

# PART B

## THE BOTSWANA ECONOMY IN 2002 AND THEME CHAPTER

BANK OF BOTSWANA

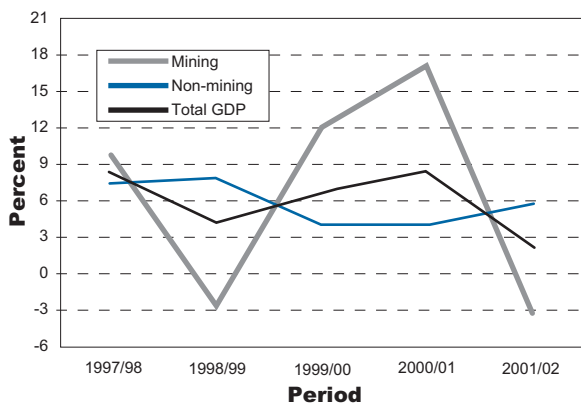
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### 1. OUTPUT, EMPLOYMENT AND PRICES

#### (a) National Income Accounts

1.1 Real gross domestic product (GDP) growth was 2.3 percent in 2001/02<sup>1</sup>, less than half the earlier estimate of 5 percent, and considerably lower than the 8.4 percent growth achieved in 2000/01<sup>2</sup> (Chart 1.1). The reduced rate of GDP growth in 2001/02 was a result of a 3.1 percent decline in mining output. However, the performance of the non-mining sector improved, with most economic sectors recording higher growth in 2001/02 than in the previous year.

**CHART 1.1 GROWTH IN REAL DOMESTIC PRODUCT, 1997/98-2001/02**



Source: Central Statistics Office.

1.2 The contraction in mining output largely reflected a 4.4 percent reduction in diamond production. A sharp reduction in the growth of diamond production had, however, been

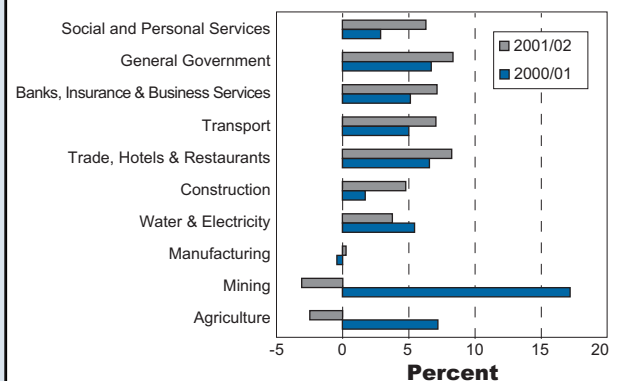
<sup>1</sup> The national accounts year runs from July each year to June the following year.

<sup>2</sup> The GDP growth rates for 1999/00 and 2000/01 have been revised downward, considerably so for the former, following an adjustment of some of the 'adjustment items', specifically, a reduction in taxes on imports and subsidies on products and production for both years and a slight increase in Financial Intermediation Services Indirectly Measured (FISIM) for 2000/01. The revisions have also had the effect of raising growth for 2001/02 because of the now lower base from which it is calculated.

expected following the rapid growth of 17.2 percent recorded in 2000/01 as new capacity came on stream. Reduced production of copper/nickel and coal also contributed to the decline in mining sector output.

1.3 The output of the non-mining sector grew by 5.5 percent, up from 4 percent in the previous year. Excluding government, output in the non-mining private sector rose by 4.5 percent, which was also better than the previous year's performance of 3.1 percent. General government expanded by 8.3 percent, largely due to the rapid increase in government recurrent and investment expenditure, both of which grew by nearly 20 percent each in nominal terms.

**CHART 1.2 ECONOMIC GROWTH BY SECTOR, 2000/01 – 2001/02**



Source: Central Statistics Office.

1.4 Output in other non-mining sectors, except agriculture, water and electricity, also rose at faster growth rates than in the previous year. The highest growth of 8.2 percent occurred in the trade, hotels and restaurants sector; trade expanded by 8 percent while output in hotels and restaurants rose by 9.7 percent, more than triple the growth rate in the previous year.

1.5 Value added for banks, insurance and business services rose by 7.1 percent while that for transport and communications grew by 7 percent,

compared to 5.1 percent and 5 percent, respectively, in the previous year. The high profitability of some of the banks, which was partly a result of interest income, contributed significantly to the improved growth rate of the banking sub-sector while the expansion in business services reflected general business buoyancy.

- 1.6 The strong performance of the transport and communications sector was due to cost savings as well as an increase in air traffic volumes and mobile telephone services compared to last year. Despite the difficult operating environment for the international aviation industry, domestic air traffic rose by 11 percent while regional services grew by 2 percent. The demand for mobile telephone service continued to increase rapidly while that for fixed-line services increased relatively slowly. There was also a significant expansion in road transport services, which was underpinned by a sharp 22 percent growth in new vehicle purchases, especially for commercial purposes. In contrast, rail transport services weakened. Although there was an improvement in rail traffic, which signalled a gradual return to more normal operations, goods moved per kilometre declined for the third successive year. However, the 4.3 percent decline in tonnage per kilometre was far less than last year's fall of 28 percent. In contrast, the number of passengers per kilometre increased moderately by 8.5 percent, compared to a rise of 41 percent in the previous year.
- 1.7 Output in the construction, social and personal services sectors expanded at rates of 4.7 percent and 6.2 percent, up from the previous year's growth rates of 1.6 percent and 2.8 percent, respectively. For the water and electricity sector growth declined for the third successive year, falling to 3.7 percent from 5.5 percent in 2000/01 and 11.3 percent in 1999/00. The modest growth in 2001/02 was, however, wholly due to a 5 percent rise in water consumption. In contrast, electricity generation fell by 8.2 percent due to a 7.9 percent decline in demand for electricity by the mines while usage by the rest of the economy slowed down considerably to a 2.4 percent growth from over 20 percent growth in the previous year.
- 1.8 Output in the manufacturing sector reversed the previous year's decline and grew marginally by 0.2 percent. The rate of expansion would have been faster were it not for a 35.6 percent reduction (against a growth of 70.6 percent the previous year) in cattle slaughtered by the Botswana Meat Commission (BMC), due to the outbreak of the foot and mouth disease (FMD) and the prevailing drought. Both these factors affected the supply of cattle to the abattoirs which were closed for some time. Moreover, manufacturing output growth was also negatively affected by the closure of a number of companies during the year including Flowtite Botswana and Liontex.
- 1.9 Agricultural production declined by 2.5 percent, reversing the previous year's 7.3 percent growth, due to insufficient and poorly distributed rains during the 2001/02 rainy season and the outbreak of the FMD, which led to the slaughter of thousands of cattle.
- 1.10 Although the overall GDP growth rate was the lowest since 1993/94, economic performance in 2001/02 was reasonably encouraging, given the healthy growth of the non-mining private sector, which is the basis for economic diversification. Within this segment of the economy, it is noteworthy that the fastest growing sub-sectors were those producing services (finance and business services, transport, trade, hotels and restaurants, and social and personal services), which compensated for the disappointing performance of the manufacturing sector. This outcome reinforces the arguments presented in the Bank's 2000 Annual Report, that diversification initiatives should support a wide range of economic activities, including services, rather than focusing specifically on manufacturing, as has been the case in the past. It is also reflected in changes in trade patterns, discussed in more detail later in this *Report*, with services accounting for an increasing share of international trade.

**(b) Economic Outlook**

- 1.11 Official forecasts<sup>3</sup> are that economic growth will recover from 2.3 percent in 2001/02 to around 5 percent in 2002/03. The forecast is based on expected growth rates of 4.5 percent and 7 percent, respectively, in mining and non-mining sectors, with the latter benefiting from expansion in manufacturing, construction and finance sectors. The forecast increase in mining output appears to be based on a reversal of the decline in diamond production in 2001/02, a small addition to output from the new Damtshaa diamond mine<sup>4</sup> and other planned increases in mineral production. While the forecast increase in mining output should be achievable, achieving 7 percent growth in the non-mining sector may be more difficult. Overall, the balance of risk around the forecast is on the downside, with growth below 5 percent more likely than growth above 5 percent, for a number of reasons.
- 1.12 While it is expected that domestic economic performance will benefit from improved – although still below trend – growth in the global economy, there remains considerable uncertainty surrounding the fallout of the conflict in Iraq, which may adversely affect consumer confidence. For Botswana, this could lead to reduced diamond sales and, therefore, either stockpiling or reduced diamond production. There are also domestic uncertainties. Beef production will be negatively affected by drought and the renewed outbreak of FMD in January 2003. Rainfall up to December 2002 was below average, resulting in the cultivation of only 4 percent of arable land, while the condition of livestock deteriorated due to inadequate grazing. Since beef is a significant component of manufacturing output, the sector's recovery is likely to be slow. It is nevertheless expected that the substantial increase in Government expenditure in 2002/03 will boost construction

output, which traditionally is dependent on work related to government projects, and raise value added for the Government sector. The output of the transport sector is also forecast to increase on account of projected increased activity in air, rail and road services.

