



Overview

Various indicators show that the rate of growth of GDP is slowing down: greater competition for construction contracts, together with a slowdown in rents and property prices; a slower rate of increase of electricity consumption and of notes in circulation; and a slowdown in the rate of increase of commercial bank lending. The slowdown is probably in response to a reduced rate of growth of government spending. It appears that De Beers will continue to try and control as much of the global supply of gem diamonds as possible, but with the completion of the Orapa expansion no further expansion of Botswana's diamond output is anticipated. Global demand for gem diamonds remains strong, however, as high as last year with its one-off millennium effect, and it is now expected that Botswana's diamond exports (in US\$ terms) will be as high in 2000 as in 1999. The recovery of nickel prices has enabled BCL to make operating profits for most of 2000. The inflation figures have been revised upwards for the period August 1999 to June 2000, and increased recently because of rent increases. However, inflation levels do not appear to endanger Botswana's competitiveness. The International Financial Services Centre has suffered a disappointment, because of changes in taxation rules in South Africa, but three companies have nevertheless been established, with three applications in process.

Growth of non-mining GDP

The Budget Speech in February announced that there would be a major slowdown in the growth of government spending this fiscal year. In fact, preliminary figures for the budget year 1999/2000 show that government spending increased by only 15%, rather than the 26% indicated in the Budget Speech (and a 22% increase in the previous budget year); and preliminary figures for the June quarter show a further deceleration. Several other indicators suggest that a turning point may have been reached.

The construction sector has been particularly affected by the boom, so that reports of a slowdown in construction are especially relevant: construction companies are having to compete more for new contracts; there is a higher vacancy rate in residential accommodation, and residential rents have started to fall: industrial and commercial property rents have stopped rising, and it is becoming more difficult to sell or let property. Fortunately, it seems unlikely that there will be a collapse in property prices as large as in the early 1990s. That time, much of the construction had been speculative, and financed by

borrowed money. During the recent construction boom, a higher proportion of property has apparently been built for owner occupation, and financed with a higher proportion of equity.

The annual rate of increase of electricity consumption fell by three percentage points in the July-September quarter, compared with the April-June quarter. Moreover, the slowdown was more marked in August and September. Electricity consumption was only 8% higher in September than in September 1999, compared with year-on-year rates of increase of 15% earlier this year.

Another indicator is the rate of increase of notes in circulation, which is correlated quite closely with the rate of growth of the economy, other things being equal. The annual increase of notes in circulation to June 2000 was 10.9%, compared to 17.8% in the year to June 1999, and a rate of increase in December 1999 of 21.7%. Again, this suggests a slowdown in the rate of growth of GDP, although not such a large slowdown as occurred at the beginning of the 1990s.

There is also news of hard times in the tourist industry, but that may be

caused more by the events in Zimbabwe (and Caprivi) than by what is happening in the rest of the Botswana economy. Many foreign tourists combine a holiday in Botswana with a holiday in Zimbabwe. The worrying news coming out of Zimbabwe has caused many people to cancel such holidays, and Botswana has suffered as a result. The current weakness of the Botswana Stock Exchange can also be attributed, at least in part, to the negative perceptions of Southern Africa caused by events in Zimbabwe.

Commercial bank lending

Commercial bank lending to the business sector in the year to June 2000 was up 26.3%, but it actually fell by a very small amount (0.05%) in the six months to June 2000. Moreover, the rate of increase of lending to households in the year to June 2000 was "only" 26.7%. While this is a high rate of increase, it is sharply lower than the 44.5% rate of increase at December 1999. Taken together, changes in lending to businesses and households support other indicators that the economy is growing less fast than it was until recently.

Mining

Mining contributes much less to GDP than it did 10 years ago. Nevertheless, it remains the dominant sector with 35% of GDP in 1998/99 (down from 51% 10 years earlier).

There has been much discussion in the press of a change in strategy by De Beers, from controlling supply in order to keep diamond prices higher than they would otherwise be, to controlling demand by advertising diamonds more heavily. However, De Beers still controls directly a significant proportion of global supply, including that of Botswana, which supplies 33% of the world's rough gem diamonds. Moreover, De Beers has bid successfully for an Australian diamond mining company which owns 40% of the world's largest diamond mine (Argyle); De Beers had lost the marketing of these diamonds some years ago. De Beers has also bought a Canadian company which is likely to be the second largest supplier of diamonds in Canada, when it starts production in about three years time. De Beers already sells approximately 35% of Canadian diamond production, and this will increase. These actions suggest that De Beers intends to continue controlling as much of global supply as possible (which is clearly in Botswana's interest). If demand can be increased by additional advertising, that would be a further benefit to Botswana's export earnings. Meanwhile, the threat to diamond sales from the campaign against "conflict diamonds" is to be addressed by certification of diamonds from non-conflict areas.

