

ECONOMIC REVIEW

fourth quarter october - december 2016

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COMMENTARY

Pick up in economic activity but longer-term concerns weigh, as NDP 11 is finalised

Economic data released during the fourth quarter of 2016 showed some improvement in macroeconomic conditions. Annual GDP growth in Q3 2016 came in at 0.9%, not a high rate but a turnaround from four quarters of negative annual growth. This reflects a recovery in the global diamond market and the falling away of the impact of cutbacks in diamond production a year ago, due to market weakness in 2015. The value of diamonds sold through De Beers Global Sightholder Sales in 2016 was nearly 40% higher than in 2015, leading to an improvement in the balance of payments and government revenues. Inflation picked up slightly to 3%, but is still at the lower end of the Bank of Botswana's inflation objective range, and interest rates were maintained at historically low levels.

For many people and firms, however, economic conditions continue to be tough. Job creation picked up in the year to September, but with only 1% annual growth in formal employment, it remains far too low and is well below the rate of population and labour force growth. Business confidence rose slightly in the second half of 2016 as compared to the first half, but remains low by the standards of recent years. Botswana's ranking improved in the World Economic Forum's Global Competitiveness Index, but declined in the World Bank's Doing Business report. The impact of the closure of the BCL copper-nickel mine has not yet showed up in the jobs or GDP figures, but will have a negative impact when the Q4 data are released. As discussed in the

last Review, the closure will have a major negative impact on north-east Botswana if, as seems increasingly likely, no rescue or buyer is forthcoming.

One further potential troubling sign has been the declining of liquidity in the banking system, last seen in 2014 and early 2015. Consolidated data on banking system liquidity recent months have not yet been released by the Bank of Botswana, but liquidity in the overnight interbank money market dropped to very low levels in late 2016 and early 2017. There could be several drivers of this, including expenditure by parastatals prior to the end of the government fiscal year, and capital outflows. In view of

the emerging interest rate differential between Botswana and South Africa (where rates have been rising), and the strengthening SA rand, such outflows are to be expected. Declining returns on the Botswana Stock Exchange and in the property market, coupled with perceptions of a deteriorating business environment and economic growth prospects, may also be driving capital outflows. There are also indications that government is delaying or deferring payment due to firms for the procurement of goods and services. This means less money deposited in the banking system, and greater use of loans and overdrafts, which further reduces liquidity. While there are no major liquidity related concerns in the banking system on yet, it will be necessary to monitor developments closely.

National Development Plan (NDP) 11

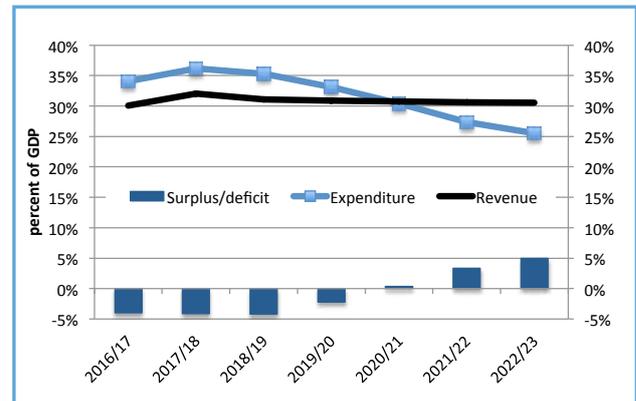
One of the most important developments of Q4 was the release of NDP 11 and its approval by Parliament. NDP 11 covers the period 2017-2023, and lays out government's fiscal plans, economic growth projections, broad strategies and development projects.

Much of the content of NDP 11 is familiar: the theme is "Inclusive Growth for the Realisation of Sustainable Employment Creation and Poverty Eradication", with macroeconomic strategy focused on "Developing Diversified Sources of Economic Growth", which is little different to past NDPs. The key challenge remains implementation: previous commitments to the type of business environment reform that is necessary to achieve the transformation to diversified, export-led growth and meaningful job creation have not resulted in enough concrete actions. Unfortunately, NDP 11 provides little detail as to how past constraints to implementation will be addressed; indeed they are hardly even acknowledged. The Plan contains little of the detail that would be expected in such a document (e.g., what will be done, by whom, when, at what cost; and what measures will be taken to ensure that these and other policy commitments actually happen). Instead, the Plan is more general, more of a strategy document than a "plan". For instance, there are no timelines or details for the implementation of the "doing business" reform roadmap and action plan; or for crucial items such as the development of water and electricity infrastructure, the introduction cost-recovery tariffs and opening up those sectors to private sector participation.

There is, however, some detail in the listing of development projects that have been approved for funding and implementation. Out of a total development budget allocation for NDP 11 of P101.4 billion, the two largest allocations are to defence (P15 bn) and support for Botswana Power Corporation (P10 bn) – although the latter seems to be for ongoing operational subsidies rather than for the development of new power generation infrastructure. This illustrates one of the puzzles of the development budget, which is that it clearly includes several items that are not investment, but are disguised recurrent spending (another item is some social welfare programmes). It also appears that, despite earlier commitments to a rigorous system of project appraisal to ensure that only high-return projects will be adopted, this has not been done. And several projects appear to be under-funded, e.g. there is an allocation of P400m to the Molembo Bridge, even though the contracted construction price is reported to be just over P1 billion. Unfortunately, the Ministry of Finance and Economic Development has been unable to convince the rest of government of the need for disciplined resource allocation and budgeting decisions.

On the macroeconomic side, NDP 11 entails an expansion of government spending in the first half of the Plan, driven in part by expenditure on the Economic Stimulus Package (ESP), leading to modest budget deficits. However, the second half of the Plan entails a significant contraction in spending, leading to budget surpluses, and a broadly bal-

Figure 1: NDP 11 Fiscal Projections (percent of GDP)



anced budget over NDP 11 as a whole. The challenge will be to ensure that this anticipated contraction in spending is actually achieved, and that sufficient business environment reforms take place to ensure that the private sector takes up the slack. NDP 11 also introduces a new fiscal rule, whereby 40% of mineral revenues will be saved. In terms of the NDP 11 fiscal forecasts, the target implied by the rule is achieved in the final year of the Plan.

Revisions to GDP data

The third quarter release of Botswana’s GDP data included some important revisions to the historical data series, which have had an impact on recorded GDP and calculated growth rates. The main changes were as follows:

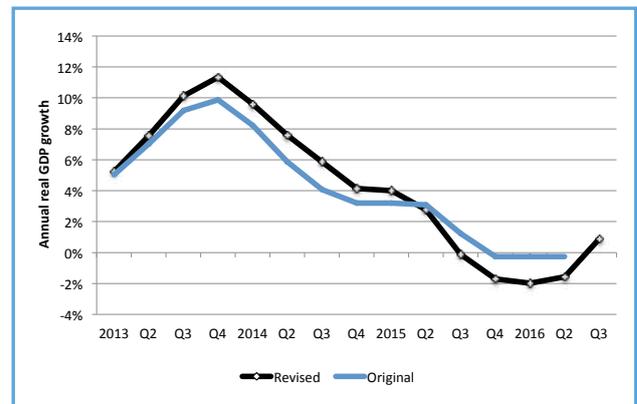
1. Revision of data on the value of copper-nickel output, due to inconsistencies between data on the value of production and the value of exports, despite the fact that all copper-nickel is exported. The revision only affected copper-nickel production at current prices, but was substantial – reducing the value of the sub-sector’s contribution to GDP by an average of 70% from 2011-15. However, recorded real output, and hence real growth, was unaffected, as this is driven by the volume of copper-nickel production, which had been recorded correctly.
2. The inclusion of information from new entities in diamond marketing, viz. De Beers Global Sightholder Sales (DBGSS) and the Okavango Diamond Company (ODC). DBGSS and ODC started operating in Botswana in 2013, but their activities had not previously been included in the national accounts. They are now included in the Trade (Wholesale) sector, and have made a large impact on recorded activity in both current and constant prices, and hence on growth rates.
3. To some extent the two revisions offset each other, as the first reduces GDP while the second increases it. However, the recorded size of the mining sector has fallen (by 3-10%, depending on the year) while that of

the trade sector has increased (by up to 25%). Overall, recorded GDP varies between being 2.1% smaller (in 2012) and 2.4% larger (in 2014) following the revision.

