

Business Expectations Survey March 2018 – Summary Review

1. Introduction

The BES summarises views of the business community regarding their perceptions about the current and future state of the economy. The response rate stood at 89 percent in the current survey.

1.1 The Bank's biannual Business Expectations Survey (BES) collects information on the local business community's perceptions about the prevailing state of the economy and economic prospects. In the survey, businesses respond to a range of questions relating to, among others, the business climate and the outlook for economic growth, inflation and business performance over the survey horizon, which starts from the first half of 2018 and ends in June 2019.

1.2 The survey responses mainly focus on the anticipated direction of change: i.e., whether conditions will improve, worsen or stay the same. The results are then consolidated on the basis of an overall 'net balance', obtained by summing up the positive and negative responses for each question/element. The major exception relates to the measures of overall business confidence and challenges, which are presented on a gross basis. Thus, by design, the survey responses are predominantly qualitative, yet they provide valuable indicators to facilitate analysis and inform policy decisions.¹

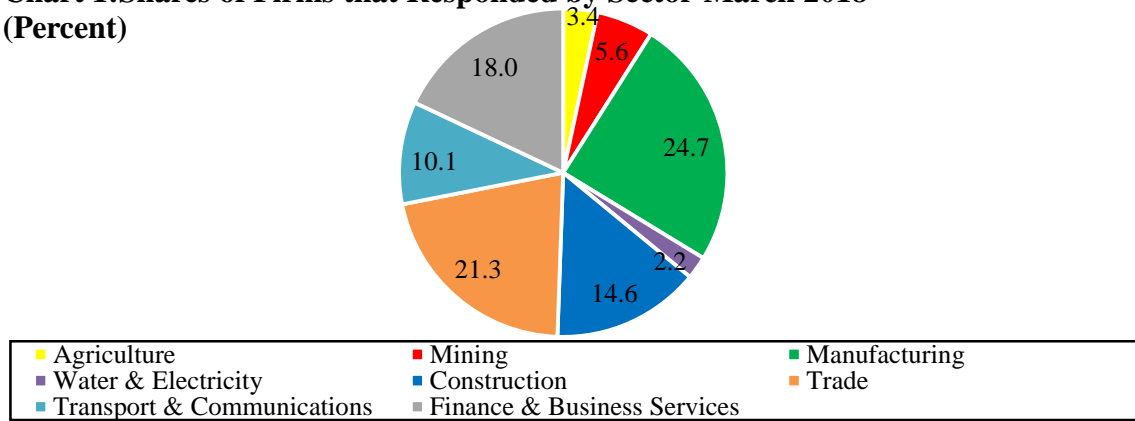
1.3 This report presents results of the survey carried out between March

and April 2018² for three distinct periods: the first half of 2018 (H1:2018; i.e., the current period); the second half of 2018 (H2:2018); and the twelve-month period to June 2019 (H2:2018-H1:2019). The survey samples 100 businesses in agriculture, mining, manufacturing, water and electricity, construction, trade, transport and communications, as well as finance and business services. Compared to the previous survey, the response rate slightly declined from 90 percent to 89 percent. Chart 1 shows the shares of firms by sector that responded for the current survey.

¹ *The Appendix at the end of this report gives more details on the methodology.*

² *A summary of most of the results is shown in Table 2.*

Chart 1: Shares of Firms that Responded by Sector-March 2018 (Percent)



Note: This is based on the total number of firms which responded. Hence, this indicates the shares of firms by sector on the respondents.

2. Survey Context: Recent Economic Developments

Modest economic growth is expected globally in 2018 and 2019. For the domestic economy, growth is expected to be driven improvements in the mining and non-mining sectors.

