THE QUARTERLY BUSINESS EXPECTATIONS SURVEY

JUNE 2020

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 prevailing business climate; outlook for economic growth and 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.

1.2 This Report presents results of the survey carried out in the second quarter of 2020, which is the current period of this survey (Q2:2020), the third quarter of 2020 (Q3:2020); and the twelve-month period (M12) from July 2020 - June 2021 (Q3:2020-Q2:2021). Thus, the Survey was conducted during the period in which the country was on lockdown and the ongoing travel restrictions and social distancing requirements were in place as part of domestic measures aimed at containing the spread of the COVID-19 pandemic.

1.3 The BES samples 100 businesses from eight economic sectors, namely: agriculture; mining; manufacturing; water and electricity; construction; trade, hotels and restaurants; transport and communications; and finance and business services. The response rate for the current survey is 73 percent, down from 77 percent in the March 2020 Survey. The lower response was mainly due to logistical challenges faced by companies, arising from reduced staff compliments necessitated by the COVID-19 containment measures. Therefore, responding to the survey was not considered a priority as most companies were focusing on trying to recover from losses incurred during the lockdown period.

1.4 In a bid to ascertain the impact of the pandemic on the business community, some COVID-19 related questions were included in the current BES. According to the results, COVID-19 containment measures have negatively affected business operations in the second quarter of 2020. The most affected firms are largely in the trade, hotels, restaurants, transport and communications; mining and quarrying; finance and business services, and the construction sectors. In general, firms anticipate that it will take a year from June 2020, for their businesses to recover from the impact of COVID-19.

1.5 The survey questions focus mainly on anticipated direction of change in selected indicators, i.e., whether conditions will improve, worsen or remain unchanged. 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 by firms belonging to the same sector, which are then weighted by the sector's contribution to nominal gross domestic product (GDP). Thus, by design, the survey responses are predominantly qualitative, and provide valuable information to facilitate analysis and inform policy decisions. However, responses to questions relating to COVID-19, GDP growth and inflation are quantitative and are consolidated into simple averages.

Highlights of the Survey Results

1.6 The results suggest that firms are less optimistic about economic activity in the second quarter of 2020 compared to the previous quarter. Overall, businesses expect a deterioration in all business condition indicators (Chart 2). Access to credit was anticipated to be much tighter in the domestic market compared to other markets. Meanwhile, firms expect cost pressures to fall significantly in the third quarter of 2020, mainly reflecting the anticipated reduction in costs of wages, transport, rent and materials. Firms also expect inflation to remain stable and within the Bank's medium-term objective range of 3 - 6 percent, in 2020 and 2021.

2. Economic Performance and Business Conditions

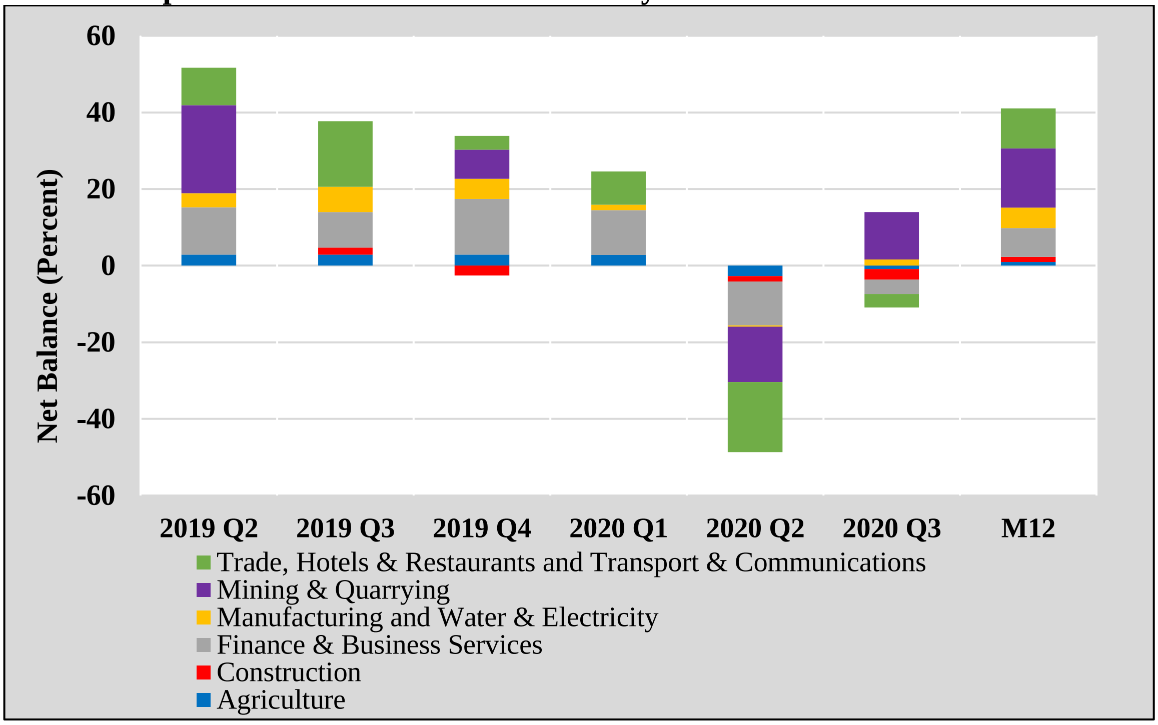
Economic Growth is expected to decline in 2020 compared to 2019

