

ECONOMIC REVIEW

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SPECIAL EDITION

The Economic Impact of Coronavirus COVID-19

Introduction

The coronavirus COVID-19 is spreading rapidly around the world, and as it does so is having a dramatic economic and social impact. As at the 23rd March, 2020, the cumulative number of confirmed COVID-19 infections globally reached 339,259, with 14,706 deaths, while 98,834 people have recovered from the viral infection¹. No cases have yet been reported in Botswana, but it is inevitable that COVID-19 will eventually appear in the country. When it does, it will impose a considerable burden on both the public and private health systems. Many preventative measures have already been taken in Botswana, including restrictions on travel into the country, the banning of large gatherings, restrictions on

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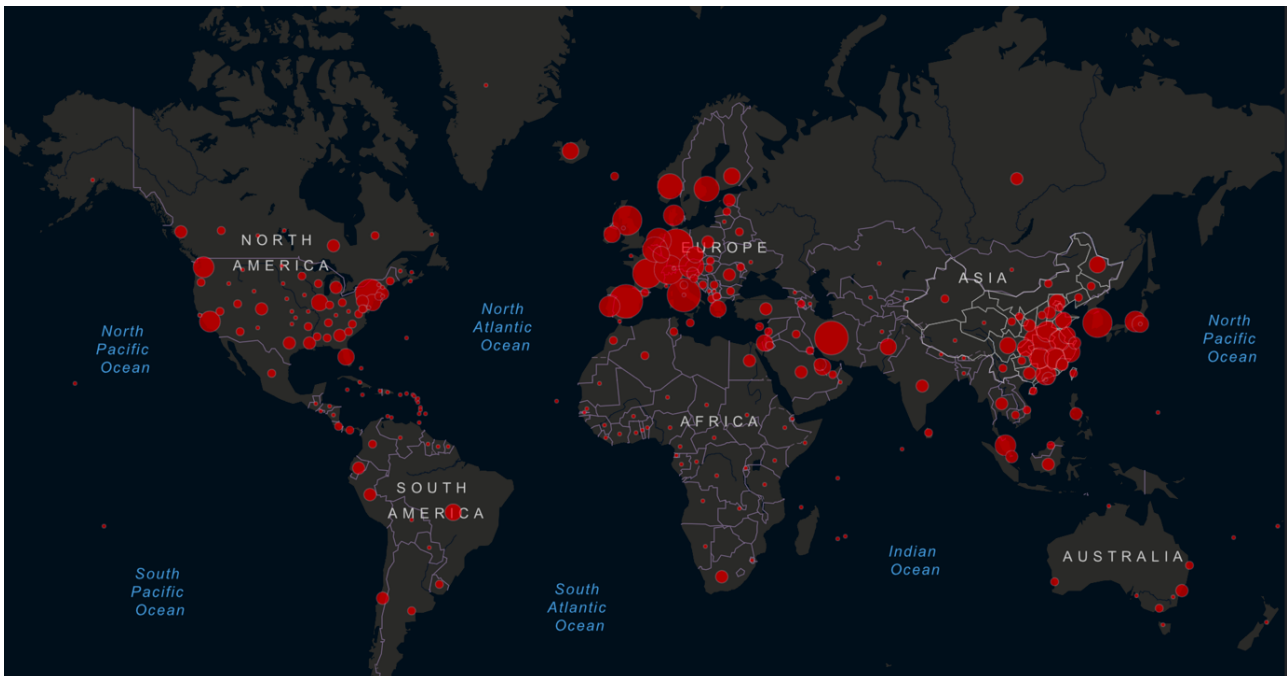


¹Center for Systems Science and Engineering (CSSE) at Johns Hopkins University (JHU) <https://www.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6>

the opening hours of some establishments, and the closure of schools and other educational institutions. Other countries have gone further than this, imposing quarantines and lockdowns that restrict public movement and close some commercial establishments and offices. While current infection rates – as a percentage of the population of affected countries - are low, at below 0.1%, there are concerns around the speed of its spread. The prime objective of the restrictions imposed is to slow down, and eventually reverse, the spread of the virus and bring the epidemic under control.

