

ECONOMIC REVIEW

third quarter jul-sep 2021

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COMMENTARY

On the Road to Recovery as Economic Growth Picks Up, Although Risks Remain Elevated

Introduction

Economic growth picked up during the second quarter of 2021, recording the first positive annual growth since June 2020. Annual GDP growth increased significantly to 4.9% in Q2 2021, compared to a contraction of 8.6% in the previous quarter. The improved growth reflects the robust recovery in the global diamond market, leading to improved production volumes and higher rough prices. The Ministry of Finance and Economic Development (MFED) forecasts strong growth of 9.7% for 2021 as a whole, owing to the continued recovery of the diamond industry, improved economic activity and trade, the rollout of covid-19 vaccines in Botswana and globally, and the positive impact of recovery interventions. Looking at shorter-term growth, GDP in the second quarter of 2021 was 36% higher than in the second quarter of 2020, when the impact of covid-19 was at its peak.

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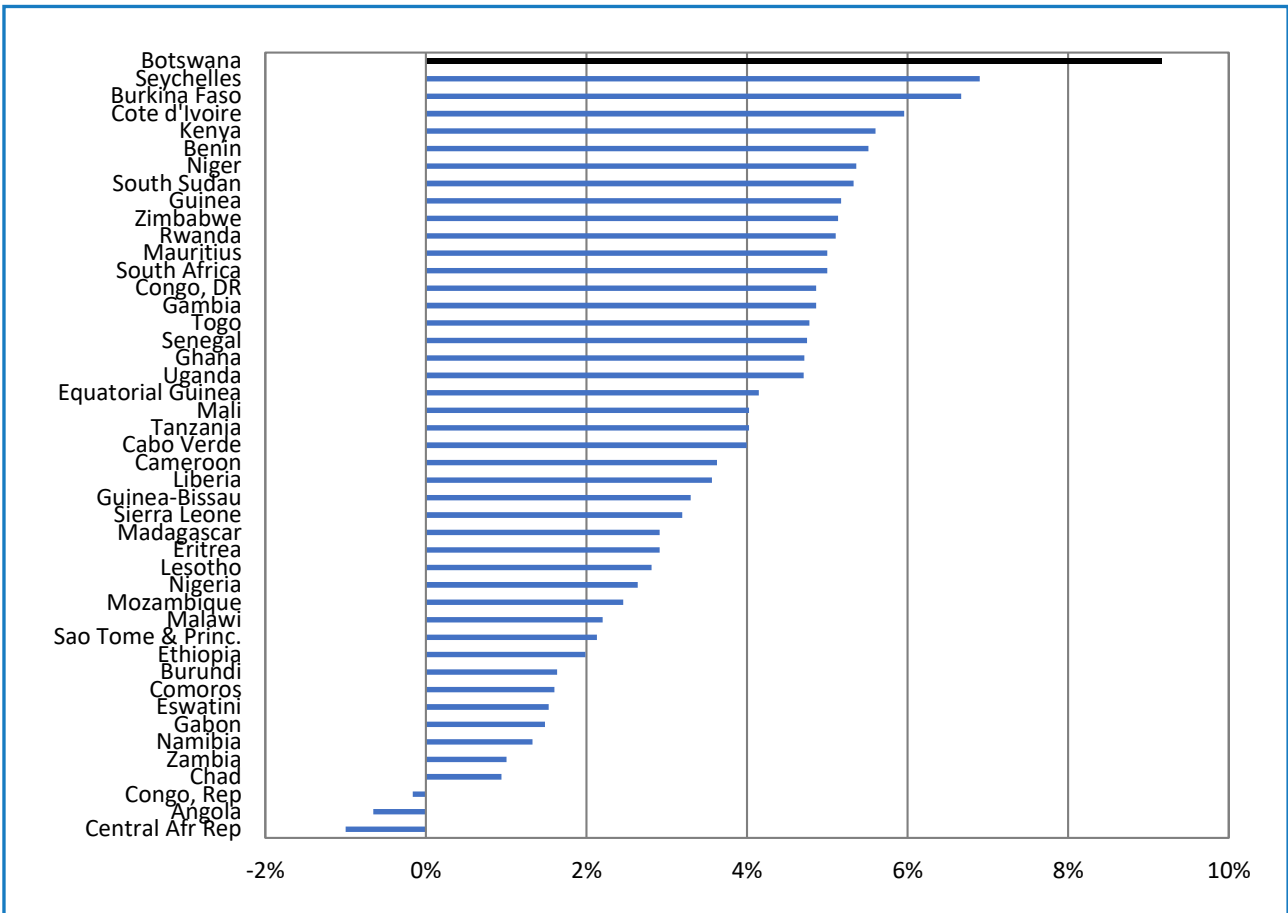
Bifm
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COMMENTARY

The International Monetary Fund (IMF) is also forecasting strong growth for Botswana in 2021, at 9.2%, before slowing down to 4.7% in 2022. Botswana has the highest projected GDP growth rate in Sub-Saharan Africa for 2021 (IMF WEO Oct 2021). While this is mainly driven by the recovery in mining/diamond production, most sectors are showing robust recovery. Tourism still lags, but the relaxation of domestic movement restrictions (post-state of emergency) and the relaxation of international travel requirements (e.g. removal of Botswana and other African countries from the UK red list) plus the roll out of vaccines indicates that 2022 should be a year of strong recovery, especially if there is pent-up demand for travel post-pandemic.

of government mineral revenues. Pre-covid, it was anticipated that the budget would have been brought under control, and budget surpluses were projected for the remainder of NDP 11. However, the pandemic took a toll on the government fiscal position, to finance health-related expenditures, supporting economic activity and financing economic recovery initiatives and activities. It is anticipated that the budget will bounce back to a surplus from 2023/24 FY (the start of the NDP 12) with strong surpluses recorded in the 2024/25 FY. This is attributable to the continued recovery of the diamond industry and higher rough prices. This is discussed in detail later in the Special feature.

Figure 1: IMF Real GDP Growth Projections for Sub-Saharan Africa, 2021



2022 Budget Strategy Paper (BSP)

The Ministry of Finance and Economic Development recently published the 2022 Budget Strategy Paper (BSP), outlining the medium-term projections for total revenues and total government expenditures. Preliminary budget figures indicate that the government’s fiscal position may not be as bad as originally forecast due to the rebound

State of Public Emergency

The 18-month long State of Public Emergency (SoPE) came to an end at the end of the third quarter (September). This meant that most economic and other activities can revert to “normal”, hence, opening up the economy. However, the pandemic has not come to an end and the fight against the virus continues with implementation of

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health measures to contain the spread of the virus and reduce infection and death rates. The rollout of vaccines is under way, and Botswana has made commendable efforts to vaccinate the population. As of 22 October 2021, about 44.2% of the eligible population had received their first covid-vaccine dose while about 17.5% of the population, including those who have received their first dose, has been fully vaccinated. While the end of SoPE means an increase in business activities, the implications could also include a loss of employment in the form of retrenchment from businesses which have not yet recovered from the impact of the pandemic. During the SoPE, businesses were not allowed to retrench unless they closed operations. It is worth noting, however, that in many developed countries, the recovery taking place as covid-related restrictions are removed has been associated with strong demand for labour, rising wages and falling unemployment. Our view is that fears of a jump in unemployment post-SoPE are overdone. Businesses that have survived so far are likely to experience stronger demand as the economy recovers, and hence are more likely to hire (or retain) than fire. The main impact of the SoPE is likely to have been on the informal sector, which was not protected from retrenchments, and this sector is now experiencing improved business conditions as recovery takes place.

