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COMMENTARY

2014 was a relatively good year for the world economy, but uncertainty lies ahead

2014 was a relatively good year for the world economy, although with mixed undercurrents. Global GDP grew by 2.6%, marginally up from 2.5% in 2013, positive yet below-trend growth. The pick-up in growth in 2014 came from a few developed countries; the US economy grew by 2.4%, its best growth rate in several years, and the United Kingdom economy also grew fast. Nevertheless, the Euro zone suffered from ongoing policy problems and slow growth (though it performed better than the previous year, raising hope of a turning point for the EU economy), while the Japanese economy stagnated.

Major emerging markets on the other hand, who have been experiencing strong growth in the last decade, were cooling off in 2014. Some large emerging market economies were affected by US quantitative easing. The rebalancing of global portfolios away from emerging-market assets resulted in capital outflows and currency depreciations in several large emerging-market countries, including South Africa. Although the Chinese economy continues to grow rapidly, at 7.4% 2014 growth was the slowest for 20 years. Oil-exporting emerging markets also suffered from a growth slowdown.

2014 culminated with a dramatic and unexpected change that affected the entire the global economy, with a fall or more than 50% in the price of oil – the impact of which we discuss later in this Review.

Many commentators had projected that higher global growth in 2014 would follow through into 2015, when the global economy would emerge from the grip of the 2008-9 financial crisis. However, prospects for 2015 are now being marred by economic uncertainty, and growth has become very difficult to forecast. Both the World Bank and the IMF have cut their global growth forecasts for 2015, warning of economic downside risks despite the benefit of cheaper oil. Projections suggest that the UK and the US will maintain the momentum built up in 2014 and will be driving global economic growth. However, the Euro area, Japan, and Russia are all expected to experience sluggish or even negative growth. Sub Saharan Africa on the other hand is expected to maintain relatively constant growth of around 4.8%, with the Ebola epidemic, slower global growth, and lower commodity prices all providing barriers to higher growth.

in this issue ...

COMMENTARY

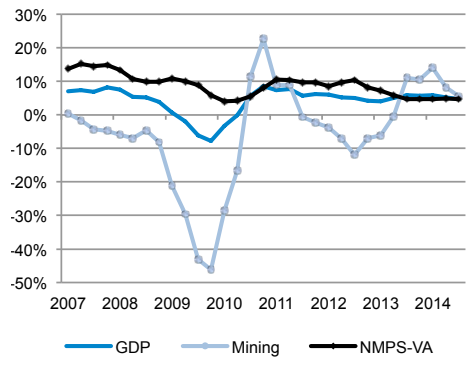
Botswana's economic performance has been reasonably stable since recovering from the global financial crisis. 2015 is projected to be similar to 2014, with GDP growth around the 5% mark, similar to Sub Saharan Africa as a whole. This is premised on a positive outlook for diamond exports as the US economy continues to show buoyant growth. However, Botswana's economy will also be impacted by lower commodity prices, particularly for copper and coal, hampering economic development in various parts of the country and potentially the feasibility of projects (especially the Trans Kalahari Railway).

Things to look out for domestically this year;

- **The long overdue BTCL IPO:** initially slated for August 2011, the initial public offering (IPO) for shares in Botswana Telecommunications Ltd (BTCL) has undergone a series of postponements. It was first delayed to 2012, then later pushed to August 2014 before it was again deferred to November, then December 31st 2014, and now pushed to an unspecified time in 2015; Botswana, therefore, still awaits it first large-scale privatisation.
- **Inflation** has fallen to low levels that are unprecedented since the introduction of the Pula in 1976, and with collapsing oil prices, inflation is likely to go lower. This will ease some recent pressures on real disposable incomes and living standards, but also has implications for expectations of wage increases etc..
- **Banking liquidity pressures:** 2014 saw a rise in the loan/deposit ratio in the banking system to historically unprecedented levels; this is resulting in a credit tightening by banks and a push for higher interest rates. This is a major change to a financial system that has long been characterised by excess liquidity, and has implications for the behaviour of all financial market participants;
- **Diamond sales:** so far, rough diamond prices have been largely immune from the impact of global growth uncertainty, and this has mitigated the general impact of declining commodity prices on Botswana; however, it is uncertain how far this can be sustained given declining prices for polished diamonds and relatively poor sales over the 2014 Christmas period, and whether diamond prices and sales will be sustained into the first half of 2015.
- **The new "fiscal rule"**, which commits 40% of mining revenues to be saved in a new future generations fund. One implication of this new rule is that the financing government expenditures will become more dependent on other revenue sources, such as domestic taxation. This will require improving the tax collection system, and potentially increasing tax rates. The new rule will also require stricter control of government spending, particularly on development projects.
- **Acceleration of "doing business" reforms:** with continued concerns about productivity and the quality of the investment climate, there is a wide variety of reforms that need to be implemented. Amongst the highest priorities are making real progress with taking government online (the e-Gov initiative); immigration reforms to make the country more open to FDI and foreign skills; and regulatory impact assessments to identify regulations that can be readily removed.

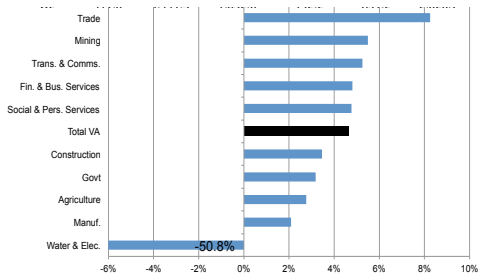
KEY ECONOMIC VARIABLES

Annual GDP Growth



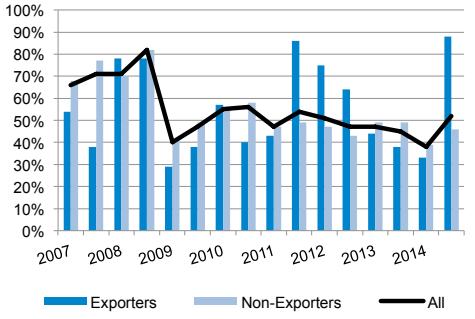
During the year to September 2014, GDP grew by 4.2%, a decrease from the 5.2% growth realised during the year to June. This was largely due to slower mining sector growth, which softened from 8.3% during the year to June 2014 to 5.5% during the year to September. On the other hand, the Non-mining Private Sector's (NMPS) growth rate remained constant at 4.8% during the same period.

