



Overview

Botswana inflation has persistently remained below South African core inflation since the latter part of 2000. This trend could partly be explained by the reduction in domestic inflationary pressures as well as the appreciation of the Pula against the rand. The Pula remained relatively stable against the rand between 1993 to 1999, but appreciated by 7.5 percent since then, making it less attractive to buy Botswana goods relative to South African goods. The Pula lost much of its international purchasing power as it depreciated against the US dollar and SDR by 60% and 56%, respectively, from the beginning of 1993 to May 2001. The Botswana stock market has performed relatively well, with the Domestic Company Index reaching a high of 2091. The overall market performance was driven by bank stocks, which were heavily traded. The services sector is a possible avenue for future economic diversification. Travel, the largest component of service exports, grew faster than non-mining GDP. The 2000/01 revised estimates envisage a 13.5 percent increase in government spending. However, the rate of growth in government spending in the last budget year was only 5.8 percent (less than the inflation rate). This means government expenditure fell in real terms. The average annual rate of increase in formal sector employment was 4.8 percent between 1997 to 2000, with the construction sector enjoying the highest growth. The proportion of non-citizens in total formal employment has ranged between 4-6 percent over the past few years, but has recently increased as growth accelerated.

Inflation

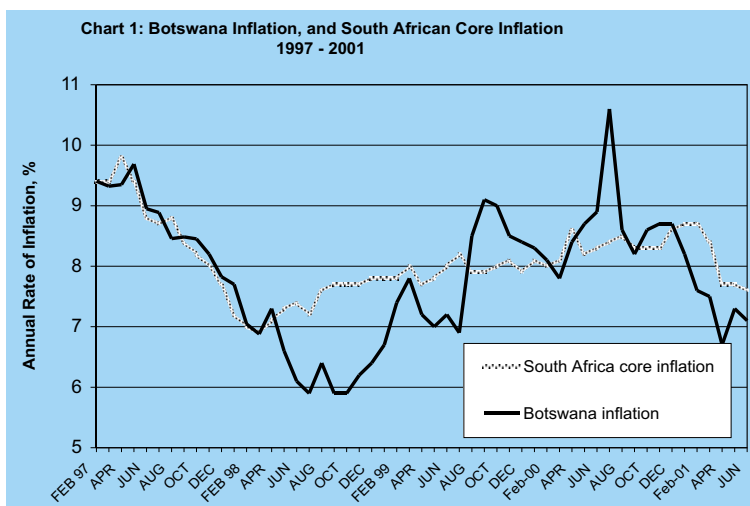
Botswana's rate of inflation at the end of 2000 stood at 8.7 percent. Subsequently, there has been a reduction in the monthly inflation figures, from 8.0 percent in January to 7.1 percent in June 2001. In contrast to previous years, there has been a reduction in inflationary pressures arising from domestic factors. The annual rate of increase in total commercial bank lending declined steadily from 41.4 percent at the end of 1999 to 17.6 percent in December 2000. This comprised a reduction in the growth of credit to the household sector, which rose by 20 percent in 2000 compared to 45 percent in 1999. Similarly, credit to the business sector grew by 14 percent in 2000, compared to 41 percent the previous year. This reduction in credit growth may have been in response to Central Bank increases in the Bank Rate (that led to increases in the prime rate) during the previous year, from 13.25 percent to 13.75 in February 2000 and further to 14.25 percent in October 2000.

The declining trend in the rate of growth of commercial bank credit was accompanied by a fall in the rate of increase in government spending. The increase in bank credit was smaller than the growth in government spending, thus its impact was smaller. However, whatever the relative influence of government spending growth and commercial bank credit growth, it is unambiguously correct to say domestic inflationary pressures have decreased. This makes it more likely that the appreciation of the Pula against the rand that has occurred over the past year will be reflected in lower inflation

in Botswana than in South Africa.

