



**BIDPA**

# Briefing

Sponsored by



**ISBN 1560-5817**

**1<sup>st</sup> Quarter 2004**

## Introduction

This BIDPA Briefing issue looks at the annual performance of the economy over the period from 1992/93 to the first half of 2003/04. Over the period, there has been a gradual transformation in structure of the economy. There is also evidence of the economy facing weakening economic fundamentals. The mining sector, on which the economy depends heavily, is not expected to be a major engine of growth. This calls for an added effort to stimulate the development of alternative sectors that can provide jobs and a sustained increase in incomes.

The Briefing also discusses inflation issues following the falling out of VAT from the calculation of the consumer price index last year. There are other inflationary pressures; and in this Briefing we consider two domestic economic developments (devaluation and the public sector salary increase) that will have a bearing on inflation.

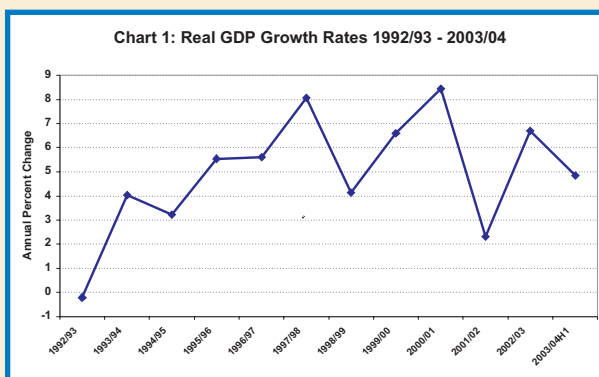
## Economic Review

GDP growth in Botswana continues to be highly variable, with annual growth rates over the past 11½ years fluctuating to as high as 8.4 percent and as low as negative 0.2 percent (see Chart 1). The aggregate economic performance is mainly driven by the minerals, government and agriculture sectors, although the services sectors (comprising water and electricity, trade, hotels and restaurants, transport and communications, finance, real estate and business services and social and personal services) have come to represent ever-increasing shares of total GDP. While the economy has improved its performance over the past five years compared to the poor performance in the early 1990s, economic growth is not enough for achievement of Vision 2016 targets, or for achieving full employment and significant reductions in poverty. To make matters worse, there are widespread signs that the economy is slowing down, as the major engines of growth of the past – diamonds and government spending – have run their course, with only modest increases expected in the future.

The Central Statistics Office has recently provided GDP figures up to the first half of the national accounts year for 2003/04 (MFDP, 2004 Annual Economic Report). These data can be compared to the GDP data for the corresponding periods in 1993/94 and 1998/99 to identify trends in growth, the contributions that different sectors have made to total economic growth and the changing structure of the economy. This review briefly discusses the performance and prospects of each of the major industrial sectors, before analysing in

more detail what has happened to the broad sectoral categories of mining, agriculture, manufacturing and construction, services and government. The review highlights the need for substantial improvements in productivity

grew at a robust average annual rate of 8.8 percent, while from then to the first half of 2003/04, the sector contracted at an average rate of -0.8 percent per annum. The sector appears to be contracting further in the first half of 2003/04.



throughout the economy, if the economy is going to be able to compete in global markets, achieve higher rates of economic growth and raise standards of living to levels comparable to those in the more industrialised nations. Without such productivity improvements, Botswana will face economic stagnation, rising unemployment, worsening poverty and growing fiscal imbalances and balance of payments problems.

## Sectoral GDP Growth

The agricultural sector has registered a real rate of growth of about zero for the past two and a half decades, despite numerous government programmes to promote productivity and boost incomes in the sector. While notable improvements have been registered in non-traditional commercial agriculture (e.g., poultry and dairy), traditional agriculture has performed poorly. Government has adopted the National Master Plan for Arable Agriculture and Dairy Development (NAMPAAADD) to foster further productivity improvements in the commercial agriculture sector. While the sector is showing signs of growth in the first half of 2003/04, because of the country's climate, geography, soils and farmer behaviour, notwithstanding NAMPAAADD, the sector is only expected to become a modest engine of macro-economic growth in the future.

