

Economic Review

Real GDP Growth

5.2%

Higher than the 4.8 percent recorded in the first quarter of 2013.

Headline Inflation

4.6%

higher than the May 2014 rate of 4.5

The Non-mining Sector

4.4%

down from a 6.2 percent growth rate in March 2013

IMF Growth Projections

3.4%

marked down from 3.7 percent

Growth Rate

4.5%

a slow growth rate for 2014.

Introduction

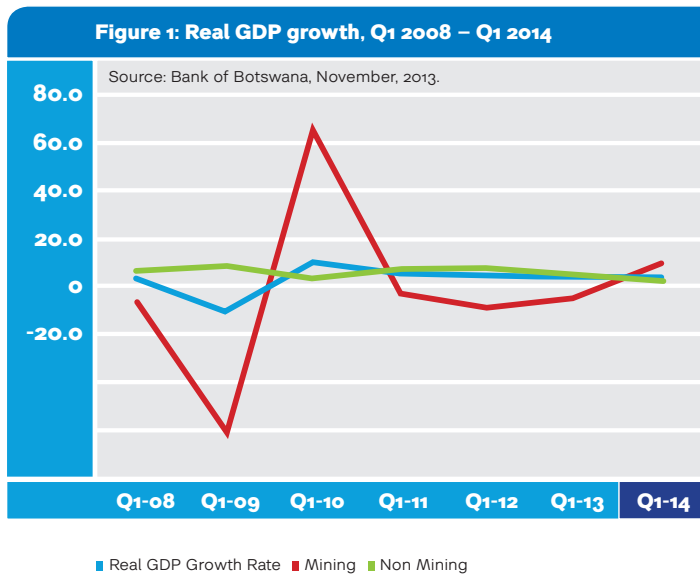
Buoyed by a 10.7 percent growth in the mining sector, Real Gross Domestic Product (GDP) grew by 5.2 percent in the first quarter of 2014, slightly higher than the 4.8 percent recorded in the first quarter of 2013. The non mining sector has, however, not performed well, down from a 6.2 percent growth rate in March 2013 to 4.4 percent in March 2014. The poor performance of the non mining sector may primarily be attributed to the water and electricity sector. The water and electricity sector's growth rates have deteriorated from -30.9 percent in March 2013 to -103.9 percent in March 2014. In addition, the inflation level in June 2014 was 4.6 percent, higher than the May 2014 rate of 4.5. Because of modest inflationary pressures, we expect inflation to remain within the Bank of Botswana (BoB)'s target range of 3 – 6 percent during 2014. The risk of a spike in oil prices due to the unrest in the Middle East and Africa, coupled with the need to ease the heavy financial leverage of the Botswana Power Corporation (BPC) may lead to a breach of the BoB's inflation range. There is a slowdown in credit growth, perhaps in part due to the increased threat of default. On international trade, a trade deficit of 1.4 billion was recorded in the first quarter of 2014. This was because imports increased and exports slumped during the quarter.

The outlook suggests that the economy will slow down in the next two quarters. The International Monetary Fund (IMF)'s growth projections for 2014 have been marked down from 3.7 percent to 3.4 percent. This is expected to negatively affect Botswana's mining sector. The well documented power sector problems are also expected to affect the already depressed non mining sector. We therefore expect the economy to slow to a 4.5 percent growth rate in 2014.