In addition to declining domestic inflationary pressures, food prices, which comprise the largest component of the consumer price basket of goods, rose by only 4.1 percent in 2000 compared to 5.3 percent in 1999. Furthermore, the annual rate of price increase of imported tradeables

(which excludes changes in the cost of mortgages and prices of volatile food items). But, Botswana's inflation rate then fell below that of South Africa in January 2001, and has continued to do so to the current period (chart 1). It could be argued that the pula appreciation towards the end of 2000 is finally starting to have an effect on the inflation rate, although not as large as



showed a declining trend, from 8.8 percent in December 2000 to 5.3 percent recorded in June 2001. Similarly, the year-on-year rate of inflation for domestic tradeables declined from 6.3 percent to 5.5 percent between December 2000 and June 2001. However, the rate of price increase for non-tradeables shows an increase, from 9.1 percent to 11.2 percent during the same period, suggesting that domestic inflationary pressures are still strong (contrary to what was suggested above).

Botswana's inflation rate throughout 2000 was generally higher than the South African core inflation rate

the appreciation itself. As a result, the real exchange rate continues to rise. Up to March 2001, there had been no discernable impact of the pula appreciation against the rand on Botswana's inflation rate.

The decline in the rate of increase in government expenditure and credit growth, accompanied by a slowdown in economic growth, should further reduce inflationary pressures. However, government wage increases risk accelerating domestic inflation again. Which of those opposing forces dominates will determine the ultimate direction of the inflation rate.

Exchange rate risks and international competitiveness

The Botswana Pula is pegged to a basket of currencies comprising the South African rand and the SDR. From the beginning of 1993 to May 2001, the Pula depreciated by 60 percent against the US dollar (56 percent against the SDR), eroding the Pula's international purchasing power. The Pula appreciated 5.3 percent against the Rand over the same period, which (other things equal) makes buying goods from South Africa more attractive relative to buying goods from Botswana firms.

Botswana's overall competitiveness has exhibited a mixed picture over the past few years with the real appreciation against the South African rand offsetting the gains from the real depreciation against the major international currencies.

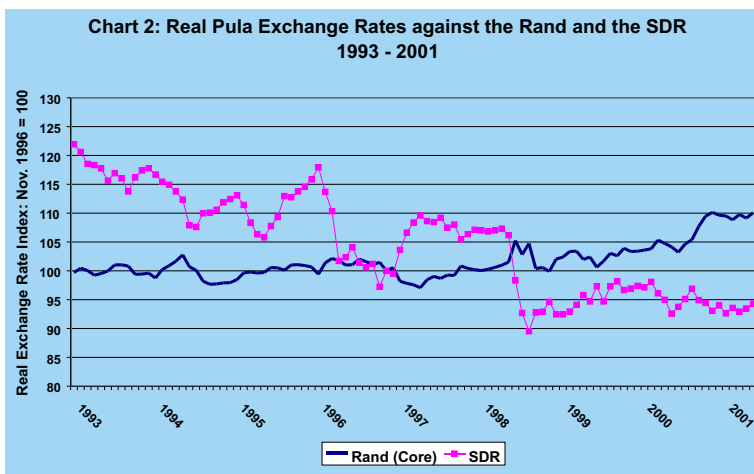
The appreciation of the pula against the Zimbabwe dollar has tended to be offset over time by higher inflation rates in Zimbabwe than in Botswana. Thus, while the real exchange rate against the Zimbabwe dollar at the end of 2000 was about the same as it was in November 1996, the continuing high inflation in that country has led to a

investment destination. Unfortunately, it has not been possible for Botswana to have stable exchange rates against currencies of its major trading partners, because these currencies have fluctuated against each other. Nevertheless, since the beginning of 1999, the pula has fluctuated within a modest range of 9.4 percent against the South African rand and 15.2 percent against the SDR, which are smaller ranges of fluctuation than have been recorded between the Euro and the US dollar (36.0%), the British pound and the US dollar (15.9%) and, of course, the South African rand and the US dollar (35.2%).

