KPMG

Economic Snapshot H2, 2016

Botswana

Inflation - Botswana's consumer price index (CPI) increased by a marginal 0.1% m-o-m in July, marking a fifth consecutive m-o-m rise. However, the annual inflation rate was unchanged, remaining at the 2.7% y-o-y also recorded in June. The inflation rates in July for towns & cities, urban villages, and rural areas were 2.5% y-o-y, 2.7% y-o-y, and 3% y-o-y, respectively.

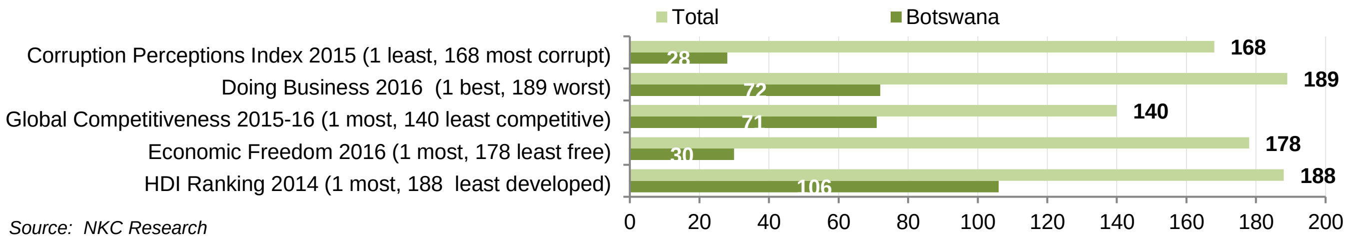
Growth - The Botswanan economy expanded by 1.8% q-o-q in Q1 2016, translating to an annual increase of 2.8% y-o-y. On a sectoral basis, the industrial sector remained in contractionary territory, although the slowdown was far less pronounced than the contractions recorded in the third and fourth quarters of 2015, respectively. On the other hand, the agricultural sector delved deeper into negative territory, while the manufacturing sector saw a slight rebound. In turn, the services sector continued to grow at a healthy pace in Q1.

National development plan - At a policy formulation and implementation level, 2016 signifies the conclusion of a number of key strategic policy papers and development plans for the country. The first of these is the 10th National Development Plan (NDP 10), originally due to expire in April 2016, but now extended until the end of March 2017. Hereafter the country's 11th National Development Plan (NDP 11) will come into play.

OPPORTUNITIES	STRENGTHS
In addition to existing opportunities in the dominant diamond sector, further potential exists in the coal sector.	Well-developed mining sector and sound regulatory environment. A track record of political and macroeconomic stability.
Although the new Economic Stimulus Programme is set to result in a fiscal deficit, the government has adequate scope for some anti-cyclical spending.	Low levels of external debt, which is further supported by a strong public sector balance sheet.
Accelerated implementation of Economic Diversification Drive (EDD) aims to promote production and consumption of local goods and services.	Sound liquidity position, manifested in robust foreign exchange reserve levels and a favourable balance of payments position.
Continuing development of the non-banking financial sector, and a good reputation for doing business.	Botswana is considered to be one of the least corrupt countries in Africa.

VULNERABILITIES	WHAT IS BEING DONE?
Economic structure: heavy reliance on diamonds. This renders the economy vulnerable to any downturn in global economic conditions given the 'luxury good' nature of diamonds.	Fast-tracking economic diversification remains a key objective, as seen by the ongoing implementation of the EDD.
Significant development needs, which continue to place pressure on budgetary expenditure. The HIV/AIDS pandemic also poses policy and financial challenges.	Botswana has been exemplar in its fight against the pandemic, leading the way in prevention and treatment programmes, while being the first SSA country to provide universal free antiretroviral (ARV) treatment to HIV/AIDS patients.
Botswana is historically a net importer of electricity, and power shortages are likely to have had a detrimental effect on economic growth last year.	The 2016 fiscal budget noted that electricity projects are to be afforded top priority.
Recurring droughts have seen the agricultural sector experience water shortages across the country.	The National Water and Waste Water Policy is set to address the country's water shortages. Funds were allocated to several water infrastructure projects in the 2016 fiscal budget.

