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ECONOMIC review

THIRD QUARTER JUL-SEP 2023

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COMMENTARY

Challenging times as GROWTH IS EXPECTED TO SLOW DOWN IN 2023

Introduction

The third quarter of 2023 has been characterised by a worsening of global economic conditions, with global growth forecasts revised downwards by the IMF, rising fuel prices, and the expectation that interest rates will remain "high for longer". This has impacted on the global diamond market, which has experienced a persistent weakening of demand through the year. Domestically, annual GDP growth has fallen, but remains in line with expectations. Inflation has risen, also as expected, and is likely to rise further in the coming months, driven mainly by global factors.

Economic Growth

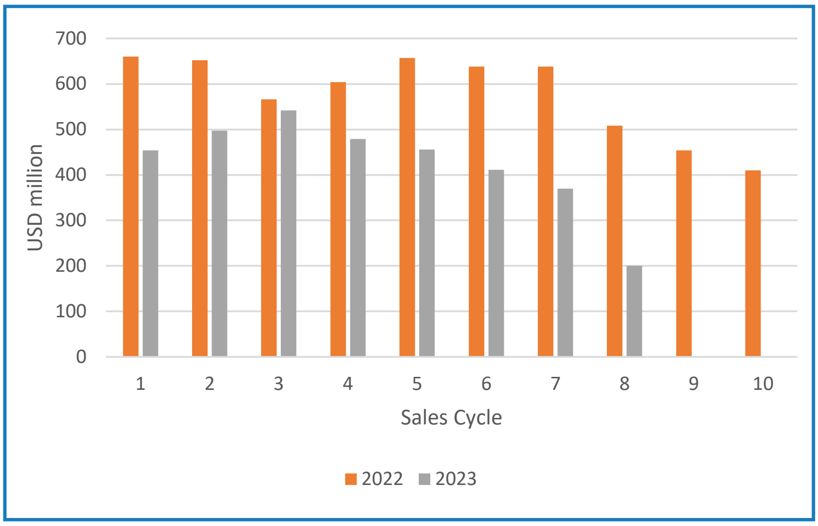
The IMF released its new World Economic Outlook (WEO) in early October, just after the end of the quarter. The IMF predicts a slowdown in global growth to 3.0% in 2023, down from 3.5% in 2022. Growth is projected to fall slightly further, to 2.9%, in 2024. Current and projected global GDP growth rates remain well below historical averages. The IMF notes that three factors are driving the slowdown in growth. One is the tailing off of the post-COVID economic recovery, particularly following the very strong 2022 recovery in travel and tourism. The second is the consequence of the tighter monetary policy implemented in most countries to bring inflation down, with tightening of credit conditions impacting on aggregate demand. Third, the impact of the commodity price shock following Russia's invasion of Ukraine persists, notably through higher energy prices, reducing real incomes in energy importing countries and of consumers generally.

To what extent have these factors had an impact on Botswana? Certainly economic growth is tailing off, with annual GDP growth down to 5.0% in Q2 2023, with a projected further decline to 3.8% for the year as a whole. However, the slowdown appears to be having a greater impact on sectors that have a domestic focus (such as agriculture, food manufacturing, wholesale and retail, and other domestic services). The main outward-facing sector that has experienced a severe slowdown is diamond trading (discussed more below). With regard to monetary policy tightening, Botswana is feeling the impact of global developments, but there has been no real domestic impact given that the Bank of Botswana has hardly tightened monetary policy while many other central banks have raised policy rates significantly. But Botswana has felt the impact of higher energy prices, which remain elevated despite some easing earlier in 2023, and there has been a squeeze on real incomes and living standards as a result.

Diamond Market

The major impact of adverse global conditions has been experienced in the diamond market. This has not yet fed through to diamond mining which, perhaps surprisingly, was up 7.1% in the 12 months to June 2023. This may just be "the calm before the storm", however. Diamond sales through DBGSS are down 31% over the first eight sales cycles of 2023 compared to the same period last year, and Okavango Diamond Company is experiencing similar pressures. It will not be possible to continue expanding mining with sales contracting, as the required stockpiling becomes increasingly expensive.

Figure 1: De Beers Sales Cycles, 2022-23.



Source: DBGSS

The global diamond market has been buffeted by multiple adverse factors during the year. Restrained consumer demand in the US, notwithstanding some resilience in the US economy, has been one factor, compounded by weak post-COVID recovery in China. Recent demand may have been impacted by a sharp increase in diamond prices in 2022, when demand was strong, but the industry is now paying the price. Synthetic diamonds are taking increasing market share, at much lower prices than natural diamonds. With slowing demand, downstream participants in the diamond value chain (cutters and polishers, traders, jewellery manufacturers and retailers) have all cut back on purchases as their stocks have risen, impacting rough diamond demand. As a result, De Beers have announced that sightholders would be permitted to defer up to 100% of their contracted purchases for the remainder of 2023 while Okavango Diamond Company cancelled its planned November auction.

Inflation and interest rates

After the sharp drop in inflation from its peak of 14.6% in August 2022 to 1.2% a year later, the increase to 3,2% in September was not unexpected. Fuel prices have been the main driver of changes in inflation over the past two years, in part because international oil prices have been so volatile, combined with their very high weight in the Botswana Consumer Price Index (CPI) basket. After the upsurge in oil prices caused by Russia's invasion of Ukraine, to over US$110 per barrel in June 2022, prices fell to just over $70 a barrel in March this year. The decline enabled pump prices to be reduced, leading to the dramatic fall inflation as the previous year's increases dropped out of the annual inflation calculation. In recent months, however, the deliberate actions by OPEC+ member states to restrict production and supply have pushed prices back over $90 per barrel, a selfish move seemingly calculated to put further pressure on households across the world who have already been badly impacted by the cost-of-living crisis.

In Botswana, regulated pump prices – which are determined under a highly politicised adjustment mechanism - have lagged the increase in global prices. For instance, the price increase in late October came about a month after the relevant increases in global prices. Following this increase, we expect inflation to continue to rise through to the end of 2023 and into 2024, when it is likely to temporarily go above the upper end of the BoB's 3-6% inflation objective range. This means that there is unlikely to be any reduction in the BoB's monetary policy rate (MoPR) in the near future.

Fiscal Developments

The Ministry of Finance's draft Budget Strategy Paper (BSP) was released in September, and provided updated information on the outturn of the 2022-23 budget, revisions to the current year (2023-24) budget, and the medium-term fiscal framework out to 2026-27. The fiscal data shows a continuation of recent trends, with an (unplanned) balanced budget for 2022-23; a (planned) deficit budget for 2023-24 and 2024-25, and a (planned) balanced or surplus budget for the outer years of the projections, which would mark the beginning of the NDP 12 period. There is a consistent story in the BSP which relates to the need for fiscal consolidation (discussed further in our special feature). In a parallel with Saint Augustine's famous prayer ("Lord, make me chaste, but not yet"), fiscal consolidation – in the form of a balanced or surplus budget – is always a year or two away. For instance, the BSP released in September 2022 projected a balanced budget from 2023/24 onwards. However, the September 2023 BSP now indicates a balanced budget two years later, from 2025/26 onwards. This largely reflects the dramatic increase in development spending first proposed in the 2023 Budget for 2023/24 and set to be continued in subsequent years.

