

Botswana economic report – February 2010

Standard and Poors downgrade Botswana as it targets 13% annual improvement in revenues and a balanced budget within three years

Botswana is targeting a balanced budget by March 2013, a current growth rate over the three year period of 48%, with GDP rising from the 2009 forecast of P 83 billion to P 123 billion.

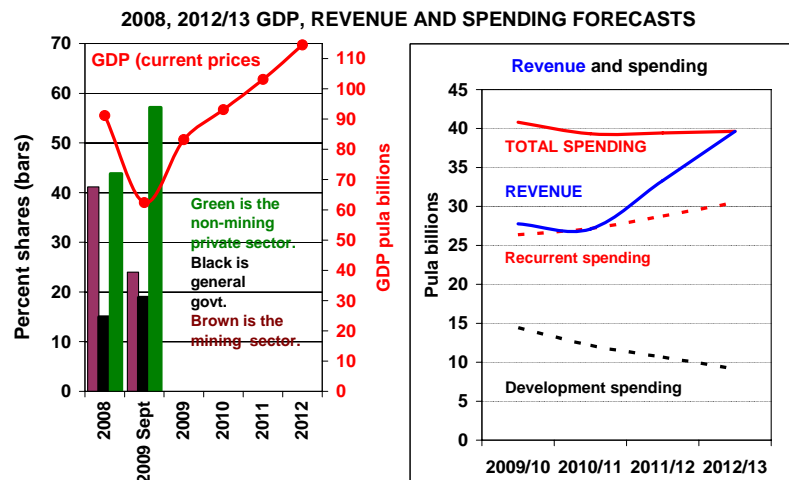
In the February Budget speech, Finance Minister Kenneth Matambo projected that while recurrent spending over the period would rise by 16% that would be offset by 37% cuts in development spending to bring total spending over the period down 4%.

He forecast an unprecedented increase in revenue of 43% over the period; close to an annual 13%. The projected 2009/2010 budget deficit of P 13.4 billion (15% of GDP) would be wiped out, dropping to P 12.1 billion (12% of GDP) over 2010/2011, P 7.7 billion (7% of GDP) over 2011/2012 and result in a balanced budget outturn by March 2013.

S&P statement at odds with unsubstantiated Budget forecasts

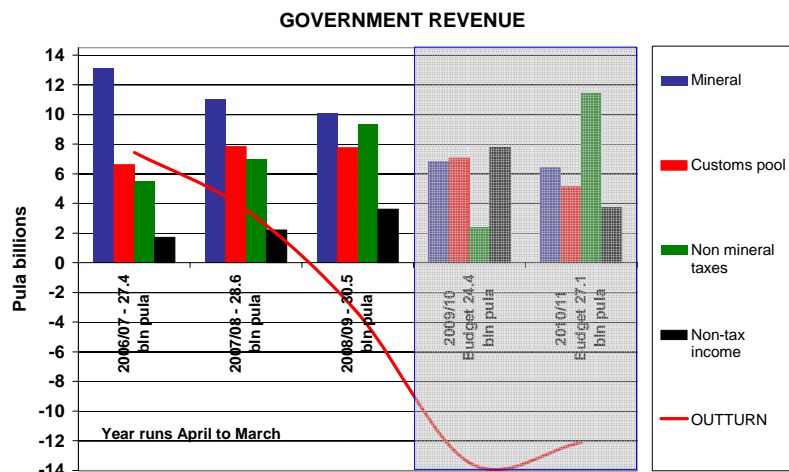
A week later ratings agency Standard and Poors (S&P) downgraded Botswana's sovereign credit rating to A minus from A but with a stable outlook. It cited concerns over the country's plans to increase spending despite falling revenues.

However, this statement is not directly in line with information released in the Botswana Budget speech, which clearly shows that whilst recurrent spending over 2010/11 will increase quite dramatically,



Highlights:

A new budget policy will need to generate a 43% increase in revenue over three years to wipe out the current P 13 billion deficit. A 48% expansion of the economy over the period will essentially depend on increased contribution from the non-mining sector, but the sources of the increased revenue are not clear.



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development spending will face cuts that will bring the total spending down.

Of concern is that whilst the Budget does predict a huge increase in revenue, beyond a two point increase in VAT, tougher collection of tax and profits from parastatals and a virtual freeze on public service salaries and allowances, there is nothing to show where the money will come from.

Fear of large fiscal deficits

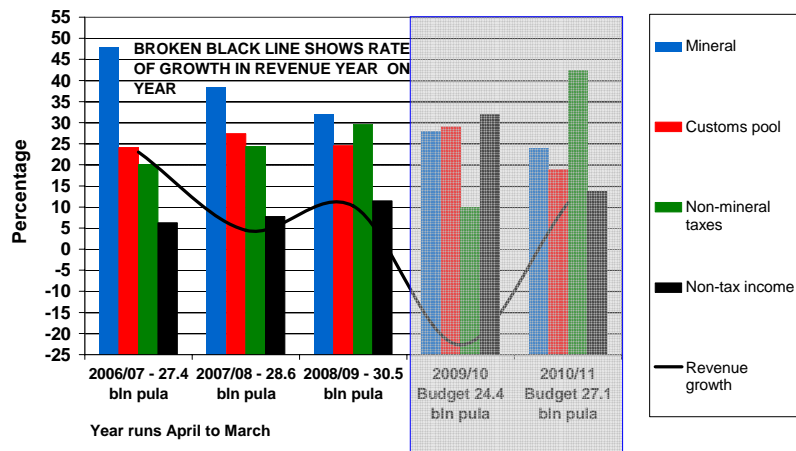
The ratings agency said it believed that this Botswana would accrue large fiscal deficits over the coming two years which would lead to a weakening of its net creditor position. The stable outlook reflected a strong public sector external balance sheet, but this was offset by significant economic and fiscal challenges.