MEGA TRENDS	
Population	2,182,719 (July 2015 est.); Age 15 - 64: 63.3%
Population growth rate (%)	1.21% (2015 est.)
Life expectancy at birth	Total population: 54.18 years; male: 55.97 years; female: 52.33 years (2015 est.)
HIV/AIDS	Adult prevalence rate: 22.2%; People living with HIV/AIDS: 350,000 (2015 est.)
Adult literacy rate (age 15 and over can read and write)	Total population: 88.2%; male: 87.2%; female: 89.2% (2015 est.)
Urbanisation	Urban population: 57.4% of total population (2015); Urban population growth: 2.3% (2015)
Population below national poverty line	19.3% (2010 est.)
Unemployment rate	20% (2013 est.)
Employment (% of total)	Agriculture: 26.4%; Industry: 17.5%; Services: 56.1% (2010 est.)
Labour participation rate (% of total population ages 15+)	76.8% (2014)
Business languages	English, Setswana, Kalanga
Telephone & Internet users	Main lines in use: 160,490; Mobile cellular: 3.48 million; Internet users: 600,248 (2015)
Sources: CIA World Factbook, World Bank, ITU, UNAIDS, Trading Economics & NKC Research	



Source: NKC Research

Risk environment / Risk outlook

Sovereign Risk Ratings		
S&P Global Ratings	**Fitch**	**Moody's**
A-/Negative	N/R	A2/Stable

Standard Global Ratings affirmed Botswana's sovereign debt ratings on April 29, with the landlocked country's long- and short-term foreign and local currency sovereign credit ratings kept stable at "A-" and "A-2", respectively. However, the outlook on Botswana's sovereign debt rating was revised from stable to negative, in order to *"acknowledge downside risks if the current diamond sector proves more structural than cyclical in nature"*. S&P noted that a sovereign debt rating downgrade could be precipitated by sustained depressed diamond production and prices such that the country's *"historically strong fiscal position erodes"*. On the other hand, Botswana's sovereign debt rating outlook could be revised back to stable if the country's fiscal position does not deteriorate as S&P expects, or if economic diversification efforts prove to be more successful than anticipated. On April 22, **Moody's Investors Service** affirmed Botswana's government bond rating. As such, the agency's rating for Botswana of "A2" (equivalent to "A" on our scale) with a stable outlook was unchanged from the previous occasion Moody's issued an update in December 2015. Moody's noted in its report that the stable outlook reflects the rating agency's *"expectation that Botswana's track record of sound fiscal management and government effectiveness will ensure a gradual rebuilding of fiscal buffers that are now being used and will gradually also support transition to a more stable growth model"*. That said, the rating could come under pressure should the government's expansionary fiscal policy lead to a marked reduction of the country's fiscal reserves, which in turn may lead to a significant deterioration in Botswana's net asset position. On the other hand, a positive outlook could be precipitated by further successful diamond beneficiation *"and progress towards broader economic diversification over the medium term"*. Botswana is currently not rated by **Fitch Ratings**.

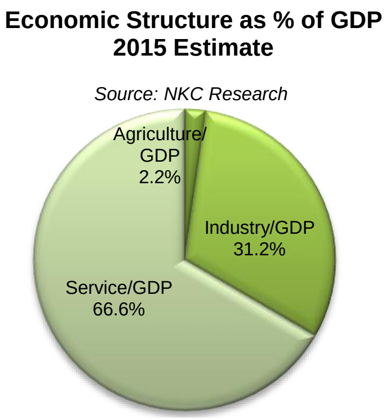
Infrastruc-ture	Diversity of the Economy	Banking Sector	Continuity of Economic Policy	GDP Growth	Key Balances	Foreign Investment	Socio-economic Develop-ment	Forex Reserves
Good overall	Dominated by diamond sector	Good	Good	Strong	Current account surplus; small fiscal deficit	Strong	High (in African context)	Exceptional

