THE QUARTELY BUSINESS EXPECTATIONS SURVEY

SEPTEMBER 2019

BANK OF BOTSWANA

1. Introduction

Description of the Survey

1.1 The Bank's quarterly Business Expectations Survey (BES) collects information on the domestic business community's perceptions about the prevailing state of the economy and prospects. In the survey, businesses respond to a range of questions relating to, among others: the business climate; outlook for economic growth; inflation and business performance over the survey horizon. The survey horizon comprises the quarter in which the survey is conducted, also referred to as the current period, the subsequent quarter and the next twelve months to September 2020.

1.2 This Report presents results of the survey carried out in the third quarter of 2019, covering the third quarter of 2019 (Q3:2019 - the current period); the fourth quarter (Q4:2019); and the twelve-month period (M12) from October 2019 - September 2020 (Q4:2019-Q3:2020). The BES samples 100 businesses from eight economic sectors: agriculture; mining; manufacturing; water and electricity; construction; trade, hotels and restaurants; transport and communications, and business services. The response rate for this Survey is 84 percent.

1.3 The main focus of survey questions is anticipated direction of change in selected indicators: i.e., whether conditions will improve, worsen or stay the same. The results are then consolidated into an overall measure called 'net balance'. This measure is obtained by summing the positive and negative responses to each question/element, weighted by each sector's contribution to nominal Gross Domestic Product (GDP). Thus, by design, the survey responses are predominantly qualitative, yet they provide valuable information to facilitate analysis and inform policy decisions.[1] However, responses to questions relating to GDP growth and inflation are quantitative and consolidated into simple averages.

Highlights of the Survey Results

1.4 The results suggest that firms were less optimistic about economic activity in the third quarter of 2019 compared to the second quarter of 2019. Overall, businesses expected a decrease in exports of goods and services; profits; and investment in buildings, plant and machinery, vehicles and equipment, and 'other' category in the third quarter of 2019. However, firms intend to increase investment in buildings, plant and machinery, and 'other' category in the fourth quarter of 2019, despite anticipating tight access to credit in the domestic market. Meanwhile, firms expect cost pressure to rise in the fourth quarter of 2019, mainly reflecting the anticipated upward pressure on costs of materials, wages and transport. However, they expect inflation to remain stable and within the Bank's medium-term objective range of 3 - 6 percent going forward.

2. Economic Performance and Business Conditions

Economic Growth is expected to be lower in 2019, than in 2018

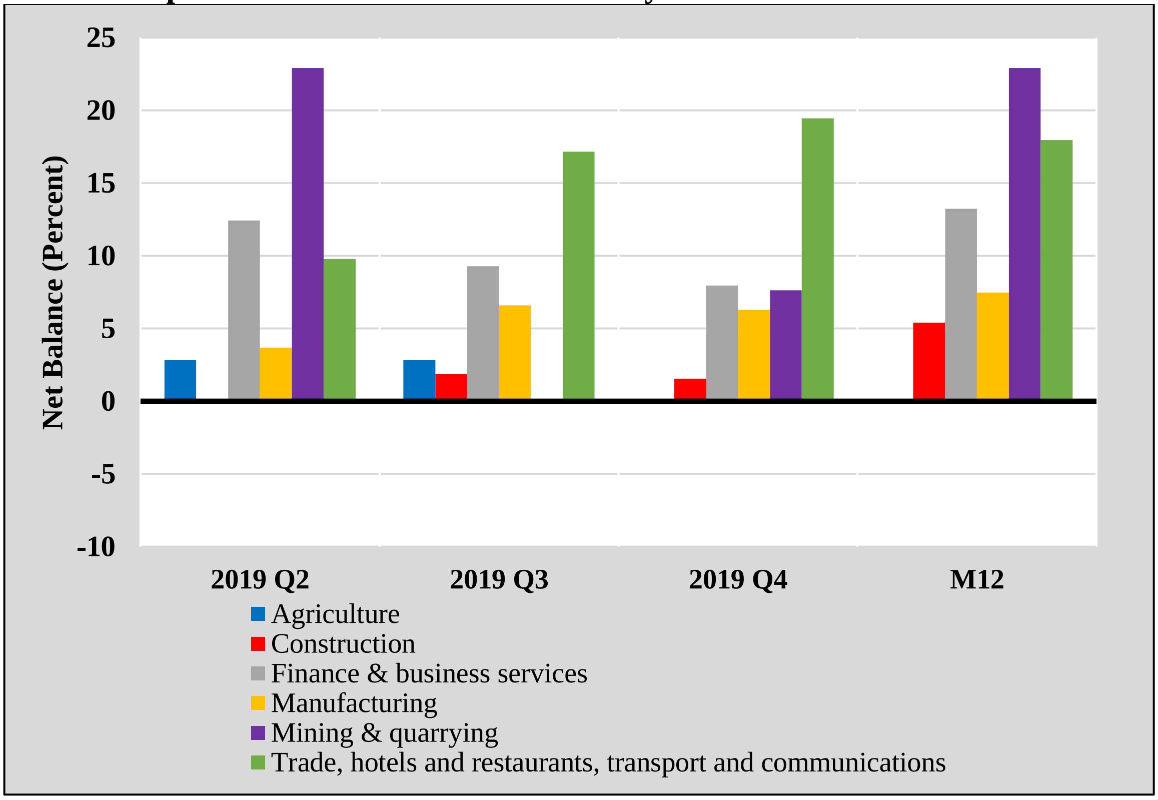
2.1 Firms are less optimistic about economic performance in 2019, with an expected output growth of 3.5 percent, which is less than the 2019 Budget Speech projection of 4.2 percent and the 4.5 percent growth in 2018. Regarding quarterly performance, firms expected a decline in economic performance in the third quarter compared to the second quarter of 2019, mainly attributable to weak economic conditions: a decline in exports of goods and