**(c) Employment***(i) Employment Results from the 2001 Population and Housing Census*

- 1.13 The 2001 census results show that between 1991 and 2001 employment outside the non-traditional agricultural sector (includes employee, self-employed and family business employment) grew considerably faster (3.4 percent) than the labour force (2.4 percent) and the population (2.4 percent) (Table 1.1). Simultaneously, unemployment rose nearly six percentage points to 19.6 percent, due to the sharp fall in employment in the traditional agriculture sector. Employment in this sector fell by 12.6 percent per annum, or 74 percent over the ten-year period. The moderate growth of employment elsewhere in the economy could not fully compensate for the rapid reduction of employment in the traditional agriculture sector. Hence, overall employment grew only slightly, by less than 2 percent per annum (or 18 percent over the entire period), compared with an increase of 6.1 percent per annum in the number of those looking for work.
- 1.14 With employment in traditional agriculture shrinking at such a rapid pace, by 2001 the sector accounted for only 3 percent of the labour force compared to 15 percent in 1991. This implies that future contributions to the unemployment problem by further labour migration out of this sector will be small<sup>5</sup>.
- 1.15 However, self-employment grew at more than

<sup>3</sup> As set out in the *2003 Budget Speech*.

<sup>4</sup> The amount of carats mined in the first half of the 2002/03 (July-December 2002) national accounts year was 22 percent higher than that for the corresponding period in the previous year.

<sup>5</sup> It should be noted, however, that there could be a significant number of 'discouraged workers' who are not currently recorded as unemployed and seeking work but might start to actively search for work in the future because of improved economic prospects.

TABLE 1.1 ECONOMICALLY ACTIVE POPULATION (1991 AND 2001)

	1991		2001		Percentage Change 1991–2001	Annual Average Percentage Change 1991–2001
	Number	Percentage Share	Number	Percentage Share		
Employee	275 750	63	370 456	66	34	3.0
Self-Employed	28 647	7	54 661	10	91	6.7
<b>Sub-total</b>	<b>304 397</b>	<b>69</b>	<b>425 117</b>	<b>76</b>	<b>40</b>	<b>3.4</b>
Family Business	7 938	2	6 446	1	-19	-2.1
Lands and Cattle Post	67 613	15	17 630	3	-74	-12.6
<b>Sub-total</b>	<b>75 551</b>	<b>17</b>	<b>24 076</b>	<b>4</b>	<b>-68</b>	<b>-10.8</b>
<b>Total Employment</b>	<b>379 948</b>	<b>86</b>	<b>449 193</b>	<b>80</b>	<b>18</b>	<b>1.7</b>
Seeking Work	60 385	14	109 512	20	81	6.1
<b>Total Labour force<sup>1</sup></b>	<b>440 333</b>	<b>100</b>	<b>558 705</b>	<b>100</b>	<b>27</b>	<b>2.4</b>
Unemployment Rate <sup>2</sup>	13.7	–	19.6	–	–	–

## Notes:

1. The labour force is the sum of people employed in both the formal and informal sectors and those looking for work.
2. The unemployment rate is the number of people looking for work expressed as a percentage of the total labour force.

Source: Central Statistics Office (2001)

twice (6.7 percent per annum between 1991 and 2001) the pace of employment growth of the 'employee' category and faster than the pool of job seekers. This is encouraging to the extent that it could potentially help ease unemployment. However, the sustainability of these jobs has yet to be established.

(ii) *Employment in 2001/02*

1.16 For the year to March 2002 total formal sector employment is estimated to have grown at a marginally faster rate of 2.7 percent compared to the revised increase of 2.6 percent for the year ending March 2001<sup>6</sup>. While this rate of job creation is faster than population and labour force growth, it may not be enough to

significantly reduce the unemployment rate. Employment in agriculture, water and electricity, transport and communications and the general Government sectors declined, while in the finance and business services sector it virtually stagnated. For the mining and construction sectors, employment growth was less than 2.5 percent. Total employment in the private sector expanded at a faster rate of 5 percent than in the previous year (3.9 percent) due to relatively strong growth of employment in manufacturing (8.4 percent), commerce (8.3 percent), community and personal services sectors (14.7 percent) and private education (4.5 percent)<sup>7</sup>.

1.17 Employment in parastatals increased by 1.2

<sup>6</sup> The Central Statistics Office (CSO) revised employment data for the year ending March 2001, the effect of which was a reduction in the overall growth rate of employment from the original estimate of 5 percent to 2.6 percent. The major downward revisions were in mining (employment fell 15.8 percent, due mainly to retrenchment at the BCL mine, compared to the original growth estimate of 2 percent), manufacturing (a 4.6 percent decline in jobs

against an initial growth of 5.4 percent) and finance and business services (growth dropped to 2.4 percent from the initial estimate of an 8.1 percent rise). In contrast, significant upward revisions were made in employment in agriculture, community and personal services; growth in the former rose to 8.2 percent from the original 3.3 percent and in the latter a higher increase of 11.6 percent from 4.5 percent.

percent following two successive years of decline due to organisational restructuring and staff rationalisation in some of the institutions. For the public sector, there was a 9.9 percent reduction in the number of employees in public schools, which more than offset employment increases in other parts of central and local government<sup>8</sup>. As a result, employment in general government declined by 0.4 percent, against an increase of 1.5 percent in 2001.

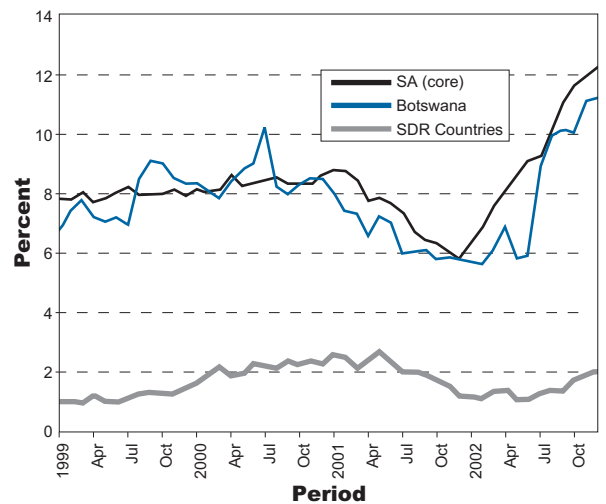
- 1.18 Official forecasts for employment growth for 2002/03 and 2003/04 suggest a 5 percent increase in each year, which is expected to be driven by expansion in non-mining sectors. However, with the downside risk on the GDP growth forecast outweighing the upside risk, there is also the possibility that employment will also under-perform.

#### (d) Inflation

- 1.19 Globally, inflation rose moderately in 2002, largely reflecting higher energy prices while excess production capacity, restrained consumer demand and benign inflation expectations dampened inflationary pressures. However, inflation rose sharply in South Africa in 2002, mostly reflecting the effects of the depreciation of the rand towards the end of 2001. Domestically, there were demand pressures on inflation as reflected in higher than desirable rates of growth in commercial bank credit to the private sector and government expenditure. Commercial bank credit grew, on average, at an annual rate of 18 percent, well above the range

of 12.5–14.5 percent indicated in the 2002 Monetary Policy Statement, while government expenditure is estimated to have grown by 18 percent. Nevertheless, the major impact on inflation during 2002 was the introduction of value added tax (VAT) on a wide range of goods and services effective July 1, 2002.

CHART 1.3 INTERNATIONAL INFLATION



Source: Central Statistics Office and Bank of Botswana.

- 1.20 It is estimated that VAT resulted in a 4–6 percent increase in the general price level spread over several months in the second half of 2002. The magnitude of the increase reflected the effects of VAT on the three groups of taxable items: those that were taxable for the first time (which did not previously attract sales tax), those for which sales tax did not cover the total value, and those that are exempt but have taxable inputs. Broadly, however, the magnitude of price increase for individual items may have been influenced by expectations of the generalised increase in prices while competitive pressures might have dampened the rate of price changes in some instances. Following the introduction of VAT, the month-on-month rate of price change rose sharply to 3.2 percent in July 2002 from an average of 0.5 percent in the preceding twelve months. However, reflecting the one-off effect of VAT on inflation, the monthly rate of price increase progressively declined to 1.1 percent in August, 0.2 percent in September and -0.1 percent in October.