Global market for diamonds

The global market for rough diamonds performed relatively well during the quarter, even though sales slowed down in the three months to September 2021. Total sales by De Beers Global Sightholder Sales (DBGSS) fell by 21.1% in Q3 2021 to USD1.04 billion, from USD1.31 billion in Q2 2021. However, sales surged in the third quarter of 2021 when compared to the same quarter in 2020, at USD450 million. The demand for rough was robust with positive midstream sentiments reflecting strong demand for polished diamond jewellery. The demand for polished diamonds has been increasing and outpacing supply as the two largest diamond companies, De Beers and Alrosa, were reported not being able to meet the robust appetite for rough. De Beers noted that the global deficit in rough supply was partly due to the reduced production at some of its mines, due to weather-related interruptions at the Venetia mine in South Africa as well as power disruptions

at the Jwaneng mine. The company has adjusted its production outlook for 2021 to around 32 million carats, down from the previous revision of 32-33 million carats. This is the fourth time the company has adjusted production outlook for 2021, reflecting the covid-19 related and other supply disruptions.

Inflation risks

Although many of the causes of the recent increase in inflation should be transient, there is a danger that higher inflation gets built into inflation expectations. Furthermore, the cycle of fuel price increases is not over yet. Recent fuel price increases have not matched the increase in global fuel prices – which are still rising – hence further domestic fuel price increases are inevitable unless international price trends go into reverse. While higher inflation is a global phenomenon, the main risks are to the upside, which could in due course lead to higher policy interest rates around the world, including in Botswana, which would slow down the post-pandemic recovery.

Financial sector

There are signs of recovery in the financial sector with the commercial credit growth continuing to improve. Bank credit growth increased to 5.7% in July 2021, driven by the increase in credit growth in both segments of the market. Credit to firms recorded the highest growth, increasing to 2.9% in July 2021 and recording the highest growth in 26 months. There has been an increase in the uptake of credit facility by firms. The increased appetite for credit by businesses is a positive sign of economic recovery, as it reflects that output is increasing. Overall, the banking sector environment remains healthy with adequate liquidity to support lending and decreasing arrears on lending which signifies the market's capacity to repay outstanding loans.

Outlook

The outlook for 2021 is broadly positive, as indicated by the GDP growth projections. Both the MFED and IMF forecast strong growth for the year, mainly because of the rebound of the global market for diamonds. The macroeconomic environment is also improving and there are signs of recovery in the financial sector. Annual bank credit growth

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has been on an upward trend, increasing for both firms and households. The accelerated increase in credit to businesses is welcome and cement prospects for increased output. The financial sector is robust with adequate liquidity level and declining arrears. S&P Global Ratings also upgraded Botswana's economic outlook from negative to stable. This is a sign of confidence, which should be boosted by the removal of the country from the FATF blacklist. The tourism industry is anticipating good demand in 2022, as international travel picks up.

However, there are some concerns about a rise in unemployment as a result of covid-19, although there is no recent data, resulting in depressed household incomes. The pandemic is likely to have worsened inequality, given that it impacted more on the informal sector than on the formal sector; the informal sector is a key source of income for lower income households. This emphasises the need to revisit social protection, as the impact of the pandemic could be detrimental to low-income households, which may struggle to meet basic necessities. However, it is worth noting that in many developed countries – albeit with different and more flexible labour markets – post-pandemic recovery has been marked by labour shortages, falling unemployment and rising wages.

In terms of government budget, the remaining major concern is the allocation of government spending. The public sector wage bill and subventions to the bloated State-

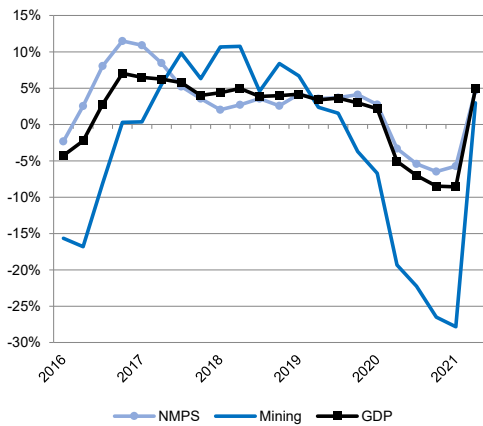
Owned Enterprise (SOE) sector is still huge and accounts for a high proportion of total spending, leaving insufficient funds for the maintenance of existing public infrastructure and investment in new projects.

Notwithstanding the prospects for recovery in 2021, global risks remain elevated, with high levels of uncertainty regarding the pace and course of the post-covid recovery. Amongst the highest risks are prolonged higher inflation, leading to monetary tightening around the world that could slow the recovery. With respect to covid-19, there is also a risk that the slow pace of vaccine rollout in poorer countries, due to inequitable vaccine distribution, will delay economic recovery and lead to a deepening of poverty, and even lead to the emergence of new variants that could be resistant to vaccines. The materialisation of any of these risks would inevitably delay Botswana's recovery.

The broader socio-economic impact of the pandemic may, of course, be hidden by a lack of up-to-date data, with no recent data on poverty levels, or household incomes or expenditures. The quarterly labour market survey that had been providing useful information on critical labour market trends has only published one set of results recently (for Q4 2020), and, perhaps surprisingly, there is no indication of when more results can be expected. There are fears that household budgets are under increasing stress due to reduced incomes, job losses and healthcare expenses, which will only mount over time, with no clear end in sight.

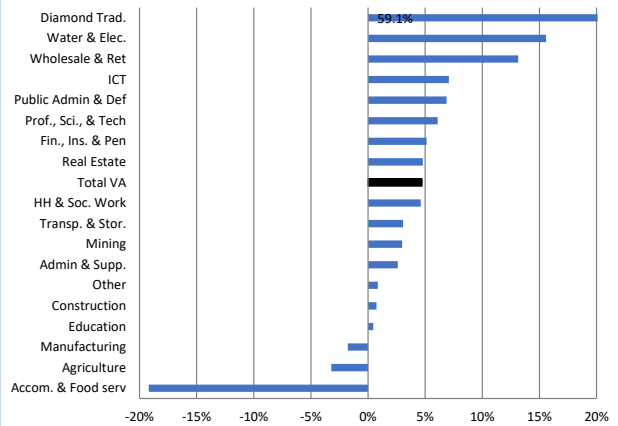
KEY ECONOMIC VARIABLES

Annual GDP Growth



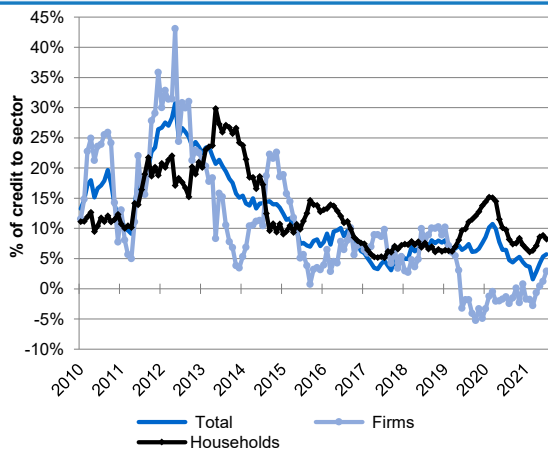
Overall GDP growth improved in Q2 2021, recording the first positive annual growth rate since Q2 2020, as a result of a strong recovery in the mining sector. Real annual GDP growth increased to 4.9%, from minus 8.6% in Q1 2021. The higher real growth is attributable to significant improvement in mining, to 3.0% y-o-y from minus 27.8% y-o-y in Q1 2021, the first positive growth rate since Q4 2019. Similarly, in the non-mining private sector (NMPS), real growth increased during the period, to 4.7% y-o-y from minus 5.7%. The improvement in economic growth reflects the gradual re-opening of businesses and the “base effect”, given the sharp contraction in activity in the second quarter of 2020.