The economic impact of COVID-19 is already extensive, and getting more severe by the day. In this special edition of the Economic Review we look at the likely impact on Botswana, and consider possible measures that can be taken by policymakers to mitigate this impact. We conclude that, while the short-term impact is likely to be severe in certain sectors of the economy, there are good prospects for economic recovery once the pandemic eases.

Figure 1:
Global distribution of confirmed COVID-19 cases (20th March, 2020)



Source: Johns Hopkins University

The Global Economy

COVID-19 is affecting economic activity largely through the measures being taken to contain its spread. This impact was first seen in China, where the virus first appeared in the human population, with restrictions imposed on social and economic activity. Travel was restricted, and people required to minimise movement and interaction, resulting in a decline in economic activity through the closure of factories, restrictions on the movement of commodities and reduced consumer spending. The disruption of supply chains soon had a global impact, given the central role that China plays in the world economy, with a reduction in trade flows.

Since that time the economic impact has spread more widely, as other countries – notably in Europe and North America – have reported significant numbers of cases of COVID-19. Border closures and restrictions on gatherings and movement have reduced trade, travel and economic activity further.

Reduced economic activity will affect company profits, and indeed many companies are facing existential threats. These developments, compounded by uncertainty over the extent and duration of the COVID-19 impact, have had an impact on financial markets, with most global stock markets showing large falls. Commodity prices, notably for oil and key industrial commodities such as copper, have also fallen, with oil down 55% and copper down 24% this year.

Making projections of the impact on global growth is difficult in such a rapidly changing situation. Prior to the pandemic, there were expectations that the global economy would show reasonable growth in 2020, with the IMF projecting global GDP growth of 3.4% for the year, up from 3.0% in 2019. These projections are now being revised steadily downwards, with many experts describing the situation as “unprecedented”, and estimates of the economic impact ranging “from very bad to catastrophic”². On March 17th, Standard and Poors projected global growth of 1.0% - 1.5% for 2020, with downside risks – i.e., this is a “best case” scenario³. Such a large fall in growth is likely to de-

note a global recession – defined by the IMF as negative growth in per capita GDP. But as the crisis deepens and the timing of recovery remains uncertain, the likelihood of an absolute contraction of global GDP (i.e. negative growth) increases. For comparison, global GDP contracted by 0.1% in 2009, during the global financial crisis.

The Impact on Botswana

Diamonds

Botswana is already experiencing the effect of the global growth slowdown. Diamonds account for the majority of the country’s exports, provide the largest single source of government revenues, and make a significant contribution to GDP⁴. 2019 was a difficult year for the global diamond industry, with weak sales. Nevertheless, there were signs of stabilisation and recovery in December 2019 and January 2020. However, the February sales round by De Beers Global Sightholder Sales (DBGSS) in Gaborone had much smaller sales than the first 2020 sight in January, as the impact of reduced Chinese demand kicked in. Future sales rounds over the next few months will be further impacted by the global slowdown, as reduced demand for diamond jewellery feeds back to purchases of rough diamonds by the cutting and polishing industry and jewellery manufacturers. In addition, travel restrictions currently in place mean that the usual buyers (sightholders) will not be able to travel to Gaborone for the regular DBGSS sights, which may reduce sales further.

Reduced diamond sales and exports will have an impact on Botswana government revenues. Diamond mining companies such as Debswana may maintain production levels for some time, but only to the extent that they have the capacity to stockpile unsold diamonds, which means that the impact on mining (and GDP) may be less than the impact on sales. The capacity for Debswana and De Beers to stockpile unsold diamonds – incurring production costs but not receiving income – is constrained, after having already undertaken some stockpiling in 2019. We forecast a contraction in the contributions of both diamond mining and diamond sales to GDP in 2020, which will hence impact negatively on growth.

