INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/247

BOTSWANA

July 2022

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND GREEN STATEMENT BY THE EXECUTIVE DIRECTOR FOR BOTSWANA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time, following discussions that ended on May 18, 2022, with the officials of Botswana on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 7, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Green Statement by the Executive Director** for Botswana.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR22/275

IMF Executive Board Concludes 2022 Article IV Consultation with Botswana

FOR IMMEDIATE RELEASE

Washington, DC – **July 27, 2022:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Botswana and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[1]

A successful vaccination campaign, prudent macroeconomic management, and strong demand for diamonds have allowed Botswana to recover to its pre-pandemic output level. The economy grew by 11.4 percent in 2021. Fiscal and current account deficits both narrowed sharply, and foreign reserves stabilized. Inflation, however, exceeded the central bank's medium-term 3–6 percent objective range, while unemployment rose close to record highs. To combat rising inflation, the Bank of Botswana raised the newly introduced Monetary Policy Rate (MOPR) by a combined 101 basis points in April and June 2022.

Growth is projected at about 4¼ percent in 2022 and 4 percent per annum through the medium term. Relatively low fiscal buffers and continued reliance on mining expose Botswana to external shocks, such as geopolitical and climate shocks. The outlook depends on the course of the war in Ukraine, the pandemic, and implementation of fiscal consolidation and economic diversification plans. With inflation projected at 11 percent in 2022, additional monetary tightening will be required. In addition, some fiscal support may be needed to cushion the most vulnerable households from the effects of rising global inflation. Accelerated implementation of the "Reset Agenda" should help to diversify the economy towards financial services (facilitated by fintech), manufacturing, and tourism. This will also help create the jobs needed to reduce unemployment and absorb the 35,000 annual labor market entrants.

Executive Board Assessment[2]

Botswana's economy is one of the few in sub-Saharan Africa where output has recovered to its pre-COVID level. This performance has been underpinned by careful management of mineral resources and a track record of very strong policies and policy frameworks.

The recovery is expected to continue through the medium term, but there is significant uncertainty. Growth will be supported by higher prices and demand for diamonds, increased copper production, prospects for a good harvest, less COVID-19 mobility restrictions, and more international tourist arrivals. These factors and a strong fiscal adjustment will strengthen buffers, particularly those held by the government. Downside risks to this outlook relate to the

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

strength of commodity markets, China's growth, the pace of tightening of monetary policy in advanced economies, and climate shocks.

Despite the positive outlook, Botswana faces difficult challenges. Unemployment has risen close to historic highs, and poverty and inequality have worsened following the COVID-19 pandemic. With inflation above the central bank's objective range, providing support to the most vulnerable through the government social programs remains a priority in the near term. In this context, improving the targeting of social programs will reduce leakages. Over the medium term, a sustained reduction in poverty and inequality will require further progress on diversification and digitalization reforms as well as moving away from inward-looking policies such as import restrictions.

Implementing the planned medium-term fiscal consolidation will rebuild buffers and financial assets for future generations. The consolidation plan will achieve fiscal surplus over the medium term and rebuild the Government Investment Account to shield the economy against shocks and build an asset base. Successful implementation of the plan will require institutional fiscal reform, including to adopt a public wage formation framework, anchor fiscal policy in a credible medium-term fiscal framework, and formalize a new fiscal rule in National Development Plan 12. Joint ventures of identified SOEs with private sectors and efforts to close the tax gap should proceed as planned. In addition, greater transparency and accountability in spending is needed to help catalyze public support for fiscal reform and revenue collection. Public investment efficiency and the quality of public procurement need to improve to help create fiscal space.

Bringing inflation back within the Bank of Botswana's objective range will require additional monetary tightening. In the absence of further tightening, the broad-based rise in inflation risks de-anchoring inflation expectations and requiring even sharper tightening later with negative effects on growth. The newly created monetary policy rate will over time enhance monetary policy transmission and implementation. Strengthened monitoring and communication would help to limit risks of volatility in interbank rates and disruptive capital flows. Lifting the restrictions on the current prime lending rate in due course would contribute to the efficiency of financial intermediation and financial access.

The external position is broadly in line with fundamentals and desirable policies. Fiscal consolidation and higher diamond exports should strengthen the current account and support reserves accumulation. Looking forward, maintaining the current crawl rate would be appropriate as domestic interest rates rise. In addition, continuing to allow flexibility within the current exchange rate regime should help the economy adjust to shocks and facilitate structural transformation.

A successful implementation of the Reset Agenda will enhance Botswana's resilience and ensure sustained high-job rich growth. Implementation of the plan will diversify the economy towards financial services (facilitated by fintech), manufacturing, and tourism, and transform Botswana into a high-income status as per Vision 2036. Reforms should include enhancing accountability, competition, and governance, deepening trade integration, and a faster energy transition. Undue reliance on import substitution and restrictions to promote industrialization could be counterproductive.

It is expected that the next Article IV consultation with Botswana will be held on the standard 12-month cycle.

Table 1. Botswana: Selected Economic and Social Indicators, 2018–2027[1]

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.			Projection			
(Annual percent change, unless otherwise indicated)										
National Income and Prices										
Real GDP	4.2	3.0	-8.7	11.4	4.3	4.0	4.0	4.0	4.0	4.0
Mineral[2]	8.4	-3.7	-26.5	29.9	5.4	2.8	1.8	1.6	2.0	1.9
Nonmineral	2.9	5.2	-3.5	7.2	4.0	4.3	4.5	4.6	4.5	4.5
GDP per capita (US dollars)	7,556	7,247	6,349	7,337	7,510	7,765	8,193	8,622	9,130	9,627
GNI per capita (US dollars)[3]	6,853	6,867	6,357	7,326	7,169	7,326	7,651	8,071	8,568	9,052
Consumer prices (average)	3.2	2.7	1.9	6.7	11.0	5.8	4.5	4.5	4.5	4.5
Diamond production (millions of carats)	24.5	23.7	16.9	23.2	24.0	24.4	24.7	25.7	25.4	26.6
Money and Banking										
Monetary Base	17.5	5.4	-7.0	-42.1	33.2	14.3	9.4	7.9	10.1	9.0
Broad money (M2)	8.3	8.0	5.9	5.0	6.3	14.3	9.4	7.9	10.1	9.0
Credit to the private sector	6.6	7.1	5.3	5.4	10.2	10.3	9.4	9.8	9.6	9.7
(Percent of GDP, unless otherwise indicated)										
Investment and Savings										
Gross investment (including change in inventories)	25.9	30.9	32.8	28.9	28.3	29.5	29.0	29.4	29.7	30.0
Public	8.8	7.8	6.5	5.8	6.1	5.8	5.5	5.4	5.3	5.3
Private	17.1	23.0	26.3	23.1	22.2	23.7	23.6	24.0	24.4	24.7
Gross savings	26.6	23.8	25.6	30.4	30.1	32.1	33.5	34.3	35.0	35.7
Public	5.6	0.5	-4.3	0.9	4.6	6.6	7.6	7.9	7.9	7.8
Private	21.0	23.3	29.9	29.5	25.5	25.5	25.8	26.3	27.1	27.8
Central Government Finances[4]										
Total revenue and grants	30.5	28.3	26.1	31.3	31.7	32.3	32.1	31.4	30.6	30.0
Total expenditure and net lending	35.6	36.9	37.2	34.0	33.5	31.7	30.3	29.5	28.7	28.0
Overall balance (deficit –)	-5.1	-8.6	-11.1	-2.7	-1.8	0.6	1.8	1.9	2.0	2.0
Non-mineral primary balance[5]	-18.6	-19.0	-18.5	-16.2	-16.6	-11.9	-11.1	-10.5	-9.7	-9.2
Total central government debt	19.5	21.5	24.2	24.3	25.0	24.6	22.4	20.3	18.3	16.3
External Sector										
Exports of goods and services, f.o.b. (% change)	9.1	-17.3	-22.8	63.9	23.0	-0.4	12.0	5.0	4.6	4.8
o/w diamonds	9.6	-19.8	-21.8	78.3	18.0	-6.3	11.2	2.1	2.0	2.0
Imports of goods and services, f.o.b. (% change)	17.2	4.5	-3.7	23.8	6.4	-1.2	5.9	3.6	3.4	3.5
Current account balance	0.4	-6.9	-8.7	-0.5	1.7	2.6	4.4	4.9	5.3	5.7
Overall Balance	2.0	-9.5	-13.0	-3.3	0.9	1.7	2.9	3.3	3.9	4.4
Nominal effective exchange rate (2018=100)[6]	100.0	98.6	93.9	93.3	89.0	-	-	-	-	-
Real effective exchange rate (2018=100)[6]	100.0	99.2	94.6	97.6	97.6	-	-	-	-	-
Terms of trade (2005=100)	166.0	143.5	139.4	160.0	176.0	162.5	170.7	171.3	172.7	174.0
External public debt[7]	12.5	12.4	12.1	11.2	11.9	11.6	10.1	8.8	7.5	6.3
o/w public and publicly guaranteed	3.9	3.9	4.0	3.3	2.8	2.5	2.3	2.0	1.9	1.7
(Millions of US$, unless otherwise indicated)										
Gross Official Reserves (end of period)	6,657	6,172	4,944	4,806	4,968	5,292	5,892	6,639	7,584	8,744
Months of Imports of Goods and Services[8]	10.4	10.0	6.5	5.9	6.2	6.2	6.7	7.3	8.1	9.3
Months of Non-Diamond Imports[8]	13.7	13.7	9.4	8.8	8.8	8.9	9.5	10.3	11.2	12.4
Percent of GDP	41.1	36.5	31.2	28.9	27.5	27.6	28.3	29.8	31.1	33.9

Sources: Botswana authorities and IMF staff estimates and projections.

[1]Calendar year, unless otherwise indicated.

[2]The projection is based on current value added and projected growth rates by different types of minerals.

[3]Based on Atlas method from the World Bank.

[4]Year beginning April 1.

[5]The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.

[6]For 2016-2021, both effective exchange rates are from IMF INS database.

[7]Includes central government-guaranteed debt.

[8]Based on imports of goods and services for the following year.

BOTSWANA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

July 7, 2022

KEY ISSUES

Context. As of end-2021, Botswana had recovered to its pre-crisis output level thanks to a strong rebound in demand for diamonds, a successful vaccination campaign, and policy support. Fiscal and current account deficits both narrowed sharply, and foreign reserves stabilized but buffers are yet to be fully rebuilt. Inflation exceeded the central bank's medium-term objective range, while unemployment rose close to record highs. Growth in 2022 and beyond is expected to be around potential, while fiscal and external positions are projected to strengthen with more favorable terms of trade and strong fiscal consolidation. Risks to the outlook are associated with the war in Ukraine, the pandemic, and the implementation of fiscal consolidation and economic diversification plans.

The authorities' plans. The Bank of Botswana is tightening monetary policy and the government is moving ahead with fiscal consolidation focused on the wage bill, subventions, and SOE reforms that will help rebuild buffers. Structural reforms aim to accelerate economic diversification, reduce the government's economic footprint, and enhance the business environment. Measures focus on public service efficiency, digitalization, and value chain development.

Policy Recommendations.

- **Fiscal policy.** Implement planned fiscal consolidation, revamp the fiscal rule, and strengthen the medium-term fiscal framework to anchor fiscal policy. Use the higher mining revenue associated with improved terms of trade in part for saving and in part to cushion the vulnerable from the effects of rising inflation.
- **Monetary and exchange rate policy.** Continue raising the policy rate further in 2022 as needed and allow the exchange rate to adjust should downside risks materialize. Strengthen the monetary policy transmission mechanism.
- **Financial sector policies.** Maintain close financial oversight, enhance crisis preparedness, and adopt a bank resolution framework. Implement proposals for financial deepening and inclusion, including development of the government bond market, fintech, and efficiency of development banks.
- **Structural policies.** Proceed with plans to prioritize reforms and avoid reliance on import substitution and restrictions. Explore options for capturing a greater share of value-added from the tourism sector and accelerate climate change policies.

Approved By
Vivek Arora (AFR) and Andrea Schaechter (SPR)

Discussions for the 2022 Article IV consultation took place in Gaborone during May 4–18, 2022. The team comprised Papa N'Diaye (head), Nan Li and Ian Stuart (all AFR). Mses. Mannathoko and Basutli (both OED) participated in the discussions. Ms. Wang and Mr. Alsokhebr provided research and editorial assistance for the preparation of this report.

CONTENTS

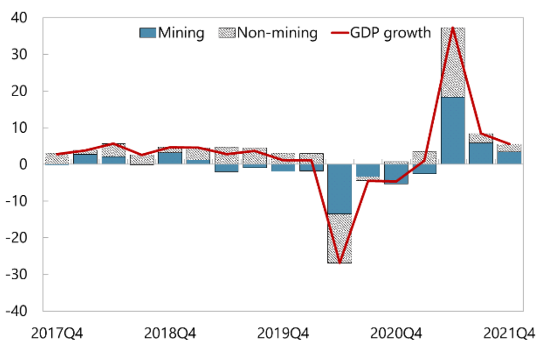
ANNEXES

CONTEXT: STRONG RECOVERY WITH LOW FISCAL BUFFERS

1. **Botswana is among the few sub-Saharan African countries where output has recovered to pre-COVID levels.** After contracting by 8.7 percent in 2020, real GDP rebounded by 11.4 percent in 2021, mainly reflecting a strong increase in diamond demand and government support. The government introduced a comprehensive vaccination campaign and fiscal relief package (2.6 percent of GDP) for households and businesses. The Bank of Botswana (BoB) reduced the policy rate to its lowest level on record and eased regulatory limits on private lending.