[1] A more detailed description of the survey can be found on the Bank of Botswana website at http://www.bankofbotswana.bw/index.php/content/2009110615047-business-expectations-survey.

services; profits; investment in buildings, plant and machinery, vehicles and equipment; and 'other' investments[2].

2.2 These prospective developments are mainly reflected in responses by firms in the mining and quarrying as well as the finance and business services sectors (Chart 1). The weak performance in the mining and quarrying sector could be attributable to the negative impact of the heightened trade tensions between the United States of America and China, which is adversely affecting the diamond market. Meanwhile, despite lower performance expectations, all other sectors, led by the trade, hotels and restaurants and the transport and communications sectors are optimistic about economic activity in the third quarter of 2019, compared to the previous quarter.

Chart 1: Expected Drivers of Economic Activity



Note: The chart shows net balances on each sector's expectations about economic performance in the third quarter of 2019, fourth quarter of 2019 and the 12 months period to September 2020. The net balances are weighted by each sector's relative share in GDP. For example, for a sector with (P+N) members in the sample, of which 'P' indicated positive perceptions and 'N' negative, with a weight of Z percent in nominal GDP, the weighted net balance is calculated as [(P-N)/P+N) x 100 x Z].

2.3 Business conditions are perceived to improve in the fourth quarter of 2019, and become even better in the twelve-month period to September 2020 (Chart 2). Firms anticipate improvements in capacity/resource utilisation; production/service capacity; sales; stocks/inventories; and investment in: plant and machinery, buildings and 'other' in the fourth quarter of 2019. These, in combination with expectations of increased growth in the mining industry, have generally led to improved overall business conditions.