²Larry Elliot in The Guardian, 22nd March 2020. <https://www.theguardian.com/business/2020/mar/22/the-coronavirus-is-leading-to-a-whole-new-way-of-economic-thinking>

³<https://www.spglobal.com/ratings/en/research/articles/200317-economic-research-covid-19-macro-economic-update-the-global-recession-is-here-and-now-11392265>

⁴Diamonds account for approximately 75%-80% of total exports, 35% of fiscal revenues and 20% of GDP.

Tourism and Hospitality

The second sector of the economy that is likely to be badly affected by COVID-19 is the tourism and hospitality sector. This cuts across a range of economic activities, including hotels, lodges, safari camps, tour operators, bars and restaurants, transportation, travel agents and airports. Indirectly, there are a range of suppliers to firms in the tourism and hospitality sector, such as food and beverages, fuel, maintenance services etc. While tourism is not a directly-measured sector of GDP (see the 2019 Q1 Economic Review for an explanation), overall it is estimated to account for around 5% of economic output. This is not nearly as big as diamonds, but tourism is far more important in employment terms. Taking into account hospitality activities that are not classified to tourism (such as restaurant spending by residents) and the indirect impact of supply chain and employee expenditures, the overall contribution of tourism and hospitality to GDP is far higher than 5%. Tourism is also the second largest source of export earnings, after diamonds.

Already, the tourism and hospitality sector is feeling the impact of COVID-19, as a visit to any hotel or airport will attest. Botswana is particularly vulnerable given that the bulk of tourism earnings come from high-value international tourists visiting the safari areas and game parks of northern Botswana, in the Chobe and Okavango. Such traffic has ground to a halt, with cancellations in the coming months approaching 100% in some cases. This reflects the position in the international aviation industry, where major airlines are cancelling almost all flights. There are domestic factors impacting on the sector as well, with government and firms cancelling conferences, workshops, retreats etc until further notice. Of course, this is only for the current and immediate months, and it may be that by the middle or third quarter of the year the epidemic is under control, as in no longer spreading, and restrictions lifted. But even with some recovery later in the year, we foresee the tourism and hospitality sector experiencing a contraction of 35-50% in 2020 as compared to 2019. Such a large contraction, even though it is a small sector of the economy, will further dampen overall GDP growth.

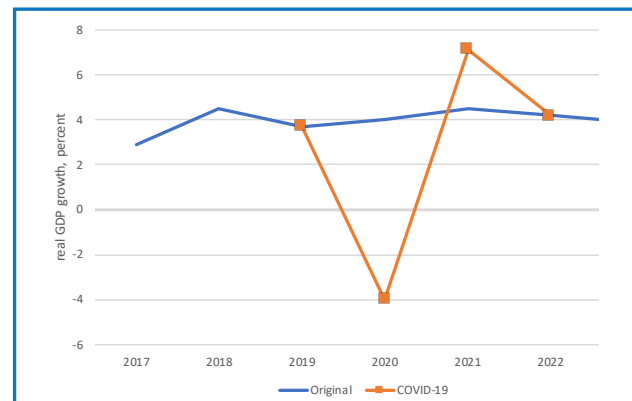
Overall GDP Growth

Making projections of the impact on COVID-19 on Botswana's GDP growth is difficult in such a rapidly changing environment, globally, regionally and domestically, But taking account of the likely substantial impact on diamonds and tourism, as well as smaller impacts on other sectors of the

economy, we predict that there will be a contraction in GDP over the year as a whole. Our forecast is for GDP growth around minus 4% in 2020, down from a pre-COVID projection of plus 3.5%-4.0% growth.

However, the impact on GDP growth could be much worse than this, if, for instance, there are more business closures. This would result if people are required to work from home, if businesses such as factories are required to close, if firms cannot continue to operate due to shortages of inputs, or there are impediments to the movement of freight across the Botswana-South Africa border. In this case the short-term contraction in GDP could reach 20%. On the positive side, if there is a global recovery towards the end of 2020, then we could see good recovery in Botswana with a growth rebound in 2021. Furthermore, the impact also depends on the types of interventions that are undertaken now to mitigate the impact of COVID-19, which we discuss further below.