Sectoral GDP Growth



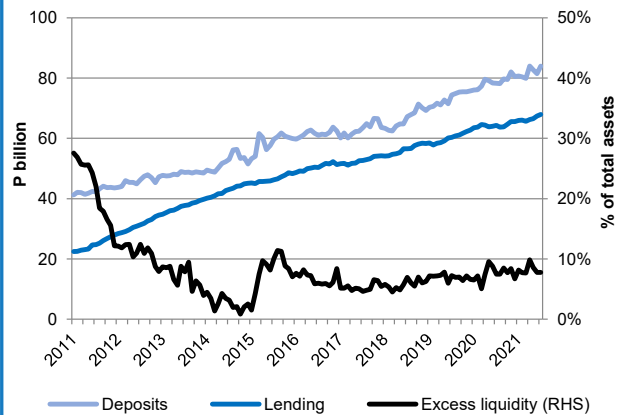
The improvement in economic growth was broad-based, with most sectors of the economy recording higher annual growth in Q2 than in the previous quarter. Diamond Traders, Wholesale & Retail and Public Administration & Defence were the fastest growing sectors, at 59.1%, 13.1% and 6.9% in June 2021, respectively. Agriculture recorded a contraction of 3.2%, due to a significant contraction in the livestock farming sub-sector, with negative growth of 4.9% y-o-y in Q2 2021. However the biggest y-o-y contraction was in accommodation and food services (a proxy for tourism), with output in the 12 months to June still almost 20% below the previous year.

Annual Credit Growth



Annual bank credit growth rose to 5.7% in July 2021, compared to 2.8% in April 2021. Bank credit increased for both private firms and households, from minus 0.7% and positive 7.1% to positive 2.9% and positive 8.2%, respectively, between April and July. Annual bank credit growth has maintained an upward trend since March 2021, reflecting an increase in loan uptake from both segments of the market. The increase in credit has been particularly concentrated in short-term lending – overdrafts and loans of up to six months – which may indicate firms’ need for working capital as output recovers. However, bank credit growth may slow down in the short term if there are job losses following the lifting of the State of Emergency (SoPE).

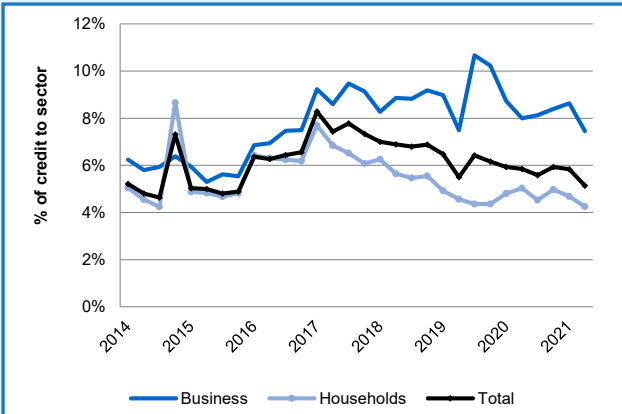
Bank Deposits, Lending & Liquidity



Bank liquidity decreased in July 2021. Excess liquidity fell to 7.8% of total assets in July, down from 9.9% in April. The decrease in bank liquidity is attributable to faster growth in lending than deposits during the period. Bank deposits recorded a marginal increase (by 0.02%); however, bank lending grew by 2.6% to P67.9 million in July 2021 from P66.2 million in April. Despite the decrease, there is still plenty of liquidity in the banking system to support lending. In addition, the banks have a considerable amount of foreign currency liquidity available, which is not counted as part of official liquid assets.

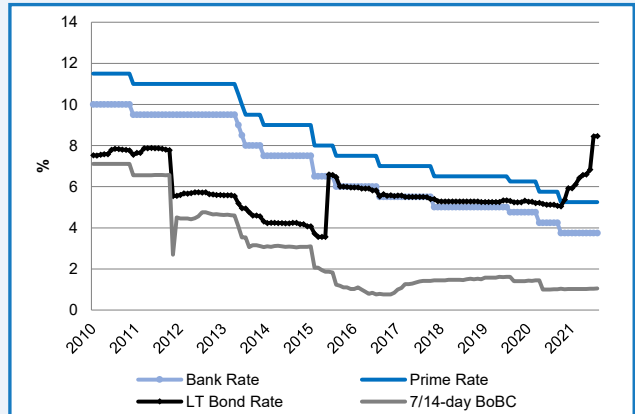
KEY ECONOMIC VARIABLES

Arrears on Bank Lending



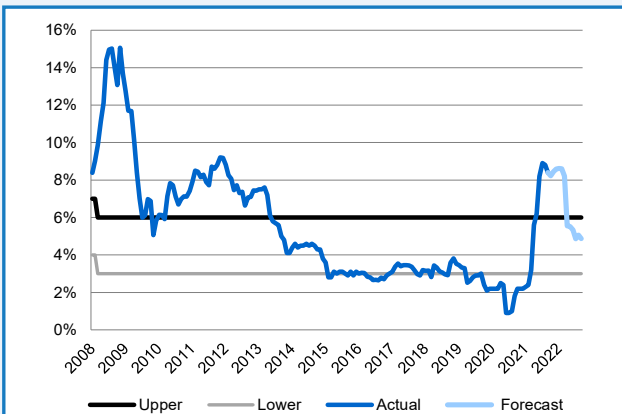
Total arrears on bank lending as a proportion of total banking assets declined during the second quarter of 2021. Arrears decreased from 5.8% in Q1 2021 to 5.1% in Q2 2021. The decline in arrears has been driven by the reduction in both household and business arrears, which fell from 4.7% and 8.6% to 4.3% and 7.5%, respectively, between Q1 and Q2 2021. The decline in arrears suggests that neither households nor businesses are experiencing debt stress. However, there are risks from potential job losses following the lifting of the SoPE, as companies were restricted from retrenching during the SoPE.

Interest Rates



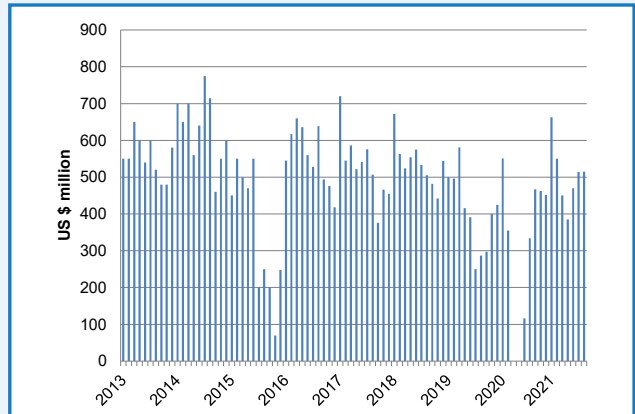
During the third quarter of 2021, the Bank of Botswana’s Monetary Policy Committee (MPC) maintained the Bank Rate at 3.75% at its August meeting. The Bank forecasts non-inflationary pressures in the medium-term, whilst the short-term increases in inflation rate are temporary, reflecting the supply-side factors. As a result, the commercial bank Prime Rate was also maintained at 5.25% during Q3. Money market interest rates increased marginally, with the 7-day BoBC rate increasing from 1.04% to 1.09% between June 2021 and September 2021. The long-term government bond rate (BW12) continued to increase, rising from 6.84% to 8.47% between June 2021 and August 2021. On the other hand, real interest rates declined in Q3, reflecting the rising inflation rate during the period.

Inflation and Forecast



The annual inflation rate continued to increase in the third quarter of 2021, increasing to 8.4% in September, up from 8.2% in June 2021. The main contributor to the increase in inflation came from the rise in the Transport index group which rose by 3.5% between June 2021 and September 2021. The Operation of Personal Transport section of the Transport index increased during the quarter, reflecting the upward changes in fuel prices in July 2021. International prices for fuel continue to increase posing upside risk to annual inflation. The IMF’s World Economic Outlook (WEO) has also forecast higher international fuel prices, and points out the risks of second-round effects if higher inflation expectations become entrenched.

