.50	..
Money & Prices													
Inflation	%	3.1	3.0	3.2	3.5	2.2	2.2	8.7	8.2	8.4	8.7	10.0	12.7
Prime lending rate	%	7.50	7.00	6.50	6.50	6.25	5.25	5.25	5.25	5.25	5.25	5.25	6.26
BoBC 7/14-day	%	0.97	0.84	1.45	1.52	1.41	1.04	1.10	1.04	1.09	1.10	1.11	2.15
Trade & Balance of Payments													
Exports - total goods	P bn	63.48	80.34	61.67	67.17	56.29	49.11	81.38	17.30	21.85	18.94	25.74	..
Exports - diamonds	P bn	52.73	70.78	54.38	60.41	51.01	42.54	73.41	15.46	19.31	16.71	23.10	..
Balance of payments	P bn	-4.15	-3.28	-4.28	-4.20	-12.02	-20.06	-2.87	-5.10	-0.51	-6.20	0.18	..
Foreign Exchange													
Exchange rate BWP per USD	end	11.24	10.65	9.87	10.73	10.63	10.79	11.74	10.92	11.30	11.74	11.42	12.36
Exchange rate ZAR per BWP	end	1.38	1.28	1.26	1.34	1.33	1.36	1.35	1.31	1.332	1.355	1.272	1.314
FX reserves	$ bn	7.55	7.19	7.50	6.66	6.17	4.94	4.81	4.67	4.605	4.81	4.63	..
FX reserves	P bn	84.88	76.80	73.69	71.43	65.23	53.36	56.02	50.94	52.10	56.02	53.07	..
Financial Sector													
Deposits in banks	P bn	59.96	62.44	63.58	69.27	75.71	80.54	84.36	81.37	82.20	84.36	84.55	..
Bank credit	P bn	48.31	51.32	54.18	58.33	62.77	65.55	68.92	67.45	68.51	68.92	69.61	..
BSE index		10,602	9,728	8,860	7,854	7,495	6,879	7,010	6,622	6,901	7,010	7,243	7,183
Business Indicators													
Diamond production (a)	mn cts	20.73	20.88	22.96	24.38	23.67	16.87	22.70	5.83	6.50	5.33	6.30	..
Copper production (b)	'000t	23.05	16.88	1.24	1.46	0.00	..	11.74	..	7.52	4.23	5.71	..
Nickel production	'000t	16.79	13.12	0.00	0.00	0.00	..	..	..	..	..	..	..
Business confidence index		44%	43%	46%	..	..	..	..	..	..	..	..	..
No. of companies formed		19,134	17,133	20,707	..	..	..	..	..	..	..	..	..
Electricity consumption	GWh	3,974	3,929	3,772	3,919	3,906	3,842	3.928	968	1,004	1,013	1,006	..
Crude oil (Brent)	$/bar	36.61	54.96	66.73	50.57	67.77	51.22	77.24	76.94	77.86	77.24	107.29	119.78
Employment (formal) (f)													
Government		130,220	129,216	129,009	156,785	156,785	152,973	152,225					
Parastatals		19,411	19,008	19,444	23,497	23,497	18,933	21,056					
Private sector		191,484	194,202	193,745	250,778	227,281	250,715	268,086					
Total		341,115	342,426	342,198	431,060	407,563	422,621	441,367					

Govt Budget		2017/18 (d)	2018/19 (d)	2019/20 (d)	2020/21 (e)	2021/22 Revised (f)	2022/23 Budget (g)
Revenues	P bn	56.41	53.47	54.30	49.37	63.40	67.87
Spending	P bn	58.39	62.35	65.40	65.79	73.57	74.84
Balance	P bn	-1.98	-8.88	-11.10	-16.41	-10.16	-6.98
Public debt & guarantees	P bn	32.99	34.41	38.18	41.56	46.76	53.77
Govt deposits at BoB	P bn	30.09	21.56	19.86	6.20	4.08	3.86
GDP	P bn	167.70	175.20	180.60	173.83	199.54	217.72
Revenues	%GDP	33.6%	30.5%	30.1%	28.4%	31.8%	31.2%
Spending	%GDP	34.8%	35.6%	36.2%	37.8%	36.9%	34.4%
Balance	%GDP	-1.2%	-5.1%	-6.1%	-9.4%	-5.1%	-3.2%
Public debt & guarantees	%GDP	19.7%	19.6%	21.1%	23.9%	23.4%	24.7%
Govt deposits at BoB	%GDP	17.9%	12.3%	11.0%	3.6%	2.0%	1.8%