Figure 2:
Economic Growth Projections



Source: Econsult

Exports and the Balance of Payments

The two economic sectors that are likely to be the hardest hit are, unfortunately, Botswana's two largest export earners. Inevitably, export earnings will be reduced; we foresee a 20% decline in export earnings in 2020 compared to 2019 – a drop of P12 billion. Assuming that imports remain largely unchanged, this will need to be financed by drawing down from the foreign exchange reserves, which should fall by a similar amount (from the November 2019 total of P70 billion)⁵.

⁵We exclude diamond re-exports (aggregated diamonds) from both the export and import side of this calculation

Government revenues and expenditure

The diamond industry is the largest single contributor to government fiscal revenues, and the likely drop in diamond sales and profits will reduce mineral revenues and knock a hole in government finances. Tourism is also a significant source of tax and other revenues, although much smaller than diamonds. As other economic activities shrink, or grow more slowly than originally forecast, there will be further reductions in revenues from income and consumption taxes. The recession in South Africa will most likely reduce income from the SACU revenue pool, although this may only be felt in future years due to the nature of the revenue distribution mechanism. SACU revenues will also be reduced by the appreciation of the Pula against the rand. The likely reduction in revenues, combined with additional health expenditures and fiscal measures to support the economy, will result in a much larger budget deficit for 2020/21 than was projected at the time of the 2020 Budget last month. Fortunately, government has unused borrowing capacity and can finance part of the deficit by issuing more bonds in the domestic market, at relatively low cost, although if significant issuance is planned then borrowing costs will rise.

On the expenditure side, some additional funding will be required for healthcare, and for other interventions to mitigate the economic impact of COVID-19 (see below).

Employment

The sector likely to be most badly affected by the COVID-19 epidemic, tourism and hospitality, is one of the most labour-intensive in the economy, with an estimated 25,000 direct jobs in the sector, supporting more jobs indirectly. The severe contraction in the industry will inevitably result in layoffs, whether temporary or permanent. Overall, with the economy likely to enter a recession, we can expect to see a rise in unemployment.

Inflation

The impact of COVID-19 on inflation is difficult to predict. Some developments have pushed prices down, such as global oil and commodity prices, which will eventually feed through to lower domestic inflation. Reduced demand generally will also be deflationary. But supply chain constraints and possible shortages will have the opposite effect. With demand and supply influences pushing in opposite directions, the outcome is impossible to predict.

Financial Sector

Some financial institutions are also vulnerable to the adverse impact of COVID-19, if unemployment rises and people struggle to repay their loans. Even if some flexibility is introduced, both banks and non-bank lenders could see an increase in arrears and bad debt.

Financial Markets and Currencies

Stock markets around the world have fallen in response to the COVID-19 pandemic. By 19th March, the MSCI World

Market Index was 28% lower than at the end of 2019. This reflects the certainty that corporate profits will decline in 2020 across many industries, hence reducing the value of shares. This is compounded by uncertainty over the duration of the crisis, the effectiveness of interventions currently being undertaken by governments, and whether companies will even survive. Although the peak-to-trough decline in the MSCI World index was larger during the Global Financial Crisis of 2008-9, at 56%, on this occasion the fall in the index has been much faster, and of course we have not seen any evidence yet that the bottom has been reached (see Figure 3). Somewhat bizarrely, the Botswana Stock Exchange domestic index has been unaffected by the crisis, and actually rose in the week to the 20th March.

Figure 3:
MSCI World Index (Global Stock Markets)



Source: MSC Barra

The market crash will have an impact on those saving for their pensions, as the value of their pension funds will have dropped. However, this is of major concern only to those who are due to retire in the very near future, as they would receive lower pensions on converting their accumulated pension funds to an annuity. For those who are some way from retirement, there is a good chance that markets will recover and restore their pension values, although this may take years rather than months.

