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ECONOMIC REVIEW

third quarter july-september 2018

in this issue ...

COMMENTARY

Recovery continues with a broad-based increase in growth

The economic highlight of the third quarter of 2018 was the release of GDP data showing that the economy grew by 4.4% in the year to June. This was the highest annual economic growth rate for nearly four years, since the third quarter of 2014. This was partly due to the impact of the closure of the BCL copper-nickel mine in October 2016 gradually falling out of the annual growth calculations. However, the recovery went far beyond the BCL effect, and growth was broad-based, with all sectors except for water and electricity experiencing the same or higher annual growth than in Q1. The data suggests that growth for 2018 as a whole is on course to reach 4.5%-5.0%, which would be the highest annual rate for five years.

Other positive economic news in the third quarter of 2018 included an upturn in bank credit growth to a respectable 7.3% in the year to July, and a continued (small) decline in the proportion of bank loans in arrears. Inflation fell to 2.9% in September, just below the lower end of the Bank of Botswana's objective range, and as a result, policy interest rates were maintained at historically low levels. The global diamond market has been stable, rather than growing, with sales at similar levels to 2017.

Our ability to monitor and analyse economic developments is, however, hindered by something of a data drought. Statistics Botswana and other agencies have been unable to provide recent data on international trade, employment, company formation, and mineral production. The long-awaited report from Statistics Botswana on the 2015/16 Botswana Multi-Topic Household Survey (BMTHS) is still not available, more than two years after the survey was completed.

There are a few economic issues that have become more pressing during the quarter. Government seems unable to come up with a coherent strategy regarding fuel prices. Officially, retail prices of petrol, diesel and paraffin are regulated, but not subsidised, with the National Petroleum Fund (NPF) providing a stabilisation mechanism. In principle, pricing decisions are taken by the newly-established regulator, the Botswana Energy Regulatory Authority (BERA). But with oil prices rising on international markets, domestic prices have not been increased sufficiently to cover the cost of oil imports. A problematic clause in the BERA Act, inserted late in the drafting process, requires all of BERA's pricing/tariff decisions to have Ministerial approval. In practice this means Cabinet approval, so even with an "independent" regulator, fuel price regulation is still politicised.

Sub-economic pricing reduces (or postpones) the impact of higher fuel import costs on inflation, but there is no clear mechanism for making up the shortfall when there is under-recovery of fuel import costs through retail prices. Even with the modest fuel price increase announced in October 2018, retail prices are still at least P1 per litre below cost. The deficit is financed by fuel importing companies, who have substantial overdrafts – believed to total around P1 billion currently, and this will steadily increase unless prices are increased further. Implicitly, this is money owed by the Government (via the NPF) to the oil companies, but there appears to be no strategy in place for paying off this debt. Similar inconsistencies are apparent in the pricing of water and electricity, both of which are below economic cost.

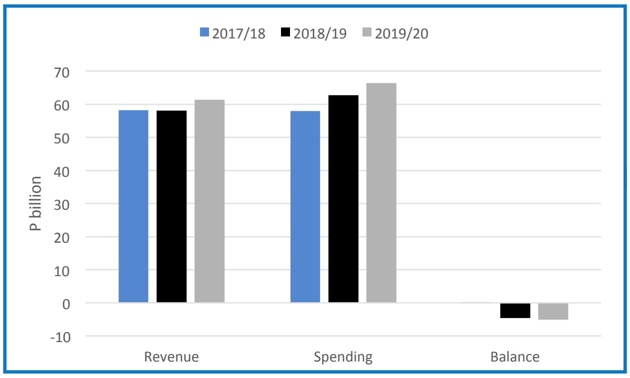
Besides creating economic distortions and undermining the new regulator, another result of the fuel price policy is to take liquidity out of the banking sector, due to the need for oil importers to borrow heavily. This will be compounded by another government decision, to remove monies held in the banks by off-budget Special Funds, which will take a further P1.8 billion of liquidity from the banks. Although there is currently not a liquidity shortage – we estimate that there is around P4 billion of liquidity in the banking system over and above the banks' statutory and operational requirements - removing the Special Funds could lead to a tightening of liquidity, and should therefore be done slowly. Liquidity tightening may lead to a slowdown in credit growth and more competition for deposits. This is already apparent, with deposit interest rates rising; however, further increases will be necessary if funds are to be attracted from balances held outside of the country or domestically in foreign currency deposits. This would in due course lead to higher lending rates, even if monetary policy remains loose.

2019 Budget Strategy Paper

One of the most significant developments of the quarter was the release of the 2019 Budget Strategy Paper by the Ministry of Finance and Economic Development. This included updated fiscal figures for the 2017/18 financial year, based on actual revenue and expenditure data. This showed that revenue came in well ahead of budget, due to the good performance of mineral revenues, although this was offset to some extent by a worrying under-performance of domestic revenues for non-mineral income tax and VAT. Government expenditure came in just below budget, mainly due to a 14% underspend on the development budget. As a result, the budget was broadly balanced, as compared to the earlier projection of a P2.4 billion deficit.

Revised data for the current (2018/19) fiscal year shows a downward revision of both revenues and expenditures as compared to the February 2018 Budget figures, with an increased deficit of P4.5 billion projected. A similar deficit is projected for the coming (2019/20) fiscal year as spending continues to rise even with revenues somewhat stagnant. This reinforces the need for improved domestic revenue mobilisation, which is quite low. With constrained revenue, this emphasises the importance of proper prioritisation of spending based on proper assessment and appraisal of competing spending demands, and improving efficiency in key areas of government spending where costs (relative to output/delivery) are very high.

Figure 1: Government Budget, 2017/18 – 2019/20



Source: MFED, Draft 2019/20 Budget Strategy Paper

IMF Article IV Report

The 2018 IMF Report on the Botswana economy was published in August, with its usual thorough review of economic issues and policies, and provision of medium-term forecasts. The GDP growth forecasts are reasonably positive, averaging around 4% a year from 2019-2022. Budget forecasts are slightly less positive, with budget deficits projected throughout this period, with revenues somewhat lower than government's figures.