Economic growth has also been affected, and is now higher than previously through in 2013 and 2014, but lower in 2015 and 2016. This is because the inclusion of diamond trading activities accentuates the swings in growth that are driven by fluctuations in diamond mining activity.

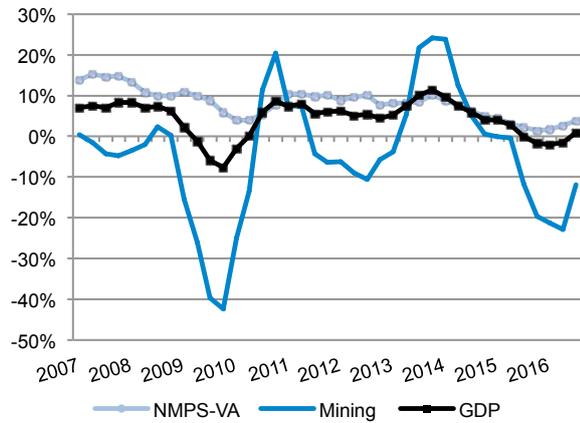
The GDP revisions provide a more accurate picture of economic activity and are therefore to be welcomed. However, the data still obscure certain aspects of economic activity in Botswana. In particular, downstream activities in the diamond sector are not separately identified; whether it be diamond cutting and polishing, diamond sorting and valuing, or diamond marketing and trading – all of these activities are hidden in the “Other Manufacturing”, “Wholesale” and “Business Services” sub-sectors of GDP. It would be helpful for assessing both economic development and policy impact if Statistics Botswana can identify these activities separately in the national accounts.

Figure 2: Impact of GDP Growth Revisions



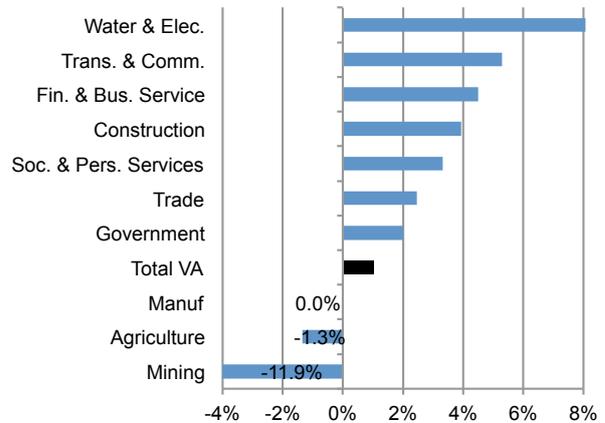
KEY ECONOMIC VARIABLES

Annual GDP Growth



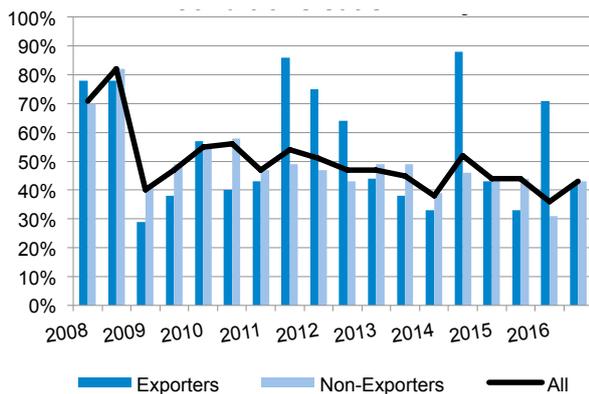
Overall GDP improved in Q3 2016, recording the first positive growth rate since the first half of 2015, as a result of the stronger global diamond market. Year-on-year real GDP growth increased to 0.9%, from (a revised) minus 1.6% in Q2 2016. The higher real growth is attributable to an improvement in mining, although still recording negative growth, to minus 11.9% y-o-y in Q3 from minus 22.9% in Q2. However, the non-mining private sector (NMPS) showed some resilience with growth of 3.8% y-o-y in Q3 2016, up from 2.7% in Q2.

Sectoral GDP Growth



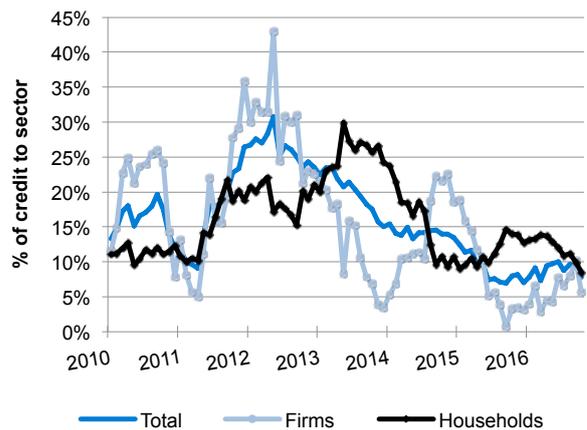
The improvement in growth was reflected in most sectors of the economy, with higher growth across the board in Q3 than in the previous quarter. Mining and Agriculture continued to be the laggards, with negative growth of 11.9% and 1.3% respectively, although still better than in Q2. The Water & Electricity sector was the fastest growing sector, recording 144% y-o-y growth, although this is distorted by negative value added in electricity production. Total value added increased from minus 1.8% y-o-y in Q2 to plus 1.0% y-o-y in Q3.

% of firms rating current business conditions satisfactory



The Bank of Botswana's H2 2016 Business Expectations Survey (BES) showed that overall business confidence increased when compared to H1 2016, from 36% to 43%. The level of confidence increased for domestic-oriented businesses from 31% to 43%, while deteriorating significantly for exporters by 29% points from 71% to 42% in H1 2016 and H2 2016 respectively. Optimism about business conditions increases in the next six to twelve months despite uncertainties about commodity demand in the global market.

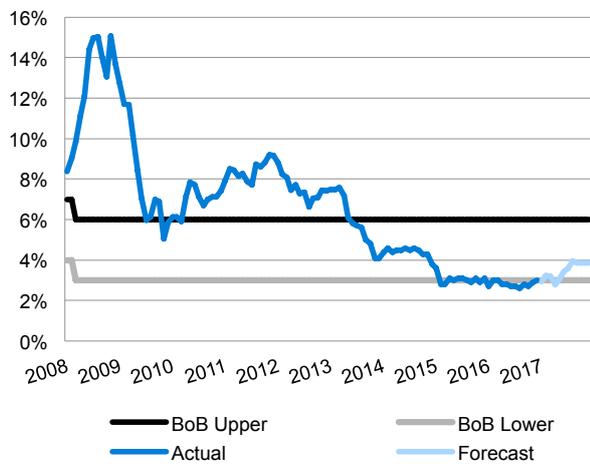
Annual Credit Growth



Annual growth in credit from commercial banks in Botswana continued to fall, reflecting slower growth in credit to both firms and households. Annual bank credit growth slowed from 8.7% in July 2016 to 7.8% in October 2016. Growth in credit to firms decreased from 6.5% y-o-y in July 2016 to 5.6% y-o-y in October 2017. Household credit growth also declined significantly from 10.9% y-o-y to 8.5% y-o-y during the same period.