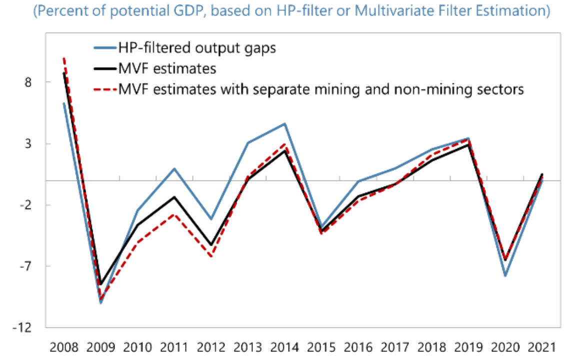
2. **Despite the recovery, the COVID-19 crisis and the war in Ukraine compound Botswana's long-standing economic challenges.** Unemployment (youth unemployment) has worsened to 26.0 (34.4) percent in 2021, up from 24.5 (32.4) percent in 2020. The poverty rate is estimated to have increased to 13.1 percent from 12 percent pre-pandemic[1], also resulting in higher inequality. Low fiscal buffers and continued reliance on mining expose Botswana to external shocks, such as geopolitical and climate shocks, increasing the urgency of economic diversification.

GDP Growth Breakdown
(Percent)



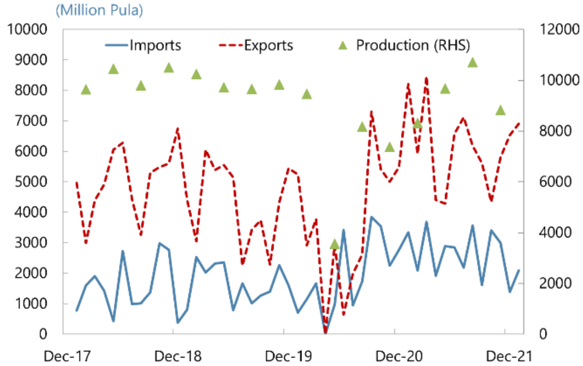
Sources: GDP Quarterly Release in Statistics Botswana, and IMF staff calculation.

Output Gap
(Percent of potential GDP, based on HP-filter or Multivariate Filter Estimation)



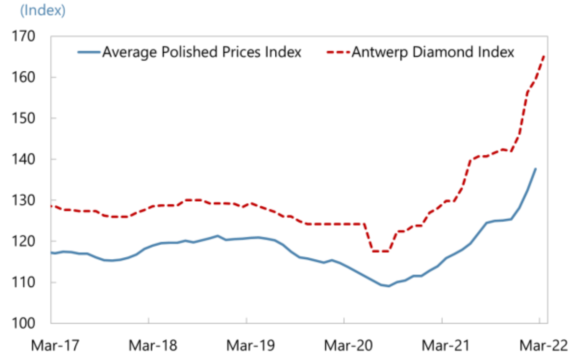
Sources: IMF staff calculation.

Botswana: Diamond Trade
(Million Pula)



Sources: International Merchandise Trade Statistics from Statistics Botswana.

Polished Diamond Price
(Index)



Sources: Bloomberg and Bank of Botswana.

[1] Based on USD1.9/day in 2011 PPP terms.

RECENT ECONOMIC DEVELOPMENTS

3. **Botswana's vaccine rollout has been among the fastest in SSA with over 95 percent of the eligible population fully vaccinated as of May 2022** (Figure 1). The COVID-19 health situation was well managed from the start. A State of Emergency was in place from April 2020 to September 2021, imposing mobility restrictions and social distancing measures. Learning loss, however, was limited (only 22 days of schooling lost due to lockdowns) as the government adopted a double-shift system and launched several remote learning programs. An additional allocation of P2 billion was made in the 2022 budget to cover further vaccine rollout and booster shots. The government also plans to build a vaccine manufacturing plant.

4. **Annual CPI inflation averaged 6.7 percent in 2021 and 10.5 percent during January-May 2022** (Figure 2). Inflation pressure mainly reflects higher imported inflation. Core inflation (excluding food and fuel) averaged 5.9 percent in 2021 and 6.5 percent in the first quarter of 2022.

5. **The fiscal deficit narrowed sharply in FY2021–22, to 2.7 percent of GDP from 11.1 percent of GDP in FY2020–21, due to higher revenue and lower expenditure to GDP ratios** (Figure 3). The rise in revenue reflected elevated diamond sales and substantial domestic revenue mobilization. Compared to FY2020–21, non-mining/non-SACU revenue rose by 1½ percent of GDP as the authorities raised the VAT rate, fuel levy, and withholding tax rate on dividends, and strengthened tax administration.[2] On the expenditure front, the wage bill was contained in nominal terms, while capital expenditure undershot the budget. The deficit was financed through external concessional financing, domestic bond issuance, and large exceptional revenue from the BoB. The Government Investment Account (GIA) increased to 5.7 percent of GDP from 3 percent in FY2020–21, yet still well below the pre-pandemic average of 18 percent of GDP.[3]

6. **The BoB raised the newly introduced Monetary Policy Rate (MOPR) in late-April and June 2022 by a cumulative 101 basis points.** The previous Bank Rate, which was at a record low for the previous 18 months, played a signaling role but was not always indicative of liquidity conditions in the market. The seven-day BoB certificate (BoBC) rate, by contrast, was closely correlated with interbank lending rates. To strengthen monetary policy transmission, the BoBC rate replaced the Bank Rate as the new monetary policy rate.

7. **The financial sector appears resilient, and banks are well capitalized** (Figure 4). Commercial bank credit grew by 5.1 percent in 2021 from 4.5 percent in 2020, while non-performing loans (NPLs) remained at 4.2 percent of total loans at end-2021. Although the level of household debt is relatively low at 23.4 percent of GDP, the high share of credit to households (65½ percent) remains a concern as these loans are mostly unsecured. In addition, NPL levels may not yet reflect the full effects of the pandemic on business owing to the crisis-related regulatory

[2] The VAT efficiency increased by 1.4 percent (measured as percent of private consumption) in FY2021/22 compared to FY2020/21.

[3] The Pula Fund (the sovereign wealth fund that includes both BoB's share and the GIA) remained broadly stable at USD 4 billion or 24 percent of GDP.

forbearance measures. Liquidity conditions have tightened and funding costs, particularly for smaller banks, are increasing.

8. **The external position improved in 2021 due to strong diamond exports and lower net capital outflows** (Figure 5). The current account deficit narrowed to ½ percent of GDP from 8.7 percent in 2020. While diamond exports rebounded, imports (especially of fuel, food, and diamonds) also increased and, together with large portfolio outflows, contributed to a slight fall in reserves to USD 4.8 billion (6 months of imports or 205 percent of the standard ARA metric) at end-2021, despite the recent SDR allocation of USD 189 million and positive valuation effects. The BoB maintained the downward crawl rate at 2.9 percent throughout 2021, resulting in a broadly unchanged REER.

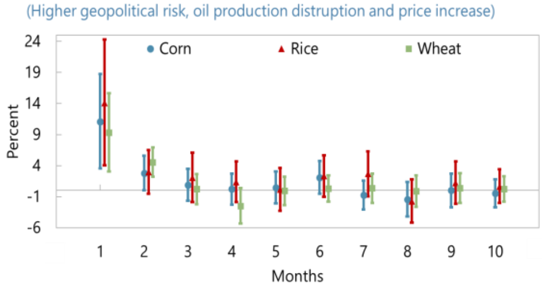
OUTLOOK AND RISKS

9. **Growth is expected to moderate to 4¼ percent in 2022 and settle at its potential rate of 4 percent from 2023.**[4] The broad-based recovery is predicated on strong growth momentum from 2021H2, higher diamond prices and copper production, international tourist arrivals, rainfall, and accommodative monetary conditions. These factors are partly offset by the effects of the war in Ukraine, the planned fiscal consolidation, and some erosion in real incomes from higher food and energy costs.

10. **Inflation pressure is expected to remain elevated in the near term—reflecting higher administered prices, energy, and food costs—before abating towards end-2022.** Inflation is projected at 11 percent in 2022 and 5.8 percent in 2023. The high share of transport and food in Botswana's CPI basket (24 and 14 percent respectively) will weigh on vulnerable households.[5]

War in Ukraine and Food Prices in Botswana

(Higher geopolitical risk, oil production distruption and price increase)

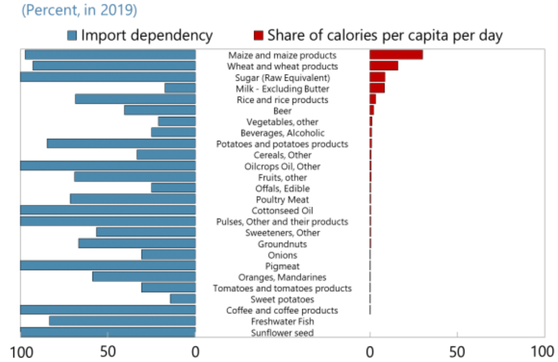


Notes: The chart shows the impulse response functions from a set of VAR models with sign restrictions, following a 10 percent increase in a geopolitical risk index. The dots denote median estimates with the range indicating the 95 confidence intervals.

Sources: Abdel-Latif and El-Gamal, "Fuel and Fire: Geopolitics of Oil and Food Prices." Forthcoming IMF working paper.

Food Dependency and Share of Calories By Items

(Percent, in 2019)



Sources: FAOSTAT, and IMF staff calculation.

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[4] Based on a sample period of 1995–2021, staff estimates the steady-state potential growth to be 4 percent. Potential growth for the medium term is different from long-term growth (Annex V), which considers a longer horizon.

[5] Almost 90 percent of Botswana's food imports come from South Africa. Ukraine and Russia do not directly export to Botswana. Dependency on fertilizer imports is relatively low in Botswana.

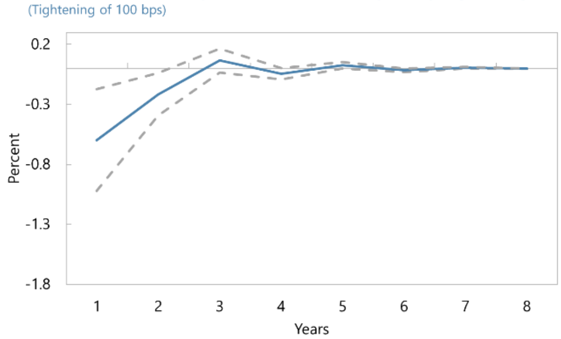
11. A sizable fiscal consolidation envisaged through the medium term should further improve the external position. Expenditures are projected to fall by 2¼ percent of GDP through FY2022–24 owing to a lower wage bill (-1½ percent of GDP) and less transfers and subventions (-¾ percent of GDP). Tax measures introduced in FY2021–22 together with higher SACU transfers will also narrow the deficit. The external position will be further supported by strong diamond production, favorable terms of trade, improvement in tourism, and smaller portfolio outflows. Reserves are projected to increase at a moderate pace over the medium term.

12. The outlook is highly uncertain.

- **The growth outlook heavily depends on the path of commodity prices.** In particular, an abrupt growth slowdown in China or a protracted war in Ukraine could weaken global demand, lowering demand for diamonds. However, prolonged sanctions against Russia, the world's largest rough diamond producer, could increase demand for and prices of Botswana's diamonds.[6]

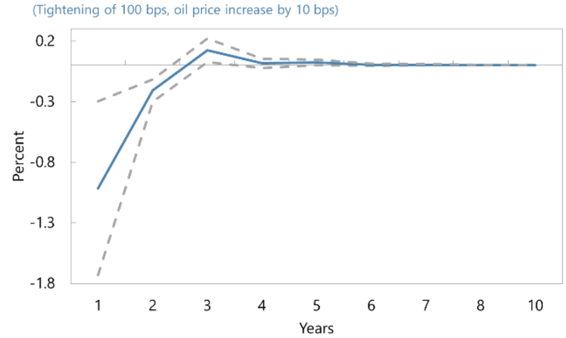
- **Other external risks include outbreaks of more lethal and contagious COVID-19 variants, faster tightening of monetary policy in key advanced economies, and climate shocks.** These could, respectively: hamper tourism and the associated recovery; trigger volatility in global markets and capital flows, exert pressure on reserves, and reduce the demand for diamonds; and threaten agriculture, mining, and tourism.

Botswana Growth Responses to US Monetary Policy Tightening
(Tightening of 100 bps)



Notes: The solid line shows median estimates with the range denoting the 95 confidence intervals.
Sources: Hany Abedel-Latif, Aqib Aslam, Marijn Arend Bolhuis, and Henry Axel Rawlings, "External Shocks and Spillovers in Sub-Saharan Africa." Forthcoming IMF working paper.

Botswana Growth Responses to US Tightening and Higher Oil Prices
(Tightening of 100 bps, oil price increase by 10 bps)



Notes: The solid line shows median estimates with the range denoting the 95 confidence intervals.
Sources: Hany Abedel-Latif, Aqib Aslam, Marijn Arend Bolhuis, and Henry Axel Rawlings, "External Shocks and Spillovers in Sub-Saharan Africa." Forthcoming IMF working paper.

- **Domestically, shortfalls in planned fiscal consolidation could further erode buffers.** This would expose Botswana to external shocks, which would require a sharper adjustment with attendant negative effects on growth. On the upside, a successful implementation of the consolidation plan and Economic Recovery and Transformation Plan (ERTP) would diversify the economy and lift medium-term growth prospects (Annex V, 2020 Article IV).