On currency markets, the response has been the usual one in times of crisis, i.e. a "flight to quality". The US dollar has benefitted from this, while key emerging market currencies – South Africa, Brazil, Turkey etc. – have weakened. Interestingly, the post-Brexit UK pound is behaving like an emerging market currency rather than a safe haven in these turbulent times. Given the nature of the Pula Basket with its rand and US dollar components, the Pula has appreciated against the rand, reaching 1.48 on 23rd March. While this has some advantages in terms of containing import prices, it is more likely to be damaging to the economy through the pressure it will add on firms exporting to South Africa or competing with imports.

Actions to Mitigate the Economic Impact of COVID-19

Governments around the world are undertaking various actions to try and mitigate the impact of COVID-19 and the resulting economic slowdown. These are initially in the area of public health, but also include various fiscal and monetary policy actions, ranging from financial support to firms, “helicopter drops” of money to households, tax deferrals, cuts in interest rates, liquidity injections by central banks, and loan rescheduling.

The objectives of mitigating actions are generally to minimise the adverse short-term impact of the COVID-19 recession on firms and households, and to ensure that economy is well placed for recovery when conditions improve. The latter requires that, as far as possible, firms that are fundamentally sound survive the crisis – if firms disappear, then recovery will be much slower and the permanent impact deeper. During the recession, many firms will have short-term cash-flow problems that could lead to bankruptcy if they have insufficient revenues to meet immediate commitments, even if they are not fundamentally uncompetitive or insolvent. Appropriate action should therefore help them to contain or reduce costs and defer financial commitments until cash-flow improves.

Similarly, at the household level, for people who lose their jobs or are temporarily laid off, or lose income-earning opportunities (e.g. small-scale traders), action should help to soften the blow of lost income and help them to meet financial commitments.

Any actions have to be taken in the context of deteriorating macroeconomic conditions, including a rising government budget deficit and declining export earnings.

Potential Interventions

Tax deferrals: most firms have regular tax payments to make, whether monthly, bi-monthly or quarterly. In some cases – particularly self-assessed profits tax – there is an argument for deferring liability so that firms can pay in future when conditions improve. This would require a waiver of penalties on late payments. Similarly, where firms are due for VAT refunds, these should be processed expeditiously by BURS.

Training Levy: firms pay a portion of their turnover to the HRDC Training Levy Fund, which now has accumulated an excess of funds over and above what is needed for the intended purposes. Firms would benefit from a waiver of training levy payments for, say 6 months.

Bank loan repayments: some firms will face difficulties in making repayments on bank loans, due to cashflow problems. Banks can be asked to hold off from declaring borrowers to be in default, and from foreclosing on loans in arrears; this may need support and direction from the Bank of Botswana, perhaps including the temporary relaxation of some regulatory requirements. The same may apply to some households, e.g. for mortgage and personal loan repayments.

Banks should also be encouraged to go beyond this, and make overdraft facilities available to firms to meet cash flow needs. In order to deal with concerns about credit risk, it may become necessary to provide low-cost government loans to banks for on-lending to firms, perhaps backed by government repayment guarantees.

Monetary policy: many central banks around the world have reduced interest rates, with two objectives: stimulating demand and easing credit conditions. It is questionable as to how effective this will be, at least as far as the first objective goes - in current conditions of heightened uncertainty and restrictions on movement, households and firms are unlikely to spend and invest more just because interest rates have been reduced. In this situation, monetary policy is akin to “pushing on a piece of string”. A reduction in interest rates may help some firms and households, especially those with mortgages (who make up a very small proportion of all households), but most household borrowers have unsecured personal loans with fixed monthly repayments, which are unaffected by changes in interest rates (which just affect the period of repayments). In other countries, interest rate reductions have been used alongside liquidity operations to counteract increases in funding costs for banks and companies in the capital markets, but these are hardly used in Botswana.