2.1 Firms expect overall output to contract by 0.2 percent in 2020, compared to a larger contraction of 8.9 percent projected by the Ministry of Finance and Economic Development (MFED), and lower than the 3 percent growth in 2019. On quarterly basis, firms expect GDP to contract in the second quarter of 2020, consistent with the anticipated decline in production; sales; profitability; exports and imports of goods and services; and investment in buildings, vehicles and equipment, plant and machinery, and 'other' investments.

2.2 In particular, firms expect the economy to have contracted by 1.1 percent in the second quarter of 2020, compared to the 3 percent growth reported by Statistics Botswana for the second quarter of 2019. The expected weak performance in the second quarter of 2020 is mainly influenced by the perceptions of lower economic growth in the mining and quarrying, the trade, hotels and restaurants and the transport and communications sectors, as well as the finance and business services sectors between the first and second quarters of 2020 (Chart1).

2.3 Notably, the mining and quarrying sector, which predominantly targets the export market, was significantly pessimistic about economic growth prospects in the second quarter of 2020 compared to an expected stagnation in the first quarter. This is consistent with the unfavourable market conditions, especially with respect to the diamond industry, occasioned by, among others, weaker global demand for rough diamonds associated with the US-China trade war (since September 2018) and the interruption of trading due to the recent outbreak of the COVID-19 pandemic. The trade, hotels and restaurants and the transport and communications sectors, which have also been hard hit by the travel restrictions and social distancing requirements, are the next highly pessimistic sectors. This is followed by the finance and business services sector, which expects poor economic performance consistent with firms' predicted decline in production and investment during the second quarter of 2020. For the third quarter of 2020, the mining, manufacturing, water and electricity sectors are optimistic about economic performance, while the rest of the sectors are pessimistic. However, firms across all sectors are optimistic about economic recovery in the twelve month period to June 2021, led by the mining and quarrying sector.