S&P projected a 4.8% contraction in Botswana's real gross domestic product over 2009, official figures to September point to a larger 8.8% contraction.

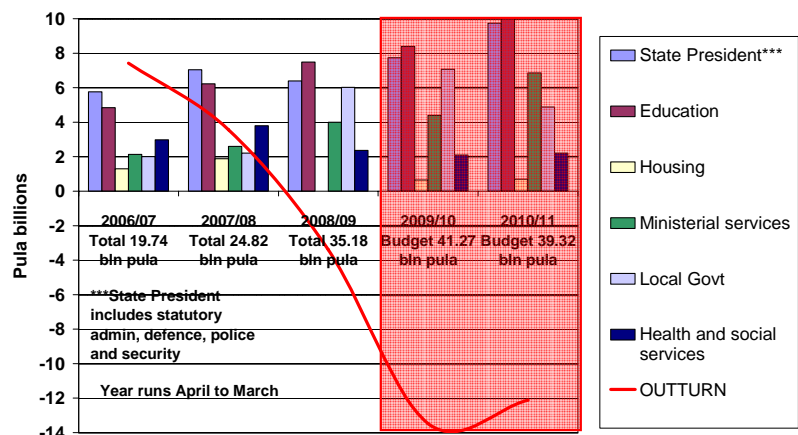
More pressure on non-mining sector as government looks for cash

Despite the lack of significant success in Botswana's efforts to diversify the economy from its overwhelming reliance on mining, it continues to look to the non-mining sector for increased contributions. The sector has so far over 2009 responded with impressive growth rates, increasing its share of GDP to 57% from 44% over 2008. However it is a share of a much reduced GDP. With the diamond market forecast to improve over 2010, it is unlikely such an improved contribution to GDP by the non-mining sector can be maintained. In absolute terms non-diamond export revenues averaged P 549 million a month over 2009 to December against an average over the two years 2007 and 2008 of P 884 million a month

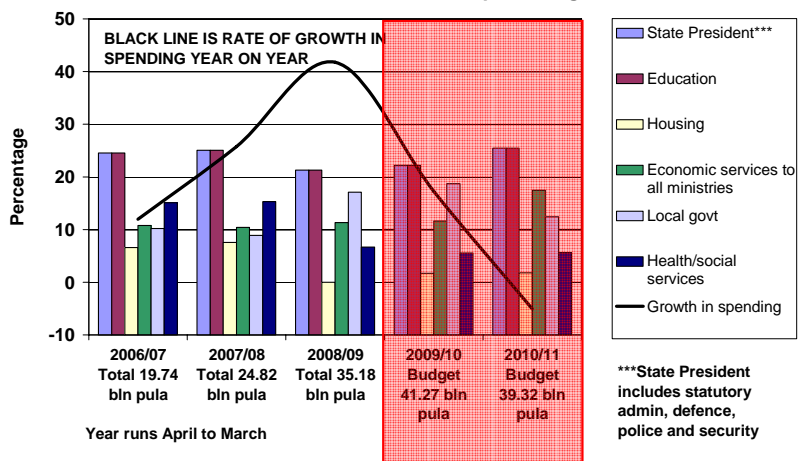
GOVERNMENT REVENUE BY SOURCE/PERCENTAGE



GOVERNMENT SPENDING



GOVT SPENDING BY SECTOR - percentage of total



***State President includes statutory admin, defence, police and security

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Yet, the 2010/2011 budget which forecasts only a modest 11% increase in overall revenue is relying on non-mining sources for 76% of the P 27 billion it hopes to raise. Matambo told parliament 42% of revenue would come from non-mineral taxes - they provided only 10% over 2009/2010. Nevertheless increased revenue of that magnitude will have to be found somewhere to fund the expected drop in customs revenue to 19% of the budget against the previous year's 30%, a drop in mining revenues to 24% from 28% and a 14% share of GDP by non-tax income down from 32% over 2009/2010.

Botswana positioned for growth on expectations of diamond revenues returning to 2008 levels

De Beers, which is Botswana's partner in diamond mining, expects to see the diamond market returning to normal toward the end of this year, managing director Gareth Penny said in February. He was hopeful demand would return to 2008 levels.

"Sales in January were more than five times what they were a year ago," he said. Rough diamond prices were up nearly 13% in the second half of 2009.

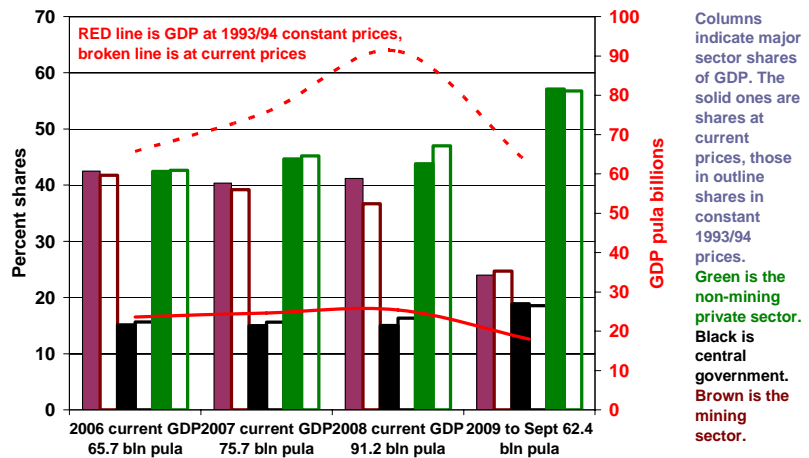
Announcing De Beers annual results earlier in February, Penny confirmed a \$500 million expansion at Botswana's Jwaneng mine, the world's richest, which would 'keep it in continuous profitable production until at least 2025'.