The expansion at Orapa is virtually complete, with full rated output expected in the fourth quarter of 2000. A new processing facility at Jwaneng to treat Orapa diamonds may lead to a slightly higher rate of recovery, but the increase to be anticipated is only of the order of 1% or 2%. De Beers has announced a change in the pricing structure of

its very large number of diamond categories, which will amount to a small overall price increase. Apart from these minor changes, there is no news of any significant future increases in diamond production.

The really good news, at least for this year, is that the dollar value of diamond exports is now expected to be as high as the record level achieved in 1999. Previously, it was thought that there would be a reduction, because the additional exports from the expansion at Orapa would be less than the selling off of the stockpile last year. In Pula terms, diamond exports will increase because of the fall in the value of the Pula in dollar terms.

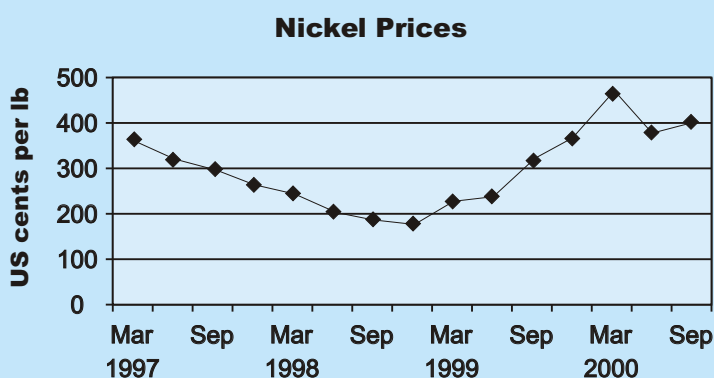
Underlying the current optimism about Botswana's diamond sales is the firm trend in global demand for rough gem diamonds. Current estimates of global sales by De Beers' Central Selling Organisation are between \$5.6 billion and \$5.9 billion in 2000, compared with \$5.3 billion in 1999. Previously, it was thought that the high level of sales in 1999 could be attributed to the marketing of "millennium" diamonds, and that sales would fall back this year.

on a single economy.

The news of copper-nickel exports is also good. After a period of disastrously low prices, the nickel price has remained consistently above BCL's breakeven price of approximately \$3.30 per pound (see Chart 1). Although BCL produces roughly equal quantities of copper and nickel, nickel produces the great majority of revenue because the price of nickel is roughly five times that of copper. The recovery of nickel prices has enabled BCL to make operating profits, and to cope without additional emergency funding from the Government.

Meanwhile, a major expansion at the Phoenix mine near Francistown will make its output as large as that of BCL, in terms of ore mined and nickel content. Employment at Phoenix will only grow from 500 to 800, however, because Phoenix is an open pit mine and therefore requires much less labour than BCL. The Phoenix mine is profitable, and pays royalty and taxes to the Government.

Chart 1: Nickel Prices 1997-2000



Inflation

It is slightly worrying, on the other hand, that the main reason for higher sales is the continued growth of the United States economy, to the point where the US share of global diamond sales has risen above 50%. Botswana's position would be more secure if sales were less dependent

It has recently become rather complicated to understand what has been happening to inflation in Botswana. The figures for inflation have been *revised upwards* for the period from August 1999 to June 2000.

The Central Statistics Office had failed take into account an increase in rents for Botswana Housing Corporation (BHC) low-cost houses, which occurred in August 1999. A revised series has now been published. For eleven months, from August 1999 until June 2000 inclusive, the annual rate of inflation was either 1.4 percentage points or 1.5 percentage points higher than the rates of inflation that were previously published. The old and new series are shown in Table 1.