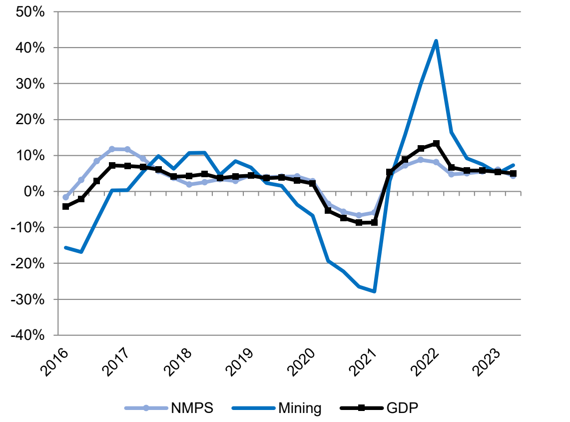
That relates to planned budgets. Outturns are quite different. In both 2021/22 and 2022/23 large projected deficits did not materialise, and in both years, budgets were broadly balanced, due mainly to significant underspending on the development budget, along with higher-than-expected mineral revenues. Notwithstanding a large (47%) planned increase in development spending in the current fiscal year, it seems quite possible that, as in the last two years, the development budget will be underspent and the budget will end up being broadly balanced – although there may be risks on the revenue side if the diamond market continues to deteriorate. Even though the outcomes are good (balanced budgets), the fact that these are unplanned reflects negatively on the quality of fiscal planning and budgetary control.

Outlook

The rest of 2023 and early 2024 looks likely to be an uncertain and somewhat challenging time for the economy. The main concern is the depressed state of the global diamond market, and the potential impact on economic growth, exports and government revenues – although it is important to note that no negative impact on these important economic indicators has yet been realised. The likelihood that inflation will rise in the coming months means that domestic interest rates are likely to be maintained – at levels that are low by international standards – for the foreseeable future. Projections of adverse climatic conditions in the coming months – with forecasts of higher temperatures and lower rainfall – are likely to have a negative impact on agriculture, water supplies and tourism, and illustrate the longer-term challenges posed by global climate change. Fortunately, Botswana's critical financial buffers – in the form of the Government Investment Account at the BoB and the foreign exchange reserves – have been rising, assisting the ability of the economy to withstand possible shocks, at least in the short term.

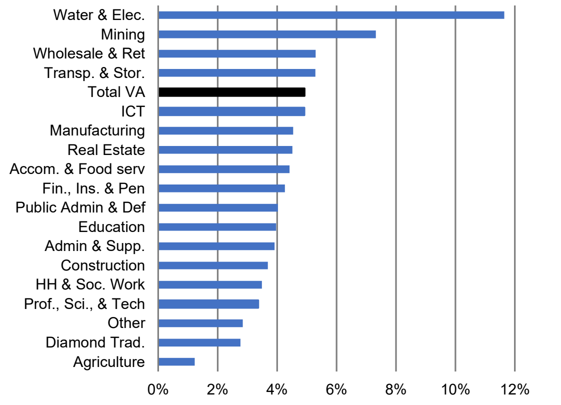
KEY ECONOMIC VARIABLES

ANNUAL GDP GROWTH



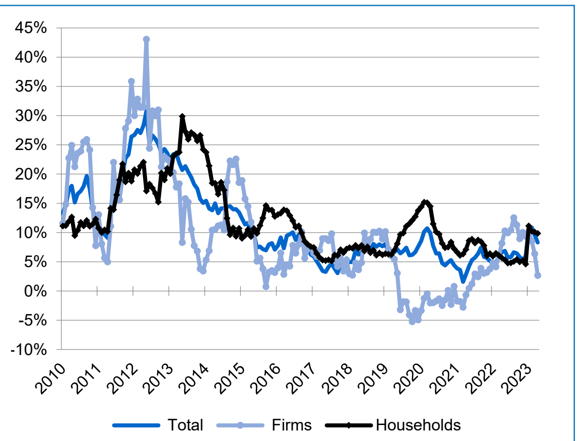
The Botswana economy continued to slow during the second quarter of 2023, partly because of the slowing global market for rough diamonds. Annual GDP growth in June was 5.0%, down from 5.5% registered in Q1 2023. This is attributable to the slowdown in non-mining private sector (NMPS) growth to 4.3% y-o-y, down from 6.0% y-o-y in Q1 2023, significantly impacted by the fall in diamond trading during the period. In contrast, mining sector growth picked up during the quarter. Annual mining sector growth was 7.5% in Q2 2023, up from 5.0% in Q1 2023. Along with weakened global market for diamonds, the fall in annual GDP reflect the effects of higher growth in 2022 falling out of the GDP calculations.

ANNUAL SECTORAL GROWTH



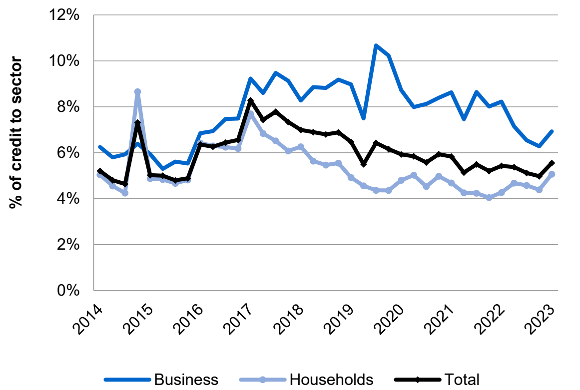
Economic performance during Q2 2023 was fair, with some sectors recording marginal declines in growth while others improved, but with all sectors recording positive annual growth. Economic sectors that had significant improvement between Q1 and Q2 2023 were Mining and Finance, Insurance & Pension Funding. Mining improved from 5.0% y-o-y to 7.5% y-o-y and Finance, Insurance & Pension Funding increased to 4.3% y-o-y up from 2.9% y-o-y, in Q1 and Q2 respectively. Diamond Traders and Water & Electricity sectors fell substantially to 2.8% y-o-y and 11.6% y-o-y from 26.1% y-oy and 51.5% y-o-y, during the period.

ANNUAL CREDIT GROWTH



Annual bank credit growth rose marginally to 10.6% y-on-y in July 2023, up from 8.3% y-on-y in April. The increase in credit growth is attributable to credit to households, with growth up from 9.9% y-on-y in April 2023 to 10.2% y-on-y in July. Mortgage loans increased significantly over the period, by 40.1% y-o-y, reflecting mainly the inclusion of mortgage loans from BBS bank since it became a licensed commercial bank. On the other hand, growth of credit to firms decreased significantly to minus 1.5% y-o-y in July 2023, from 2.7% in April 2023. This is the first time that annual credit growth to the private sector has been negative since April 2021. This subdued growth is worrying especially for achieving private sector led growth. The inclusion of BBS bank in the data with effect from January 2023 adds an estimated 4-5% to annual credit growth, so the underlying credit growth remains quite low.

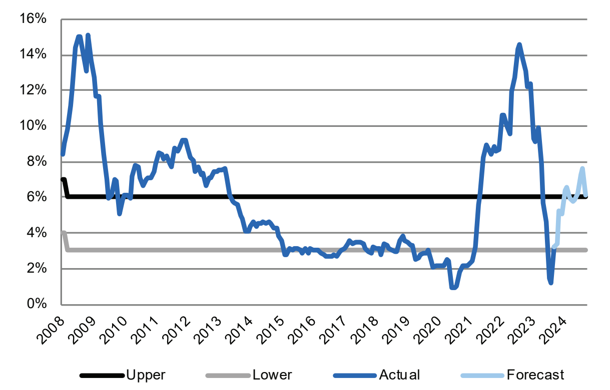
ARREARS ON BANK LENDING



Total arrears as a proportion of outstanding bank credit fell during the second quarter of in 2023. Arrears on lending decreased from 5.6% in March 2023 to 5.0% in June 2023, with the decline apparent across all sectors. Arrears on lending to households fell to 4.7% in Q2 2023 from 5.1% in Q1 2023, and arrears on lending to businesses fell to 6.7% from 6.9% during the same period.