Stock Market	Listed Companies	Liquidity	Market Cap	Dominant Sector	Daily Trading Volume
Botswana Stock Exchange	22 Domestic listings (Main Board)	Limited	$4.57bn at end-June 2016 (Source: Bank of Botswana)	Banking	$2.6m in June 2016 (Source: Bank of Botswana)
Capital Market	**Development**	**Liquidity**	**Maturity Range**	**Municipal Bonds**	**Corporate Bonds**
Yes	Limited	Limited	14-days to 364-days (BoBCs) 1-Yr to 10-Yr (Govt. bonds)	No	Yes

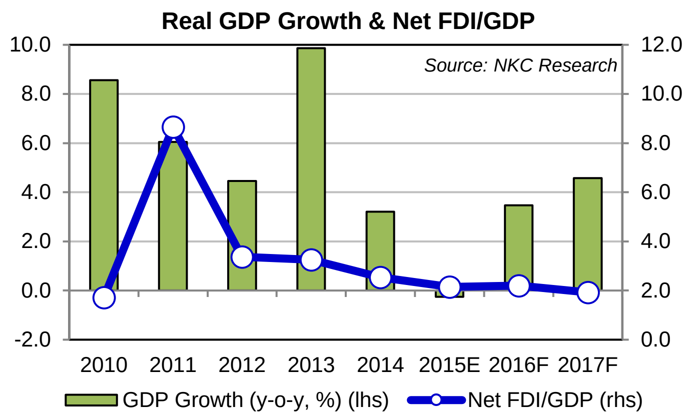
Macro-economic overview

Developments over the past two years have unceasingly affirmed the risks associated with the country's continuing dependence on the volatile diamond mining industry. Indeed, notwithstanding significant efforts made by Gaborone in diversifying the economy as outlined in the nationally prioritised Economic Diversification Drive (EDD), the wellbeing of the domestic economy remains inextricably linked to that of the global economy; for global diamond demand in particular. Furthermore, in addition to the deleterious impact that flailing global diamond demand has had on economic growth in recent years, the country's external position – the trade balance in particular – has come under significant pressure as a direct result. In addition, state finances have been adversely affected by a sharp downturn in mineral revenues as well as a downturn in Southern African Customs Union (SACU) transfers due to lower regional and international trade. Considering these effects, the single largest concern pertaining to Botswana's sovereign risk continues to be the country's continuing reliance on the diamond sector.

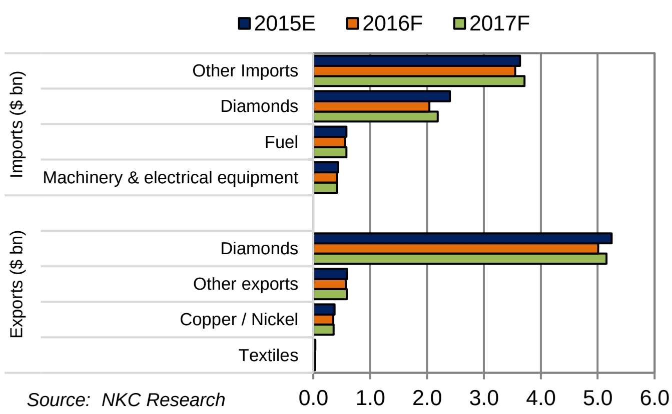
That said, the minerals sector beyond diamonds holds much potential; the downstream sectors and the opportunities for 'value-add' in particular, as well as the fledgling coal sector given the country's wealth of coal resources. Furthermore, the said EDD bodes well for Gaborone's attempt at invigorating the non-mining sector, with the services sector likely to benefit significantly. The country's recently adopted fiscal stimulus plan, the Economic Stimulus Programme (ESP), which at the broadest level involves high-cost capital expenditure in a bid to boost domestic (non-mining) growth, will further buoy the economy. The country's strong macroeconomic fundamentals, solid economic and fiscal policies, and relatively low debt levels provide further support to the sovereign rating. Additional support is provided by still-high foreign exchange reserve levels, amassed from years of prudent management of the country's diamond wealth.