Table 1: Revised rates of inflation, August 1999 to June 2000

Month	Old rate	Revised rate	Difference
1999 Jul	6.9	6.9	0.0
Aug	7.0	8.5	+1.5
Sep	7.6	9.1	+1.5
Oct	7.5	9.0	+1.5
Nov	7.0	8.5	+1.5
Dec	6.9	8.4	+1.5
2000 Jan	6.9	8.3	+1.5
Feb	6.6	8.1	+1.5
Mar	6.4	7.8	+1.4
Apr	7.0	8.4	+1.4
May	7.3	8.7	+1.4
Jun	7.5	8.9	+1.4
Jul	10.6	10.6	0.0
Aug	8.6	8.6	0.0
Sep	8.2	8.2	0.0

Source: CSO
Consumer Price Statistics,
July and August 2000

A second complicating factor is that there was another BHC rent increase in July 2000. The major item was a 50.1% increase in rents for BHC high cost houses. This pushed the rate of inflation up to 10.6%. However, using the revised inflation series, inflation only jumped from 8.9% in June, to 10.6% in July. This increase, at 1.5 percentage points, was only half the percentage point increase indicated by the earlier series.

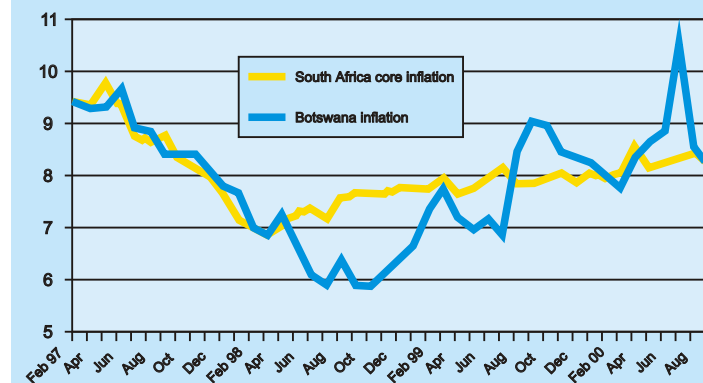
Meanwhile, the inflation figure for August fell back to 8.6%, from the 10.6% of July, partly because the point of comparison (August 1999) is considerably higher under the revised series than it was under the original published series. In September, the annual rate of inflation fell further, to 8.2%. This

is marginally lower than it was a year ago.

As can be seen from Chart 1, the upward shift in the Botswana inflation rate brings it much nearer to the core inflation rate in South Africa, than was shown in previous BIDPA Briefings. However, Botswana's inflation has not risen significantly above South Africa's, and rent increases do not affect Botswana's competitive position directly. Indirect effects will also be small: it is unlikely that the managers employed by private sector investors live in BHC high cost houses. It is bad news that inflation has been higher than

of 2000, should have only a small effect on prices, assuming that the decline in the rand has no greater effect on South African inflation than during other recent periods of rand weakness. And the inflationary effect will be offset to some extent by the 5.4% rise of the Pula against the rand. The slow down in the economy, probably caused mainly by a reduction in the rate of increase in government spending, will also tend to reduce inflationary pressure. Overall, there seems to be no particular reason at present to forecast more than marginal changes in either direction in the rate of inflation (and therefore in interest rates).

Chart 2: Botswana Inflation and South African Core Inflation 1997-2000



Previously believed, but the difference is not large enough to endanger the country's basic strategy, of economic diversification led by the private sector.

For the future, there is some further pressure on prices to come, notably from the most recent increase in the cost of petrol (which was not included in the September consumer price index). This will obviously increase the price level to some extent, not only in the transport sector but in other sectors whose transport costs will increase. It is notable that the much larger percentage increase in the cost of petrol earlier this year has not yet had much effect on the rate of inflation, although the impact on the price level may occur after a lag. The decline of the Pula against the US dollar, by 13.6% since the start

International Financial Services Centre (IFSC)

There has been a setback for the IFSC. It was expected that a large proportion of business attracted to the IFSC would be from South Africa. One of the main attractions of the IFSC is a corporate tax rate of 15%. Unfortunately, the South African Government has announced that the taxation of the foreign profits of South African companies will be changed. It has been proposed that income from the foreign investments of South African companies, if they are subject to a lower rate of corporate tax than in South Africa, will have to pay additional South African tax (at a rate equal to the difference between the foreign and the South

African Tax rate) if the foreign rate of tax is less than 90% of the South African rate. This would eliminate the attractions of the 15% corporate tax rate in Botswana for investors in the IFSC.