Mining sector growth has been highly variable over the past decade, but is showing signs of slowing down. The manufacturing sector has recorded very modest rates of growth over the past decade, with the rate of growth from the first half of 1993/94 to the first half of 2003/04 averaging 2.9 percent per annum. But, this conceals the fact that from the first half of 1993/94 to the first half of 1998/99, the sector

The water and electricity sector has experienced fairly rapid growth over the past decade, with an average rate of growth of 7.0 percent per annum over the period from the first half of 1993/94 to the first half of 1998/99, and a 5.3 percent per annum growth rate over the period from the first half of 1998/99 to the corresponding period in 2003/04. However, the data for the first half of 2003/04 suggests that output

is dropping off in 2003/04. Growth in the construction sector has been modest, at an annual average rate of 3.6 percent over the past decade, with a somewhat higher rate of growth of 4.2 percent per annum recorded for the period from the first half of 1998/99 to the first half of 2003/04. The trade, hotels and restaurants sector has registered steady growth of 7.8 percent per annum over the past ten years. But, the sector is showing signs of tapering off in 2003/04. Apart from the tourism sub-sector, which can attract external demand, the trade, hotels and restaurants sector cannot be expected to be an engine of growth. The driving force for the sector comes from the performance of the other sectors of the economy.

The transport and communications sector has been slowing down since 1998, with the annual rate of growth over the five years to the first half of 2003/04 being 0.8 percent compared to 6.4 percent per annum for the five year period to the first half of 1998/99. The national accounts data for the first half of 2003/04 suggests the rate of growth in the trade, hotels and restaurants sector is turning negative (-6%). The finance, real estate and business services sector has recorded positive rates of growth of value added throughout the past decade, with the growth rate from the first half of 1993/94 to the corresponding period in 1998/99 averaging 9.7 percent per annum, and that from 1998/99 to 2003/04 averaging 3.9 percent per annum. But, the rate of growth appears to be tapering off to nearly zero in 2003/04.

The social and personal services sector has experienced a bit of a roller coaster ride over the past ten years, with an average annual rate

of growth of 4.3 percent from the first half of 1993/94 to the first half of 2003/04. While the annual rate of growth has been positive throughout the period from 1993/94 to 2002/03, it appears to have turned negative in the first half of 2003/04.

Government GDP growth has been consistently strong, averaging 6.5 percent per annum, over most of the past decade. The national accounts data for the first half of 2003/04 suggests that it is still expanding strongly, at 9.8 percent. However, government cannot afford to continue to grow rapidly, as its revenue prospects are not that bright. With the plateauing of the mineral sector, the new SACU agreement and other trade liberalisation agreements and the drop in international reserves as government savings at the Bank of Botswana decline, Government's mineral revenues, customs union revenues and revenues from the Bank of Botswana are not expected to grow much, if at all. The growth of the government sector, therefore, must taper off in order to maintain a sound and sustainable fiscal position.

Over the period from the first half of 1993/94 to the first half of 2003/04, real value added (measured in constant 1993/94 prices) grew at an average annual rate of 5.2 percent, with growth over the first five year period averaging 4.6 percent per annum, and over the second five year period 5.7 percent per annum. But, within that overall pattern there were marked differences in the performances of broad sectoral categories, both within sub-periods and in terms of overall performance. The four broad sectoral groups reviewed include: (1) mining; (2) agriculture, manufacturing and construction; (3) services (as defined above) and (4) government. The mining sector averaged growth of 2.2 percent per annum over the period from the first half of 1993/94 to the first half of 1998/99, and 7.2 percent per annum over the subsequent five-year period. The overall rate of growth of the sector over the decade of 4.6 percent per annum was slightly below that of the rest of the economy.

The agriculture, manufacturing and construction sector as a group was the weak performer in the macroeconomy. This sector's growth averaged 2.7 percent per annum, with both sub-periods recording similar growth rates. The services sector performed very strongly over the period from 1993/94 to

1998/99, with an average annual rate of growth of 7.8 percent. Growth in the subsequent five-year period was more modest at 4.8 percent per annum. The government sector was the star performer in terms of growth of real value added over the ten-year period to 2003/04, with an average annual rate of growth of 6.5 percent. Growth in the latter five-year period from the first half of 1998/99 to the first half of 2003/04, at 6.9 percent per annum, was stronger than that in the earlier five-year period from 1993/94 (6.1 percent per annum).

## Contribution to Total GDP Growth

Of the total growth in value added recorded over the period from 1993/94 to 1998/99, the mining sector accounted for 17.3 percent. The agriculture, manufacturing and construction sectors contributed only 9.0 percent of the total increase in value added, while the services sector accounted for the lion's share (51.8 percent) of the growth. The expansion of the government sector represented 21.9 percent of the total rise in value added over the five-year period to the first half of 1993/94. In contrast, over the period from the first half of 1998/99 to 2003/04, the mining sector accounted for 44.6 percent of the total increase in value added, while the services sector contributed 27.4 percent of the total growth. Government in the latter five-year period provided 21.4 percent of the total increase in real value added, while the combined agriculture, manufacturing and construction sector contributed a modest 6.6 percent.