- 2.1 *Global output is projected to expand by 3.9 percent in 2018 and 2019, an upward revision of 0.2 percentage points relative to the October 2017 forecast, and slightly higher than the 3.8 percent growth in 2017. The upward revision to the forecast of global output growth reflects anticipated developments in advanced economies due to supportive financial conditions and the spillover effects of expansionary fiscal policy in the United States (US), as well as the expected increase in output growth in emerging market and developing economies. In addition, it reflects the sentiment that growth momentum of 2017 will be sustained.*
- 2.2 *Advanced economies are forecast to grow by 2.5 percent in 2018 and 2.2 percent in 2019, compared to 2.3 percent realised in 2017. Meanwhile, output growth in the emerging*

market and developing economies is expected to increase from 4.8 percent in 2017 to 4.9 percent and 5.1 percent in 2018 and 2019, respectively. The prospective improvement in performance in emerging market countries is due to recovery in commodity prices and continued fiscal support. However, inward-looking policies, the rising financial vulnerabilities and increasing geopolitical and trade tensions, present downside risks to global economic performance.

- 2.3 *Regionally, South Africa GDP is projected to grow by 1.5 percent in 2018 and 1.7 percent in 2019, slightly higher than 1.3 percent in 2017. The improved outlook is attributable to strong growth in agriculture, higher commodity prices and recovery in investor sentiment, which is reflective of the recent political developments in the country.*
- 2.4 *In the domestic economy, real GDP grew by 2.4 percent in 2017, lower than the growth of 4.3 percent recorded in 2016. The lower increase was partly attributed to a slower growth of non-mining GDP, mainly reflecting the deceleration in output growth for trade, hotels and*

restaurants, as a result of lower quality of diamonds sold by De Beers Global Sightholder Sales (DBGSS) in the third quarter of 2017. Moreover, the larger contraction of 11.2 percent in mining output during 2017 compared to a decline of 3.5 percent in 2016, mainly due to the closure of the BCL and Tati Nickel mines in October 2016, also stifled overall economic growth.

2.5 The 2018 Budget Speech presented a forecast of output growth of 5.3 percent for 2018. The positive outlook is largely attributable to the projected improvement in the mining sector. The mining sector is expected to recover due to improvement in demand for diamonds as a result of favourable global economic prospects. Furthermore, the projected accommodative monetary conditions in the domestic economy, the anticipated expansion in government spending in the 2018/19 fiscal year and other activities promoted by government initiatives such as promotion of dam tourism, continued efforts to develop Information Communication and Technology through broadening network coverage, including by rolling it out to secondary schools, and continued implementation of measures to improve the ease of doing business in Botswana), as well

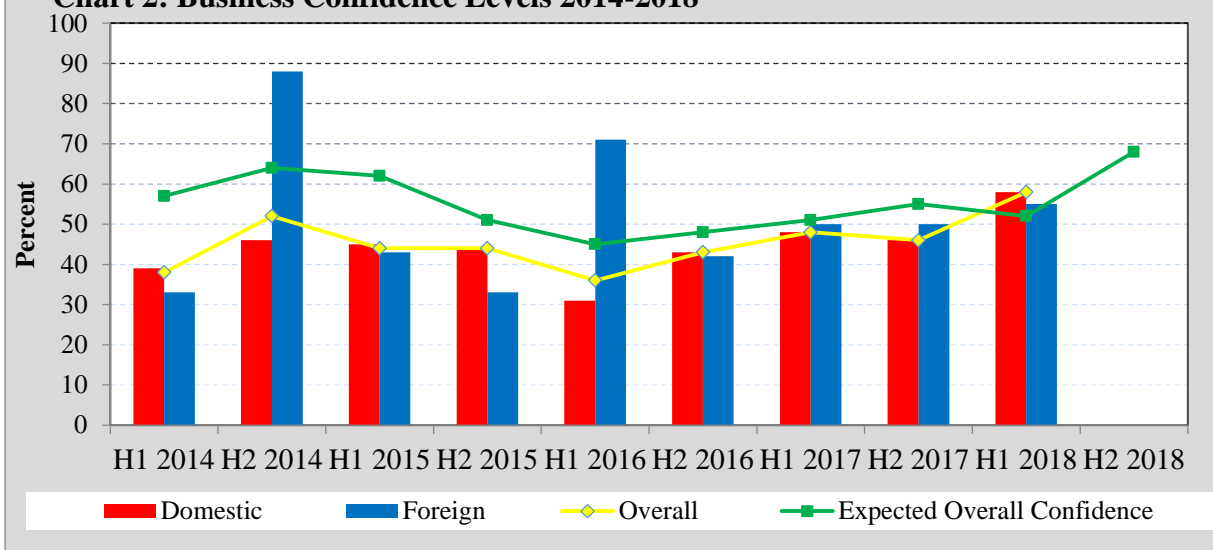
as stability in water and electricity supply, are expected to support growth of the non-mining sectors.