Sources: BoB; MFED; Statistics Botswana; Department of Mines; CIPA; BSE; US Energy Information Administration; Bloomberg; Econsult

Notes:
(a) Figures include production from Lucara Diamonds (Karowe mine) and Debswana. In 2016 and 2017, figures also include production from Gem Diamonds (Ghaghoo) and Lerala mines. (no longer operational)
(b) Copper production starting Q2 2017 for Mowana mine and Q2 2022 for Khoemacau
(c) Numbers in Italics reflect revisions from the previous review.
(d) Actual.
(e) Budget.
(f) Employment figures up to 2018 are not comparable with those from 2019 onwards due to changed methodology of data collection and reporting

SPECIAL FEATURE

An Overview of Commercial Banks in Botswana and Performance: Does Bank Size Matter to be Profitable?

Introduction

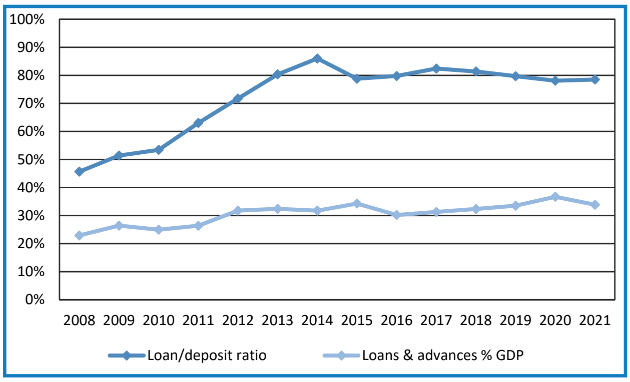
Botswana's commercial banking sector has developed and grown significantly over the years. The sector has benefitted from financial reforms that have contributed to its growth and performance. The liberalisation of the sector encouraged entry and growth, particularly during the 1990s. The number of banks in Botswana grew from two in the 1970s, to eight banks as at the end of December 2021, although it had reached as many as 11 banks in 2013. The asset base of commercial banks has also increased. However, the sector is dominated by four large banks, which collectively have more than P80 billion in assets.

Commercial banks are important as they offer financial intermediation and facilitate the flow of payments. Financial intermediation involves taking customer deposits and using those deposits to create loanable funds. Hence, commercial banks promote saving and transform savings into loans, from which they earn interest income. The more a bank can attract deposits, give out loans and earn higher revenue from interest, the more profitable the bank can become and grow. These dynamics influence the size and market share of a bank.

Banking Sector Size and Development

Financial reforms have led to the financial deepening of Botswana's banking sector. Financial deepening refers to the increase in the provision of financial services relative to overall GDP. As shown in figure 1, financial depth, as measured by loans and advances as a percentage of GDP, increased from 22.9% in 2008 to 33.9% in 2021. However, the ratio is smaller when compared to the global credit to GDP ratio of 52.2%, but higher than the 21.6% credit to GDP estimated for Sub-Saharan Africa (Global Financial Development Report, 2019/20). Hence, by global standards, credit extension in Botswana is low and should expand further to support economic growth. Nevertheless, financial intermediation in Botswana has improved, as shown by the increase in the ratio of loans to deposits, from 45.7% in 2008 to 78.5% in 2021, indicated in figure 1.