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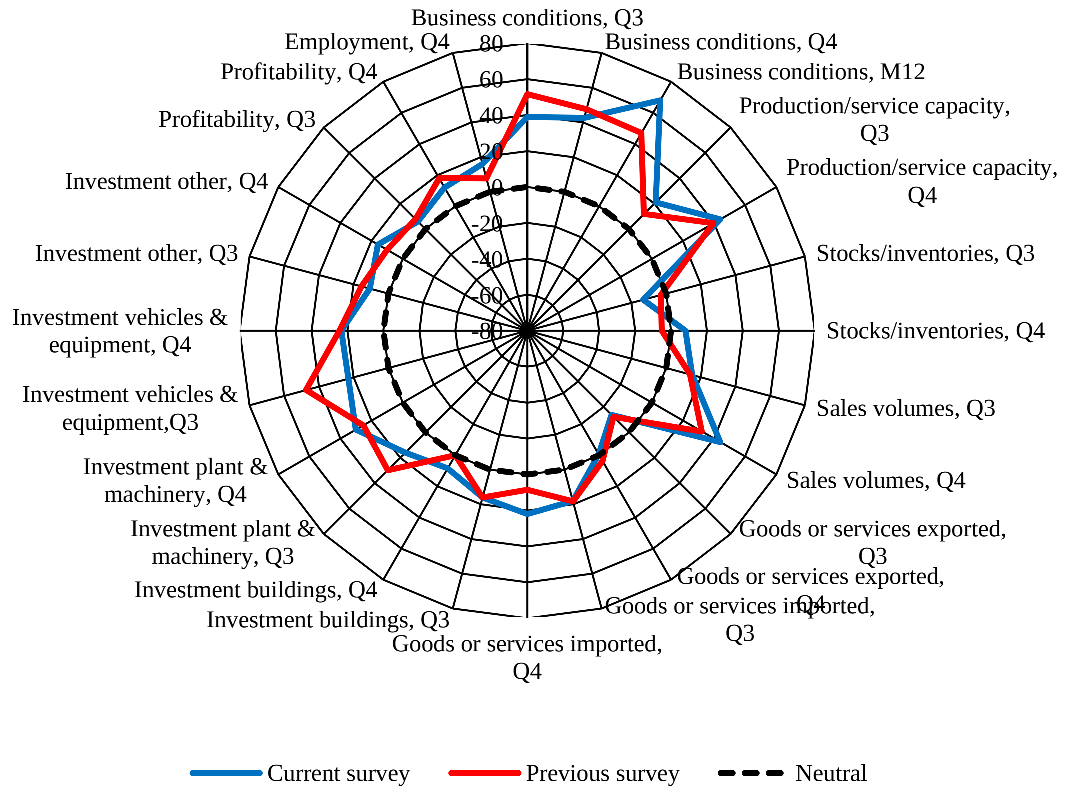
2 Other investments refers to any investments apart from the ones listed.

Chart 2: Summary of Economic Conditions

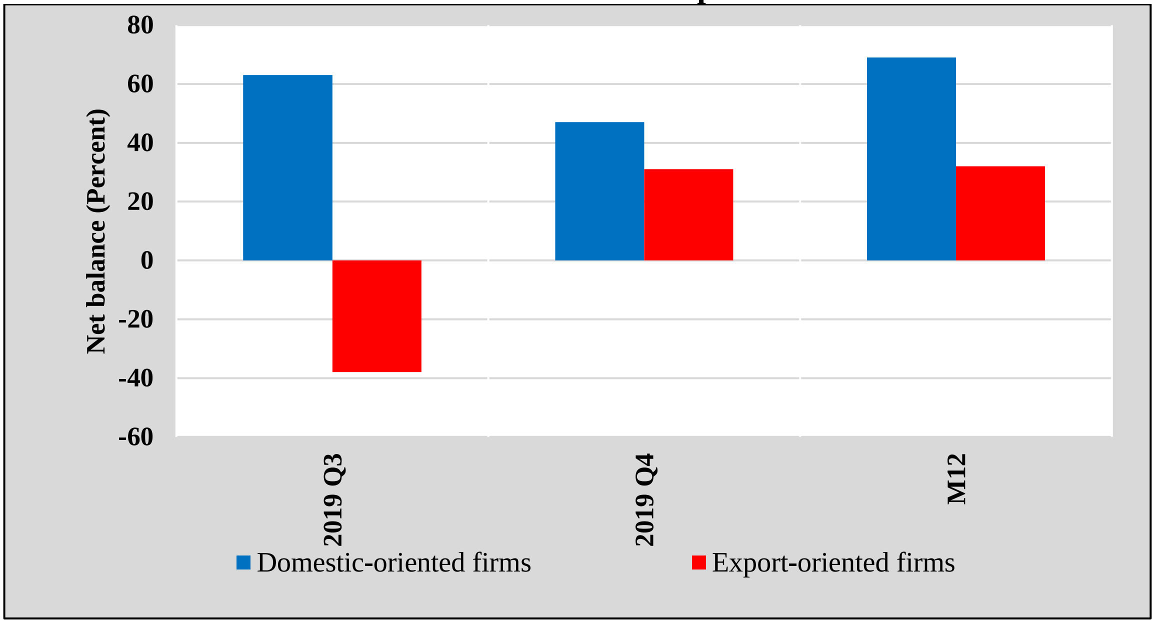


Notes: The chart summarises firms' expectations about business conditions. The blue line represents the results of the September 2019 Survey while the red line represents the results of the June 2019 survey. The black dashed line is the static position, representing unchanged expectations. The net balances of how respondents view economic conditions are plotted along the slanted lines extending from the centre of the chart. Values moving further away from the 'static' line show an improvement, whereas those moving towards the centre of the chart represent a deterioration.