Sector GDP Growth



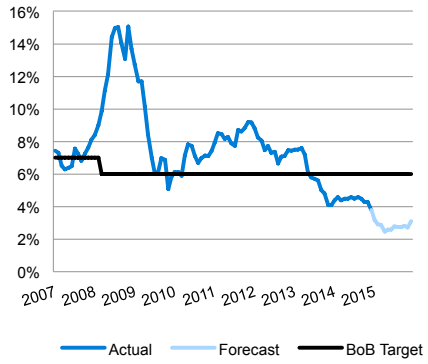
Trade and mining have been the fastest growing sectors in 2014 thus far, and remain the two fastest growing sectors for the third consecutive quarter. The water and electricity sector continued as the slowest growing, contracting by 50.8% during the year to September.

% of firms rating current business conditions satisfactory



Business confidence has surged during H2 2014. The proportion of firms that rated current business conditions as satisfactory stood at 52%, an improvement from 37% recorded in H1 2014. Notably, this is the first time in over two years that business confidence was above 50%. Moreover, it is striking that an overwhelming proportion of exporters (88%) find the current business conditions. This may be attributable to a combination of the Pula's depreciation against the USD and the low interest rates (and inflation) in Botswana.

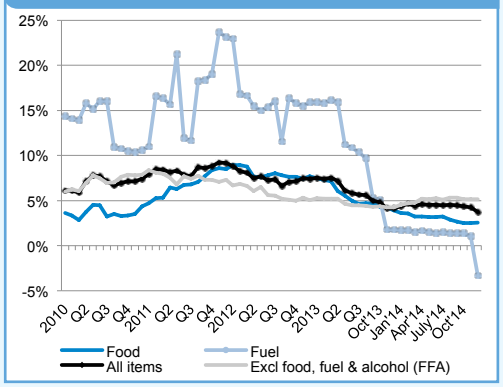
Inflation and Forecast



Headline inflation decreased from 4.5% in September to 3.8% in December. This decreased was largely attributable to the downward adjustment of (regulated) retail fuel prices in early December following the sustained decline in global oil prices. Given sluggish global economic growth and falling oil prices, we anticipate inflationary pressures to remain benign during 2015. As such, inflation should fall further and is forecast at around 3% for most of 2015, i.e. at the lower end of the Bank of Botswana's inflation objective range of 3-6%.

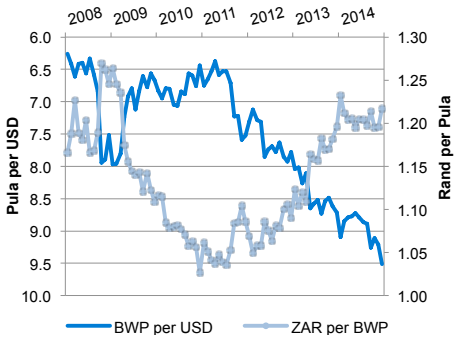
KEY ECONOMIC VARIABLES

Food, fuel and other items inflation



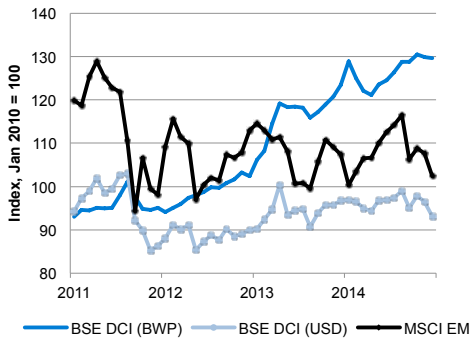
Fuel prices have been one of the main drivers of changes in inflation in the past, due to both their high weight in the CPI ("operation of personal transport" has a weight of 10.9%) and the fuel price volatility. Food prices are also important, with a weight of 21.84%. While the sharp drop in inflation in December 2014 was mainly driven by lower fuel prices, declining food price inflation has also been an important driver of lower inflation over the past year.

Exchange rates



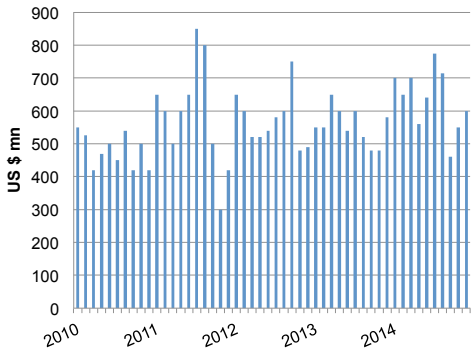
The Pula continued to depreciate against the USD and appreciate against the Rand during Q4 2014. The Pula appreciated by 0.3% against the Rand during Q4 2014 and by 1.7% during the whole of 2014. Inversely, the Pula depreciated by 2.7% against the USD during Q4 2014 and by 8.4% during 2014. The main cause of this continues to be the weakness of the Rand against the US dollar, which fell to a multi-year low during the quarter.

Stock Markets



The BSE DCI gained 0.7% in Pula terms during the last quarter of 2014. Moreover, the BSE DCI gained 5.0% (in Pula terms) during 2014. However, in USD terms, the Pula lost 2.0% and 3.8% in Q4 2014 and 2014, respectively. Nevertheless, the BSE DCI outperformed its peers as the MSCI EM index fell by 3.6% and 4.6% (in USD terms) during Q4 2014 and 2014, respectively. Sechaba, ABCH and Chobe where the top 3 gainers on the DCI, each gaining more than 40% during 2014.