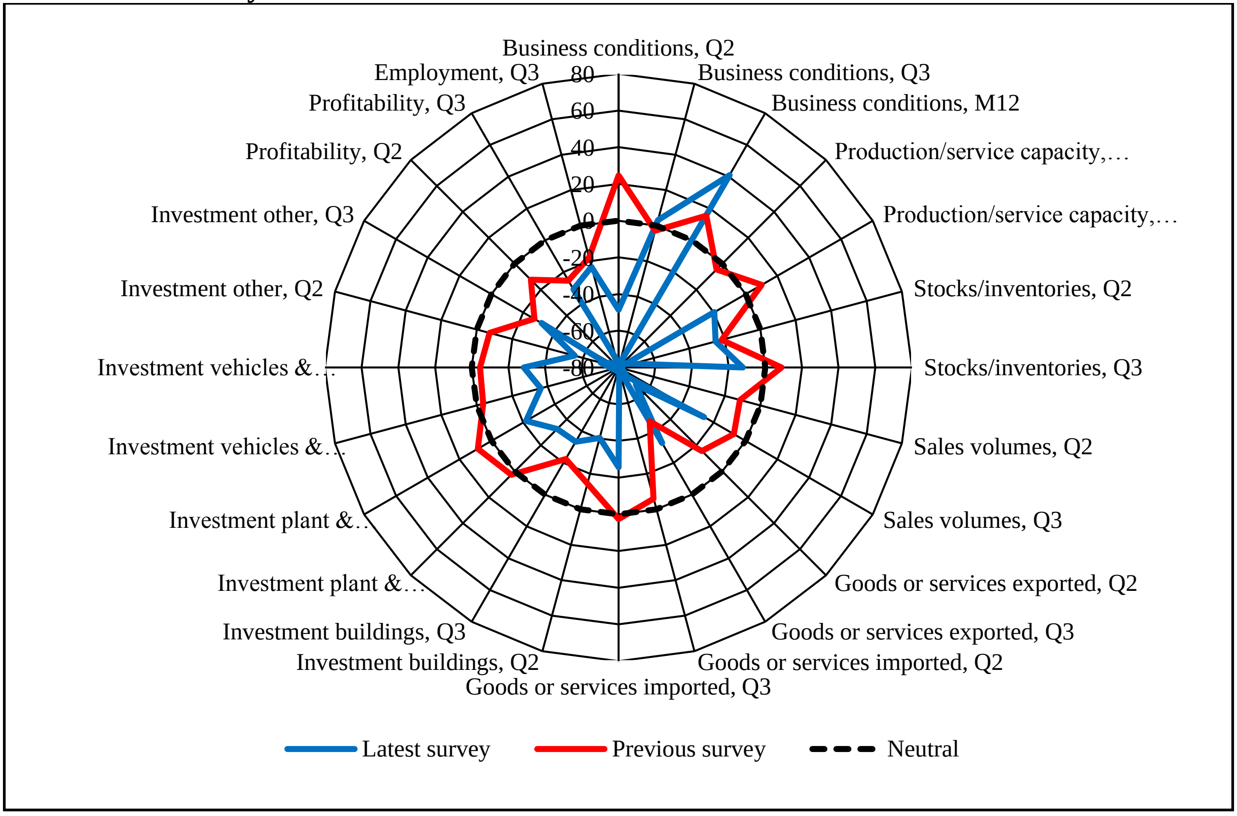
Chart 1: Expected Drivers of Economic Activity



Note: The chart shows net balances on each sector's expectations about economic performance from the second quarter of 2019 to the third quarter of 2020 and the 12 months period to June 2021. 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].

2.4 Firms expect business conditions to deteriorate in the second quarter of 2020, followed by an improvement in the next quarter and over the twelve-month period to June 2021 (Chart 2). The firms' level of optimism improves in the third quarter of 2020 following the decline in the second quarter of 2020. The perceived generally weaker economic performance in the current survey compared to the previous one is associated with the disruption of business operations arising from the COVID-19 containment measures.