Stock market performance

The Botswana stock market has been performing impressively, as measured by the Domestic Company Index (DCI), which is a weighted average of all the domestic companies listed on the stock exchange. The index towards the end of July 2001 reached a record high of 2091, well above the 2000 average of 1466. The index has experienced steady gains throughout 2001, despite the gains and losses experienced by the different firms in the market. The overall performance was largely driven by gains in the financial sector, specifically heavy trading in bank stocks.

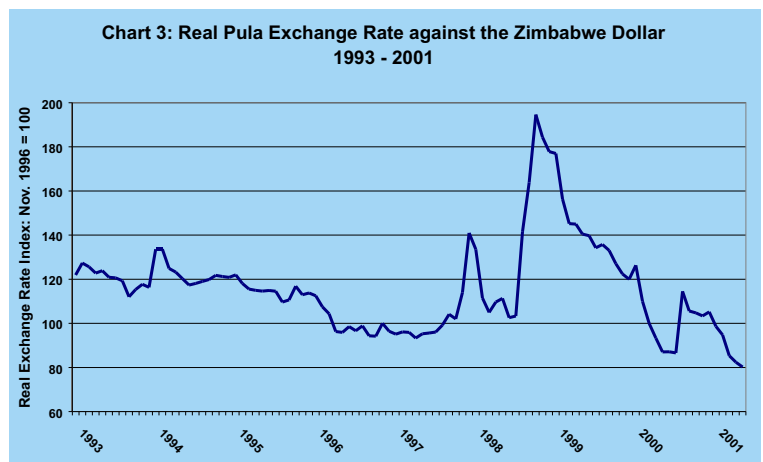
Chart 4 shows movements in the DCI over the past three and a half years, with a rapid increase in mid-1999, and another rise starting in January 2001. The index appeared to plateau from



Assessing the effects of such exchange rate movements on international competitiveness is generally done using the *real exchange rate*. This measurement adjusts the level of nominal exchange rates (say the Pula-Rand exchange rate) for the difference in inflation in the two countries. The real Pula-Rand exchange rate (using the South African core inflation rate) was relatively stable from 1993 to 1999, but has appreciated by 7.5 percent since then.

sharp 24% real depreciation of the Pula against the Zimbabwe dollar in 2001. The fluctuations in the real exchange rate against the Zimbabwe dollar, along with the economic difficulties there, must have been bad for trade and investment.

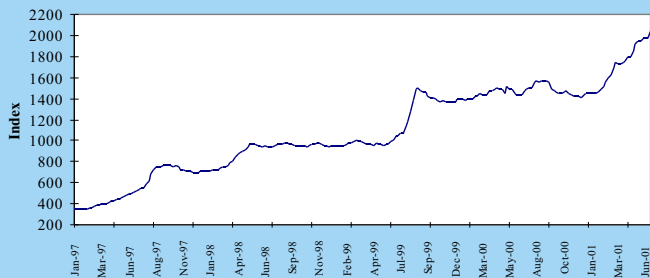
While the nominal depreciation against the major international currencies appears massive, the prices of Botswana goods and services, as reflected in the consumer price index, have more than doubled over the period (+116%), compared to a 19 percent increase in prices in the major industrial countries. This difference in rates of inflation has offset a large part of the nominal pula depreciation. Chart 2 shows a *real* depreciation of the pula against the SDR over the eight-year period of about 23 percent, compared with the nominal depreciation of 56 percent. As noted in previous BIDPA Briefings, the real exchange rate against the SDR has been relatively stable in the last two years, appreciating only 2%.



The variability of exchange rates is also important for businesses and consumers in Botswana. Exchange rate fluctuations increase the riskiness of international transactions, both for foreigners and for Botswana residents. The risk of unexpected decreases in profits, due to exchange rate variability, makes Botswana less attractive as an

August 1999 to January 2001. While the non-mining economy experienced accelerating growth from 7.2 percent to 8.9 percent between 1997/98 and 1998/99, the DCI still fell in the latter part of 1999. There appears to be little positive correlation between stock market performance and economic growth.