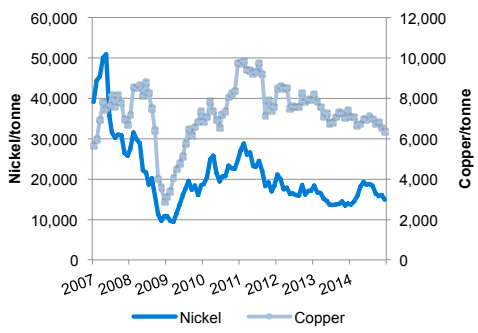
DTC Sales



Q4 2014 had 3 DTC sights estimated to have a total value of USD1,610 mn. During the last quarter of 2014, rough diamond prices softened slightly as sightholders deferred purchases; about 20% of diamonds were rejected by sightholders during the December sight. The value of DTC sights in 2014 was at estimated to be USD6,350 mn, an increase from an estimated USD5,550 mn in 2013. Moreover, Anglo American, De Beers' parent company, indicated that prices of rough diamond increased by 7% during 2014.

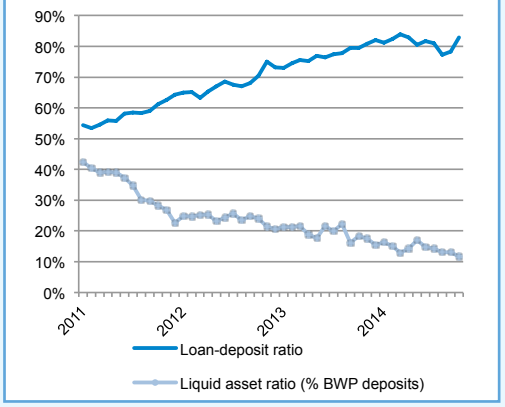
KEY ECONOMIC VARIABLES

Copper & Nickel Prices



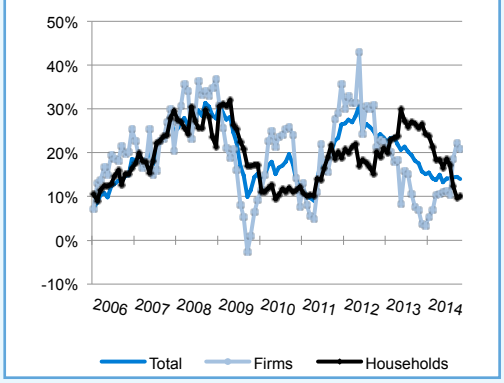
Commodity prices were also under pressure during the last quarter of 2014; copper and nickel prices fell by 5.6% and 9.5%, respectively. Copper prices were on a downward trajectory throughout the year, dropping by 14.0% during 2014. Conversely, nickel prices rose by 6.9% during 2014, notwithstanding the fall in the last quarter. These trends are more favourable for Botswana's mines that produce nickel (e.g. BCL, Tati), rather than relying on copper (Boseto, Mowana).

Loan-Deposit and Liquid Asset Ratios



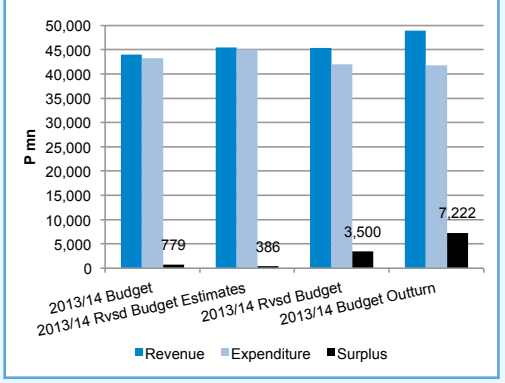
The loan-deposit (L/D) ratio in the banking system has been on the rise while the liquid asset ratio has been declining. This can be attributable to deposits growing more slowly than advances. Between 2009 and 2013, total bank deposits grew by 30% while advances grew by 132%. Now banks are almost fully lent, with a L/D ratio of about 80%, while the liquid asset ratio has fallen to about 10%, close to the statutory minimum.

Annual Credit Growth



Annualised bank credit growth softened from 17.5% in October 2013 to 14.2% in July 2014 and 14.0% in October 2014. Similarly, annualised bank credit growth to households decreased from 17.3% in July 2014 to 10.1 in October 2014. Conversely, credit growth to firms hastened from 10.4% in July 2014 to 20.8% in October 2014. These trends are encouraging as credit are increasingly being directed towards investment activities (firms) and less towards consumption spending (households). However, with a shortage of liquidity in banks, we expect the rate of credit growth to fall further.

Budget Outlay: 2013/14 FY



The 2013/2014 Budget proposal, presented in February 2013, budgeted Government revenues of P44.0 bn and a modest budget surplus of P779 mn. However, the revised Budget estimates and ultimately the budget outturn indicated that Government revenues were significantly underestimated. In the event, during the FY 2013/14 the Government realized a budget surplus of about P7.2 bn. This is attributable to mineral revenues coming in above expectations, raising total revenues to P49.0 bn, combined with underspending of P41.7 bn.

Sources: Statistics Botswana, Bank of Botswana, Rappaport Diamond Report, MCSI, Econsult

