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Briefing

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Note: BIDPA wishes to acknowledge and apologise for errors that may have arisen in the BIDPA Briefing on the 'Cost of Banking in Botswana: 2001-2002', published in January 2003. The Briefing referred to Standard Chartered Bank instead of Standard Bank of South Africa. There were also a few errors regarding interpretations of figures on the tariff guides and fees. However, we note that the issues raised by commercial banks in as far as the article is concerned are not substantial to result in any change in the conclusions drawn from the analysis at the time, that 'the extremely high cost of banking service charges by commercial banks in Botswana, coupled with relatively low quality of banking service, act as a deterrent to productive investment'. In fact, following the publication of the comparative analysis, several commercial banks reduced their charges, which also lends credibility to our conclusion that, indeed, the charges were high.

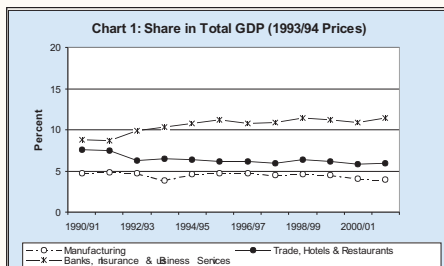
Introduction

The Botswana economy experienced a slow down in real GDP growth due to lower growth experienced in the mining sector. Nevertheless, the mining sector continues to play a dominant role in the growth and development of Botswana. In line with the objectives of sustainable economic diversification, it still remains critical for Botswana to vigorously pursue diversification strategies and to strengthen policies aimed at accelerating the growth of non-mining sectors. An analysis of the 2001 Population and Housing Census reveals a much lower rate of population growth rate than that recorded over the previous two decades, a fall in life expectancy at birth, deterioration in the infant mortality rate and the crude death rate. Directly related to these developments is the challenge of the HIV/AIDS pandemic, which has had a negative impact on the indicators of progress on human development. The appreciation of the Pula since the end of 2002 against major international currencies has led to a deterioration in Botswana's international competitiveness, making Botswana

products appear relatively more expensive and foreign products cheaper, hence making investment in the country less attractive.

Review of GDP Growth

In 2001/02, the economy experienced a slow down in real GDP growth, mainly as a result of the performance of the mining sector, following the completion of the Orapa 2000 project. Real GDP growth of 2.3% was realized in 2001/02, compared to 8.4% in 2000/01.



The mining sector, which has been the main driving force in the economy, declined by 3.1% in 2001/02, compared to the high growth of 17.2% achieved in the previous year. Agricultural output also declined in 2001/02 by 2.5% as a result of the outbreak of foot and mouth disease and drought. In contrast, growth of the non-mining sectors increased. While the period of rapid mining sector growth seems to have come to an end, the sector's output as a share of total GDP is still quite high, at 34.5% in 2001/02, compared to 36.5% in 2000/01.

The mining sector continues to be the dominant sector in terms of its contribution to total GDP and the overall economic development of Botswana. In accordance with the objectives of sustainable economic diversification, non-mining sectors, such as manufacturing, financial services and tourism, should now take the lead in the long term development of Botswana through registering high growth rates and gradually increasing their contribution to GDP. Each of the main non-mining sectors have, on average, contributed less than 12% to total GDP over the last decade (see chart 1).

While the manufacturing and tourism sectors' contribution to GDP has remained stable over the period covered, the contribution of financial services to GDP has steadily increased from 8.8% in 1990/91 to 11.4% in 2000/01. This may have prompted the call from some quarters for government to promote financial services as the new engine of growth for the economy, as reflected, for example, in the promotion of the international financial services centre.

It still remains critical for Botswana to vigorously pursue diversification strategies and strengthen its policies to accelerate the growth of non-mining sectors. Previous issues of the BIDPA Briefing have emphasized the importance of development of other sectors in the economy in the diversification process. Relying on only one sector for growth and development, particularly one that is vulnerable to fluctuations in the international market, which Botswana cannot significantly influence or predict, renders the economy susceptible to external shocks, which can have serious implications for long term planning and implementation of development projects.

2001 Population and Housing Census

The 2001 Population and Housing Census recorded an annual increase of the total population over the previous decade of 2.4%. This is a much smaller rate of population growth than that recorded over the previous two decades. For the 1981 Census, the population growth rate was estimated at 3.6%, while in the 1991 census, the rate had declined very slightly to 3.5%.