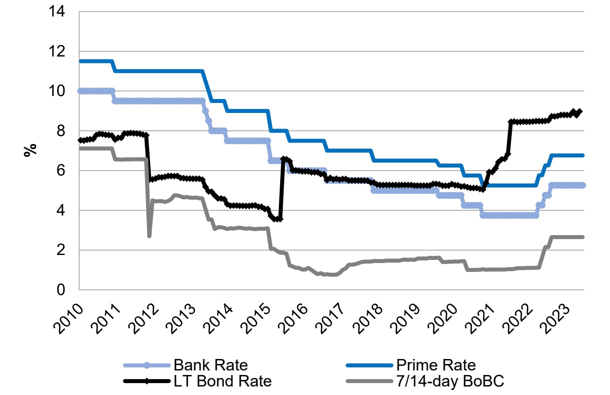
KEY ECONOMIC VARIABLES

INFLATION AND FORECAST



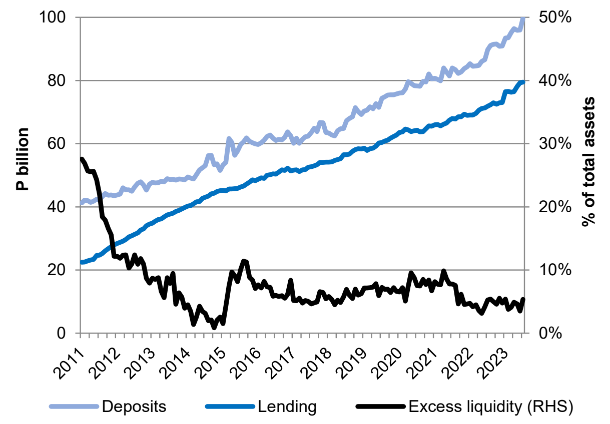
In line with forecasts, annual inflation in September 2023 was 3.2%, up from 1.2% in June 2023. Inflation is forecast to gradually increase during the final months of the year. Notwithstanding the increase in headline inflation, there was a welcome decrease in core inflation (excluding administered prices) by 1.9% to 5.2%. Group indices were generally stable between the two quarters except for Transport, which rose because of the increase in local fuel prices in September 2023. Nevertheless, food prices remain the largest single contributor to overall inflation. Inflation is expected to rise temporarily above the BoB's objective range in the first half of 2024, due to recent and expected further increases in fuel prices.

INTEREST RATES



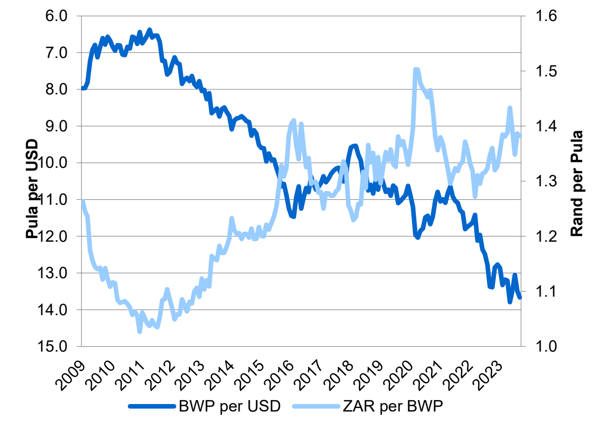
The Monetary Policy Committee (MPC) maintained the Monetary Policy Rate (MoPR) at 2.65% in August 2023, because of the positive medium-term inflation outlook. Commercial banks have also not changed their Prime Lending Rate, which remained unchanged at 6.76%. The 7/14-day BoBC rate was unchanged at 2.65% in Q2 2023 while the long-term government bond rate (BW012) decreased to 8.95% in August 2023 from 8.98% in May 2023. However, there may be pressure on the MPC to consider an increase in rates in the months ahead, given the expected sharp increase in inflation and the fact that monetary policy has been looser in Botswana than in all other countries in sub-Saharan Africa

BANK DEPOSITS, LENDING & LIQUIDITY



Bank liquidity increased in July 2023, to 5.3% up from 4.9% in April. Liquidity increased because of a faster rise in bank deposits than in lending. Bank deposits in July were valued at P99.7 billion, up by 3.4% from P96.4 billion in April, while lending increased by 3.9% to P79.5 billion over this period. The level of liquidity in the banking sector indicates that banks have a considerable amount of loanable funds available to extend credit in the market.

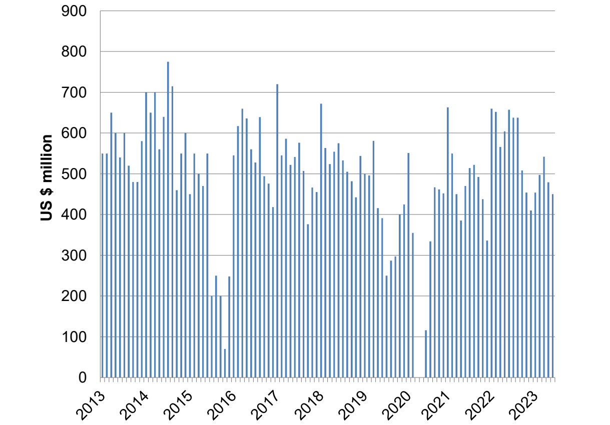
EXCHANGE RATES



Foreign exchange markets were much calmer in the third quarter of 2023, registering less volatility than in the previous quarter. The Pula weakened against the US dollar and strengthened against the rand during the quarter. The Pula-US dollar rate depreciated by 0.7% to end the quarter at BWP13.66 per USD, while appreciated against the rand by 1.3% with an exchange rate of ZAR1.382.

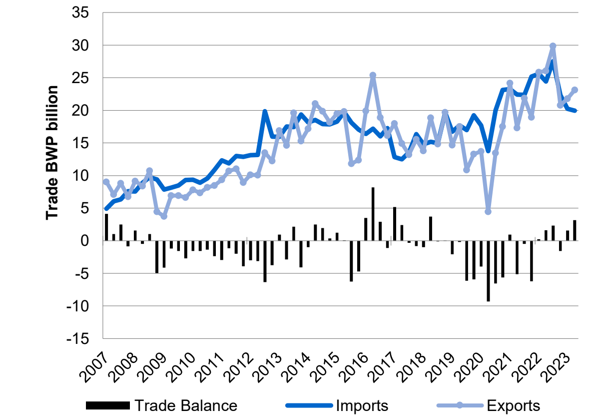
KEY ECONOMIC VARIABLES

DE BEERS DIAMOND SALES



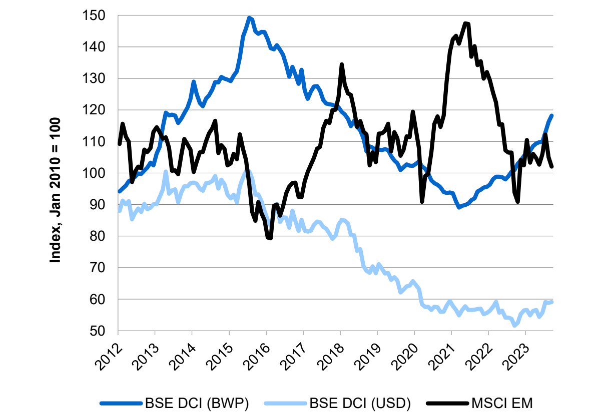
The global market for rough diamonds continues to experience a tough 2023, with weaker demand for diamonds combined with low prices and increased competition from synthetics. De Beers Global Sightholder Sales (DBGSS) were 15.9% lower in the two sales cycles held in Q3 2023, recording sales valued at USD781 million, down from USD929 million in Q2 2023. DBGSS sales fell further in the eighth sale cycle to a provisional sales value of USD200 million, the lowest since 2020 when the Covid-19 pandemic hit. Activity through the diamond value chain is sluggish, with excess stocks and limited purchasing by traders, cutting and polishing firms, jewellers, and retailers.