Production by the De Beers group worldwide dropped 49% during 2009, sales were down 46% in value. The value of Botswana's diamond production was down 47%, the value of its exports down 34% over the year, examples of Botswana's 'favoured nation' status.

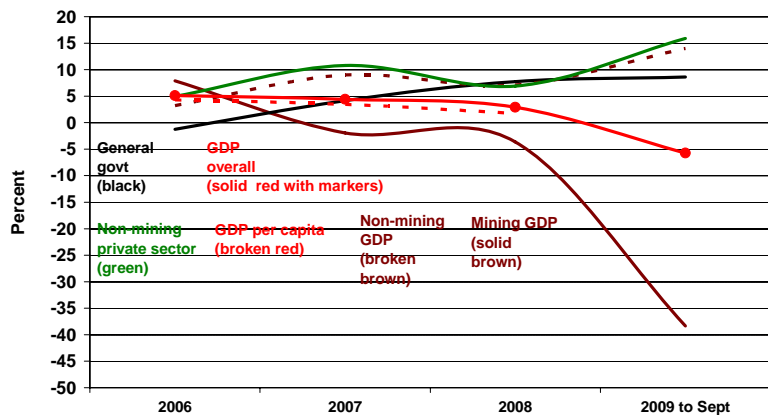
Spreading the risk of a further downturn

Botswana is a 15% shareholder in De

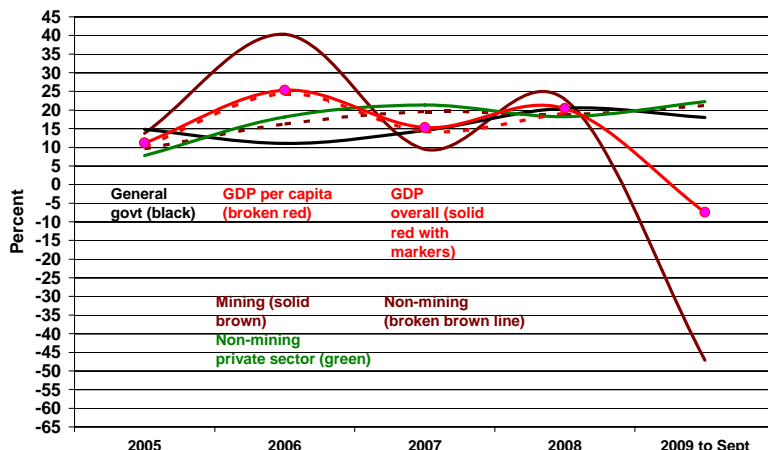
GDP CURRENT AND CONSTANT PRICES



GDP GROWTH RATES - CONSTANT 1993/94 PRICES - MAJOR SECTORS



GDP GROWTH RATES - CURRENT PRICES - MAJOR SECTORS



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Beers and its mines provide most of the diamonds sold by the group. A Botswana Diamond Trading Company, 50/50 De Beers and Botswana-owned, and located in a new \$85 million building in Gaborone is now virtually replacing the London DTC.

With the aggregation of diamonds produced both in Botswana and other countries and sights (sales) to sell them conducted in Gaborone, Botswana may be spreading its risk; but it will still remain vulnerable to the world diamond market.

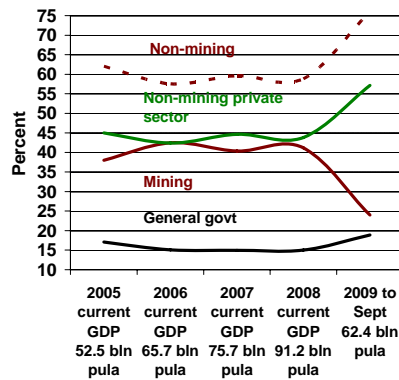
Copper prospects brighter

Currently, Botswana's second largest mineral income – around 15% of total revenue - is from copper nickel. Whilst many commodity sectors experienced heavy losses over 2009 as many copper miners avoided them. Botswana's mines suffered a 50% loss of revenue over the year but still operated profitably. Botswana is not as close to those who set world copper prices as it is to those who influence diamond prices but the world market for copper is, according to most analysts, positive. Top miner BHP Billiton has said it is to revive billions of dollars worth of copper mining projects, in January US copper miners said prices had more than doubled from a year earlier. After aluminium, copper is the world's biggest base metal.

Mineweb analysts said in January: "There are many copper producers, not too many, but many buyers." In Botswana African Copper said it had reached encouraging levels of production at its Mowama mine since re-commissioning it in August. It was removing bottlenecks hampering the ramp up to full capacity. It was now close to its targeted recovery rate.