The populations of selected villages surrounding Gaborone (including among others, Mogoditshane, Gabane, Mmopane, Metsimotlhabe and Tlokweng) grew rapidly over the decade. Overall, these villages around Gaborone grew by 7.3% annually. Mogoditshane, which had only 14,246 inhabitants in 1991, recorded a total

population of 32,843 in 2001, showing an annual growth rate of 8.71%. The faster rate of growth of places in the environs of Gaborone, which is mainly due to migration and shortages of land and accommodation in Gaborone, have put pressure on land use in these places, to the extent of triggering problems of self-allocation and squatting. Further, the provision of amenities, even in plots demarcated for allocation, has not been able to keep pace with this high rate of growth of population.

Table 2: Selected Demographic Indicators

	1981	1991	1998 *	2001
Life Expectancy at birth (in years)	56.2	65.3	64.3	55.7
Infant Mortality Rate ^a	71.0	48.0	51.0	56.0
Crude Death rate ^b	13.9	11.5	-	13.5
Annual Rate of population Growth (%)	3.6	3.5	2.3	2.4

*From the 1998 Demography Survey
^aDeaths per 1000 live births
^bDeaths per 1000 population
 Source: Central Statistics Office, NDP8.

against the commercial viability of producers in Botswana and the goal of sustainable economic diversification.

Table 1: Growth Rates of Gaborone and selected villages in its environs

Village	1991 Population	2001 Population	% Annual Growth Rate 1991-2001
Gaborone	133468	186007	3.37
Mogoditshane	14246	32843	8.71
Gabane	5975	10399	5.70
Mmopane	1249	3512	10.89
Metsimotlhabe	1586	4056	9.84
tlolkweng	12501	21133	5.39
Selected Villages	35557	71943	7.30

Source: Central Statistics Office 2001 Census Data

In 2001, the life expectancy at birth stood at 55.7 years, having plummeted from 65.3 years in 1991. The Infant Mortality Rate has deteriorated from 48.0 per 1000 live births to 56.0 over the past decade, while the Crude Death Rate has also become worse, rising from 11.5 per 1000 of the population in 1991 to 13.5 in 2001. These indicators are very important in gauging the progress that a country is making on the human development front. While the decade from 1981 to 1991 witnessed significant improvements, as shown by higher life expectancy and falling death rates, it is becoming increasingly clear that during the 1990s there has been a reversal of such gains. Directly related to these developments is the challenge of the HIV/AIDS pandemic.

Pula Exchange Rate Appreciation Erodes Competitiveness

Botswana has long recognised the need to diversify the economy beyond its dependence on a handful of natural resource-based exports, such as diamonds, copper-nickel, beef and soda ash. To do so on a sustainable basis requires industries that are competitive internationally. This means that Botswana must have enterprises that can match or beat foreign producers in terms of price and quality. Exchange rate policy plays a crucial role in enabling local firms to have cost structures and output prices that can compete with those of foreigners. Unfortunately, exchange rate policy seems to have lost its way in Botswana, and increasingly over the past few years has worked

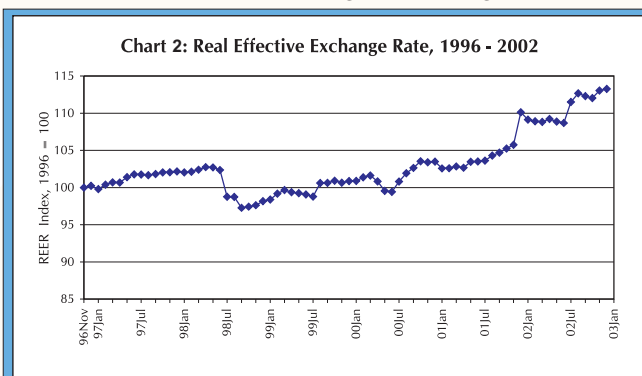
The standard measure of changes in the international competitiveness of an economy is a tool called the real effective exchange rate (REER) index. The REER for Botswana takes into account

three aspects: the nominal exchange rates between Botswana and its trading partners; rates of inflation in Botswana and its trading partners and the weights that should be applied in aggregating the different countries exchange rates and inflation rates into an overall measure of international competitiveness for Botswana. It is basically the weighted average of the nominal exchange rates of Botswana vis-à-vis its major trading partners, with each bilateral nominal exchange rate (e.g., the Rand-Pula exchange rate) adjusted for changes in the relative price level of the two countries (e.g., Botswana's consumer price index relative to South Africa's consumer price index). The weights applied to the different nominal exchange rates used in calculating the real effective exchange rate reflect the importance of the different countries and commodities traded to the performance of the economy and the policy objectives being pursued. In Botswana's case, countries which receive Botswana's non-traditional exports of goods and services like textiles and vehicles, which are sensitive to exchange rate changes,