[6] Empirical estimates suggest an elasticity of Botswana's growth to demand from trading partners of 1.8. Relative to the pre-war baseline, staff estimates the war in Ukraine has a small impact on Botswana's growth (-½ ppt in 2022 and -¼ ppt in 2023).

Authorities' Views

13. The authorities broadly agreed with Staff's outlook and risks assessment. They cautioned that the war in Ukraine could support demand for synthetic diamonds. They vowed to use digital technologies to improve the traceability of diamonds sourced in Botswana.

POLICIES TO ENSURE DURABLE GROWTH AND REBUILD BUFFERS

A. Macroeconomic Policies

Fiscal Policy

14. The authorities aim to rein in government spending, better align it with development objectives, and restore fiscal buffers to pre-COVID levels. Revenue measures include raising fees and services charges and improving tax administration (through review of taxation laws, use of ICT, and increased tax audits) starting from FY2022–23. On the expenditure side, the authorities have agreed with three public service trade unions on an across-the-board annual salary increase of five percent for FY2022–25. Other cost containment measures include savings on vacancies, allowances, and overtime, and cutting subventions to SOEs through rationalization. In particular, the government has started restructuring and rationalizing ministries and SOEs to reduce the overlapping mandates and improve efficiency, including finding private sector partners to some SOEs[7]. Finally, the authorities aim to target social spending better, improve the public investment management framework (relying more on PPPs), and strengthen accountability and governance.

15. Relative to the budget, social transfers will need to increase temporarily to help the most vulnerable households cope with the spillovers from the war. Staff estimates this additional support at P500 million in FY2022–23. This could be paid for in part by higher mining revenue and will have a negligible impact on the 2022 fiscal deficit. Beyond 2022, as energy and food prices ease, the additional pressure on the budget will fall.

16. The envisaged pace and composition of fiscal consolidation are appropriate but fiscal reform will be needed to contain considerable implementation risks. The large adjustment in FY2020–21 provides a good basis for the future strengthening of the fiscal position.

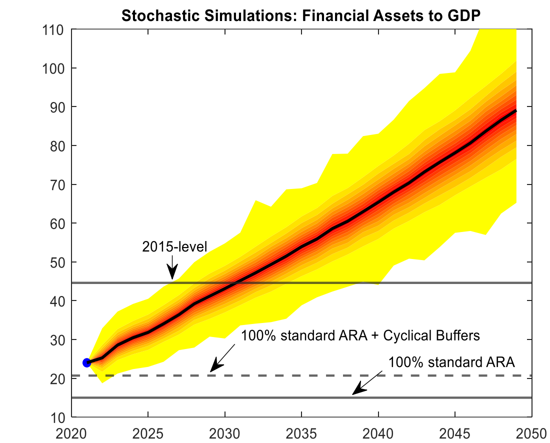
- *Fiscal consolidation will help rebuild buffers against future shocks and deliver meaningful intergenerational transfers*. Staff simulations show that under the baseline medium-term fiscal consolidation plan, the fiscal position will turn into surplus by 2024 and the financial assets in the Pula fund could be replenished by 2031. This would provide Botswana enough

[7] The rationalization plan also includes streamlining the mandates of some SOEs (e.g., National Development Bank to focus only on agriculture) and introducing private sector partners to others (e.g., Botswana Savings Bank, National Development Bank, Botswana Meat Commission, Air Botswana). The National Development Planning portfolio has been moved from the Ministry of Finance to the Office of the President, under the newly created National Planning Commission.

buffers against mining and SACU revenue shocks within the 75th percentile of the historical distribution and help keep reserves above 100 percent of the ARA metric. In this context, staff recommends that part of the higher-than-expected mining revenue be used to support the most vulnerable households, while saving the rest.

- *Containing the wage bill is key for consolidation and structural transformation*. The government's latest wage agreement with trade unions was above the budgeted amount for FY2022–23. While the wage agreement leaves cumulative wage increases during 2019–2024 broadly in line with productivity growth, Botswana's wage bill is higher than other middle-income countries and the average for sub-Saharan Africa, and public sector wages in the upper segments of the pay scale are high compared to the private sector.[8] This weighs on the fiscal balance and reduces incentives for labor and capital to move to the private sector, hampering structural transformation.

An Illustrative Example of Financial Assets Accumulation

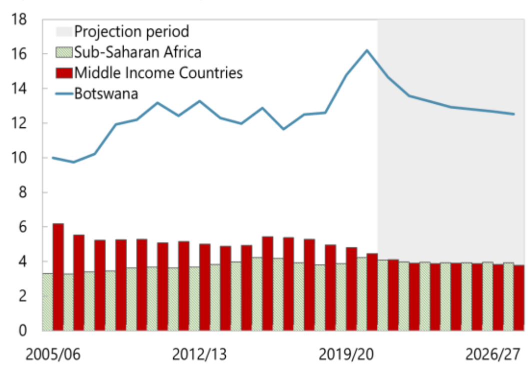


Source: Staff calculation.

Notes: Given the estimated stochastic shocks to mining and SACU revenues, additional buffers of about 3–5 percent of GDP would be needed to deal with negative shocks of the size above the 75th percentile. The simulations assume baseline fiscal consolidation throughout the medium-term, nominal return on asset of 9 percent, growth at potential in the long-term, and debt stabilizing at its 2027-level.

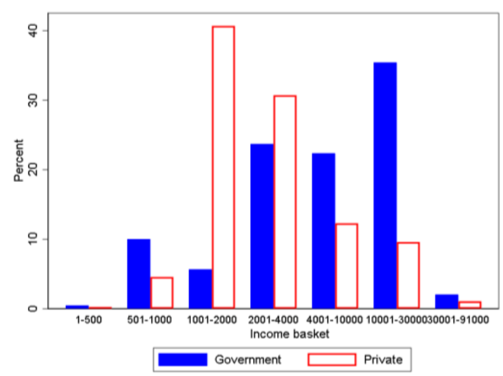
Botswana Wage Bill to GDP Ratio

(Percent of Fiscal Year GDP)



Sources: IMF WEO database, and IMF staff calculation.

Botswana Job Distribution over Salary Baskets, Public vs. Private



Sources: 2020 Quarterly Multi-Topic Survey: Labor Force Module Report Q4, IMF staff calculation. Income basket is defined in terms of Pula.

- *A framework for public wage formation is needed*. This includes (i) adopting an evidence-based approach to pay-setting policies, by relying on an independent pay review body; (ii) improving the wage bill management by linking pay to performance, awarding grade

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[8] Staff estimates an average public wage premium at 42 percent using data from Quarterly Multi-Topic Survey (2019Q4), and the traditional Mincer equation with propensity score matching method.

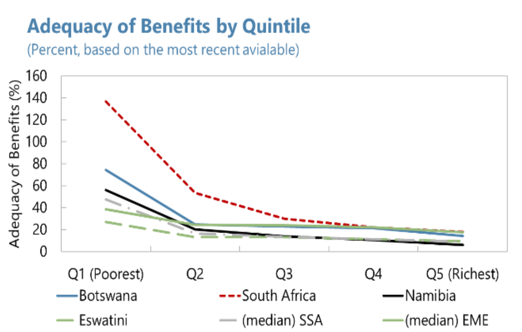
progression only in the context of competitive promotion and notch increments as part of performance appraisal; (iii) rationalizing the complex system of allowances;
(iv) strengthening human resource management; and (v) developing a communication strategy to promote buy-in.

- *Anchoring the consolidation plans in a credible medium-term fiscal framework (MTFF) would support countercyclical policy and intergenerational transfer*. This requires formalizing a new fiscal rule to provide a long-term source of income to partially replace depleted mineral assets and build enough buffers to counter shocks. An expenditure rule, combined with a floor on liquid financial assets, can achieve these objectives (Annex V). Such a fiscal rule should be included as part of National Development Plan (NDP) 12 and given a strong legal basis to support implementation.

17. The authorities' planned improvements to governance and accountability should raise returns on investments and sustain domestic revenue mobilization. Staff supports the plans to digitalize the provision of public services through e-government, improve public procurement and project implementation, and increase fiscal transparency. The restructuring of government ministries should help enhance efficiency and service delivery, but it is paramount that oversight and accountability be maintained at all levels, especially in the selection and financing of public investment projects. Audited financial statements of parastatals should be published regularly. Targeted public investment could promote climate resiliency while facilitating private sector growth.

18. Social benefits should be better targeted to reduce leakages to high-income households. Staff welcomes progress on the modernization of the social protection system, including through the Single Social Registry (a digital platform for registration and determination of eligibility) and the implementation of the Proxy Means Testing (for identification of beneficiaries). This should lead to a better targeted safety net. However, as inflation pressure persists, social spending could weigh significantly on the budget.

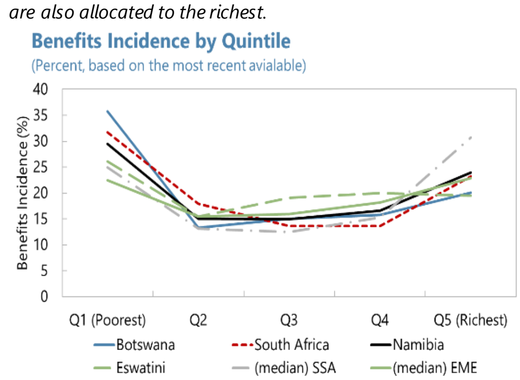
Botswana's social spending is higher than most comparators.



Sources: IMF FAD Social Protection & Labor - Assessment Tool (SPL-AT).

Note: Adequacy of benefits (%) is defined as the total transfer amount received by all beneficiaries in the population (or pre-transfer (pre-T) quintile) as a share of the total income/expenditure of beneficiaries (in that quintile). The indicator is estimated by program type and by quintiles of the pre-transfer welfare distribution.

While the poorest receive the highest share of benefits, sizable resources are also allocated to the richest.

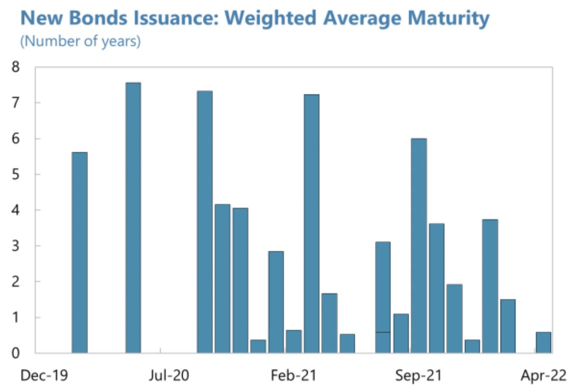


Sources: IMF FAD Social Protection & Labor - Assessment Tool (SPL-AT).

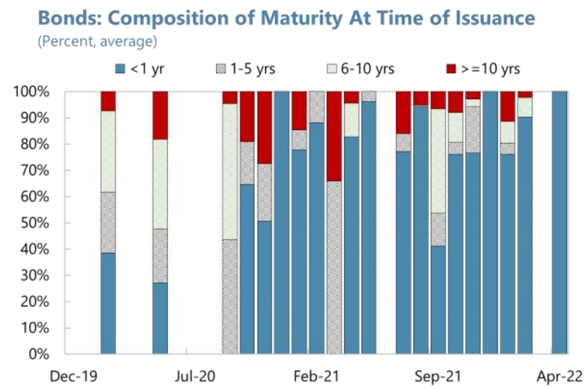
Note: Beneficiary incidence is defined as percentage of program beneficiaries in a quintile relative to the total number of beneficiaries in the population. The indicator is estimated by program type and by quintiles of the pre-transfer welfare distribution.

19. The tax base needs to be diversified over time to reduce Botswana's dependence on mineral and SACU revenue. Domestic revenues only cover about 35 percent of government expenditure, exposing the fiscal position to high external risks. Potential diversification measures include raising property tax rates and coverage (which requires accelerating land registration and improving valuation) and countering international tax avoidance[9].

20. The strategy for financing the fiscal deficit should slow the erosion of fiscal buffers and deepen the domestic bond market. Ongoing budget support from the World Bank, the AfDB, and Government of Japan and domestic bond issuance reduce the need to draw down buffers in FY2022–23. Furthermore, the planned regular issuance of medium- and long-term maturities helps to build the yield curve, support secondary market development, and reduce government's financing costs. But additional efforts to enhance the efficiency and liquidity of the domestic bond market are required, including a robust medium-term debt strategy. The introduction of inflation-linked bonds, currently under consideration by the authorities, could assist in this regard.



Sources: Bank of Botswana.



Sources: Bank of Botswana.

21. Stronger fiscal management is needed to contain risks, including contingent liabilities from public-private partnerships (PPPs). The authorities have incorporated fiscal risk analysis into the budget process with technical assistance from the Fund. However, there is a need to enhance capacity and adopt an appropriate legal and institutional framework to safeguard public finances risks arising from PPPs. Public financial management (PFM) systems could be strengthened by incorporating risk analysis (including climate risks) into the MTFF and broadening fiscal statistics to include local government, special funds, and extra-budgetary entities.

Authorities' Views

22. The authorities broadly agreed with staff's recommendations and emphasized their strong commitment to support the most vulnerable and to fiscal consolidation. The authorities highlighted that the 2022 budget has already increased allocations for social welfare programs, but they will continue to monitor the inflationary impact of the war in Ukraine on the vulnerable. If needed, additional measures to counter the impact would be introduced through existing safety mechanisms and would be temporary and targeted. In the context of planned fiscal consolidation,

[9] With assistance from the Fund, the authorities are working on updating the Income Tax Act to address gaps that offer opportunities for avoidance (e.g., transfer pricing) and the VAT Act to incorporate the taxation of the digital economy.