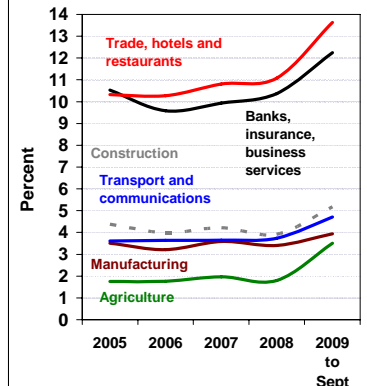
Growth rates: Real growth in GDP over 2009 to September was a

SHARES OF GDP CURRENT PRICES
MAJOR SECTORS - ABOVE 15 PCT

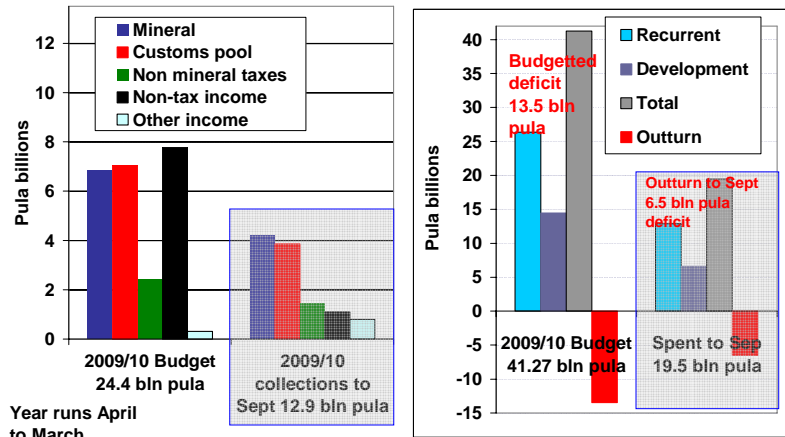


Year runs April to March

SMALLER SECTORS - LESS THAN 15 PCT

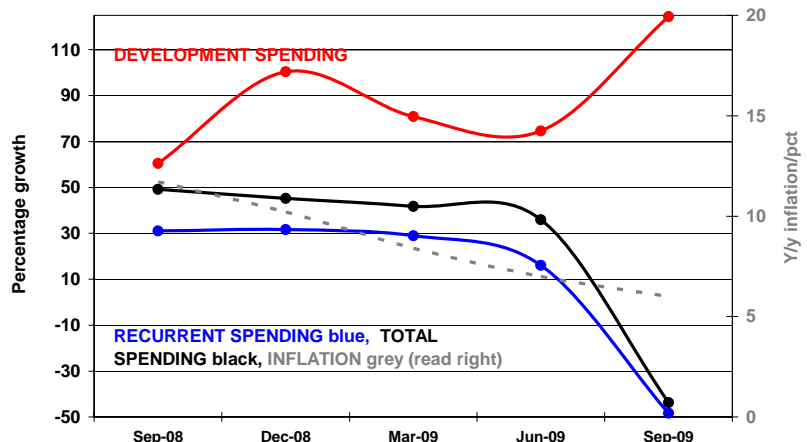


REVENUE AND SPENDING - BUDGETTED AND ACTUAL 2009/10



Year runs April to March

GROWTH IN GOVT SPENDING over previous 12 months



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negative 5.8% measured in constant 1993/94 prices. Growth over the full year 2008 was 2.9%. Forecast real growth for 2009 is a negative 5.5%. The economy has contracted so far this year by 7.5% with a forecast for the year of 8.8%.

The real rate of growth in the mining sector over 2009 to September was a negative 38.3%, against a negative 3.7% over the full year 2008. The forecast for 2009 is negative growth of 36.4%. The sector has so far contracted 47.1% over 2009, with a forecast of 46.9%.

Real growth in the non-mining sector to September was 14.0%, the full year 2008 recorded growth of 7.1%. The forecast for the full year 2009 is 12.3%. The non-mining private sector has recorded growth of 15.9% over the period, also well ahead of its growth over the full year 2008 which was 6.9%.

The forecast for 2009 is 14.2%.

Current update

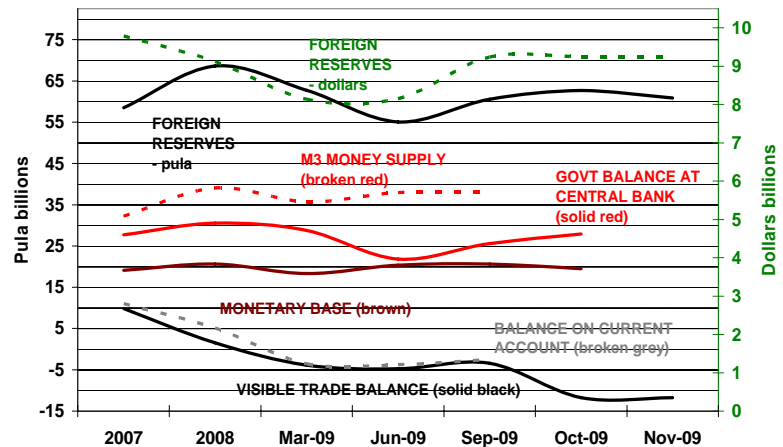
Revenue and spending:

Revenue collections (year runs April/March) as at September totalled P12.9 billion, down 24.3% on those in the same period of the previous year. Spending was 13.2% up at

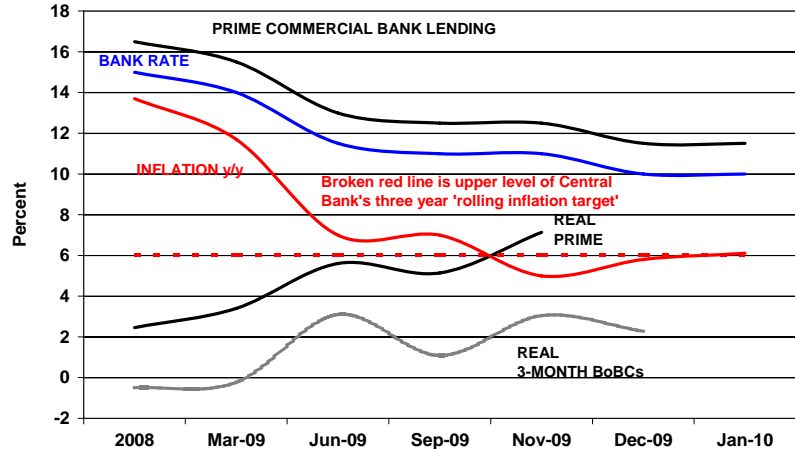
P 19.5 billion. The outturn to date is a negative P 6.5 billion. The budgetted outturn for the year is a deficit of P 13.5 billion, the current average projection a deficit P 13.1 billion.

