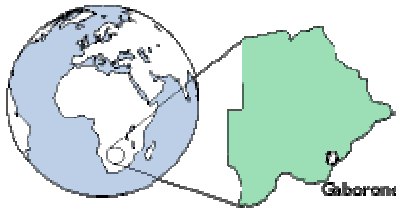


# COUNTRY REVIEW

## Botswana



10 April 2009

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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.

## Strengths

- Track record of political and economic stability
- Market-oriented economic policy and sound management and overall policy formulation
- Acknowledgement of the seriousness of HIV/AIDS and adoption of appropriate policies
- Significant diamond resources
- Regular current account and balance of payments surpluses that have contributed to a strong net foreign asset position, allowing the country to be a net creditor
- Low external debt levels and ratios
- Investment grade rating from S&P and Moody's

## Weaknesses

- Dependence on mineral output for around 40% of GDP, over 50% of government revenues and over 75% of export earnings
- Diamond resources are finite and marginal costs of gem mining are increasing
- Prevalence of HIV/AIDS has long-term costs in terms of medical expenditure, reduction of the workforce and disruption of social and human development
- Bordering Zimbabwe, Botswana has had refugee flows to cope with
- Vulnerability to currency volatility because the pula is influenced strongly by the South African rand
- Weak non-mineral FDI inflows

## Key Risks

- Demand for diamonds may not recover for some time and Botswana's FX reserves and foreign assets may be depleted to an extent that further external shocks will not be managed without recourse to IFI support mechanisms
- The track record of social and political stability has been built on solid economic fundamentals but the country has yet to be tested in a challenging environment. The current global recession may lead to domestic pressures that cause social discord

## Country Risk Assessment

Ratings	Botswana		Median Grade BB	Median Grade B	Peers	
	Latest	Previous			South Africa	Kuwait
<b>Systemic Political Risk:</b>	<b>P2+</b>	<b>P2+</b>	<b>P2-</b>	<b>P2-</b>	<b>P2-</b>	<b>P2-</b>
<b>Systemic Economic Risk:</b>	<b>E4</b>	<b>E2</b>	<b>E3</b>	<b>E4</b>	<b>E3</b>	<b>E3</b>
ME rating:	ME4	ME2	ME3	ME4	ME3	ME3
<i>Structure</i>	4.7	4.7	3.8	5.0	1.6	5.0
<i>Policy</i>	5.6	2.3	3.9	3.2	4.2	5.6
<i>Solvency</i>	1.6	1.0	1.7	2.8	1.0	1.0
<i>External Liquidity</i>	3.8	1.3	3.2	4.2	5.8	1.7
SBE rating:	SBE2	SBE2	SBE2	SBE3	SBE3	SBE2
<b>COUNTRY GRADE:</b>	<b>B</b>	<b>BB</b>	<b>BB</b>	<b>B</b>	<b>BB</b>	<b>BB</b>

Nomenclature:  
 Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).  
 Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).  
 ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).  
 The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).  
 SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).  
 Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

## ECONOMIC STRUCTURE

### Country Profile

Capital city:	Gaborone
Population:	1.88 mn (2007)
GDP:	USD 11595 mn (2007)
Currency:	Pula (BWP)
Form of state:	Republic
Head of government:	President Ian Khama
Next elections:	Legislative by October 2009

Major Industries (% of GDP at market prices, 2008e)		Global Assumptions	2008	2009f
Agriculture	2.0%	Real GDP grth (% yr/yr) *	1.0	-0.6
Industry	46.0%	Inflation (% , av) *	3.4	1.5
Services	52.0%	Dated Brent (USD/b)	98.0	50.0
		* Major economies		

Main Exports (% of total, 2008e)		Main Imports (% of total, 2008e)	
Diamonds	65.0%	Fuels	18.0%
Copper & nickel	14.0%	Machinery & electrical equipment	17.0%
Meat & products	2.0%	Food, drink & tobacco	12.0%
		Vehicles & transport equipment	11.0%
Lead Export Markets (% of total exports, 2008e)		Lead Import Markets (% of total imports, 2008e)	
UK	52.0%	Southern Africa Customs Union	79.0%
Southern Africa Customs Union	19.0%	UK	6.0%
Zimbabwe	4.0%	US	1.0%
US	1.0%	Zimbabwe	1.0%