Chart 2: Summary of Economic Conditions

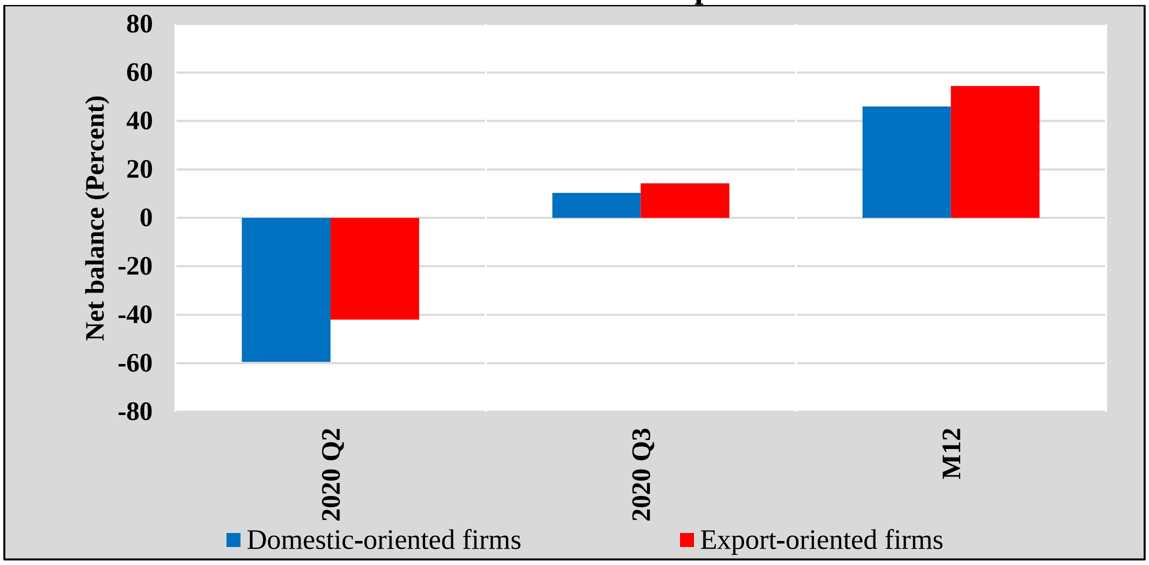


Notes: The chart summarises firms' expectations about business conditions. The blue line represents the results of the June 2020 Survey while the red line represents the results of the March 2020 survey. The black dashed line is the static position, representing unchanged expectations. The net balances 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: Q2 denotes perceptions about business conditions in the second quarter of 2020, Q3 represents expectations about business conditions for the third quarter of 2020, while M12 depicts the perceived business conditions for the twelve-month period from July 2020 to June 2021. Similarly, the red line denotes perceptions about business conditions as envisaged in the previous survey.

2.5 As reflected in Chart 3, the level of optimism among domestic market-oriented firms improves markedly in the third quarter of 2020 compared to the second quarter of 2020. It improves further in the twelve-month period to June 2021 (M12) in line with the anticipated economic recovery in 2021. Confidence in the domestic market-oriented firms is mainly driven by firms in the manufacturing, water and electricity sectors. Similarly, export market-oriented firms are optimistic about business conditions in the third quarter of 2020 and the year to June 2021 (Chart 3). These firms are predominantly in the mining and quarrying business, which is expected to increase output in the third quarter of 2020 and the next 12-month period, as trade conditions improve (Chart1).

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

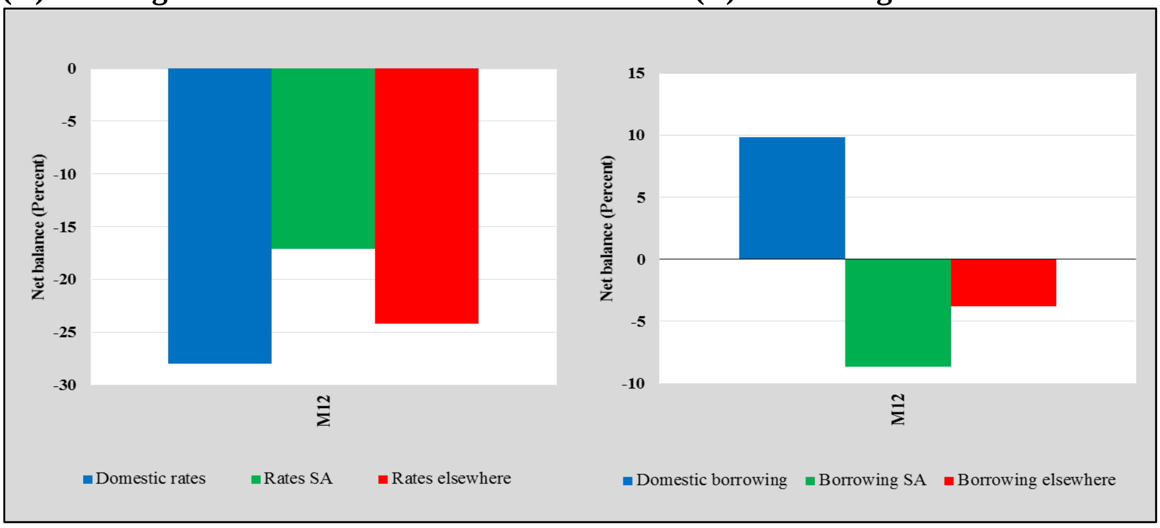


3. Expected Lending Rates and Volume of Borrowing

Lending rates are expected to decline across all markets in the year to June 2021

3.1 In general, firms expect the cost of credit (lending rates) to decrease across all markets, and a few cited the need for affordable credit to stimulate economic activity in the wake of the adverse impact of COVID-19 pandemic, as the main reason. A few other firms based their expectation of lower lending rates on the recent policy rate cut by the Bank. Regarding borrowing volumes, firms broadly expect an increase in domestic credit, and a reduction in credit from South Africa and elsewhere[1] in the twelve-month period to June 2021 (Chart 4).