Spending over the coming financial year (whilst the national accounting year follows the calendar, the budgetary year is from April to March) is projected to be 5% down on the current year. There is little difference in the make-up of the spending budget; education is up to 26% of the total from 22%, statutory administration, defence, police and security to 26% from 22%, with a cut in local government to 12% from 17%.

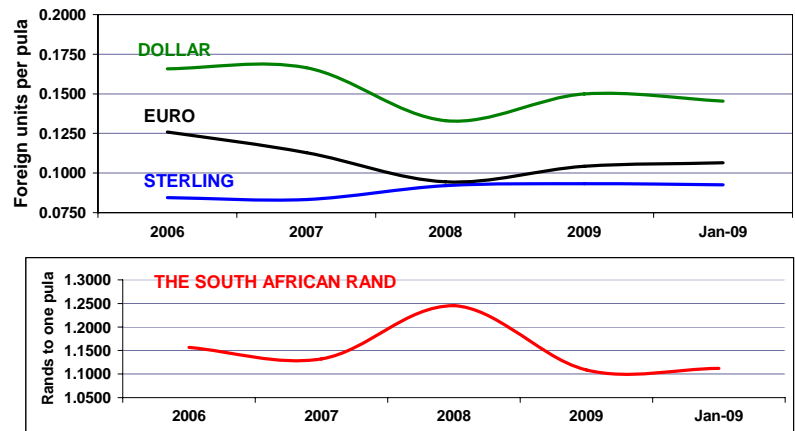
MAJOR ECONOMIC INDICATORS



INTEREST RATES AND INFLATION



REGIONAL AND INTERNATIONAL CURRENCIES PER PULA



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Reserve position:

Botswana's foreign-exchange reserves stood at P 60.9 billion or \$9.2 billion as at November 2009, down 15.9% in pula terms, up 1.5% in dollars over 12 months. The government's balance at its central bank was P 27.8 billion as at October, down 19.4% over 12 months.

Financials:

M3 money supply as at October was P 13.1 billion, up 95.2% over the year. The central bank reported the monetary base as P 40.1 billion, up 84.9%.

As at end 2008 the visible trade balance was a negative P 3.5 billion, down 64.2% over the year; as at September 2009 it was a negative P 3.4 billion, down 159% over 12 months. The balance on current account was a negative P 4.5 billion, down 59.3 % over the year; as at September it was a negative P 2.5 billion, down 146% over 12 months.

The overall balance of payments as at end 2008 was a negative P 7.5 billion, down 30.3% over the year; as at September 2009 it was a negative P 1.7 billion, down 122.0% over 12 months.

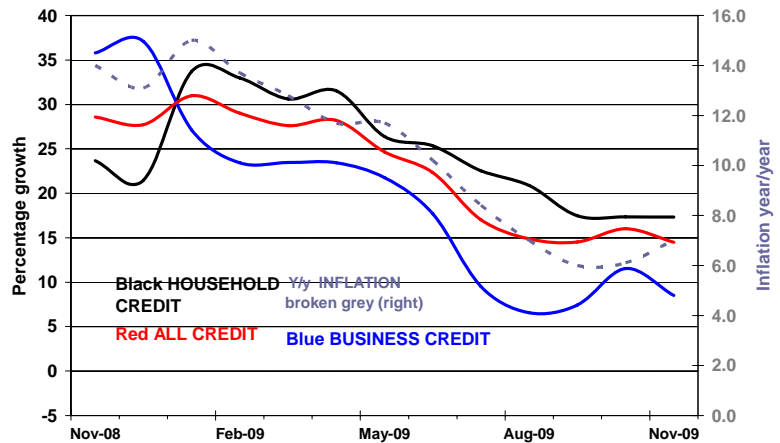
Provisional trade figures as at November 2009 show a negative P 11.2 billion, with imports reaching 162% of exports.

Interest rates and inflation:

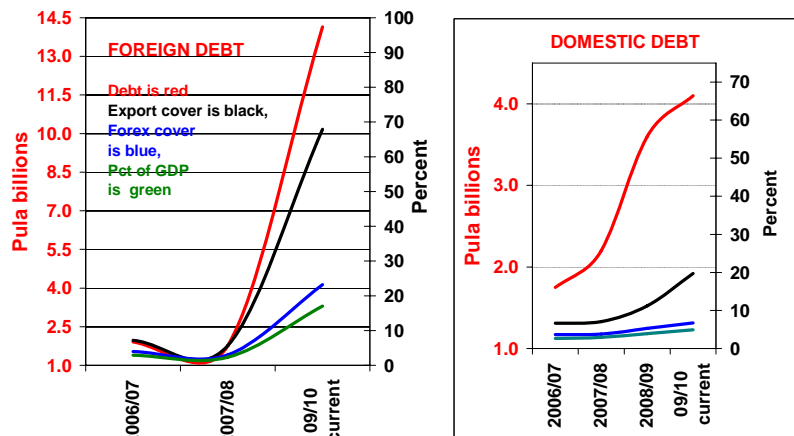
The bank rate was 10.0 % as at end January, down from 15.0% 12 months previous and prime was 11.5%, from 16.5%. Inflation y/y was 6.1% as at end January, from 5.8 the previous month, 6.9% over three months, 6.0% over six months, 12.8% over 12 months.