<sup>7</sup> This is surprising given that manufacturing output increased by only 0.2 percent. It is worth noting, however, that the employment figures are very preliminary and as such the employment growth rate could change significantly once the figures are revised.

<sup>8</sup> The decline could be indicative of previous misclassification, by respondents to the labour surveys, of the general cadre on Councils' payroll but attached to public schools. The cadre forms part of the employees of Local Authorities, but are sometimes mistakenly recorded as public school employees. It would appear that in 2001/02 these workers were correctly recorded as employees of the former and not the latter.

1.21 Consumer price inflation averaged 8.1 percent in 2002, compared to 6.6 percent in 2001 and 8.5 percent in 2000. Most of the increase in inflation in 2002 occurred in the second half of the year, from an average of 6 percent in the first half, due to the impact of VAT. Apart from the impact of VAT, the 14.3 percent increase in food prices in 2002 (compared to 4.1 percent in 2001), which was partly due to drought conditions in the Southern African region, also contributed significantly to inflation in 2002 while the change in the telephone billing system in November resulted in higher inflation at the end of the year<sup>9</sup>. Generally, indications are that when the effect of VAT is allowed for, underlying inflation was stable at around 6–7 percent in 2002.

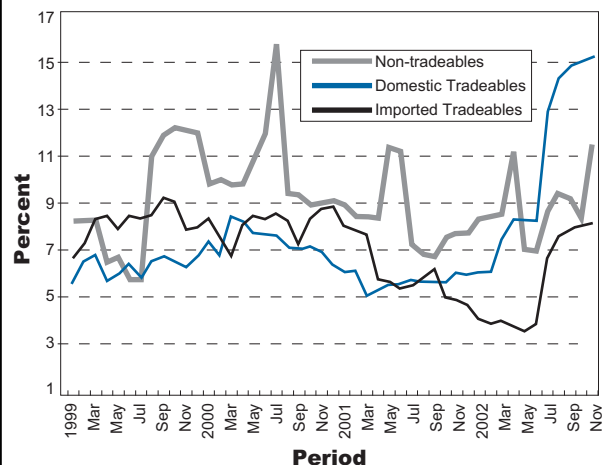
1.22 By tradeability, the annual rate of increase in the cost of tradeables rose at a faster rate of 10.6 percent in December 2002 compared to 5.1 percent in December 2001 reflecting, among other factors, the sharp increase in inflation in South Africa, following the depreciation of the rand towards the end of 2001, the increase in food prices and the impact of VAT. Within tradeables, prices of imported tradeables accelerated to 8.2 percent from 4.6 percent while the cost of domestic tradeables rose year-on-year by 15.2 percent from 5.9 percent over the same period. For non-tradeables the annual price change rose to 11.7 percent in December 2002, from 7.7 percent in December 2001.

### (e) Inflation Outlook

1.23 Inflation has largely been contained globally,

<sup>9</sup> There was a substantial increase, of 60.7 percent, in the cost of the telephone call component of the CPI basket in November 2002 which, however, mainly reflected a change in the billing system rather than an increase in the cost of phone calls. Previously telephone calls were charged in units with a specified duration and the full cost of a unit was incurred even if only a fraction of the duration was used in making the call. The new billing system is on a per second basis. The charge will tend to make shorter calls cheaper and longer calls more expensive, but is designed to be cost/revenue neutral and is, therefore, unlikely to result in an increase in telephone bills, on average.

CHART 1.4 CPI INFLATION BY TRADEABILITY



Source: Central Statistics Office.

reflecting a combination of improved credibility of monetary policy in the major economies and subdued economic activity worldwide. Despite the expected improvement in economic performance, output will remain below trend and global inflation is forecast to remain steady at around 2.5 percent in 2003. In South Africa, inflation is forecast to slow down in 2003 following a sharp increase in 2002, indicating the appreciation of the rand and the impact of the restrictive monetary policy stance on demand. The overall impact of external price developments on domestic inflation in 2003 is, therefore, expected to be benign, especially if the international oil prices remain relatively stable. However, domestic demand pressures remain, due to the high rates of growth in both commercial bank credit and government expenditure, although these are expected to be moderated in 2003 by the increase in interest rates in the fourth quarter of 2002 and the considerable slowdown in government expenditure growth announced in the 2003/04 budget. These developments are expected to reduce pressure on inflation in 2003. This positive outlook on inflation may, however, be negated by any major increases in administered prices and any Government award of salary increases to civil servants in the second quarter of 2003 following the ongoing review of the Government salary structure.

## 2. PUBLIC FINANCE

### (a) Budgetary Performance – 2001/02 and 2002/03

#### (i) *The Final 2001/02 Budget*

2.1 The final outturn for the fiscal year 2001/02<sup>10</sup> was worse than forecast in both the original and revised budgets, with the overall balance in deficit compared to the significant surplus of the previous year. Total revenue fell to P12 707 million while total expenditure rose slightly to P13 671 million, resulting in a deficit of P964 million, which was higher than the original and revised estimates of P527 million and P85 million, respectively. Shortfalls in both non-mineral income tax revenue and mineral revenue, due to factors including weakness in international diamond prices explained most of the decline in total revenue. The rise in total expenditure was largely a result of a 16.1 percent increase in wage costs.

#### (ii) *The Revised 2002/03 Budget*

2.2 In the 2002/03 revised budget estimates

(Table 1.2) the deficit increased (P2 216 million) and considerably exceeded the P1 619 million originally budgeted. The increased deficit was due to a reduction in total revenue to P14 426 million, following a 17.1 percent drop in mineral revenue due to continued weakness in the diamond market and the appreciation of the Pula against the US dollar.

### (b) The 2003/04 Budget Estimates

2.3 In contrast to the previous year, the 2003/04 Budget is in approximate balance. This reflects the Government's effort to contain spending and projected increases in revenue through a combination of planned increases in mineral production, expansion of tax coverage and general improvement in tax collection.

#### (i) *Revenue*

2.4 Total revenue is projected to rise by 21.6 percent over the revised estimate for 2002/03 to P17 539 million. The revenue growth is expected to rise across the board from mineral revenues, non-mineral income tax, customs and excise as well

**TABLE 1.2 THE GOVERNMENT BUDGET: 2001/02 – 2003/04 (P MILLION)**

	2001/02			2002/03		2003/04
	Budget	Revised	Final	Budget	Revised	Budget
<b>Revenue</b>	13 558	13 347	12 707	15 411	14 426	17 539
Mineral	7 953	7 463	6 996	8 492	7 040	8 140
Non-mineral	5 605	5 885	5 711	6 919	7 386	9 399
<b>Expenditure</b>	14 084	13 433	13 671	17 031	16 642	17 333
Recurrent	9 368	9 613	9 935	11 642	11 940	13 319
<i>of which:</i>						
Salaries <sup>1</sup>	2 944	2 966	3 447	3 884	3 903	4 132
Development	4 709	3 762	3 698	5 187	4 502	4 431
Other <sup>2</sup>	7	58	37	201	70	-503
<b>Balance</b>	-527	-85	-964	-1 619	-2 216	206

Notes:

1. Wages, Salaries and related staff costs

2. Includes FAP grants and net lending

Source: Financial Statements, Tables and Estimates of the Consolidated Development Fund Revenues 2002/03, MFDP.

<sup>10</sup> The fiscal year runs from April to March.

as VAT. Mineral revenue is forecast to rise by 15.6 percent to P8 140 million, due in part to an expected increase in diamond production. Non-mineral income taxes are expected to grow by 12.3 percent to P2 533 million while customs and excise revenue is projected to rise by 36.4 percent to P2 120 million, due to both an increase in the volume of imports and the Pula depreciation against the rand. Collections from VAT are expected to grow by 79.1 percent to P2 306 million, reflecting both the first full year of operation of VAT and improved collection of revenue.<sup>11</sup>

(ii) *Expenditure*

2.5 Total expenditure is forecast to increase by 4.2 percent over the revised 2002/03 estimates to P17 333 million. This is a much slower growth than in the previous year and is expected to result from a slight drop (1.6 percent) in development expenditure and a slowdown in the rate of increase of the two largest components of recurrent expenditure, 'other charges' and 'personal emoluments'. Growth for the former is forecast to decline to 14.5 percent from 24.1 percent in 2002/03, while the latter is projected to rise by 5.9 percent compared to 13.3 percent in the last fiscal year.