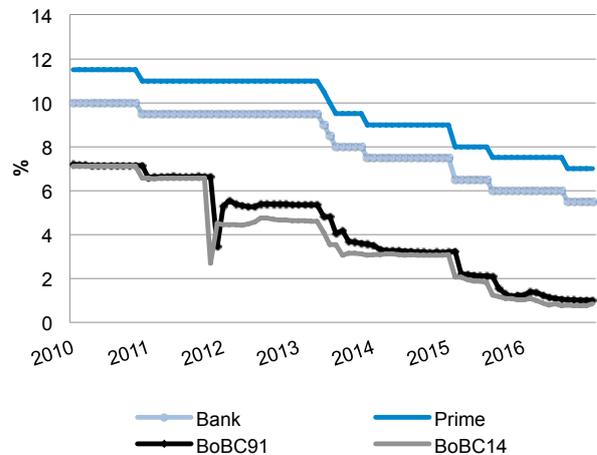
KEY ECONOMIC VARIABLES

Inflation and Forecast



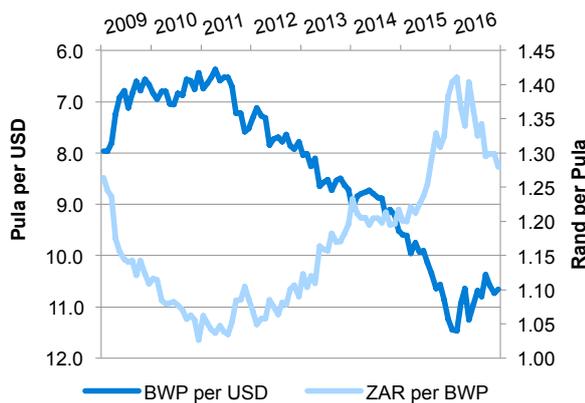
Annual inflation remained at or below the Bank of Botswana's lower limit of 3% in the last quarter of 2016. Headline inflation was 3.0% in December 2016, slightly lower than the 3.1% annual inflation recorded same month in 2015, but up from the 2.8% inflation rate recorded in Q3 2016. We expect inflation to rise slowly through 2017 to end the year around 4%, with increases in food, fuel and utilities prices. During the fourth quarter, Statistics Botswana rebased the Consumer Price index (CPI) from September 2006 to September 2016 and revised the weights of items in the basket (see later discussion).

Interest Rates



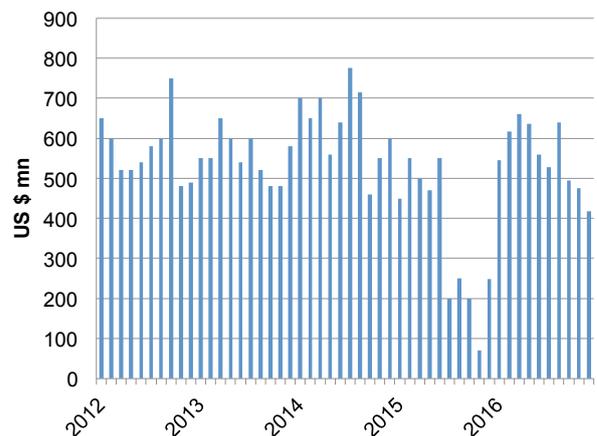
Interest rates have been fairly stable during Q4 2016. During the last meeting of 2016 of the Bank of Botswana's Monetary Policy Committee (MPC), the Bank Rate was maintained at 5.5%, reflecting the low inflation outlook and prospects of continued price stability in the medium term. Consequently, the Prime Rate has been maintained at 7.0%. The BoBC 91 and 14 day rates also remained soft during the quarter with marginal changes.

Exchange Rates



Foreign exchange rates were volatile in the last quarter, reflecting uncertainty over the outcome of the U.S Presidential election and other geopolitical events. Unusually, the Pula depreciated against both the US Dollar and South Africa Rand. The Pula-US Dollar exchange rate was 10.65 at the end of 2016 from 10.37 in September, a depreciation of 2.6%. The Pula depreciated against the Rand, by 1.2%, ending the year at ZAR1.28, from ZAR1.30 in September.

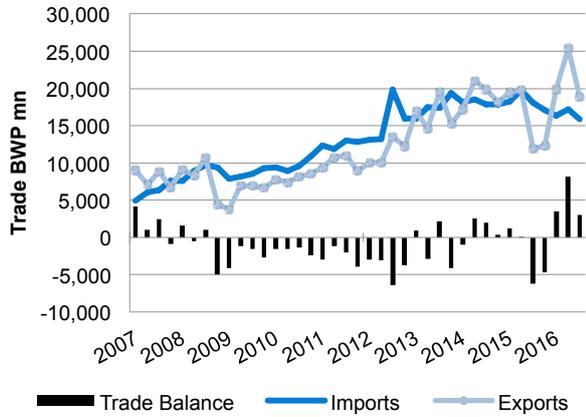
De Beers Diamond Sales



The global diamond market was generally quiet during the last quarter of 2016, with demand for diamonds in the important US market somewhat weak over the holiday period. However, the market was firmer than it had been a year earlier. De Beers Global Sightholder Sales (DBGSS) recorded sales valued at USD1,388 million in Q4, far better than USD518 million sales recorded in Q4 2015. The weak holiday sales from the U.S. as well as the liquidity crisis in India provide uncertainty surrounding demand for diamonds going into 2017. Overall DBGSS sales in 2016 were almost 40% higher than in 2015. De Beers holds 10 sightholder sales each year, and the first cycle of sales will be held in January 2017.

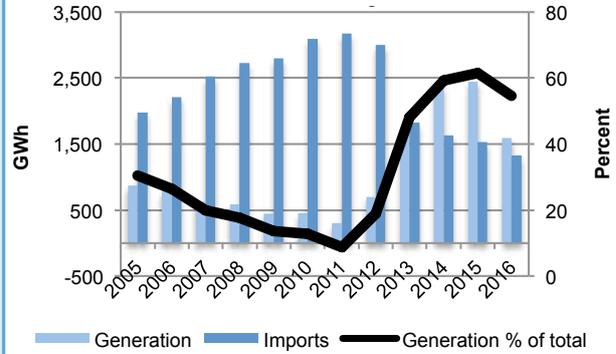
KEY ECONOMIC VARIABLES

International Trade



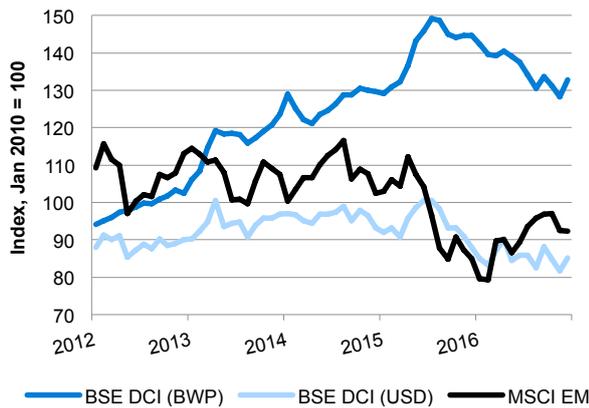
Total trade slowed in the quarter to September when compared with the previous quarter. Total exports and imports fell to P18,9 million and P15,7 million in Q3, from P25,3 million and P17,2 million in Q2 respectively. However, trade improved significantly compared to 2015, with exports in Q3 some 60% higher than a year earlier, driven by stronger diamond exports. Imports contracted 12% over the same period. This translated into a trade surplus of P3,003 million in Q3 2016.