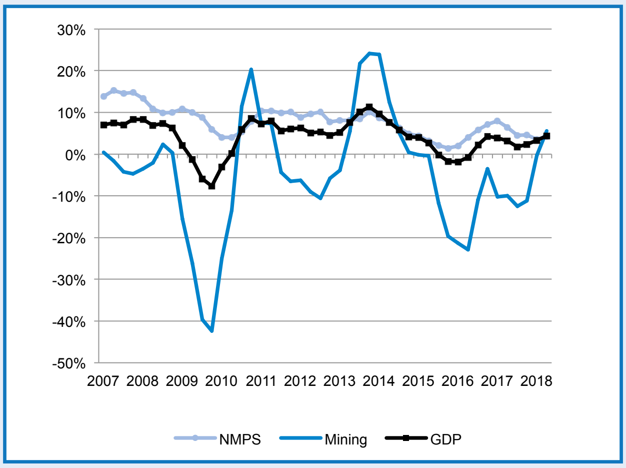
However, the IMF emphasises that "economic outlook is positive assuming key structural reforms are implemented". Key economic objectives are to "improve public sector efficiency, boost non-mining growth, diversify exports, and lower unemployment, all of which will hinge on the successful implementation of critical structural reforms". These cover a wide range of public sector, business environment and financial sector reforms. Highlights include:

- improve domestic revenue mobilisation, through extending the coverage of property taxes and reducing VAT exemptions;
- stop the proliferation of parastatals and restructure or privatize existing ones;
- formulate a civil service reform to reallocate resources and reduce bureaucracy;
- use the opportunity of the political transition to once and for all move ahead with reforms to reduce red tape and the costs of doing business
- swiftly liberalize the granting of visas and work permits;
- improve information on the labour market;
- increase the volume and frequency of issuance of government bonds;
- adopt measures to increase the breadth and depth of mobile money payments.

The IMF notes that without these key reforms, growth is likely to decline.

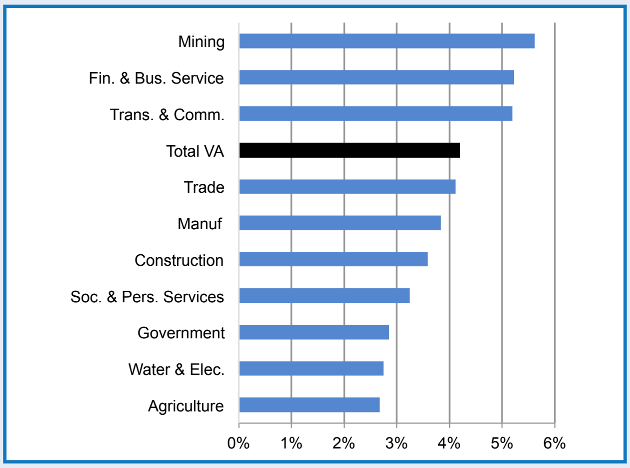
KEY ECONOMIC VARIABLES

Annual GDP Growth



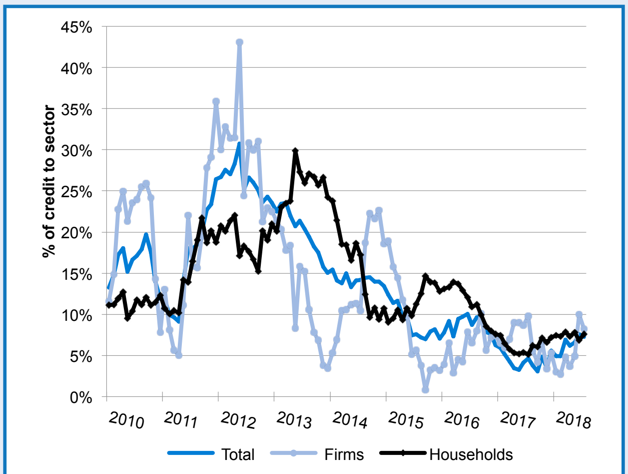
Real GDP growth continued its resurgence during the second quarter of 2018, registering y-o-y growth of 4.4%, compared to 3.3% in Q1 2018. This is the highest rate of y-on-y GDP growth recorded since 2014 Q3. Growth has again been driven by the recovery of the mining sector, which recorded y-o-y growth of 5.6%, up from negative 0.3% in Q1 2018. This is also the first quarter to produce positive y-o-y growth in the mining sector since Q4 2014. Growth in the non-mining private sector (NMPS) increased to 4.2%, from 3.6% during the previous quarter indicating an improvement across the whole economy.

Sectoral GDP Growth



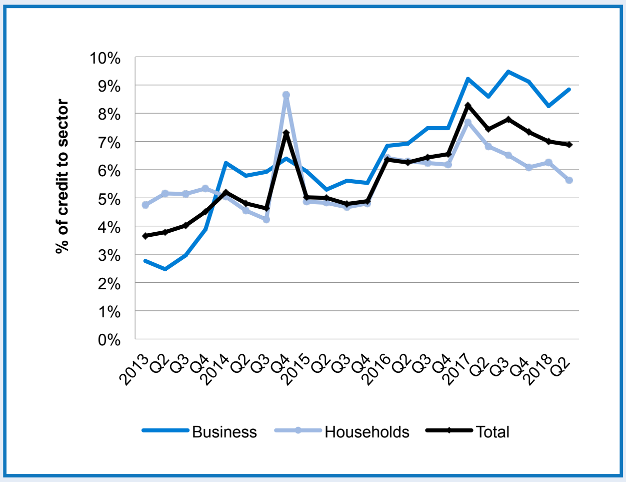
In line with the improved economic performance, all sectors except for Water & Electricity recorded either the same or higher growth rates in Q2 2018 compared to Q1. Mining was the fastest growing sector recording y-o-y growth of 5.6%, in contrast to the previous quarter when it was the slowest growing sector. This recovery is mainly technical, due to the effect of the BCL closure gradually dropping out of growth calculations. However, there was also strong growth in the output of diamonds, coal and soda ash. There was also a significant increase in the growth rates of the Trade, Manufacturing and Agriculture sectors compared to Q1 2018, recording y-o-y growth rates of 4.1%, 3.8% and 2.7% respectively.