2.6 Development expenditure is projected to increase to P4 431 million. Just over 40 percent of the development budget is allocated to social services, within which more than half is allocated to education and health sectors; 32.5 percent was earmarked for economic services, the bulk (23.4 percent) of which will finance electricity and water supply, as well as roads; and 27.2 percent was assigned to general public services.

2.7 The sharp drop in the growth of total government spending in 2003/04 compared with double digit

spending growth rates in recent years, as well as the balanced budget that compares favourably with the large deficits of the previous two years, bode well for both monetary policy and macroeconomic balance in the coming year. It is also particularly encouraging that the revised estimate of 22 percent government spending growth in 2002/03 is lower than the 27 percent growth originally forecast in last year's budget. With the easing of fiscal pressures and the fiscal balance becoming relatively less of a concern from a monetary policy perspective, monetary policy in the coming year could focus on demand pressures arising from the private sector within a more conducive environment.

(c) **The 2003/04 Budget – Theme and Programmes**

(i) *The Theme of the Budget*

2.8 The 2003 Budget Speech focused on the theme 'Improving Botswana's Competitiveness in Global Markets', and outlined measures to support the competitiveness drive. The need to maintain competitiveness derives from the fact that Botswana is a small open economy with limited influence on global trade and capital flows in the context of the ongoing globalisation process. In this competitive environment, the country can benefit from open trade and the free movement of resources if it continues to pursue prudent macroeconomic policies, foster an enabling environment for inward investment and improve service delivery.

(ii) *Performance of State-owned Enterprises*

2.9 It is considered that an improvement in service delivery by state-owned enterprises that provide utilities, housing, air transport and financial services would support efficiency in the broader economy and export competitiveness. For this reason, the Government has for some time encouraged state-owned enterprises to be self-sustaining and rely more on the private sector for funding. As a result, there has been some improvement in the financial performance of a

<sup>11</sup> The previous year's figure includes revenue from sales tax for part of the year and for VAT subsequent to its introduction on July 1, 2002. Therefore, the growth rate should be carefully interpreted as the rapid growth projected is partly because the coverage of sales tax and VAT are not the same.

number of parastatals, including the Botswana Development Corporation (BDC), Air Botswana (AB), Botswana Housing Corporation (BHC), Water Utilities Corporation (WUC), Botswana Power Corporation (BPC), National Development Bank (NDB) and the Botswana Savings Bank (BSB).

- 2.10 Some key institutions, however, especially the Botswana Telecommunications (BTC), the Botswana Meat Commission (BMC) and the Botswana Agricultural Marketing Board (BAMB), have for a variety of reasons been unprofitable in recent years. Moreover, despite the profitability of some of the utility providers, there continue to be concerns about access, efficiency and the cost of services compared to other countries. To address these concerns, several projects have been initiated with the objective of widening access to, and increasing the supply of water, electricity and telecommunications services. The projects include the rural electrification programme and the expansion of rural telecommunications to cover a population of 120 000 in 147 villages. In order to prevent these high-cost projects from driving tariffs up further, part of the infrastructure costs are being met by the Government.
- 2.11 On privatisation, the Public Enterprise Evaluation and Privatisation Agency (PEEPA) is expected to complete the preparation of a Privatisation Master Plan (PMP) by the first quarter of 2003/04. The PMP will provide a broad strategic framework that outlines the tools and methods of privatisation together with a three-year privatisation work programme. The agency is also compiling a database of privatisation activities and opportunities, which is expected to ensure transparency, efficiency and effectiveness in its implementation.
- 2.12 Work on the privatisation of Air Botswana was resumed in September 2002 and will be completed by the end of 2003, following its suspension earlier due to unfavourable conditions in the international aviation industry,

particularly against the background of the September 11, 2001 terrorist attacks in the USA. It is planned that 45 percent of the shares of the privatised airline will be owned by a strategic partner, 10 percent will be allocated to citizen employees of the airline and the remaining 45 percent will be retained by Government; the latter may subsequently be sold to the public. The other institutions considered for privatisation are the NDB and BSB. The Government will assess the feasibility of merging the two institutions and the possibility of privatising them either as a merged entity or separately. In order to improve its recent weak performance, the BTC is implementing a three-year organizational and financial restructuring programme subsequent to which the parastatal is expected to be privatised.

(iii) *Programmes and Other Initiatives*

- 2.13 The Citizen Entrepreneurial Development Agency (CEDA), the objective of which is to support business development and meet the financing needs of citizen entrepreneurs, had approved 792 projects worth P421.1 million as at the end of 2002. Significantly, the largest proportion of applicants financed (45 percent) was in the service sector followed by 10 percent in manufacturing, indicative of the growing importance of the services industry, which is in line with global trends. However, after the first year of operation, arrears of P3.6 million were 50 percent of expected repayments, suggesting the need for increased efforts to guard against the onset of loan repayment problems that have previously affected similar financial assistance programmes. The guidelines for the operation of the CEDA Venture Capital Fund have been finalised and the process of identifying a manager has started. The Fund is expected to be operational in the first half of 2003.

(iv) *Industrial Development and Trade Issues*

- 2.14 In recognition of the importance of domestic industry in the achievement of global competitiveness, the Ministry of Trade and

Industry, in collaboration with the United Nations Development Programme (UNDP), has introduced a programme that aims to develop investment and export promotion strategies, a modern investment law and capacity for negotiating bilateral investment treaties. The Government also intends to review administrative barriers to investment in Botswana, an area that has been of concern to industry. The investment code, which was introduced last year, will be withdrawn and replaced by a more investor-friendly one during 2003/04. Moreover, in order to improve the operational efficiency of the Ministry and therefore service delivery to industry, the reorganisation announced in the last Budget Speech is ongoing. The Local Enterprise Agency, the role of which is to speed up the delivery of training and mentoring support to local enterprises, will start operations during the 2003/04 financial year, while the Office of the Registrar of Companies will be established as an autonomous entity.

2.15 In an effort to improve market access, Botswana will actively participate in regional and international trade initiatives. Following successful negotiations for the temporary relaxation of some AGOA<sup>12</sup> requirements, Botswana, together with other Southern African Customs Union (SACU) countries, will enter into negotiations with the USA Government during 2003-2004 on the creation of a free trade agreement between SACU and the USA, with a view to securing uninhibited market access for SACU goods and services on a more permanent basis. Meanwhile, Botswana and other African, Caribbean and Pacific (ACP) countries will negotiate free trade arrangements with the European Union (EU), which will replace the current non-reciprocal trade arrangements in 2008 (see Chapter 2).

<sup>12</sup> The Africa Growth and Opportunity Act (AGOA) is a framework for the promotion of trade and investment between the USA and Sub-Saharan African countries. The details of this arrangement are covered in Chapter 2.

(v) *Fiscal Legislation*

- 2.16 A number of legislative amendments were proposed for the 2003/04 fiscal year with a view to improving tax compliance and collection, closing loopholes and easing tax administration. The amendments will be made to the Income Tax and Transfer Duty legislation while a new law is proposed for the creation of a unified revenue service. The major changes are summarised below:
- 2.17 *Withholding Tax on Rental and Interest Income:* Coverage of withholding taxes will be extended to rental income from immovable property (10 percent) and interest income (15 percent) received by residents. The proposal has been prompted by failure of some residents to declare their rental and interest income in their tax returns. To encourage savings, it is proposed to raise the threshold of interest income above which the withholding tax is applicable to P6 000 a year (or P500 a month), from the current P2 500 a year.
- 2.18 *Company Directors' Responsibility for Payment of Taxes:* The amendment seeks to hold directors personally liable for outstanding company tax on disposal of their shareholding or upon liquidation of the company.
- 2.19 *Transfer Duty Act:* The Transfer Duty Act will be amended retrospectively to July 1, 2002 such that the 5 percent transfer duty payable on a property transaction is waived or reduced where VAT is also payable. The taxpayer will be entitled to apply for a refund of the transfer duty paid if VAT has also been paid.
- 2.20 *Treatment of Bad and Doubtful Debts of Banking and Financial Institutions:* The law will be amended to allow banks and financial institutions to deduct up to a prescribed percentage of their outstanding debts or advances, for which provision for bad and doubtful debts has been made in the accounts.
- 2.21 *Unified Revenue Service:* Following last year's announcement, legislation is being prepared to create a unified revenue service that will take

over the functions of the Departments of Taxes and Customs and Excise.