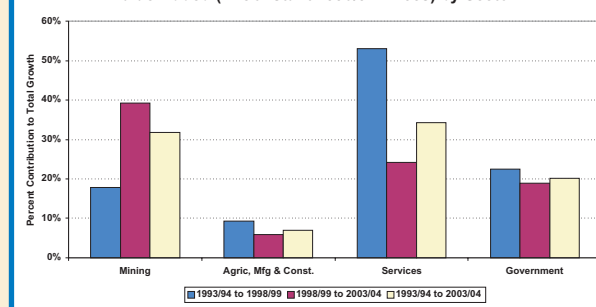
For the entire ten-year period, the services sector accounted for the largest proportion of the growth in real value added, with its contribution representing 36.8 percent. The mining sector contributed 34.0 percent of the total rise in value added over the decade, while government contributed another 21.6 percent. The industry grouping of agriculture, manufacturing and construction only accounted for 7.5 percent of the increase in real value added over the period.

Over the period from 1993/94 to 2003/04, the Botswana economy has been growing at a rate of about 5.2 percent per annum in real terms. With population growth of about 2.2 percent per annum over that decade, per capita income has been rising about 3 percent per annum. As a result of that economic growth, along with the provision of social welfare programmes, such as the old age pension, orphan's allowance, destitute's

allowance and labour-intensive public works, the incidence of poverty has fallen from about 47 percent of the population to 36 percent. That is still too high, and additional efforts to expand income-generating opportunities are needed in order to make significant inroads to further poverty reduction.

However, the Botswana economy is facing weakening economic fundamentals. The mining sector, mainly diamonds, and government can no longer be expected to be the major engines of growth. The services sector, except for tourism and international financial services, is dependent on the performance of the domestic economy for its growth prospects. In the past, the services sector has been able to grow rapidly because of the stimulus provided by the growth in the government sector and increases in government spending and lending to other sectors. The government can no longer afford

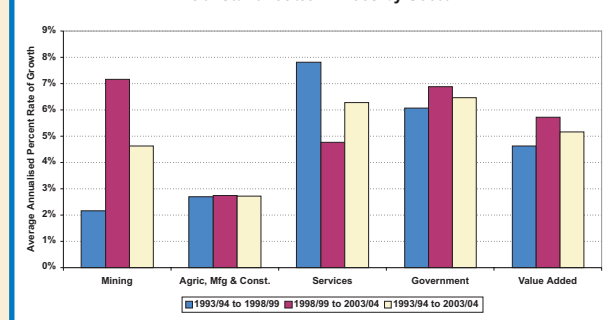
Chart 3: Contribution to Growth of First Half of Year Real Value Added (in Constant 1993/94 Prices) by Sector



to give much additional stimulus to the rest of the economy. Despite government efforts to promote other potential engines of growth in manufacturing and agriculture, these sectors have not lived up to hoped and/or expectations. Even tourism and international financial services have not provided much stimulus to the macro-economy. Other potential engines of growth in human resources development, social and personal services, such as care for the elderly and entertainment, have yet to be seriously explored and exploited.

To provide the needed engines of growth, the Botswana economy needs to become much more productive and competitive. Becoming more productive will require not only improvements in the skills, competencies and work ethic of workers, managers and entrepreneurs, it will also require making serious progress in removing the many impediments to private sector development in Botswana. While Botswana prides itself on having established an investor-friendly environment, with favourable credit ratings, good governance ratings, political stability and a stable macroeconomy, recent studies of the investment climate in Botswana by the United Nations Conference of Trade and Development (UNCTAD) and the World Bank's Foreign Investment Advisory Service, as well as by BIDPA, have identified a number of areas where meaningful reforms are urgently needed. These include:

Chart 2: Rates of Growth of First Half of Year Value Added in Constant 1993/94 Prices by Sector



- Remedying the lack of infrastructure needed by the private sector
- Eliminating the shortages of skilled labour
- Introducing programmes to remedy the lack of entrepreneurship
- Eliminating the shortages of capital
- Eliminating the shortages of land, especially serviced land for industrial and commercial activities
- Getting rid of Botswana's overvalued real exchange rate
- Removing the anti-export bias in various national policies
- Reforming the slow, unproductive bureaucracy
- Removing obtrusive regulations
- Remedying inappropriate product standards
- Modernising the outdated legal framework
- Improving the enforcement of laws and regulations

