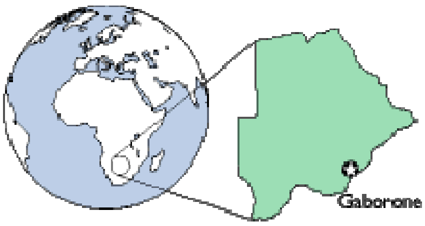
COUNTRY REVIEW

Botswana



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EULER HERMES COUNTRY RISK GRADE: B

Country Risk Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest risk.

COUNTRY PROFILE

Capital city:	Gaborone
GDP:	USD14,765mn (2010f)
Population:	2mn (mid-2010 estimate)
GDP per capita:	USD7,400 (2010f)
Currency:	Pula (BWP)
Form of state:	Republic
Head of state:	President Ian Khama
Next elections:	Legislative by October 2014

Botswana has a **record of stability** that is in marked contrast to the experience of many Sub-Saharan African countries. The Botswana Democratic Party (BDP) has been in power since independence in 1966 and wins democratic elections convincingly (latterly in October 2009), reflecting its strong rural support base, increased standards of living and the lack of an organised opposition. Despite some divisions within the BDP itself, the main opposition parties, the Botswana National Front (BNF) and Botswana Congress Party (BCP), remain fractured and do not present, individually or collectively, a parliamentary threat to the BDP's dominance. Accordingly, **we expect the BDP to continue its mandate to govern without undue domestic problems**. Ian Khama (son of Botswana's first leader, Sir Seretse Khama) took over as head of state—the president is selected by parliament—when Festus Mogae stood down in 2008 and the **changeover was enacted smoothly**. As expected, the political and economic policy agenda has not altered substantially under Khama's leadership, although he is seen as a more forceful and, perhaps at times, more autocratic leader. Nevertheless, for now, Khama appears generally popular with the public (according to recent opinion polls) and firmly in power. **Probity of officials is good by regional standards, and ethnic tension is relatively low.**

A concerted attempt to tackle the problems associated with the country's **high incidence of HIV/AIDS—Botswana's estimated infection rate is between 25% and 39%**—will remain the government's main domestic policy focus over the medium term. To its credit, the government has adopted a National Strategic Framework for HIV/AIDS (NSF), including a transparent and all-inclusive roll-out of free anti-retroviral treatments.

Botswana's **foreign relations are generally good**, although the government has voiced strong condemnation of the perceived excesses of President Robert Mugabe in neighbouring Zimbabwe and has also raised concerns relating to the power-sharing agreement forged in Harare and the general outlook for stability in that country. Close links are maintained with fellow members of the Southern African Development Community (SADC) and the Southern African Customs Union (SACU), particularly South Africa. Good relations are maintained with the IFIs, although an IMF support facility has not been required. **The country is a net creditor**.

Botswana is **classified as an upper-middle income economy**, with a GDP per head currently around USD7,400. Expanding output from the mineral sector **(mining accounts for around 37% of GDP)** has contributed to impressive **long-term, annual and average growth of real GDP of over 5%** (1992-2008). However, dependence on diamond output led to a **contraction in GDP of an estimated 5-8% in 2009 as the global financial crisis and associated economic recession in some key markets led to a significant reduction in demand for gemstones.** While the muted global recovery will enable economic expansion—**we forecast GDP growth of 4-5% in 2010 and 2011**—output of Debswana, a joint diamond venture between the government and De Beers, is now in trend decline. The non-diamond sectors will need to contribute significantly more if overall expansion is to sustain levels of GDP growth of over 5% going forward. The government has acknowledged the fact that diamond revenues are no longer assured (artificial gemstones and developing sources in Canada are changing the international market) and is aware of the need for economic diversification. Indeed, a **structural move away from dependence on the diamond sector** is a focus of National Development Plans—the latest (and tenth) covers the period April 2009 to March 2016—as is providing financial and support services to counter the human, social and economic impact of HIV/AIDS. However, to date, **success in diversification has been limited** because Botswana's nascent manufacturing sector (<4% of GDP) is necessarily small in relation to that in neighbouring South Africa and thereby subject to severe competitive forces, the textile sector has lost market share now that the Multi-Fibre Arrangement has expired and plans to operate an international financial services centre are similarly subject to regional competition and limitations of location and accessibility.

Botswana is the **world's largest producer of gem diamonds measured in value terms** (and second only to Australia in volume terms) and supplies around 70% of all gems sold through the operations of De Beers, which is equivalent to approximately 40% of global output. However, Botswana is heavily dependent on actions of De Beers, which halted production entirely for a period in 2009, reflecting decreased sales of polished diamonds as consumers cut consumption of luxury goods.

As **a landlocked nation**, Botswana is dependent on trade flows through its neighbours and over three-quarters of its imports by value are from fellow members of the Southern African Customs Union (SACU). As a result, there is a strong degree of imported inflation, which is particularly noticeable when international food and energy prices are high, as in 2008. **We forecast average annual inflation of 6-8% in 2010 and 2011.**

A crawling band exchange rate has operated since 2005. The currency weights of the basket against which the pula is pegged are not released but, reflecting trade patterns, the South African rand is likely to have a 60-70% influence. The exchange rate mechanism is designed to reduce the volatility of the pula and it is official policy to attempt to maintain a stable and competitive real effective exchange rate. **We forecast a steady depreciation of the pula against the USD in 2010 and 2011**.

The **current account of the balance of payments registered a surplus from 1991 to 2008** but the downturn in the gem market **in 2009** resulted in a current account **deficit of around 2% of GDP** and we forecast a smaller deficit will be recorded this year before surpluses become evident again from 2011. With only moderate net FDI inflows, these current account deficits will have entailed depletion of foreign exchange reserves and, possibly, of part of the net foreign asset base. However, **FX reserves still provide import cover of 10-15 months.** Moreover, liquidity remains strong as foreign debt servicing is not onerous at 1-2% of annual export earnings. **External debt is relatively low and the country is a net creditor**, factors that help underpin Botswana's investment grade rating from both S&P and Moody's.

The **structural business environment is generally sound and above average for the Sub-Saharan African region as a whole**, although it is broadly on a par with other upper middle income economies. To encourage foreign investment, all exchange controls have been lifted, the judicial system simplified and business applications are speedily processed. Transport and communications infrastructure compares favourably with most other sub-Saharan African nations. There are few non-tariff barriers to trade and Botswana is an active member of the Southern African Customs Union (SACU), which has reduced significantly its common external tariff.

The **banking sector is sound**, with the IMF reporting that all commercial banks exceed international capital adequacy ratios and local liquidity requirements. The financial system is more competitive and advanced than most in Africa, with no barriers to foreign banks and no restrictions on credit and interest rate decisions. South African banks have a large presence in the sector but these have had little exposure to "toxic" assets undermining some institutions in Europe and North America.

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