Annual Credit Growth



Annual bank credit growth has continued its upward trajectory. Total bank credit rose by 7.3% in the year to July 2018 from 6.2% in April. This has been driven by a sharp increase in the annual growth rate of credit to firms, which rose from 3.6% in April to 8.3% in July. This may reflect the reported increase in business confidence within the economy over the first half of the year. Household credit growth increased marginally to 7.6% from 7.3% during the same period.

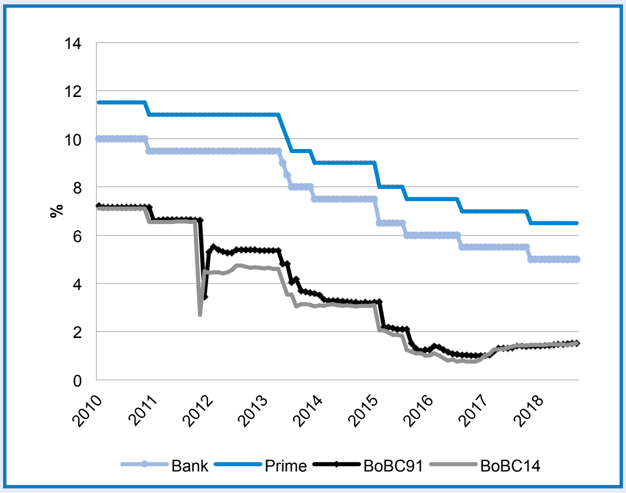
Arrears on Bank Lending



Arrears as a proportion of outstanding bank credit fell marginally during the second quarter of 2018. Total arrears decreased to 6.9% in Q2 2018, from 7.0% in Q1. The reduction in household arrears from 6.3% in Q1 to 5.9% in Q2 2018 has been offset by an increase in both business and government & parastatal arrears. Business arrears rose to 8.9% in Q2 2018, up from 8.3% in Q1, whilst government & parastatal arrears increased to 6.5% from 6.1% during the same period.

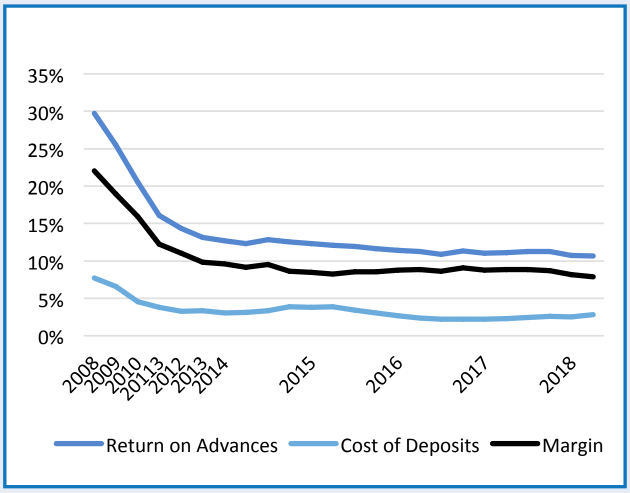
KEY ECONOMIC VARIABLES

Interest Rates



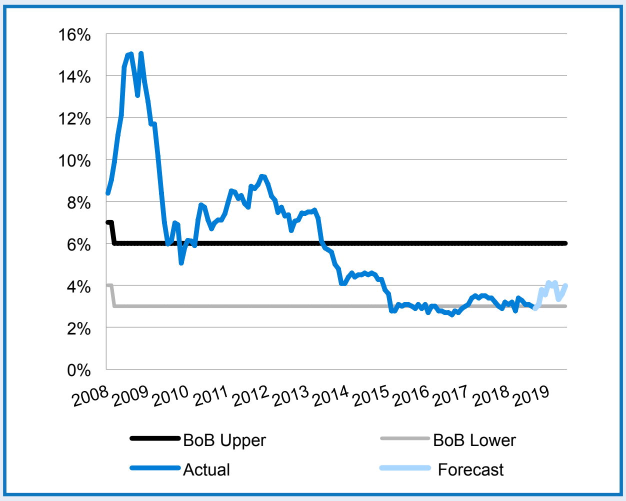
The Bank of Botswana's Monetary Policy Committee (MPC) decided to maintain the Bank Rate at 5% in August 2018. Consequently, the commercial banks' Prime Rate also remained unchanged at 6.5%. Money market rates have however continued to slowly increase. The BoBC91 interest rate rose to 1.52% in Q3 2018 from 1.48% in Q2 2018, and the BoBC14 rate rose from 1.47% to 1.52% during the same period.

Interest Rate Spread



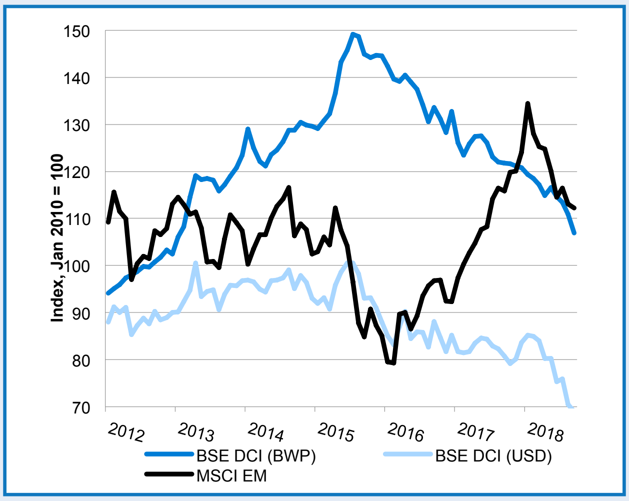
The long-term trend of both lending and deposit rates for commercial banks has followed BoB's Bank Rate downwards. However, the average return on advances has fallen much more than the cost of deposits, and hence the spread between the two has also fallen, from over 20% in 2009 to only 8% in recent years. However, the cost of deposits has begun to rise as liquidity has tightened and banks compete for deposits. This situation will be exacerbated by the government's decision to move "special funds" deposits from commercial banks to the central bank. We expect the trend of tightening margins (and bank profitability) to continue as the cost of deposits rises.

Inflation and Forecast



Headline inflation decreased slightly during Q3 2018, from 3.1% in June to 2.9% in September. This is below the 3-6% inflation objective range of the BoB. Core inflation (trimmed mean measure) was recorded at 2.9% whilst core inflation without administered prices was 1.6%. Inflation is expected to rise during Q4 given the increase in fuel prices that took place in October. We expect a further increase, similar in magnitude, to take place in January 2019, and therefore project inflation to rise above 4% during the first quarter of 2019.