## Inflation

The impact of the Value Added Tax on inflation has subsided after a long spell of substantially high rates of increases in prices that were above the Bank of Botswana's inflation target. It is now important that a review of the development surrounding inflation in Botswana be conducted without being clouded by the concerns about VAT, some of which were perhaps exaggerated in the eyes of the general public. The probable determinants of inflation range widely and are both domestic and external. While the policy makers have some leeway to effect adjustments on the domestic components,

a continued increase in inflation. This was attributed, to a large extent, to the effect of VAT on the general level of prices. From July 2003, as expected, there has been a continued downward trend in inflation. The level of inflation was 6.4% in December 2003 and had fallen further to 6.2% in January 2004. These developments are attributable mainly to the falling away of VAT in the computation of the national rate of inflation. Looking ahead, however, it is doubtful whether we will continue to have falling inflation rates. This is reflected in the Bank of Botswana's decision to increase the range for its upper limit for the inflation objective by 1% (from 4% - 6% to 4% - 7%). The upward adjustment of the inflation objective should ease the amount of pressure on the Bank, such that the need to frequently adjust the interest rates would be less necessary.

Contrary to some expectations, Government has not announced any plans to increase taxes in 2004. Speculation was rife that VAT would be increased as a measure by Government to further increase its revenue collection capacity, as well as ensure fiscal harmonisation at the SACU level. Instead, Government has settled for somewhat minor amendments to close loopholes and strengthen tax administration capacity. The amendments are estimated to fetch government only P50 million more in revenue. As a result, taxes (VAT in particular) are not expected to play any role in pressuring inflation upwards. However, there exist some other government actions that are expected to contribute to higher inflation. Last November, Government announced a substantial increase in civil servants' salaries in the financial year beginning in April, a move that cast doubts on Government's effort to restrain fiscal spending. This move will make more difficult the task of the Bank of Botswana to reduce the level of inflation.

Moreover, Government decided to devalue the Botswana Pula by 7.5% in February, citing the need to improve the competitiveness of

Botswana's products in the local and international markets. While competitiveness and loss of it in key markets had to be given consideration in implementing devaluation, perhaps there is need to spell out the likely effects of the devaluation, particularly on inflation. Firstly, it is worth noting that the timing of the devaluation is, though to a limited extent, detrimental, in that it comes less than two

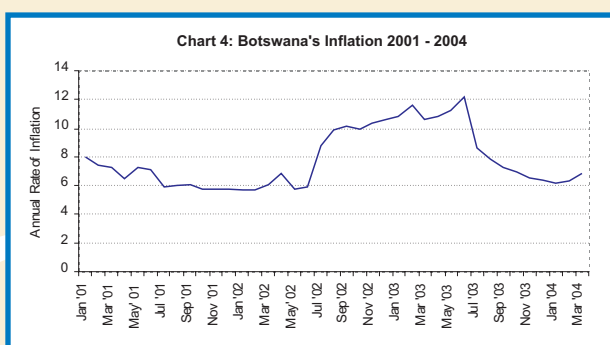
months before the implementation of the new increases in civil servants' salaries. It is, therefore, likely to be at the same time when the inflationary effects of the devaluation start to make their impact that the effects of the salary increases will also begin to permeate the economy. It should be expected that the higher rates of inflation will take a longer period to work their way through the economic system

before they subside. Secondly, the other effect of the devaluation has to do with the behaviour of the economic agents in response to such an action, both in the short run and, more importantly, in the long run. Devaluations have been used in some countries to curb some problems beyond competitiveness. Government should, in using devaluation, not overlook the important issue of the credibility of the central bank, which is crucial for the stability of the currency and the ability to attract investors.

Furthermore, the devaluation will make imports more expensive. A weaker pula will fetch a smaller amount of, for example, South African rands, or, more practically, a smaller basket of goods in the South African markets. This will have a negative cost impact on the domestic (and importing) retailers, as well as on domestic producers who source their inputs from South Africa. As a result, local producers, in particular, will increase their prices in order to compensate for the higher cost that would result. Inflation will go up and the Bank of Botswana will be under pressure to react by hiking interest rates, as it has tended to do in the past, particularly, as was evident during the period when the effects of VAT were exerting pressure on the level of inflation.