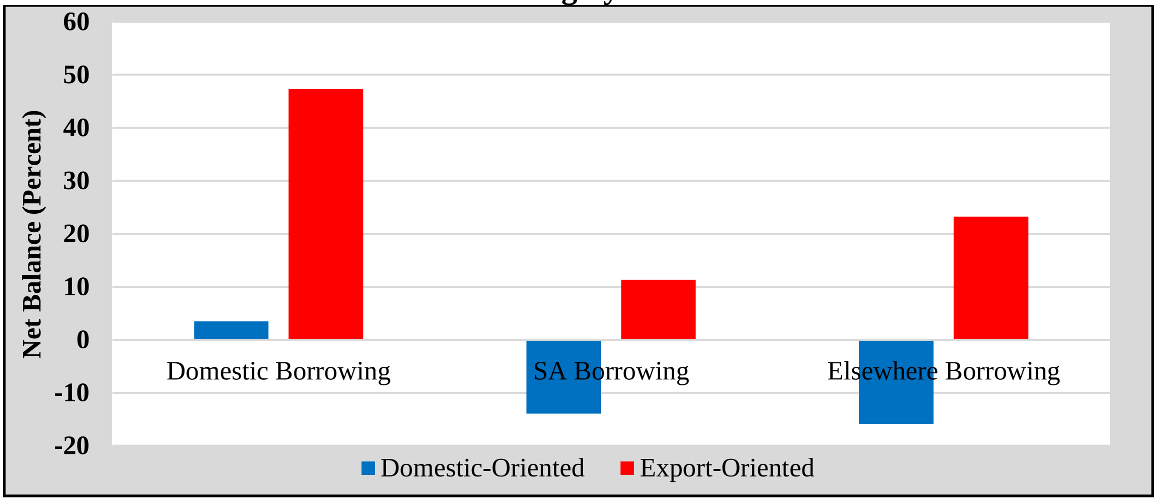
Chart 4: Lending Rates and Borrowing Volumes
(A) Lending Rates **(B) Borrowing Volumes**



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

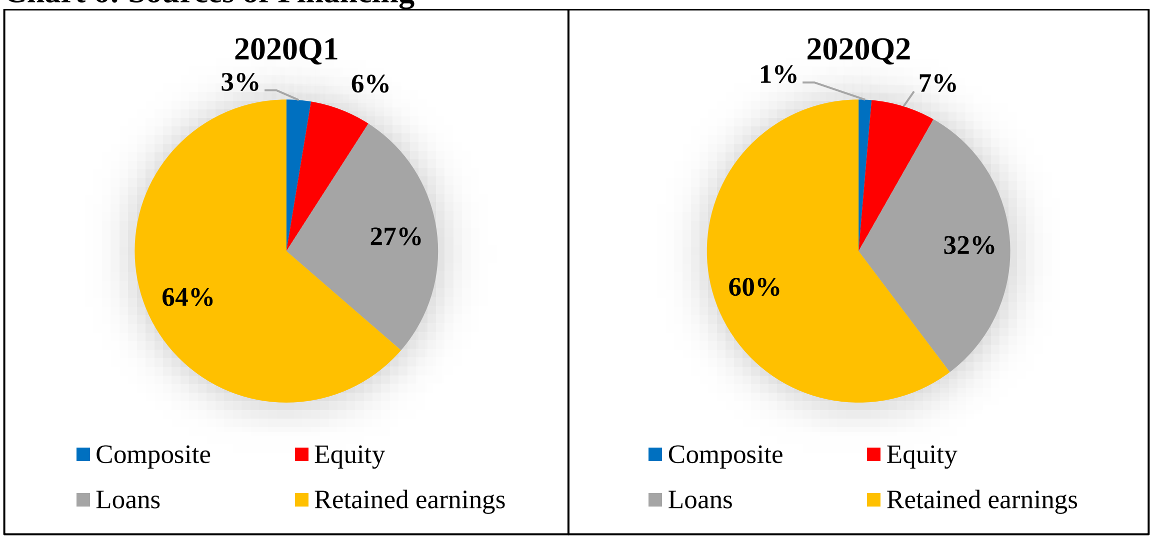
3.2 Both domestic- and export- market oriented firms perceived access to credit to be tight in the second quarter of 2020, despite expecting interest rates, one of the determinants of credit accessibility, to be lower than in the previous quarter. All firms which predominantly target the domestic market, prefer to borrow from the domestic market in 2020 and have no plans to borrow from other markets. Conversely, export-oriented firms prefer to borrow from all markets, with more preference given to the domestic market (Chart 5).