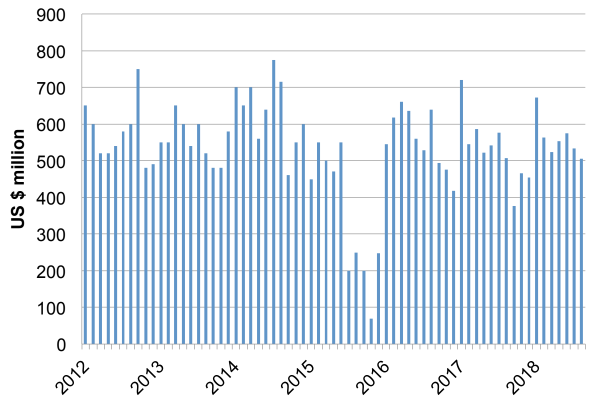
Stock Markets



The Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) continued to weaken into the third quarter of 2018. The DCI fell by 6.7% and 8.5% in Pula and USD terms respectively. Minergy was the best performing stock on the BSE board, gaining 21%. Conversely, Choppies was the worst performer, losing 84% during Q3 2018 due to concerns related to delays in the publication of its financial statements. The DCI was outperformed by both the MSCI Emerging Markets Index, which declined by 2.0%, and the MSCI World Index which rose by 4.5%.

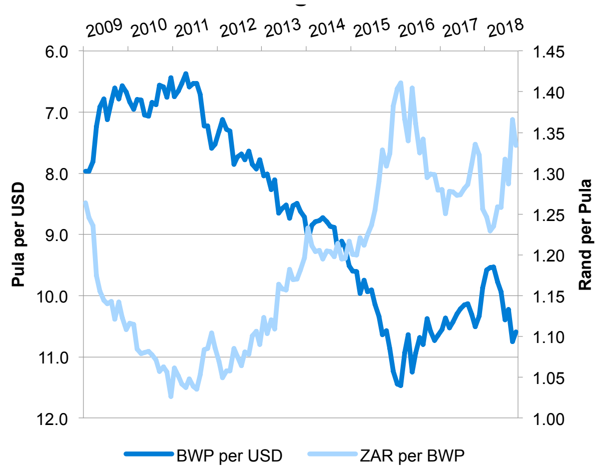
KEY ECONOMIC VARIABLES

De Beers Diamond Sales



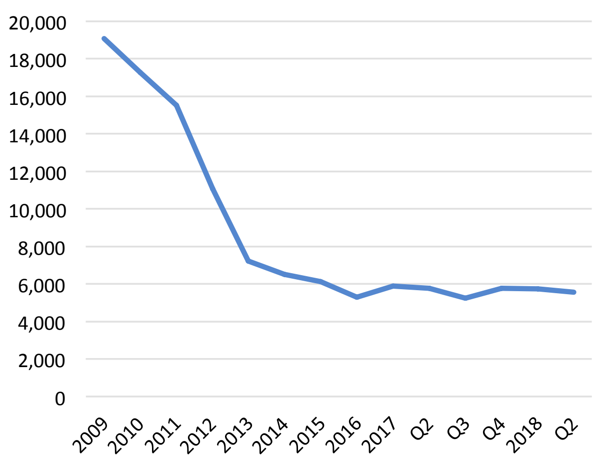
The global demand for rough diamonds has been relatively stable during the third quarter of 2018. De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1.038 billion from the two sights held in Q3 2018. This is 4.2% lower than the value of sales for the same period last year. Total sales for the year to Q3 2018 were valued at USD5.223 billion, up from USD4.891 billion over the same period in the previous year. It is however worth noting that there had been one more sight held over the most recent twelve month period.

Exchange Rates



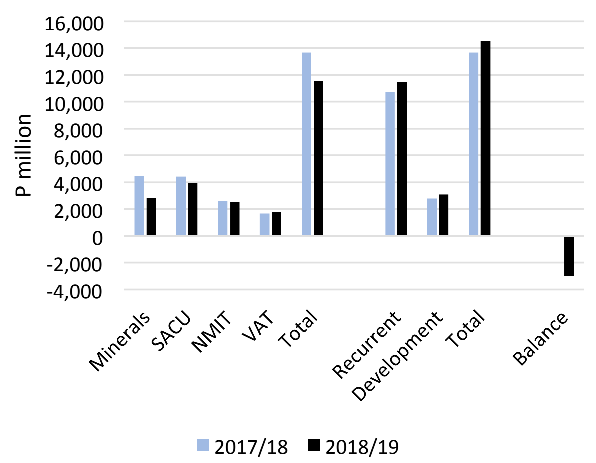
The Pula strengthened against the SA rand by 1.3% during Q3 2018, to end the quarter at ZAR1.334 compared to ZAR1.317 at the end of Q2. This is mainly due to a major sell-off of South African bonds in August and the general weakness of the South African economy, which caused a weakening of the rand against the US dollar and the Pula during the quarter. However, partial link to the rand also caused the Pula to depreciate against the US dollar. The Pula-US dollar exchange rate was 10.59 by the end of September 2018, down from 10.40 at the end of June 2018, representing a depreciation of 1.9%.

Work Permit Holders



The number of individuals holding work permits in Botswana has declined by 71% from 19,080 in Q4 2009 to 5,561 individuals in Q2 2018. The trend has however been relatively flat since Q4 2016. With an improvement in the business environment expected under the new administration, we expect an increase in the number of expatriates and foreign investors looking to do business in Botswana. As a result, a rise in the number individuals holding work permits is expected and is a good barometer to check whether the changes in the business environment are truly coming to fruition.

FYQ1 Budget Outturn



Fiscal data for Q1 of the 2018/19 financial year, released September 2018, indicates a budget deficit of P3.0 billion for the first quarter of the fiscal year. This is a significant increase in the budget deficit given the approximately balanced budget in the same period in the previous year. The deficit is mainly due to a reduction of 16% in revenue compared to Q1 FY2017/18. The drop in overall revenue has been driven by a 37% fall in mineral revenues and a reduction of 11% in SACU receipts. There was also an increase of 6% in total government expenditure, driven by an 11% increase in development spending. The deficit has been funded by a combination of bond issuance and drawdowns of government balances at the Bank of Botswana.