NEWS HIGHLIGHTS

6th October	'Botswana self sufficient in Poultry' (Sunday Standard)	The Head of the Poultry Division with the Ministry of Agriculture said that Botswana is largely self sufficient in poultry (portions and whole birds). During the 2013/14 financial year, the country produced 42,133 tonnes of broiler meat and 10,786,405 dozen eggs. However, Botswana still lags behind in processing and supplying of further processed poultry meat.
8th October	Retail investors rise 200% on BSE (Mmegi)	According to the Botswana Stock Exchange (BSE) 2013 Annual Report,the share of BSE turnover attributable to local individual investors has risen by nearly threefold over the past five years from 3.0% in 2008 to 8.7% in 2013. The growth in retail investor participation is a welcome indication of financial inclusion of citizens in the economy of the country.
10th October	BMC bounces back to profitability (Mmegi)	The Botswana Meat Commission (BMC) realized after tax profits to the tune of P26.0 mn during the year ended 31st December 2013. This was on the backdrop of successive losses of P324.0 mn in 2012 and P87.8 mn in 2011. This was attributed to Botswana re-entering the high-value EU market in 2013. Botswana's beef exports to the EU market increased from 750 tonnes in 2012 to 5,991 tonnes in 2013.
10th October	IMF upholds 4.4% Botswana growth forecast (Mmegi)	The International Monetary Fund's (IMF) October World Economic Outlook (WEO) report projects that the Botswana economy will grow by 4.4% in 2014, maintaining the same estimate announced in July. Moreover, the report indicated that the growth rate of Botswana's economy is forecast to decrease to 4.2% in 2015.
13th October	Tourism Sector must review Management of Training Levies-Report (Sunday Standard)	According to a detailed HRDC study, there is a need to review the current administration of the Vocational Training Fund and Tourism Industry Training Fund which both currently sit with two completely different bodies. The study also suggests that, there is need to align the training levies to the HRD Plan to ensure the effective and efficient usage of funds for the benefit of the sector.
13th October	Investec says investing abroad can help Botswana's concentrated market (Sunday Standard)	Investec Asset Management Botswana asserted that investing offshore can play a key role in helping diversify from the narrow local market with its small market capitalisation. The asset manager's views were sparked by the debate in the market between the regulatory authority (Non-Bank Financial Institutions Regulatory Authority) and the investment industry about a reduction in the offshore limit for pension funds.
13th October	BSB retrenches as it gears for commercialization (Sunday Standard)	Botswana Savings Bank (BSB) has confirmed that some of its employees will lose jobs following the government owned bank's conversion from a statutory body into a commercial bank.
14th October	BCM steps up import substitution drive (Mmegi)	The Botswana Chamber of Mines has launched a business development project aimed at sustaining local companies that manufacture capital goods and machinery to the mining industry. This will be achieved by ensuring that local mining companies are actively involved in the procurement of goods and services in the mining industry.
17th October	Business confidence dips (Mmegi)	According to the results of the Deloitte CFO 2014 survey, majority of the 34 CFOs and financial directors that participated in the Botswana survey do not expect a major improvement in operational performance this year and will opt to improve existing operations rather than expand into new markets and businesses.

NEWS HIGHLIGHTS

20th October	Norilsk sheds African assets in US$337mn deal (Mining Weekly)	Norilsk Nickel is set to sell its African assets to Botswana-based mining company BCL for US$337 mn, as the Russian miner's newly adopted strategy to shed all international assets moves forward. The deal marked Norilsk's full exit from all the international assets it had identified as non Tier-1 mining operations when the company embarked on a new strategy last year.
20th October	RMB report exposes 'pressured margins' in Botswana's financial services (Sunday Standard)	Rand Merchant Bank Botswana (RMB), a division of First National Bank Botswana (FNBB), says Botswana has a highly competitive financial services market, where one of the major challenges is that margins are under pressure. Despite the country's positive growth rate, rising costs are impacting on disposable income and that, in turn, is impacting on the manufacturing and retail sectors in particular.
23rd October	Morupule B crackles back to life (Mmegi)	At least one of the four units at Morupule B power plant sputtered back to life this week, a development that partially reduces the country's electricity imports. All four units at the 600MW Morupule B Power broke down last week, placing the country in a precarious position of relying on imports for 100% of its electricity needs.
27th October	BSE to introduce online trading (Mmegi)	In an effort to enhance local and international trading of securities on the local bourse, the Botswana Stock Exchange (BSE) is working on introducing an internet-based trading platform. BSE deputy chief executive officer Thapelo Tsheole said the objective of introducing internet trading is to further extend the functionality of the Automated Trading System (ATS) that was introduced in 2012 to enable investors both in Botswana and abroad online access to trading.
31st October	Lower savings culture in Botswana (Mmegi)	According to the Barclays Africa Prosper report, approximately four in 10 Batswana (42%) said they would invest or save if they found themselves with an extra US$100 (P920) at the end of the month. The Botswana score is significantly lower than that of the Ghanaians (82%) and Kenyans (63%) who said they were more likely to invest additional funds.
31st October	A-Cap readies for uranium mining licence (Mmegi)	Botswana Stock Exchange (BSE) listed mining company A-Cap Resources says it will soon apply for a mining licence for the development of the Letlhakane uranium project. In its activities report for the quarter ended 30 September 2014, the company stated that it continues to progress with the feasibility studies required to submit a mining licence application for the uranium project, in the first half of 2015.
3rd November	Turnstar on verge of awarding Game City expansion contractor (Sunday Standard)	Turnstar Holdings Limited said it will soon name a building contractor for its Game City Mall expansion project as it looks to bolster the status of the shopping centre as the biggest in the city and the country at large.
3rd November	Botswana encouraged to adopt GMO foods (Sunday Standard)	The Permanent Secretary in the Ministry of Agriculture, Dr Micus Chimbombi, indicated that Botswana is still developing a policy on genetically modified (GM) crops. Some experts in the agricultural field are of the opinion that Botswana should follow suit with the rest of the world and allow the use of GM crops to boost food production in the country.
10th November	First Ghaghoo Diamonds Sales In February (Mmegi)	The first diamonds recovered from the newly established Ghaghoo mine in the Central Kalahari Game Reserve (CKGR) are expected to go on sale in February 2015. Ghaghoo mine, which was opened in September 2014, has a total carat resource of 20.5 mn carats at an average of US$162 per carat with a total in situ value of US$3.3 bn. However, the mine had only produced 4,028 carats by the end of September 2014.