3. Business Confidence and Performance

Confidence among businesses strengthened in the first half of 2018 compared to the second half of 2017, and is expected to rise further in the survey horizon.

3.1 Chart 2 indicates that optimism among businesses strengthened significantly from a confidence level of 46 percent in the second half of 2017 (H2:2017) to 58 percent for the current survey period (H1:2018). Firms seem to have developed some positive sentiment with the business conditions in H1:2018, as their confidence level for the period increased by 6 percentage points compared to their perceptions about the same period in the previous survey. This higher confidence is also reflected in the forecast of a higher domestic growth rate of 5.3 percent for 2018 announced in the 2018 Budget Speech. Furthermore, in line with previous trends, more firms expect better business conditions going forward, with an overall confidence level of 68 percent for the second half of 2018 and 79 percent for the twelve-month period to June 2019. The improved confidence is reflected in both domestic-oriented and export-oriented firms.

Chart 2: Business Confidence Levels 2014-2018



Note: Expected confidence refers to the level of confidence businesses anticipate in the next period.

3.2 Confidence amongst domestic-oriented businesses is 58 percent in H1:2018, compared to 46 percent in the second half of 2017, attributable to the estimated increase in Government spending in 2018/19 and the new leadership in the country. Looking ahead, the level of optimism for domestic firms improved to 69 percent in H2:2018 and 78 percent in the year to June 2019. Similarly, the confidence level of export-oriented businesses increased from 50 percent in H2:2017 to 55 percent in H1:2018 and is anticipated to increase to 60 percent in H2:2018, before rising markedly to 82 percent in H2:2018-H1:2019, reflecting the anticipated improvement in global trading conditions.

4. National Output

Businesses expect domestic output growth in 2018 to be higher than in 2017, but lower than that anticipated in the 2018 Budget Speech.

4.1 On average, businesses expect real GDP to grow by 4.1 percent in 2018. The projection is lower than the government forecast of 5.3 percent

for 2018 announced in the 2018 Budget Speech. However, the expected economic growth rate for 2018 by the business community is broadly in line with overall government expectations of an improvement in economic activity for the year and higher than the growth of 2.4 percent realised in 2017.

5. Capacity Utilisation, Investment, Input Costs and Employment

86 percent of businesses expect to utilise at least 50 percent of their productive capacity in the first half of 2018, consistent with the optimistic outlook for 2018.