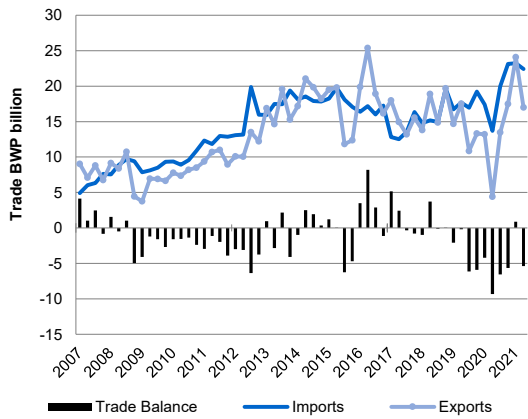
De Beers Diamond Sales



The global market for rough diamonds has been generally stable during the third quarter of 2021, after months of robust growth. De Beers Global Sightholder Sales (DBGSS) experienced a 21.1% drop in sales in Q3 when compared to Q2 2021, with a sales value of USD1.03 billion, down from USD1.31 billion. However, DBGSS sales in the third quarter of 2021 show a substantial increase compared to the previous year, rising from USD450 million in Q3 2020 to USD579 million in Q3 2021. Prices were generally stable during the quarter and De Beers continued with a flexible approach for rough sales. The industry has positive sentiments about sales going into the holiday season. However, it remains cautious about the risks posed by the pandemic. The company held two sightholder sales during the quarter compared to three in Q2 2021.

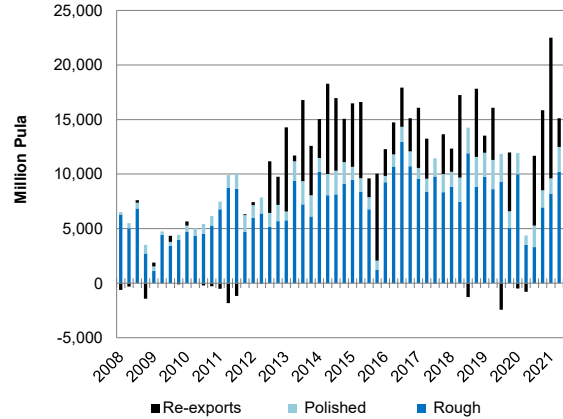
KEY ECONOMIC VARIABLES

International Trade



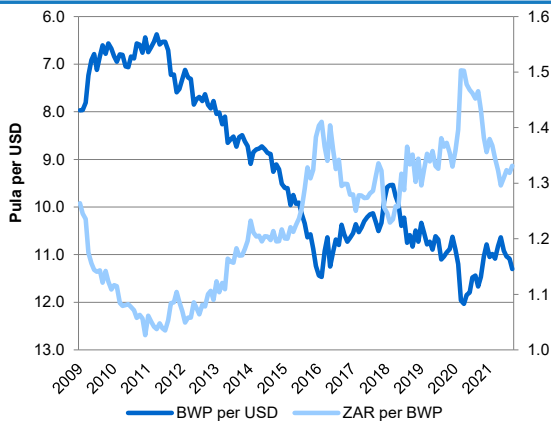
International trade slowed during the second quarter of 2021, with both imports and exports declining. Total imports were P22.4 billion in Q2 2021, down from P23.2 billion in Q1, a decrease of 3.5%. Total exports decreased substantially, down to P17.0 billion, from P24.1 billion in Q1, a decrease of 29.4%. This resulted in a significant trade deficit of P5.4 billion in Q2 2021, compared to a P0.9 billion trade surplus in Q1. However, in Q2 both imports and exports were much higher than in the same quarter in the previous year, recording increases of 63.5% and 287.6%, respectively, attributable to the recovery of economic activity globally. Nevertheless, the persistence of a large trade deficit in Q2, notwithstanding improved performance in diamond exports, illustrates the absolute necessity of diversifying exports.

Diamond Exports



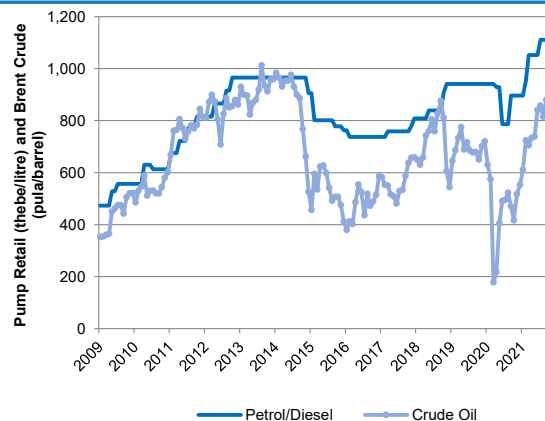
Total diamond exports registered a decrease of 33.1% during the second quarter of 2021, to P15.1 million, down from P22.6 million in Q1 2021. This was driven by a decrease in the value of re-exports, by 79.7% during the period. On the other hand, Botswana rough and polished diamond exports increased by 24.2% and 65.8% between Q1 and Q2, respectively, but could not offset the decline in value of re-exports.

Exchange Rates



Foreign exchange rate trends were reversed during the third quarter of 2021, as the Pula strengthened against the South African rand and weakened against the US dollar. The Pula appreciated by 1.6% against the rand to end Q3 2021 at ZAR1.3316, up from ZAR1.3100 at the end of Q2. Conversely, the Pula depreciated by 3.4% against the US dollar during the quarter, ending Q3 with the Pula-US dollar exchange rate of P11.30.

Fuel prices



Local fuel prices have been on an upward trend since September 2020, following international prices. Local fuel prices increased by 23.9% (including a tax increase) in the 12 months to September 2021 while international oil prices rose by 86.9% during the same period. In the nine months to September 2021, retail pump prices have been adjusted three times. Globally, the demand for oil continues to outpace the supply of oil and this has led to stronger prices, reaching pre-covid-19 pandemic levels. The fact that local prices have lagged international prices suggests that the former may have further to rise.

NEWS HIGHLIGHTS

01/07/2021	Khoemacau produces first concentrate (Mining Weekly)	On June 30 2021, Khoemacau Copper Mines, through its Khoemacau copper/silver project, began production of its first copper/silver concentrate from its Boseto process plant. This was achieved safely and on schedule whilst remaining within 3 percent of the original budget.
02/07/2021	Botswana steps closer to exiting dirty money greylist (Mmegi)	The Financial Action Task Force (FATF) has noted that Botswana has made significant strides in completing their AML/CFT reforms action plan. Therefore, the FATF will conduct an on-site assessment to verify the implementation of these reforms and ensure that the necessary political commitments remain intact to sustain implementation in the future.
02/07/2021	BoB pays government P2.9 billion windfall (Mmegi)	The Bank of Botswana has paid the Government of Botswana a total of P2.9 billion. This includes a payment of P848 million in pre-set dividends linked to holdings within the Government Investment Account (GIA) and approximately P2.1 billion in residual income from investment activities.
07/07/2021	Sandfire granted licence for copper mine in Botswana (Mining.com)	Australian firm, Sandfire Resources has been granted a mining license for its Motheo copper project. The project, valued at USD208 million, is located in the Kalahari Copper Belt and is expected to operate for 12.5 years.
08/07/2021	Britain's Firestone to sell Botswana diamond mine for \$50,000 (News Central Africa)	Botswana registered, Visionary Victor Recourses has entered an agreement to purchase British-based Firestone's BK 11 diamond mine for USD50,000. The BK 11 mine is located 10km south-west of Letlhakane, and has been mothballed since 2012. There had been two previous attempts to sell the mine in 2015 and 2017, both of which collapsed for different reasons.
09/07/2021	Shumba Energy gets P800m solar plant approval (Mmegi)	Shumba Energy has received approval for a 100MW solar power plant which will be situated near Francistown. Funding for the first 50MW phase of the project is expected to be secured within the next six months. The plant is reportedly targeting the Southern African Power Pool (SAPP), the common spot market for electricity sales within the region.
11/07/2021	De Beers Mulls Sale of Botswana Mine (Diamonds.net)	Debswana, a joint venture between De Beers and the Government Botswana is contemplating the sale of its Damtshaa mine. This follows a pause in production in November due to challenging market conditions brought on by the covid-19 pandemic. Debswana has expressed its desire to hold on to the mine if it proves economically viable but is considering various strategies for dealing with the future of the mine.