The results of the current survey, along the blue line, are interpreted as follows: Q3 denotes perceptions about business conditions in the third quarter of 2019, Q4 represents expectations about business conditions for the fourth quarter of 2019, while M12 depicts the perceived business conditions for the twelve-month period from October 2019 to September 2020. Similarly, the red line denotes perceptions about business conditions as envisaged in the previous survey.

2.4 As indicated in Chart 3, the domestic market-oriented firms' optimism falls in the fourth quarter of 2019 compared to the third quarter of 2019 before improving in the twelve-month period to September 2020 (M12). Confidence in the domestic market-oriented firms is mainly driven by trade, hotels and restaurants, transport and communications and the finance and business services sectors. Export market-oriented firms, particularly those engaged in the mining and quarrying business, are less optimistic about the third quarter of 2019 compared to other periods of the survey.

Chart 3: Business Confidence for Domestic and Export Markets-Oriented Firms



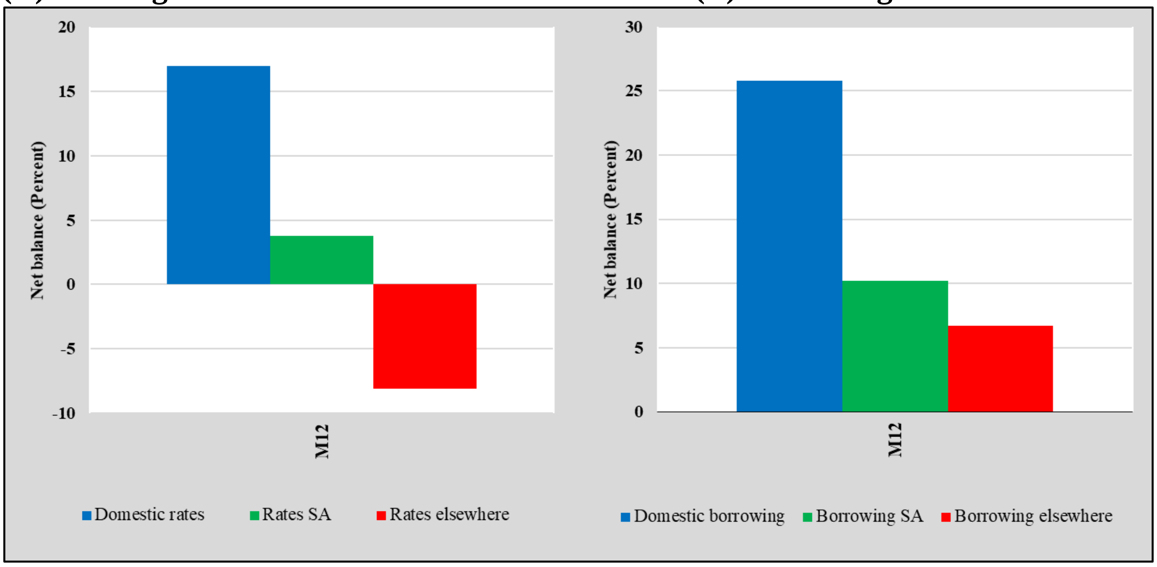
3. Expected Lending Rates and Volume of Borrowing

Domestic lending rates and borrowing are expected to rise in the year to September 2020

3.1 Firms expect both the lending rates and the volume of borrowing from domestic and South African markets to increase in the twelve-month period to September 2020 (Chart 4). Meanwhile, some firms prefer borrowing from elsewhere[3] mainly due to the anticipated decline in the lending rates in those markets.