NEWS HIGHLIGHTS

5th July	Bona Life closes shop. (Mmegi)	Troubled life insurance company, Bona Life, has shut its doors indefinitely, marking the culmination of a bitter shareholder dispute that traces back to the P400 million battle between the Botswana Public Officers Pension Fund (BPOPF) and asset management firm, Capital Management Botswana (CMB).
6th July	BSEL secures approval for "tough" new rules. (Mmegi)	The Botswana Stock Exchange Limited (BSEL) will initiate a new set of equity listing requirements in 2019 following regulatory approval by the Non-Bank Financial Regulatory Authority (NBFIRA). The new requirements are intended to enforce compliance from listed companies, failing which tough penalties will be incurred. These include moving companies' securities to a default board and a daily fine of P500 levied in the event of failing to publish financial statements. The new rules are applicable to all BSEL equity platforms.
9th July	De Beers and Botswana prepare for new sales deal. (Rapaport News)	The 2011 agreement between the Botswana Government and De Beers diamond company regarding the marketing of Botswana diamonds is due for renewal in 2020 and negotiations for new agreement are expected to begin in 2019. It is anticipated that under the new agreement the Government seek a greater supply of rough diamonds to the Okavango Diamond Company (ODC), with the aim of creating more jobs. Moreover, Botswana will continue efforts to diversify the diamond industry and the economy in recognition that diamond mining will not last forever. Botswana and De Beers have a long-standing relationship going back to the late 1960s.
26th July	Botswana's SACU revenue decline by P4.1 billion. (Sunday Standard)	Botswana's revenue received from the Southern African Customs Union (SACU) Common Revenue Pool (CRP) fell from P15.82 billion in 2015/16 to P11.77 billion in 2016/17, a decline of P4.1 billion. Under the SACU Agreement, member states collect and pay all custom duties, excise duty and additional duties into the CRP. Thereafter, revenues are shared according to an agreed formula, which favours the smaller member states (Botswana, Lesotho, Namibia and eSwatini).
30th July	IMF proposes new growth model for Botswana. (Sunday Standard)	The International Monetary Fund (IMF) Deputy Managing Director Mr Toa Zhang proposed a new growth model for Botswana, where the role and size of the government is different and the economy is led by private sector. Under the new model, Botswana has to diversify into sectors with export and employment potential, creating a good environment for private sector growth, whereby employers can hire a well-trained labour force. In this model, the public sector should focus on providing high quality and cost-effective public services and infrastructure.
3rd August	Orapa's cut 3 to remove 96 million tonnes. (Mmegi)	The expansion of the Orapa diamond mine open pit, named "Cut 3", will require the removal of approximately 96 million tonnes of waste in order to tap into the diamonds. According to Debswana officials, the Cut 3 project represents the next phase of mining at Orapa and is forecast to extend the mine's lifespan beyond 2030. While the project is still at pre-feasibility stage, implementation is expected to start in 2020.
8th August	Lucara announces second quarter 2018 results. (Newswire)	Lucara Diamond Corp. announced its second quarter 2018 results. Revenue during the quarter decreased to USD64.5 million when compared to USD79.6 million in Q2 2017, this is attributable to smaller volume and lower quality of exceptional diamonds recovered during the period. On the other hand, operating costs increased to USD6.2 million in Q2 2018 from USD3.5 million in Q2 2017 as a result of higher depletion and amortisation expenses.

NEWS HIGHLIGHTS

9th August	Sefalana Group's best results ever. (The Patriot)	Sefalana Group's financial results for the year ended 30 April 2018 revealed the company recorded a 12 percent revenue increase from P4.3 billion in the 2016/17 financial year to P4.8 billion in 2017/18. Operations in Botswana contributed 54 percent and 23 percent to the group's revenue and profit before taxation, while the Namibian market contributed 32 percent and 23 percent respectively. According to the Group's Managing Director, the results are the best ever the company has recorded. The group also has operations in Lesotho.
10 August	Migration of special funds sparks bank liquidity fears. (Mmegi)	The Ministry of Finance and Economic Development (MFED) intends to move Special Fund balances held by commercial banks to the Bank of Botswana (BoB). The move has sparked fears of a possible liquidity crunch in the commercial banking space reminiscent of the crisis that rocked the sector four years ago. The total value of the Special Funds is P8.2 billion, but it has not been announced how much of this is held by the banks, as much of it is already on deposit at BoB.
10th August	BSEL to list on BSE. (Mmegi)	The Botswana Stock Exchange Limited (BSEL) plans to self-list, following the finalisation of its demutualisation, a process that means the bourse is now a company owned by shareholders. BSEL is owned by the Government (81.3 percent), Stockbrokers Botswana (5.75 percent), Imara Capital (5.75 percent), Motswedi Securities (4.32 percent) and African Alliance (2.88 percent). At its demutualisation, BSEL was valued at P35.6 million.
13th August	BPC extends grid to 100 more villages. (Mmegi)	The Botswana Power Corporation (BPC) is extending the national grid to 100 more villages this year, in a move that will extend electricity to nearly all villages in the country. The extension of the grid has been a national priority for several years, with government's position being that electricity provision is the bedrock of social upliftment as development depends on reliable and stable power. Moreover, the corporation intends to improve efficiency in delivery of its services by connecting electricity within 10 days of connection payment.
15th August	First-half diamond sales down 16 percent at Botswana's Okavango Diamond Company. (Mining Weekly)	Sales at Botswana's state-owned Okavango Diamond Company (ODC) fell 16 percent by value in the first half of 2018, to USD 260 million, compared to the same period last year. The company sold 1.778 million carats in H1 2018, down from 1.808 million carats in H1 2017. Sales are expected to remain somewhat sluggish for the remainder of the year due to market conditions.
29th August	Construction begins at Botswana's first privately-owned coal mine. (Reuters Africa)	Minergy Limited has announced that the construction of the P400 million Masama Coal Mine will begin in January 2019, making it Botswana's first privately-owned coal mine, and the second coal mine in the country. The mine is forecast to produce 2.4 million tonnes of coal per year. It is estimated that Botswana has total deposits of 212 billion tonnes of coal.
5th September	IMF Executive Board concludes 2018 Article IV consultation with Botswana. (International Monetary Fund)	The International Monetary Fund (IMF) Executive Board has concluded the 2018 Article IV consultation with Botswana. Botswana has been commended for implementing sound policies which have contributed to macroeconomic stability, low debt and strong buffers. The authorities noted the slower progress with regards to key structural reforms, hence, accelerating the implementation of the reforms is critical to promote private sector growth. Several recommendations has been made including relaxing restrictions on visas and work permits, and addressing data gaps to improve the quality of economic statistics and fiscal transparency.