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12/07/2021	De Beers raises prices yet again (Diamonds.net)	De Beers has lifted prices of rough-diamonds for the fifth time in eight months as the diamond market continues to recover. Insiders reported average price increases of 4 percent to 5 percent during the first day of the July sight sale. The market for rough diamonds continues its upsurge reflecting solid US and China retail sales and a shortage of mining production.
13/07/2021	Lucara finalises USD220 million in funding for Karowe expansion project in Botswana (Mining-technology.com)	In order to expand its Karowe diamond mine, Lucara Diamonds has secured USD220 million in debt facilities with five mandated lead arrangers, namely, African Export-Import Bank (Afreximbank) Africa Finance Corporation, ING, Natixis, and Societe Generale. USD170 million will be used to finance the Karowe underground expansion project and USD50 million is allocated towards working capital. The expansion is expected to extend the life of mine to at least 2040.
14/07/2021	Lucara uncovers Botswana's largest fancy pink diamond yet (MiningWeekly.com)	Lucara Diamonds has recovered Botswana's largest pink diamond at its Karowe mine. The diamond, named Boitumelo, weighs 62.7 carats and has been classified as a high-quality pink Type 2a gem. Furthermore, Lucara recovered three other pink diamonds which weighed 22.21 carats, 11.17 carats and 5.05 carats.
16/07/2021	BITC targets P180 million in FDI at Dubai 2020 Expo (Mmegi)	The Botswana Investment and Trade Centre (BITC) is aiming to attract P180 million in foreign direct investment over the next five years as a result of participating in the Dubai 2020 Expo. The event which features at least 190 countries, will run for a period of six months between October 1, 2021 and March 31, 2022.
20/07/2021	Production Report for the Second Quarter of 2021 (De Beers Group)	During Q2 2021 rough diamond production rose by 134% to 8.2 million carats. This reflects both planned higher production to match the stronger demand for rough diamonds in Q2 2021 as well as the impact of covid-19 related lockdowns in Q2 2020. Production in Botswana, South Africa and Canada increased by 214%, 130% and 14% respectively, whereas production in Namibia declined by 6%.
28/07/2021	Power Metal exercises option to acquire Tati gold/nickel project in Botswana (Mining Weekly)	Power Metal Resources Botswana have triggered their option to acquire a full interest in two gold/nickel exploration licences located within the Tati Greenstone Belt. Power Metal Resources now has four project interests in Botswana.
30/07/2021	Lucara recovers 393 ct diamond at Karowe (Mining Weekly)	Lucara Diamond Corporation has recovered a 393.5 carat top white Type 2a gem-quality diamond from its Karowe mine. The diamond was recovered from the M/PK(S) unit of the south lobe of the mine.

NEWS HIGHLIGHTS

11/08/2021	Stock market maintains momentum into Q3:2021 (Sunday Standard)	The Botswana Stock Exchange has continued to narrow its losses during the first half of 2021. Between January and July 2021 (seven months) the domestic companies index (DCI) has declined by 2.5%, compared to a 5.3% decline during the same period in 2020. The top three traded companies during this period were Letshego, FNBB and Sefalana.
17/08/2021	Ngamiland abattoir eyes two new foreign markets (Sunday Standard)	In an effort to improve its uptake of cattle in the North-western region, Ngamiland Private Abattoir is exploring new markets in Namibia and Angola. The abattoir is currently working on meeting the standards required by the Namibian government but expects to make its first exports (to Namibia) as early as September 2021.
19/08/2021	Monetary Policy Committee Decision - August 2021 (Bank of Botswana)	The Monetary Policy Committee (MPC) of the Bank of Botswana (BoB) has decided to maintain the Bank Rate at 3.75 percent. The MPC reports risks on inflation to be skewed to the upside, but with a central forecast that inflation will revert to within the Bank's objective range of 3-6 percent by the second quarter of 2022.
24/08/2021	Okwa Diamonds agrees to acquire Gem Diamonds' Botswana subsidiary (African Mining Market)	Okwa Diamonds, a joint venture between Botswana Diamonds (10%) and Vast Resources (90%), has agreed to purchase Gem Diamonds Botswana for USD4 million. The primary asset held by Gem Diamonds Botswana is the Ghaghoo diamond mine, which is located in the central region Botswana and has a mining licence for 25 years (until December 2036). The agreed sum will be paid through two USD2 million instalments, the first of which is payable five days after suspensive conditions are fulfilled and the second payable on or before 31 December 2021. The Ghaghoo mine has been closed and under care and maintenance since 2017.
25/08/2021	De Beers and National Geographic partner to protect a natural wonder (De Beers Group)	De Beers and National Geographic have launched a joint venture, "Okavango Eternal", a strategic partnership with the aim of protecting the source waters of the Okavango Delta. The five-year commitment represents critical inward investment in the region's resilience and long-term recovery in the years ahead.
27/08/2021	Botswana's Minergy Coal revives LSE listing plans (Reuters)	In a bid to both reduce debt and increase output amid the boom in global commodities prices, Minergy Limited has revived its plans to list its shares on the London Stock Exchange (LSE). Minergy abandoned plans for an initial public offering on the AIM stock market in 2018 due to a crash in coal prices in the Southern African market along with uncertainty surrounding Brexit also weighing in.

NEWS HIGHLIGHTS

27/08/2021	BERA considers BPC's 5% tariff increase request (Mmegi)	The Botswana Energy Regulatory Authority (BERA) will soon make a decision on a request from the Botswana Power Corporation (BPC) to increase tariffs by 5 percent. BPC laid out its initial request for a 5 percent tariff increase last year, which will be followed by another 5 percent increase in 2022-2023 and another 4 percent increase in 2023-2024. On average, consumers are currently being charged P1.28 per unit of electricity, compared to a P1.41 per unit cost of provision, BPC highlights this shortfall as the reason behind the request for an increase in tariff prices.
27/08/2021	Budget outlook weakens as forecast deficit rises to P7.8 billion (Mmegi)	Botswana's budget deficit for the 2021/22 financial year is expected to reach P7.75 billion (3.6 percent of GDP), up from an initial forecast of P6.03 billion. This is due to additional spending on covid-19 and lower than expected revenues. The revisions to the government budget were presented to Parliament by Finance and Economic Development minister, Peggy Serame, as she requested parliamentary approval of a USD250 million loan from the World Bank.
02/09/2021	Giyani Announces Maiden Indicated Mineral Resources at K.Hill Manganese Project, Botswana (Global Newswire)	As part of the feasibility study for its K. Hill Manganese Project, Giyani Metals Corporation has announced an updated Mineral Resource Estimate (MRE) for the project. As a result of infill drilling, 95 percent of the current Inferred Mineral Resources at the K. Hill project have been converted to the Indicated Mineral Resources category, a 25 percent in total contained manganese metal. The results significantly reduce risks associated with the K. Hill project and demonstrates the potential for either 1) a longer mine life than initially modelled or 2) larger production over a similar period of time.
03/09/2021	IMF hands Botswana P3bn 'windfall' (Mmegi)	The International Monetary Fund (IMF) has allocated Botswana SDR189 million in Special Drawing Rights. The SDR allocation will primarily be used to beef up the country's foreign exchange reserves.
09/09/2021	Lucara's Botswana expansion formally approved (Engineering News)	The USD534 million expansion of Karowe mine has been formally approved by the board of Lucara Diamond Corporation. This follows the financial closure and satisfaction of all conditions precedent to a \$220-million debt package which was announced in July 2021.
10/09/2021	DPF assets soar to P9.5 billion (Mmegi)	The Debswana Pension Fund's (DPF) assets under management have risen to P9.5 billion, up from P8.83 billion as at September 30 last year. The increase in the value of assets has been driven by the performance of offshore investments.