Electricity



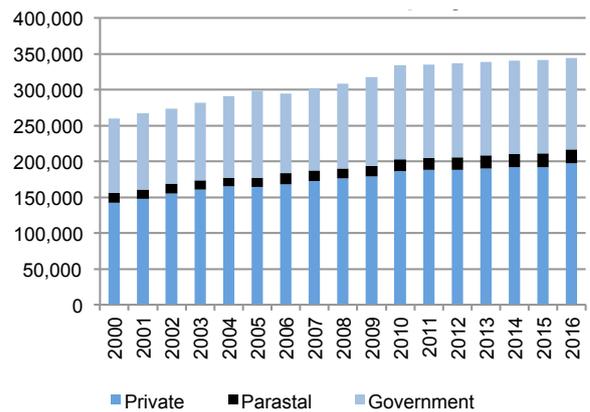
Domestic generation of electricity decreased by 8.6% y-o-y to 1,591 GWh in the first 3 quarters of 2016, from 1,740 GWh in Q1-3 2015. Conversely, the volume of imported electricity during the same period rose 11.3% to 1,325 GWh. Total electricity consumed in the first three quarters of 2016 fell to 2,917 GWh, a reduction of 0.5% compared to the same period in 2015, reflecting sluggish economic growth. South Africa's Eskom reported surplus electricity, and it is likely that Botswana chose to import power rather than use the very expensive emergency diesel generating capacity locally.

Stock Markets



Over 2016 as a whole, the Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) performed relatively poorly, losing 8.2% and 3.2% in Pula and USD terms respectively. On the other hand, the MSCI Emerging Markets out-performed the BSE-DCI gaining a substantial 8.6% by the end of the year. Major emerging stock markets have recovered during the year, after a very poor performance in 2015. On the BSE, shares of several companies in banking, financial services and retail performed particularly badly, reflecting weak domestic economic conditions.

Formal Sector Employment



Overall formal sector employment increased by a sluggish 1.0% in the year to September 2016. Formal employment rose to 344,487, resulting in 3,372 net new jobs, compared to 1,008 new jobs in 2015. Private sector employment grew by 2.9%, employing 5,623 additional persons in 2016. Growth in the private sector was partially offset by the loss of jobs in both parastatals and government, by 310 and 1,941 persons respectively. However, given the job losses at the BCL copper-nickel mine in Q4, private sector employment is expected to decline significantly in the next formal employment data.

NEWS HIGHLIGHTS

1st October	The International Monetary Fund (IMF) adds Chinese Renminbi to Special Drawing Rights (SDR). (IMF)	The International Monetary Fund (IMF) has added the Chinese Renminbi (RMB) to the basket of currencies that make-up its Special Drawing Right (SDR), joining the US Dollar, Euro, Japanese Yen and the British Pound. China is increasingly integrated in international markets and the inclusion of RMB marks the country's expanding role in global trade. The SDR is an international reserve asset created by the IMF to supplement its member countries' official reserves, as well as an important unit of account.
3rd October	Botswana crawls up in Global Competitiveness rankings. (Sunday Standard)	Botswana has improved in the 2016/17 World Economic Forum (WEF)'s Global Competitiveness rankings by moving up 7 places, from position 71 out of 140 countries in 2015/16 to 64 out of 138 countries in 2016/17. Botswana performed better in infrastructure, higher education and goods market efficiency.
3rd October	MOD Resources upbeat on substantial maiden copper resource in Botswana. (Weekend Post)	MOD Resources has declared a maiden mineral resource of 28.36 million tonnes (Mt) containing about 350,200 tonnes of copper and 14.27 mn oz of Silver in the Kalahari Copper Belt. The project is a joint venture between MOD Resources, listed on the Australian Stock Exchange, and Metal Tiger, listed on the AIM in London.
9th October	BCL Mine under liquidation. (Daily News)	The Ministry of Minerals, Energy and Water Resources (MMEWR) made a decision to close and place the BCL Ltd mine under provisional liquidation. The cash-strapped copper and nickel mine has not been doing well, making losses perpetuated by depressed international base metal prices and declining ore grades.
11th October	Botswana pulls out of the P3 billion Norilsk Nickel mine deal. (Mining Weekly)	Botswana withdrew from a commitment to buy a 50% stake in Norilsk Nickel's Nkomati mine in South Africa. The decision to withdraw comes after BCL, which in 2014 agreed to buy the 50% share of Nkomati nickel held by Norilsk, was placed under liquidation. BCL has no funds to continue with the transaction, and could not raise the USD250 million needed to fund the purchase from a proposed bond sale.
14th October	Botswana diamond project poised for 2017 completion as it surpasses 80% completion mark. (Mining Weekly)	Construction at Debswana's Lethakane mine tailings resource treatment plant project (LMTRTP) is reportedly 80% complete, and the project is reported to be within budget. The plant is planned to undergo commissioning and attain full production in Q3 2017. The LMTRTP will extend production beyond the existing mine's life and is expected to achieve yearly production of 800,000 carats of diamonds.
17th October	New Bank of Botswana Governor appointed. (Daily News)	The President has appointed Mr Moses Pelaelo to the position of Governor of the Bank of Botswana. Mr Pelaelo joined the Bank in 1990, and has assumed different positions within the Bank, most recently Deputy Governor.
17th October	Shumba Energy raise P14 million. (Mmegi)	Shumba Energy has raised P14 million required for the purchase of the Mabesekwa Prospecting License from Daheng Group, through the issue of convertible loan notes.
19th October	Botswana Diamonds starts drilling at Orapa. (Rapaport New)	Drilling has commenced at the AK 22 kimberlite pipe in Orapa for diamond exploration. The work is a joint venture partnership between Botswana Diamonds and Alrosa.