The proposal would affect *all South African companies* with investments in Botswana, not just those in the IFSC. Manufacturers pay 15%, and other companies pay 25%, both of which are less than 90% of the South African rate. Representations have been made to the South African Government, and

the issue has not yet been resolved. South African companies which have expressed interest in the IFSC are waiting until a decision is made.

It is hoped that the additional tax in South Africa will only have to be paid if and when profits are remitted back to South Africa, as is the case under current South African law. A company setting up in Botswana wishing to reinvest its profits, or to use them for expansion elsewhere (in the rest of SADC for example), would then not be subject to additional tax, and could take full

advantage of the lower rate of tax in Botswana. However, a recent article in *Business Day*, by South Africa's Chief Director of Tax Policy, says that South African tax will apply to controlled foreign subsidiary income *as it is earned*.

Despite this setback, three companies have already been approved by the IFSC, and a further three applications are pending, from Zimbabwe and Britain. If these projects develop satisfactorily, it will help in attracting further applications.

ECONOMIC FACTS AND FORECASTS

	Quarterly								
	1998	1999			2000				
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
(end of period)	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Interest rates (%)									
BOBC (3 month)	10.66	11.55	11.75	11.68	11.95	12.45	12.53	12.46	
Prime	14	14.25	14.75	14.75	14.75	15.25	15.25	15.25	
Inflation (%)	6.4	7.8	7.2	9.1	8.4	7.8	0	0	
Rand-Pula	1.32	1.33	1.30	1.32	1.33	1.35	1.35	1.38	
Pula-US\$	4.46	4.67	4.63	4.55	4.62	4.85	5.11	5.26	
BSE index	947	990	1033	1417	1399	1471	1435	1475	
	Annual								
	1993	1994	1995	1996	1997	1998	1999	2000	
Growth (%)									
GDP (real)	d	4.2	2.5	6.6	7.1	8.0	4.2	9.0	7.0 f
Non-mineral GDP (real)	d	3.5	4.8	5.0	7.9	7.7	8.9	8.5	5.0 f
Exports (nominal)	b	15.3	18.4	19.0	23.1	39.6	-15.4	43.1	1.0 f
Imports (nominal)	b	9.2	2.7	20.4	8.3	43.8	16.7	11.1	13.0 f
Govt. spending (nominal)	c	11.8	-4.6	21.5	17.3	21.6	22.4	15.0 e	13.0 f
Govt. revenues (nominal)	c	14.3	-16.5	22.2	35.3	12.0	-7.3	55.0 e	0.0 f
Domestic (bank) credit	b	11.8	18.2	-3.7	1.2	5.6	56.1	45.0 e	25.0 f
Interest rates (%)									
BOBC (3 month)	a	13.5	11.9	12.0	12.2	11.4	11.6	12.5	12.3 f
Prime	a	15.0	14.0	14.5	14.5	14.0	14.3	15.3	15.3 f
Inflation (average, %)	b	14.4	10.6	10.5	10.1	8.9	6.7	7.2	8.6 f
Rand-Pula	a	1.32	1.30	1.29	1.28	1.28	1.33	1.35	1.38 f
Pula-US\$	a	2.56	2.72	2.82	3.64	3.81	4.67	4.85	5.25 f
BSE index	a	279	313	333	352	709	990	1471	-
Balance of Payments (Pm)									
Exports (diamonds)	b	3340	3727	3994	5272	7821	6081	9813	9900 f
Exports (other goods)		841	1304	1994	2100	2474	2627	2651	2700 f
Imports (goods, cif)	b	4290	4406	5305	5743	8256	9637	10710	12400 f
Current account balance	b	1220	642	937	2108	3059	860	1842	200 f
Foreign Reserves									
Pula m	a	10509	11961	13249	19076	21619	26485	28852	32500 f
US\$ m	a	4097	4402	4695	5234	5675	5941	6229	6200 f
Govt. spending (Pm)	c	4481	4277	5195	6092	7406	9065	10400 e	11730 f
Govt. revenue (Pm)	c	5359	4473	5464	7395	8281	7678	11922 e	12100 f
Budget surplus/(deficit) (Pm)	c	878	196	269	1303	875	-1387	1522 e	370 f
Govt. balances at BOB	a	5598	6705	6460	7204	15634	19212	20199	24000 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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