The devaluation is also expected to yield some positive results, which provides the basis for defending the move. If, on the other hand, we look at the producers who are mostly targeting the international markets, the devaluation implies that they will realise an increase in their pula denominated revenues. Assuming that their input costs are not overly affected negatively by the devaluation, these firms can afford to mark down their prices in their foreign markets and thus become more competitive. A devaluation, gives them a larger profit margin if some of their costs are in pula and do not rise.

On the whole, inflation is expected to be on the increase during the year, taking into account the domestic environment that seems geared up for that to happen. To the extent that the Central Bank, through its Monetary Policy Statement, is committed to trying to maintain low levels of inflation, there is bound to be some adjustments of interest rates as a tool to restrain domestic demand through curtailing growth in credit. It, therefore, remains important that Government also exercise restraint in spending, to avoid the Bank's excessive use of the interest rate as a tool, lest it impacts negatively on private investment. While implementing monetary policy through, among other things, interest rate and exchange rate adjustments has sometimes proved to be inevitable, it is equally advisable that the Bank and Government restrain from frequently fiddling with these variables, lest the credibility of the country's policy framework be jeopardised and impact negatively on prospects for economic growth. The public and, perhaps more importantly, the investors should face a Central Bank whose actions can be trusted so they can make sound long term business commitments.



there is very little that they can do with the external ones. For instance, a small country like Botswana can do almost nothing to influence the prices of oil in the global market; it has to live with the effects pertaining to the changes in such prices.

In Chart 4, it can be clearly seen that over the twelve-month period from July 2002 there was

months before the implementation of the new increases in civil servants' salaries. It is, therefore, likely to be at the same time when the inflationary effects of the devaluation start to make their impact that the effects of the salary increases will also begin to permeate the economy. It should be expected that the higher rates of inflation will take a longer period to work their way through the economic system