Chart 5: Preferred Market for Borrowing by Firms



3.3 About 73 percent of the surveyed firms stated that their decisions on which market to borrow from were informed by accessibility and availability of required loan products. Meanwhile, 21 percent of the firms indicated that their decisions on the credit were influenced by affordability of suitable credit facilities. As in the previous survey, most firms preferred to finance their business operations mainly from retained earnings and loans, rather than using a combination of the two (Chart 6). Retained earnings as a source of finance was more prevalent among the Mining and quarrying, manufacturing,water and electricity; trade, hotels ,restaurants,transport and communications sectors. Conversely, most of the firms in the finance and business services sector planned to fund their businesses through loans.

Chart 6: Sources of Financing



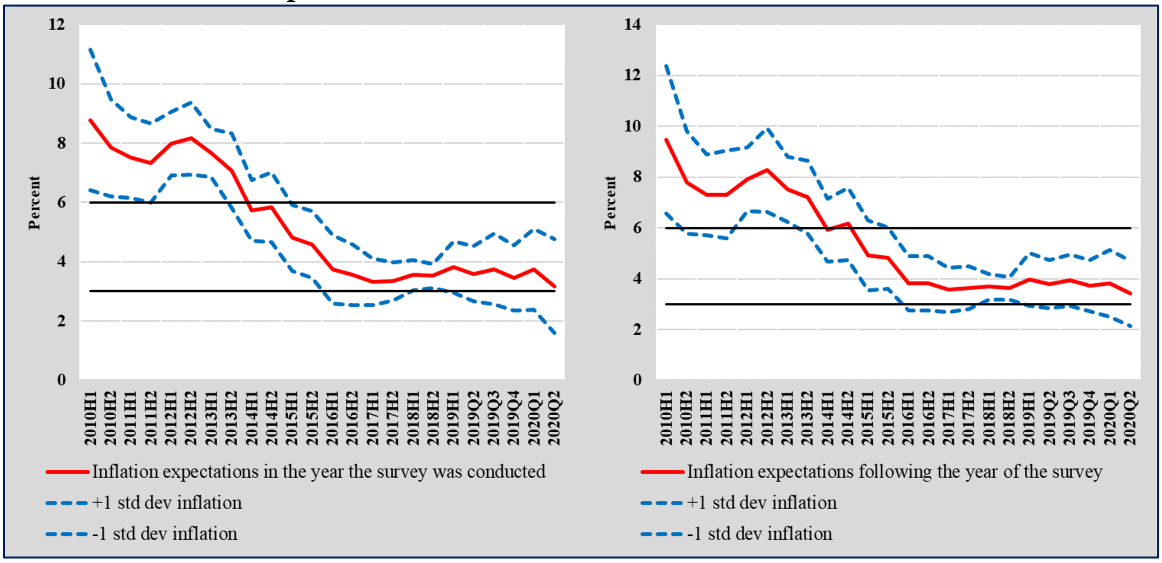
Note: Composite refers to preference for a combination of more than one source of financing (e.g. retained earnings and loans or equity and loans).

4. Price Developments and Inflation

Cost pressures expected to decrease in the third quarter of 2020

4.1 Overall, firms expect cost pressures to be subdued in the third quarter of 2020, mainly attributable to the expected decline in costs of wages, transport, rent and materials. 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 reflected by the narrowing standard deviation (std dev) from the average expected inflation despite the noticeable divergence in the past six surveys. Firms' inflation expectations for 2020 and 2021 averaged 3.2 percent and 3.4 percent respectively, suggesting that inflation expectations were 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

Weak international demand was perceived to be a major challenge to doing business

5.1 In general, firms, particularly those in the manufacturing, mining and quarrying, trade, hotels, restaurants, transport and communications sectors[2], cited weak international demand as the greatest challenge to their business operations in the second quarter of 2020 (Chart 8). Shortage of raw materials, was the second most commonly cited impediment to doing business, especially in the manufacturing and construction sectors. Furthermore, a number of firms (predominantly in finance and business services) mentioned difficulty in accessing financing from abroad as the greatest challenge to their business operations. Unavailability of skilled labour was also seen as a challenge in doing business in Botswana, mainly by firms in the manufacturing and construction sectors, reflecting reported