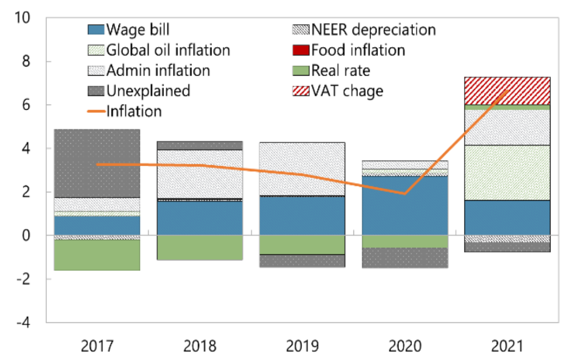
they noted that although the recently announced wage settlement is above the budgeted amount, it keeps nominal wage increases in line with cumulative inflation over the last decade, and importantly, reduces the uncertainty in the spending pressure in the run-up to the 2024 national election. To contain the overall wage bill and improve productivity, they plan to eliminate half of existing vacancies and implement a skills audit to ensure proper allocation of human resources. In addition, they emphasized that the government restructuring would help broaden the planning process without undermining the Ministry of Finance's expenditure oversight, and that all checks and balances would remain in place. In this context, they mentioned that a three-stage appraisal and selection method for major capital projects will be adopted in the planning for NDP12 to address the high efficiency gap in development spending.

Monetary and Exchange Rate Policy

23. Monetary policy faces difficult trade-offs in the near term between reducing inflation pressures and supporting the recovery. In recent years, inflation has been driven by the public wage bill, administered prices, and global oil prices. Inflation pressures from food and energy costs could last longer than envisaged as the war in Ukraine unfolds, with a risk of expectations becoming unanchored. Meanwhile, advanced economies' monetary policy normalization and the war could weaken global demand and undermine the domestic recovery.

Inflation Determinants

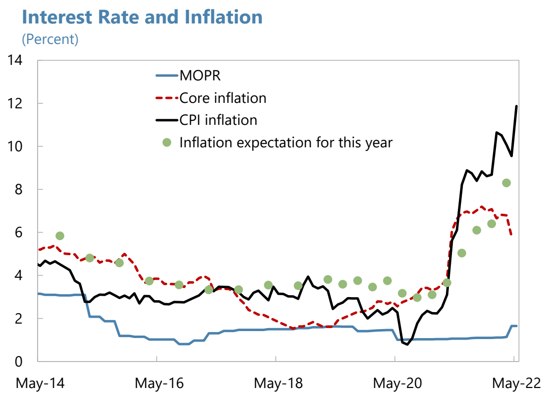
(Percent of inflation)



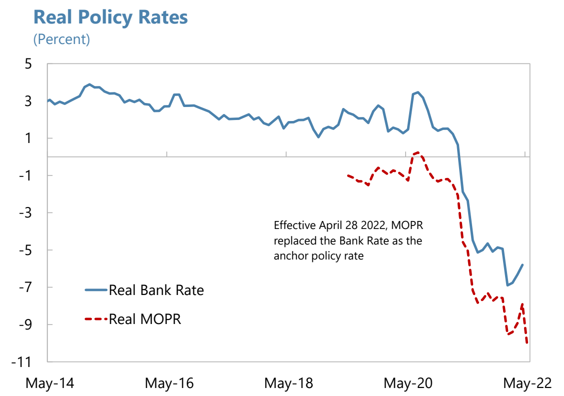
Sources: IMF staff estimates.

24. The BoB's rate increases in April and June were appropriate, and additional tightening will be needed going forward. Inflation expectations for 2023 have risen above 7 percent; real interest rates remain strongly negative despite the recent hikes; and the strong rebound in 2021 has helped bring output closer to potential (Annex VI). Thus, in the absence of further tightening, the broad-based rise in inflation risks de-anchoring inflation expectations, which – if it were to occur – would erode households' purchasing power, worsen poverty, and require an even sharper tightening later with negative consequences for growth and employment.

25. Over time, the monetary reform will enhance the transmission and implementation of monetary policy. Staff welcomes the transition from the bank rate to the MOPR and recommends enhanced communication around this transition. The BoB will need to closely monitor interbank rates and capital flows to assess the appropriateness of the level of the MOPR. The restrictions on the current prime lending rate – introduced as part of the transition process – should be lifted in due course as they could undermine the efficiency of financial intermediation and harm financial access. Conducting regular open market operations at fixed-rate full-allotment and complementing these actions with fine-tuning operations should smooth volatility. Staff recommends fostering the development of the unsecured interbank and REPO markets to strengthen monetary policy transmission.



Sources: Bank of Botswana
Note: Data for the 7-day BoBC rate starts in May 2019 and data before that are for the 14-day BoBC rate.



Sources: Bank of Botswana, and IMF staff calculation.
Note: The 7-day BoBC rate replaced the Bank Rate as the policy rate in April 2022. The real rate is calculated by subtracting monthly CPI inflation from the nominal rate.

26. **The external position is broadly in line with fundamentals and desirable policies.** For 2021, the REER and CA gaps are estimated at 1½ percent and -½ percent of GDP, respectively (Annex I). Fiscal consolidation and higher diamond exports should strengthen the current account and support reserves accumulation. Capital outflows, however, have increased in recent years and are likely to remain strong, largely reflecting offshore investing by pension funds. The Net International Investment Position (NIIP) stood at 37.7 percent of GDP in 2021 and is projected to increase over the medium term. Reserves remained above the ARA metric adequacy levels and are projected to strengthen. Looking ahead, maintaining the current crawl rate would be appropriate as domestic interest rates rise. This, together with a clear communication of monetary policy actions, should help keep inflation expectations anchored. In addition, continuing to allow flexibility within the current exchange rate regime should help the economy adjust to shocks, while facilitating structural transformation.[10]

Authorities' Views

27. **The authorities broadly agree with the staff proposals but are still considering the merits of additional monetary tightening.** The BoB considers inflation pressures as temporary and supply-driven, and views monetary accommodation as necessary to support the recovery. They argue that much of the inflation increase is attributable to higher imported fuel and food prices, while the relative weak non-diamond economy is indicative of weak demand-side inflation. The BoB expects inflation to return within the 3–6 medium-term objective range in the third quarter of 2023.

Financial Sector Policies

28. **The financial sector appears sound, but risks need to be managed.** Credit growth, NPLs, market liquidity and house prices all fall within acceptable risk limits. The financial sector has remained profitable, despite the impact of the pandemic. At end-2021, average return-on-equity of

[10] For a more detailed discussion of flexibility in the exchange rate regime, see the 2019 Botswana Article IV report

commercial banks stood at 21.6 percent, with NPLs at 4.3 percent of gross loans. Nevertheless, some risks remain:

- The authorities have removed most COVID-19 crisis-related regulatory forbearance measures but the lower Capital Adequacy Ratio (CAR) and Prudential Reserve Requirements (PRR) remain in place. Returning the CAR to 15 from 12.5 percent is unlikely to have a significant effect, given banks' existing adequacy ratios. But increasing the PRR for commercial banks from 2.5 to 5 percent could reduce liquidity and increase funding costs, particularly for smaller banks. While both changes are still under consideration, they could add to the liquidity pressures created by continued portfolio outflows and the weak recovery in foreign direct investment.

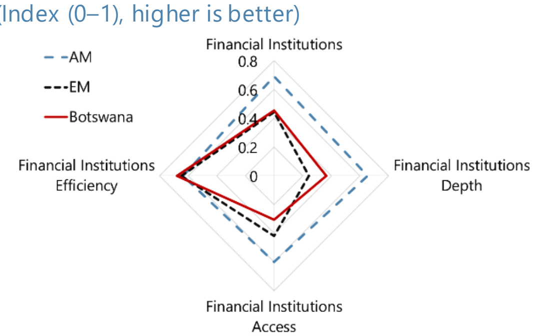
- Credit to households continues to dominate commercial banks' lending portfolio and is mostly concentrated in unsecured lending. With many households relying on income related directly or indirectly to government operations, there is a strong sovereign-banks nexus. In addition, several state-owned development financial institutions are not profitable.

29. Staff recommends close monitoring of risks and recording and provisioning for NPLs. In addition, the authorities should review the remaining forbearance measures and the implications of removing them. There is a need to enhance the crisis preparedness and resolution frameworks. In this regard, staff supports expediting the amendment of the Banking Act and operationalizing the deposit insurance mechanism. These topics will be explored more fully in the Botswana Financial Sector Assessment Program (FSAP) which commences in June 2022 and is anticipated to be completed by end-May 2023.

30. There is room to further deepen the financial system. The domestic securities market remains underdeveloped. Historically, banks primarily extended credit to households and invested in short-maturity BoBCs, in part reflecting a low demand for credit as well as gaps in the availability of collateral. With the passage of draft legislation, some progress has been made towards the planned 2024 deadline for implementing a collateral registry for movable assets, but additional measures are needed, including the establishment of a land registry and improving valuation.

Financial Institution Development, 2019

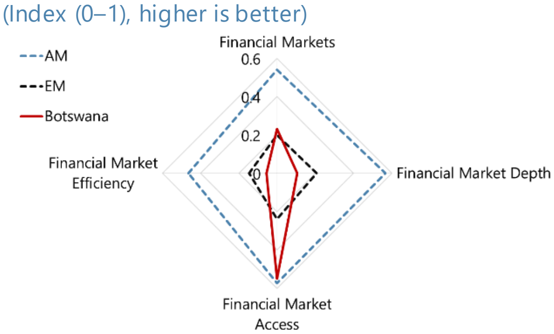
(Index (0–1), higher is better)



Note: Financial institutions include banks, insurance companies, mutual funds, and pension funds. The dataset is maintained by the IMF SPR department.
Souce: IMF Financial Development Index.

Financial Market Development, 2019

(Index (0–1), higher is better)



Note: Financial markets include stock and bond markets. The dataset is maintained by the IMF SPR department.
Souce: IMF Financial Development Index.

31. Fintech has increased the reach of the banking sector, but more progress is needed. Staff welcomes the BoB's plans to assess the potential impact of fintech on the national payments system and central bank monetary policy transmission (including through digital currency). Staff agree with the authorities that establishing a national switch (routing electronic transactions to a central point for settlement instead of through a network of different payment systems) could promote financial inclusion by reducing costs and time of mobile transactions.

Authorities' Views

32. The authorities are in broad agreement with the staff recommendations. The authorities are keeping regulatory forbearance measures in place and will monitor the situation closely. They reiterated their commitment to expanding fintech, modernizing national payments system, and improving interoperability between financial institutions and the availability of collateral. The authorities' and staff's views are aligned on crisis resolution and deposit insurance and progress is being made in implementing these reforms. The authorities welcome the forthcoming FSAP mission.

B. Structural Policies

33. The government seeks to prioritize structural reforms. The "Reset Agenda" prioritizes public service reforms, digitalization, and value chain development (with initial sectoral focuses on minerals, tourism, food, and education).

34. Accelerating implementation of the "Reset Agenda" is key to transforming Botswana into a high-income economy by 2036. Sustaining the necessary 5 to 6 percent average annual growth to attain the goal requires developing new sources of durable growth outside the mining sector (e.g., financial services facilitated by fintech, manufacturing, and tourism). This will also help create the jobs needed to reduce unemployment and absorb the 35,000 annual labor market entrants. The reforms should be supported by the following:

- *Enhancing accountability, competition, and governance.* Higher probability of success requires performance targets, promotion of competition, and a focus on exports. Staff welcomes the introduction of an annual review of the implementation of the government reform agenda. These efforts should be supported by improved governance, including complementary reforms to control rent-seeking and corruption.

- *Avoiding reliance on import substitution and restrictions to promote industrialization* (Box 1). Recent restrictions on selected food and beverage imports have created shortages in the domestic market, increased prices, and reduced the welfare of domestic consumers. Cross-country evidence on the success of such import substitution policies is weak, often leading to rent seeking and stunting the development of other industries. Targeting infrastructure, attracting FDI, providing R&D subsidies, and supporting start-ups have often proven effective in developing new industries when complemented by broader reforms to improve the business and macroeconomic environment. In this context, planned visa and work permit reforms to meet the skills needed by businesses should be implemented.

- *Deepening trade integration, including through the AfCFTA, could provide significant benefits (*SSA REO, 2019; Abrego et al., 2020).[11] Reaping those benefits requires broadly open trade policies at home, accelerating technological and quality upgrade (for certification), improving trade-supporting infrastructure (e.g., reforming the network and electricity industries), strengthening export and investment promotion institutions, and coordination of policy implementations.

Box 1. Import Restrictions and Implications for Development

Since January 2022, the Botswana authorities have restricted the imports of certain vegetables and beverages to develop domestic value chains and improve food security. This forms part of broader citizen empowerment initiatives, which include localization, job reservation and public procurement restrictions. The food restrictions will be reviewed on a biennial basis.

Trade restrictions tend to hinder the development of competitive domestic industries. Structural constraints often play an important role in impeding competitiveness, including high input costs (reflecting other inefficiencies in the economy), poor infrastructure, financial constraints, and a restrictive regulatory environment (Cherif and Hasanov, 2019a).[1] In the current environment of high food inflation, these restrictions are likely to add pressure on households. Other role-players higher up the value chain (e.g., hotels and restaurants) have already felt the effects of fewer goods, lower quality, and higher prices.