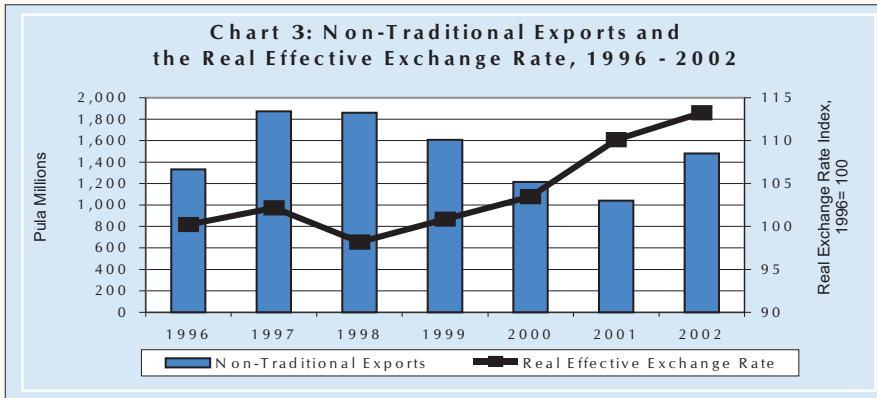
should have a higher weight in calculating the REER than countries which import Botswana's diamonds, since those exports are not sensitive to fluctuations in the Pula exchange rate vis-à-vis other currencies.

The Bank of Botswana, which is responsible for implementing Government's exchange rate policy, monitors and reports on the REER monthly in its financial statistics. The Bank reviews exchange rate developments in its Monetary Policy Statements and Annual Reports, and advises Government regarding economic policy in general, and exchange rate policy in particular. In its 2003 Monetary Policy Statement, the Bank of Botswana notes that both monetary policy and exchange rate policy aim at maintaining Botswana's international competitiveness while having a stable nominal effective exchange rate. This requires that Botswana's inflation rate should not be any higher "than the average inflation rate of its major trading partners." (p. 2) Unfortunately, this pre-requisite for maintaining international competitiveness in the context of a stable nominal effective exchange rate has not been achieved, and the profitability and viability of Botswana producers of tradeable goods and services has been eroded.

Chart 2 presents the REER index calculated by the Bank of Botswana, using the trade weights that the Bank feels are relevant, and, in the case of South Africa, the core inflation rate for estimating the appropriate price level adjustment to make to the Rand-Pula exchange rate. What stands out from the chart is the general rising trend in the REER, indicating that the Pula has been generally appreciating against the currencies of its trading partners, once inflation is taken into account. In general, prices of Botswana's goods and services, compared to its trading partners, have been rising; thus making Botswana's goods less competitive. The real appreciation of the Pula has been especially marked since September 1998. Since that time, up to the end of 2002, the REER index increased from 97.3 to 113.3, an increase of 16.4%.



Increases in the REER in excess of 10% usually signal the demise of many producers



who have to compete with foreign producers either in export markets or in the domestic market. For many countries, increases in the REER in excess of 10% also herald impending balance of payments problems and often times financial crises, as indeed happened to the East Asian Tigers in 1997. Some evidence of the damage the appreciation of the REER has done to Botswana's development objectives can be found in the trade statistics for non-traditional exports. Over the period from 1996 to 1998, while the REER index was relatively stable, indeed the index declined by 2.7 percent, non-traditional exports grew from P1,333 million to P1,861 million, an increase of nearly 40 percent. (See chart 3). In contrast, over the period from 1998 to 2001, while the REER index appreciated 12.1 percent, non-traditional exports declined by 44 percent to P1,041 million. Non-traditional exports are estimated to have increased in 2002 to P1,480 million; but, this may be due to special factors and it is not clear that such export growth can be sustained in the face of continuing real exchange rate appreciation.