NEWS HIGHLIGHTS

8th September	Botswana says china agreed to extend loan and cancel debt. (Reuters Africa)	President Mokgweetsi Masisi has announced that China has agreed to extend a new loan facility to Botswana and in addition, cancel the existing loan debt. The new loan will be used for rail and road infrastructure. The President had recently visited China on a state and Forum on China-Africa Cooperation (FOCAC) summit accompanied by other cabinet ministers.
11th September	Local court to decide Norilsk claim on BCL. (Business Live)	The matter between Norilsk Nickel's USD277 million claim against Bamangwato Concession Limited (BCL) will be decided in South Africa courts to find the merits of a mining right awarded to BCL. The BCL, represented by the liquidator Nigel Dixon-Warren, argues that the mining right should have not been transferred to BCL as the company was in financial turmoil. If BCL is successful in the court then Norilsk Nickal's case will all about end. In 2014 Norilsk Nickel struck a deal with BCL to sell its 85 percent stake in the Tati nickel mine in Botswana and its 50% stake in South Africa's Nkomati Nickel to the state-run nickel producer for USD337 million. The price was later reduced to USD277 million.
12th September	FNBB's profits up 23 percent. (The Patriot)	First National Bank Botswana recorded a 23 percent increase in profit before taxation (PBT) for the year ended 30 June 2018. PBT increased from P680.32 million in 2016/17 to P838.21 million in 2017/18. This is attributable to a 24 percent reduction in impairment charges. Total assets stood at P4.36 billion in 2017/18 from P4.4 billion in 2016/17. The bank is optimistic about the future and expects positive growth during the National Development Plan (NDP) 11 period.
12th September	BBS floats shares on BSEL Serala board. (Botswana Guardian)	Botswana Building Society Limited has become the first company to register shares on the BSEL's Serala board. Mr Pius Molefe, the Managing Director of BBS, has stated that by registering on the board it will enable existing shareholders to trade shares to interested buyers. Mr Molefe also stated that the company intends to apply for a banking license in accordance with the Banking Act, following which it intends to list on the BSEL main board. The OTC Serala board facilitates secondary (over-the-counter, or OTC) trading of shares in companies that are not yet fully listed.
14th September	Ministry of Investment, Trade and Industry at the heart of transformation. (The Voice)	The Minister of Ministry of Investment, Trade and Industry (MITI) Ms Bogolo Kenewendo has stated that MITI is at the centre of economic transformation of Botswana. So far MITI has passed a number of laws to improve the ease of doing business, which has been cited as one of the impediments to foreign direct investment and private sector growth in the country.
20th September	Minergy lauds Botswana regulatory authorities. (Mining Weekly)	Minergy Chief Executive Officer (CEO) Mr Andre Bojé praised regulatory authorities for their use of legislation to assist mining investment. The CEO stated that they experienced challenges with the Environment Impact Assessment (EIA), but once it was approved the mining license was granted in two days. Minergy will construct the first private owned coal mine in Botswana, Masama Coal Mine, the mine is expected to operate for about 70 years.
24th September	P5 billion budget deficit for 2019/20 financial year. (Weekend Post)	The revised budget from the Budget Strategy Paper (BSP) showed that the economy is forecast to record a budget deficit P4.57 billion in 2018/19, compared to a small surplus of P220.3 million in 2017/18. The deficit is attributable to flat revenue collection and higher total expenditures. Total revenue and grants are expected to record a marginal fall of P58.11 billion in 2018/19 from P58.15 billion in 2017/18. Revenues received from the SACU Customs and Excise pool are expected to decrease to P14.21 billion from P17.86 billion during the period. On the other hand, total expenditures and net lending is estimated to increase to P62.69 billion in 2018/19, up from P57.93 billion in 2017/18.

NEWS HIGHLIGHTS

25th September	Pula Card to improve service delivery. (Daily News)	The Government has recently launched the Pula Card to improve service delivery and offer convenient access to cash and payments anytime. The card is intended to improve efficiency within the government revenue system as it will be used to receive or disburse payments to individuals without them having to travel to revenue offices. In addition, the Pula card is convenient for use anywhere in the world as it is a Visa card and can hold various currencies such as the Pound, US Dollar, Rand and Euro. The government plans to use the card for disbursement of social welfare programmes to beneficiaries and student allowances, thereby increasing financial inclusion.
26th September	Budget Pitso: Public debt within set range. (The Patriot)	The Government intends to continue to finance budget deficits by borrowing from both domestic and external markets as well as tapping into accumulated reserves. According to the deputy secretary for Economic Policy at the Ministry of Finance and Economic Development, Mr Kelapile Ndobano, public debt remains modest and within the statutory limit of 40 percent of GDP. The Budget Strategy Paper showed an estimated total debt of 25 percent of GDP in 2017/18, which is forecast to decline marginally to 23 percent of GDP in 2018/19.
27th September	Stanbic Botswana secures USD125 million loan guarantee to support the diamond sector. (Mining Weekly)	Stanbic Bank Botswana along with the Overseas Private Investment Corporation (OPIC) and Botswana Finance signed a USD125 million loan guaranty to support lending to diamond manufacturers and polishing companies. The support is expected to keep the value-adding process of the diamond supply chain in Botswana as well as promoting job creation and economic diversification.