INTERNATIONAL TRADE



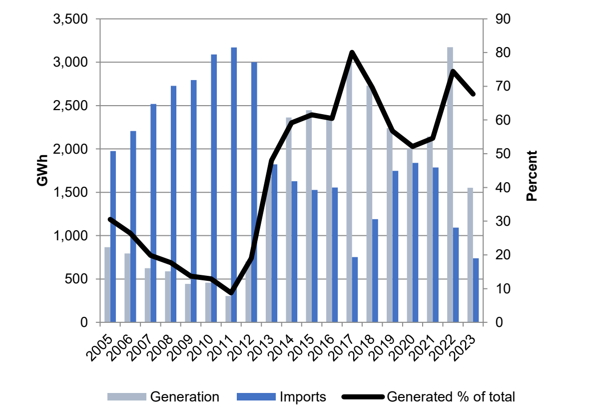
Trade performance continued positively in Q2 2023. Total exports increased by 6.2% to P23.14 billion in Q2 2023, up from (a relatively poor) P21.79 billion in Q1. Total imports fell during the quarter, by 1.3% to P19.96 billion, down from P20.23 in Q1. The changes were mainly driven by diamonds, with higher exports in Q2 than in Q1 and lower diamond imports. The greater value of exports compared to imports resulted in a trade surplus of P3.17 billion in Q2 2023, significantly increasing from a surplus of P1.56 billion registered in Q1 2023. Notwithstanding the improvement in exports, they remain well below the record figures of well over P25 billion achieved in each of the first three quarters of 2022.

STOCK MARKETS



The Botswana Stock Exchange (BSE)'s Domestic Companies Index (DCI) outperformed international market indices during the third quarter of the year. The BSE DCI rose by 7.5% and 6.1% in Pula and USD terms, respectively. The DCI has been performing strongly in the first nine months, recording higher trading volume. International markets fell during the period, with the MSCI Emerging Markets Index declining by 3.7% and the MSCI World Index declining by 3.8%.

ELECTRICITY



Domestic generation of electricity declined between Q1 and Q2 2023. Total electricity generated was 660.3 GWh in Q2 2023, down from 890.7 GWh in Q1 2023, representing a decrease of 25.9% between the quarters. This was due to worsening operational challenges at the Morupule B power plant. Total electricity consumed during the same period fell by 3.5% to 1,125.0 GWh, down from 1,165.6 GWh consumed in Q1 2023. Conversely, the volume of imported electricity during the same period rose significantly by 69% to 464.6 GWh, up from 275.0 GWh in the previous quarter. Imports increased to 41% of total consumption in Q2. The main source of imports was Zambia (46% of total imports), followed by Mozambique (33%).

NEWS HIGHLIGHTS

3rd July	De Beers commits billion pula upfront to diamonds-for-development in Botswana. (Engineering News)	The De Beers Group has committed P1 billion upfront to fund economic diversification within Botswana through the proposed Diamonds for Development Fund. The focus will be on agriculture, climate change, solar development, and tourism.
3rd July	Diamond Industry Experts Hail Botswana-De Beers Deal. (AllAfrica)	Diamond industry experts have hailed the signing of a 10-year diamond sales agreement between the De Beers Group and the Botswana government. The agreement between the two parties has been anxiously awaited by industry players, given De Beers' role in the marketing of natural diamonds and Debswana's role as one of the of the largest diamond mining companies in the world. According to experts, the agreement will ensure a stable supply of rough diamonds as well as stability in the global market.
5th July	De Beers, Botswana Poised to Partner on High-Value Diamonds. (Rapaport News)	The new sales agreement gives De Beers' and the Botswana Government an opportunity to partner on exceptional diamonds. Under the current deal, De Beers and the Government have rotating access to special and exceptional stones. This will remain the case under the new system, but De Beers will offer the government more partnerships on an optional basis. According to De Beers, this arrangement was already there, although it was not formalised. Moreover, there was no uptake when De Beers occasionally offered them to the Government.
13th July	Giyani announces 310% increase in indicated mineral resources for K. Hill project. (GlobeNewswire)	Giyani Metals Corp., developer of the K. Hill battery-grade manganese project in Botswana, has announced an updated Mineral Resource Estimate (MRE) for K. Hill. The updated data indicated 310% increase in Indicated Mineral Resource to 8.6 million tonnes, with approximately 3.1 million tonnes (Mt) of contained High Purity Manganese Sulphate Monohydrate (HPMSM) equivalent, before processing recoveries are applied, and 97% increase in Inferred Mineral Resources to 6.1 Mt with approximately 2.1 Mt of contained HPMSM equivalent, before processing recoveries are applied. Based on the new MRE, the K. Hill project has a potential project life of more than 25 years. The company is currently preparing a preliminary economic assessment based on the new MRE.
16th July	Botswana sees a huge jump in sovereign fund. (Sunday Standard)	Total foreign assets were valued at P64.9 billion in April 2023, an increase from P55.9 billion balance in March 2023. Over a 12-month period, foreign reserves increased by 15.3% from April 2022. The Pula Fund, which accounts for a large portion of foreign reserves, rose to P47.7 billion. The Government Investment Account (GIA), which represents the Government's share of the Pula Fund, jumped from to P18 billion, up from P15.5 billion in April 2022.

NEWS HIGHLIGHTS

25th July	Botswana doubles planned capacity of power plant to be built by India's Jindal. (Reuters Africa)	Jindal Steel and Power Ltd has been awarded yet another three hundred megawatt (MW) coal-fired power plant contract by the Botswana Power Corporation, bringing the company’s planned coal-fired power plant to 600 MW. Jindal Steel and Power was first awarded a contract for a 300MW coal-fired power plant in 2022. Production is expected to begin in 2028 and it is anticipated that the project will contribute to energy security. There are also hopes that once the domestic market is secured excess power will be supplied to regional countries.
27th July	De Beers earnings slide in challenging first half. (Rapaport News)	According to De Beers Diamond Company, results for the first six months of the year revealed lower earnings when compared to the same period in 2022. Underlying EBITDA recorded in H1 2023 was USD5.11 billion, falling from USD8.70 billion in H1 2022. Revenues fell by 13% to USD15.67 billion, down from USD18.11 billion recorded in H1 2022.
31st July	Botswana, South Africa seek funds for $230m minerals line. (Mining Weekly)	State-owned rail companies from Botswana and South Africa are seeking funding for a P3 billion (USD230 million) railway line between the two countries to transport commodities including coal. The Mmamabula-Lephalale link will run for 113 km and have a capacity of 24-million tonnes a year. It will connect to existing routes to South Africa’s Richards Bay and the Maputo port in Mozambique — both key export terminals for bulk minerals.
4th August	Botswana plans extra diamond sales route after De Beers deal. (Reuters)	The Okavango Diamond Company (ODC) is planning to diversify how it sells precious stones to the market as it gears up to receive more rough diamonds supply from Debswana under the new sales deal with De Beers. Currently, ODC receives 25% of the gems produced by Debswana, which are sold via open tender model.
17th August	Sefalana’s revenue reaches P9.1 billion. (Weekend post)	Sefalana Group has recorded strong financial results for the year ended 30 April 2023. The Group recorded revenue of P9.1 billion, up by 21% from P7.5 billion recorded in the previous year. Earnings before interest, tax, and amortization (EBITA) were P412 million, up by 27%, while profit before tax was P403 million, representing an increase of 21%. The company stated that during the financial year, there was continued recovery from the effects of the pandemic.