Over January annual CPI-based inflation rose 0.3 percentage points to 6.1%, moving marginally outside the top end of the medium-term objective range of 3% to 6%.

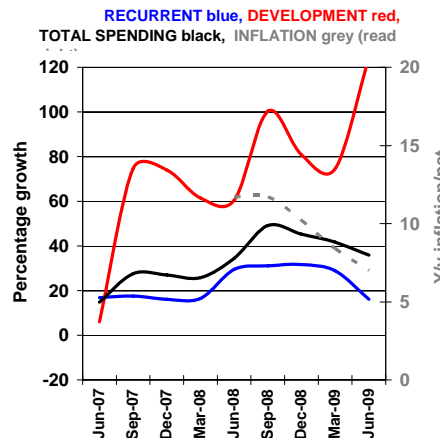
CREDIT GROWTH over previous 12 months



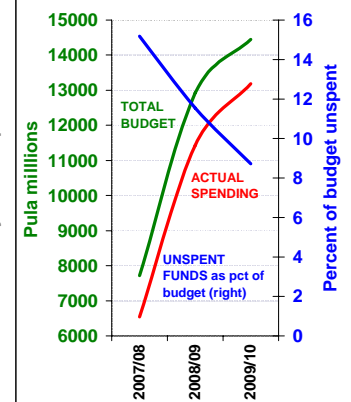
S7 LONG AND MEDIUM TERM DEBT OUTSTANDING



12-MONTHLY GROWTH IN GOVT SPENDING



DEVELOPMENT SPENDING v BUDGET



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Foreign exchange:

As at February 12, the pula was 0.1454 against the dollar (13 wk change -3.20%, 52 wks +15.21%); 0.0926 against sterling (13 wks +2.66%, 52 wks +5.47%); 1.112 against the South African rand (13 wks -1.60%, 52 wks -11.45%).

During January, the Pula depreciated against the US dollar by 2.4%, the pound by 2.7%, while it appreciated by 0.7% against the rand and the euro.

Credit growth:

12 monthly growth in business credit as at November 2009 was 8.5%, 27.3 points down over 12 months previous. Growth over the last three months was 12.2%. Annual growth in credit to households was 17.3%, down 6.3 points over 12 months. Over the last three months it was 3.7%. Households accounted for 59.17% of total credit against 57.3% 12 months previous.

Debt:

Current medium and long term foreign debt outstanding is P 14.1 billion, up from P1.8 billion as at end 2007/08. It is the equivalent of 68% of forecast current year exports, 17% of expected current year gross domestic product, 23% of current foreign reserves.

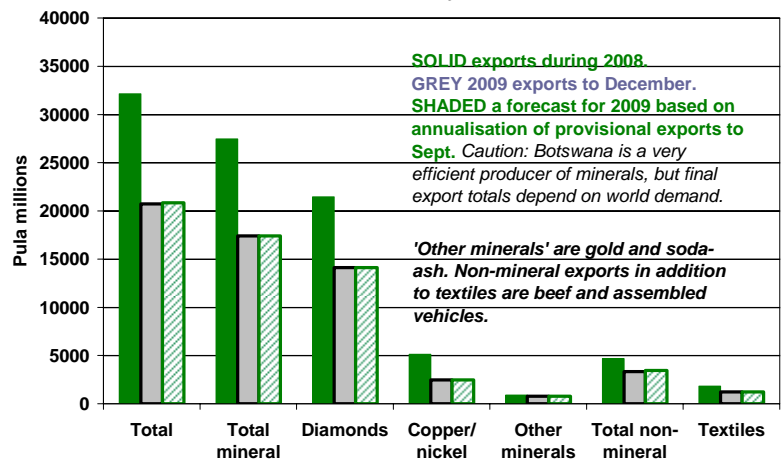
Domestic debt outstanding is P 4.1 billion, up from P 2.2 billion as at end of 2007/08. It is the equivalent of 20% of forecast current year exports, 5% of expected current year GDP, 7% of current foreign reserves.

Foreign investment:

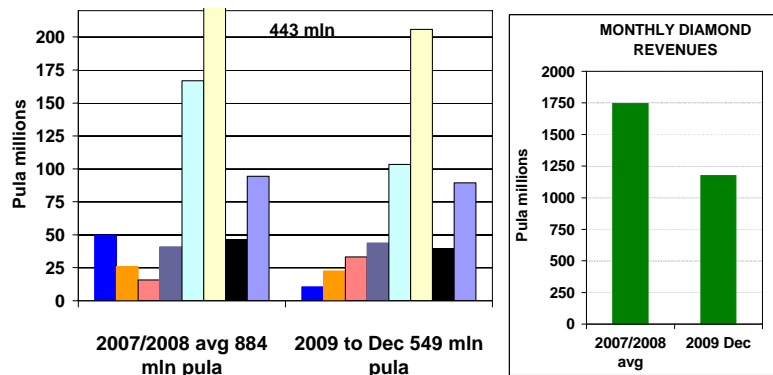
Direct investment in Botswana as at end 2008 was 32.5% up to P 6.7 billion compared to end 2007, while portfolio investment was 47.0% down to P 1.3 billion.