MACRO-ECONOMIC DATA

Key Economic Data	unit	2013	2014	2015	2016	2017	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3
Annual Economic Growth													
GDP	%	11.3	4.1	-1.7	4.3	2.4	4.0	*3.2*	1.8	2.4	3.3	4.4	..
Mining	%	24.2	0.5	-19.6	-3.7	-11.2	-10.2	*-10.0*	*-12.4*	-11.2	-0.3	5.6	..
Non-mining private sector	%	10.1	4.9	1.4	7.2	4.7	7.9	6.5	4.5	4.7	3.6	4.2	..
GDP current prices	P mn	125,158	145,868	146,066	170,589	180,113	43,857	*44,639*	*44,963*	46,654	46,153	47,363	..
GDP 2006 prices	P mn	84,081	87,569	86,083	89,797	91,917	22,467	*22,893*	*22,660*	23,897	23,545	24,099	..
Money & Prices													
Inflation	%	4.1	3.8	3.1	3.0	3.2	3.5	3.5	3.2	3.2	2.8	3.1	2.9
Prime lending rate	%	9.0	9.0	7.5	7.0	6.5	7.0	7.0	7.0	6.5	6.5	6.5	6.5
BoBC 14-day	%	3.06	3.07	0.97	0.84	1.45	1.26	1.34	1.42	1.45	1.47	1.47	1.52
Trade & Balance of Payments													
Exports - total goods	P mn	66,404	76,261	63,484	80,336	61,093	*17,535*	*14,931*	*13,204*	15,479	13,737	..	..
Exports - diamonds	P mn	55,367	65,328	52,730	70,781	54,384	16,084	*13,246*	*11,400*	13,654	12,345	..	..
Balance of payments	P mn	1,340	11,404	- 57	2 843	6 258	4 783	2 437	- 326	- 636	- 766	..	..
Foreign Exchange													
Exchange rate BWP per USD	end	8.718	9.515	11.236	10.650	9.872	10.526	10.215	10.309	9.872	9.533	10.395	10.593
Exchange rate ZAR per BWP	end	1.196	1.217	1.383	1.279	1.256	1.278	1.274	1.312	1.256	1.235	1.317	1.334
FX reserves	$ mn	7,726	8,323	7,546	7,189	7,502	7,041	7,288	7,454	7,502	7,383	7,147	..
FX reserves	P mn	67,772	79,111	84,881	76,804	73,693	73,957	74,734	76,763	73,693	70,582	74,297	..
Financial Sector													
Deposits in banks	P mn	48,512	51,492	59,961	62,438	63,581	60,120	62,380	63,842	63,581	62,495	64,838	..
Bank credit	P mn	39,763	45,116	48,307	51,316	54,181	51,141	52,555	53,290	54,181	54,695	56,531	..
BSE index		9,053.4	9,501.6	10,602.3	9,727.7	8,860.1	9,225.2	9,244.2	8,930.4	8,860.1	8,589.6	8,402.7	7,837.3
Business Indicators													
Diamond production (a)	'000 cts	23,134	24,658	20,732	20,880	22,961	8,553	5,992	6,117	5,568	..	..	..
Copper production (c)	tonnes	49,448	46,721	23,050	16,878	1,239	0	*689*	*340*	*210*	..	..	..
Nickel production	tonnes	22,848	14,958	16,789	13,120	0	0	0	0	0	..	..	..
Business confidence index		45%	52%	44%	43%	46%	48%	..	46%	..	58%	..	..
No. of companies formed		14,190	16,300	19,134	17,133	20,707	5,661	4,913	5,350	4,783	5,327	..	..
Electricity consumption	GWh	3,502	3,990	3,974	3,929	3,772	888	899	1,018	967	960	992	..
Crude oil (Brent)	$/bar	109.95	55.27	36.61	54.96	66.73	52.20	47.08	57.02	66.73	69.02	77.44	73.16
Employment (formal)													
Government		130,175	129,918	130,220	129,216	129,009	129,078	128,520	128,950	129,009			
Parastatals		18,838	18,790	19,411	19,008	19,444	19,314	19,579	19,469	19,444			
Private sector		189,894	191,399	191,484	194,202	193,745	193,582	192,937	193,480	193,745			
Total		338,907	340,107	341,115	342,426	342,198	341,974	341,036	341,874	342,198			

Govt Budget		2014/15	2015/16	2016/17 Outturn	2017/18 Actual	2018/19 Revised
Revenues	P mn	55,904	47,420	57,398	*58,154*	*58,113*
Spending	P mn	50,564	54,411	56,275	*57,934*	*62,688*
Balance	P mn	5,340	-6,991	1,123	*220*	*-4,575*
Public debt & guarantees	P mn	33,131	35,342	36,864	38,000	38,539
Govt deposits at BoB	P mn	41,680	33,916	29,819	*30,094*	30,596
GDP	P mn	147,920	149,111	174,836	*182,408*	203,175
Revenues	%GDP	*37.8%*	*31.8%*	32.8%	*31.9%*	28.6%
Spending	%GDP	*34.2%*	*36.5%*	32.2%	*31.8%*	30.9%
Balance	%GDP	*3.6%*	*-4.7%*	0.6%	*0.1%*	-2.3%
Public debt & guarantees	%GDP	*22.4%*	*23.7%*	21.1%	20.8%	19.0%
Govt deposits at BoB	%GDP	*28.2%*	*22.7%*	*17.1%*	*16.5%*	*15.1%*

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

Notes:

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

(b) Copper production starting Q2 2017 for Mowana mine

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

Should Botswana Borrow from China?

Introduction

Following the recent visit by His Excellency and other senior officials to China, it is reported that the government intends to borrow a significant sum from China, possibly as much as USD1.1 billion, or P12 billion. The loan(s) would be applied to infrastructure development, notably the rebuilding of major trunk roads in the north and east of the country, as well to construct a new northern railway link from Mosete (north of Francistown) to Kazungula and across the new Zambezi bridge into Zambia.