NEWS HIGHLIGHTS

20th October	Air Botswana partners with Qatar Airways. (Daily News)	Air Botswana secured a code-share partnership deal with Qatar Airways, one of the world's major airlines, with a network that accesses over 150 destinations worldwide. The partnership gives Qatar access to Botswana's route network to Gaborone, Francistown and Maun via Qatar's South Africa gateway. Botswana sought to benefit from Qatar's developed IT and infrastructure and gateway to Qatar's network.
24th October	Liquidator retrenches all 5,000 workers at the mothballed BCL mine. (Mining Weekly)	About 5,000 employees at the BCL copper-nickel mine face retrenchment, following the Government's decision to provisionally liquidate the mine. According to the liquidator, a few of the employees will be retained during the liquidation process.
26th October	Botswana's growth seen at 4.4% annually for the next six years – Government. (Reuters)	Botswana is expected to achieve an annual growth of 4.4% during the period of the National Development Plan (NDP) 11 from 2017 to 2023. The mining sector is forecast to have an annual growth of 2.8%, with non-mining sector growing at 4.6% annually. In addition, a new fiscal rule will be adopted during the Plan period. The Government plans to save 40% of annual mineral revenues, and allocate 60% to development (investment) spending.
27 October	Giyani acquires Botswana manganese project. (Marketwired)	Giyani Gold Corp. has acquired shares in various prospecting licenses that are highly prospective of manganese development with two companies, Menzi Battery Metals Pty Ltd and Qakaza Diamond Corp. Pty Ltd. According to the company, the acquisition positions Giyani to world class manganese project and virtually untapped mineral potential within the Kalahari Manganese Field. The licenses are in the Kanye Basin and extend to the Griqualand West basin, which hosts a number of manganese mines that collectively comprise the Kalahari Manganese Field.
30th October	Lerala Mining Operations halted to ease stockpiles. (Rapaport News)	Production at Lerala Diamond mine has been suspended to reduce excess ore stockpiles that accumulated as a result of increased mining rates, which exceeded the plant's ability to process feed. Pit mining will begin once the stockpiles have been reduced.
31st October	S&P maintains negative outlook for Botswana. (Bank of Botswana)	Standard & Poors (S&P) affirmed Botswana's investment-grade credit rating but maintained the negative outlook, reflecting the risks over the next 12 to 18 months if the current diamond-sector slump proves more structural than cyclical in nature. S&P maintained an A-/A-2 long and short-term foreign and local currency sovereign credit rating for Botswana, and forecasts gradual recovery of diamond prices in the medium term.
7th November	Botswana to sell Morupule B. (Reuters)	The Government intends to sell the 600 megawatt Morupule B power plant. The power plant has persistently had technical problems and had at times contributed to power shortages and load shedding. Due to its problems the plant has become expensive to maintain and operate as a result of construction defects rendering the plant unreliable.

NEWS HIGHLIGHTS

13th November	Local companies have to wise up to the outside – Econsult. (Sunday Standard)	The Managing Director of Econsult, Dr Keith Jefferis, advised that companies that are successful are those that expand to regional markets once they have exhausted the scope to grow in their core domestic markets. According to him, companies need to understand the local conditions regarding competition and politics, prepare for risk and do not shy away from retreating if not successful.
14th November	Statistics Botswana changes CPI base year. (Weekend Post)	Statistics Botswana has rebased the Consumer Price Index (CPI) to September 2016 from September 2006. The index basket has been re-weighted using the 2009/10 BCWIS results. The rebasing of the CPI was necessary to reflect changing consumer expenditures and to improve the quality of the data as socio-economic and monetary policies depend on price statistics. It is expected that another rebase of the CPI will be done in 2019 using data from the 2015/16 Botswana Multi-topic Household Survey results.
1st December	Lucara sees more lucrative mining in 2017. (Rapaport News)	Lucara Diamond Corp. is shifting operations to a higher-value part of the Karowe mine, which it believes will enable an increase in dividend payments in 2017 to USD0.07 per share up from USD0.04 per share in 2016. Lucara had a successful 2016 and will focus on advancing the push back at the Karowe open-pit.
2nd December	Botswana and Namibia expand scope of Trans-Kalahari railway project. (Mining Weekly)	The scope of the Trans-Kalahari Railway Line project promoted by the governments of Botswana and Namibia has been expanded from being a dedicated coal export route to a multi-sectoral project designed to unlock the potential of other economic sectors along the corridor. The project was remodelled in 2015 as coal prices slumped and threatened the viability of the project. The proposed Trans-Kalahari railway is a 1,500 km railway line that now includes other sectors of agriculture, manufacturing, mining, real estate and transport and logistics.
4th December	Housing will remain a pipe dream for many – report. (Sunday Standard)	According to the 2016 Centre for Affordable Housing Finance in Africa (CAHF) report, housing affordability in Botswana is a challenge for many as the average income needed to buy the cheapest formally-built house is almost double the average annual urban household income. The 2009/2010 Botswana Core welfare Indicators Survey (BCWIS) estimates that 50% of households in Botswana has monthly consumption expenditure of P1,600 or less. When using the benchmark that housing cost should not exceed 40% of household income, an average household cannot afford to spend approximately P1,100 monthly on housing. Thus, home ownership in Botswana will remain an idea sought after by many and gravely unattainable.
7th December	BDC double profits to P224 million. (Mmegi)	The Botswana Development Corporation (BDC) doubled its profits before tax for the year ended 2016 after from P110 million in 2015 to P224 million in 2016. Assets grew by 6% to P4.4 million in 2016 from P4.1 million in 2015. According to the BDC, it was able to achieve profitability by re-modelling its programme in order to address its major challenges.
8th December	De Beers reduced rough prices by 5% in 2016. (Rapaport News)	According to De Beers Diamond Company, prices for rough diamonds fell 5% in 2016 (from January to November) despite the diamond industry having shown recovery. Nevertheless, De Beers diamond sales in 2016 were far better when compared to 2015.

NEWS HIGHLIGHTS

9th December	Botswana diamond mine to retrench 450 workers. (Mining Weekly)	At least 450 miners will be retrenched at Karowe Diamond miner following a decision by Lucara Diamonds to prematurely terminate a mining services contract with South African company Eqstra, over differences in the volumes of diamond ore mined by Eqstra. Eqstra's contract was due to expire in 2020 and was contracted for mining Karowe's open-cast pit. However, most retrenched miners are expected to be re-employed by the replacement mining contractor.
13th December	Tight liquidity slows De Beers sales. (Rapaport News)	De Beers revenue from rough diamonds declined to USD418 million in the final sales' cycle of the year, as tighter liquidity in India hit demand for lower-priced stones. Sales were 12% lower in December, compared to USD476 million sales in November. However, when compared to the last cycle of 2015 rough diamond sales in December 2016 was 69% higher than the USD248 million in December 2015.
16th December	BTCL records P87.8 million profit, declares dividend. (Mmegi)	Botswana Telecommunications Corporation Limited (BTCL) recorded 19 percent growth in profit after tax of P87.8 million for the six months ended 30 September 2016, up from P73.9 million recorded the same period in 2015. Revenues during the period also increased, mainly attributable to growth in sectors of retail and wholesale. At the end of the period BTCL declared a dividend of 3.6% per share.
13th December	Bank of Botswana maintains Bank Rate. (Bank of Botswana)	The Bank of Botswana Monetary Policy Committee (MPC) decided to maintain the Bank Rate at 5.5 percent at the last meeting of the year. The outlook for price stability remains positive and inflation is expected to be within the Bank's medium term objective range of 3-6 percent. Monetary policy is aligned with the need to safeguard financial stability.
15th December	Business Confidence increases in H2 2016. (Bank of Botswana)	According the Business Expectations Survey (BES) released by Bank of Botswana, overall confidence among businesses in Botswana increased in the last half of 2016 (H2 2016) when compared to H1 2016, from 36 percent to 43 percent. The level of confidence for exporters fell significantly, from 71 percent to 42 percent, while increasing by 12 percentage points for domestic-oriented businesses from 31 percent to 43 percent. Optimism about business conditions in the future increased, despite uncertainty surrounding demand for commodities in the global market.
21st December	Alecto looks to buy Mowana Copper Mine. (Mining Weekly)	Alecto Minerals announced its intent to acquire 60 percent interest in Cradle Arc Investments. Cradle Arc owns Leboam Holdings and has recently acquired Messina Copper's Mowana and Thakadu copper mines. Alecto intends to raise funds through issuing convertible loan notes. Production is to be increased from 1.2 million tonnes per year to 2.6 million tonnes per year.