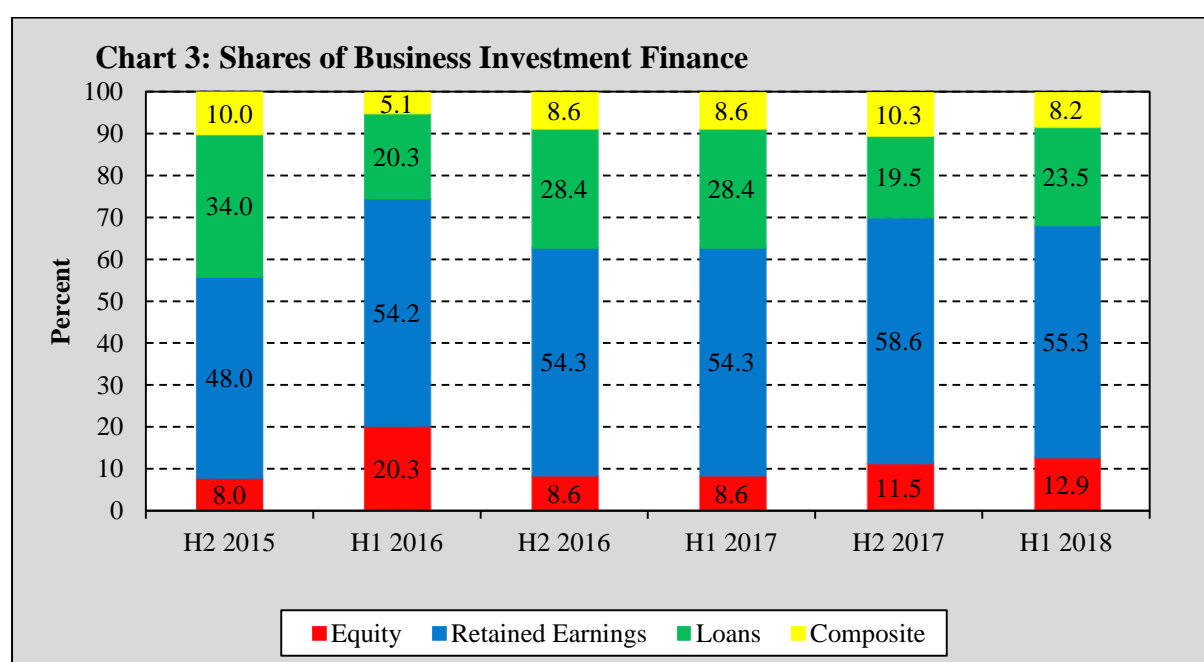
5.1 The survey indicates that 14 percent of the respondents anticipate operating below 50 percent of their productive capacity in the current period, while 56 percent expect to produce between 50 and 80 percent. The remaining 30 percent of the businesses expect their productive capacity to exceed 80 percent. Thus, the current levels of capacity utilisation by businesses are broadly comparable with those reported in the September 2017 survey (12 percent expected to operate below

50 percent, 58 percent expected to operate between 50 and 80 percent and 30 percent expected to exceed 80 percent). The business environment is still considered to be challenging, but remained largely stable in comparison to the previous survey.

5.2 Despite the perceived challenging business environment, survey respondents are relatively optimistic (compared to the previous survey) about the demand for their products in 2018. The improved optimism, in turn, has led to higher expectations regarding production, as reflected by the net balance of 31 percent in H1:2018 against 7 percent in H2:2017. Meanwhile, businesses are expecting an improvement in profitability as reflected by the net balance of negative 14 percent profitability for H1:2018 against negative 22 percent in H2:2017.

5.3 Expectations regarding investment in plant and machinery, vehicle and equipment, and other items are higher in the current survey compared to the previous survey. Similarly, for H2:2018, expectations improved substantially in all categories. Therefore, the generally improving expectations with respect to investment are consistent with the optimistic outlook for 2018.

5.4 In the context of improving expectations regarding investment financing, Chart 3 shows a relatively stable trend in shares of business investment finance for the past five surveys. The current survey shows that retained earnings are the main source of finance, accounting for 55.3 percent of all sources of finance for investment, followed by loans (23.5 percent), equity (12.9 percent) and composite (8.2 percent).



5.5 The overall sentiment amongst firms regarding the rising cost of inputs (materials, rent, utilities, wages, transport and other) remains strong and higher than in the previous survey, except for wages. For materials, the strong expectation of rising costs is due to higher

commodity prices in South Africa. However, businesses expect costs of inputs to generally decrease as the survey horizon extends from the second half of 2018 to June 2019.

6. Debt, Interest Rates and Access to Finance

Business sentiment about access to finance has generally improved, although there is a bias towards borrowing from South Africa due to the fact that some companies are subsidiaries.

- 6.1 *To finance their planned capital investments for the second half of 2018 and the twelve-month period to June 2019, most businesses prefer to borrow from South Africa with a net balance of 11.4 percent for both periods. This possibly reflects, to some extent, the fact that some companies are subsidiaries and, therefore, getting funding either from their parent companies or borrowing through their parent companies in South Africa. Meanwhile, some firms prefer to borrow domestically rather than*

7. Inflation Outlook

Inflation expectations remain within the Bank of Botswana's medium-term inflation objective range for both 2018 and 2019, suggesting credibility of the Bank's monetary policy.