Botswana's international competitiveness has deteriorated further since the end of 2002, as the Pula has appreciated substantially against the major international currencies, except the Rand, and Botswana continues to have an inflation rate well in excess of those of its major trading partners, except South Africa. From the end of 2002 to the beginning of May 2003, the Pula appreciated 12.5 percent against the US dollar, 12.2 percent against the British pound and 5.9 percent against the Euro. Inflation in Botswana has been running at over double digit levels in 2003 the annual rate of inflation in March 2003 was 11.3 percent while in the USA and Europe it has been at about 2 percent. Thus, against competitors in the major

industrial countries, Botswana's prices have risen by about 15 percent on average in 2003. This is more than enough to wipe out any profit margins or competitive advantages Botswana producers might have had in those markets.

Table 3: Foreign Currency per Pula

	End of March 2002	End of Dec. 2002	End of March 2003	May 2 2003
Rand	1.6869	1.5801	1.5401	1.5044
US Dollar	0.1477	0.1829	0.1938	0.2058
Pound	0.1036	0.1140	0.1229	0.1279
Euro	0.1690	0.1745	0.1790	0.1833
SDR	0.1186	0.1356	0.1428	0.1496

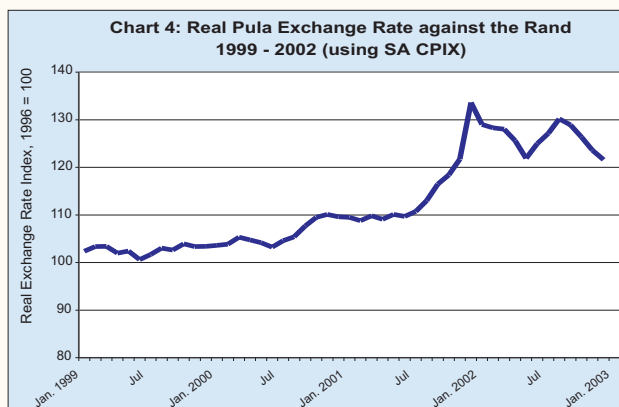
Source: Bank of Botswana

Against the South African Rand, the Pula has depreciated 4.8 percent over the first four months of 2003. But that is in sharp contrast to the appreciation that occurred between June 2000, when the Pula was 1.33 against the Rand, and December 2001, when the Pula reached 1.72 against the Rand; an appreciation of 29 percent.

Core inflation in South Africa was 11.2 percent in March 2003, slightly less than Botswana's rate of inflation. So there has been some real depreciation of the Pula against the Rand during 2003. But, this is quite modest in comparison

to 17.8 percent real appreciation against the Rand that occurred between June 2000 and December 2002 (see Chart 4). The real appreciation of the Pula against other currencies, which makes Botswana's products look expensive and foreign products look cheaper, is also reflected in the growth of exports of 12.7 percent p.a. over the period from 1996 to 2002, in contrast to the growth of imports, which averaged 14.4 percent p.a. The erosion of Botswana international competitiveness also makes investment in Botswana, either by Botswana or by foreigners, less attractive and certainly less profitable. It is not surprising, therefore, that Botswana's international reserves, which had grown from USD 5,234 million in 1996 to USD 6,317 million in 2000, have since dropped to USD 5,491 at the end of 2002.

Of course, appreciation of the real effective exchange rate has not been the only factor at work influencing international competitiveness, growth of non-traditional exports, growth of imports and the level of international reserves. Other factors, such as government initiatives fostering citizen economic empowerment or new trade agreements like AGOA, also play a role. In addition, there are other impacts that appreciation of the real exchange rate makes on other areas of the economy, such as reducing government revenues from external sources like diamond exports or Bank of Botswana profits, thus contributing to budget deficits and the squeeze on public resources available for development or needy social programmes. Appreciation of the real exchange rate also acts as a deterrent to Botswana's tourism sector.



While it should not be expected that a quick devaluation of the exchange rate would or could, by itself, serve to remedy an uncompetitive real exchange rate, the current policy of allowing the real exchange rate to trend its way upward and progressively erode the opportunities for Botswana producers to diversify the economy and remain viable is not a recipe for success.