Chart 4: Lending Rates and Borrowing Volumes

(A) Lending Rates **(B) Borrowing Volumes**

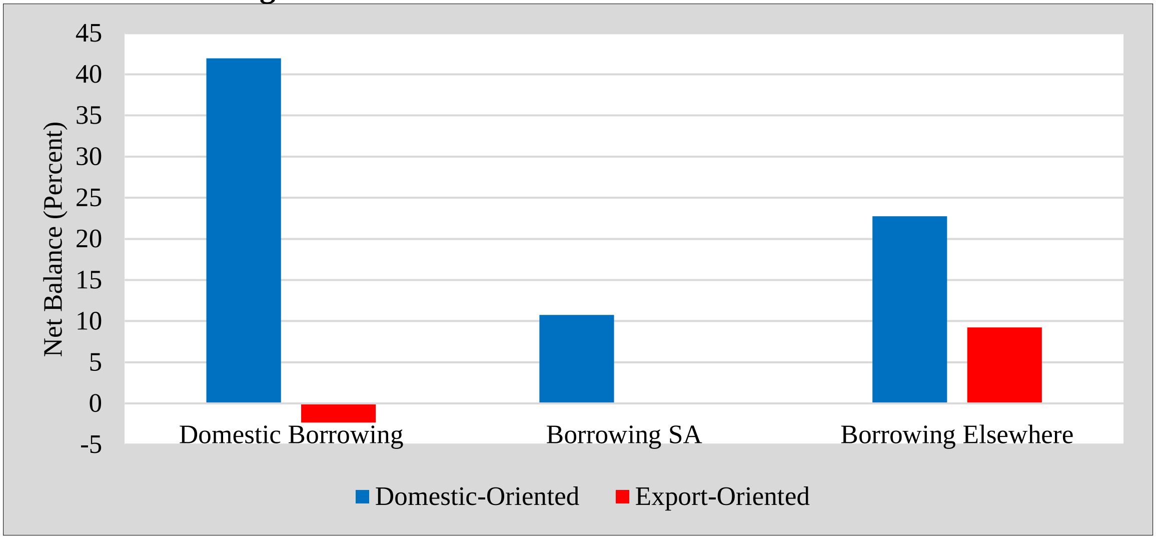


3.2 Firms in the domestic and export-oriented markets perceive access to credit to be tight in the third quarter of 2019, mainly because they consider the domestic interest rates to be

3 'Elsewhere' refers to any market other than Botswana and South Africa.

high. During the year ending in September 2020, some firms, especially those targeting the domestic market, would prefer to borrow from the domestic market. Conversely, export-oriented firms would prefer to borrow from the international markets other than South Africa (Chart 5). They also intend reducing their borrowing from the domestic market.

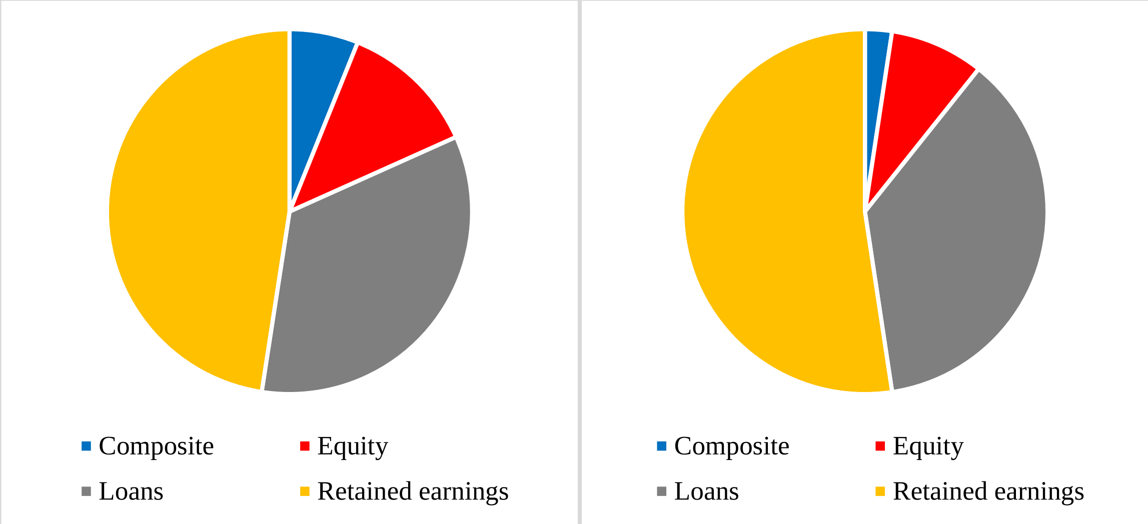
Chart 5: Borrowing Preference of Firms



3.3 About 73 percent of the firms cited the availability and accessibility of the required loan products as the basis for their borrowing decisions. Meanwhile, affordability of credit facilities influenced borrowing plans of 27 percent of businesses irrespective of whether funds are to be sourced from Botswana or abroad.