MACRO-ECONOMIC DATA

Key Economic Data									
	unit	2012	2013	2014	2015	2016Q1	2016Q2	2016Q3	2018Q4
Annual Economic Growth									
GDP	%	4.5	9.3	4.4	-1.7	-2.0	-1.6	0.9	..
Mining	%	-5.8	23.9	4.5	-19.6	-21.4	-22.9	-11.9	..
Non-mining private sector	%	7.7	6.8	4.1	1.4	1.7	2.7	3.8	..
GDP current prices	<i>P mn</i>	111,896	125,158	145,868	145,715	39,079	40,932	42,761	..
GDP 2006 prices	<i>P mn</i>	75,515	84,081	87,569	86,081	22,103	22,107	21,920	..
Money & Prices									
Inflation	%	7.4	4.1	3.8	3.1	3.0	2.7	2.8	3.0
Prime lending rate	%	11.0	9.0	9.0	7.5	7.5	7.5	7.0	7.0
BoBC 14-day	%	4.6	3.1	3.1	0.97	1.0	0.84	0.76	0.84
Trade & Balance of Payments									
Exports - total goods	<i>P mn</i>	45,915	66,404	76,233	63,467	19,877	25,378	18,872	..
Exports - diamonds	<i>P mn</i>	36,143	55,367	65,328	52,730	17,003	22,741	16,581	..
Imports - total goods	<i>P mn</i>	62,114	70,218	72,418	73,168	16,374	17,180	15,869	..
Balance of visible trade	<i>P mn</i>	-16,199	-3,814	3,816	-9,701	3,503	8,198	3,003	..
Balance of payments	<i>P mn</i>	-862	1,340	11,404	-57	-261	2,432	..	..
Foreign Exchange									
Exchange rate BWP per USD	<i>end</i>	7.776	8.718	9.515	11.236	10.929	10.941	10.373	10.650
Exchange rate ZAR per BWP	<i>end</i>	1.090	1.196	1.217	1.383	1.366	1.361	1.295	1.279
FX reserves	<i>\$ mn</i>	7,628	7,726	8,323	7,546	7,559	7,402	7,631	..
FX reserves	<i>P mn</i>	59,317	67,772	79,111	84,881	81,891	80,283	79,990	..
Financial Sector									
Deposits in banks	<i>P mn</i>	47,216	48,512	51,492	59,961	61,078	61,700	61,198	..
Bank credit	<i>P mn</i>	34,555	39,763	45,116	48,307	49,040	50,476	51,703	..
BSE index		7,510.2	9,053.4	9,501.6	10,602.3	10,202.6	10,081.3	9,797	9,728
Business Indicators									
Diamond production (a)	<i>'000 cts</i>	20,619	23,134	24,658	20,732	5,429	5,294	..	..
Copper production (c)	<i>tonnes</i>	57,916	49,448	46,721	23,050	5,777	2,747	..	..
Nickel production	<i>tonnes</i>	17,942	22,848	14,958	16,789	7,303	3,770	..	..
Business confidence index		47%	45%	52%	44%	36%	..	43%	..
No. of companies formed		16,561	14,190	16,300	19,134	4,592	..	..	..
Electricity consumption	<i>GWh</i>	3,703	3,502	3,990	3,974	967	955	995	..
Crude oil (Brent)	<i>\$/bar</i>	110.80	109.95	55.27	36.61	36.75	48.05	48.24	54.39
Employment (formal)									
Government		131,033	130,175	129,918	130,220	126,737	127,537	128,279	..
Parastatals		17,484	18,838	18,790	19,411	19,999	19,476	19,101	..
Private sector		188,531	189,894	191,399	191,484	193,460	195,747	197,107	..
Total		337,048	338,907	340,107	341,115	340,196	342,760	344,487	..
Govt Budget									
		2013/14	2014/15	2015/16 Outturn	2016/17 Budget				
Revenues	<i>P mn</i>	48,951	55,904	48,291	48,062				
Spending	<i>P mn</i>	41,730	50,564	54,923	54,445				
Balance	<i>P mn</i>	7,222	5,340	-6,632	-6,382				
Public debt & guarantees	<i>P mn</i>	29,481	32,991	33,670	34,459				
Govt deposits at BoB	<i>P mn</i>	31,745	41,680	33,916					
GDP	<i>P mn</i>	131,221	148,027	148,353	159,888				
Revenues	%GDP	37.3%	37.8%	32.6%	30.1%				
Spending	%GDP	31.8%	34.2%	37.0%	34.1%				
Balance	%GDP	5.5%	3.6%	-4.5%	-4.0%				
Public debt & guarantees	%GDP	22.5%	22.3%	22.7%	21.6%				
Govt deposits at BoB	%GDP	24.2%	28.2%	22.9%					

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

Notes: (a) 2013 figures include production from Boteti Diamond and Debswana

(b) 2016 figures include production from Gem Diamonds and Lerala mines

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

SPECIAL FEATURES

Household Consumption Expenditure in Botswana

Household final consumption expenditure (HFCE) by private households has become progressively more important over the past 20 years, as economic activity has become driven less by net exports and government consumption spending. Household consumption spending is now the largest contributor to gross domestic product (GDP) by expenditure. In this note we highlight the growing importance of household spending in GDP, and also consider the types of goods and services that households spend money on.

GDP can be measured and analysed in different ways, including the Output (value added) approach, and the Income (wages, return on capital etc.) approach. The GDP by Expenditure approach adds household consumption spending, government consumption spending, investment or gross fixed capital formation (GFCF), inventory accumulation and net exports (export less imports). Hence, the expenditure measure of GDP totals the amount spent on goods and services produced in the economy for a particular period, usually a year.

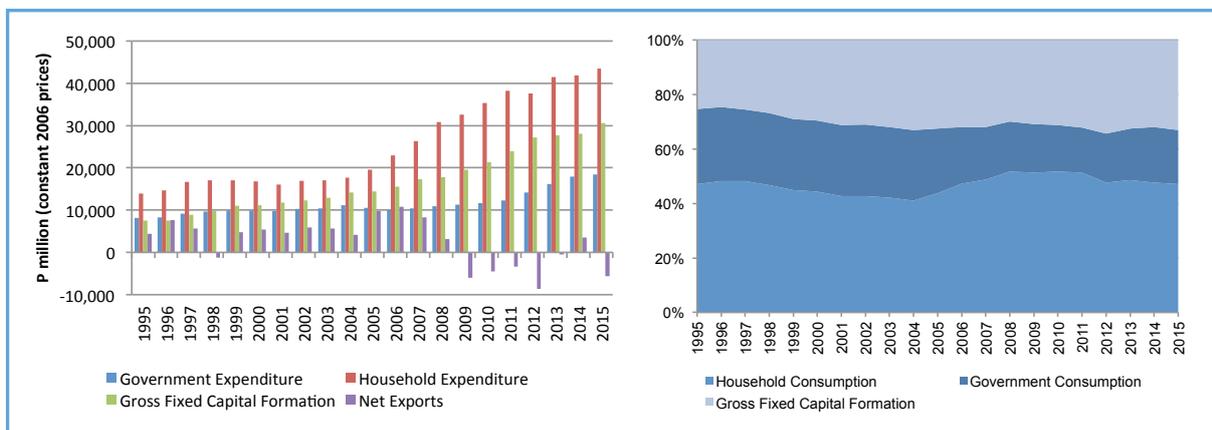
Household final consumption expenditure (HFCE) is defined as the final amount of spending made by households to acquire goods and services. An analysis of GDP by expenditure in Botswana shows that historically the contribution of HFCE to total GDP was very high - in 1960 it was 89.2 percent. After independence in 1966 and the discovery of mineral resources, the share of household final consumption expenditure in total GDP decreased gradually. Valuable mineral resources brought in high revenues for the government in the form of taxes, dividends and royal-

ties. Businesses were also established and more revenues for the government were collected from taxes. Hence, the Government was able to accumulate more resources and public spending became more important. The development of the mining sector also involved high levels of investment.