NEWS HIGHLIGHTS

17th November	BAMB will not import grains (Sunday Standard)	The Botswana Agricultural Marketing Board (BAMB) will not be importing grains for a second financial year. This is attributable to the bumper harvest after the past ploughing season.
18th November	Call for tax reforms to attract FDI (Mmegi)	Professor Roman Grynberg, a senior research fellow at the Botswana Institute for Development Policy Analysis (BIDPA) said creation of tax-free export processing zones would be an important step for the country. However, he cautioned that to reform the tax system without addressing the underlying causes of lack of competitiveness of firms located in Botswana would not result in long-term sustainable investment.
19th November	Turnstar secures P250m for Game City expansion (Mmegi)	RMB Botswana, a division of FNB Botswana Limited and FirstRand Bank Limited, held a ground-breaking ceremony following the signing of a P250 million deal with Turnstar Holdings.
21st November	CMB clinches BPOPF P500m tender (Mmegi)	Local asset management firm, Capital Management Botswana (CMB) has won a contract to manage Botswana Public Officers Pension Fund (BPOPF) P500mn private equity fund. This is the first tranche of BPOPF's P800 mn private equity funds targeted for investments in Botswana only.
21st November	Insurance industry nears saturation (Mmegi)	The Chairman of the Organisation of East and Southern Africa Insurers (OESAI) Botswana Organising Committee, Dziki Nganunu, said that insurance companies in Botswana need to look for markets outside Botswana as the local market is becoming saturated.
21st November	BIDPA study reveals hideous wage disparity (Mmegi)	A study conducted by the Botswana Institute for Development Policy Analysis (BIDPA) has revealed that salaries of Botswana's professional labour force are high by regional standards while unskilled workers are comparatively underpaid. It is because of these high wages that Botswana's services and products are internationally uncompetitive thus retarding efforts to diversify the economy.
25th November	Textile industry forecast exports rebound (Mmegi)	Local textile and clothing manufacturers, one of the largest employers in Botswana, are expecting a change of fortunes in the forthcoming financial year since the country's economy is showing signs of recovery from the global financial meltdown.
25th November	BTC IPO faces another deferral (Mmegi)	The long awaited Botswana Telecommunications Corporation Limited (BTCL) Initial Public Offer (IPO) issue date might be postponed again. Initially slated for August 2011, the IPO launch has undergone a series of postponements. It was first delayed to 2012, and then later pushed to August 2014 before it was again deferred to November 7 and now December 31st 2014.
27th November	Mohohlo dispels liquidity crisis concerns (Mmegi)	Bank of Botswana (BoB) Governor, Linah Mohohlo has dispelled observations that the banking system is inching towards a liquidity crisis. She asserted that contrary to perceptions, the liquidity in the banking system is not tight, adding that there is excess liquidity in the banking system which currently stands at approximately P3bn.
27th November	De Beers set to co-operate with small Players (Business Day)	De Beers is considering allowing junior miners or community groups to mine small, diamondiferous kimberlite deposits around the Orapa operations in Botswana as it investigates mining alluvial diamonds northwest the mine. The study includes investigating the need to either demolish or work around the No.1 processing plant built in 1970 and how to increase the capacity at the newer No.2 processing plant, which has a direct feed into the completely automated recovery plant.

NEWS HIGHLIGHTS

28th November	Diamond manufacturers in turmoil (Mmegi)	Government is in negotiations with local diamond manufacturers over the introduction of a training levy, which the industry claims will drive the already distressed sector out of business and trigger more job cuts. After 5 years of exemption, most of the 21 diamond cutting and polishing companies will soon be obliged to pay 0.2% of turnover as training levy. While observers assert that the 0.2% is a small amount for a sector that does not pay a lot of taxes, industry insiders told BusinessWeek that their already troubled industry is a high turnover, high cost but low profit margin sector and cannot therefore cushion the effects of any more taxes.
30th November	More in store for Jwaneng, Orapa Mines (Daily News)	Debswana envisages undertaking major diamond production projects in the next five years at Jwaneng and Orapa. These are tipped to larger than the current P24 bn Cut 8 project in Jwaneng. Moreover, Debswana Managing Director, Mr Balisi Bonyongo, said that in line with the company's long term strategy dubbed the Resource Development Plan (RDP) they had decreased production levels from over 30 mn carats to a range of 23 to 26 mn carats a year. This will see Debswana producing diamonds up to 2050.
2nd December	Debswana squeezes first carats from tailings dumps (Mmegi)	Debswana has recovered the first stones from the treatment of a 37 mn tonne tailings dump at Jwaneng Mine. This marks the first time the diamond giant gleaned value from the 'waste' material. It is expected that the 37 mn tonne dump will yield 900,000 carats annually for about 20 years.
3rd December	BancABC secures Eurobank millions for local companies (Mmegi)	BancABC has secured a €25 mn (P290 mn) deal with the European Investment Bank (EIB) to fund local companies. The funds will be used as loans that will finance the banks' corporate banking and SME operations.
3rd December	Local millers want wheat levy retained (Mmegi)	Local millers maintain that the 15% wheat import levy that was introduced in 2003 must be retained. The levy was introduced on all wheat flour imported into the country, in order to develop the local industry. The chairman of the Botswana Millers Association, Nkosi Mwaba, asserted that the levy was an effective tool to curtail dumping and to address predatory pricing from South African millers.
3rd December	Kimberley Diamonds receives environmental authorisation (African Mining)	Kimberley Diamonds Limited has received approval from the Department of Environmental Affairs regarding the transfer of the authorisation of the previously approved Environmental Impact Assessment from DiamonEx Botswana. Following the transfer, the Company will be permitted to undertake the planned upgrade of the plant, site infrastructure and the tailings storage facilities at the Lerala diamond mine, which is scheduled to recommence production in mid-2015.
3rd December	Tlou Energy's Selemo 1P steadily increases gas flow (African Mining)	Tlou Energy Limited, a coalbed methane and natural gas explorer, reported that gas flow at Selemo 1P has been steadily increasing since the commencement of production. The flow test results to-date suggests that commercial development is possible and achievable.