Successful industrial policy interventions typically: (i) fix market failures that preclude the emergence of domestic producers in sophisticated industries, (ii) are export oriented, in contrast to the typical failed inward-looking mostly based on import substitution (Irwin, 2020)[2], and (iii) pursue competition both abroad and domestically with strict accountability (Cherif and Hasanov, 2019b) [3]. Countries that have successfully moved from middle- to high-income status, like Korea, are defined by the creation of technologies by domestic firms and a push to leapfrog to the technological frontier at an early stage of development.[4]

Internationally, targeted infrastructure, R&D subsidies, and support for start-ups appear in many cases to have proved effective for supporting specific industries. Accountability can be achieved by setting clearly defined responsibilities, clear performance criteria and sunset clauses (SSA REO 2021).[4]

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[1] Cherif, R. and Hasanov, F. 2019a. The Return of the Policy That Shall Not Be Named: Principles of Industrial Policy. IMF Working Paper WP/19/74.
[2] Irwin, D. 2020. The Rise and Fall of Import Substitution. Peterson Institute for International Economics Working Paper 20–10.
[3] Cherif, R. and Hasanov, F. 2019b. The Leap of the Tiger: Escaping the Middle-income Trap to the Technological Frontier Global Policy Volume 10. Issue 4.
[4] IMF. 2021. Regional Economic Outlook: Sub-Saharan Africa. April.

35. The travel and tourism sector, which accounts for a high share of exports earnings and employment, needs a clear strategy for the post-pandemic world.[12] Gaining higher tourism earnings may require securing a greater share of the value chain. Some companies have achieved

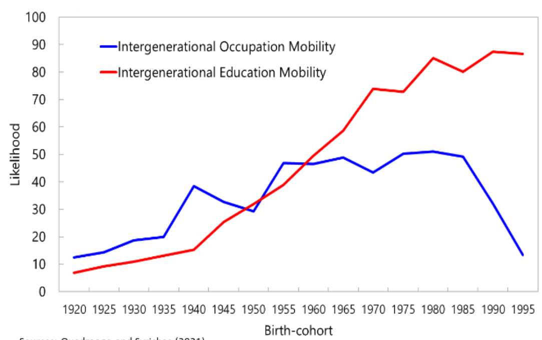
[11] Implementation of the AfCFTA Agreement has been delayed owing to outstanding negotiations on the Rules of Origin (88 percent of total tradable products agreed) and tariffs. Botswana is among 11 countries out of 54 that have not yet ratified the agreement. A draft National Implementation Strategy has been developed, with assistance from United Nations Economic Commission for Africa (UNECA).

[12] The UNWTO and the Ministry of Tourism of Botswana are collaborating on a National Tourism Strategy and Master plan for 2022–2032.

this by shifting services onshore using digital technologies. Continuing supporting eco-tourism is warranted as it is a fast-growing, resilient, and high value-added industry (Annex VII).

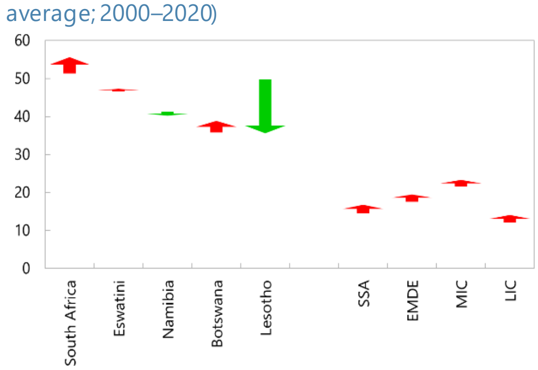
36. The COVID-19 crisis has stalled poverty reduction, and inequality remains high. It has caused net job loss of 46,577 through 2021Q4. The authorities' plan to increase social spending and strengthen the social protection system by improving its efficiency and targeting is commendable. But without successful diversification of the economy, job creation will be too slow to absorb the young, educated, and growing labor force, and economic gains will remain skewed.

Intergenerational Upward Mobility by Birth-Cohort
(Percent)



Sources: Ouedraogo and Syrichas (2021).
Note: The intergenerational upward mobility of education (occupation) shows the average probability of children, aged 14+ born from non-educated parents (parents occupied in agricultural sector) to complete primary school (be occupied in a non-agricultural job).

Youth Unemployment
(Percent; share of total labor force ages 15–24; simple average; 2000–2020)



Note: Data for a given year are averaged over the year and the previous four years.
Sources: World Bank, World Development Indicators database.

37. Staff welcomes the authorities' efforts to adapt to climate shocks (Figure VI). Botswana Climate Change Policy prioritizes adaptation and mitigation measures to support food security, job creation and protection of carbon sinks. Staff welcomes the licensing of one of the two planned 50 megawatts of renewable energy projects and encourages the government to accelerate its plan to increase renewable power generation, reduce fossil fuel subsidies, and introduce carbon taxes.[13] Developing a pipeline of projects and getting accredited though improved PFM measures could help unlock more resources from climate funds. Climate financing could also be mobilized through green bonds and setting up carbon credit markets (Annex VIII).

38. Staff supports the authorities' efforts to accelerate Botswana's transition to a digital economy, including implementing the Smart Botswana Strategy to digitalize public service delivery (e.g., building a responsive public service by aggregated data portal from all ministries), leveraging smart technologies to address food security, and digitalizing education. Other efforts include the recently launched National E-Commerce Strategy, which promotes digital technology in commercial and public spaces, and the significant progress made in internet penetration.

[13] Together with the World Bank, Botswana has secured funding to support the design and implementation of a carbon tax. However, no specific implementation timeline has been established yet. The government is also currently updating its Nationally Determined Contribution in line with its commitment to the Paris Climate Agreement.

Authorities' Views

39. The authorities view restrictions on imports of food and vegetables as a necessary step to reduce food import dependency and support domestic producers. The authorities noted that large annual imports of food have weakened the external position, caused high food reliance on other countries, and discouraged domestic production. As part of the citizen empowerment focus, the program is also meant to create jobs and increase competitiveness of the agricultural sector. Food shortages were most apparent during the first few months, but situation has been stabilizing. They agreed that they would closely monitor the food situation and adapt if needed. They noted that the restrictions will be reviewed biannually.

OTHER SURVEILLANCE ISSUES

40. Staff commends Botswana's decision to prioritize the fight against corruption. Further efforts are needed to address conflict of interests when public officials hold private businesses. This includes introducing a system to detect and prevent conflict of interests for public officials in line with international best practices, as well as implementing a strong institutional framework and good practices and processes. Staff urges the authorities to publish the execution and audit reports of the COVID-19 Relief Fund Order and all related procurement contracts, including beneficial owner information of companies awarded public contracts.

41. Data provision is broadly adequate for surveillance. The authorities have continued to improve statistics, with adequate support from AFRITAC South and IMF. Notable progress includes rebasing national accounts estimates to 2016, constructing supply and use tables, and compiling monetary statistics for other financial corporations. Staff urges the authorities to quickly move to GFSM 2014. In addition, data gaps on government financial statistics need to be closed, including classification of current and capital expenditures, local government, special funds, and extra-budgetary entities (including SOEs).

42. The Financial Action Task Force removed Botswana from its list of jurisdictions under increased monitoring (the "grey list") in October 2021. This removal could further boost confidence, attract capital inflows, and support economic activity. The authorities have taken additional steps to improve AML/CFT supervision. Staff welcomes the amendment of the Financial Intelligence Act, in particular to reinforce the provisions on beneficial ownership information and encourage the authorities to continue efforts to strengthen the effectiveness of the AML/CFT regime, including in the areas of consolidated supervision, DNFBPs monitoring, and enforcement/sanctions.

STAFF APPRAISAL

43. Botswana's economy is one of the few in sub-Saharan Africa where output has recovered to its pre-COVID level. This performance has been underpinned by careful management of mineral resources and a track record of very strong policies and policy frameworks.

44. The recovery is expected to continue through the medium term, but there is significant uncertainty. Growth will be supported by higher prices and demand for diamonds, increased copper production, less COVID-19 mobility restrictions, and more international tourist arrivals. These factors and a strong fiscal adjustment will strengthen buffers, particularly those held by the government. Downside risks to this outlook relate to the strength of commodity markets, China's growth, the pace of tightening of monetary policy in advanced economies, and climate shocks.

45. Despite the positive outlook, Botswana faces difficult challenges. Unemployment has risen close to historic highs, and poverty and inequality have worsened following the COVID-19 pandemic. With inflation above the central bank's objective range, providing support to the most vulnerable through the government social programs remains a priority in the near term. In this context, improving the targeting of social programs will reduce leakages. Over the medium term, a sustained reduction in poverty and inequality will require further progress on diversification and digitalization reforms as well as moving away from inward-looking policies such as import restrictions.

46. Implementing the planned medium-term fiscal consolidation is critical to rebuild buffers and financial assets for future generations. The consolidation plan will achieve fiscal surplus over the medium term and rebuild the Government Investment Account to shield the economy against shocks and build an asset base. There are significant risks to the plan, and its successful implementation will require institutional fiscal reform, including to adopt a public wage formation framework, anchor fiscal policy in a credible medium-term fiscal framework, and formalize a new fiscal rule in National Development Plan 12. Joint ventures of identified SOEs with private sectors and efforts to close the tax gap should proceed as planned. In addition, greater transparency and accountability in spending is needed to help catalyze public support for fiscal reform and revenue collection. Public investment efficiency and the quality of public procurement need to improve to help create fiscal space.

47. Bringing inflation back within the Bank of Botswana's objective range will require additional monetary tightening. In the absence of further tightening, the broad-based rise in inflation risks de-anchoring inflation expectations and requiring even sharper tightening later with negative effects on growth. The newly created monetary policy rate will over time enhance monetary policy transmission and implementation. Strengthened monitoring and communication would help to limit risks of volatility in interbank rates and disruptive capital flows. Lifting the restrictions on the current prime lending rate in due course would contribute to the efficiency of financial intermediation and financial access.

48. The external position is broadly in line with fundamentals and desirable policies. Fiscal consolidation and higher diamond exports should strengthen the current account and support reserves accumulation. Looking forward, maintaining the current crawl rate would be appropriate as domestic interest rates rise. In addition, continuing to allow flexibility within the current exchange rate regime should help the economy adjust to shocks and facilitate structural transformation.

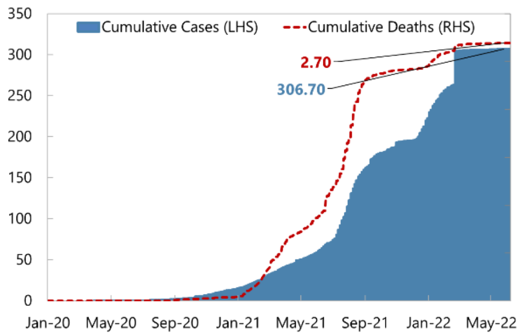
49. A successful implementation of the Reset Agenda will enhance Botswana's resilience and ensure sustained high-job rich growth. Implementation of the plan, together with a reduced government footprint, will diversify the economy towards financial services (facilitated by fintech), manufacturing, and tourism, and transform Botswana into a high-income status as per Vision 2036. Reforms should include enhancing accountability, competition, and governance, deepening trade integration, and a faster energy transition. Reliance on import substitution and restrictions to promote industrialization could be counterproductive.

50. Staff recommends that the next Article IV consultation with Botswana be held on the standard 12-month cycle.

Figure 1. Botswana: COVID-19 Developments

New infections and deaths have dropped…

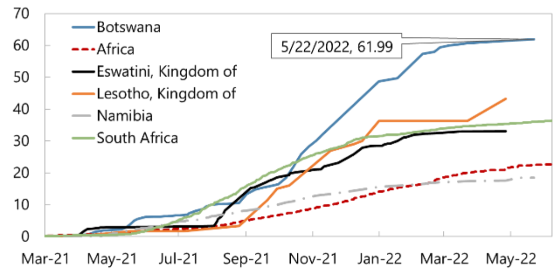
Cumulative Cases and Deaths
(Number of thousand people)



Sources: WHO Coronavirus Disease (COVID-19) Dashboard18

…as vaccine rollout is amongst the most rapid in SSA.

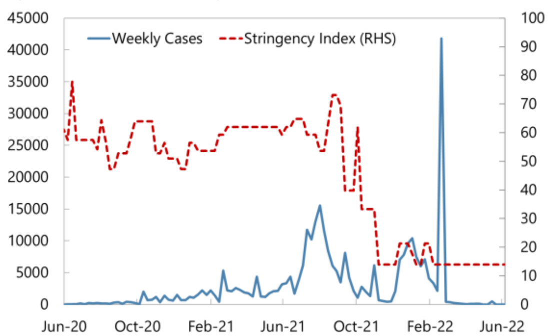
COVID-19 Vaccine Doses Administered
(Per hundred,)



Note: All doses, including boosters, are counted individually. As the same person may receive more than one dose, the number of doses per 100 people can be higher than 100.
Sources: Our world in Data.

Most restrictions have been lifted as weekly cases dropped to almost zero in February 2022…

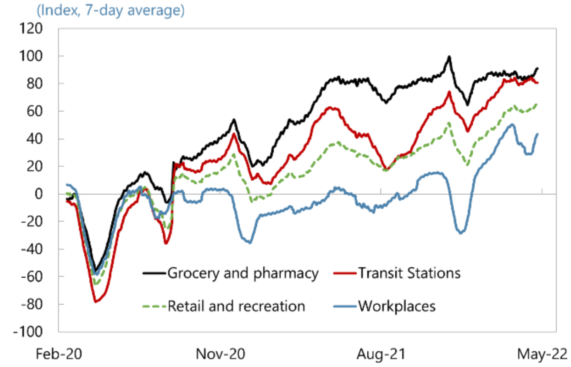
Cumulative Weekly Cases and Stringency Index
(Number of cases; Index value)



Sources: WHO and Oxford COVID-19 Government Response Tracker.