While a far cry from its peak of 63% to GDP in 1983, the industrial sector's contribution to GDP has remained relatively steady in recent years, contributing an estimated 31.2% to GDP in 2015. Within the industrial sector, the manufacturing sector made an estimated contribution of around 5.9% to GDP last year, with activities in this sector predominantly focused on textiles and apparel. In addition, downstream diamond activities continue to gain in importance. The services sector remains the largest contributor to GDP, with an estimated contribution of 66.6% in 2015. The most important sub-sectors within the services industry were the retail & hospitality sub-sector, government services, and financial services contributing 16.1%, 15.3%, and 14.7% of GDP in 2015, respectively. The agricultural sector's contribution to GDP has declined significantly over the years, from 10.7% in 1980 to about 2.2% last year. However, despite agriculture only making a marginal contribution to GDP, it remains an important feature of the economy, given that more than half of the population lives in rural areas and is dependent on subsistence crop and livestock farming, and also in terms of agriculture's contribution to export earnings.

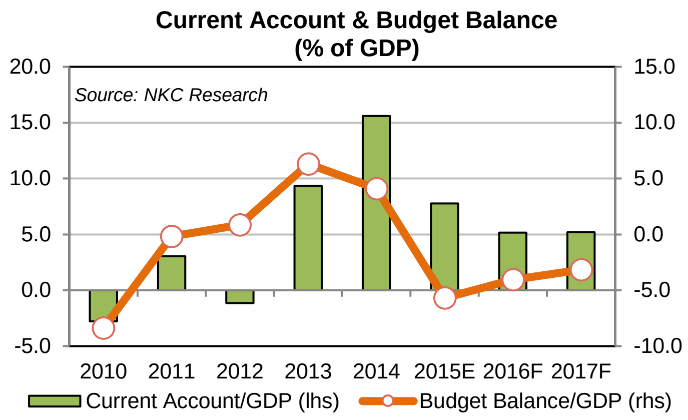


While developments in the global diamond and commodities markets will ultimately dictate the speed at which the economy recovers, our expectation is that GDP growth will recover to an estimated 3.5% in 2016 and 4.6% in 2017 on the back of a slight uptick in global diamond demand. Additional momentum is set to be seen from the fiscal stimulus package, which is aimed at boosting/stimulating the domestic economy. The services sector is likely to remain the primary driver of real GDP growth in the forecast period, underpinned by progress made in terms of economic diversification and an increase in downstream diamond activities. In turn, the industrial sector is forecast to recover as mining production slowly picks up. Output in the agricultural sector is expected to remain subdued as a result of the ongoing drought, while manufacturing expansion is also forecast to remain relatively subdued in 2016-17. Notwithstanding a number of policy measures aimed at promoting economic diversification, the dominant diamond industry remains a key recipient of foreign direct investment (FDI), with the relocation by De Beers of its Global Sightholder Sales to Gaborone in 2013 of particular significance. In essence, the relocation has shifted the centre of global rough diamond sales from Europe to Africa, thereby heralding a new chapter in the country's economic progress. The coal-to-liquids (CTLs) space is also of growing importance, with construction of the massive $4.2bn Project Tsosoloso, which includes a CTL, fertiliser and power plant.