NEWS HIGHLIGHTS

17/09/202	Botswana bags another multi-billion Pula loan, this time from AFDB (Sunday Standard)	Botswana has managed to secure a USD137 million loan from the African Development Bank (AFDB) Group. The loan is to be used to finance the country's economic recovery from the covid-19 pandemic through multi-sector reforms which aim to improve spending efficiency, create jobs and promote inclusive growth. The loan, which is subject to approval by Parliament, will be extended under the Bank Group's Botswana Economic Recovery Support Programme.
17/09/2021	S&P Global Ratings Affirms the Sovereign Credit Rating and Upgraded the Economic Outlook on Botswana from Negative to Stable (Bank of Botswana)	Standard and Poors Global Ratings (S&P) has updated Botswana's sovereign credit rating. The rating's agency has maintained Botswana's sovereign credit rating for long and short term foreign and local currency sovereign credit at "BBB+/A-2". S&P have also revised the economic outlook for Botswana from negative to stable, citing the anticipated rebound in the country's economic growth partially led by a recovery in diamond mining.
22/09/2021	Sandfire study for expanded Motheo proves positive (Engineering News)	Sandfire Resources has announced their intention to advance plans to increase the size of its Motheo copper project, from 3.2 million tonnes to 5.2 million tonnes per year. An internal prefeasibility study (PFS) for the expansion case has estimated a 47 percent increase in estimated life-of-mine revenue, a 116 percent increase in pre-tax net present value and an internal rate of return of 36% for the project.
29/09/2021	Botswana sells troubled state-owned mine to Canada's Premium Nickel Resources (Mining.com)	Minister of Minerals, Green Technology and Energy Resources, Lefoko Moagi, has stated that Canada's Premium Nickel Resources (PNR) will purchase BCL copper mine from Botswana's government with the aim of resuming operations within three years. The Canadian firm has signed an agreement to purchase two of three shafts at the site along with some associated infrastructure. Furthermore, PNR are negotiating a separate deal to purchase Tati Nickel Mine which is owned by the BCL Group.

MACRO-ECONOMIC DATA

KEY ECONOMIC DATA										
	<i>unit</i>	2015	2016	2017	2018	2019	2020	2021Q1	2021Q2	2021Q3
Economic Growth										
GDP	%	-5.7	7.0	4.0	4.0	3.0	-8.5	-8.6	4.9	..
Mining	%	-15.3	0.3	6.3	8.4	-3.7	-26.5	-27.8	3.0	..
Non-mining private sector	%	-5.0	11.5	3.6	2.6	4.1	-6.5	-5.7	4.7	..
GDP current prices	P bn	137.54	164.42	166.47	172.53	178.48	172.55	47.6	49.7	..
GDP 2016 prices	P bn	153.61	164.42	171.00	177.81	183.13	167.58	44.3	44.6	..
Money & Prices										
Inflation	%	3.1	3.0	3.2	3.5	2.2	2.2	3.2	8.2	8.4
Prime lending rate	%	7.50	7.00	6.50	6.50	6.25	5.25	5.25	5.25	5.25
BoBC 7/14-day	%	0.97	0.84	1.45	1.52	1.41	1.04	1.02	1.04	1.09
Trade & Balance of Payments										
Exports - total goods	P bn	63.48	80.34	61.67	67.17	56.29	48.24	24.09	17.01	..
Exports - diamonds	P bn	52.73	70.78	54.38	60.41	51.01	42.54	22.58	15.11	..
Balance of payments	P bn	-4.15	-3.28	-4.28	-4.20	-12.02	-20.06	-0.90	..	..
Foreign Exchange										
Exchange rate BWP per USD	end	11.24	10.65	9.87	10.73	10.63	10.79	11.09	10.92	11.299
Exchange rate ZAR per BWP	end	1.38	1.28	1.26	1.34	1.33	1.36	1.34	1.31	1.332
FX reserves	\$ bn	7.55	7.19	7.50	6.66	6.17	4.94	4.82	4.67	..
FX reserves	P bn	84.88	76.80	73.69	71.43	65.23	53.36	53.08	50.94	..
Financial Sector										
Deposits in banks	P bn	59.96	62.44	63.58	69.27	75.71	80.54	79.88	81.37	..
Bank credit	P bn	48.31	51.32	54.18	58.33	62.77	65.55	65.64	67.45	..
BSE index		10,602	9,728	8,860	7,854	7,495	6,890	6,528	6,622	6,901
Business Indicators										
Diamond production (a)	mn cts	20.73	20.88	22.96	24.38	23.67	16.87	5.04	5.827	..
Copper production (b)	tonnes	23.05	16.88	1.24	1.46	0.00	..	..	..	..
Nickel production	tonnes	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	..	..	..	8,110	..	..
Electricity consumption	GWh	3,974	3,929	3,772	3,919	3,906	3,842	943	968	..
Crude oil (Brent)	\$/bar	36.61	54.96	66.73	50.57	67.77	51.22	63.52	76.94	77.86
Employment (formal) (f)										
Government		130,220	129,216	129,009	156,785	156,785	152,973	..	..	..
Parastatals		19,411	19,008	19,444	23,497	23,497	18,933	..	..	..
Private sector		191,484	194,202	193,745	250,778	227,281	250,715	..	..	..
Total		341,115	342,426	342,198	431,060	407,563	422,621	..	..	..
Govt Budget										
		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23			
		(d)	(d)	(d)	Preliminary (e)	Revised (f)	Projection (g)			
Revenues	P bn	56.41	53.47	54.30	51.25	63.76	63.06			
Spending	P bn	58.39	62.35	65.40	65.80	70.98	71.55			
Balance	P bn	-1.98	-8.88	-11.10	-14.56	-7.22	-8.50			
Public debt & guarantees	P bn	32.99	34.41	36.19	46.69	56.64	..			
Govt deposits at BoB	P bn	30.09	21.56	19.86	6.20	..	..	
GDP	P bn	167.70	175.20	180.60	173.83	194.93	213.39			
Revenues	%GDP	33.6%	30.5%	30.1%	29.5%	32.7%	29.6%			
Spending	%GDP	34.8%	35.6%	36.2%	37.9%	36.4%	33.5%			
Balance	%GDP	-1.2%	-5.1%	-6.1%	-8.4%	-3.7%	-4.0%			
Public debt & guarantees	%GDP	19.7%	19.6%	20.0%	26.9%	29.1%	..			
Govt deposits at BoB	%GDP	17.9%	12.3%	11.0%	3.6%	..	..	

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
- (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

2022 Budget Strategy Paper

Introduction

The 2022 Budget Strategy Paper (BSP) published by the Ministry of Finance and Economic Development (MFED) outlines medium-term projections for Botswana’s aggregate revenue and expenditure. The BSP provides an early basis for the forthcoming 2022/23 Budget along with highlighting the anticipated economic and fiscal revenue developments which provide the basis for the fiscal resource envelope. Furthermore, the BSP presents high-level expenditure proposals as well as the combined impact of all anticipated developments on fiscal balances and debt. The BSP also details Botswana’s medium-term prospects and adjustments that will be made in order to restore fiscal stability.