…and mobility has increased.

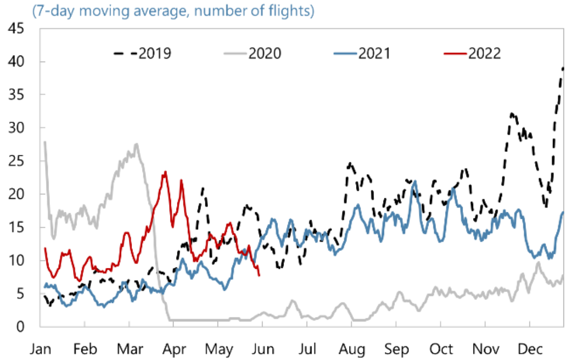
Google Mobility
(Index, 7-day average)



Sources: Google Mobility Report.

The lifting of mobility restrictions has led to full recovery of domestic travel…

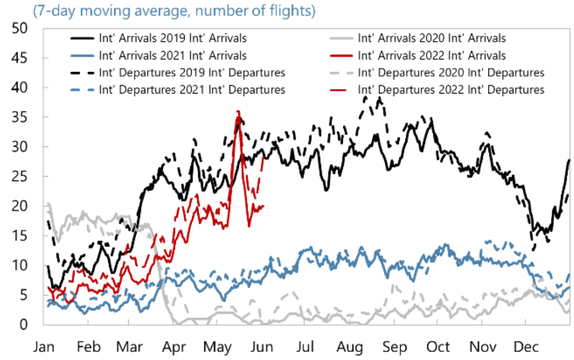
Botswana Domestic Flights
(7-day moving average, number of flights)



Sources: FlightRadar 24

…but international travel has yet to recover to its pre-COVID level.

Botswana International Flights
(7-day moving average, number of flights)

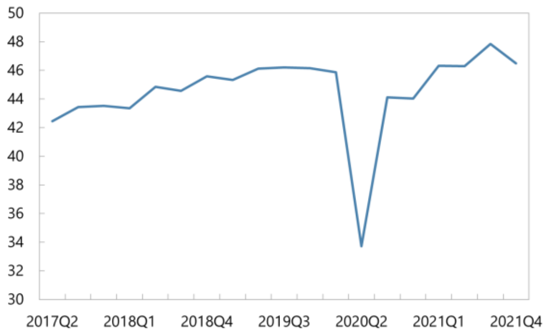


Sources: FlightRadar 24

Figure 2. Botswana: Real Sector

Real GDP has recovered to the pre-pandemic level...

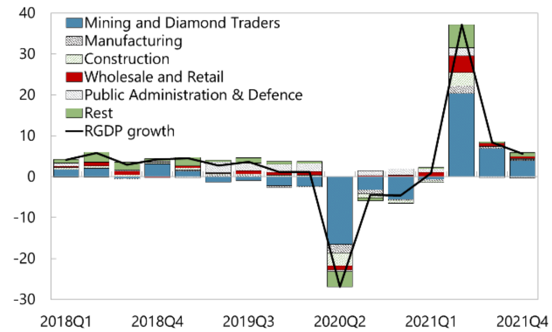
Real GDP
(Constant 2016 price, Billion Pula)



Sources: GDP Quarterly Release in Statistics Botswana, and IMF staff calculation

... driven by strong rebound in the mining sector and positive growth rates of other sectors ...

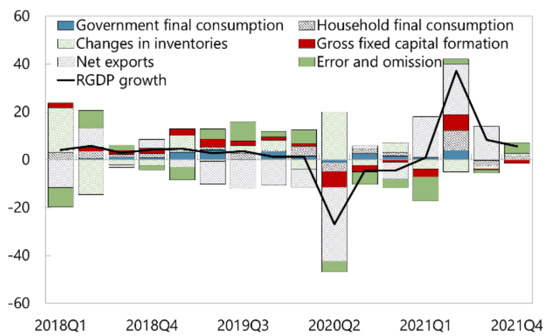
Real GDP Growth Breakdown by Selected Sectors
(Percent)



Sources: Botswana Financial Statistics, and IMF staff calculation.

...as net exports and consumption contributed most strongly to growth.

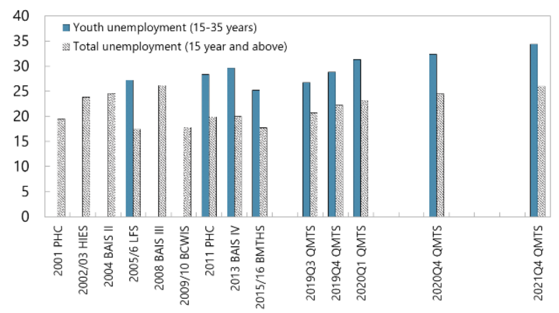
Real GDP Growth Breakdown by Type of Expenditure
(Percent)



Sources: Botswana Financial Statistics, and IMF staff calculation.

Despite the strong recovery in GDP, youth and overall unemployment continue to climb.

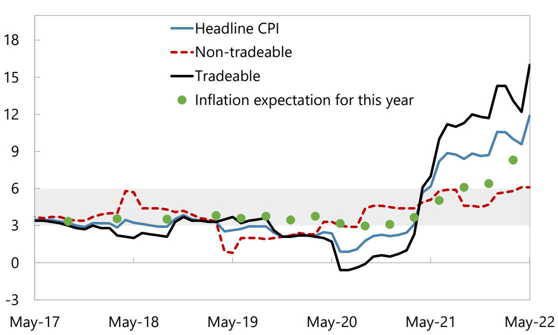
Unemployment Rate
(Percent of labor force)



Sources: Population and Housing Census (PHC); The Household Income Expenditure Survey (HIES); Labor Force Survey (LFS); Botswana Aids Impact Survey (BAIS); Botswana Core Welfare Indicators Survey (BCWIS); Botswana Multi-topic Household Survey (BMTHS); Quarterly Multi-Topic Survey Report (QMTS)

Headline CPI breached the BoB's 3-6 percent objective range reflecting a sharp increase in tradable inflation...

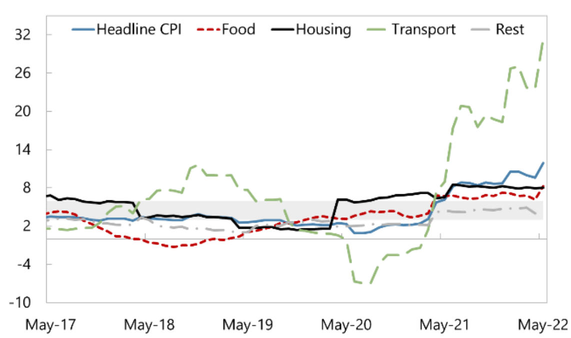
Consumer Price Index: Tradable and Non-Tradable
(Percent change, yoy)



Sources: Haver Analytics, and IMF staff calculation.

...which is driven by higher fuel inflation that has passed through to transport inflation.

Consumer Price Index by Commodity Group
(Percent change, yoy)

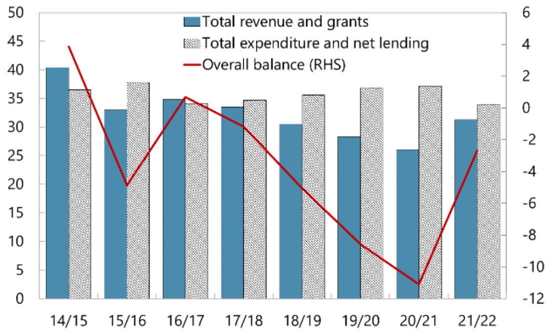


Sources: Haver Analytics, and IMF staff calculation.

Figure 3. Botswana: Fiscal Sector

The fiscal deficit is projected to narrow sharply due to lower expenditure and higher revenue,...

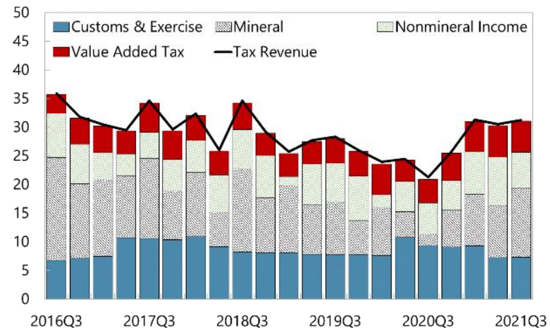
Fiscal Balance
(Percent of fiscal year GDP, both y-axis)



Sources: Ministry of Finance, and IMF staff calculation.

... which mainly reflects a recovery in diamond revenue, nonmineral income tax and increases in the VAT rate.

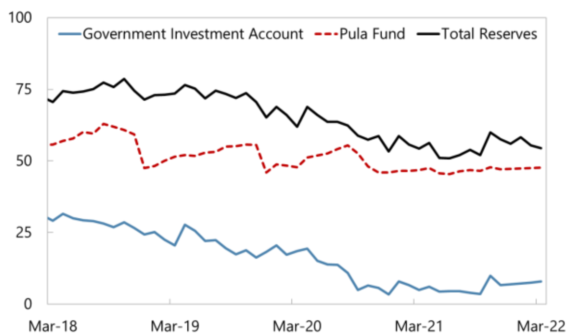
General Government Revenue
(Percent of GDP)



Sources: Business Financial Statistics.

With buffers eroding,..

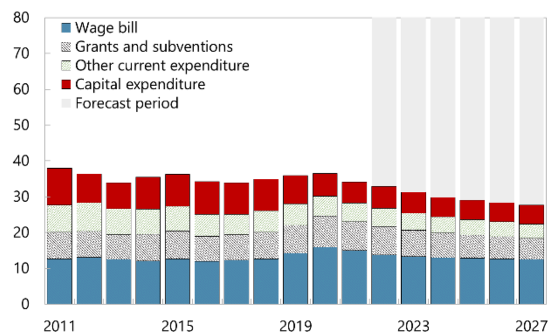
Botswana Buffers
(Billions of Pula)



Sources: Monthly and Annual Financial Statements from Bank of Botswana.

... the authorities reined in government spending, reducing the wage bill and subventions...

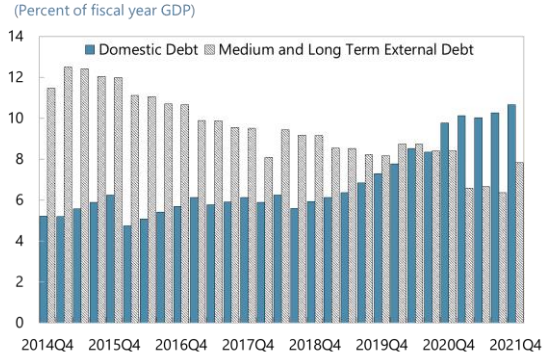
General Government Expenditure
(Percent of GDP)



Sources: Ministry of Finance, and IMF staff calculation and projections.

... and increased domestic issuance of government bonds...

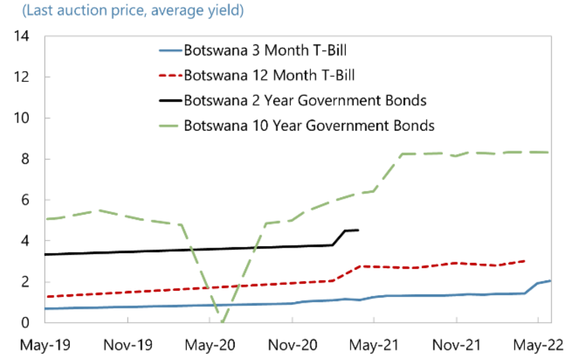
General Government Debt
(Percent of fiscal year GDP)



Sources: Businesss Financial Statistics, and IMF staff calculation.

... resulting in sharp increases in long-term bond yields.

Botswana Bond Yields
(Last auction price, average yield)

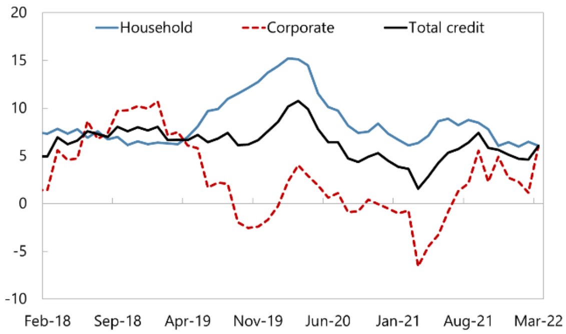


Sources: Bloomberg.

Figure 4. Botswana: Financial Sector

Credit growth has recovered from the pandemic, with faster growth of household credit than business.

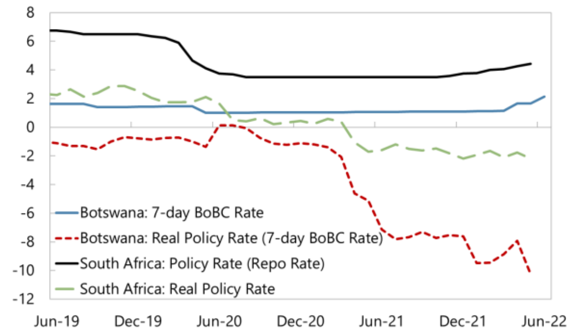
Credit Growth by Sectors
(Percent change, yoy)



Sources: Haver Analytics.

The bank rate has fallen to historic low and, with inflation rising rapidly, the real rate is negative.