Chart 4: BSE Index Jan 1997 - June 2001



Source: Botswana Stock Exchange

The services sector

It is generally accepted that services play a critical role in determining both

particularly in the transport of goods between Botswana and South Africa, which has been dominated by South

Table 1: Average Annual Growth in Services Exports(%)

	Total Services	Transport	Travel	Gov't	Other	Total Non-Mining GDP
Growth Rate	16.4	14.4	18.1	9.5	14.6	15.9
Real Growth Rate	5.0	3.2	6.6	-1.2	3.4	5.9

Source: Bank of Botswana, CSO

the quality and speed of the process of economic development, and that an efficient and technologically advanced service sector is essential for a

African transport companies. However, one of the main constraints for Botswana transport companies gaining access to the South African

Table 2: Annual Percent Change in Government Spending

Year Ending March	1998/1999	1999/2000	2000/2001 Revised Estimate	2000/2001 Provisional	2001/2002* Budget Estimate
Recurrent Exp	27.6	12.9	17.1	17.1	14.6
Development Exp	12.7	17.2	5.9	-20.6	30.6
Total Gov't Spending	27.6	14.3	13.5	5.8	28.2

*Annual percentage change based on the provisional figure.

competitive economy. It is for this reason that in the Uruguay Round of trade talks, services were included in the agenda and the General Agreement on Trade in Services (GATS) was established. The GATS provides for secure access to markets and progressive liberalisation of trade in services, which are expected to promote investment opportunities, economic growth and a more efficient utilisation of services. In its bid to diversify the economy, Botswana should explore opportunities provided by the services sector.

Between 1990 and 1999, the real rate of growth of service exports was 5.0 percent per annum. Though encouraging, this is less than the rate of growth of real non-mining GDP, which was 5.9 percent per annum, over the same period. Travel, which is the largest component of service exports, grew slightly faster than non-mining GDP. This could be due to the influence of tourism, currently targeted by the Government as a potential engine of growth.

It is disappointing that the transport

market is the fact that only goods carried by South African officially registered VAT transporters are exempt from the payment of VAT. As such, Botswana exporters are likely to engage South African transporters to qualify for exemption, making it difficult for Botswana transporters to increase their share of the market.

The category "other", which includes new types of service exports, such as the location of administrative services for companies doing business in the rest of the region, or in the rest of Africa, is not performing well. To the extent that such activities receive payments from abroad, they constitute service exports. It is possible, however, that the statistics are not picking

component of service exports has grown relatively slowly. It would benefit Botswana transport companies to gain an increasing share of transport in South Africa,

this up, hence understating Botswana's service exports.

Indicators of GDP growth: Government spending

Growth in government spending is one of the strongest indicators of economic activity. The rate of increase of total government expenditure and net lending was more than 25 percent in 1998/99, but fell to 14.3 percent in 1999/00. The 2000/01 revised estimates envisaged a 13.5 percent increase in government spending.

In the last budget year, the rate of growth of government spending was only 5.8 percent. This is actually less than the rate of inflation, which means government expenditure fell in real terms.

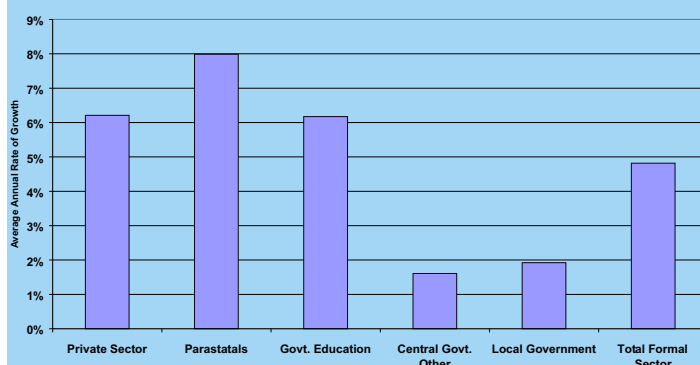
These figures suggest that the economy may have grown slower than previously thought. If the current budget estimates for 2001/02 materialise, there will be an increase of 28 percent in government expenditure. Such a large increase in expenditure is likely to be accompanied by implementation problems. Thus, it seems unlikely that government spending could grow that rapidly.

