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Overview

The Botswana economy continues to grow rapidly. There is a possibility, however, that growth will slow down. According to NDP8, development spending should have been cut back in the current budget year, but was budgeted to increase substantially. In order to stick to the planned estimates, development spending would have to be cut drastically in the next three budget years. The cutbacks would not have to be so great if this year's budget estimates are underspent, as happened in 1998/99. On the other hand, growth in Botswana could be helped by the higher growth expected in South Africa.

Inflation in Botswana has remained at about 7%, considerably higher than headline inflation in South Africa. However, inflation in Botswana has been slightly below core inflation in South Africa, which is more relevant. The competitive position of producers in Botswana has not therefore been adversely affected.

The demand for diamonds has recovered rapidly. 1999 was a year of record sales by De Beers. Botswana's diamond exports increased from P6 billion in 1998, to P9 billion in 1999. Diamond exports are expected to be slightly down in 2000, because the sale of stockpiled diamonds in 1999 was worth more than the expected increase from the Orapa expansion. The copper-nickel mine has also benefited, from an increase in nickel prices of more than 80%. As a result, the mine is currently making an operating profit.

Economic Developments

Economic growth and the budget

There is no reason to change the assessment of recent BIDPA Briefings, that the Botswana economy is growing at about 8%. The rate of growth of commercial bank lending has slowed down very slightly, but was still 46% higher in July 1999 than a year earlier. Within this total, it is encouraging that in the three most recent months for which data are available, lending to the business sector grew rather faster (12%) than lending to households (8%). This is too short a period on which to base expectations, but it is at least a change in the right direction.

Recent figures for actual spending in the 1998/99 budget year reveal that it was less than the revised estimates presented in last year's budget. Total government spending in that year increased by "only" 21%, not the revised estimate of 32%. If the current budget spending estimates, for the year ending in March 2000, turn out to be correct, then spending will have increased again by approximately 20%, rather than a cutback from 32% to 12%. These revised statistics provide some explanation of why economic growth has not yet slowed down.

The greatest threat to continued rapid economic growth, in the medium term, is the planned reduction in government spending. It was always intended that development spending would be less in the last four years of NDP8, than in the first two. That means that the 1999 Budget Speech should have announced a sharp cut for 1999/00. Instead, there was another large increase (see Table 1).

As a result, the development budget was P0.5 billion *higher* in 1999/00 than in 1998/99, when it should have been P0.5 billion *lower*. If the Government is to keep development spending to the six-year total in the Plan, then development spending will have to be more than 40% lower than the planned figures in the remaining three years of the Plan; and annual development spending *would have to be cut by two thirds* compared with its current level.

The Government is therefore faced with a dilemma, of its own making. If it sticks to its own spending plans, there will be a much lower rate of growth in the next few years than at present. The alternative is for the Government to exceed its own expenditure estimates, as approved by Parliament. To do so would be very damaging. Botswana has managed its economy better than

Table 1
National Development Plan 8, planned and actual development spending (P million)

Budget Years	NDP8 planned	Actual	Actual less Plan
1997/98	2427	2476	+ 49
1998/99	2377	2752	+ 375
1999/00	1771	3287[(a)]	+ 1516
1997/98-1999/00	6575	8515	+ 1940
2000/01-2002/03	5208	3268[(b)]	- 1940
Total 1998-03	11783	11783	-

Notes: (a) expenditure for 1999/2000 from budget estimates; (b) difference between NDP8 total and total for 1998-00.
Sources: NDP8; Bank of Botswana; Budget Estimates 1999/00

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other mineral boom economies precisely because it has generally succeeded in keeping to its own spending plans.