### 3. EXCHANGE RATES, BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION

#### (a) Exchange Rates

3.1 During 2002, there was considerable exchange rate volatility, although most of the movement was in the opposite direction from that experienced in 2001. The Pula strengthened against major international currencies on the back of a recovery of the rand from losses incurred towards the end of 2001. The rand appreciated by 29 percent against the SDR, reflecting prudent macroeconomic policy in South Africa, a more favourable assessment of South Africa vis-à-vis other emerging markets by international investors, a perception that the rand had become undervalued, the weakness of the US dollar, the rise in the price of gold accompanied by an improved outlook for commodities more generally, and the repatriation of export earnings by South African exporters.

Given the link to the rand through the currency basket, the Pula appreciated by 18.6 percent against the SDR during the year, including a 27.9 percent appreciation against the US dollar, but depreciated by 8 percent against the rand (Table 1.3).

3.2 Botswana's exchange rate policy is based on the desire to maintain competitiveness of domestic producers by ensuring that the real exchange rate of the Pula remains relatively stable. The Pula value is linked to a basket of currencies comprising the rand and the SDR with weights that are based on Botswana's international trade and financial relations. An appreciation of the real exchange rate due to nominal appreciation and/or a rise in inflation in Botswana compared to trading partner countries reduces the competitiveness of domestic producers while reducing the cost of imports in Pula terms.

3.3 The trade-weighted nominal effective exchange rate (NEER), which reflects the weighted average of the Pula exchange rates against trading partner countries, was largely stable in 2002, appreciating marginally by 0.5 percent as

**TABLE 1.3 NOMINAL AND REAL PULA EXCHANGE RATES AGAINST SELECTED CURRENCIES**

Nominal Exchange Rates (foreign currency per Pula)			
As at end of	2001	2002	Percentage Change
SA rand	1.7188	1.5801	-8.1
SDR	0.1143	0.1356	18.6
US dollar	0.1432	0.1829	27.7
Pound Sterling	0.0987	0.1140	15.5
Japanese yen	18.80	21.68	15.3
Euro	0.1617	0.1745	7.9
<b>Nominal Effective Exchange Rate</b>	<b>100.8</b>	<b>101.3</b>	<b>0.5</b>
Real Pula Exchange Rate Indices (November 1996=100)			
SA rand <sup>1</sup>	133.6	121.6	-9.0
SA rand <sup>2</sup>	144.5	129.0	-10.7
SDR	77.8	100.5	29.2
US dollar	66.2	91.7	38.5
<b>Real Effective Exchange Rate</b>	<b>110.1</b>	<b>113.3</b>	<b>2.9</b>

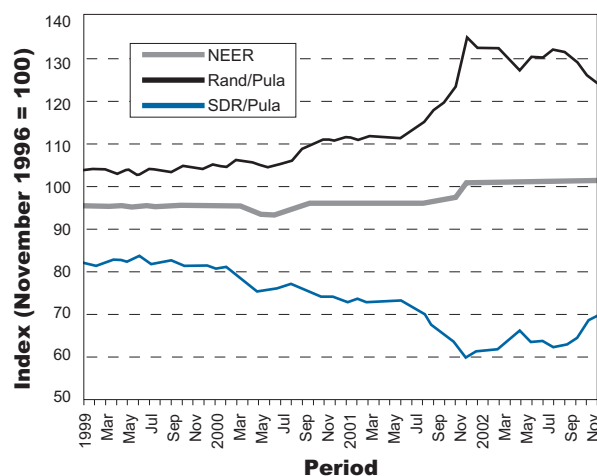
Notes:

1. Calculated using core inflation. Core inflation is the all items of consumer price inflation excluding mortgage interest costs and prices of various volatile food items.
2. Calculated using headline inflation.

Source: Bank of Botswana.

the impact of the Pula appreciation against the SDR was offset by the local currency's depreciation against the rand (Chart 1.5). Given the stability of the NEER, exchange rate developments are not expected to have any impact on inflation. The real effective exchange rate (REER), which measures Botswana's overall competitive position, appreciated by 2.9 percent in the twelve months to December 2002, indicating loss of competitiveness. This was due largely to higher inflation in Botswana compared to the average for trading partner countries. Against individual currencies, the Pula weakened in real terms by 10.7 percent against the rand (using core inflation) but appreciated by 29.2 percent against the SDR and 38.5 percent against the US dollar (see Chart 1.6).

**CHART 1.5 NEER AND NOMINAL EXCHANGE RATE INDICES AGAINST SELECTED CURRENCIES**

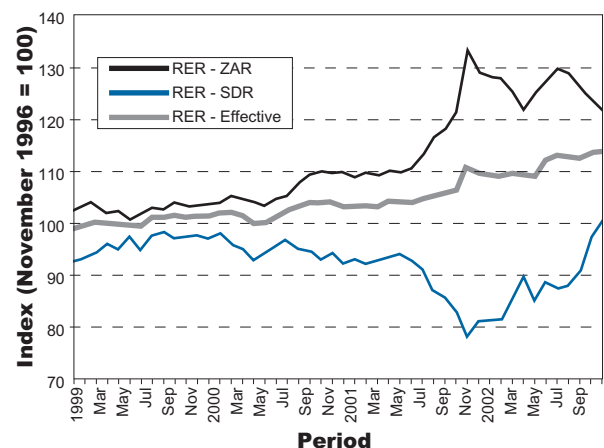


Source: Bank of Botswana

**(b) Overview of the Balance of Payments**

3.4 The 2002 preliminary balance of payments estimates show a surplus of P3 153 million on the current account, 14.5 percent lower than the P3 689 million recorded in 2001. The decline in the current account surplus reflected the combined effect of an increase in the income account deficit and a substantial rise in imports, which reduced the balance of trade surplus. There was a net outflow of P3 322 million on the financial account, which continued the trend of large net

**CHART 1.6 REER AND REAL EXCHANGE RATE INDICES AGAINST SELECTED CURRENCIES**



Source: Bank of Botswana

outflows evident since 1998; the overall balance<sup>13</sup> declined by 67 percent to P336 million.

(i) *The Merchandise Trade Account*

3.5 Although the merchandise trade account continued to be in surplus, the surplus declined by 6 percent in 2002 to P4 078 million from P4 346 million in 2001. Exports are estimated at P14 983 million, a 12 percent increase from P13 345 million in 2001. The increase in exports was mainly a result of the 11 percent rise in diamond exports, which continued to be the major source of export earnings, accounting for 83 percent of the total. As a result of improvements in global demand in 2002, part of the 2001 production that was stockpiled was exported alongside the entire output for 2002. Pula export revenues also benefited from the depreciation of the Pula against the US dollar as diamond exports only increased by 1 percent in US dollar terms.

3.6 Copper-nickel and soda ash exports increased by 13 percent and 29 percent, respectively. However, beef exports declined considerably, by about 40 percent, from P427 million recorded in 2001 to P257 million in 2002. The reduction was partly a result of the outbreak of the foot and mouth disease (FMD) in the north-east (Matsiloje) of the country in early 2002, which led to the closure of the Francistown abattoir during the first quarter of the year, and the

<sup>13</sup> Before movements in official reserves.

TABLE 1.4 BALANCE OF PAYMENTS: 1999 – 2002

	1999	2000	2001 <sup>1</sup>	2002 <sup>2</sup>
Current Account Balance	2 859	2 782	3 689	3 153
Visible Trade Balance	3 629	4 603	4 346	4 078
Services Balance	-721	-1 136	-1 010	-620
Income Balance	-1 213	-1 792	-801	-1 741
Net Current Transfers	1 164	1 108	1 153	1 436
Financial Account Balance	-1 127	-1 021	-2 976	-3 322
Capital Account Balance	95	194	34	99
Net Errors and Omissions	2	-15	474	405
Overall Balance	1 829	1 941	1 024	336

Notes:

1. Revised
  2. Provisional
- Source: Bank of Botswana.

temporary suspension of exports to the EU, the major market for Botswana beef. The future of the beef industry depends partly on the ability of Botswana to combat cattle diseases. Due to uncontrolled movements of cattle from neighbouring Zimbabwe, there was another outbreak of foot and mouth disease, again in the north-east (Matopi), in January 2003, which is likely to have similar adverse effects on beef exports.