Formal sector employment by sector and citizenship

Formal sector employment grew steadily from 1997 to 2000. The average annual rate of increase was 4.8 percent, not nearly as high as in the 1980s, but higher than the rate of growth of population. As a result, the rate of unemployment has fallen, although it remains uncomfortably high (from 19.8% in 1998 to 15.8% in 2000).

The most rapid rate of growth was in the construction sector, which accounted for 26 percent of the total increase in formal employment over the period.

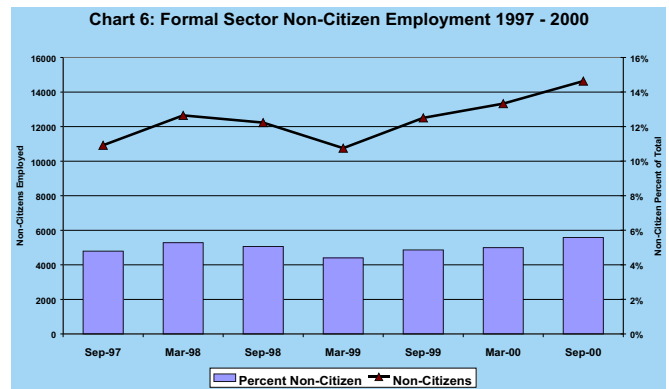
Chart 5: Formal Sector Employment Growth 1997 - 2000



But, employment growth was reasonably well spread across sectors (chart 5). Additional positive features were that private and parastatal employment increased faster (6.1% p.a.) than government employment (3.0%), and that most of this increase in government employment was in education. Employment growth in the private sector is crucial for economic diversification and sustained development, and spending on education is a productive investment that should contribute to future development. Employment in central and local government rose steadily throughout the period September 1997 to September 2000. As noted above, much of that growth was due to rapid

increases in employment in government education, which rose from 26 900 in September 1997 to 32 200 in September 2000, an average increase of 6.2 percent per annum.

As shown in (chart 6), the number of non-citizens employed has recently increased, but the ratio of non-citizens in total employment has remained in the 4-6 percent range over the past few years.



This ratio has recently increased as economic growth accelerated, thus increasing the demand for foreign expertise in areas where local manpower is in short supply.