Economic Growth

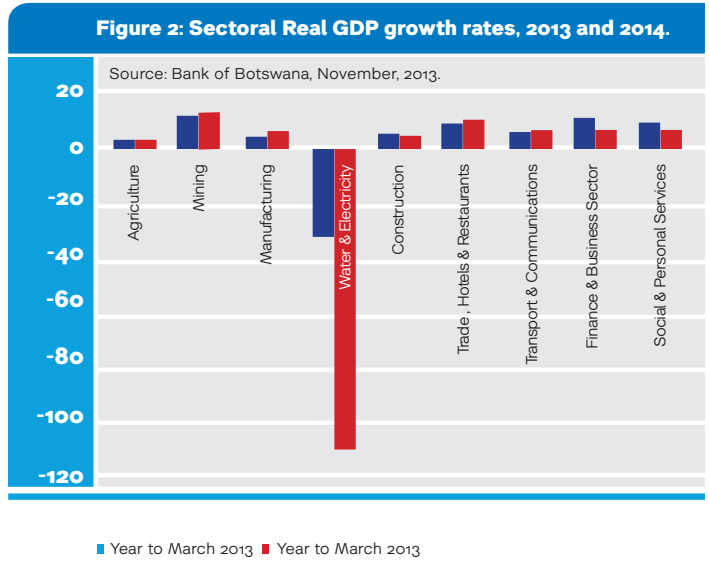
Quarterly data shows that real GDP grew by 5.2 percent year on year during the first quarter of 2014, a 0.4 percent improvement from the 4.8 percent recorded during the same period in 2013, but lower than the 5.8 percent recorded during the same period in 2012 (see Fig 1). The improvement in real GDP growth was largely due to a 10.7 percent growth in the mining sector, after a 3.6 percent decline in the first quarter of 2013.



However, concerns raised in the first quarter review regarding the performance of the non mining sector remain. The sector grew by 4.4 percent during the year to March, down from 8.3 and 6.2 percent during the same period in 2012 and 2013 respectively.



The continued slow down of the non mining sector is largely driven by the water and electricity sector, construction, finance and business, social and personal services sectors whose growth rates have slowed down between March 2013 and March 2014 from -30.9 to -130.9, 3.8 to 2.6, 8.2 to 4.7 and 6.2 to 4.7 percent respectively.



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The poor performance of the water and electricity sector may be attributed to increased reliance on imported electricity. As shown in Figure 3, the proportion of imported electricity to the total electricity usage increased from 74.4 percent in 2007 to 93.1 percent in 2012 before falling slightly to 79.7 percent after the commissioning of Morupule B in 2013, which subsequently contributed 19.1 percent of the country's electricity consumption.

Figure 3: Composition of electricity source: 2007 - 2013

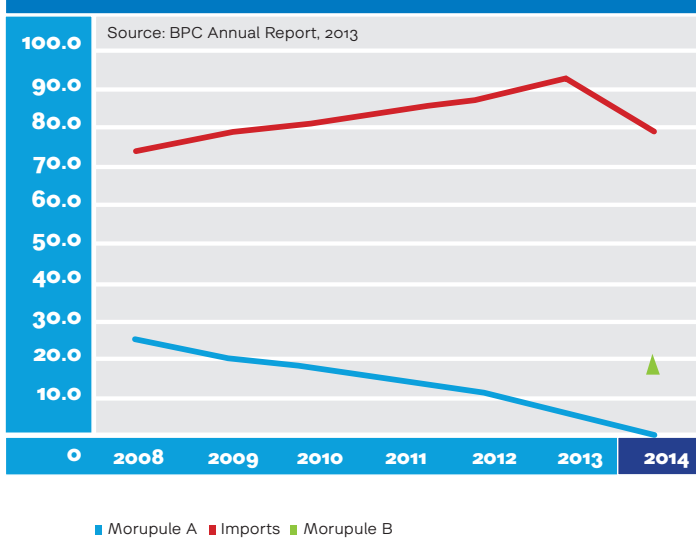
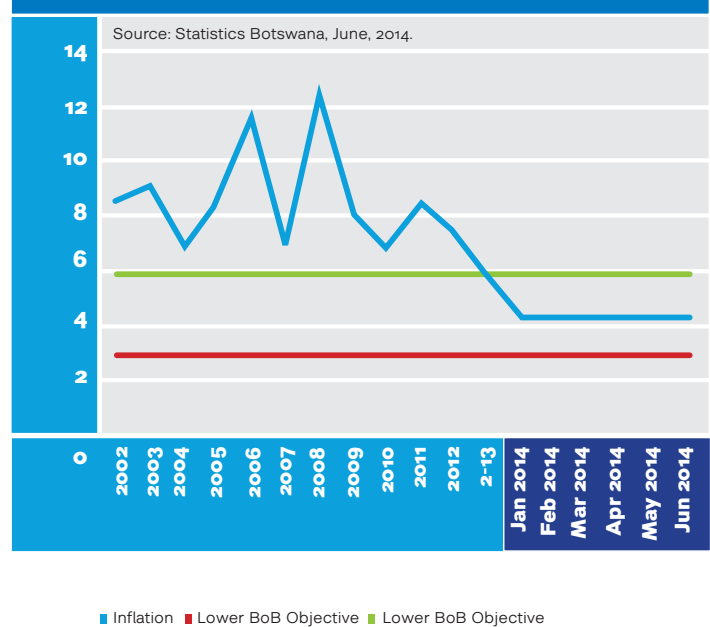