NEWS HIGHLIGHTS

18th August	Copper sales climb beyond BCL-era levels. (Mmegi)	Local copper exports continue to ride the wave of growing international prices, with sales in the first quarter of 2023 reaching P1.4 billion. Copper exports have been gradually increasing since Q3 2021 attributable to opening of new copper mines and high copper prices in recent years.
22nd August	Banking industry performance in 2022 was satisfactory – BoB. (Sunday Standard)	According to data from the Bank of Botswana, the banking industry was profitable in 2022, with net after-tax profit increasing by 49.5% to P2.7 billion for the year, up from P1.8 billion in 2021. The growth in the net after-tax profit was driven by an increase in net interest income from loans and advances. Loans and advances, which constituted 62.6% of banking industry assets, rose by 6.2% to P73.2 billion in December 2022, up from P68.9 billion in December 2021.The commercial banks assets also improved as non-performing loans (NPLs) decreased by 6% from P2.9 billion to P2.7 billion in the same period. Total assets increased by 7.7% from P108.6 billion in December 2021 to P117 billion in December 2022.
22nd August	Lucara unearths 692 carats rough at Karowe. (Rapaport News)	Lucara Diamond Corp. continues to recover large diamonds at its Karowe diamond mine. It has recovered diamonds weighing 692.3 and 1,080.1 carats diamonds in August 2023. According to Lucara, the continuous recovery of large diamonds cements expectations for the underground expansion project.
24th August	New buyer emerges after Pula Steel sale flops. (Mmegi)	Sherashiya Pty Ltd, a firm established by Indian mining investors, is finalising the purchase of Pula Steel and plans to resuscitate the Selebi Phikwe plant before the end of 2023, following the collapse of a previous takeover attempt by local iron ore producer, Vision Ridge. Pula Steel closed in 2017, just two years after it was built at a cost of P130 million, strained by financial and technical challenges, particularly the shortage of its raw material, scrap metal.
30th August	De Beers' August Sight Yields Lowest Sales This Year. (Rapaport News)	De Beers' global sightholder sales in August 2023 recorded the lowest sales value for the year registering sales of USD370 million. This compares with the USD638 million sales value recorded in the same period in 2022 and USD411 million in July 2023. According to the company, the global rough diamond market continues to experience softer demand for diamonds and lower diamond prices.

NEWS HIGHLIGHTS

6th September	Three Chinese Groups vying to acquire $2 billion Botswana Copper Mine. (Bloomberg)	Three prominent Chinese groups have emerged as leading contenders to acquire the Khoemacau copper mine, with the potential transaction estimated to be worth around USD2 billion. Similarly, two South African companies have also advanced to the second round of bidding.
7th September	IMF doubles down on Botswana's fiscal structure. (Sunday Standard)	In the just concluded Article IV consultation with Botswana, the International Monetary Fund (IMF) Executive Board advised Botswana to forge ahead with fiscal consolidation, through improving revenue measures and cutting down on expenditure. The Board noted the country's prudent macroeconomic policies and strong recovery from the pandemic but highlighted the continued decline in external and fiscal buffers and the expected depletion of diamond reserves in coming decades. The Board cautioned about the planned fiscal expansion citing issues of inflation and the need to rebuild fiscal buffers and welcomed the 2023 Botswana's Financial Sector Assessment Program (FSAP) noting that the financial system stability assessment (FSSA), appears broadly sound, stable, and resilient to a wide range of shocks. The IMF underscored the importance of advancing structural reforms to promote economic diversification and private sector development, thereby boosting growth and employment potential, and reducing inequality. Policy priorities and recommendations for Botswana included, trade facilitation and integration, comprehensive State-Owned Enterprises (SOE) reforms, improving the business environment, enhancing climate change resilience, implementing the digitalization strategy, and more targeted support for high-productivity, export-led sectors.
12th September	Orange's N'stakolle loans surpass P1.5 million. (Mmegi)	Orange Botswana says the growth in its innovative product, N'stakolle Loan Service, which allows customers to borrow short-term cash through Orange Money, showed demand in the market. According to the company, through its latest digital nano loan offering Orange Money N'stakolle Loan Service, it has disbursed loans exceeding P1.5 million. Hence, this achievement is a testament that the product addresses a market opportunity for low-value loans. The N'stakolle has loan amounts ranging from P20 to P2,000 and the interest on loans ranges from 7.5% and 12.5% depending on the tenure of the loan which each customer chooses, the options for which are 3, 7, 14, 21 and 30 days.
15th September	FNBB's profits reach P1.4 billion. (Mmegi)	First National Bank Botswana (FNBB), has recorded P1.4 billion in profit before tax for the year ended 30 June 2023, representing an 18% increase from the year. The bank recorded higher profit because of a healthy post-COVID-19 loan book and economic recovery from the pandemic.

NEWS HIGHLIGHTS

15th September	Sandfire raises financing facility to expand Motheo mine. (Mining Technology)	Sandfire Resources has increased its financing facility from USD140 million to USD200 million to support the expansion of its Motheo mine in the Kalahari copper belt in Botswana. The expansion will see processing capacity increasing from the present rate of 3.2 million tonnes per annum (mtpa) to 5.2mtpa by the end of December 2024. In August 2023, Sandfire Resources was granted an extension of mine license at Motheo copper mine.
21st September	Pension funds rebound in H1. (Mmegi)	The value of assets collectively held by Botswana's pension funds rebounded from losses in 2022, to reach P130.5 billion by June 2023, an increase of P12.5 billion compared to December 2022. Pension funds in Botswana, which are partially invested offshore, endured a trying 2022 with much of the losses associated with downtrends in global giants such as Meta, Apple, Amazon, Netflix, and Google, the global tech giants. Global markets have held steady this year, while returns on local government bonds have continued a general upswing. The Botswana Stock Exchange, the primary vehicle for pension funds' local investments, has enjoyed a strong year with growth of 4.2 percent in the first six months, compared to 2.5 percent over the same period last year.
22nd September	KGK to produce diamond jewellery with Mupane's gold. (Mmegi)	KGK Diamonds Botswana, a De Beers' sightholder boasting the country's largest jewellery plant, has sealed an arrangement with Mupane Gold Mine, under which gold produced in the country will be worked into locally made diamond jewellery. KGK Diamonds Botswana opened its doors in Botswana in 2014 with a focus on cutting and polishing rough diamonds, before launching its jewellery plant in January 2023.
26th September	BSE equity turnover reaches P753.9 million. (Weekend post)	The Botswana Stock Exchange (BSE) market performance update showed that 270.8 million shares worth P753.9 million were traded in the local equity market in the period from 1 January 2023 to 31st of August 2023. According to the update, the top three traded companies during the period under review were Letlole La Rona (P158.8 million), Chobe (P136.0 million) and Sechaba (P119.0 million), accounting for 54.9% of the total equity turnover.

NEWS HIGHLIGHTS

27th September	Lucara Diamond Announces Termination of Diamond Sales Agreement. (Junior Mining Network)	Lucara Diamond Corp. has announced the termination of the Diamond Sales Agreement between Lucara Botswana (Proprietary) Limited and HB Trading BV ("HB"). This follows a material breach of financial commitments by HB. Lucara noted that it will continue to use its established mechanisms to sell Karowe's rough diamond production, namely through its Clara diamond sales platform, traditional tenders, and other value-added mechanisms for stones.
28th September	Botswana reassessing HB Antwerp deal after Lucara Diamond cuts ties. (Reuters Africa)	President Mokgweetsi Masisi noted that the government is reassessing the proposed deal with HB Antwerp to purchase 24% shares in the company as well as supplying it with rough diamonds through Okavango Diamond Company. The statement comes after Lucara Diamond announced that it has terminated its sales agreement with HB Trading BV, a unit of HB Antwerp, citing financial irregularities.
28th September	Tsodilo welcomes positive court outcome in Botswana. (Mining Weekly)	The High Court of Botswana has rendered an order that interdicts and restrains the Minister of Minerals and Energy – through the Department of Mines or any other department – from receiving, considering, or assessing the renewal applications in relation to prospecting licences (PLs) 021 to 024/2018 held by Tsodilo Resources company. Tsodilo Resources company argued that the Mines and Minerals notes clearly that it is the discretion of the licence holder to determine which areas to retain and which areas to relinquish.
29th September	ODC sales drop 60% as diamond downturn deepens. (Mmegi)	Okavango Diamond Company's (ODC) revenues in the first six months of 2023 dropped by 60% when compared to the same period last year, as the rough diamond industry experiences a sharp downturn. The global market is experiencing a tough time in 2023, where sales, prices and revenues have fallen sharply because of high inventory levels of polished diamonds in the midstream.