- 3.7 Provisional estimates indicate that imports of goods rose to P10 905 million, an increase of 21 percent from P8 664 million in 2001. Imports of machinery and electrical appliances as well as vehicles and transport equipment accounted for the bulk of the increase. Food and beverage imports also rose due to higher prices which reflected regional food shortages and lagged effects of the previous year's depreciation of the rand. Overall, imports rose due to increased consumption as well as the ongoing construction boom.
- 3.8 The services account, which covers transportation as well as insurance and other professional services, had a deficit of P620 million during the year compared to P1 010 million in 2001. The net outflow was mainly in transportation, which was principally affected by an increase in freight costs. Payments for

travel also rose due to the increase in the number of students on overseas training, but the rise was lower than that in 2000 and 2001 when the Government had just started sending students to South Africa in large numbers. The current transfers account, which forms part of the current account, is dominated by the South African Customs Union (SACU) payments and continued to be in surplus.

- 3.9 The adverse balance on the income account increased to P1 741 million in 2002 from P801 million in 2001, reflecting the decline in earnings on reserves, which resulted from the poor performance of the equity markets in which part of the reserves are invested.

(ii) *Current Account*

- 3.10 Although still at a healthy level, the 2002 current account surplus of P3 153 million was much lower than the P3 689 million in 2001 (Table 1.4). The decline was due to both the fall in the visible trade surplus and a larger deficit on the income account.

(iii) *Capital and Financial Accounts*

- 3.11 The capital account, which summarises transactions relating to migrant transfers and all other transfers of a capital nature, was also in

surplus during the year, with a much larger balance of P99 million in 2002 compared to P34 million in 2001. In contrast, there were large net outflow in the financial account in 2001 and 2002. The net outflow of P2 976 million was largely a result of Debswana's increased shareholding in DeBeers. The financial account net outflow, which increased to P3 322 million in 2002, was due to increased portfolio investment outflows stemming from the new Public Officers Pension Fund. Moreover, a net outflow of P1 256 million is estimated in 'other investment' which is related to SACU transactions and bank deposits abroad as well as loans and trade credits.

(iv) *Foreign Exchange Reserves*

3.12 The foreign exchange reserves were P30 billion as at end of December 2002, and covered 26 months of import of goods and services. The reserves decreased by P11 billion, or 27 percent, from P41 billion in December 2001, owing mostly to the effect of the Pula appreciation, particularly against the US dollar. In US dollar and SDR terms, the reserves fell by 7.2 percent and 13.8 percent respectively, largely reflecting the fall in equity values in major international markets during 2002, combined with outgoing payments linked to the funding of the Public Officers Pension Fund.

**(c) International Investment Position and Foreign Direct Investment**

(i) *International Investment Position (IIP)*

3.13 Comprehensive International Investment Position (IIP) data are available up to the end of 2001. For 2002, preliminary estimates are derived by adding flows to the previous year's stocks, and indicate that Botswana's total foreign assets declined by P7 936 million from P51 607 million in 2001 to P43 761 million in 2002. The decrease in foreign assets was attributable to the P11 253 million fall in foreign exchange reserves in 2002, which continued to account for a large proportion (68 percent) of Botswana's foreign

assets. Offsetting the impact of the fall in foreign exchange reserves was the substantial increase in portfolio assets in 2002, due to investment abroad of part of the new Public Officers Pension Fund. Foreign liabilities increased by P605 million to P17 676 million in 2002, from P17 079 million in 2001. The bulk of the increase (P357 million) was due to a rise in loans to the domestic private sector.

(ii) *Industry and Country Classification of Investment*

3.14 Tables 1.5 and 1.6 show Botswana's stock of foreign liabilities at the end of 2001 classified by industry and country<sup>14</sup> of investment origin. The liabilities are shown by categories of foreign direct investment (72 percent of total) and other investment<sup>15</sup>.

3.15 At the end of 2001, a large proportion of foreign direct investment (81 percent) was in the mining industry, virtually unchanged from 79 percent in 2000. BCL Ltd's indebtedness for loans and accrued interest continued to dominate this category. Equity investment in the financial sector contributed to an increase in this sector's share of foreign direct investment, which rose to 7 percent in 2001 from 6 percent in 2000, becoming the second largest recipient. Wholesale and retail trade accounted for 6 percent while manufacturing, which is widely expected to be a major beneficiary, accounted for only 3 percent of foreign direct investment in 2001.

3.16 As at the end of 2001, South Africa was the largest source of foreign direct investment, accounting for 60 percent while the European Union countries had 35 percent.

3.17 Under 'Other Investment', 52 percent of the

<sup>14</sup> Derived from the 2001 balance of payments survey conducted by the Bank of Botswana.

<sup>15</sup> Includes all financial transactions not included under direct investment portfolio or reserve assets. In the case of Botswana, the account comprises both government and private sector loans, trade credits, currency and deposits, as well as SACU transactions.

**TABLE 1.5 LEVELS OF FOREIGN INVESTMENT IN BOTSWANA BY INDUSTRY (P MILLION)**

Industry <sup>1</sup>	Foreign Direct Investment			Other Investment			Total Investment
	Equity	Non Equity	Total	Equity	Non equity	Total	
Mining	2 980	5 432	8 412	10	1 206	1 216	9 627
Manufacturing	184	90	274			1	275
Finance	610	120	729	6	178	184	913
Retail and Wholesale	651	...	651	...	223	223	874
Electricity, Gas and Water	...	...	...	...	217	217	217
Real Estate and Business Services	100	14	115	...	77	77	191
Transport, Storage and Communication	48	47	96	1	51	52	148
Construction	5	18	23	...	5	5	28
Hospitality	126	9	135	...	...	...	135
Public Administration	...	...	...	...	2 102	2 102	2 102
Other	1	0	1	...	1	1	2
<b>Total</b>	<b>4 705</b>	<b>5 730</b>	<b>10 435</b>	<b>17</b>	<b>4 060</b>	<b>4 077</b>	<b>14 512</b>

Source: Bank of Botswana

**TABLE 1.6 LEVELS OF FOREIGN INVESTMENT IN BOTSWANA BY COUNTRY (P MILLION)**

Country	Foreign Direct Investment			Other Investment			Total Investment
	Equity	Non Equity	Total	Equity	Non equity	Total	
North and Central America	45	3	48	...	340	340	<b>388</b>
of which							
United states of America	45		45	...	340	340	<b>385</b>
Europe	3 593	711	3 665	5	445	450	<b>4 115</b>
of which							
United Kingdom	546	44	591	5	218	223	<b>814</b>
Netherlands	18	3	22	...	...	...	<b>22</b>
Luxembourg	2 979	22	3 002	...	80	80	<b>3 081</b>
Other Europe	45	2	48	...	134	134	<b>181</b>
Asia Pacific	94	9	103	...	631	631	<b>734</b>
Africa	680	5 623	6 303	...	1 067	1 067	<b>7 370</b>
of which							
South Africa	662	5 613	6 275	...	939	939	<b>7 214</b>
Middle East	88	21	109	...	60	60	<b>169</b>
Other	205	3	208	11	1 517	1 528	<b>1736</b>
<b>Total</b>	<b>4 705</b>	<b>5 730</b>	<b>10 435</b>	<b>17</b>	<b>4 060</b>	<b>4 077</b>	<b>14 512</b>

Source: Bank of Botswana.

liabilities in 2001 were government foreign debt while the mining industry accounted for 30 percent of the total.

#### **4. MONEY AND CAPITAL MARKETS**

##### **(a) Monetary Policy and Liquidity Management**

###### *(i) Monetary Policy*

4.1 The main objective of monetary policy is to achieve sustainable low inflation, which besides contributing to macroeconomic balance and creating an environment that encourages investment, facilitates the achievement of positive real rates of interest in order to encourage savings and high quality investment. Low inflation is also essential for the maintenance of exchange rate competitiveness in relation to trading partners. For the first time, the Bank publicly specified the inflation objective of 4 – 6 percent in the 2002 Monetary Policy Statement which, given forecast trading partner inflation, was considered necessary to maintain external competitiveness. Moreover, by stating the desired range for inflation and clear indications of the policy response to inflationary developments that would push inflation away from this desired range, the Bank expected to anchor inflation expectations downwards.

4.2 The Bank of Botswana maintained a tight monetary policy stance in 2002 which was necessitated by concerns about inflationary pressures generated by the high rates of growth

in both commercial bank credit and government expenditure which throughout the year were well above rates consistent with the Bank’s inflation objective. Nevertheless, inflation was stable in the first half of the year, although it was at the upper end of the desired range. It was expected that following the introduction of VAT there would be a one-off increase in inflation over a few months while demand declined as prices increased. However, due to concerns about persistent higher than desirable growth in nominal demand, the Bank, in line with the policy framework outlined in the 2002 Monetary Policy Statement, increased the Bank Rate by 50 basis points each in October and November, to 15.25 percent, in order to moderate commercial bank credit growth and curtail expectations of a sustained increase in inflation.