Employment: preventing an increase in unemployment is one of the most difficult challenges facing government in current circumstances. Firms may not be able to continue paying their workers, and could be forced into bankruptcy as a result. One option is to change the law to enable firms to lay off workers temporarily, to reduce costs, but with a commitment to re-hire when conditions improve. Another option is to provide wage subsidies, while access to any low-cost government loans and guarantees (noted above) could be made conditional upon not reducing employment.

Ipelegeng and social safety nets: if there is a substantial negative impact on employment, government may need to increase the availability of public works employment through the Ipelegeng scheme, and consider other extensions of social welfare schemes. Ipelegeng has the advantage that it directly targets able-bodied adults without work, and can be scaled up and down fairly quickly. Other social welfare schemes may be more difficult to dial back as the burden of the epidemic eases.

As a general principle, interventions should be flexible and time-limited. The impact of the virus is likely to be variable over time, hopefully short-lived, but with the possibility that there may be flare-ups of infections and restrictions at some point in the future. Governments need to avoid getting locked-in to long-term financial commitments, and be able to scale back rapidly when the need for support declines.

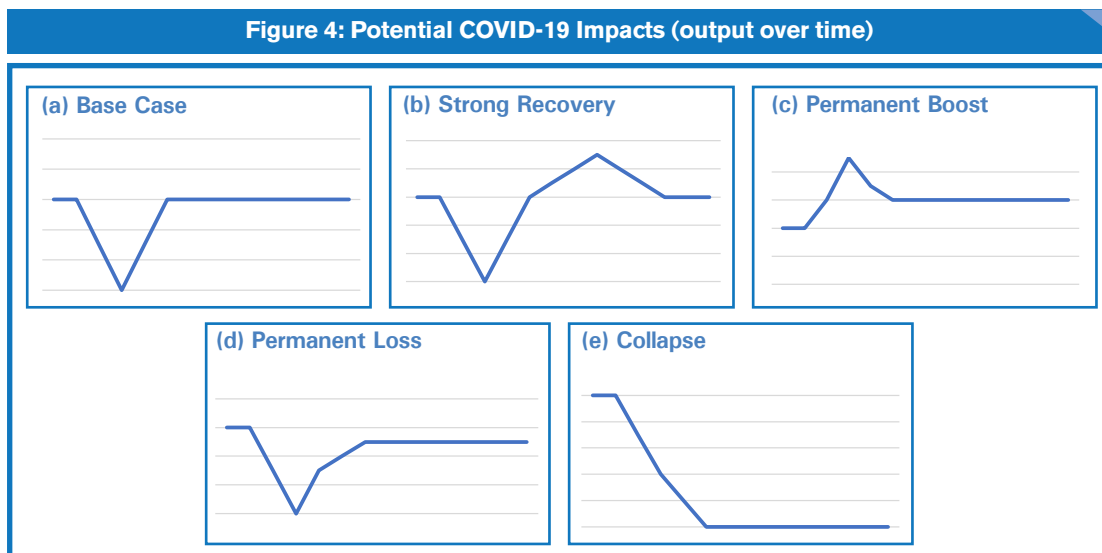
The Government will of course be concerned about the deteriorating fiscal situation as a result of COVID-19, with reduced diamond and SACU revenues, as well as potentially reduced general tax revenues from non-mineral income taxes and VAT. The deficit will rise above previously-planned levels. As in 2009/10, when the budget deficit was allowed to increase to 12.4% of GDP so as to support the economy during the global financial crisis, the current crisis is likely to require substantial fiscal support to mitigate the impact on the economy and society. The availability of finance to support budget deficits is, however, far more constrained than it was in 2009, with a substantial decline in available balances in the Government Investment Account. Financing the larger deficit will require increased government borrowing through bond issuance, and external funding agencies.

Longer-term impacts

The longer-term impact of COVID-19 will vary across industries. Broadly, five different COVID-19 and post-COVID trajectories can be identified.