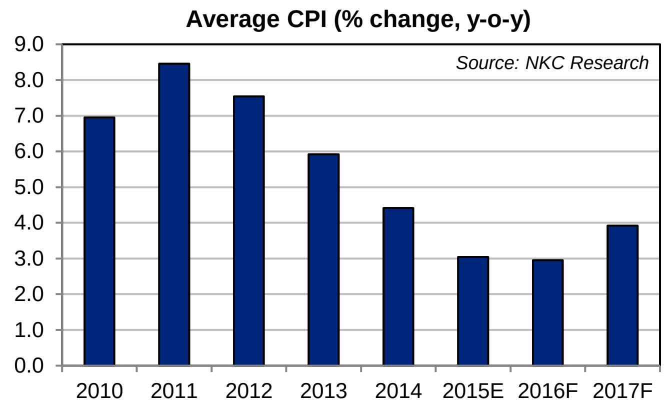


Main Imports: % share of total	2015E	2016F	2017F
Other Imports	51.50	54.07	53.78
Diamonds	34.03	31.10	31.65
Fuel	8.26	8.48	8.47
Machinery & electrical equipment	6.21	6.34	6.09
Main Exports: % share of total	**2015E**	**2016F**	**2017F**
Diamonds	83.96	83.96	84.03
Other exports	9.50	9.58	9.58
Copper / Nickel	5.95	5.92	5.85
Textiles	0.59	0.54	0.54

Notwithstanding ongoing progress made in reducing its dependence on the diamond sector, the diamond industry remains an integral and determining factor of the economy's well-being; that of the balance of payments position in particular. To this end, diamond exports accounted for 85.6% of total exports in Q1 2016, according to official trade data. While diamond export values may still remain relatively subdued throughout 2016-17, the gem market's proportion as a percentage of exports is expected to remain high and relatively stable. Other key primary exports include copper and nickel, followed by machinery and electrical equipment. Meat and meat product exports remain key earners of foreign exchange too, with the main destinations being the EU and the SADC.



Despite a significant weakening in the trade position in 2015, Botswana's current account remained in surplus overall last year at an estimated $1.1bn, equivalent to 7.8% of GDP. The underlying reasons for the external position's resilience were the country's strong invisible trade accounts; the positive transfers account balance, and services account surplus in particular, which together more than counteracted the deterioration in the merchandise trade position. Albeit weaker than seen in recent years, our expectation is that the current account will remain in surplus throughout the period under review, at a forecast $0.7bn (5.2% of GDP) and $0.8bn (5.2% of GDP) in 2016 and 2017, respectively. Gaborone's unwavering commitment to fiscal prudence, sound fiscal policies, and the astute implementation hereof have contributed significantly to the country's long-standing track record of macroeconomic stability. While recognising that the country has sufficient fiscal space to overcome the current strain on state finances without having to undertake any sharp adjustment measures, we foresee that the fiscal balance will remain in deficit throughout the forecast period. Looking ahead, our latest projections are more guarded than those provided in the Ministry of Finance's budget speech in February, with forecasts underpinned by the possibility of higher-than-forecast expenditure, particularly in terms of the ESP, as well as the prospect of below average Southern African Customs Union (SACU) inflows. Our baseline projection is that Botswana's fiscal deficit will narrow to a shortfall of 4.1% of GDP in 2016/17 FY, from a deficit of 5.7% of GDP in 2015/16 FY, before easing further to a shortfall of 3.2% of GDP in 2017/18 FY.



Botswana's benign inflation environment, with headline inflation staying close to 3% y-o-y since February last year, afforded the central bank the necessary scope to adopt an easier monetary policy stance in August. According to the minutes released by the Monetary Policy Committee (MPC), *"[t]he current state of the economy and both the domestic and external economic outlook as well as the inflation forecast provide scope for easing monetary policy to support economic activity without undermining maintenance of inflation within the Bank's medium-term objective range of 3% - 6%"*. As such, the committee elected to decrease the country's policy rate by 50 bps to 5.5%, ending the 12-month streak at 6%. Looking ahead, average inflation is set to remain well within the medium-term inflationary target range throughout 2016-17. In the context of still restrained global economic activity and low oil prices, we foresee annual inflation at an estimated average of close to 3% in 2016, before rising slightly to an average of 3.9% in 2017.

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