Figure 1: Financial sector deepening, measured by loans and advances as % of GDP

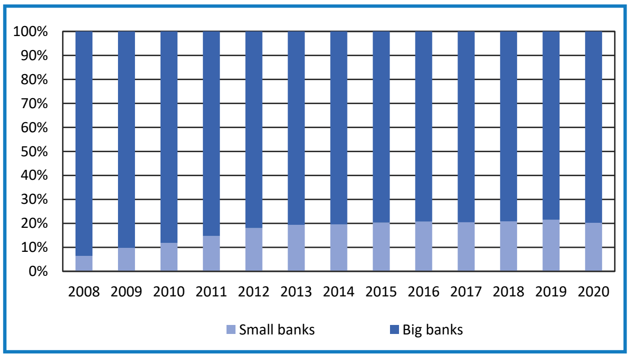


Source: Botswana Financial Statistics

Bank Market Share

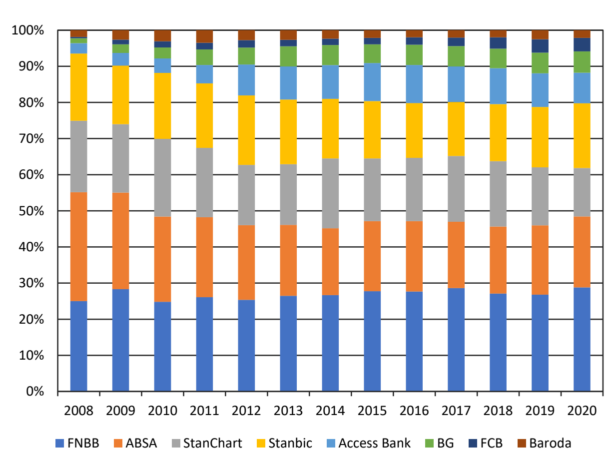
The total assets of commercial banks rose from P45.9 billion in 2008 to P107.7 billion in 2021. Banking sector assets are dominated by the four large banks, First National Bank Botswana (FNBB), Absa Bank Botswana (Absa), Stanbic Bank (Stanbic) and Standard Chartered Bank Botswana (StanChart), which together account for more than 80% of total banking assets. As a percentage of GDP, commercial banks' assets measure the size of the banking sector. Assets can also be used to determine the market share of individual banks.

Figure 2a: Market share of large and small banks (by total assets)



SPECIAL FEATURE

Figure 2b: Market share of individual commercial banks



Source: Commercial bank annual reports, various years.

The market share of the big four banks has been unchanged at around 80% since 2013. In 2020, the largest bank in terms of assets was FNBB, followed by Absa, Stanbic and Standard Chartered, respectively. FNBB has been able to retain its size and market share in the industry, and accounted for 28.8% of total assets in 2020. Standard Chartered bank, on the other hand, has been experiencing a decline in market share. The bank moved from being the second largest bank in 2014 to the fourth largest since 2019, while its market share declined from 19% in 2014 to 13% in 2020.

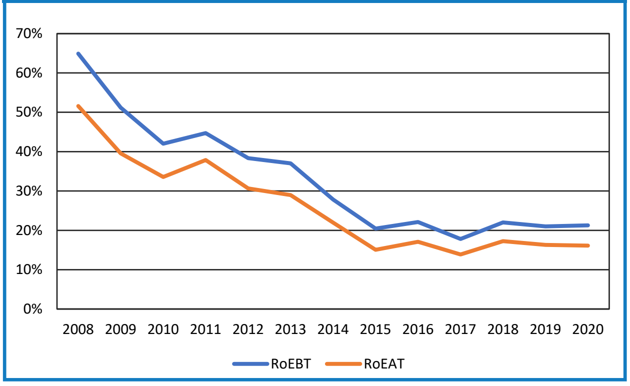
The smaller banks have been able to penetrate the market and increase their market share to some extent. Market share for the small banks increased between 2008 and 2017, from 6.5% to 20.7%, but has been unchanged since then at around 20%. Access Bank (previously Bank ABC), the biggest of the small banks, rapidly attained an increase in market share, rising from 2.9% in 2008 to 10.4% in 2016, although it has since fallen slightly to 8.5% in 2020. However, it has been unable to break into the top four, and it has not been particularly profitable. Bank Gaborone has also struggled to achieve a good return on equity. Notable improvements within the small banks are First Capital Bank (FCB) and Bank of Baroda. The two banks have been able to improve their market presence and improve their market shares.