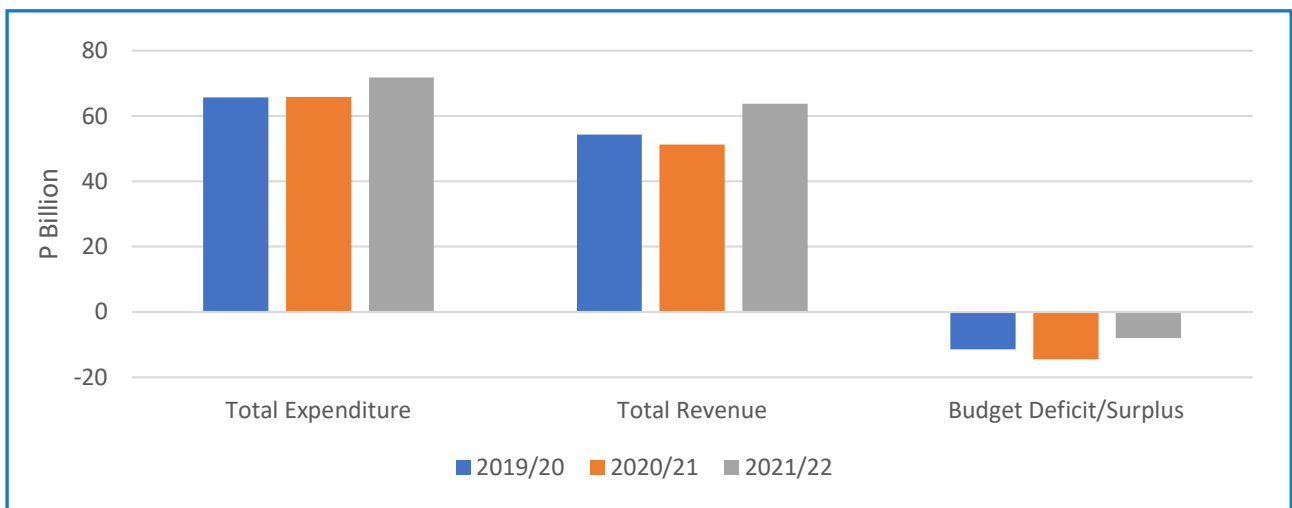
Economic Background

The 2022 BSP has been drawn up against the backdrop of challenging economic circumstances brought by the covid-19 pandemic. According to the IMF World Economic Outlook, global economic growth is estimated to be 5.9% in 2021, compared to a contraction of 3.1% in 2020. The Sub-Saharan African region is projected to register growth

mining and non-mining growth. However, the domestic economy is expected to rebound strongly, with projected growth rates of 9.7%, 4.3% and 4.2% in 2021, 2022 and 2023 respectively. Inflation is a challenge, with increases to administered prices, an adjustment in VAT from 12% to 14%, higher fuel prices, increased electricity tariffs and other factors causing inflation to rise above the Bank of Botswana’s (BoB) objective range of 3-6%. Nevertheless, inflation is expected to revert to within the Bank’s objective in Q2 2022, and the BoB has adopted an accommodative monetary policy stance, cutting the Bank Rate to 3.75% in order to support the economy during covid-19 and the post-covid recovery. The Pula basket weights have been maintained at 45% South African rand and 55% SDR; however, the downward rate of crawl was adjusted to 2.87% in May 2020 to support the competitiveness of local goods in export markets. The balance of payments recorded a deficit of P20.1 billion in 2020, and the foreign exchange reserves dropped by 19.7%, from P63.6 billion to P50.9 billion, between June 2020 and June 2021.

Fiscal Conditions

Figure 1: Budget Outlay



Source: MFED BSP

of 3.7% and 3.8% in 2021 and 2022 respectively following a 1.7% contraction in 2020. Botswana has not been immune to the global economic downturn, with the economy contracting by 8.5% in 2020 due to major reversals in both

The covid-19 pandemic has had a dramatic fiscal impact on Botswana. Preliminary outturn figures for the 2020/21 financial year (FY) indicate that total revenue and grants stood at P51.25 billion, whilst total expenditure and net

SPECIAL FEATURE

lending amounted to P65.80 billion, resulting in a budget deficit of P14.55 billion or 8.4% of GDP. For the 2021/22 FY, total revenue and grants are forecast to reach P63.76 billion, a 24.4% increase when compared to the previous year.

This is mainly attributable to the anticipated recovery of the diamond market, pushing mineral revenues up. Total expenditure and net lending for the 2021/22 FY is projected to reach P70.98 billion, rising by 7.9% from 2020/21. The projected budget deficit for the 2021/22 FY is forecast to be approximately P7.92 billion, cutting the deficit by almost half.

Covid has therefore resulted in large budget deficits for both the 2020/21 and 2021/22 financial years. To fund these deficits, the government has had to make significant drawdowns from the Government Investment Account (GIA) and increase the level of debt it has taken. However, Botswana's fiscal position remains quite strong, with the country's overall debt level remaining low by international standards. Furthermore, the BSP projects a return to balanced government budgets in the medium term. Holding a strong fiscal position prior to the outbreak of the covid-19 pandemic meant that Botswana had the fiscal capacity to absorb and respond to the economic shock caused by the pandemic¹. This meant that government was able to quickly implement a fiscal support package with a total value of around P8 billion, or 4% of GDP, to support firms, households and the economy. Nevertheless, this was implemented at a time of sharply reduced revenues and the result was the rapid depletion of accumulated savings balances.

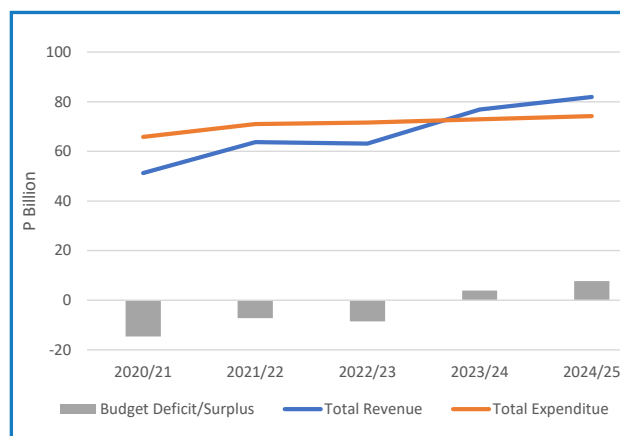
The pandemic came at a time when Botswana already faced pressing needs for fiscal adjustments and structural reforms. It has reinforced the need to strengthen the fiscal position and undertake corrective fiscal reforms to tackle problems such as the country's long-term structural decline in revenues and persistent budget deficits.

The pandemic has, however, reduced the time available to achieve these reforms, by accelerating the depletion of the country's savings.

Medium term Fiscal Projections

Government revenues are expected to rise to P81.9 billion by 2024/25, up from P51.2 billion in 2020/21, representing a 59.8% increase. However, for the 2022/23 FY, revenues are anticipated to drop by approximately P700 million to P63.06 billion. This follows a P3.19 billion downward revision in revenues for the year from the figures presented with the 2021 Budget, due to covid-19 persisting longer than was initially expected. Total expenditure is projected to rise by 12.3% from P65.8 billion in 2020/21 to P74.2 billion in 2024/25. The budget balance is projected to reach a surplus at the start of the NDP 12 period in 2023/24.

Figure 2: Revenues, Expenditures and Budget Balances



Source: MFED BSP

The Impact of Covid-19 on Fiscal Projections

The BSP also shows that the covid-19 pandemic will have an impact on Botswana's fiscal position over the next three years (2020/21, 2021/22 and 2022/23).

Table 2: Original and Post-covid Projections

	2020/21	2021/22	2022/23
Revenue (pre-crisis)	62,394	67,993	72,599
Revenue (post-crisis)	52,246	63,760	62,559
Revenue losses	-11,148	-4,233	-10,040
Losses as % of GDP	-6.4	-2.1	-4.6
Expenditure (pre-crisis)	67,615	69,234	68,842
Expenditure (post-crisis)	65,804	71,774	72,306
Overall balance (pre-crisis)	-5,222	-1,241	3,757
Overall balance (post-crisis)	-14,558	-8,014	-9,747

Source: MFED BSP, Table 4. Note that the figures in this table vary slightly from those elsewhere in the BSP and in the text above.