3.4 Similar to the previous survey, the majority of firms prefer to finance their business operations from retained earnings and loans (Chart 6). Retained earnings as a source of finance is more prominent in the trade, hotels and restaurants, and the transport and communications sectors. On the other hand, most of the firms in manufacturing, finance and business services and the construction sectors plan to fund their businesses through loans.

Chart 6: Sources of Financing in 2019 Q2 Survey (LHS) and 2019 Q3 Survey (RHS)



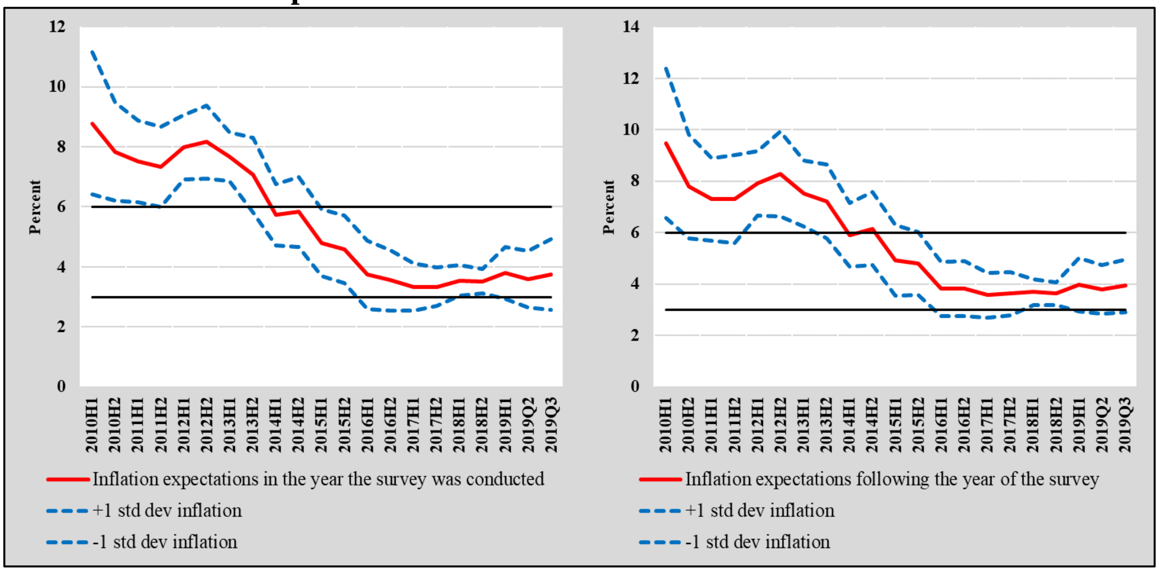
Note: Composite refers to a preference for a combination of more than one source of financing (e.g. retained earnings and loans). LHS refers to the chart on the left-hand side and RHS refers to the chart on the right-hand side.

4. Price Developments and Inflation

Pressure from rising costs expected to increase in the fourth quarter of 2019

4.1 Overall, there is a strong expectation of cost escalation in the fourth quarter of 2019, attributable to the expected rise in wages and cost of materials and transport. Firms' expectations about domestic inflation have generally been on a downward trend since 2013, and within the Bank's inflation objective range of 3 - 6 percent since 2014 (Chart 7). Furthermore, uncertainty about future inflation has generally declined as shown by the narrowing standard deviation (std dev) from the average expectations despite the noticeable divergence in the past three surveys. Firms' inflation expectations for 2019 average 3.8 percent, suggesting that inflation expectations are well anchored within the Bank's objective range.

