Business Expectations Survey September 2017 – 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 improved from 85 percent in the previous survey to 90 percent in the current survey, which is the highest achieved since the inception of the 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 second half of 2017 and ends in December 2018. 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 proportions on '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]

1.2 This report presents results of the survey carried out between September and October 2017[2] for three distinct periods: the second half of 2017 (H2:2017; i.e., the current period); the first half of 2018 (H1:2018); and the twelve-month period to December 2018 (H1:2018-H2:2018). The survey samples 100 businesses in agriculture, mining, manufacturing, water and electricity, construction, trade, transport, as well as financial and business services. Compared to the previous survey, the response rate improved from 85 percent to 90 percent, which is the highest achieved since the inception of the

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[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.*

Bank's Business Expectations Survey in 2004.

2. Survey Context: Recent Economic Developments

Modest economic growth is expected globally in 2017 and 2018 based on various reasons. For the domestic economy, growth is expected to be driven by improvements in the mining and services sectors.

2.1 *Global output is expected to expand by 3.6 percent and 3.7 percent in 2017 and 2018, respectively[3], higher than the estimated growth of 3.2 percent in 2016, due to the projected strengthening of investment, trade, industrial production, as well as business and consumer confidence in the global economy. However, the forecast improvement in global economic activity encompasses varying performance across countries, with*

advanced economies expected to grow by 2.2 percent in 2017 and 2 percent in 2018, compared to 1.7 percent in 2016. On the other hand, economic activity in the emerging market economies, is expected to pick up from 4.3 percent in 2016 to 4.6 percent and 4.9 percent in 2017 and 2018, respectively, as commodity prices increase. However, the uncertainty with regard to the sustainability of the recovery of commodity prices, possible protectionist/inward-looking trade policies, geopolitical tensions, and persistence of tight financing conditions in some key markets continue to present downside risks to global economic performance.

2.2 *Regionally, the outlook for South Africa indicates a weak growth of 0.7 percent for 2017 and 1.1 percent for 2018. The weak growth outlook for South Africa, which is likely to have an adverse impact on neighbouring countries, including Botswana, is mainly due to political uncertainty which affects consumer and business confidence. Potential negative spillovers into Botswana, though expected to be moderate,*

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[3] *International Monetary Fund's World Economic Outlook (WEO), October 2017. The WEO revised the growth forecasts for 2017 and 2018 upwards by 0.1 percent from the April and July forecasts. The upward revisions to growth in the euro area, Japan, China and Russia more than offset downward revisions for the United States, the United Kingdom and India.*

include lower exports to South Africa and reduced SACU receipts.

2.3 In the domestic economy, economic growth prospects have improved significantly compared to 2015. Real GDP grew by 4.3 percent in 2016, following a contraction of 1.7 percent in 2015. In the twelve-month period ending in June 2017, GDP grew by 3.1 percent, up from a contraction of 0.7 percent recorded in the twelve-month period ending in June 2016. The strong growth in output mainly reflects improvement in the non-mining sector, which grew by 4.9 percent in the twelve-month period ending in June 2017, from 3.3 percent during the corresponding period in 2016. The growth in the non-mining sector was mainly attributable to diamond trade (wholesale sub-sector), which propelled growth in the Trade, Hotels and Restaurants sector. In addition, mining output contracted at a slower rate of 10.1 percent in the year to June 2017, compared to a contraction of 22.9 percent in the 12-month period ending in June

2016. The lower rate of contraction in the mining sector reflects some degree of recovery in trading conditions, particularly with respect to the demand for rough diamonds in major markets.

2.4 The Budget Strategy Paper for 2018/19 forecasts output growth of 4.7 percent and 5.3 percent for 2017 and 2018, respectively. The positive outlook is attributable to projected improvements in the mining and services sectors. The mining sector is expected to recover due to improvement in demand for diamonds as a result of favourable global economic prospects, while the services sector is expected to benefit from stability in water and electricity supply and the projected expansion in government spending.

3. **Business Confidence and Performance**

Confidence among businesses weakened marginally in the second half of 2017 compared to the first half of 2017, but strengthened going forward in to 2018.