ECONOMIC FACTS AND FORECASTS

Quarterly		1999		2000				2001	
(end of period)		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Interest rates (%)									
	BOBC (3 month)	11.68	11.95	12.43	12.49	12.49	12.71	12.67	12.89
	Prime	14.75	14.75	15.25	15.25	15.25	15.75	15.75	15.75
	Inflation (%)	9.1	8.4	7.8	8.9	8.2	8.7	7.5	7.1
	Rand-Pula	1.320	1.328	1.354	1.330	1.385	1.411	1.426	1.429
	US\$-Pula	0.220	0.216	0.206	0.195	0.190	0.187	0.177	0.174
	BSE index	1417	1399	1471	1435	1475	1454	1733	2037
Annual									
		1994	1995	1996	1997	1998	1999	2000	2001
Growth (%)									
	GDP (real) <i>d</i>	3.2	5.5	5.6	8.1	4.1	7.7	9.7 <i>f</i>	3.9 <i>f</i>
	Non-mine ral GDP (real) <i>d</i>	5.8	6.1	5.5	7.3	7.8	5.7	7.1 <i>f</i>	5.8 <i>f</i>
	Exports (nominal) <i>b</i>	20.6	19.0	23.1	39.7	-15.4	41.2	10.8 <i>p</i>	-4.0 <i>f</i>
	Imports (nominal) <i>b</i>	3.9	21.5	9.6	44.0	19.3	3.4	8.0 <i>p</i>	13.2 <i>f</i>
	Govt. spending (nominal) <i>c</i>	-4.6	21.5	17.3	21.6	22.4	15.0	5.1 <i>p</i>	28.5 <i>f</i>
	Govt. revenues (nominal) <i>c</i>	-16.6	22.2	35.3	12.0	-7.2	55.8	8.4 <i>p</i>	-9.2 <i>f</i>
	Formal employment <i>s</i>	1.3	1.2	2.2	-4.5	6.1	6.2	2.2	2.2 <i>e</i>
	Unemployment rate <i>a</i>	21.3	21.5	20.9	20.4	19.8	17.8	15.8	17.3 <i>e</i>
	Domestic (bank) credit <i>b</i>	18.2	-3.7	1.1	5.6	56.1	41.3	17.7	13.2 <i>f</i>
Interest rates (%)									
	BOBC (3 month) <i>a</i>	11.90	11.95	12.23	11.40	10.66	11.98	12.71	12.89 <i>f</i>
	Prime <i>a</i>	14.00	14.50	14.50	14.00	15.25	14.81	14.00	15.75 <i>f</i>
	Inflation (average, %) <i>a</i>	10.6	10.5	10.1	8.9	6.5	7.8	8.5	7.3 <i>f</i>
	Rand-Pula <i>a</i>	1.305	1.294	1.284	1.278	1.318	1.329	1.411	1.424 <i>f</i>
	US\$-Pula <i>a</i>	0.368	0.354	0.274	0.263	0.224	0.216	0.187	0.180 <i>f</i>
	BSE index <i>a</i>	313	333	352	709	947	1399	1454	2167 <i>f</i>
Balance of Payments (Pm)									
	Exports (diamonds) <i>b</i>	3,727	3,994	5,272	7,675	6,004	9,603	11,319	9,406 <i>f</i>
	Exports (other goods) <i>b</i>	1,305	1,995	2,100	2,620	2,704	2,970	3,323 <i>p</i>	3,676 <i>f</i>
	Imports (goods, cif) <i>b</i>	3,663	4,451	4,879	7,026	8,380	8,664	9,360 <i>p</i>	10,593 <i>f</i>
	Current account balance <i>b</i>	568	831	1,644	2,634	860	2,859	2,882 <i>p</i>	1,961 <i>f</i>
Foreign Reserves									
	Pula m <i>a</i>	11,961	13,249	19,076	21,619	26,485	28,852	33,880	36,244 <i>f</i>
	US\$ m <i>a</i>	4,402	4,695	5,234	5,675	5,941	6,229	6,317	6,507 <i>f</i>
	Govt. spending (Pm) <i>c</i>	4,277	5,195	6,092	7,406	9,065	10,428	10,965 <i>e</i>	14,084 <i>f</i>
	Govt. revenue (Pm) <i>c</i>	4,472	5,464	7,395	8,281	7,681	11,963	12,963 <i>p</i>	11,766 <i>f</i>
	Budget surplus/(deficit) (Pm) <i>c</i>	196	270	1,302	875	-1,385	1,536	1,998 <i>e</i>	-2,318 <i>f</i>
	Govt. balances at BOB <i>a</i>	6,705	6,460	7,204	15,364	19,212	20,199	24,740	24,634 <i>f</i>
Notes:		<i>a</i> end of period; <i>b</i> calendar year; <i>c</i> financial year (starts March); <i>d</i> statistical year (starts July)							
		<i>e</i> BIDPA estimate; <i>f</i> BIDPA forecast; <i>p</i> preliminary data; <i>s</i> year to September							
		Details of assumptions underlying the forecasts can be obtained from BIDPA.							
Sources:		CSO, Bank of Botswana, MFD P, BIDPA							

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