The contribution of net exports to GDP also became more important as diamond mining developed. The external balance was positive for many years and recorded surpluses that enabled savings in the form of foreign exchange reserves. It was only in 2008, during the global financial crisis that the country recorded a trade deficit for the first time in many years.

In the ten years from 1995 to 2004, household final consumption fluctuated between 33% and 42% of GDP – a relatively low figure by international standards. However, it rose sharply over the ten years to 2015. In the last decade, HFCE more than doubled in real terms, and rose from 38% to 52% of GDP.

Figure1: Contributions to GDP by Expenditure



SPECIAL FEATURE

Patterns of Consumption Spending

A closer look at individual household expenditures uses the results from the Botswana Core Welfare Indicators Survey (BCWIS) of 2009/10, a nationwide household survey on welfare and poverty. The survey results provide an interesting insight into how households distribute their income across different commodity groups, and how it varies by income level.

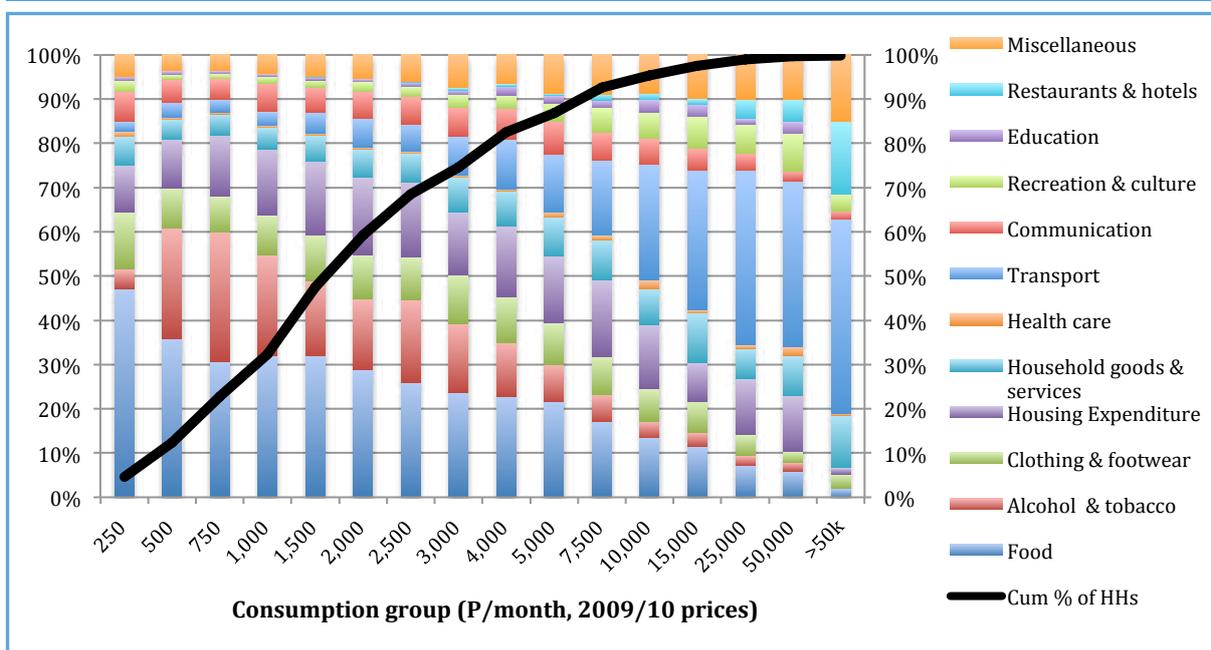
Household expenditure patterns differ according to the level of each household's income, as well as other characteristics such as where they live and their life stage. Their expenditure pattern provides an indication of the goods and services that they consume, which in turn reflects their choices and priorities. High income households spend more on luxury goods and services while a large share of income is spent on necessary goods and services for low income households. Financing of this consumption expenditure comes from sources such as wages and salaries, savings, investment income, loans and other incomes sources.

food expenditures decrease with increase in incomes (in relative terms) is a good indicator that household well being is improving. This is so because as household incomes increase, resources become available for spending on non-food items.

Interestingly, however, lower income households spend a lot on alcohol and tobacco, and the proportion of income spent on alcohol and tobacco falls when income increases. The outcome that alcohol and tobacco is the second largest expenditure category for low income households is worrying and raises social welfare and health questions regarding lifestyles of some low income households. It also indicates where the incidence of the alcohol levy is most keenly felt.

When it comes to housing, there is a only a small variation in housing expenditure across the income groups; the proportion spent on housing averages 15 percent of total consumption spending. In some respects it is surprising that the proportion of housing expenditure is fairly constant

Figure 2: Proportion of household consumption spending by category and consumption level (2009/10)



As expected, the proportion of household income level spent on food declines as income increases. Households that have low incomes spend more on food (as a proportion of their income) and less on luxury items while the opposite is true for high income earning households. The fact that

across income groups and does not increase with income. Given that housing is expensive in Botswana, relative to incomes, one might expect that when incomes increase, the proportion of housing expenditure would also increase.

SPECIAL FEATURE

Given that 50 percent of the population had monthly consumption expenditure of P1,500 or less (in 2009/10 – equivalent to around P2,200 in 2016 prices), affordability of housing for households in the lower half of the national income distribution is a challenge. And access to housing finance is also a problem for these households. There is limited availability of financing through Government schemes such as Self Help Housing Agency (SHHA) home improvement loans and the Turnkey houses, but the demand for these services is high and supply is limited due to the availability of funding as well as non-repayment of loans by beneficiaries.

As income increases, households have more likelihood of obtaining financing from commercial banks and other lenders. Given that financing constraints should be relaxed as income rises, it is a puzzle that households do not in general choose to spend more of their income on housing as they become better off.

By contrast, it is clear that for transport, the share of expenditure has increased over time and rises with income. This category includes spending on public transport, vacations and - most importantly - the acquisition of motor vehicles. According to the Transport and Infrastructure Statistics, the national stock of vehicles increased at an average annual rate of 9.3% from 2006 to 2015, far higher than the rate of

economic growth or population growth. While low income households allocate only around 3% of their expenditure to transport, for high income households this rises to 40%. In terms of choices and priorities, it is clear that as households become better off, they choose to spend more of their income on vehicles rather than housing.

The BCWIS 2009/10 also notes that priority spending on income has changed when compared to the previous national survey (HIES 2002/03), with a decrease in the amount of income allocated to food, while that for transport has increased.

Changes in consumption patterns from food to non-food items correspond to improving living standards of living of the population. However, more still needs to be done to address the socioeconomic issues of poverty and inequality in Botswana. Poverty rate remains high and Botswana is still ranked among the most unequal countries in the world. Income disparity between the rich and poor is extreme, and many households have to survive on very low incomes. Many initiatives can contribute to addressing this situation, including improving the role and efficiency of social welfare programmes, and ensuring that the economy is dynamic enough to create jobs and other income earning opportunities.