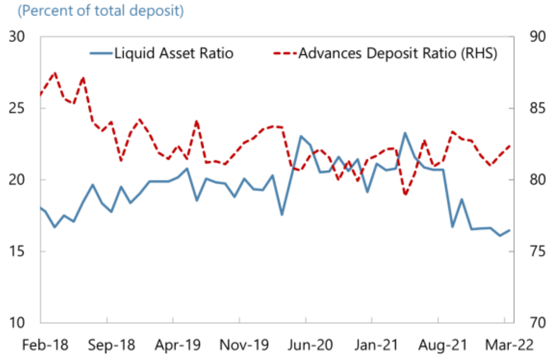
Policy Rates
(Percent, eop)



Sources: Haver Analytics.

Liquid assets in commercial banks decreased as the government sought to finance the deficit with longer-term government bonds…

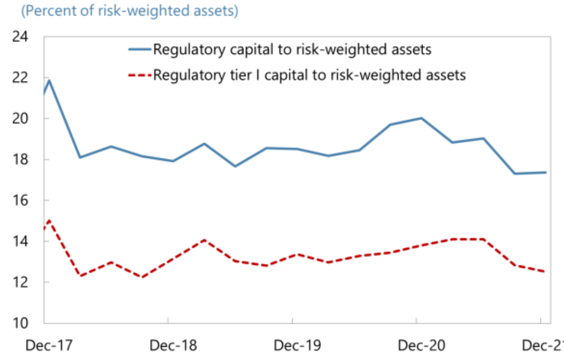
Advances and Liquid Asset Ratio
(Percent of total deposit)



Sources: Business Financial Statistics.

… but the banking sector remains well capitalized …

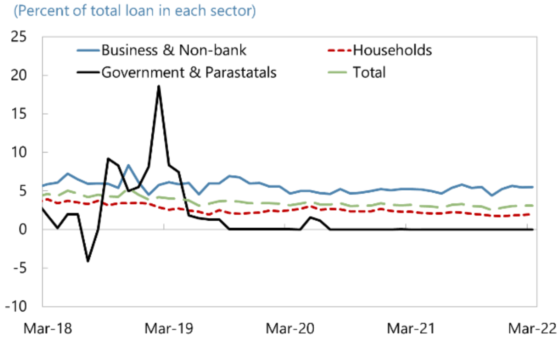
Adequacy
(Percent of risk-weighted assets)



Sources: IMF FSI Database.

… with low and stable NPLs…

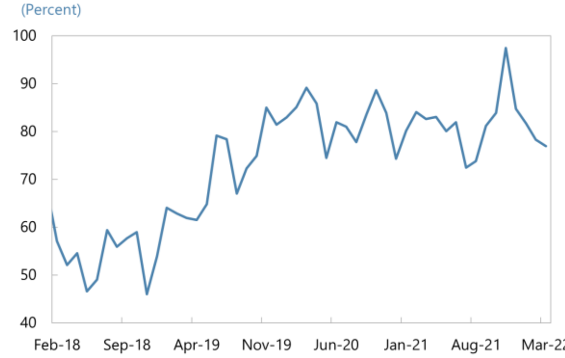
Non-performing Loan by Sector
(Percent of total loan in each sector)



Sources: Business Financial Statistics.
Note: Non-performing loan is defined as arrears over 30 days net of provisions.

… and ample provisions.

Provisions to Total Non-performing Loans
(Percent)

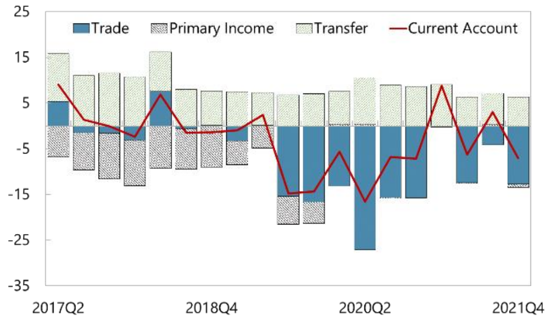


Sources: Business Financial Statistics.

Figure 5. Botswana: External Sector

The current account balance has narrowed sharply…

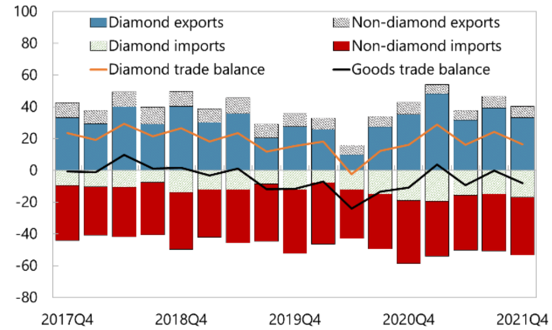
Current Account
(Percent of GDP)



Sources: Haver Analytics/Bank of Botswana and Statistics Botswana, and IMF staff calculation.

… reflecting a substantial increase in diamond net exports.

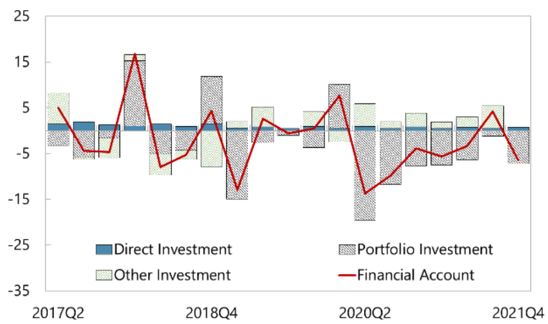
Goods and Diamond Trade
(Percent of GDP)



Sources: Haver Analytics/Statistics Botswana, and IMF staff calculation.

The financial account has recovered at a slower pace, reflecting weak FDI and continued portfolio outflows

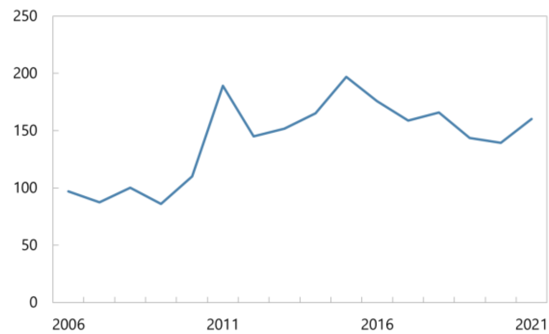
Financial Account
(Percent of GDP)



Sources: Haver Analytics/Bank of Botswana and Statistics Botswana, and IMF staff calculation.

Terms of trade strengthened on the back of higher diamond prices.

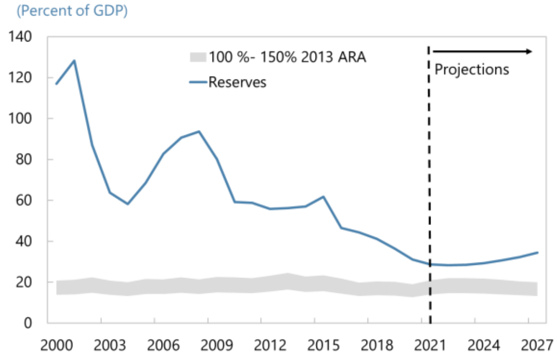
Terms of Trade
(Index, 2005=100)



Sources: Kimberley Process, and IMF staff calculation.

Reserves are projected to improve over the medium term.

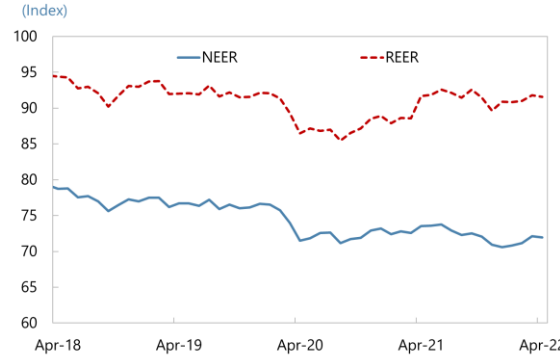
Reserve Adequacy
(Percent of GDP)



Sources: IMF staff calculation and projections.

The NEER depreciated in line with the crawling peg target while the REER remained broadly unchanged.

Botswana Effective Exchange Rate
(Index)



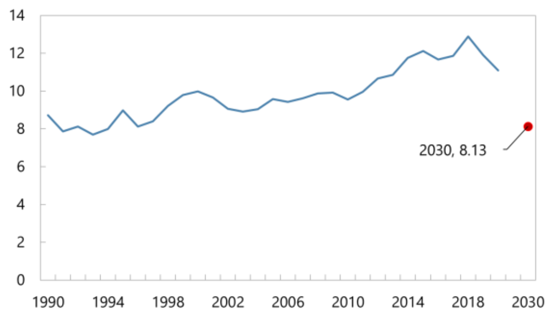
Sources: IMF INS.

Figure 6. Botswana: Climate Monitor

Botswana's emissions have been rising since 1990, and way above the 2030 target,...

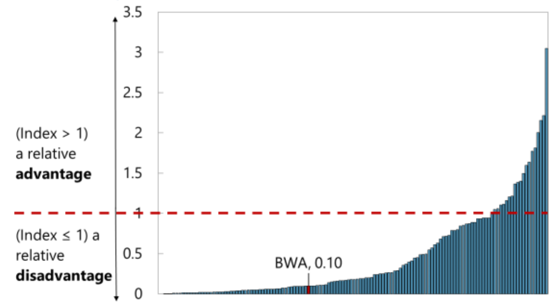
...and it has a comparative disadvantage in exports of low carbon technology products.

Greenhouse Gas (GHG) Emissions vs Trended Targets
(Millions of metric tons of CO2 equivalent, excluding LULUCF)



Note: LULUCF means Land use, land-use change and forestry.
Sources: UNFCCC; EDGAR; FAO; IMF staff calculations.

Comparative Advantage in Exports of Low Carbon Technology Products
(Index in the year of 2020)

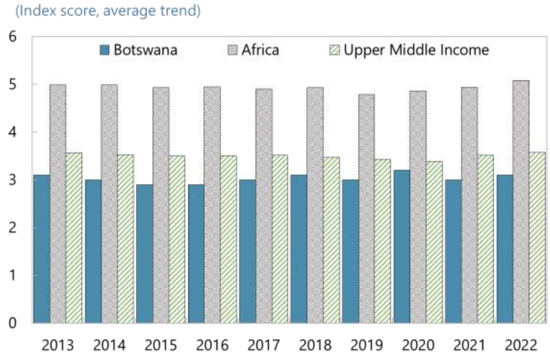


Sources: UN Comtrade, DESA/UNSD; IMF staff calculations.

The risk of climate-related hazards in Botswana has been relatively low...

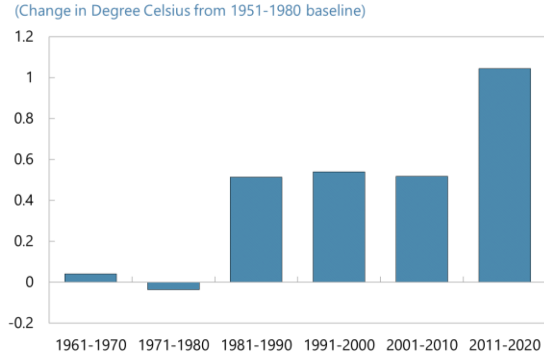
... but extreme weather risks are rising with warmer temperatures.

Climate-driven INFORM Risk Index
(Index score, average trend)



Sources: INFORM Risk.

Mean Temperature Change of Meteorological year
(Change in Degree Celsius from 1951-1980 baseline)

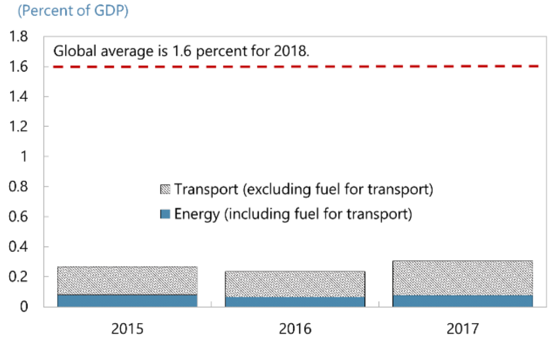


Sources: FAO Annual Mean Global Surface Temperature.

Botswana's environmental taxes, concentrated on transport, are low compared to the global average.

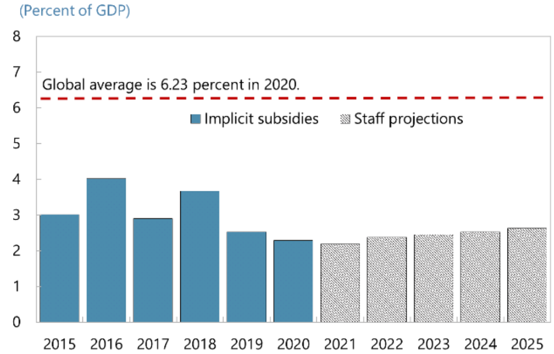
Botswana spent 2.3 percent of GDP on implicit fuel subsidies, lower than the global average of 6.23 percent.

Enviornmental Taxes By Type
(Percent of GDP)



Sources: OECD Environmentally Related Tax Revenue; IMF Statistics Department Questionnaire.

Fossil Fuel Subsidies by Types
(Percent of GDP)



Sources: Parry et al. 2021; IMF staff estimations..