Figure 4: Inflation level, Jan 2010 - March 2013



Inflation and Monetary Policy

Inflation in June 2014 stood at 4.6 percent, up from the 4.5 percent recorded in May 2014 but lower than the 5.8 percent recorded in June 2013. Notable contributors to the increase in inflation in June are health and hospital services, rentals as well as clothing and footwear. All these recorded very marginal increases.

Going forward, we expect inflation to remain within the Bank of Botswana's target range of 3 – 6 percent, reaching 5.5 by the end of the year. This is because domestic inflationary pressures remain modest.

We note, however, that pressure on electricity prices is likely to mount in the next few years because of a number of reasons: First, the BPC's long term debt has grown from P119 million in 2009 to P6,313 billion in the last five years (See table 1). Second, the corporation has made accumulated losses of P4.9 billion in the last five years. Third, the selling price per unit has only grown by an annualised rate of 10.8 percent while that of the average cost per unit has grown by 16.9 percent. Fourth, the Government has extended grants worth 1.8 billion in the last three years. All these come with a lot of pressure to increase electricity prices.

Table 1: BPC Statistical Data

	2009	2010	2011	2012	2013
Long term debt	119,209	1,460,764	4,154,439	5,359,783	6,313,407
Net profit/loss	(133,623)	(1,572,169)	(796,620)	(1,122,872)	(1,254,112)
Average selling price per unit (Thebe/KW)	36	36	48	57	60
Average cost per unit (Thebe/KW)	50	57	68	85	109
Grant revenue from the Government of Botswana	-	-	454,000	508,000	871,000