1. **“Base Case”**: the industry takes a hit from COVID-19, but recovers fairly quickly and business returns to its pre-COVID level. The “dip” represents sales that are lost, but there is no permanent change in the level of business. This is likely to apply to some tourism establishments, e.g. in the Okavango Delta.
2. **“Strong recovery”**: the industry takes a hit from COVID-19, but then recovers strongly, with post-COVID sales increasing to take account of the sales not made during the dip. In this case, the dip represents sales that are delayed or deferred, but not permanently lost. Diamonds may well fall into this category; people who were planning to buy diamond jewellery do not do so during the recessionary phase, but will do so in the recovery phase (e.g. a wedding may be delayed but is unlikely to be cancelled altogether because of COVID-19).
3. **“Boost”**: some industries are benefitting from lockdowns, for instance online streaming services (e.g. Netflix), home delivery and online shopping services (e.g. Amazon), and video-conferencing services. Some of the additional business will be from people who have never used these services before, and a portion may permanently change their consumption patterns (e.g. realising that video-conferencing can replace face-to-face meetings). These industries will benefit from a permanent increase in demand and sales.
4. **“Loss”**: these industries are the counterpart of those in (3) – industries that recover, but not fully, and suffer a permanent loss of sales as consumption patterns change.

Indicative sales patterns for these four types of industries are shown in Figures 4a to 4d below. In practice, of course, some industries may experience a combination of the above, but these represent to four different types of potential impact and outcomes.



Source: Econsult

A fifth possible outcome is “Collapse”, whereby firms do not survive the downturn. This possible outcome is more relevant at the level of individual firms rather than entire industries, and is something to be avoided if at all possible.

In most cases we anticipate a fairly rapid recovery, bearing in mind that the negative impact of COVID-19 is not (currently) from the virus itself, but from the restrictions imposed to slow the spread of the virus. The critical factor therefore becomes the speed at which this spread can be contained, and at what level of infection this is achieved; the quicker containment can be achieved, and the lower the level of COVID-19 infection in the global population, the quicker will be the recovery once restrictions are lifted. Related factors include how quickly a vaccine (to prevent infection) and treatment (to deal with infection) can be developed.

As we are still in the upward phase of the epidemic, at least outside of China, it is impossible to predict how long the restrictions will last. Figures of 3-6 months have been suggested for the most intensive restrictions, but this is nothing more than a guess at this stage.

A further concern is the possibility that even if the spread of COVID-19 infections is controlled during 2020, this may not be the end of the epidemic. The remaining pool of infections could spread again once restrictions are lifted, and hence this may need to be done cautiously. The successful development of a vaccine is critical to prevent the resurgence of infections.

Conclusion

The outbreak of COVID-19 is having a major, negative impact on the global economy, and, with some lag, on the Botswana economy. The situation is still deteriorating, such

that what seems like a “worst case” scenario quickly becomes normality. It is virtually certain that the Botswana economy enter will recession – or is already in recession – and will experience negative growth for 2020 as a whole. Employment will also be affected with temporary or permanent job losses. Exports and government revenues are declining and both the balance of payments and the government budget will be impacted. The full economic impact has not yet been felt, however, and broader lockdowns and border closures – intended or unintended – would exacerbate the negative economic impact.

Various policy interventions can be undertaken to mitigate some of the adverse economic impact, including possible concessions regarding deferral of payment of tax obligations and loan repayments, to ease company cashflows and to help companies to survive. Other options such as wage subsidies and access to credit guaranteed by government should be considered, to help firms and households. In line with the experience of other countries, it is likely that fiscal injections by government will be more effective than monetary policy actions such as reducing interest rates. Fiscal support in the region of 1%-2% of GDP – which would amount to P2-4 billion – could be required. This in turn would require additional government borrowing. Interventions are needed quickly, so the emphasis should be on simple actions that can be rolled out without delay.

With such a rapidly-changing situation there needs to be close monitoring of developments in key industries such as diamonds, and access to inputs by firms, especially from South Africa, so that the economic impact can be continuously evaluated. Similarly, the effectiveness of interventions undertaken needs to be continuously reviewed, so that they can be revised as necessary.

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