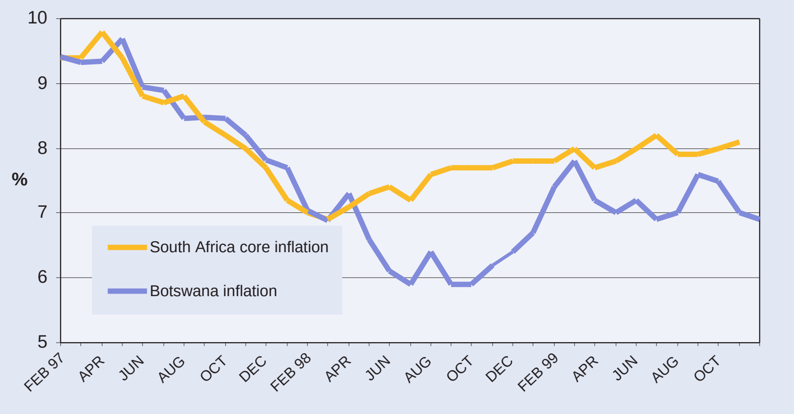
It is possible that private sector investment could fill the gap created by lower levels of government spending. This seems unlikely. There is clearly something of a current boom in private sector investment, but much of this investment is dependent on the demand created by government spending. Unfortunately, there is no information as to how much of private sector investment is independent of government-induced demand.

Actual development spending in the current year could be lower than the estimates, as happened last year. This would help a bit. Meanwhile, the spending estimates presented in the Budget on 7 February will show the extent to which the Government is prepared to abandon its own rules in order to sustain the current rate of economic growth. Alternatively, they will show the extent to which government intends to maintain expenditure discipline, at the cost of a reduction in economic growth in the short term.

This dilemma is the inevitable result of "front-end loading" of the Plan. It has been made considerably worse by overspending the front-end loading, and failing to cut back as planned in 1999/00.

Any forecast of GDP growth for the national income year 2000/01, or beyond, depends heavily on this year's actual spending, and what the Government does about

Figure 1: Botswana Inflation, and South African Core Inflation 1997 - 99



development spending in the final three years of NDP8. The forecast of non-mineral GDP growth in 2000/01, shown on page 4, is therefore unusually arbitrary; it assumes some cutback in development spending by the Government, but not to the extent implied by the Plan estimates.

Growth of non-tradional exports in Botswana could also be helped by higher growth in South Africa. There is now a widespread expectation that the South African economy will grow at between 3% and 4% in the current year, compared with recent estimates of 1.3% growth in 1999. Faster growth in South Africa will benefit some non-mining sectors of the Botswana economy. This should have included car exports, as car sales in South Africa are forecast to increase by 6% in 2000, but the failure of the Hyundai factory has closed off this opportunity.

Inflation and exchange rates

Inflation in Botswana fluctuated narrowly in 1999, with a low of 6.7% in January and a high of 7.8% in March. Towards the end of the year it was within the lower range of this band, being 7% in November.

Botswana has not benefited from the quite sharp fall in inflation in South Africa, but that is because the "headline" inflation figure in South Africa has been strongly affected by falling interest rates. A currency crisis in mid-1998 pushed interest rates in South Africa to exceptionally high levels. As they fell back to more normal levels, the cost of mortgages also fell. They have quite a heavy weight in this index, and that is the main reason why inflation has fallen below 2%. Inflation in Botswana is not affected by the cost of mortgages in South Africa. Equally, although inflation in South Africa is expected to rise again in 2000 (when high interest rates in 1998 no longer affect the year-on-year comparison), there is no reason to think that this will cause increased inflation in Botswana.

Normally it would be of great concern if Botswana had higher inflation than South Africa, with a steady nominal rate of exchange between the Pula and the rand (as has been the case). A faster rate of increase in costs in Botswana would make producers uncompetitive against imports from South Africa, and in the South African market which is the main destination of non-traditional exports.

Higher cost inflation could in theory be offset by increases in productivity, but there is no evidence to suggest this has been happening.

However, the rate of inflation in Botswana has actually been lower than South African "core inflation" since May 1998 (Figure 1), because the latter excludes the cost of mortgages, and other goods and services with exceptionally unstable prices (such as fresh food). During this period, the nominal exchange rate of the Pula against the rand has fluctuated within a narrow band. This means that the competitive position of

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Botswana producers has not been damaged by inflation differentials and the rand exchange rate.

There is a strong possibility that the relative stability of the South African rand against non-regional currencies will not be maintained. In recent years, there has been a tendency for the rand to maintain a stable nominal value for periods of more than a year, against the United States dollar (and other major currencies), followed by a large depreciation. For example, the rand was fairly steady against the US dollar during 1997 and for the first part of 1998. It then depreciated by 27% between April and August 1998.