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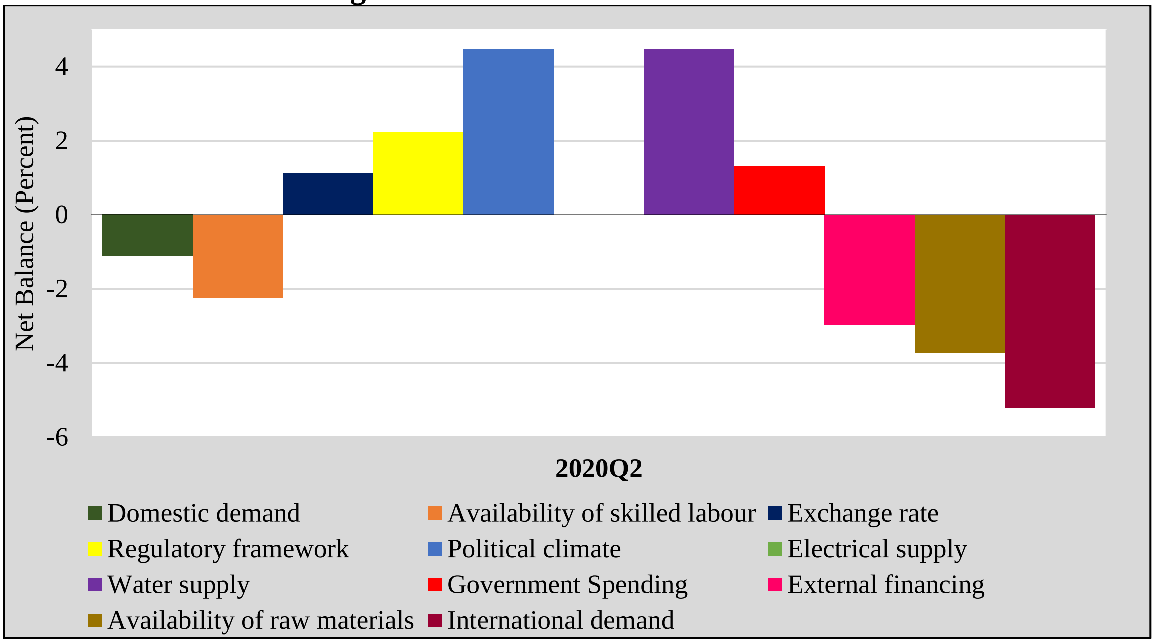
[2] The Trade, Hotels and Restaurants, and Transport and Communications Sectors are merged for ease of analysis since the two are interconnected.

difficulties experienced in recruiting foreign skilled labour. Domestic demand was also cited as a challenge and that can be attributed to zonal movement restrictions and long queues at points of service resulting from COVID-19 containment measures such as social distancing and customer registration requirements. Further, loss of revenue generating activities by some sectors of the economy such as creative arts, entertainment and tourism, coupled with apprehension to spend amid the uncertainty related to COVID-19 impact, also contributed to subdued domestic demand.

5.2 On the positive side, the local political climate, government spending and the current regulatory framework were viewed as being the most supportive factors to doing business in Botswana (Chart 8) during the second quarter of the year. Another observation is that the water sub-sector contributed positively to economic activity, reflecting improvement in the supply, which had previously been a serious challenge.

Chart 8: Factors Affecting Business Conditions



6. Conclusion

6.1 Overall, firms were less optimistic about business conditions in the second quarter of 2020 compared to the previous quarter, consistent with the anticipated decline in production; sales; profitability; exports and imports of goods and services; and investment in buildings, vehicles and equipment, plant and machinery, and 'other'. The expected weakening of the business conditions is in line with the deterorating global economic activity associated with the outbreak of the COVID-19 pandemic. Firms expect the economy to contract by 0.2 percent in 2020 and inflation to average 3.2 percent and 3.4 percent in 2020 and 2021, respectively.

6.2 Regarding the COVID-19 Relief Measures implemented by Government, the majority of the surveyed firms indicated that they had benefited from the wage subsidy while only a few had also benefited from other relief measures such as tax concessions; value added tax (VAT) refunds; loan repayment holiday; expedited government purchase orders; and government loan guarantees with commercial banks. It is not clear why survey respondents failed to take advantage of other benefits, since no reasons were provided.