4.3 The Bank undertook open market operations to absorb excess liquidity in the banking system, which increased substantially due to the P4.9 billion transfer of pension funds by the Government from its accounts at the Bank of Botswana to the Public Officers Pension Fund. During the year Bank of Botswana Certificates (BoBCs) outstanding rose by 49 percent to P7 783 million in December 2002, from P5 148 million at the end of 2001, even faster than the 39 percent increase in 2001. Most of the increase in BoBCs was in holdings by commercial banks’ clients and other financial institutions, in particular fund managers or institutional investors for the Public Officers Pension Fund. Holdings by commercial banks’ clients increased by 131 percent, and were 46 percent of total

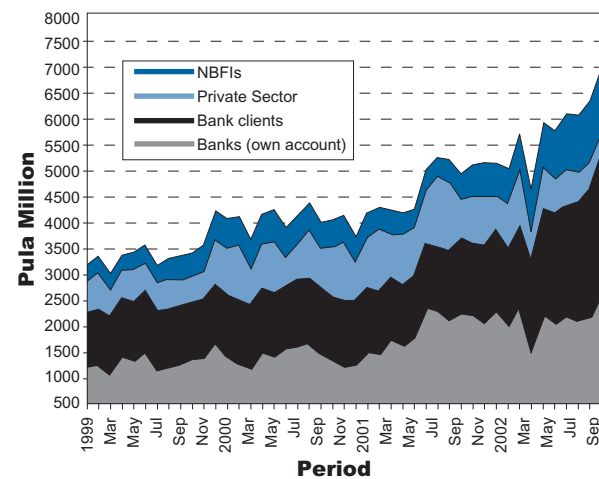
**TABLE 1.7 STRUCTURE OF BANK OF BOTSWANA CERTIFICATE HOLDINGS**

	P million		Percentage	Share of Total (Percent)	
	2001	2002	Change	2001	2002
Commercial banks	2 361	1 776	-24.8	45.2	22.8
Banks' clients	1 536	3 544	130.7	29.4	45.5
Other Financial Institutions	655	1 849	182.3	12.5	23.8
Other institutions	669	614	8.2	12.8	7.9
Total	5 221	7 782	49.1	–	–

Source: Bank of Botswana.

BoBCs, while those held by other financial institutions rose by 182 percent to make up 24 percent of the total. In contrast, BoBCs held by commercial banks fell by 25 percent, as did those for the other private sector entities which declined by 8 percent.

**CHART 1.7 OUTSTANDING BANK OF BOTSWANA CERTIFICATES**



Source: Bank of Botswana.

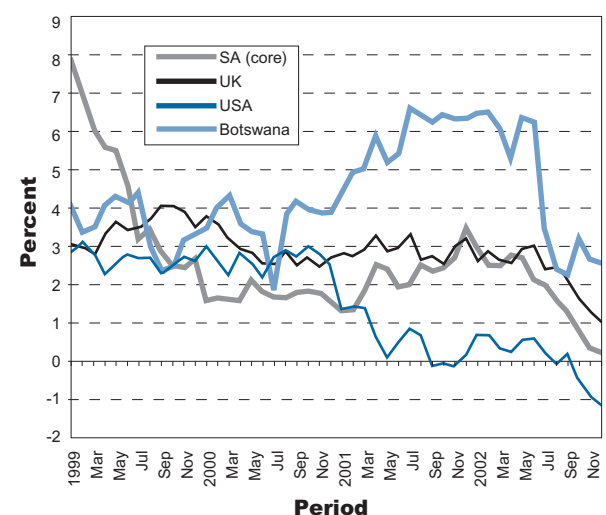
4.4 Secondary market trading for BoBCs was sluggish, as the value of total certificates traded during the year declined by 2.4 percent to P5 202 million. It is notable that secondary market activities continued to be dominated by the Bank of Botswana (88 percent) compared to trading between primary counterparties. The value of BoBCs traded in the secondary market between the Bank of Botswana and counterparties was P4 572 million, 10.4 percent less than P5 105 million traded over the same period in 2001. The value of transactions among counterparties more than doubled to P630 million in 2002 from P223 million in 2001. The Bank seeks to encourage increased activity in the secondary market and trade among the primary counterparties and is, therefore, reviewing the relevant operating rules.

**(b) Interest Rates**

4.5 Interest rates were largely unchanged during the first nine months of 2002, but rose following the increase in the Bank Rate in the last quarter of the year, to 15.25 percent from the 14.25

percent that had prevailed since October 2000. The nominal three-month BoBC mid-rate fluctuated in a narrow range of 12.51 percent and 12.54 percent between January and September, but rose in the last quarter of the year to 14.03 percent in December, reflecting the increase in the Bank Rate. Following the increase in the Bank Rate, commercial banks increased the cost of borrowing by raising the prime lending rate to 16.75 percent from 15.75 percent. However, the spread between lending rates and deposit rates increased, as the deposit rates generally rose by less than the prime lending rate; the 88-day deposit rate was increased to 10.15 percent from 9.81 percent prior to the Bank Rate increase.

**CHART 1.8 INTERNATIONAL REAL INTEREST RATES**



Source: Bank of Botswana.

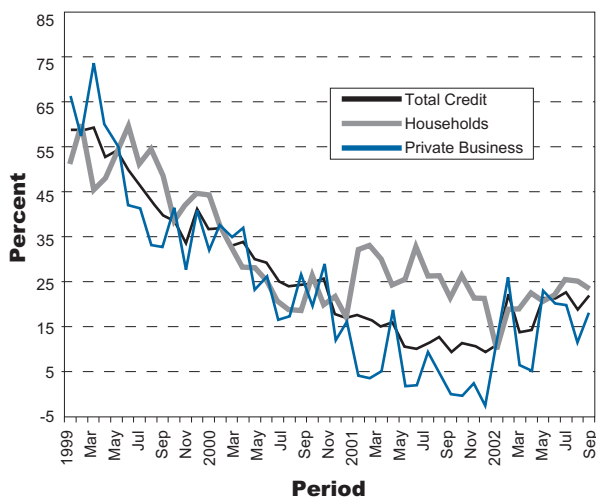
4.6 Real money market rates, which exclude inflation from nominal interest rates and which had been stable at a relatively high level, declined sharply in the second half of 2002 as a result of the increase in inflation following the introduction of VAT in July 2002. The real three-month BoBC rate fell to 2.5 percent in December 2002 from 6.3 percent in December 2001, but continued to be higher than comparable rates in the UK, USA and South Africa.

**(c) Banking System**

*(i) Domestic Credit*

4.7 The average annual rate of growth of commercial bank credit was 18 percent in 2002, higher than the 13.2 percent growth rate in 2001, while the year-on-year credit growth rate was 21.3 percent in December 2002, compared to 10.7 percent in December 2001. The 2001 credit growth rate was, however, understated because of the impact of the extension and subsequent early repayment of loans, using offshore funds, by certain large borrowers. If these loans are excluded, the rate of credit growth in 2002 was more or less the same as the average for 2001. The rate of credit expansion, however, was well above the target range of 12.5 percent to 14.5 percent<sup>16</sup>, and was a major influence on the decision to increase interest rates during the fourth quarter of 2002. It is expected that the increase in interest rates will lead to a slowing in the rate of credit growth and reduce pressures on inflation. Lending to businesses fell as a proportion of total credit, as its rate of growth was lower than for the household sector. The average annual rate of growth of commercial bank credit to businesses was 14.4 percent in 2002 compared to 21.5 percent for the household sector.

**CHART 1.9 GROWTH RATES OF CREDIT**



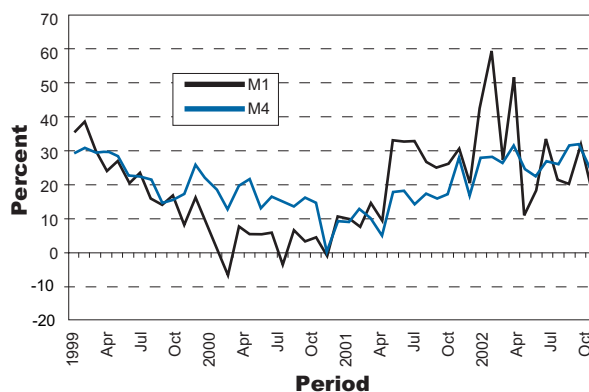
Source: Bank of Botswana

<sup>16</sup> The target range was derived from the expected annual capacity for growth (aggregate supply) of the non-mining sector of the economy, as presented in the eighth National Development Plan (NDP 8), and desired inflation for the year, with an allowance for the process of financial deepening as the economy develops.