NEWS HIGHLIGHTS

12th December	BOBS laments low SMME standards uptake (Mmegi)	The Botswana Bureau of Standards (BOBS) indicated in their 2014 Annual Report that it continues to struggle to encourage adoption of standards among Small, Micro and Medium Enterprises, a situation which the organisation says is limiting the optimal use of local expertise.
12th December	Moody's reaffirms Botswana's sovereign credit rating	Moody's Investors Service indicated in their annual credit analysis report that strong economic growth and robust government fiscal strength continue to support Botswana's credit profile. As such, the agency reaffirmed the country's 2014 sovereign credit rating of A2 for both foreign and domestic bonds and the stable outlook for the year. However, it noted that the economy's heavy reliance on the diamond industry and the relatively slow pace of economic diversification remain key weaknesses for the rating over the long term.
17th December	BSE commercialisation gets 'Parly' nod (Mmegi)	Parliament has adopted Botswana Stock Exchange (BSE) transition bill, which allows the bourse to be registered as a company under the Companies Act.
18th December	Discovery shuts Boseto Mine, axes 380 jobs (Mmegi)	Discovery Metals Ltd will retrench 380 workers at its flagship Boseto Mine, early 2015, before suspending mining and processing operations in July 2015 due to high mining costs set against softening international copper prices.

MACROECONOMIC DATA

Key Economic Data

	unit	2011	2012	2013	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Annual Economic Growth									
GDP	%	6.2	4.3	5.8	5.8	*5.8*	5.2	4.8	..
Mining	%	-2.3	-7.0	10.6	10.6	*14.1*	8.3	5.5	..
Non-mining private sector	%	9.8	8.2	4.7	4.7	*4.7*	4.8	4.8	..
GDP current prices	*P mn*	105,071	110,763	*124,122*	*31,592*	*32,705*	*36,122*	34,377	..
GDP 2006 prices	*P mn*	70,663	73,712	*77,956*	*20,101*	19,958	20,284	20,522	..
Money & Prices									
Inflation	%	9.2	7.4	4.1	4.1	4.4	4.6	4.5	3.8
Prime lending rate	%	11.0	11.0	9.0	9.0	9.0	9.0	9.0	9.0
BoBC 14-day	%	4.5	4.6	3.1	3.1	3.1	3.1	3.1	3.1
Trade & Balance of Payments									
Exports - total goods	*P mn*	*39,996*	*45,723*	*66,491*	18,552	12,479	17,020	..	..
Exports - diamonds	*P mn*	30,248	36,143	55,443	15,863	10,348	14,249	..	..
Imports - total goods	*P mn*	*49,994*	*66,166*	*56,327*	*16,580*	*13,837*	12,730	..	..
Balance of visible trade	*P mn*	*-9,998*	*-20,443*	*10,164*	*1,972*	*-1,358*	4,290	..	..
Balance of payments	*P mn*	3,430	-862	1,340	-1,621	2,856	4 765	1 082	..
Foreign Exchange									
Exchange rate BWP per USD	*end*	7.524	7.776	8.718	8.718	8.787	8.787	9.259	9.515
Exchange rate ZAR per BWP	*end*	1.086	1.090	1.196	1.196	1.204	1.205	1.214	1.217
FX reserves	*$ mn*	8,082	7,628	7,726	7,726	7,992	8,547	8,240	..
FX reserves	*P mn*	60,271	59,317	67,772	67,772	70,102	75,174	76,295	..
Financial Sector									
Deposits in banks	*P mn*	43,505	47,216	48,512	48,512	48,778	52,304	56,328	..
Bank credit	*P mn*	27,968	34,555	39,763	39,763	40,928	42,694	44,138	..
BSE index		6,970.9	7,510.2	9,053.4	9,053.4	8,955.9	9,133.9	9,440.0	9,501.6
Business Indicators									
Diamond production *(a)*	*'000 cts*	22,903	20,619	23,134	6,473	5,870	6,364	..	..
Copper production	*tonnes*	22,319	26,736	41,753	9,760	7,304	9,925	..	..
Nickel production	*tonnes*	15,675	17,942	22,848	5,287	2,715	4,134	..	..
Business confidence index		54%	47%	45%	..	38%	..	52%	..
No. of companies formed		11,788	16,561	14,190	3,942	3,616	3,989	4,682	..
Electricity consumption	*GWh*	3,472	3,703	3,502	806	933	1,007	..	..
Crude oil (Brent)	*$/bar*	108.09	110.80	109.95	109.95	105.95	111.03	94.67	55.27
Employment (formal)									
Government		130,196	131,033	..	..	..	..	..	..
Parastatals		16,992	17,484	..	..	..	..	..	..
Private sector		187,986	188,531	..	..	..	..	..	..
Total		335,174	337,045	..	..	..	..	..	..

Govt Budget		2012/13	2013/14 Revised	2014/15 Budget
Revenues	*P mn*	41,658	48,951	50,183
Spending	*P mn*	40,736	41,730	48,857
Balance	*P mn*	922	7,222	1,326
Public debt & guarantees	*P mn*	29,585	30,922	32,574
Govt deposits at BoB	*P mn*	20,611	..	..
GDP	*P mn*	112,730	*128,502*	136,140
Revenues	*%GDP*	*36.9%*	*38.1%*	*36.9%*
Spending	*%GDP*	*36.1%*	*32.5%*	*35.9%*
Balance	*%GDP*	*0.8%*	*5.6%*	*1.0%*
Public debt & guarantees	*%GDP*	*26.2%*	*24.3%*	*23.9%*
Govt deposits at BoB	*%GDP*	*18.3%*	*24.7%*	..