## Basic indicators

Selected economic indicators	2005	2006	2007	2008	2009f
Nominal GDP (USD mn)	9,749	9,908	11,596	11,729	9,268
Population (mn)	1.84	1.86	1.88	1.91	1.94
GDP per capita (USD)	5,298	5,327	6,168	6,141	4,777
Real GDP growth (% yr/yr)	9.4	0.6	5.2	3.3	-2.0
Inflation (% , average)	8.6	11.6	7.1	12.7	6.0
Fiscal balance (% of GDP)	1.1	8.0	10.7	4.7	-2.6
Current account balance (% of GDP)	16.4	19.6	21.0	5.1	-5.4
External debt/GDP (%)	4.8	4.1	3.5	3.5	4.3
External debt/Exports of goods & services (%)	8.2	7.0	6.2	6.7	11.4
Debt-service ratio (%)	0.9	0.9	1.0	1.1	2.0
Foreign exchange reserves (USD mn)	6,248	7,927	9,722	9,000	7,000
Import cover (months)	15.5	20.0	22.3	16.9	15.3
Exchange rate assumption, BWP:USD (av)	5.11	5.84	6.14	6.83	8.20
f: CRU central forecast					

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

## Political Stability

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, 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 win comfortably in legislative elections later this year and to continue its mandate to govern. 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 excesses of President Robert Mugabe in neighbouring Zimbabwe and has also raised concerns relating to the recent 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.

## Economic Stability

Botswana is classified as an upper-middle income economy, with a GDP per head currently around USD6,000. Expanding output from the mineral sector (around 40% of GDP) has contributed to impressive annual growth of real GDP of around 6.5% in 1989-99 and over 5% in 1999-2008. However, growth in diamond output by Debswana—a joint 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 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, De Beers has taken action to limit output of diamonds from operations in Namibia, South Africa and the Democratic Republic of Congo and recently halted production in Botswana, reflecting decreased sales of polished diamonds as the global economic downturn has curbed conspicuous consumption on luxury goods. While some operations will re-open by mid-April, production at Damtshaa and Orapa No.2 mines has been suspended for the whole of 2009. As a result, we forecast that the long trend of high overall GDP growth will now be disrupted and outright contraction of around 2% is likely this year.

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. Last year, inflation averaged 12.7%, compared with a central bank target band of 3-6%. However, international oil prices have fallen by around USD100/barrel since July 2008 and some inflationary pressures from this source will ease through 2009. We forecast average inflation of around 6% this year.

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. In 2008, reflecting inflation differentials and a weaker South African rand against the USD, the pula depreciated to average USD1:BWP6.83 from BWP6.14 in 2007. Despite an easing in domestic inflationary pressures, continuing inflation differentials with trade partners suggest further pula depreciation to average USD1:BWP8.2 in 2009.

The current account has been in surplus since 1991, with sizeable diamond-export trade surpluses more than offsetting deficits in the income account caused by outward profit repatriation. However, with slowing diamond output and relatively weak gem prices, the current account surplus in 2008 was reduced to the equivalent of 5.1% of GDP (from over 20% the previous year). This year, with significantly reduced diamond output and weaker global gem sales, the current account is forecast to record a deficit, equivalent to over 5% of GDP. With only moderate net FDI inflows, the current account deficit will entail depletion of foreign exchange reserves and, possibly, of part of the net foreign asset base. FX reserves of around USD7bn by end-2009 will still provide import cover of over 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.

## Structural Business Environment

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. A broad measure of the institutional environment in which economic activity (and by extension businesses) may or may not flourish is the Heritage Foundation's Index of Economic Freedom (IEF). In the 2009 IEF, Botswana ranks 34 out of 179 countries assessed by this methodology, above Taiwan, the Slovak Republic and the Czech Republic but below Spain, Lithuania and El Salvador. Botswana ranks a more lowly 126 out of 179 countries covered by the UN Human Development Index 2008, which provides a proxy for the overall level of development and sophistication of the country concerned, reflecting the country's declining average life expectancy because of HIV/AIDS. However, Transparency International's Corruption Perceptions Index 2008 ranks Botswana 36= (with Malta) out of 180 countries covered, above Taiwan, South Korea and Mauritius but below Portugal, Israel and the UAE.

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. However, in line with the economic downturn, it is expected that NPLs will increase this year and in 2010.

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**Charts**