In the 16 months since that time, the rand has again fluctuated narrowly against the dollar. During this period, core inflation in South Africa has been steady at between 7% and 8%, while inflation in the United States and Europe has been slightly positive or slightly negative (depending on whether one uses producer or consumer price inflation statistics). As a result, costs in South Africa have increased about 8% a year faster than costs in the main industrial countries, without any offset from the exchange rate. This suggests that there may be a large correction in 2000, possibly exaggerated by "overshooting". If this happens, it will create problems for Botswana. The Pula would have to follow the rand downwards, if the competitive position of domestic producers is to be protected, even though it would be preferable not to have an unstable exchange rate against other currencies. It is of course impossible to maintain a stable exchange rate against all currencies when they fluctuate against each other.

While this scenario is likely at some point, it is not certain, and it is impossible to say when it is most likely to occur. It could be activated by a financial crisis somewhere else in the world, of the sort which would cause markets to look for overvalued currencies in countries like South Africa, or it could be sparked off by domestic events.

Mining

The recovery in global demand for gem diamonds continued in the final quarter of 1999. Indeed, it went further than a recovery. Sales by the Central Selling Organisation of De Beers (the CSO) were 45% higher in the first half of 1999, and 70% higher in the second half, than in the comparable periods in 1998. The increase in the second half of 1999 was so large that sales were actually higher in the second half than in the first half. This is unusual. The best period for sales of diamond jewellery is Christmas, and sales of rough gem diamonds to meet Christmas jewellery demand usually occur in the first half of the year.

Overall, CSO sales in 1999 were an all-time record at $5.2 billion, up 57% on their depressed level in 1998 ($3.3 billion). Botswana's diamond exports in 1999 were approximately $2.2 billion, or P10.0 billion. This compares with exports of P6.0 billion in 1998. As a result, the government budget should be in surplus for 1999/00, and the foreign exchange reserves are again increasing.

Some of the recovery in demand can be attributed to the "millennium effect". De Beers made a major marketing effort, encouraging people to commemorate the millennium by giving diamond jewellery. The Far East recovery also contributed, as did the continued growth and rising stock market prices in the United States and European economies. That may be why De Beers is talking of sales in 2000 being as high as in 1999, even though the millennium effect was by definition a one-off increase in demand. Indeed, there is widespread expectation in the press that sales in 2000 will actually be higher than in 1999. This would require either De Beers to sell down its own stockpile, or a price increase, or both.

For the first time, De Beers has experimented with selling "brand name" diamonds, using laser technology to inscribe polished gems with the De Beers name. The branding is not visible to the naked eye, so that branded diamonds do not lose anything in appearance, while the inscription provides some sort of guarantee of quality. Test marketing in England has shown that people are indeed prepared to pay a premium for branded gem diamonds. This could provide a permanent upward shift in the demand for De Beers' diamond production, although it is too soon to know how big the effect might be.

From Botswana's point of view, all of diamond output is now being sold, in contrast to 1998 and 1999 when De Beers imposed a quota, forcing Botswana to stockpile part of production. Moreover, all of the diamonds stockpiled during the period have already been sold. In 2000, Botswana's output and exports will be slightly lower than in 1999, because the stockpile was greater than the increase in output expected from the Orapa expansion. The latter is already in production, and should be producing at full capacity by the end of the first quarter of 2000. When fully operational, it will add more than P1 billion to annual exports at current diamond prices and rates of exchange.

Another excellent piece of news, for Botswana, is that the global price of nickel has recovered quite sharply. It reached a 1999 low of $1.94/lb in January. This meant that BCL was producing at a substantial operating

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loss, and required emergency funding to maintain itself in operation. In the second half of 1999, the nickel price rose rapidly, and was more than $3.50 by the end of the year. This means that BCL has been making an operating profit for some months. The company has not needed to draw on the financing facility provided by the Government since April 1999. In addition, a first repayment of the company's emergency borrowing has been made.

The copper price has also improved, but by much less than the nickel price (a 10% increase on the average for 1998, by the end of 1999). In any case, copper only generates 10% of BCL's revenues at current prices, compared with 75% for nickel (and 15% for other metals).