MACRO-ECONOMIC DATA

Key Economic Data	unit	2017	2018	2019	2020	2021	2022	2023Q1	2023Q2	2023Q3
Annual Economic Growth										
GDP	%	4.1	4.2	3.0	-8.7	11.9	5.8	5.5	5.0	..
Mining	%	6.3	8.4	-3.7	-26.5	29.8	7.5	5.0	7.3	..
Non-mining private sector	%	3.7	2.9	4.2	-6.7	8.8	5.5	6.0	4.3	..
GDP current prices	P bn	166.65	173.73	179.90	171.39	207.74	251.73	66.9	70.3	..
GDP 2016 prices	P bn	171.18	178.35	183.76	167.72	187.63	198.48	52.3	50.5	..
Money & Prices										
Inflation	%	3.2	3.5	2.2	2.2	8.7	12.4	9.9	4.6	3.2
Prime lending rate	%	6.50	6.50	6.25	5.25	5.25	6.76	6.76	6.76	6.76
BoBC 7/14-day	%	1.45	1.52	1.41	1.04	1.10	2.65	2.65	2.65	2.65
Trade & Balance of Payments										
Exports - total goods	P bn	61.67	67.17	56.33	49.12	82.28	102.51	21.79	23.14	..
Exports - diamonds	P bn	54.38	60.41	51.01	43.30	74.13	89.22	17.43	..	..
Balance of payments	P bn	-4.28	-4.20	-12.02	-20.06	-2.87	4.49	-1.70	..	..
Foreign Exchange										
Exchange rate BWP per USD	end	9.87	10.73	10.63	10.79	11.74	12.77	13.18	13.48	13.66
Exchange rate ZAR per BWP	end	1.256	1.344	1.330	1.356	1.355	1.328	1.381	1.392	1.382
FX reserves	$ bn	7.502	6.657	6.171	4.941	4.806	4.22	4.29	4.89	..
FX reserves	P bn	73.69	71.43	65.23	53.36	56.02	54.53	55.89	66.11	..
Financial Sector										
Deposits in banks	P bn	63.58	69.27	75.71	80.54	84.36	90.93	95.18	99.71	..
Bank credit	P bn	54.18	58.33	62.77	65.55	68.92	73.05	76.27	79.23	..
BSE index		8,860	7,854	7,495	6,879	7,010	7,726	7,954	8,055	8,662
Business Indicators										
Diamond production (a)	mn cts	22.96	24.38	23.67	16.87	22.70	24.48	6.99	5.92	..
Copper production (b)	'000t	1.24	1.46	0.00	..	11.74	34.20	14.87	16.03	..
Electricity consumption	GWh	3,772	3,919	3,906	3,842	3,928	4,265	1,166	1,125	..
Crude oil (Brent)	$/bar	66.73	50.57	67.77	51.22	77.24	82.82	79.19	74.51	95.86
Employment (formal) (f)										
Government		129,009	156,785	156,785	152,973	152,225	143,022			
Parastatals		19,444	23,497	23,497	18,933	21,056	18,674			
Private sector		193,745	250,778	227,281	250,715	268,086	257,618			
Total		342,198	431,060	407,563	422,621	486,432	494,457			

Govt Budget		2019/20	2020/21	2021/22	2022/23 Preliminary (d)	2023/24 Revised (e)	2024/25 Projection (e)
Revenues	P bn	54.30	49.37	68.57	74.10	81.67	83.69
Spending	P bn	65.40	65.79	68.68	74.09	87.38	88.78
Balance	P bn	-11.10	-16.41	-0.11	0.01	-5.71	-5.09
Public debt & guarantees	P bn	38.18	42.37	49.81	58.28	58.95	59.53
Govt deposits at BoB	P bn	19.86	6.20	12.82	14.02	..	..
GDP	P bn	180.94	171.91	216.76	259.75	284.71	308.31
Revenues	%GDP	30.0%	28.7%	31.6%	28.5%	28.7%	27.1%
Spending	%GDP	36.1%	38.3%	31.7%	28.5%	30.7%	28.8%
Balance	%GDP	-6.1%	-9.5%	0.0%	0.0%	-2.0%	-1.6%
Public debt & guarantees	%GDP	21.1%	24.6%	23.0%	22.4%	20.7%	19.3%
Govt deposits at BoB	%GDP	11.0%	3.6%	5.9%	5.4%	..	

Sources: BoB; MFED; Statistics Botswana; Department of Mines; CIPA; BSE; US Energy Information Administration; Bloomberg; Econsult

Notes:
(a) Figures include production from Lucara Diamonds (Karowe mine) and Debswana. In 2016 and 2017, figures also include production from Gem Diamonds (Ghaghoo) and Lerala mines. (no longer operational)
(b) Copper production starting Q2 2017 for Mowana mine and Q2 2022 for Khoemacau
(c) Numbers in Italics reflect revisions from the previous review.
(d) Preliminary budget outturn for 2022/23
(e) Budget forecast/MTFF
(f) Employment figures up to 2018 are not comparable with those from 2019 onwards due to changed methodology of data collection and reporting

Structural Reforms for NDP12
PROPOSALS FROM THE IMF AND BANK OF BOTSWANA

Introduction

Botswana is now one-quarter of the way through the Transitional National Development Plan (TNDP) period, which runs from April 2023 to March 2025. Work has now started on the preparation of National Development Plan 12 (NDP 12), which will commence in April 2025. NDP 12 is one of two Plans that will take the country to 2036, a critical date given the ending of Vision 2036, which has provided an overarching long-term development framework since 2016.

Vision 2036 has a wide range of objectives, but one of the most important and widely-known of them is that of becoming a High-Income Country (HIC) by 2036. This requires a significant increase – a near doubling - in Gross National Income per capita (GNIpc), to reach the World Bank HIC threshold of US$13,205 (for 2023), compared to Botswana's actual GNIpc (in 2021) of $6,610. Botswana's recent economic growth rates have been far below the rate required to achieve the HIC target, and hence a significant increase – approximately a doubling of the growth rate of real GDP per capita – is required. In other words, "Business as Usual" will not achieve HIC status by 2036. As has been widely acknowledged, there needs to be structural change in the drivers of economic growth in order to achieve the target within the next 13 years. The required structural change will need to be central to NDP 12.

In recent months, two important economic assessments have been produced that address the issue of the structural change required. The first is the Bank of Botswana's 2022 Annual Report, and the second is the IMF's 2023 Article IV Report on Botswana. The BOB 2022 AR Theme Chapter is entitled "Building Economic Resilience: Fiscal, External Sector Sustainability and Climate Change Resilience". The IMF report has a key section entitled "Policies to Support Macroeconomic Resilience", with discussions on Fiscal Policy, Monetary and Exchange Rate Policy, Financial Sector Policies, and Structural Reforms: Transforming Botswana's Growth Model.

These two reports cover a range of issues associated with the structural change required to increase the trend rate of economic growth sufficiently to achieve High-Income status. In this special feature, we discuss three of the issues common to both reports that are critical components of structural change. These are (i) achieving export-led growth; (ii) fiscal reform; and (ii) reform of state-owned enterprises.

Export-led growth

The term "export-led growth" has been frequently put forward as an economic growth strategy in recent years. What does it mean? It essentially refers to an industrialization and development strategy where a desired increase in real GDP (and employment) is significantly driven by rapid expansion of exports of goods and services, which provide the basis for the growth of aggregate demand and output in an economy. An export-led growth strategy is by definition outward-looking, as it involves increased trade and integration into regional or global value chains. An export-led growth strategy can be contrasted with one based primarily on the growth of domestic demand, which is often associated with import-substitution and an inward-looking approach to industrialization.

There are several arguments for the pursuit of an export-led growth strategy. One is that this is the path almost universally followed by countries that have reached high-income status in recent decades. Second, Botswana has a very small domestic economy that cannot generate the demand needed for sustainable income growth. As the BoB notes, "any inclination towards focus on "targeted production and service provision" for the domestic market (inward-looking strategy) cannot generate the requisite 6 percent and above annual GDP growth necessary to transition to high-income status and realisation of the Vision 2036 goals in the next 13 years" (para 4.20).

