

**Recent Developments and Outlook**

**GDP will not contract as much as previously anticipated.** While the recovery in the diamond industry has been only partial, with diamond exports between January and October 2009 at only 53% of their levels in 2008, the diamond pipeline has begun to function again and prices for rough diamonds are rising. Mining output expanded by 2.3% q-o-q in the third quarter of 2009, after contracting significantly in the first half of the year. The non-mining private sector has continued to perform well, expanding by 8.9% in the year to September, largely, though not entirely, on the back of increased Government spending. The GDP decline in 2009 will thus not be as sharp as initially anticipated, and likely to be much smaller than the projected -10%, perhaps on the order of -5% - although data are still only available through September.

**The non-mining sector will face challenges in 2010.** In 2010, mining production and exports should continue to improve. Copper and nickel exports will benefit from the recovery in global growth. Diamond exports will do so to a lesser extent as their sales depend on growth in developed countries whose recovery is still expected to be weak. Debswana forecasts a 13% increase in diamond production in 2010 over 2009 levels. Prospecting and mine development should benefit from improved global prospects. The non-mining private sector, on the other hand, may face greater difficulties if Government spending turns less buoyant as fiscal sustainability issues come to the fore. Textiles and tourism may also face challenging conditions. Textiles have already been hard hit in 2009, and Botswana's largest textile and garment producer closed in December. This will be compounded by a weak projected recovery in South Africa which will limit to some extent the recovery in Botswana's non-traditional exports for which South Africa is an important market. In addition, Botswana's over-indebted households are likely to limit their consumption despite the decline in interest rates. Arrears on household lending have risen significantly since the start of the global crisis and are today at a historical high.

**President Khama has reportedly cut by 10% the (yet-to-be-made-public) 2010/11 government budget** just as it was about to be finalized. Official data on public revenues and expenditures are only available for the first 4 months of the 2009/10 fiscal year. Nevertheless it appears that while revenue performance has been somewhat better than initially expected, public spending has also expanded significantly in an effort to cushion the economy from the effects of the global downturn. Initial budget estimates for a 14% of GDP Central Government deficit are thus likely to be met, and perhaps surpassed. Meeting the commitment made in the 2009 budget speech to keep deficits to no more than 10% of GDP averaged over 2009/10 and 2010/11 would imply large cuts in spending, particularly as a decline in SACU revenues is expected to at least partially offset improvements in mineral revenues. The President's action is a reflection of concerns that excessively large deficits today will make longer-term fiscal sustainability more difficult to attain. The Government now faces the significant challenge of balancing fiscal stimulus and economic growth concerns with maintaining sound public finances.

**International trade has improved since the beginning of 2009, but Botswana will experience a current account deficit for the first time in over 25 years.** The trade balance is likely to be on the order of -10% of GDP, but is partially offset by SACU transfer and other income. While exports are recovering, they are doing so only partially relative to pre-crisis levels. Total January-October merchandise exports were 35% below their 2008 level. Simultaneously, imports are rising largely as a result of large Government capital investment demand.

**December year-on-year CPI inflation rose to 5.8% from 5% the previous month** as a result of higher transport (i.e. fuel) costs, while food inflation declined. Inflation has fallen from a peak of 15% in August 2008. With inflation forecast to stabilize within the Bank of Botswana's 3-6% target range in the coming year, the central bank lowered its benchmark bank rate by 1 percentage point to 10% in December 2009, bringing the cumulative reduction since December 2008 to 550 basis points.