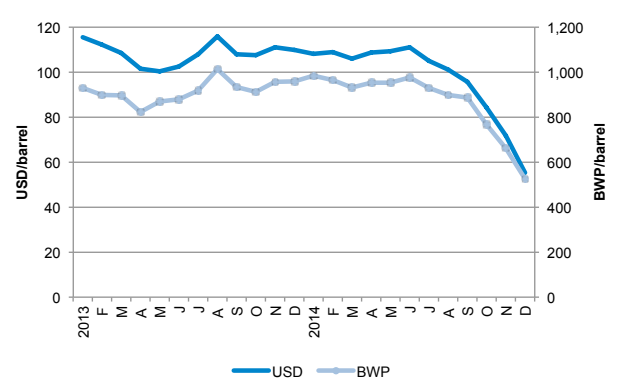
Sources: Bank of Botswana; MFDP; Statistics Botswana; Department of Mines; Registrar of Companies; Econsult
Notes: (a) 2013 figures include production from Boteti Diamond and Debswana
(b) Numbers in Italics reflect revisions from the previous review

The Impact of Falling Oil Prices

One of the most dramatic global economic developments over the past six months has been the collapse in global oil prices. After trading in the range of $100-$120 a barrel since early 2011, the price of Brent crude fell from $101 at the end of August 2014 to $55 at the end of December. It has since fallen further during January 2015, to well below $50. The impact of this decline is being widely felt around the world, but will affect different countries in different ways. The impact works through several different channels – inflation, real incomes, balance of payments and exchange rates – and the net effect on growth is complex. Furthermore, it is not just oil prices that have dropped, but prices of other commodities too. In this article we discuss the likely impact of these developments on the Botswana economy.

The last time oil prices fell so dramatically was back in the dark days of 2008, when the global financial crisis caused the price of Brent crude to fall from $145 to $33 in less than six months. On that occasion, the cause was collapsing demand as the global economy went into deep recession. On this occasion the causes are more diverse, and weak demand is only part of the story. While the US economy is growing at a healthy rate, growth is disappointing in many other parts of the world: the Euro zone and Japan are on the verge of recession, and growth in China has slowed. This is compounded by an oil supply glut, with steadily rising output from US shale oil producers, and a decision by OPEC producers not to reduce oil output in the face of weak demand and falling prices – in contrast to their actions in similar situations in the past.

Figure 1: Crude Oil Prices (Brent, USD and BWP per barrel)



Source: US EIA; Econsult

The economic impacts of this decline are diverse: globally, it is likely to affect inflation, economic growth, savings, investment, exchange rates, balance of payments and foreign exchange reserves. However, these impacts will vary across countries. The main difference is between oil importing countries and oil exporting countries, but other important differences stem from the weight of fuel prices in the consumer price index, and policy responses to falling fuel prices.

Inflation: almost everywhere, fuel prices will be reduced, and inflation will drop as a result. In many countries falling fuel prices may cause the overall price level to drop, causing inflation to turn negative – JP Morgan is forecasting negative inflation in the USA, Canada, Japan, the Euro zone, and Singapore, among other countries, by mid-2015. Even if inflation remains positive, it is likely to drop to very low levels, by historical standards.

Interest rates: central banks may respond to very low levels of inflation by reducing policy interest rates. However, this is unlikely to be very significant, because interest rates are already at very low levels in many countries, and furthermore monetary authorities will look at underly-

ing or core inflation when determining policy responses, rather than headline inflation, and core inflation is unlikely to fall as far or as fast as headline inflation. However, the anticipated increase in policy interest rates – particularly in the USA - in 2015, may be delayed as a result.

Balance of payments and exchange rates: the impact here will differ sharply between oil importers and oil exporters. The former will benefit from reduced spending on oil imports, and an improvement in the balance of payments. The opposite will apply to oil exporters. In some cases this will cause their exchange rates to weaken, and the plunging value of oil exports has already caused the value of the Russian rouble and the Nigerian naira to fall. Countries will sharply weaker exchange rates may prove to be the exception to the prediction of lower inflation, as the rising costs of imports in general offsets lower fuel prices.

Economic growth: in most countries, lower fuel prices will cause real incomes to rise. Furthermore, the redistribution of income from oil exporters (many of which are large savers) to oil importers (which tend to spend a higher proportion of national income) will provide an expenditure boost. Lower inflation and rising real incomes is expected by some commentators to cause economic growth to increase; JP Morgan, for instance, is anticipating global GDP growth to rise by 0.5% in 2015 as a result. However, this view is not universally shared. Other analysts consider that the depressed demand that has been one of the causes of lower oil prices will continue to dominate the global economy, and will not be offset by the impact of higher real incomes; the World Bank, for instance, has recently cut its forecast of global growth for 2015 to 3%, from 3.4%, and the IMF has cut its 2015 growth forecast by a similar amount.

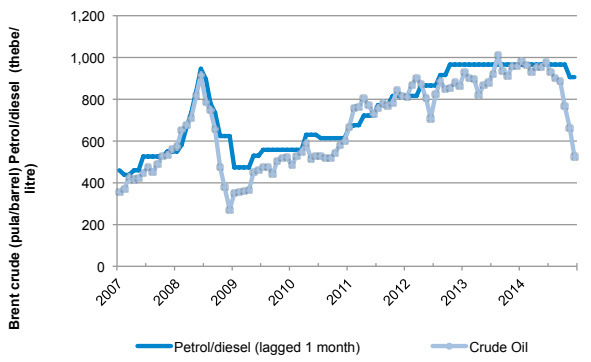
Government budgets: in some major oil producing countries government budgets are heavily dependent upon oil revenues, and they could be badly affected by lower prices, leading to reduced expenditures and/or budget deficits. Some countries have prudently built up reserves to cushion the impact of lower prices, and they will be in a stronger position. But countries that have not done so, and that have based their budgets on high price expectations, will be badly hit. There will be fiscal benefits, however, for countries that have high fuel subsidies.

How will these developments play out in Botswana?

There has already been a small impact, in that the (regulated) retail price of fuel has already been reduced. This has had an impact on inflation, and was a major reason for annual inflation falling to 3.8% in December. However, there is good reason to expect fuel prices to fall further. At the end of December the price of a barrel of crude oil was equivalent to P526 (and has since fallen further). The last time international fuel prices were this low (in pula terms) was in October 2010. At that time, the retail price of petrol was 605t per litre, compared with the current price of 900t per litre. Retail fuel prices are not just determined by the costs of crude – in addition the costs of refining, transport, storage, wholesale and retail margins, and taxes (levies) imposed to finance the Motor Vehicle Accident Fund, the Roads Fund and the National Petroleum Fund must also be taken into account. But there is no doubt scope to reduce retail fuel prices further, and quite substantially. This would cause inflation to drop even further, although it is unlikely to turn negative. Real incomes for many people would rise as a result, and the additional spending power will provide amodest boost to economic growth.