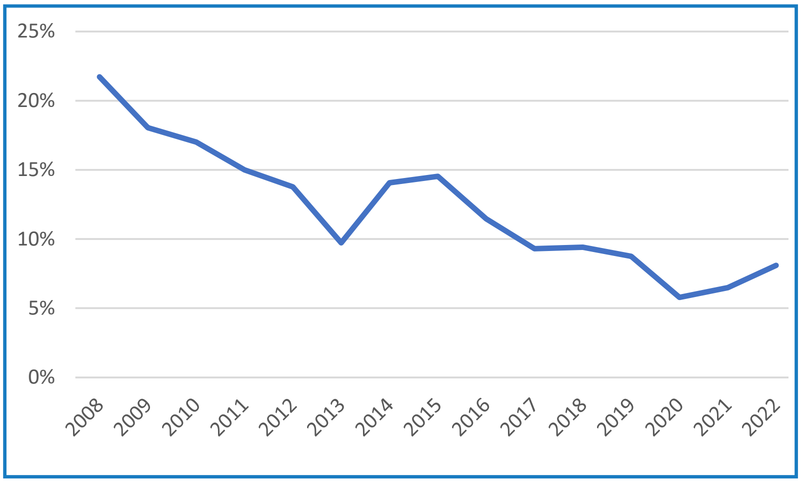
However, an export-led growth strategy is not just about the drivers of GDP and employment growth, it is also about external sustainability (one of the themes of the BoB chapter). This refers to the balance of foreign currency inflows and outflows that make up the balance of payments, and in particular having sufficient inflows (from exports, transfers and financing items) to cover external obligations (for imports, debt repayment etc.) without building up unsustainable external liabilities. Typically, exports are the largest single source of inflows, and hence they play a critical role in ensuring external sustainability.

An export-led growth strategy has numerous other anticipated advantages. Because export markets are competitive, export success by definition depends on competitive production of goods and services, which in turn drives productivity and efficiency (the main long-term drivers of real income growth). By contrast, an inward-looking strategy, based on protection, shields firms from competition and encourages inefficiency. Export-led growth is typically associated with foreign direct investment (FDI), which brings capital inflows and access to skills, technology, and markets. Hence, there are numerous spin-off benefits of an export-led growth strategy. The BoB also notes that "an export-led growth strategy is fundamental in generating resilience and external stability" (para 4.11).

In some respects Botswana has always followed an export-led growth strategy, based around the export of diamonds. But this is not a sustainable forward-looking strategy, not least because diamond production has plateaued and will in due course (currently expected around 2050) come to an end. And while diamond exports have helped GDP growth and external sustainability, they have not contributed significantly to employment creation (other than indirectly by financing public sector employment), as diamond mining is highly capital intensive. The challenge then is to increase and diversify exports into other minerals, manufactured items and services (such as tourism).

The recent record with respect to export diversification has been poor (see figure 1), with the level of non-diamond exports declining steadily, relative to GDP, rather than increasing. This is associated with a very low level of FDI inflows; total FDI inflows amounted to 1% of GDP in 2002, compared with 5% or more in successful export-led economies such as Vietnam.

Figure 1: Non-Diamond Exports as a share of GDP



Source: Econsult, based on data from Statistics Botswana

Notwithstanding the rhetorical commitments to export-led growth, these need to be backed up by real policy reforms if the strategy is to succeed. These include:

Reducing non-tariff barriers to trade. if Botswana is to take advantage of new trade agreements such as the African Continental Free Trade Area/ Agreement (AfCFTA) and pursue regional integration, it will need to be easier for goods and services to cross borders. The IMF Article IV report notes that Botswana's "non-tariff barriers remain elevated" (para 38). Recent moves towards increased protectionism through import bans etc. also discourage export-led growth, by increasing domestic costs. It is important to understand that integration into global value chains involves increased imports (e.g. of components for manufacturing processes) as well as increased exports. Borders need to become "thinner", i.e. easier and quicker to cross, rather than "thicker". This is both a regulatory issue as well as a physical one, helped by simple changes such as one-stop border posts and 24-hour border opening. It will also be necessary to improve the infrastructure required for cross-border trade.

Encouraging inflows of FDI: backing up the high-level encouragement of foreign investment with actions on the ground. One of the most important ones is to make it easier for foreign entrepreneurs, investors and skilled workers to obtain work and residence permits. This has become far more difficult in recent years (the number of work permits granted to non-citizens has fallen by 80% between 2009 and 2022) and is a real disincentive to investors. Clumsy regulations that are aimed to promote economic empowerment are also a disincentive to inflows of FDI.

Exchange rate policy: the level of the exchange rate is a critical determinant of export competitiveness (as well as of domestic production vis a vis imports). In the 2023 the Selected Issues Paper that accompanies the Article IV report, the IMF carried out a review of exchange rate policy. While this was mainly from the perspective of co-ordinating exchange rate and monetary policy, the IMF concluded that the Pula was overvalued (although not badly so). A wide range of economic literature and country experience demonstrates that export-led growth benefits from a competitive (undervalued) exchange rate, and that an overvalued exchange rate can be a drag on exports. It will therefore be important to ensure that Pula is valued appropriately to support the export-led growth strategy. The IMF analysis concludes that in due course it would be appropriate to move towards a more flexible exchange rate policy framework, where market forces have more influence on the exchange rate as compared to the current pegged exchange rate framework.

Industrial Policy Targeting: a final recommendation is that Botswana targets specific industries or sectors for the promotion of investment and economic diversification. The IMF notes that current industrial policy "appears broad, inward-looking, and with some emphasis on low-productivity sectors". By contrast, the IMF recommends that policy support and interventions should be targeted on firms or industries meeting certain key criteria, including, amongst others, (i) scope for high productivity gains, related to the ease of absorbing foreign technology and exposure to competition (i.e. outward oriented); (ii) export orientation and tradability .... by placing the products in global value chains; and (iii) labour intensity and scope for reducing unemployment.

Reform of State-Owned Enterprises

A second area where reform is needed is the operation of State-Owned Enterprises (SOEs). The IMF givers this a lot of attention, and the SIP accompanying the Article IV report," delves into SOE performance in detail. The BoB AR pays less attention to SOEs, but does lament the very slow progress with implementing the official (2000) privatisation policy over the past 20 years. Notwithstanding the official commitment to SOE reform and privatisation, the practice has been just the opposite, with no full privatisations, the creation of several new SOEs in recent years, and very slow progress with SOE reforms.

In this context, the term SOEs refers to revenue-generating enterprises, of which there are around 20 in total. In addition, there has been a proliferation of parastatals, which are primarily funded by subventions rather than their own revenues; these mainly have regulatory or promotional functions.

The IMF points out that SOEs are responsible for a significant proportion of GDP and employment. More to the point, however, is the fact that SOEs dominate particular sectors of the economy. Many of them have concessions and privileges from a regulatory perspective and are often monopolies or quasi monopolies that are not subject to meaningful competition, all of which crowds out the private sector from several important economic activities. This conflicts with the objective of pursuing private-sector led growth.

The IMF report also documents that many SOEs are inefficient from an economic and financial perspective, and also underperform by international standards for SOEs. This in turn acts as a drag on Botswana's economic growth, due to inefficient use of capital and human resources, as well as the market distortions they create or benefit from. Poor SOE performance also costs the government financially due to the perpetual subsidies required to support inefficient and loss-making SOEs, and makes it more difficult to achieve fiscal sustainability. Many SOEs are also characterised by a lack of accountability, with weak ministerial oversight, and a lack of transparency, such as a failure to publish annual reports and accounts.

The IMF also compares salary costs in SOEs with the rest of the economy. It concludes that SOE employees benefit from a fifty-six percent wage and salary premium relative to their counterparts in government and the private sector. This also causes economic distortions and undermines competitiveness, by depriving the private sector of access to skills and raising costs.