Chart 1: Business Confidence Levels 2013-2018
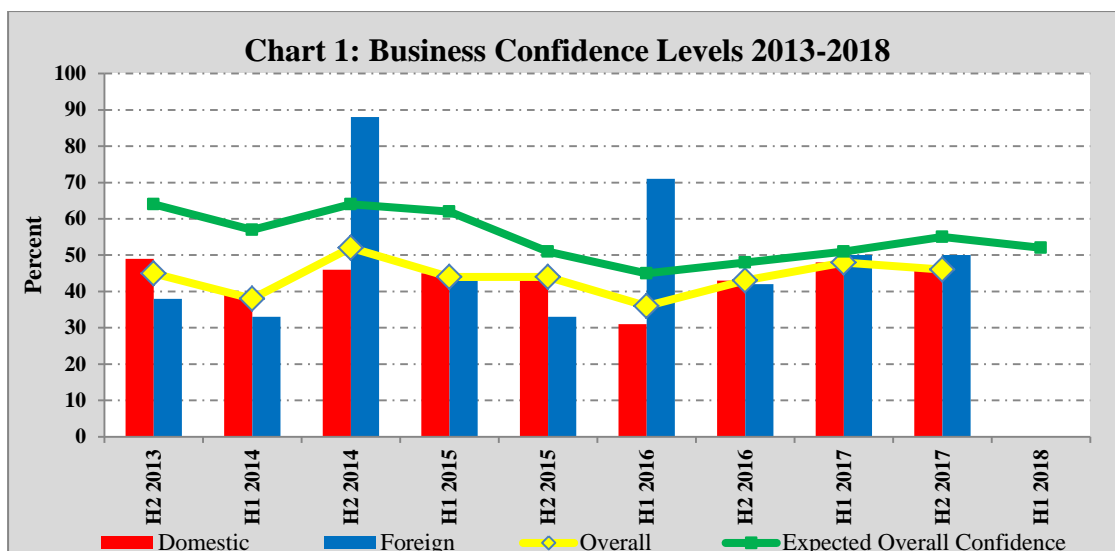
3.1 Chart 1 indicates that optimism among businesses weakened marginally from a confidence level of 48 percent in H1:2017 to 46 percent in the current survey period (H2:2017). Firms seem to have developed some uneasiness with the business conditions as their confidence level for the period was 9 percentage points lower than perceptions (55 percent) about the same period in the previous survey. This lower confidence level is also reflected in the forecast lower growth of 3.5 percent for the domestic economy by local businesses compared to the 2018/19 Budget Strategy Paper forecast output growth of 4.7 percent. However, in line with previous trends, more firms expect better business conditions going forward, with an overall confidence level of 52 percent for the first half of 2018 and 64 percent for entire year (2018). The improved confidence could be attributable to Government's projection of a pick-up in economic performance during 2018.

3.2 Current confidence amongst domestic-oriented businesses is also lower at 46 percent from 48 percent in the first half of 2017. Looking ahead, the level of optimism for domestic firms improves to 53 percent in H1:2018 and 67 percent in the year to December 2018. With respect to export-oriented businesses, the confidence level was at 50 percent in both halves of 2017 and is anticipated to remain the same in

H1:2018, before declining to 42 percent in H1:2018-H2:2018. Thus, the expected upswing in the overall business confidence for 2018 is due to a more positive outlook by domestic-oriented businesses, perhaps premised, on the expected increase in government expenditure in 2018/19.

4.   National Output

Businesses expect domestic output to grow at a slower pace than anticipated in the Budget Strategy Paper for 2018/19 and remain subdued over the survey horizon.

4.1   *On average, businesses expect real GDP to grow by 3.5 percent in 2017 and 3.8 percent in 2018. These are lower than the government forecasts of 4.7 percent and 5.3 percent for 2017 and 2018, respectively, as indicated in the Budget Strategy Paper for 2018/19. The expected lower output growth by businesses is consistent with the constrained demand, cited among challenges to doing business in Botswana. However, the expected growth by firms for 2017 is broadly in line with the latest GDP growth of 3.1*

percent realised three months before the survey was launched.

5.   Capacity Utilisation, Investment, Input Costs and Employment

88 percent of businesses expect to utilise atleast 50 percent of their productive capacity in the second half of 2017 compared to 80 percent in the first half of 2017, consistent with the upward revision in levels of production in the second half of 2017.

5.1   *The survey indicates that 12 percent of the respondents anticipate operating below 50 percent of their productive capacity in the current period, while 58 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 March 2017 survey (20 percent expected to operate below 50 percent, 56 percent expected to operate between 50 and 80 percent and 24 percent expected to exceed 80 percent). The business environment is still considered to be challenging, but largely stable.*

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 the current period and the first half of 2018. As a result, they expect to have smaller levels of inventory during the period and have revised upward their expectations regarding production and profitability.

5.3   Expectations regarding investment in buildings, plant and machinery, vehicle and equipment and other items have been revised downward across the board between H1:2017 and H2:2017. For H1:2018, there is an improvement in expectations regarding all categories of investment except for other items, which declined marginally from 3.3 percent to 2.2 percent. The generally improving expectations in 2018 with respect to investment are consistent with the optimistic outlook for 2018.

5.4   Overall sentiment amongst firms regarding the rising cost of inputs (materials, rent, utilities, wages,

transport and other) remains somewhat strong, but lower than in the previous survey. The decline in the net number of firms expecting further increases in the cost of these inputs is consistent with expectations of moderate inflation, given that actual inflation continues to be above but closer to the lower end of the Bank's 3-6 percent medium-term objective range. However, expectations of rising costs of inputs increase in the later period of the survey, except for wages, reflecting that businesses do not expect wages to rise in the near future.

6.   Debt, Interest Rates and Access to Finance

Business sentiment about access to finance has generally improved, with a bias towards domestic borrowing due to favourable interest rates.

6.1   Even though there is a general apprehension to borrow in 2018, as reflected in negative net balances, there is preference to borrow domestically than externally. This reflects to some extent, the expectation of lower domestic interest rates following the recent reductions of the Bank Rate from 6

percent to 5.5 percent in August 2016 and to 5 percent in October 2017.