- 7.1 *Businesses expect inflation to average 3.5 percent in 2018 and 3.7 percent in 2019. The expected average rate of inflation for 2018 remains consistent with observed current rates of inflation which averaged 3.1 percent for the first four months of 2018. Finally, consistent with current trends and prospective developments, the majority of respondents expect inflation to be within the Bank's medium-term inflation objective range of 3-6 percent for both 2018 (94 percent) and 2019 (98 percent).*

8. Challenges

externally, as reflected by the net balance of 1.4 percent in H2:2018 and 5.2 percent in H2:2018-H1:2019, owing to currently low interest rates.

- 6.2 *Despite firms preferring to borrow from South Africa, sentiment about easy access to domestic credit has improved from 4.6 percent in the second half of 2017 to 9.4 percent in the first half of 2018. Nonetheless, business sentiments about access to finance have worsened with those viewing it as tight increasing slightly as reflected by a rise in the net balance from 41.4 percent in H2:2017 to 43.5 percent in H1:2018. Furthermore, the proportion of businesses which believe access to credit is normal declined from 54 percent in H2:2017 to 47.1 percent in the current period.*

Restricted government spending, constrained domestic demand and lack of skilled labour are the most cited impediments to doing business in the current survey.

- 8.1 *Government spending was ranked as the most significant challenge facing businesses due to perceived slow growth in both government spending and household disposable income, while constrained domestic demand ranked second (Table 1). Unavailability of skilled labour is cited as the third most significant impediment to business operations, especially with respect to the difficulties experienced in the recruitment of foreign skilled labour. This is also one of the areas that are highlighted among the main challenges to doing business in Botswana by the recent Global Competitiveness reports.*

Table 1: Challenges Ranked Top 3 in the Last Five Surveys

RANKINGS					
CHALLENGES TO DOING BUSINESS	2016		2017		2018
	March	Sept	March	Sept	March
<i>Constrained Domestic Demand</i>	2	1	1	1	2
<i>Government Spending</i>	2	2	2	2	1
<i>Unavailability of Skilled Labour</i>	2			3	3
<i>Water Shortages</i>	1				
<i>Inadequate Electricity Supply</i>	2				
<i>Regulatory & Supervisory Framework</i>		3			
<i>Exchange Rate Changes</i>			3	3	

9. Conclusion

Overall business confidence increased from 46 percent in September 2017 to 58 percent in March 2018, reflecting the expected improvement in government spending in 2018/19 and trading conditions. Looking ahead, there is an increase in optimism, despite subdued demand

in the domestic and global markets, which continue to pose threat to business confidence. Inflation expectations appear to be firmly anchored within the Bank of Botswana's medium-term objective range, suggesting that the business community views the Bank's pronouncements of its policy stance as credible.

TABLE 2: Results from the Business Expectations Surveys, March 2018 and September 2017 (All results are percentages and net balances except for business conditions, which are gross balances)

	MARCH 2018			SEPTEMBER 2017		
	H1 2018	H2 2018	H2 2018- H1 2019	H2 2017	H1 2018	H1 2018- H2 2018
Output						
• <i>Production</i>	30.8	51.8		6.9	33.9	
• <i>Expected level of stocks</i>	3.1	8.2		-20.6	-12.6	
• <i>Volume of sales</i>	14.4	40.0		-17.7	16.1	
• <i>Expected volume of goods exported</i>	12.6	26.0		-12.8	10.7	
• <i>Expected volume of goods imported</i>	6.8	3.1		11.1	40.6	
• <i>Employment</i>	...	-2.3	5.4	...	-10.7	-20.3
• <i>Profitability</i>	-14.2	8.2	...	-21.9	24.6	...
Input costs						
• <i>Materials</i>	...	75.0	75.6	...	61.0	69.9
• <i>Rent</i>	...	41.6	39.1	...	34.7	55.7
• <i>Utilities</i>	...	66.5	62.0	...	47.6	51.7
• <i>Wages</i>	...	56.0	46.3	...	60.6	52.7
• <i>Transport</i>	...	64.1	55.3	...	47.2	49.7
• <i>Other</i>	...	46.5	45.7	...	46.4	50.1
Investment						
• <i>Buildings</i>	18.9	22.4	...	-10.7	-7.9	...
• <i>Plant and machinery</i>	28.3	45.6	...	9.5	21.7	...
• <i>Vehicles and equipment</i>	27.0	32.6	...	15.4	21.3	...