Botswana's direct investments aboard were down 48.4% to P 4.1

EXPORTS - current year forecast

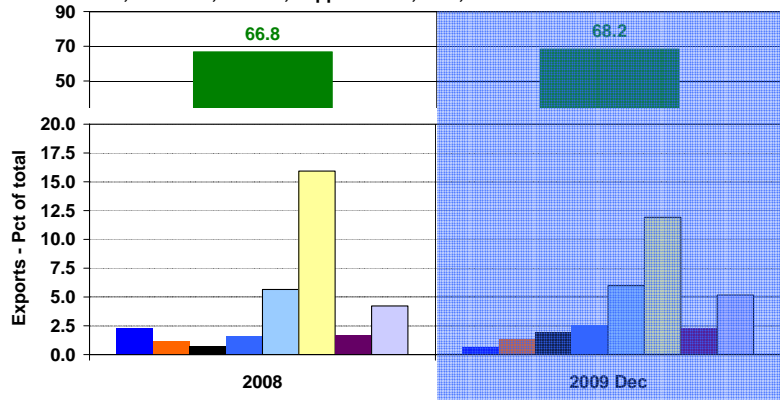


MONTHLY EXPORT REVENUES. Left: Non-diamond, from left each year: unidentified, gold, vehicles, soda ash, textiles, copper-nickel, beef, small category items. Right, Diamonds



EXPORTS, PERCENTAGES OF TOTALS 2008 AND 2009

Recovery monitor: Top, diamonds. Bottom, from left: unidentified non-mineral, gold, vehicles, soda ash, textiles, copper-nickel, beef, minor non-mineral



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billion, portfolio investments down 13.3% to P 18.1 billion.

Exports and diversification:

Botswana relies upon minerals, principally diamonds, for upwards of 85% of its export revenues, ultimately more than a direct half of its national revenues and a third of its gross domestic product. Indirectly the contributions to national revenue and GDP are far higher.

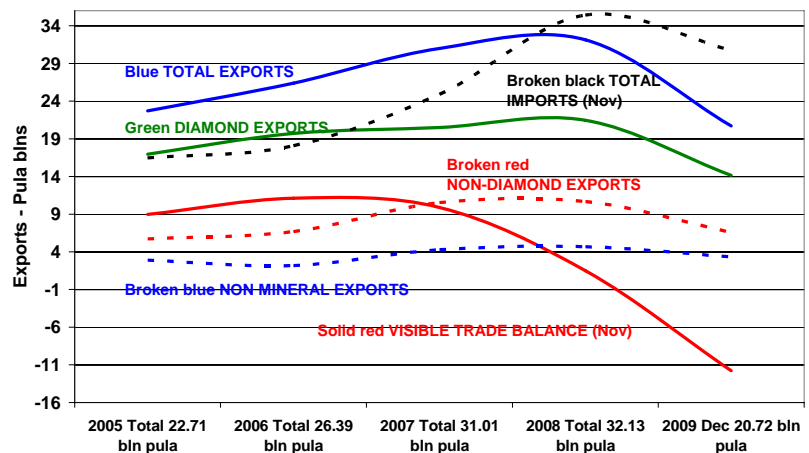
The government is well aware of the inherent dangers of this situation. Much time and money has been spent, particularly over the last 10 years, to diversify the economy and promote more sustainable non-mining and financial service industries.

The focus has more recently moved to diversification within the mining sector. Beneficiation of some of Botswana's diamond output in the form of cutting and polishing and eventually jewellery making is being vigorously promoted. The use of rough diamonds by this nascent industry has increased over the last five years from P 153 million in 2005 to P 3142 million in 2008. It has dropped to P 2493 million so far over 2009 because of the slowdown in the international diamond market.

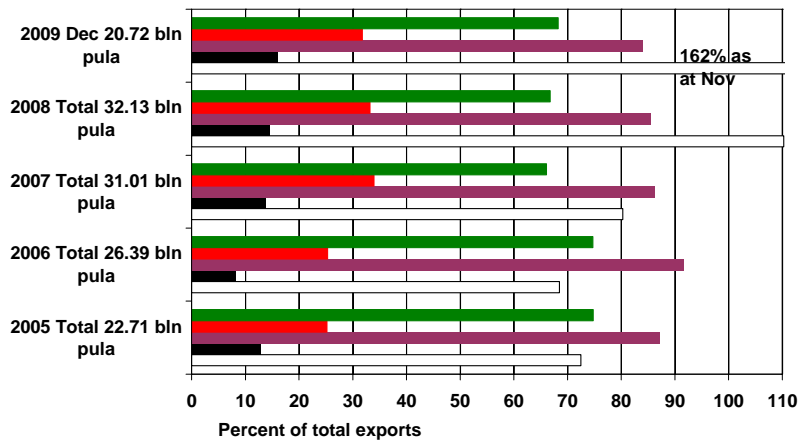
This is diversification, it does reduce Botswana's reliance on revenues from its own diamond mining industry but still leaves it exposed to the ups and downs of the diamond industry worldwide. The situation is clearly the same with regard to the activities of the Botswana Diamond Trading Company which will aggregate diamonds from producers in other countries as well as those from Botswana's mines.

Non-diamond exports over the past three years accounted for 30% of total exports. Half of this was copper nickel which is also subject to market demand and the prices for which are set outside of Botswana with little if any influence from that

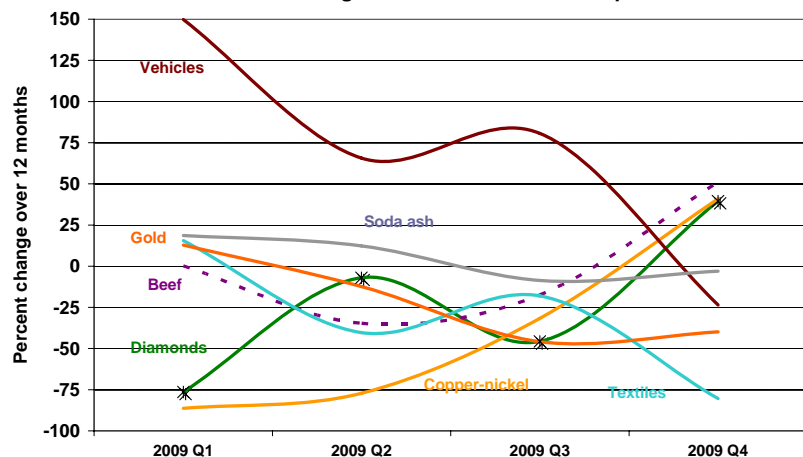
EXPORT PATTERN AND TRADE BALANCE



EXPORTS and IMPORTS as pct of total exports. From top, each year: Diamond, non-diamond, mineral, non-mineral. WHITE imports pct exports.