*(ii) Monetary Aggregates*

4.8 Money supply (M4) grew year-on-year by 24 percent in December 2002 compared to 28 percent in December 2001. The main influence on monetary growth during the year was the 41 percent reduction in government deposits at the Bank of Botswana reflecting the funding of the Public Officers Pension Fund and the sharply increased budget deficit in 2002 compared to the previous year. The 21 percent annual increase in commercial bank credit also contributed to the increase in money supply, while the 28 percent decrease in net foreign assets was contractionary. Rapid money supply growth led to an increase of 110 percent in BoBCs held by non-banks, compared to a rise of 16 percent in 2001. Deposits at commercial banks grew at a slower rate in 2002 with demand deposits up by 23 percent compared to 38 percent in 2001, and savings, notice and time deposits falling by 2 percent during the year, compared to an increase of 23 percent in 2001. Due to the appreciation of the Pula against major international currencies, the Pula value of foreign currency deposits declined by 22 percent in 2002 compared to a 67 percent expansion in 2001. The 9 percent growth rate of currency outside banks was also lower than the increase of 13 percent in 2001.

**CHART 1.10 ANNUAL GROWTH RATES OF MONETARY AGGREGATES**



Note: Refer to statistical section for definition of the aggregates.  
Source: Bank of Botswana.

*(iii) Bank of Botswana*

4.9 Total assets/liabilities of the Bank of Botswana decreased by 27 percent in 2002, to P30 109

million as at the end of December 2002, following an increase of 22 percent in 2001. The fall in liabilities was mainly attributable to the 41 percent decrease in Government deposits at the Bank of Botswana, largely reflecting the P4.9 billion funding of the new Public Officers Pension Fund during 2002. The release of these funds into the banking system resulted in a substantial increase of 49 percent in the Bank's liability with respect to BoBCs. On the assets side of the balance sheet, the foreign exchange reserves declined by 27 percent in 2002. The long-term investment fund (Pula Fund), decreased by 24 percent during the year while the short-term Liquidity Portfolio fell by 42 percent. The reduction in the reserves partly reflected the purchase of foreign exchange during the year to finance offshore investments made by pension fund managers, as well as developments in international financial markets and exchange rate movements (see paragraph 3.12).

(iv) *Commercial Banks*

- 4.10 There was no change in the number of banks during 2002, although established banks continued to expand their branch networks, service points and the range of services offered<sup>17</sup>. Total assets of commercial banks grew year-on-year by 2 percent in 2002, to P11 183 million compared to the much higher growth rate of 29 percent in 2001. Although outstanding loans and advances grew by 21 percent, this was offset by substantial reductions in foreign currency balances and in balances due from foreign banks.
- 4.11 On the liabilities side, total deposits at commercial banks decreased by 15 percent in 2002 to P8 925 million, compared to a faster increase of 35 percent in 2001. Of the deposits, 16 percent was held in foreign currency accounts compared to 21 percent at the end of 2001. Commercial banks' capital and reserves rose by 6 percent, largely reflecting the capitalisation of profits.

(v) *Merchant Banks*

- 4.12 During 2002, the two merchant banks, Investec Bank and ABC (Pty) Ltd, increased their total assets/liabilities by 30 percent, to P846 million at the end of the year, from P651 million as at the end of 2001. Most of the growth in assets was due to a 28 percent increase in loans and advances, to P351 million, raising their share of the total loans and advances of the consolidated banking sector to 5 percent. Their holdings of BoBCs increased by a substantial 51 percent in line with an overall increase of 49 percent in the total value of outstanding BoBCs. With regard to their sources of funds, they increased deposit liabilities by 35 percent.

**(d) Non-Bank Financial Institutions**

- 4.13 Most non-bank financial institutions (NBFIs) experienced slower growth in their lending and financing activities in 2002 compared to the previous year. The National Development Bank (NDB) managed to expand its loan book by 17 percent, to P402 million, a much slower growth than the 36 percent expansion in 2001. In addition, NDB has in the past derived considerable income from agency activities carried out on behalf of the Government, such as the Financial Assistance Policy (FAP) and the Small, Medium and Micro Enterprises (SMME) loan scheme. As these incentive schemes have now been wound up, and their successor, the Citizen Entrepreneurial Development Agency (CEDA), operates independently, NDB has been seeking to develop new revenue sources and restructure its operations appropriately. One of NDB's main challenges is to continue to increase its lending in the face of competition from the newly-established CEDA, which provides highly subsidised loans to part of the NDB's potential client base. The Botswana Building Society (BBS) increased its mortgage lending to P359 million, but the growth of 7 percent in 2002 was below the 11 percent growth experienced in the previous year and mark a standstill in real terms. A similar situation prevailed at the Botswana Savings Bank (BSB), which expanded its lending, mostly in the form

<sup>17</sup> Including card-based payment services such as credit and debit cards.

of vehicle and housing loans to Government employees, by 10 percent to P85 million, lower than the 14 percent lending growth experienced in 2001. As mentioned in the 2003 Budget Speech, the Government is considering the possibility of merging the NDB and the BSB, and has earmarked the two institutions for privatisation, either individually or as a merged entity.

4.14 By contrast, the Botswana Development Corporation (BDC) managed to grow rapidly in 2002, with assets up by 42 percent to P1 089 million, compared to a growth of only 4 percent in 2001. In recent years BDC had experienced many problems, with losses from investments in the Hyundai motor assembly plant and various textile projects. However, the Corporation is now recovering and, during 2002, it made new investments in the Gaborone International Conference Centre, the Riverwalk Shopping Complex and Lobatse Tiles.

4.15 The performance of the stock exchange was lacklustre during 2002. The share index of the domestic component of the Botswana Stock Exchange rose by 2 percent to 2 497 in the year to December 2002, far below the growth of 69 percent recorded in 2001. Market capitalisation also rose at a slower rate than in the previous year. The foreign companies index fell sharply by 27 percent, largely on account of the decline in the share price of Anglo American Corporation, which accounts for the bulk of the value of listed foreign sector companies.

4.16 As regards activity in the market, a total of 71.1 million shares valued at P345 million, including two new listings, were traded during 2002 compared to 65.4 million shares valued at P400 million in 2001. The number of domestic companies listed on the Botswana Stock Exchange increased from sixteen in 2001 to eighteen in 2002 following the listing of Turnstar Holdings, a property management company, and Letshego, a micro loan finance company. The number of foreign listed companies was unchanged at seven, while companies in the

venture capital market increased from one to two as Turnstar Holdings joined Gallery Gold, a foreign listed company. In the bond market, the total number of bonds increased to six with new issues by Barclays Bank of Botswana Ltd (P150 million) and Standard Chartered Bank Botswana Ltd (P50 million) in 2002.

### (e) Credit Rating

4.17 After the initial assignment of sovereign ratings in the 'A' grade by Moody's Investors Service and Standard and Poor's in 2001, the subsequent review in 2002 by both rating agencies maintained the 'A' rating. The investment grade rating reflects the strong external position and a development strategy that successfully balances the provision of social services with prudent fiscal and monetary policies. These ratings enhance Botswana's competitiveness and the country's profile as an investment destination which, in turn, supports the process of economic diversification and economic development.

### (f) Other Financial Sector Developments

4.18 There continued to be improvements in the domestic financial system that accord with global technological developments and innovations in the delivery of financial services. Progress was made in 2002 in the implementation of the National Payments System (NPS) reform project, with the Bank of Botswana as a key player. The National Clearance Settlement System (NCSS) Act was approved by Parliament while the regulations for the NCSS were submitted to the Attorney General's Chambers. The Bank of Botswana commenced a review of all other legislation related to the NPS.

4.19 To facilitate improvements in the payments system, new standards for cheques and debit vouchers were introduced. With effect from May 2002, only cheques printed with Magnetic Ink Character Recognition (MICR) numbering format can be used in the clearing system. The introduction of MICR printed vouchers and

cheques was an important element in the automation of cheque clearing through the Electronic Clearing House (ECH), linking the Bank of Botswana and the commercial banks. Automated cheque clearing was complemented by the establishment of the Electronic Funds Transfer (EFT) module of the ECH, to facilitate the electronic transfer of bulk payments, including salaries.

- 4.20 The banking system continued to be stable and sound, with banks maintaining prudential ratios in excess of statutory requirements. The banks continued to invest in up-to-date infrastructure to provide customers with a range of products and services, such as ATM connectivity across banks, Pula credit cards, telephone banking and internationally accepted visa-badged debit cards.