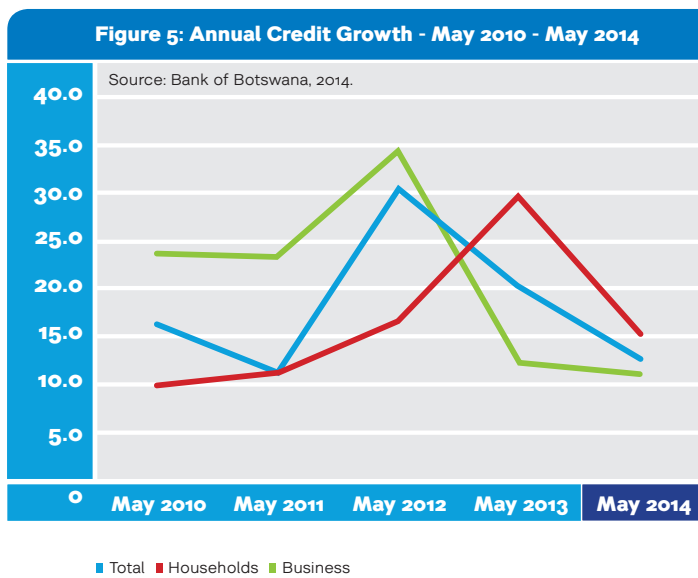
Source: BPC Annual Report



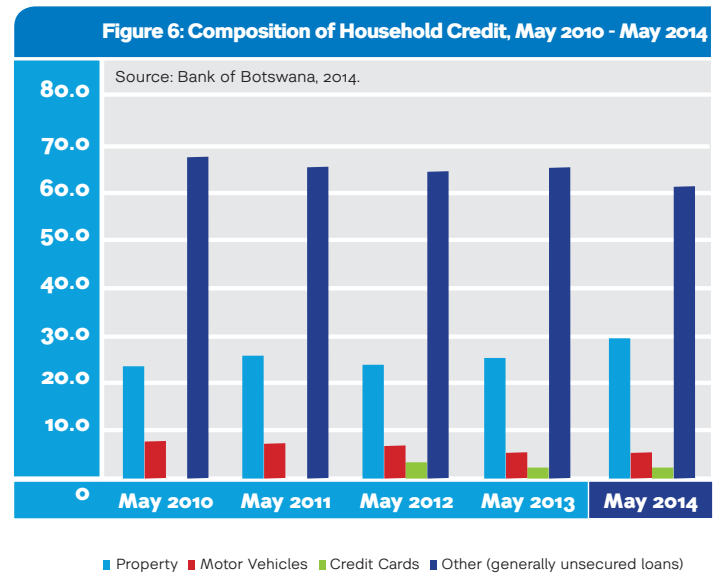
Additionally, risks of a spike in oil prices remain. This is because of the threat of disruptions associated with the increasing unrest in the Middle East and North Africa. Hence, there are uncertainties in the domestic and international economic fundamentals that may easily lead to a breach of the BoB's inflation range.

Credit Growth

The latest available credit data is for May 2014. The data shows that total credit grew (annual) by 13.3 percent in May 2014, lower than the 20.7 percent recorded during the same time in 2013. The downward trend in credit growth is also observed for credit to households and resident businesses. The overall fall in bank credit is in line with the falling credit trends reported in the first quarter review, where year on year credit growth between 2012 and 2013 was 15.7 percent, down from 23.1 percent recorded during the 2011 – 2012 period. Of particular importance is that household credit has had the fastest decline in the past year (14.0 percent) compared to the 7.4 and 1.2 percent recorded by total credit growth and business credit growth. The overall credit growth patterns are therefore in line with the recent calls to monitor and control the expansion of credit, particularly to the household sector.



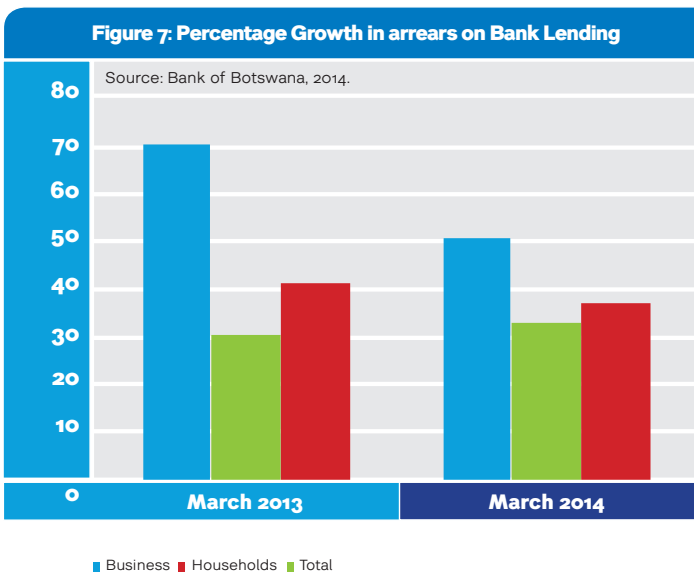
In view of the declining credit growth trajectory and in particular the marked decline in household credit growth, two long outstanding concerns with the Botswana economy need further probing: First, whether or not the decline is accompanied by a shift in household expenditure priorities. Second, whether or not the decline in credit growth is accompanied by the improvement in the economy's ability to repay its loans. The figure below shows that although household credit growth has shown a marked decline in the last year, household priorities have not changed much. The proportion of unsecured loans and motor vehicle loans to total credit has declined by only 3.8 and 2.5 percent respectively, while that extended for purchase of property has gone up by 4.1 percent. That notwithstanding, it is encouraging that the decline is observed in the consumption oriented categories of unsecured loans and motor vehicles and the increase is for the investment oriented property borrowing.