SPECIAL FEATURE

Updating and Rebasing of the Consumer Price Index (CPI)

The recent move by Statistics Botswana to rebase and update the consumer price index (CPI) is a welcome development in terms of aligning statistics with the changing economy. Statistics agencies regularly revise the CPI to reflect current prices and changing lifestyles of the population. When revising the CPI, items in the index may be dropped, new items added, or the weights of items remaining in the index may be changed. Essentially, revisions to the index reflect changes in the spending patterns of consumers.

What is the CPI?

The consumer price index is used to measure changes in the prices of goods and services over a base period (Statistic Botswana, 2016), and to track changes in the overall price level. The CPI is used to show the cost of living and is sometimes referred to as the Cost-of-Living Index. It is essentially a weighted average of price changes for a wide range of goods and services, classified into groups such as Food, Clothing and Transport. The CPI basket comprises all of the items in the index.

In Botswana the CPI provides information on the cost of living for three groups of the population: towns and cities, urban villages and rural villages. The needs of the three groups are different and are reflected by the varying weight of each item in the basket for the population groups. However, it does not mean that each area of the population has its own CPI basket. The CPI is one index apportioned to three areas. Every month Statistics Botswana releases the CPI and the report reflects price changes of items for that period (monthly). The percentage price change for all items index (CPI) give the inflation rate for that month. The national inflation rate or the headline inflation rate is calculated year-on-year, and data for inflation is released every month.

When Statistics Botswana released the October 2016 CPI, a new basket was introduced, marking the start of a new CPI index series. The old index series was linked with the new series by allocating a common index level 100 to all prices as at September 2016, and splicing the old series with the new reference period. This is rebasing.

Introducing the new series and linking it to the old index series did not in itself change the annual inflation rate. However, recorded inflation may be different with the new basket than it would have been with the old basket, because of the new basket composition and item weights. With the new weights, price changes for individual items and categories

will have a different impact on overall inflation. For example, the impact of a change in the price of petrol depends on the weight that petrol has in the overall CPI basket. As it stands it is impossible to tell whether the CPI revision will cause recorded inflation to be higher or lower. Ideally, Statistics Botswana could have calculated changes in the CPI for the two series in parallel over a year to September 2016, which would have allowed an assessment of the impact on inflation over this period, but this was not done.

Reasons for CPI revision and rebasing

Until October 2016, the CPI had a base period of September 2006, with basket weights based on the 2002/3 Household Income and Expenditure Survey. Over time, these weights became less representative of consumer spending patterns. CPI revision was therefore needed to reflect changes in household spending patterns. The revision of the CPI used the results of the Botswana Core Welfare Indicators Survey (BCWIS) 2009/10 to reflect consumption expenditures.

When Statistics Botswana changed the reference period to 2016 a number of other changes were made. The revised CPI was enhanced by:

- Expanding the coverage area and including new coverage areas. A total of 49 areas is now covered compared to 46 previously, and the number of outlets for price collection also increased to 2100 from the previous 1288;
- Modifying the index basket items from a total of 384 items to 393 items. The CPI basket category groups, sections have not changed from the initial 12 groups and 51 sections.

The table below shows some of the items which have been removed, replaced and added in the new index.

SPECIAL FEATURE

New items	Items replaced	Items removed
<ul style="list-style-type: none"> • 500g Oats • 500g Fattis & Monis macaroni • Rape leaves • Ceramic floor tiles • Chicken braai pack • Black label Beer 750ml can • Castle lite 330ml bottle • Consultation to optician • Second hand car (Toyota Corolla 1.4) • Electric cooker – 4 plates with oven • Sunday Standard newspaper • The Voice newspaper • USB flash drive – 4 GB • Laptop personal computer • Legal services fees (consultation for will and trust) • Union monthly subscription fee 	<ul style="list-style-type: none"> • 5kg Tastic rice replaces 1kg • 5kg White Star maize-meal replaces 5kg Super A1 maize-meal • 1 kg Kellogs cornflakes replaces 500g • 410g KOO baked beans replaces 420g • 80g Cadbury chocolate dairy milk replaces 100g • 330ml Coca cola can replaces 340ml • Private rent, 2 ½ house with servant quarter (SQ) replaces 2 ½ house without SQ 	<ul style="list-style-type: none"> • Fresh chicken per kg* • Condensed milk • Repair to men's trouser with a hole at the back • Paraffin stove, single • Chicken necks per kg • Windhoek light lager 340ml can • Baby's nappy 68 x 68 cm • Rump steak and chips • Blank video cassette • Panasonic video cassette recorder • All train fares • Pre-recorded cassette, popular music • The Johannesburg Star newspaper

* Frozen chicken per kg remains

It is internationally recommended that national statistics offices' revise their CPI baskets at least every five years to accurately reflect changes in the economy. This in turn improves the quality of CPI data and informs a more accurate policy decision making, especially monetary policy decisions which depend on inflation data. The ten year gap

in Botswana is therefore far from ideal. In future, the CPI is expected to be revised every five years from 2019, using data from more frequent household surveys.

The 2016 revision involved changing the CPI basket group weights as shown below.

Comparison of group weights for CPI 2006 and 2016

Group	Sept. 2006 Weights				Sept. 2016 Weights			
	National	Cities & Towns	Urban Villages	Rural Villages	National	Cities & Towns	Urban Villages	Rural Villages
Food & Non-Alcoholic Beverages	21.84	18.06	22.21	28.82	16.51	10.79	17.51	25.14
Alcoholic Beverages, Tobacco & Narcotics	9.29	7.76	7.95	15.48	7.83	7.04	7.81	9.26
Clothing & Footwear	7.52	6.77	9.33	6.17	6.27	5.59	6.83	6.63
Housing, Water, Electricity, Gas & Other Fuels	11.46	13.87	11.36	5.60	14.90	15.77	16.33	11.30
Furnishing, Household Equipment & Maintenance	6.79	6.56	7.18	6.52	6.39	6.32	6.44	6.42
Health	2.71	1.59	2.17	6.50	3.62	1.74	3.08	7.70
Transport	18.98	20.45	19.16	14.98	20.65	24.60	18.86	16.27
Communications	3.01	3.51	2.85	2.06	4.27	4.16	4.61	3.99
Recreation & Culture	2.22	2.99	1.58	1.45	2.92	3.34	2.63	2.59
Education	3.37	4.34	3.09	1.44	3.34	4.42	3.16	1.69
Restaurants & Hotels	3.27	3.48	3.07	3.07	2.76	4.32	1.98	1.14
Misc. Goods & Services	9.57	10.62	9.04	7.90	10.55	11.91	10.75	7.86

Consistent with survey results, Transport has the highest weight followed by Food & Non-Alcoholic Beverages, Housing, Water, Electricity, Gas & Other Fuels and Alcohol Beverages, Tobacco & Narcotics. As mentioned before, the CPI is a reflection of consumption expenditure and is shown for three geographical areas of the population. Comparing the weights, the share of consumption expenditure (given by the weight) on food is higher in rural villages than it is for cities and towns. Expenditures are higher for bread and cereals, in particular maize meal. On the other hand, the weight for transport in cities and towns is high for both periods indicating that the proportion of income spent is higher on transport. The food weight is high in rural areas while the transport weight is high in cities & towns. This

partly reflects the fact that rural areas are poorer than urban areas; elsewhere in this Review, we note that relative food expenditures decline with income, while relative transport expenditures rise with income.

People sometimes question the accuracy of inflation figures in Botswana, especially now that recorded inflation has been consistently low by historical standards. The calculation of inflation is based on information on a large number of prices, collected regularly all over the country, and is in line with international standards and practices. In view of this, our view is that inflation is one of the most reliable of the macroeconomic data series in Botswana.

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