The table above highlights the impact of covid-19 on government revenues (reduced) and expenditure (increased). The greatest impact of the pandemic was felt in the 2020/21 FY with revenue losses as a percentage of GDP reaching 6.4% compared to 2.1% and 4.6% in 2021/22 and 2022/23 respectively. There was a reduction in expenditure during 2020/21 due to underspending in the development budget. Botswana's budget balance was initially projected to reach a surplus by the 2022/23 FY; however, because SACU revenues adjust with a lag (there was an overpayment in SACU revenues in 2020/21, and a once-off drop is to be experienced in 2022/23 to correct it), covid-19's negative impact on revenues will be spread over a longer period of time, resulting in a budget deficit in the 2022/23 FY.

¹ In an article in The Economist published on April 30th, 2020 ("Rout 66"), ranked Botswana as the strongest of 66 emerging and developing economies in terms of capacity to absorb shocks based on four measures of financial strength: public debt; foreign debt; cost of government borrowing; and foreign exchange reserve cover.

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Key Fiscal and Debt Challenges

The three consecutive years of large budget deficits pose significant risks to Botswana’s fiscal stability. Therefore, government is faced with four main challenges:

1. Finding a way to increase other sources of revenues.

This could be achieved through an increase in VAT and income tax rates. However, the government will want to avoid excessive increases in tax rates as this could have a negative impact on real incomes, consumer demand, investment and subsequently economic growth. Therefore, improving the efficiency of revenue collection will be the immediate priority. This will include strategies to broaden the tax base such as the taxation of the digital economy, and the introduction e-billing platforms to improve VAT compliance, etc. Taxation can be increased on under-taxed areas such as property, especially as this would generally impact higher income groups.

2. Controlling spending.

Government expenditure will have to be careful and considered with resources being diverted towards high impact, high return projects. The composition of spending will also need to be taken into account. There are three main categories of spending, namely (i) recurrent spending - public sector wages; (ii) recurrent spending - other, including maintenance, social welfare, transfers to SOEs etc.; and (iii) development spending - projects. Further increases in the already excessive share of spending on pub-

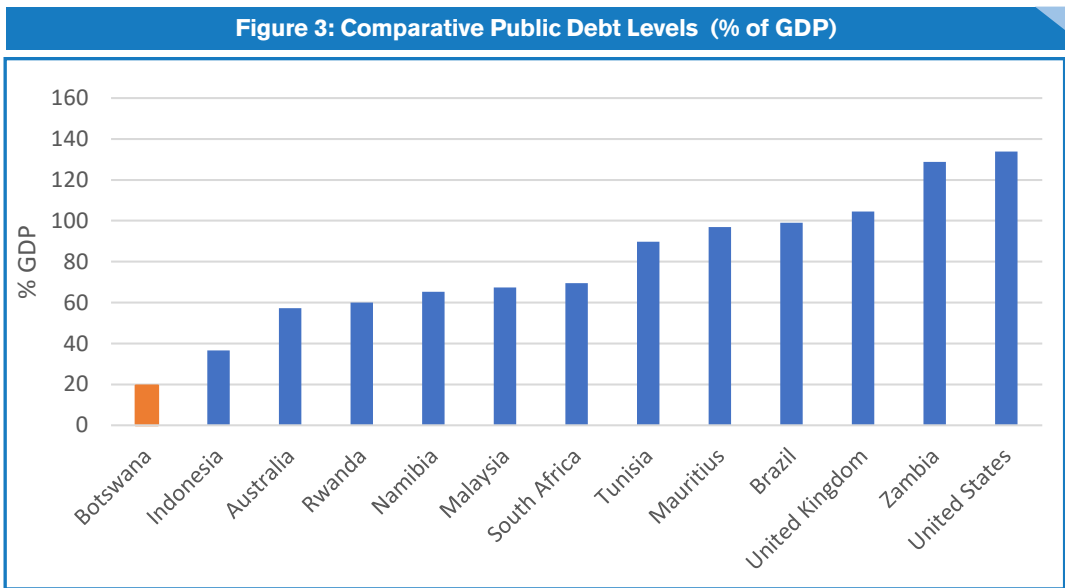
lic sector wages will result in a squeeze in spending across other categories, and result in a distribution of limited fiscal resources towards public sector employees and away from the population as a whole and the economy.

3. Restoring the budget to a balanced position by early NDP 12.

The 2023/24 FY will be the first year of NDP 12 and in order to achieve a balanced budget or surpluses by then, government will have to ensure that spending is kept under control as revenues continue their recovery. It is imperative that a return to budget surpluses is attained so that savings can be built up and the GIA restored in order to safeguard against future shocks to the economy.

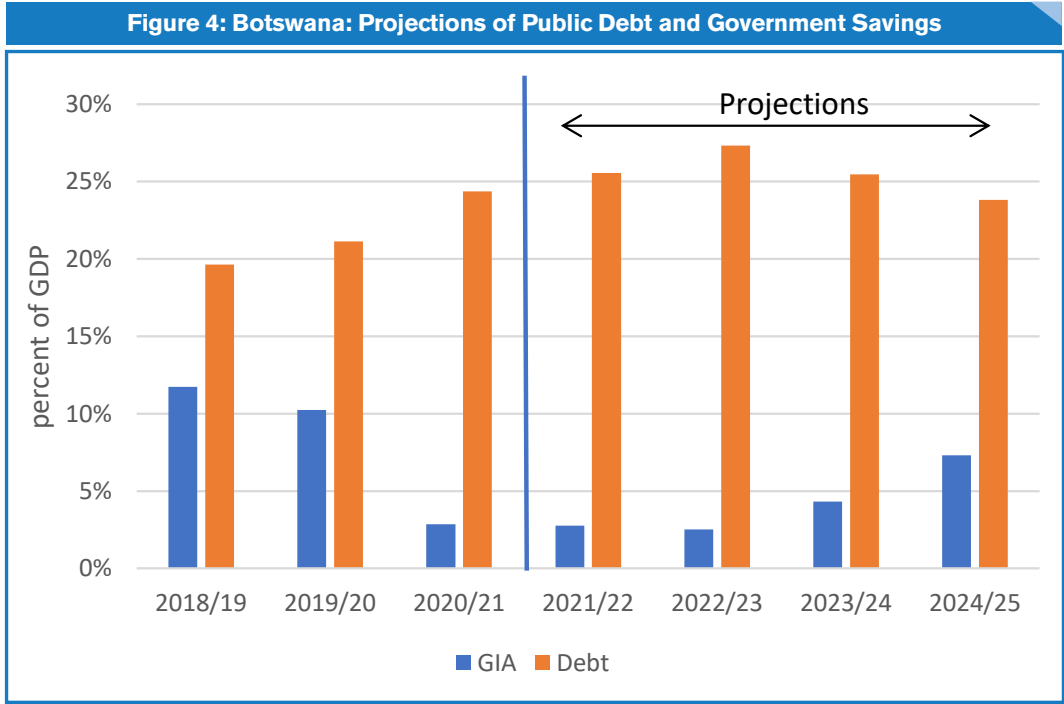
4. Sustainable debt management.

The inevitable increase in public debt needs to be managed well whilst maintaining total debt at a sustainable level. Taking on large amounts of debt too quickly could result in a downward revision of Botswana’s credit rating, subsequently reducing the country’s FDI attractiveness and making it more expensive to borrow. Nevertheless, the extremely low starting level of debt and magnitude of projected deficits make sustainable debt management very achievable. As noted, Botswana’s current level of public debt is very low by international standards (Figure 3) and debt projections are favourable (Figure 4) as long as expenditure growth can be contained.



Source: IMF

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Source: MFED, Econsult

Conclusion

The 2022 BSP has been drawn-up in the midst of very challenging economic conditions. Revenues are expected to improve marginally as we move towards the early years of NDP 12, at which point the budget balance is expected to reach a surplus. However, this will require very tight control of expenditures. The projected budget surpluses will help replenish the GIA and improve savings which will in turn provide a financial buffer against future shocks. It will also require some politically tough decisions to be taken regarding the reduction of the unsustainable public sector salary bill. The positive outlook for the medium-term is based on increased economic activity, improved tax collections and responsible spending on programmes and projects.

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