6.2 However, sentiment about easy access to domestic credit remains weak, worsening slightly from 6 percent of respondents in the first half of 2017 to 4.6 percent in the second half of 2017. Nonetheless, business sentiments about access to finance, in general, has broadly improved, with those viewing it as tight declining slightly from 43.4 percent in H1:2017 to 41.4 percent in H2:2017. Furthermore, proportion of businesses which believe access to credit is normal rose from 50.6 percent in H1:2017 to 54 percent in the current period.

7.   **Inflation Outlook**

Inflation expectations remain within the Bank of Botswana's medium-term inflation objective range for both 2017 and 2018, suggesting credibility of the Bank's monetary policy.

7.1 Businesses expect inflation to average 3.3 percent in 2017 and 3.6 percent in 2018, which is the same view as in the previous survey. The average expected level of inflation for 2017 remains

consistent with observed current levels of inflation. Finally, consistent with current trends and prospective developments, the majority of respondents (89 percent) expect inflation to continue to be within the Bank's medium-term inflation objective range of 3-6 percent for both 2017 and 2018.

8.   **Challenges**

Constrained domestic demand, restricted government spending, unfavourable exchange rates and lack of skilled labour are the most cited impediments to doing business in the current survey.

8.1 Similar to the previous two surveys, constrained domestic demand[4] and government spending were ranked as the first and second most significant challenges facing businesses due to perceived slow growth in both government spending and household disposable income (Table 1). Two impediments to doing business ranked third; unfavorable exchange rate (where by exporters

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[4]   *This is unsurprising given the dominance among respondents of those for which the main market is Botswana.*

consider the Pula to be overvalued, while importers are of the view that the domestic currency is undervalued) and unavailability of skilled labour, which is exacerbated by difficulties encountered in recruiting foreigners.

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

	RANKINGS					
CHALLENGES TO DOING BUSINESS	**2015**		**2016**		**2017**	
	March	**Sept**	**March**	**Sept**	**March**	**Sept**
Constrained Domestic Demand	1		2	1	1	1
Government Spending		3	2	2	2	2
Unavailability of Skilled Labour	2		2			3
Water Shortages		1	1			
Inadequate Electricity Supply	3	2	2			
Regulatory & Supervisory Framework				3		
Exchange Rate Changes					3	3

9.   Conclusion

9.1   *Overall business confidence decreased marginally from 48 percent in March 2017 to 46 percent in September 2017. Looking ahead, there is an increase in optimism, despite subdued demand in the domestic and regional markets, which continue to threaten 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, September 2017 and March 2017 (All results are percentages and net balances, except for overall business conditions, which are gross balances)

	SEPTEMBER 2017			MARCH 2017		
	H2 2017	H1 2018	H1 2018- H2 2018	H1 2017	H2 2017	H2 2017- H1 2018
Output						
• Production	6.9	33.9		2.4	17.9	
• Expected level of stocks	-20.6	-12.6		-27.8	20.4	
• Volume of sales	-17.7	16.1		-7.3	9.0	
• Expected volume of goods exported	-12.8	10.7		2.2	-4.4	
• Expected volume of goods imported	11.1	40.6		-37.7	-24.5	
• Employment	...	-10.7	-20.3	...	13.1	30.0
• Profitability	-21.9	24.6	...	-28.8	-11.0	...
Input costs						
• Materials	...	61.0	69.9	...	79.4	93.7
• Rent	...	34.7	55.7	...	74.9	77.9
• Utilities	...	47.6	51.7	...	87.7	83.8
• Wages	...	60.6	52.7	...	73.1	83.3
• Transport	...	47.2	49.7	...	71.9	76.4
• Other	...	46.4	50.1	...	73.8	64.3
Investment						
• Buildings	-10.7	-7.9	...	15.1	29.3	...
• Plant and machinery	9.5	21.7	...	33.2	41.9	...
• Vehicles and equipment	15.4	21.3	...	31.1	42.2	...
• Other	3.3	2.2	...	19.1	-12.6	...
Expected volume of borrowing						
• Domestic	...	-11.4	-12.4	...	-4.9	-12.8
• South Africa	...	-42.8	-21.2	...	8.7	7.3
• Elsewhere	...	-33.0	-27.2	...	-0.1	0.1
Expected level of lending interest rates						
• Domestic	...	-7.4	24.0	...	-11.6	-7.3
• South Africa	...	7.8	23.7	...	1.4	8.0
• Elsewhere	...	16.6	22.6	...	-5.1	10.4
Business Conditions						
Rating current business conditions satisfactory						
• Overall	46	...	...	48	...	...
• Exporters	50	...	...	50	...	...
• Domestic	46	...	...	48	...	...
Optimistic about business conditions in 6 months' time						
• Overall	...	52	...	...	55	...
• Exporters	...	50	...	...	50	...
• Domestic	...	53	...	...	56	...
Optimistic about business conditions in 12 months' time						

• Overall	...	...	64	...	...	67
• Exporters	...	...	42	...	...	75
• Domestic	...	...	67	...	...	65

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.

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