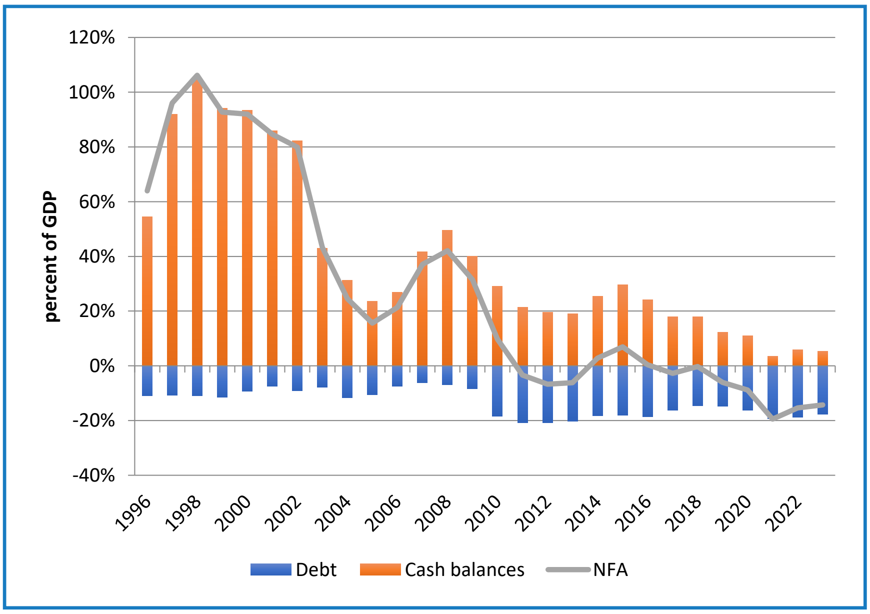
The reforms needed to improve the performance of the SOE sector have long been discussed and identified. They are not particularly difficult from a technical perspective. What is needed is the political will to implement them.

Fiscal Reform.

Both the IMF and the BoB raise major concerns about the trajectory of fiscal policy in recent years, and hence the need for "fiscal consolidation". This is manifested in the emergence of structural budget deficits, with revenues declining (relative to GDP) and expenditures entrenched at unsustainably high levels. The impact of this has been somewhat hidden; in other countries it would be manifested in public debt increasing to unsustainable "debt crisis" levels, as governments continuously borrow to finance those deficits. Botswana's case is different, as high levels of financial savings (fiscal buffers) had been accumulated over previous decades. Recent budget deficits have largely been financed by drawing down on those savings rather than borrowing.

The unsustainable fiscal path is reflected in the way in which government's net financial assets (NFA) have been depleted. NFA essentially refers to government's financial assets (mainly deposits in the Government Investment Account at the BoB) less its liabilities (mainly domestic and external borrowing). As Figure 2 shows, the level of NFA has dropped from over 100% of GDP back in the later 1990s to minus 20% of GDP recently. The trend is for NFA to decline by 4.4% of GDP each year. Even if we take a shorter period to identify recent trends, we can see that NFA was over 40% of GDP in 2008.

Figure 2: Government Debt, Cash Balances and Net Financial Assets (% of GDP)



Source: Econsult, based on data from Bank of Botswana and Ministry of Finance

The unsustainability of this trend has been hidden by the fact that Botswana started off with high levels of savings. But if the same trend was manifested in the level of public debt alone, it would be the equivalent of debt rising from 10% of GDP in 2008 to 70% of GDP in the early 2020s – a trend that nobody would consider to be sustainable.

Both the IMF and the BoB offer a range of policy recommendations to reverse this decline in NFA and return to a sustainable fiscal path. The IMF makes the obvious point that with the anticipated exhaustion of diamond deposits around 2050, Botswana should be accumulating financial assets in the interim, not depleting them. Savings are required to provide both a buffer against shocks and a potential future source of revenue to (partially) replace mineral revenues when diamonds are depleted.

The IMF suggests a new "fiscal rule" to support this outcome, leading to the steady accumulation of savings which would be protected from being drawn down to finance government expenditure (unlike past savings). The idea of a fiscal rule has also been put forward by the Ministry of Finance in the 2023 Budget Strategy Paper (BSP), albeit with a different format to the one proposed by the IMF. Introducing such a fiscal rule leading to the accumulation of government savings would also help to rebuild external savings in the Pula Fund. This initiative would be supported by BoB as it would reverse the decline in the Pula Fund and "ring fence" it against further depletion.

Reversing adverse fiscal trends and restoring long-term fiscal sustainability would require adjustments on both the revenue (taxation) side and spending sides of the budget, in association with introducing a fiscal rule. The IMF notes that Botswana's tax revenues (excluding SACU revenues) are relatively low by the standards of other upper-middle income countries, and hence there is scope to improve the effectiveness of the tax system to collect more tax revenues.

On the revenue side, the IMF puts forward several proposals to increase tax revenues. These include:

Income Tax: considering the introduction of a higher income tax rate with an additional tax band that would be applicable to high income earners (which would raise revenues and make the tax system more progressive);

VAT: reducing tax exemptions and concessions, which have significant fiscal cost and are ineffective at targeting the lower income groups that they are intended to benefit. It is preferable to have a lower general VAT rate with minimal concessions rather than a higher general rate with many concessions, to raise the same amount of money.

Property Taxes: the IMF notes that Botswana's property taxation system is ineffective, and raises far less revenue than it should. Property tax revenues could initially be increased by making the existing system more effective (e.g. updated property valuations, better collection systems, taxing properties on tribal land). Subsequently, higher tax rates and new forms of property taxation could be introduced. Property taxation is highly effective for raising revenues, as it is difficult to avoid (fixed property is by definition immobile and cannot easily be concealed), and it is also highly progressive, with the burden falling mostly on the higher income groups.

In addition to these suggestions from the IMF, the BoB also suggests that unused land should be taxed, to discourage speculative hoarding of land, and that digitalisation should be used to improve tax coverage and compliance by the informal sector. The BoB also proposes greater emphasis on better tax administration, enforcement and compliance.

Both the IMF and the BoB propose ways of containing expenditure and making it more efficient. These include:

Better targeting of social welfare payments, to focus on the needy. This would help to reduce waste (by errors of extending social welfare to the non-poor, and omitting the poor from eligibility). It would therefore help to reduce poverty and inequality, without requiring more funding. Various proposals have been put forward to achieve this, including a Single Social Registry and the use of Proxy Means Testing to determine eligibility for new entrants.

Digitalisation of public services. Properly moving a large number of public services online, so that they can be completed beginning to end without requiring physical presence at a government office, would reduce access costs for the population and make service delivery cheaper and more efficient.

Reducing the public sector wage bill by cutting the size of the central and local government work force. The public sector wage bill is high by international standards, and is unsustainable. Moving public services online could be an important mechanism to achieve this.

More efficient development (investment) spending. Many comments have been made about the need for more infrastructure spending. This is misleading. The main problem with spending on development projects is that it is inefficient and badly prioritised. The 2023 Public Investment Management Assessment (PIMA) concluded that the efficiency of Botswana's public infrastructure investment spending falls some 30% below the levels of the best-performing upper-middle income countries. This reflects poor project appraisal and preparation, a failure to prioritise effectively, and weak project management. Raising the level of effective infrastructure investment does not need more funding (or borrowing), just better management. The IMF also comments that the separation of planning and budgeting functions with the creation of the National Planning Commission (NPC) could weaken public financial management practices further.

Reduced subventions to SOEs. This has long been discussed, but will not be achieved unless, amongst other things, SOEs are required to charge cost-reflective tariffs and to effectively collect the revenues they are owed. What is required is well known and understood, but implementation requires political will and commitment.

Conclusion

The above discussion highlights some of the critical structural reforms put forward by the BoB and the IMF to support structural transformation to the higher growth path needed to achieve high-income status by 2036. The list is not exhaustive – it is necessary but not sufficient. Many other reforms are needed, such as digital transformation, other supply-side reforms to support the private sector, and of course a range of critical issues related to the green transition. We will return to these in future issues of the Review.

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