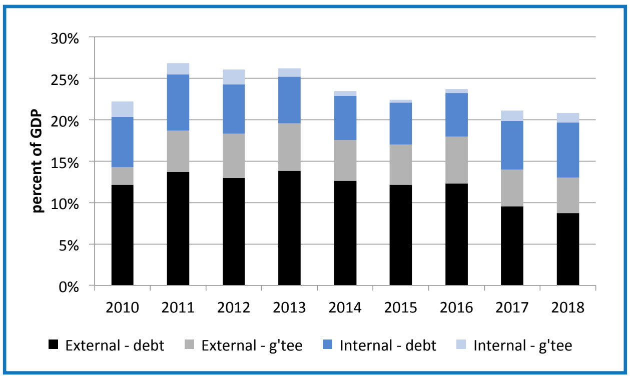
Assuming that the money is indeed on offer from China – part of a reported USD60 billion offered to various African countries at the recent Forum on China – Africa Co-operation (FOCAC) – how should the government evaluate whether this is good offer to accept? As a starting point, it is important to note that the Government of Botswana has many more choices with regard to the financing of infrastructure development than most African governments. It is not obliged to borrow from China if it deems the designated projects to be worthwhile, as it could also borrow domestically (by issuing bonds) or finance the investments from its accumulated savings in the Government Investment Account (GIA) at the Bank of Botswana. With these available choices, it is important to evaluate the various options and determine, on the basis of the costs and benefits of each, which financing option(s) to use for infrastructure financing.

Legal and Policy Framework for Project Financing

Government's financing decisions are taken within the context of relevant laws and policies. The key law is the Stocks, Bonds and Treasury Bills Act, which specifies that the total of government debt and guarantees is limited to 40% of GDP (in two tranches, 20% of GDP each for domestic and foreign debt). The key policy is the Medium-Term Debt Management Strategy (MTDMS), 2016-2018, which lays out the principles to be followed in managing debt. According to the MTDMS, "the primary objective of Botswana's debt management will be to ensure that the financing needs and payment obligations of Government are met at the lowest possible cost consistent with a prudent degree of risk, and in coordination with fiscal and monetary policies…[while] the secondary objective of the debt management will be to support the development of the domestic capital market".

As of March 2018, total government debt and guarantees totalled 21% of GDP, of which 13% was external and 8% domestic (Figure 2). The MTDMS notes that while the overall level of debt is well within statutory limits, the structure is far from ideal. In particular, there is too much foreign debt and too much debt with variable interest rates, both factors that raise the level of risk (due to fluctuations in exchange rates and interest rates). It therefore sets an objective of reversing the current composition of total debt from 30% domestic/70% foreign to 70% domestic/30% foreign. "To achieve the goal of having a higher proportion of domestic debt in total debt portfolio would involve restricting foreign borrowing to the bare minimum in the medium term, and prepaying some of the external loans, while continuing and/or increasing with the Government Bond Issuance Programme" [para 38].

Figure 2:
Government Debt and Guarantees (as at March)



Source: MFED, Budget in Brief, 2018

A second objective is to minimise the cost of debt issuance. The MTDMS notes that in order to make an appropriate comparison between the cost of foreign debt (mostly contracted in US dollars) and domestic debt (in Pula), it is necessary to take into account changes in the Pula/US dollar exchange rate. Over the ten years from the end of 2007 to the end of 2017, the average annual change in the BWP/USD exchange rate was 5%; on the assumption that this trend will continue, this has to be added to the interest rate charged on a US dollar loan to determine its true cost.

Assessing the Options

So how does the proposed loan from China stack up in terms of the legal and policy parameters regarding borrowing? First, the legal limit of 20% of GDP for foreign debt and guarantees translates to around P40 billion in 2018/19; with around P23 billion currently outstanding, an additional P12 billion can be accommodated with the legal limit.

Where does it stand in terms of the Government's debt management strategy? Clearly it conflicts with the stated objective of "restricting foreign borrowing to the bare minimum" and reversing the 70%/30% foreign/domestic mix – as it increases the foreign debt share, rather than reducing it.

How about the cost? Nothing has been said publicly about the interest rate that would be paid on Chinese loans, but we understand that the average rate would be around 2%. This may sound low, but once we add on the exchange rate impact, the total cost becomes 7% (i.e., 2% + 5%). We can compare this with the cost of domestic borrowing. At the most recent government bond auction, the benchmark 10-year bond yield was just under 5%, and even the 25-year bond had a yield of only 5.2%. While the cost of domestic debt might increase if bond issuance jumped sharply, it is evident that domestic borrowing is significantly cheaper than borrowing from China. It is also cheaper to issue domestic bonds than to use the savings in the GIA, which we estimate to have earned an average annual return of 8.1% over the past decade (and hence have an opportunity cost higher than the bond interest rate).

Finally, how does foreign borrowing contribute to the secondary objective of developing the domestic capital market? Not at all, as capital market development depends on the issuance of debt instruments (such as bonds) in Pula. Indeed, domestic institutions such as pension funds and life insurance companies have long been requesting greater government bond issuance in order to meet their investment needs. Estimates prepared recently by Econsult for the pension sector conclude that the industry requires P1.5 – P2.5 billion of additional bonds each year over the next five years, with a total demand of P11 – 12 billion over the next five years – exactly the same amount as the envisaged borrowing from China. This is without factoring in potential demand from foreign investors in Pula bonds.

So borrowing from China doesn't appear to be a very good deal, in terms of the government's own strategy. It does not support the stated objective of reducing foreign borrowing and increasing domestic borrowing, and does not minimise financing risks. It is probably more expensive than borrowing domestically, and so does not meet the cost minimisation objective. Thirdly, it does not meet the objective of domestic capital market development. More generally, it raises the question of what is the point of having an official debt management strategy if it is going to be ignored on implementation.

There are also other issues associated with borrowing from China, which is normally tied to procurement from Chinese firms, which may not always offer the best value. As *The Economist* wrote in September this year, when discussing the decision by the new Malaysian Prime Minister to cancel loans from China, one reason was that "we know how inflated the costs are, and how skewed the deals are in China's favour".

Finally, it is important to realise that the financing decision is independent of the investment decision. The infrastructure projects should be evaluated in their own right, and if they pass the economic viability tests that are (or should be) central to the development planning process, they should proceed. Once this decision is taken, the financing question can be addressed. If they are good projects, they do not depend on loans from China, but can be financed from domestic capital markets. Indeed, financing the projects from other sources enables a much more rigorous and procurement process to be undertaken, based on competitive, open international tendering. Chinese firms would be welcome to participate in such tenders, as could firms from other countries. The pricing of projects in these circumstances is likely to be much more attractive than when procurement and project implementation is tied to specific sources of finance.

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