## ECONOMIC FACTS AND FORECASTS

(end of period)	Quarterly									
	2001 Q4	2002 Q1	Q2	Q3	Q4	2003 Q1	Q2	Q3	Q4	2004 Q1
Interest rates (%)										
BOBC (3 month)	12.51	12.51	12.51	12.54	14.03	13.99	13.92	13.84	12.74	12.92
Prime	15.75	15.75	15.75	15.75	16.75	16.75	16.75	16.75	15.75	15.75
Inflation (%)	5.8	6.1	5.9	10.1	11.2	11.3	12.8	7.0	9.2	6.3
Rand-Pula	1.719	1.687	1.667	1.675	1.580	1.540	1.520	1.509	1.488	1.354
US\$-Pula	0.143	0.148	0.161	0.159	0.183	1.940	0.204	0.210	0.225	0.215
BSE index	1,435	1,475	947	1,733	2,037	2,214	2,455	2,346	2,499	2,641
	Annual									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Growth (%)										
GDP (real) <i>d</i>	5.5	5.6	8.1	4.1	6.6	8.6	2.1	6.7	2.0 <i>f</i>	2.3 <i>f</i>
Non-mineral GDP (real) <i>d</i>	6.1	5.5	7.3	7.8	4.0	4.1	5.1	5.0	2.6 <i>f</i>	3.0 <i>f</i>
Exports (nominal) <i>b</i>	23.1	39.7	-15.4	41.2	11.0	-1.0	8.5	-3.7	1.4 <i>f</i>	12.3 <i>f</i>
Imports (nominal) <i>b</i>	9.6	44.0	19.3	3.4	4.4	3.6	16.4	12.0	10.7 <i>f</i>	11.3 <i>f</i>
Govt. spending (nominal) <i>c</i>	19.2	21.6	22.4	15.0	10.6	17.4	14.6	4.4	15.3 <i>e</i>	n.a. <i>f</i>
Govt. revenues (nominal) <i>c</i>	35.3	12.0	-7.2	55.8	18.0	-10.0	12.6	13.1	3.1 <i>e</i>	n.a. <i>f</i>
Formal employment <i>s</i>	2.2	-4.5	6.1	6.2	2.3	1.5	3.1	2.4	1.3 <i>e</i>	1.4 <i>f</i>
Unemployment rate <i>a</i>	20.9	20.4	19.8	17.8	15.8	19.6	19.4	19.3	19.5 <i>e</i>	19.6 <i>f</i>
Domestic (bank) credit <i>b</i>	1.1	5.6	56.1	41.3	17.7	10.7	21.3	10.0	12.0 <i>f</i>	10.7 <i>f</i>
Interest rates (%)										
BOBC (3 month) <i>a</i>	12.23	11.40	10.66	11.98	12.71	12.51	14.03	12.74	11.00 <i>f</i>	10.00 <i>f</i>
Prime <i>a</i>	14.50	14.00	14.00	14.81	15.75	15.75	16.75	15.75	13.00 <i>f</i>	11.50 <i>f</i>
Inflation (average, %) <i>a</i>	10.1	8.9	6.5	7.8	8.5	6.6	8.0	9.2	7.5 <i>f</i>	7.0 <i>f</i>
Rand-Pula <i>a</i>	1.284	1.278	1.318	1.329	1.411	1.719	1.580	1.488	1.353 <i>f</i>	1.282 <i>f</i>
US\$-Pula <i>a</i>	0.274	0.263	0.224	0.216	0.187	0.143	0.183	0.225	0.208 <i>f</i>	0.187 <i>f</i>
Real Effective Exchange Rate <i>a</i>	100.0	101.1	101.8	109.0	117.3	144.3	130.5	130.3	122.6 <i>e</i>	113.8 <i>f</i>
BSE index <i>a</i>	352	709	947	1,399	1,454	2,455	2,497	2,499	2,800 <i>f</i>	3,100 <i>f</i>
Balance of Payments (Pm)										
Exports (diamonds) <i>b</i>	5,272	7,675	6,004	9,843	11,420	11,395	12,499	11,704	11,638 <i>e</i>	13,129 <i>f</i>
Exports (other goods) <i>b</i>	2,100	2,620	2,704	2,449	2,230	2,124	2,172	2,420	2,679 <i>e</i>	2,953 <i>f</i>
Imports (goods, cif) <i>b</i>	4,879	7,026	8,380	8,664	9,047	9,370	10,905	12,218	13,528 <i>e</i>	15,055 <i>f</i>
Current account balance <i>b</i>	1,644	2,634	860	2,859	2,782	3,491	1,078	1,661	198 <i>e</i>	485 <i>f</i>
Foreign Reserves										
Pula m <i>a</i>	19,076	21,619	26,485	28,852	33,880	41,182	29,926	22,754	23,375 <i>e</i>	24,897 <i>f</i>
US\$ m <i>a</i>	5,234	5,675	5,941	6,229	6,317	5,897	5,474	5,122	4,867 <i>e</i>	4,666 <i>f</i>
Govt. spending (Pm) <i>c</i>	6,092	7,406	9,065	10,427	11,536	13,549	15,528	16,207	18,684 <i>e</i>	n.a. <i>f</i>
Govt. revenue (Pm) <i>c</i>	7,395	8,281	7,681	11,963	14,115	12,709	14,311	16,182	16,687 <i>e</i>	n.a. <i>f</i>
Budget surplus/(deficit) (Pm) <i>c</i>	1,302	875	-1,385	1,536	2,579	-840	-1,217	-24	-1,996 <i>e</i>	n.a. <i>f</i>
Govt. balances at BOB <i>a</i>	7,204	15,364	19,212	20,199	24,740	27,880	16,548	9,413	8,018 <i>e</i>	n.a. <i>f</i>

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; *s* year to September

Details of assumptions underlying the forecasts can be obtained from BIDPA.

Sources: CSO, Bank of Botswana, MFDP, BIDPA

This edition of BIDPA Briefing was written by Jay Salkin and Johnson Maiketso

(e-mail: maiketso@bidpa.bw).

Published by BIDPA, Private Bag Br29, Gaborone, Botswana

Tel: (+267) 3971750 Fax: (+267)3971748. Website: <http://www.bidpa.bw>  
While every attempt is taken to ensure the accuracy of the information contained in this document, no responsibility can be assumed for any action based thereon.  
The Botswana Institute for Development Policy Analysis (BIDPA) is an independent, non-government research institute with two main areas of interest: development policy analysis and capacity building. BIDPA's functions include carrying out research and consultancy in the fields of economic and social policy, as well as monitoring the performance of the economy and the management of public policy. BIDPA's clients include government, international organisations, NGO's and companies.

BIDPA's Briefing is sponsored by bifm, Botswana's largest manager of pension and insurance fund assets with over P4 billion under management. Bifm encourages greater public understanding and awareness of Botswana business and economic issues and is therefore delighted to support BIDPA's Briefing, providing independent analysis and economic forecasts to business and policy makers throughout Botswana. The views expressed in this edition of BIDPA's Briefing are those of BIDPA and are not necessarily those of bifm.