However, the strides of the smaller banks have not be successful in increasing their collective market share since about 2013. Some have resorted to consolidation. For example, the small Indian banks, Bank of India Botswana (BOI) and State Bank of India Botswana (SBI), voluntarily exited the industry in 2019 and 2021, and merged with FCB and Bank of Baroda, respectively.

Bank Profitability

Bank profitability is a key measure of bank performance. Banks make profits through service fees and commissions for transactions, and on earnings from the net interest margin. The net interest margin is the difference between interest income earned from its assets and interest paid on its liabilities. Profitability is best measured using ratios such as the return on equity, to better understand how banks use resources at their disposal to generate profits effectively and efficiently. Return on equity (RoE) is calculated as net income divided by equity (capital), and may be measured before or after tax.

Figure 3: Bank profitability as measured by return on equity

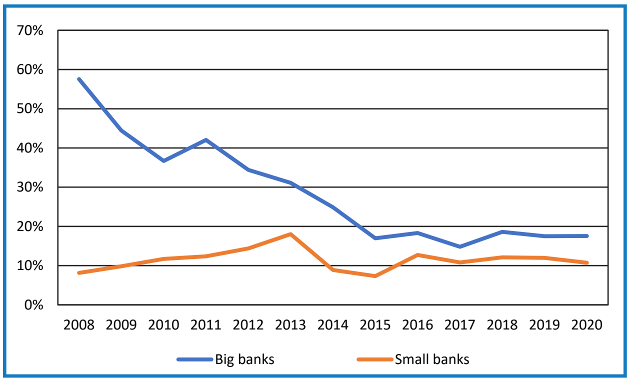


Source: Commercial bank annual reports, various years.

Profitability, as measured by the RoEAT, decreased drastically since the global financial crisis (GFC) in 2008, falling from 51.6% in 2008 to 16.1% in 2020. The decrease is attributable to the fall in bank profits (interest income and other incomes), in part due to a general decline in interest rates, coupled with higher expenses as banks had to make provisions for bad debts. In the period between 2015 and 2020, the RoEAT for commercial banks was almost flat. This is consistent with the level of credit growth during the period, which has been subdued, perhaps reflecting a lack of profitable lending opportunities combined with concerns about credit risk. Also, in the previous years banks' profits and earnings were on a downward trend and it was important for banks to be cautious to meet prudential capital adequacy requirements and contribute to financial stability.

SPECIAL FEATURE

Figure 4: Profitability for big and small banks



Source: Commercial bank annual reports, various years..

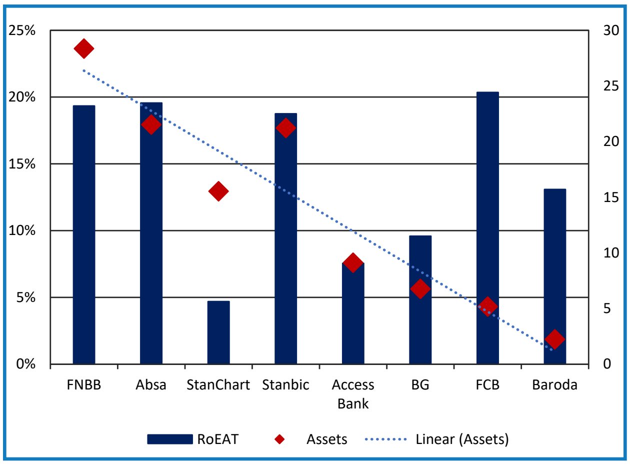
Another realisation is that profitability varies when comparing the bigger banks (FNBB, Absa, Stanbic and Standard Chartered) and the smaller banks (Access Bank, First Capital Bank, Bank of Baroda and Bank Gaborone). Normally, bigger banks would have higher returns than the smaller banks because of economies of scale. This is because an increase in the size enables banks to spread their costs over a larger asset base. Hence, because of their size, banks can diversify, reduce risk, and promote profitability by improving efficiency.