As for whether the credit growth decline is accompanied by improvement in the economy's ability to repay its loans, figure 7 below suggests that overall, the economy's ability to repay its loans has improved in the last year. Growth in total arrears has slowed down from 40.8 percent in March 2013 to 37.7 percent in March 2014. A similar trend is observed with arrears on lending to businesses, where growth in



arrears has declined from 71.0 percent in March 2013 to 50.9 percent in March 2014. However, the situation is different for households. Growth on arrears on lending to household has slightly increased from 31.2 percent in March 2013 to 33.6 percent in March 2014, suggesting that households face difficulties in servicing their loans. This may partly explain the marked decline in the growth of household credit observed in figure 5.

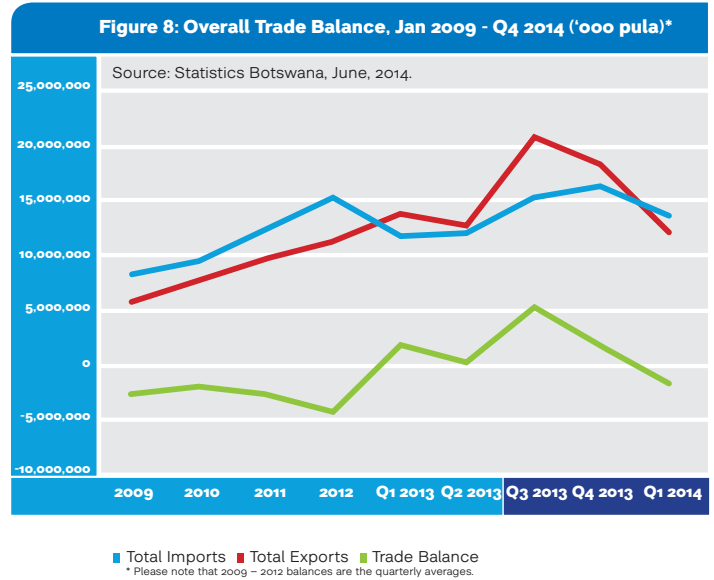


International Trade

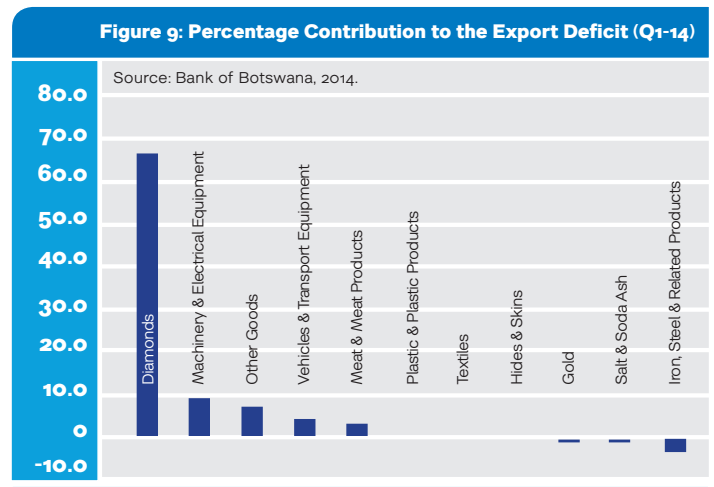
The second quarter international trade data shows a trade deficit of 1.4 billion, a deterioration from the 2.1 billion surplus recorded at the same time in 2013. This was due to the 16.6 percent increase in imports (P11.9 billion in Q1 2013 to P13.9 billion in Q1 2014) and an 11.2 percent (P14.0 billion in Q1 2013 to P12.4 billion in Q1 2014) slump in exports or a total slump of P1.6 billion.