It is possible that lower inflation could lead to a monetary policy response in the form of lower interest rates; however, the Bank of Botswana is likely to pay more attention to core inflation – which is unlikely to drop significantly - than headline inflation in these circumstances[1]. Just as interest rates were not increased to fully reflect the sharp jump in headline inflation to 15% in mid-2008 as a result of higher fuel prices, they may not be reduced to reflect a temporary fall in headline inflation as a result of lower fuel prices.

Figure 2: Crude oil prices and retail fuel prices (Pula)



Source: Econsult, EIA

There will, however, be further benefits to the economy. Fuel is one of Botswana's largest single imports, accounting for 16% of total imports in 2013, at a cost of P8.8 billion. The majority of this represents the cost of petrol, diesel, paraffin, LPG imports etc.. Depending on how low fuel prices go and for how long, there could be savings of several hundred million Pula each month. This would improve the balance of payments and boost the foreign exchange reserves. However, this would have no direct effect on the exchange rate, given the Pula basket peg in operation.

What about prospects for future oil prices?

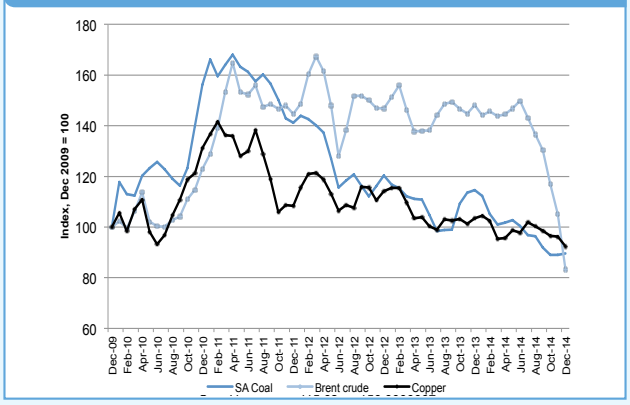
Certainly oil prices have fallen faster and further than most commentators expected, and it is difficult to call where the

[1] Core inflation measures underlying inflation trends, whereas headline inflation is also driven by short-term price volatility of some components of the CPI basket that may obscure underlying trends. Core inflation measures generally exclude items with high levels of price volatility, and by focusing on underlying inflationary pressures are more useful from a monetary policy perspective for central banks.

bottom might be. But we do expect prices to rise from current levels in the medium term. At some point, oil supplies will adjust, as loss-making high-cost producers exit the market – this might include some US shale gas producers, and deep-water offshore producers. Such supply reductions will push prices up. We expect oil prices to recover slowly back towards $70 a barrel.

However, as noted above, the current episode does not just involve oil prices, but includes other commodities too. Copper prices – one of the main indicators of industrial activity – have also reached their lowest level in more than five years. The reasons are similar to those for declining oil prices – rising supply and weak global demand. The price of nickel – widely used in steel production – has fallen by 50 percent from its peak over the past five years, although unlike oil and copper the price rose slightly during the year. Other energy prices have to some extent followed oil prices downwards. The price of South African export coal fell by 22% in 2014. Although the price declines of these commodities have been less abrupt than that of oil prices, the long-term trends are similar.

Figure 3: Copper, coal and oil prices



Source: Indexmundi (www.indexmundi.com)

Just as declining oil prices will disadvantage oil producing countries, declining commodity prices more generally will disadvantage commodity producers. This is where the broader impact on Botswana will be felt. A decline in the value of copper and nickel exports will, to some extent, offset the benefits from lower fuel import prices. Already, one copper mine (Boseto) has announced that it will close in the next few months unless there is a strong price recovery. Weak nickel prices will make it more difficult for BCL to make a success of its takeover of Tati Nickel and Nkomati Nickel.

Fortunately, diamonds have to some extent been spared the impact of declining commodity prices. Although information on diamond prices is not published in the same transparent manner as for almost all other mineral commodities, available information suggests that rough diamond prices rose slightly in 2014 – making diamonds one of the best performing mineral commodities.

The decline in coal prices is particularly problematic. As is well known, Botswana has very large coal deposits that have been earmarked for development as a major new export commodity. Planning for the Trans-Kalahari Railway (TKR) has been taking place to facilitate this. However, financing the TKR depends on the backing of mining companies with viable coal export plans. Indications from the TKR project consultants are that the project needs a coal price of at least $85 per tonne (fob) to make it viable. Back in 2012, the futures price of SA coal for delivery in 2018 was as high as $115, providing support for the TKR. By mid-2014 the price was down to $85, but it has since fallen further, to around $62. At these price levels, financing the TKR and developing a large-scale export coal industry will be difficult.

This does not mean that the falling price of oil has driven coal prices downwards – as Figure 3 shows, the decline in export coal prices has been going on for much longer than the weakness in oil prices. The prices of coal and oil are not highly correlated. However, they are to some extent driven by common factors – for instance the general move away from fossil fuel consumption, and the impact of weak global demand, will have a similar impact on both products.

As with recent announcements by oil companies that lower oil prices have caused them to put exploration and development projects on hold, lower coal prices will have a similar impact on coal projects around the world, particularly high cost ones.

Overall, low oil prices – and lower commodity prices more generally - will have a mixed impact on Botswana. Undoubtedly there will be a positive impact on inflation, with lower inflation boosting real incomes, expenditure and growth, at least in the short term. Fortunately, Botswana's main commodity export – diamonds – has not so far been significantly impacted by downward commodity price trends or concerns about global growth. But non-diamond mining has been negatively impacted by global growth concerns and price weakness, particularly base metals (copper and nickel) and coal, with investment in new projects likely to be reduced or postponed.

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