• Other	29.4	38.7	...	3.3	2.2	...
Expected volume of borrowing						
• Domestic	...	1.4	5.2	...	-11.4	-12.4
• South Africa	...	11.4	11.4	...	-42.8	-21.2
• Elsewhere	...	2.9	-4.0	...	-33.0	-27.2
Expected level of lending interest rates						
• Domestic	...	-0.9	5.6	...	-7.4	24.0
• South Africa	...	8.4	13.8	...	7.8	23.7
• Elsewhere	...	15.0	29.8	...	16.6	22.6
Business Conditions						
Rating current business conditions satisfactory						
• Overall	58	...	...	46	...	...
• Exporters	55	...	...	50	...	...
• Domestic	58	...	...	46	...	...
Optimistic about business conditions in 6 months' time						
• Overall	...	68	...	...	52	...
• Exporters	...	60	...	...	50	...
• Domestic	...	69	...	...	53	...
Optimistic about business conditions in 12 months' time						
• Overall	...	...	79	...	...	64
• Exporters	...	...	82	...	...	42
• Domestic	...	...	78	...	...	67

APPENDIX: METHODOLOGY

In processing the BES results, the following methodologies were used. The methods, as applied more generally and specifically in this report, are discussed below. They closely follow those used by the OECD and, to some extent, the Bureau of Economic Research (BER) in South Africa.

The first step is to assign the plus (+), minus (-) and equal (=) signs to responses to each question in accordance with the following criteria. The (+) sign is used to denote the following responses: "increase" or "higher" or "more" or "above normal"; the (-) sign to denote "decrease" or "lower" or "less" or "below normal"; and the (=) sign to denote "same" or "normal" or "uncertain". Even with this type of coding, responses to multiple choice questions are difficult to interpret when all are presented

simultaneously. Because of this difficulty, the BES results are normally converted into a single number through the use of net balances (B). The net balance method transforms all responses to a particular question to percentages and discards the percentage of (=) responses and subtracts the percentage of (-) responses from the percentage of (+) responses, i.e., $B = 100(P - N)$, where B is the net balance and takes values from -100 to +100, P is the percentage of (+) responses in the total and N is the percentage of (-) responses in the total. Experience elsewhere, notably in the OECD, shows that this loss of information is unimportant for most uses of the BES information; and that for purposes such as cyclical analysis, the use of net balances is considered both practical and adequate. If, however, this information is considered important, it can be shown along with information on the net balances. In addition, changes in the percentage of (=) replies can be

interpreted as showing changes in the degree of uncertainty among respondents.

percent of all respondents (gross) rated prevailing conditions as satisfactory.

In this report, the majority of the survey results are reported on a net balance basis, a few on a gross balance basis (e.g., current business conditions) and yet others for which quantitative data were directly collected, i.e., for inflation and national output growth rates no netting or grossing is done, they are reported as annual averages. Net balances, as defined above, are used without the explicit reference to the term 'net'. Where a different concept of the word balance is used, e.g., gross, an appropriate qualifying word is included.

What follows is an example of how the net balances are interpreted. If 80 percent of the respondents expect an increase in investment expenditure in Q2 of 2017 compared with the same quarter in 2016, 10 percent expect a decrease, while 10 percent expect no change and/or are uncertain, it can be concluded that the net majority (70 percent = 80 percent – 10 percent) of respondents expect to increase investment expenditure in the next quarter. The reverse – that investment expenditure is expected to fall – would be true if the net balance was a negative percent. A net balance value between: 0 and 100 indicates an improvement compared to the corresponding period in the past; between 0 and –100, a deterioration; and 0 no change.

The business confidence index (BCI) reflects business conditions at a particular point in time. Unlike the reporting of most other results, the BCI is reported on a gross basis. That is, it is calculated as the percentage of respondents indicating 'satisfactory' conditions to the total number of respondents indicating 'unsatisfactory' and 'satisfactory' conditions. The BCI value varies from 0 to 100, with zero indicating extreme lack of confidence, while 100 indicates extreme confidence. As an example, a BCI value of 40 percent is interpreted to mean that 40