“It is encouraging that the decline is observed in the consumption oriented categories of unsecured loans and motor vehicles and the increase is for the investment oriented property borrowing.”



Further analyses of the exports data show that the highest contributor to the P1.6 billion decline in total exports was diamonds at 67.1 percent or P1.0 billion pula. Other significant contributors are machinery and electrical equipment (9.2 percent), miscellaneous goods (7.2 percent) and vehicles and transport equipment (7.2 percent).



In terms of the composition of exports, diamonds accounted for the largest share (81.4 percent) in the first quarter of 2013. The proportion has since increased to 84.5 percent in the first quarter of 2014. As noted in the first quarter review, this calls for diversification of export products.



Economic Review

Figure 10: Sectoral Contributions to Exports: Q1 2013

Source: Statistics Botswana, 2014.

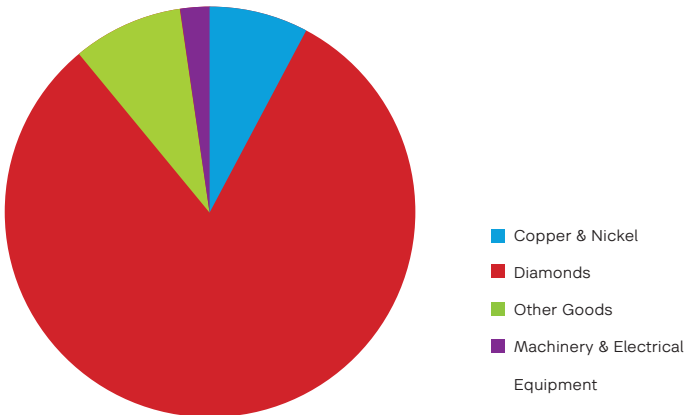
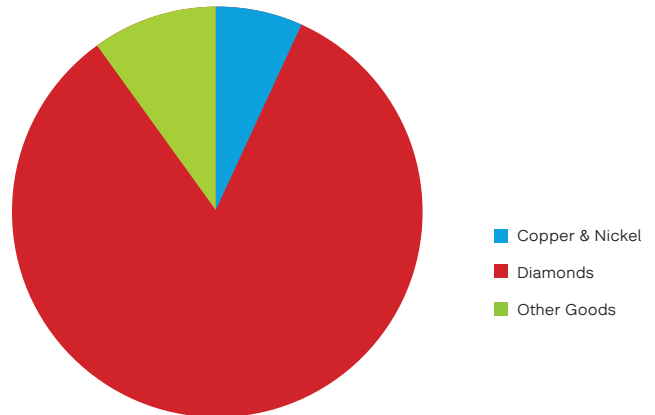


Figure 11: Sectoral contributions to exports - Q1 2014

Source: Statistics Botswana, 2014.



Economic Outlook

Although GDP grew by 5.2 percent during the year to March 2014, which was an improvement over the 4.8 percent recorded during the same period in 2013, indications are that the economy will slow down in the next two quarters. The IMF has marked down the global growth projections for 2014 by 0.3 percent to 3.4 percent. This is expected to negatively affect the performance of the mining sector, which has, in the face of declining performance of the non mining sector, been the catalyst of growth in the last two quarters. The effects of the power problems are likely to be felt in the medium term, leading to the continuation of the subdued performance of the non mining sector for the remainder of 2014. This somewhat pessimistic outlook of the economy is

in line with the Bank of Botswana's Business Expectations Survey of March 2014, which shows that business expects GDP to grow by 3.9 percent in 2014.

That notwithstanding, in its latest surveillance mission to Botswana, the IMF identified the Mid Term Review (MTR) of the tenth National Development Plan (NDP 10) as the blue print of the country's structural reform. Specifically, reducing the size of the government relative to GDP to allow the private sector to take the lead in driving the economy is expected to help spare the economy from the low levels of growth expected by the business community. Thus, in line with the IMF, we expect the economy to grow by around 4.5 percent.



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