At Sua Pan, Botash is currently profitable. The company has abandoned plans to produce a pure white soda ash for the detergent market, but it is planning to increase its pumping capacity for getting brine from underground, in order to meet an expected upturn in demand from the glass manufacturing industry in South Africa.

ECONOMIC FACTS AND FORECASTS

Quarterly

(end of period)	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4
Interest rates (%)								
BOBC (3 month)	10.26	10.21	10.46	10.66	11.55	11.75	11.68	12.0
Prime	13.31	13.25	14.00	14.00	14.25	14.75	14.75	14.8
Inflation (%)	6.9	6.1	5.9	6.4	7.2	7.5	7.6	7.5 *f*
Rand-Pula	1.29	1.36	1.30	1.32	1.33	1.30	1.32	1.33 *f*
Pula-US$	3.90	4.33	4.48	4.46	4.67	4.63	4.55	4.62
BSE index	811	949	954	947	990	1033	1417	1399

Annual

		1993	1994	1995	1996	1997	1998	1999	2000
Growth (%)									
GDP (real)	*d*	4.2	2.7	6.6	7.2	8.3	4.6 *e*	9.0 *f*	7.0 *f*
Non-mineral GDP (real)	*d*	3.5	4.8	5.0	7.9	7.7	9.0 *e*	8.5 *f*	5.0 *f*
Exports (nominal)	*b*	15.3	18.4	19.7	40.7	27.8	-12.5	45 *f*	-2 *f*
Imports (nominal)	*b*	9.2	2.7	20.4	8.2	43.9	19.7	16 *f*	15 *f*
Govt. spending (nominal)	*c*	11.8	-4.6	21.5	17.3	21.6	31.5	17 *f*	13 *f*
Govt. revenues (nominal)	*c*	14.3	-16.5	22.2	35.3	12.0	-0.1	55 *f*	9 *f*
Domestic (bank) credit	*b*	11.8	18.2	-3.7	1.2	5.6	56.1	45 *f*	- *f*
Interest rates (%)									
BOBC (3 month)	*a*	13.5	11.9	12.0	12.2	11.4	10.7	12.0	11.0 *f*
Prime	*a*	15.0	14.0	14.5	14.5	14.0	14.0	14.8	14.0 *f*
Inflation (average, %)		14.4	10.6	10.5	10.1	8.9	6.7	7.2	6.7 *f*
Rand-Pula	*a*	1.32	1.30	1.29	1.28	1.28	1.32	1.33	1.36 *f*
Pula-US$	*a*	2.56	2.72	2.82	3.64	3.81	4.46	4.62	4.78 *f*
BSE index	*a*	279	313	333	352	709	947	1399	-
Balance of Payments (Pm)									
Exports (diamonds)	*b*	3340	3727	3994	5272	7654	5929	10000 *f*	9400 *f*
Exports (other goods)		841	1304	1994	2100	2454	3079	3300 *f*	3600 *f*
Imports (goods, cif)	*b*	4290	4406	5305	5743	8256	9670	11200 *f*	12700 *f*
Current account balance	*b*	1220	642	937	2108	3059	478	3000 *f*	1000 *f*
Foreign Reserves									
Pula m	*a*	10509	11961	13249	19076	21619	26347	29000 *e*	31000 *f*
US$ m	*a*	4097	4402	4695	5234	5675	5960	6350 *f*	6500 *f*
Govt. spending (Pm)	*c*	4481	4277	5195	6092	7406	9736	10500 *f*	11900 *f*
Govt. revenue (Pm)	*c*	5359	4473	5464	7395	8281	8271	11300 *f*	11700 *f*
Budget surplus/(deficit) (Pm)	*c*	878	196	269	1303	875	-1465	800 *f*	-200 *f*
Govt. balances at BOB	*a*	5598	6705	6460	7204	15634	19212	20000 *f*	20500 *f*

Notes: *a end of period; b calendar year; c financial year (starts March); d statistical year (starts July)*
e BIDPA estimate; f BIDPA forecast; p preliminary data
Details of assumptions underlying the forecasts can be obtained from BIDPA.

Sources: *CSO, Bank of Botswana, BIDPA*

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