Chart 7: Inflation Expectations



Note: The chart shows the average of inflation expectations across different surveys, as well as the standard deviation for the inflation expectations. Previously, the surveys were conducted biannually, but effective

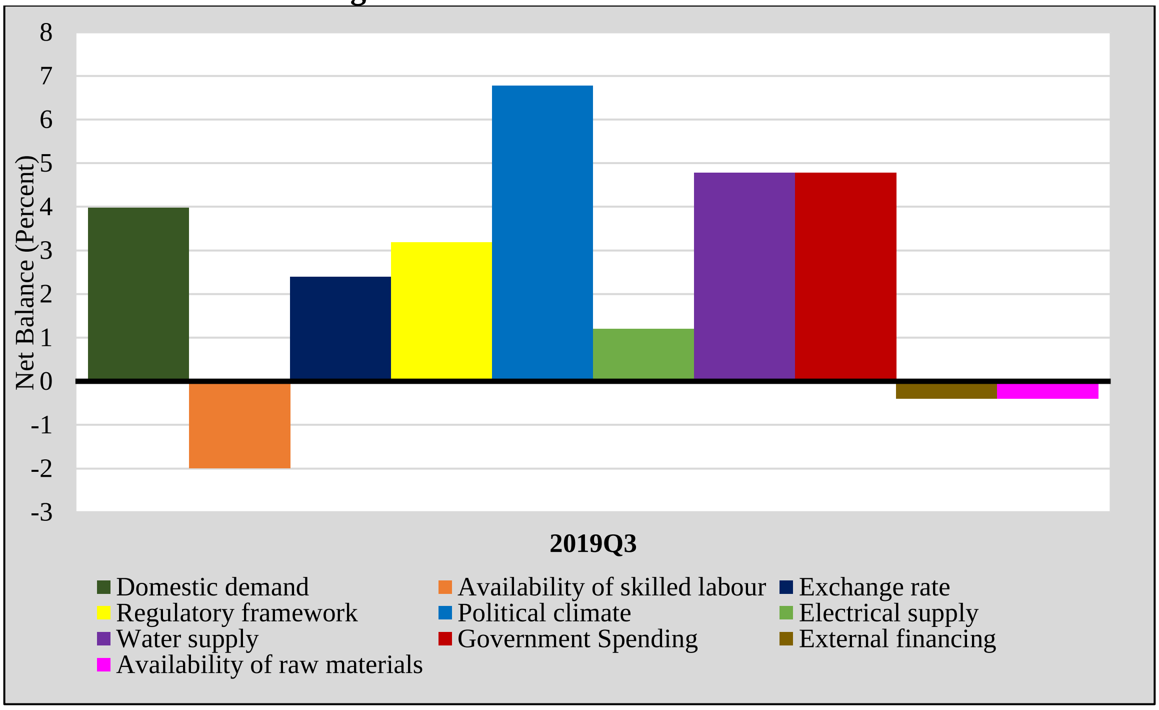
2019 Q2, surveys are conducted on a quarterly basis. The bi-annual survey horizons comprised the half-year in which the survey was conducted/current period (H1) and the next half-year (H2).

5. Factors Affecting Business Conditions

Unavailability of skilled labour is perceived to be a major challenge to doing business

5.1 Unavailability of skilled labour was cited as the greatest challenge facing businesses mostly in the construction, trade, hotels, restaurants, transport and communications sectors in the third quarter of 2019, arising from the reported difficulties experienced in recruiting foreign skilled labour (Chart 8). The second major business impediment is shortage of raw materials, commonly cited by firms in the manufacturing sector. Furthermore, a number of firms (predominantly domestic market-oriented ones) across various sectors, cited the difficulty in accessing financing from abroad as the greatest challenge to their business operations in the third quarter of 2019. On the positive side, the local political climate, domestic demand and the current regulatory framework are viewed as being the most supportive factors to doing business in Botswana during the third quarter of 2019 (Chart 8). Another observation is that water and electricity sub-sectors reportedly contribute positively to economic activity, an improvement from the recent past. There are ongoing efforts to improve the supply of these utilities through measures such as the implementation of the North-South Carrier 2 water project and the North-West Transmission Grid electricity connection.

Chart 8: Factors Affecting Business Conditions



6. Conclusion

6.1 Overall, firms were less confident about business conditions in the third quarter of 2019 compared to the previous quarter. However, business conditions are expected to improve in the fourth quarter of 2019, and become even better in the twelve-month period to September 2020, consistent with the anticipated improvements in capacity/resource utilisation; production/service capacity; sales; stocks/inventories; and investment on: plant and machinery; buildings; and 'other'. Firms expect the economy to grow by 3.5 percent in 2019, lower than the 4.2 percent projection in the 2019 Budget Speech. Furthermore, on average, firms expect inflation to be slightly below 4 percent, which is consistent with the Bank's projection that inflation will remain within the objective range of 3 - 6 percent in the medium term.