The decrease in bank profitability over the years is largely attributable to the fall in profitability for the big banks. An analysis of figure 4 indicates that larger banks recorded low returns post-GFC while the smaller banks had higher returns post-GFC. Profitability for the four big banks decreased from 57.6% in 2008 to 17.5% in 2020. Among the bigger banks, Standard Chartered Bank has struggled the most, and profitability has been deteriorating. Its profitability declined from 88.6% in 2008 to 26.6% in 2014, and fell further to 4.6% in 2015, and recorded a loss in 2017 due to high operating expenses. It was able to bounce back to some extent in the later years, with profitability of 4.7% in 2020. Stanchart has faced problems over the years in trimming its operating expenses and keeping them in line with its declining (relative) size.

Although smaller banks are less profitable, profitability has nevertheless increased marginally between 2008 and 2020, from 8.1% to 10.7%. This suggests that economies of scale may not be the only factor driving profitability. Smaller banks can still be profitable if they can secure a niche in the industry. It also appears that the smaller banks have been doing well in attracting customer deposits. During the same period, customer deposits for the smaller banks increased at a faster rate than customer deposits for the larger banks. The average growth of customer deposits in the smaller banks was 16.8% while the average growth of customer deposits in the big banks was 5.5% between 2008 and 2020. Smaller banks may have been successful in forming relationships with customers and offering competitive interest rates for both deposits (savings) and loans. Loans and advances to customers increased faster for the small banks. Hence, the small banks have been able to use deposits productively to generate income.

A key issue is what is the minimum efficient scale for banks in Botswana. With a certain level of fixed costs, it is evident that a bank has to be a certain size in order to be profitable; the question is, what is that size? A bank's RoEAT probably has to be 10% or more in order to satisfy shareholders, attract risk capital and build up its capital base in terms of regulatory requirements. There is risk of having too many banks, if this results in many small banks with insufficient profitability, bearing in mind that unprofitable banks can be unstable banks. Indeed, it appears that this point may have been reached in Botswana during the decade following 2010, when smaller banks struggled to reach this target level of profitability.

Figure 5: Relationship between size and profitability



Source: Commercial bank annual reports.

Figure 5 suggests that there is a relationship between bank size and profitability, albeit perhaps a weak one. In 2020, three of the four large banks had profitability of between 15% and 20%, the exception being StanChart, which recorded the lowest RoEAT for all the banks. However, only one of the four small banks achieved this level of profitability. FCB, the second smallest bank by market share, recorded the highest profitability in 2020, at 20.3%, following its acquisition of Bank of India Botswana in 2019.

SPECIAL FEATURE

Conclusion

The banking industry in Botswana is dominated by four banks. They account for a significant level of market share, of 80%, since 2013. FNBB remains the largest bank, achieving market share of 29% in 2020. Of the big banks, Standard Chartered has been doing less well, with a declining market share, which deteriorated to 13% in 2020. Small banks have managed to penetrate the industry to some extent. However, they have been somewhat struggling to increase their relative size in recent years. This may be attributable to the fact that big banks enjoy economies of scale, which contributes to higher profitability. It appears that for the smaller banks to survive and remain profitable, they need to secure a niche that enables them to earn a higher net interest margin, or higher fee income, to compensate for the lack of economies of scale.

Overall, the relationship between bank size and profitability is relevant for the commercial banking industry in Botswana's relatively small economy. Small banks can survive, but it is tough, as evidenced by the exit of three small banks (Bank of India, State Bank of India and ABN Amro) over the past decade, and of four other banks (Botswana Co-operative Bank, ANZ-Grindlays, Zimbank and Investec Bank) in earlier years. The need to achieve a certain minimum size poses a barrier to the entry (and survival and growth) of new, small banks, However, it is not an absolute barrier, and successful entry is possible with a well-designed and executed market and growth strategy. It is also important to recall that banks do not have to just grow organically, and that acquisitions may be an important route to gaining scale and market share. After all, two of the big four banks have acquired other banks on their way to their current position (FNBB and Stanbic), as have two of the smaller banks (FCB and Baroda).

PO Box 45016, Gaborone, Botswana

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

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

The Econsult Economic Review is sponsored by BIFM, Botswana's largest asset manager. All content and commentary in the Review is produced by Econsult and should not be attributed to BIFM.