EXPORTS - annual growth rates over last four quarters



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country. Small amounts of gold are also exported-amounting to approximately 1% of total exports. A fourth mineral export is soda ash which amounts to approximately 2% of total exports.

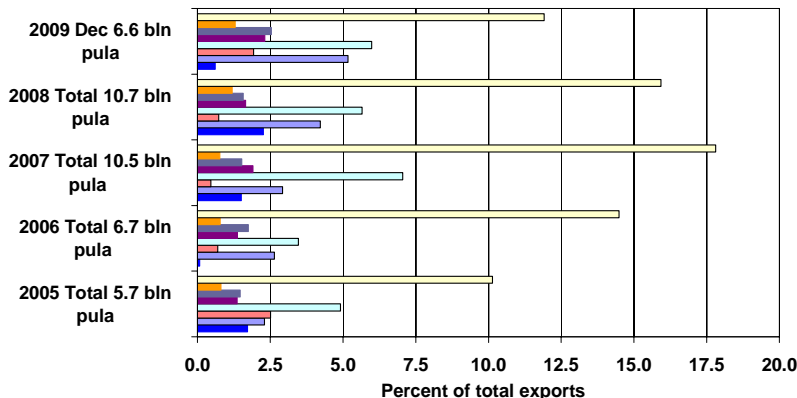
Exports of non-mineral products have over the past five years amounted to no more than 15% of Botswana's total exports in any one year. That figure will be exceeded over 2009 only because of the drop in diamond exports.

The most significant non-mineral export is textiles which over the past three years has exceeded 5% of the country's total exports. The production of textiles in Botswana has benefited immensely from the US Africa Growth and Opportunity Act which gives Botswana produces access to the US market.

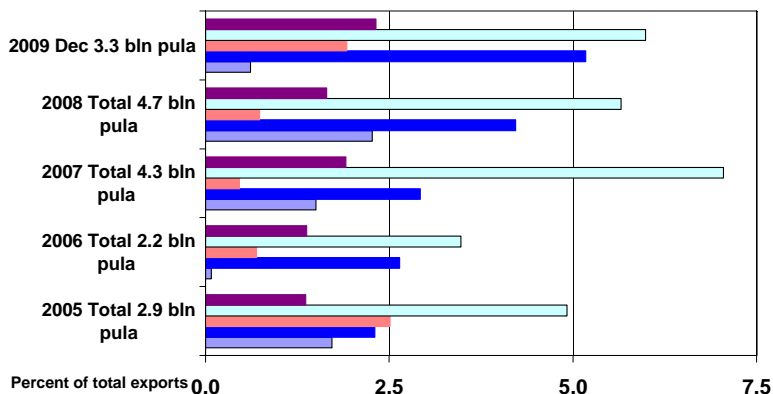
The beef industry of Botswana, which has preferential access to the EU, often struggles to fill its quota and exports have been running at about 2% of Botswana's total. This will be increased to around 2.5% over 2009 because of the reduced overall exports. The government has announced plans to revamp the beef industry but no details are yet available.

There is a host of minor categories of exports none of which exceed P 750 million a year, most are much less. They add up to less than 5% of Botswana's total exports. The depression in the economy with, for example, business credit at extremely low levels does not augur well for the establishment of new export industry at those levels

NON DIAMOND EXPORTS as percentage of total exports. From top, each year: copper-nickel, gold, soda ash, beef, textiles, vehicles, small categories, unidentified.

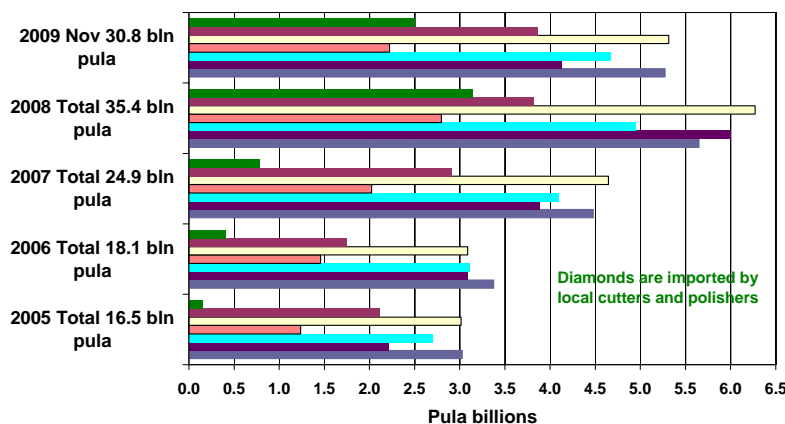


NON MINERAL EXPORTS as percentage of total exports. From top, each year: beef, textiles, vehicles, minor categories, unidentified.



MAJOR IMPORTS

Bars, from top, each year: Diamonds, vehicles, transport equipment; machinery, electrical; metals; chemicals, paper; fuel; food, clothing, beverages and tobacco



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