ECONOMIC FACTS AND FORECASTS

(end of period)	Quarterly									
	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1
Interest rates (%)										
BOBC (3 month)	12.71	12.67	12.87	12.65	12.51	12.51	12.51	12.54	14.03	13.99
Prime	15.75	15.75	15.75	15.75	15.75	15.75	15.75	15.75	16.75	16.75
Inflation (%)										
Rand-Pula	1.411	1.426	1.421	1.502	1.719	1.687	1.667	1.675	1.580	1.540
US\$-Pula	0.187	0.177	0.176	0.167	0.143	0.148	0.161	0.159	0.183	0.194
BSE index	1454	1733	2036	2214	2455	2634	2533	2480	2497	2265
Annual										
Growth (%), except where specified	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP (real) d	3.2	5.5	5.6	8.1	4.1	7.7	8.4	2.3	5.3 e	6.0 f
Non-mineral GDP (real) d	5.8	6.1	5.5	7.3	7.8	5.7	4.0	5.5	6.0 e	7.0 f
Mining GDP (real) d	-1.4	4.5	5.8	9.5	-2.8	11.9	17.2	-3.1	4.0 e	4.0 f
Exports (nominal) b	16.2	19.7	36.9	27.8	-16.3	40.6	13.1	3.4	10.8	14.0 f
Imports (nominal) b	3.2	20.4	8.2	43.8	18.7	3.7	4.9	-1.0	16.4	11.7 f
Govt. spending (nominal) c	-4.6	21.5	17.3	21.6	22.4	15.0	6.6	20.9	26.8 p	4.1 f
Govt. revenues (nominal) c	-16.6	22.2	35.3	12.0	-7.2	55.8	18.0	-5.4	10.4 p	21.6 f
Formal employment s	1.3	1.2	2.2	-4.5	6.1	6.4	2.1	3.8	1.5 f	3.0 f
Unemployment rate a	21.3	21.5	20.9	20.4	19.8	17.8	15.8	19.6	21.0 f	22.0 f
Domestic (bank) credit b	18.2	-3.7	1.1	5.6	56.1	41.3	17.7	10.7	21.3	12.5 f
Interest rates (%)										
BOBC (3 month) a	11.90	11.95	12.23	11.40	10.66	11.98	12.71	12.51	14.03	13.25 f
Prime a	14.00	14.50	14.50	14.00	14.00	14.81	15.75	15.75	16.75	16.25 f
Inflation (average, %)										
	10.6	10.5	10.1	8.9	6.5	7.8	8.5	6.6	8.1	8.7 f
Rand-Pula a	1.305	1.294	1.284	1.278	1.318	1.329	1.411	1.709	1.580	1.450 f
US\$-Pula a	0.368	0.354	0.274	0.263	0.224	0.216	0.187	0.143	0.183	0.165 f
BSE index a	313	333	352	709	947	1399	1454	2455	2497	2300 f
Balance of Payments (Pm)										
Exports (diamonds) b	3,727	3,994	5,272	7,675	6,004	9,603	11,748	11,471	12,478	13,839 f
Exports (other goods) b	1,305	1,995	2,100	2,620	2,704	2,690	1,901	2,048	2,505 p	3,244 f
Imports (goods, cif) b	3,663	4,451	4,879	7,026	8,380	8,664	9,047	9,370	10,905 p	12,181 f
Current account balance b	568	831	1,644	2,634	860	2,859	2,782	3,689	3,153 p	3,400 f
Foreign Reserves										
Pula m	11,961	13,249	19,076	21,619	26,485	28,852	33,880	41,182	29,926 p	35,152 f
US\$ m	4,402	4,695	5,234	5,675	5,941	6,229	6,317	5,897	5,474 p	5,800 f
Govt. spending (Pm) c	4,277	5,195	6,092	7,406	9,065	10,428	11,537	13,671	16,642 p	17,333 f
Govt. revenue (Pm) c	4,472	5,464	7,395	8,281	7,681	11,963	14,115	12,707	14,426 p	17,539 f
Budget surplus/(deficit) (Pm) c	196	270	1,302	875	-1,385	1,536	3,002	-85	-2,289 p	206 f
Govt. balances at BOB a	6,705	6,460	7,204	15,364	18,955	19,899	24,219	27,881	16,548 e	18,559 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; s - year to September; m - year to March.
Details of assumptions underlying the forecasts can be obtained from BIDPA.

Sources: CSO, Bank of Botswana, MFDP, BIDPA

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