Table 1. Botswana: Selected Economic Indicators, 2018–27[1]

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Projection					
			(Annual percent change, unless otherwise indicated)							
National Income and Prices										
Real GDP	4.2	3.0	-8.7	11.4	4.3	4.0	4.0	4.0	4.0	4.0
Mineral[2]	8.4	-3.7	-26.5	29.9	5.4	2.8	1.8	1.6	2.0	1.9
Nonmineral	2.9	5.2	-3.5	7.2	4.0	4.3	4.5	4.6	4.5	4.5
GDP per capita (US dollars)	7,556	7,247	6,349	7,337	7,510	7,765	8,193	8,622	9,130	9,627
GNI per capita (US dollars)[3]	6,853	6,867	6,357	7,326	7,169	7,326	7,651	8,071	8,568	9,052
Consumer prices (average)	3.2	2.7	1.9	6.7	11.0	5.8	4.5	4.5	4.5	4.5
Diamond production (millions of carats)	24.5	23.7	16.9	23.2	24.0	24.4	24.7	25.7	25.4	26.6
Money and Banking										
Monetary Base	17.5	5.4	-7.0	-42.1	33.2	14.3	9.4	7.9	10.1	9.0
Broad money (M2)	8.3	8.0	5.9	5.0	6.3	14.3	9.4	7.9	10.1	9.0
Credit to the private sector	6.6	7.1	5.3	5.4	10.2	10.3	9.4	9.8	9.6	9.7
			(Percent of GDP, unless otherwise indicated)							
Investment and Savings										
Gross investment (including change in inventories)	25.9	30.9	32.8	28.9	28.3	29.5	29.0	29.4	29.7	30.0
Public	8.8	7.8	6.5	5.8	6.1	5.8	5.5	5.4	5.3	5.3
Private	17.1	23.0	26.3	23.1	22.2	23.7	23.6	24.0	24.4	24.7
Gross savings	26.6	23.8	25.6	30.4	30.1	32.1	33.5	34.3	35.0	35.7
Public	5.6	0.5	-4.3	0.9	4.6	6.6	7.6	7.9	7.9	7.8
Private	21.0	23.3	29.9	29.5	25.5	25.5	25.8	26.3	27.1	27.8
Central Government Finances[4]										
Total revenue and grants	30.5	28.3	26.1	31.3	31.7	32.3	32.1	31.4	30.6	30.0
Total expenditure and net lending	35.6	36.9	37.2	34.0	33.5	31.7	30.3	29.5	28.7	28.0
Overall balance (deficit –)	-5.1	-8.6	-11.1	-2.7	-1.8	0.6	1.8	1.9	2.0	2.0
Non-mineral primary balance[5]	-18.6	-19.0	-18.5	-16.2	-16.6	-11.9	-11.1	-10.5	-9.7	-9.2
Total central government debt	19.5	21.5	24.2	24.3	25.0	24.6	22.4	20.3	18.3	16.3
External Sector										
Exports of goods and services, f.o.b. (% change)	9.1	-17.3	-22.8	63.9	23.0	-0.4	12.0	5.0	4.6	4.8
o/w diamonds	9.6	-19.8	-21.8	78.3	18.0	-6.3	11.2	2.1	2.0	2.0
Imports of goods and services, f.o.b. (% change)	17.2	4.5	-3.7	23.8	6.4	-1.2	5.9	3.6	3.4	3.5
Current account balance	0.4	-6.9	-8.7	-0.5	1.7	2.6	4.4	4.9	5.3	5.7
Overall Balance	2.0	-9.5	-13.0	-3.3	0.9	1.7	2.9	3.3	3.9	4.4
Nominal effective exchange rate (2018=100)[6]	100.0	98.6	93.9	93.3	89.0	-	-	-	-	-
Real effective exchange rate (2018=100)[6]	100.0	99.2	94.6	97.6	97.6	-	-	-	-	-
Terms of trade (2005=100)	166.0	143.5	139.4	160.0	176.0	162.5	170.7	171.3	172.7	174.0
External public debt[7]	12.5	12.4	12.1	11.2	11.9	11.6	10.1	8.8	7.5	6.3
o/w public and publicly guaranteed	3.9	3.9	4.0	3.3	2.8	2.5	2.3	2.0	1.9	1.7
			(Millions of US$, unless otherwise indicated)							
Gross official reserves (end of period)	6,657	6,172	4,944	4,806	4,968	5,292	5,892	6,639	7,584	8,744
Months of imports of goods and services[8]	10.4	10.0	6.5	5.9	6.2	6.2	6.7	7.3	8.1	9.3
Months of non-diamond imports[8]	13.7	13.7	9.4	8.8	8.8	8.9	9.5	10.3	11.2	12.4
Percent of GDP	41.1	36.5	31.2	28.9	27.5	27.6	28.3	29.8	31.1	33.9

Sources: Botswana authorities and IMF staff estimates and projections.

1 Calendar year, unless otherwise indicated.

2 The projection is based on current value added and projected growth rates by different types of minerals.

3 Based on Atlas method from the World Bank.

4 Year beginning April 1.

5 The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and

6 For 2016-2021, both effective excahnge rate are from IMF

7 Includes central government-guaranteed debt.

8 Based on imports of goods and services for the following year.

Table 2. Botswana: Balance of Payments, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.			Projection			
(millions of U.S. dollars, unless otherwise indicated)										
Current Account Balance	67	-1,155	-1,292	-90	321	500	927	1,095	1,285	1,493
Trade balance	486	-1,066	-1,970	-622	387	407	993	1,153	1,318	1,498
Exports, f.o.b.	6,594	5,260	4,292	7,345	8,941	8,773	9,806	10,272	10,735	11,236
Diamonds	5,923	4,750	3,714	6,621	7,816	7,325	8,144	8,311	8,477	8,647
Other raw materials	94	52	90	182	615	907	1,092	1,350	1,612	1,907
Other	578	458	489	541	510	541	571	612	646	682
Imports, f.o.b	-6,108	-6,326	-6,262	-7,967	-8,554	-8,367	-8,813	-9,119	-9,417	-9,739
Diamonds	-1,799	-1,864	-2,011	-2,880	-3,204	-2,857	-3,095	-3,158	-3,221	-3,286
Other	-4,310	-4,462	-4,251	-5,088	-5,350	-5,510	-5,718	-5,961	-6,196	-6,453
Services	-316	-401	-634	-672	-449	-386	-383	-369	-371	-362
Transportation	-191	-200	-219	-292	-282	-278	-287	-293	-305	-314
Travel	304	414	164	202	343	415	489	519	539	560
Other services	-429	-615	-579	-582	-511	-523	-585	-595	-604	-608
Income	-1,584	-876	20	-29	-835	-1,097	-1,383	-1,437	-1,496	-1,560
Current transfers	1,529	1,190	1,166	1,217	1,218	1,576	1,699	1,748	1,834	1,917
SACU receipts	1,525	1,318	1,382	1,328	1,167	1,483	1,582	1,622	1,698	1,771
Capital and Financial Account	271	-439	-655	-496	-158	-177	-327	-347	-340	-334
Direct investment	204	113	100	108	147	194	230	281	304	327
Portfolio investment	628	-927	-987	-974	-634	-453	-446	-441	-439	-434
Other investment	-563	375	232	370	329	82	-111	-187	-205	-226
Assets	-608	458	253	37	-106	-127	-135	-154	-175	-191
Liabilities	45	-83	-21	332	435	209	24	-33	-30	-35
Net government long-term borrowing	-95	-137	-140	90	303	57	-139	-177	-180	-185
Other net private long-term borrowing	64	62	121	243	132	153	164	145	151	151
Short-term borrowing	77	-9	-1	-1	-1	-1	-1	-1	-1	-1
Net Errors and Omissions	-1,218	1,106	718	0	0	0	0	0	0	0
Overall Balance	338	-1,594	-1,947	-586	162	323	600	748	945	1,159
(Percent of GDP, unless otherwise indicated)										
Current Account	0.4	-6.9	-8.7	-0.5	1.7	2.6	4.4	4.9	5.3	5.7
Trade balance	2.9	-6.4	-13.2	-3.5	2.1	2.1	4.7	5.1	5.4	5.7
Exports of goods	38.7	31.5	28.7	41.7	48.6	45.2	46.9	45.7	44.2	43.0
Of which: diamonds	34.8	28.5	24.9	37.6	42.5	37.7	38.9	37.0	34.9	33.1
Imports of goods	35.9	37.9	41.9	45.2	46.5	43.1	42.1	40.6	38.8	37.2
Of which: diamonds	10.6	11.2	13.5	16.3	17.4	14.7	14.8	14.1	13.3	12.6
Services balance	-1.9	-2.4	-4.2	-3.8	-2.4	-2.0	-1.8	-1.6	-1.5	-1.4
Income and transfers balance	-0.3	1.9	7.9	6.7	2.1	2.5	1.5	1.4	1.4	1.4
Financial Account	1.6	-2.6	-4.4	-2.8	-0.9	-0.9	-1.6	-1.5	-1.4	-1.3
Direct investment	1.2	0.7	0.7	0.6	0.8	1.0	1.1	1.3	1.2	1.3
Portfolio investment	3.7	-5.6	-6.6	-5.5	-3.4	-2.3	-2.1	-2.0	-1.8	-1.7
Other investment	-3.3	2.2	1.6	2.1	1.8	0.4	-0.5	-0.8	-0.8	-0.9
Net Errors and Omissions	-7.2	6.6	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (increase reserves +)	2.0	-9.5	-13.0	-3.3	0.9	1.7	2.9	3.3	3.9	4.4
(Annual percentage change, unless otherwise indicated)										
Export Volumes	1.1	-9.4	-14.3	40.2	2.9	2.3	5.5	2.9	2.7	2.9
Import Volumes	21.0	1.1	2.7	18.1	-4.1	-3.3	4.4	1.5	3.1	2.1
Terms of Trade	4.4	-13.6	-2.8	14.8	9.9	-7.7	5.1	0.4	0.8	0.8
End-of-Year Reserves (US$ millions)	6,657	6,172	4,944	4,806	4,968	5,292	5,892	6,639	7,584	8,744
Months of Imports of Goods and Services[1]	10.4	10.0	6.5	5.9	6.2	6.2	6.7	7.3	8.1	9.3
Months of Non-Diamond Imports[2]	13.7	13.7	9.4	8.8	8.8	8.9	9.5	10.3	11.2	12.4
Nominal GDP (US$ millons)	17,032	16,696	14,930	17,614	18,403	19,423	20,920	22,475	24,295	26,148

Source: Bank of Botswana; IMF staff estimates.

[1] Based on imports of goods and services for the following year.

[2] BOP data have been revised starting in 2012. A change in the information sytem may explain the large drop in import prices in 2017.

Table 3a. Botswana: Central Government Operations, 2018/19–27/28[1]
(Billions of pula, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Prel.			Projection			
(Billions of pula, unless otherwise indicated)										
Total Revenue and Grants	53.5	50.2	46.2	63.1	71.4	79.3	86.1	91.6	96.9	103.2
Total revenue	53.4	50.2	46.2	63.1	71.4	79.3	86.1	91.5	96.9	103.1
Tax revenue	37.8	38.0	38.2	46.0	50.5	58.7	62.9	67.2	71.8	76.9
Income taxes	15.1	15.3	13.4	20.2	23.4	24.5	27.2	29.1	31.1	33.3
Mineral	5.2	4.5	3.3	7.9	9.7	9.4	10.7	11.1	11.4	11.8
Nonmineral	9.9	10.8	10.1	12.4	13.7	15.1	16.5	18.0	19.7	21.5
Taxes on goods and services [2]	7.4	8.1	7.8	11.0	12.0	13.2	14.5	15.8	17.3	18.9
Customs Union receipts [3]	14.8	14.0	16.5	14.1	13.9	19.8	19.9	20.8	21.9	23.1
Other	0.5	0.6	0.5	0.7	1.1	1.2	1.3	1.4	1.5	1.7
Nontax revenue	15.6	12.2	8.0	17.1	20.9	20.6	23.2	24.3	25.1	26.2
Mineral royalties and dividends	13.3	10.0	6.3	15.4	18.9	18.3	20.8	21.6	22.1	23.0
Grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Expenditure and Net Lending	62.4	65.4	65.8	68.5	75.6	77.8	81.4	85.9	90.7	96.4
Current expenditure	47.3	51.8	55.6	56.7	61.7	63.9	66.9	70.2	74.1	78.3
Wages and salaries	22.1	26.3	28.7	29.5	30.6	32.5	34.7	37.3	40.0	43.0
Interest	1.1	1.2	1.2	1.2	1.9	2.2	2.2	1.8	1.8	1.8
Other	24.1	24.4	25.7	26.0	29.2	29.2	30.1	31.2	32.2	33.4
Of which: grants and subsidies	13.3	13.8	16.0	15.6	17.7	17.8	18.2	18.8	19.2	19.9
Capital expenditure	15.5	13.6	10.2	11.8	14.0	14.0	14.5	15.7	16.8	18.2
Net lending	-0.4	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Primary Balance (deficit -)	-8.7	-15.0	-19.3	-4.7	-3.0	2.9	6.1	6.5	6.9	7.4
Overall Balance (A)	-8.9	-15.2	-19.6	-5.4	-4.2	1.5	4.8	5.7	6.2	6.8
Financing (B)	8.9	15.2	19.6	5.4	4.2	-1.5	-4.8	-5.7	-6.2	-6.8
Foreign (net)	-1.1	-1.6	-1.6	1.9	4.5	-0.3	-2.0	-2.1	-2.1	-2.2
Drawing	0.4	0.1	0.2	3.3	6.3	1.6	0.0	0.0	0.0	0.0
Amortization	-1.4	-1.5	-1.5	-1.5	-1.5	-1.6	-1.7	-1.9	-1.9	-2.0
IMF transactions (net)[4]	0.0	-0.2	-0.2	0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Domestic (net)	10.0	16.8	21.2	3.6	-0.3	-1.2	-2.8	-3.6	-4.1	-4.5
Issuance	4.0	4.4	12.1	12.8	9.5	11.3	12.4	8.0	8.0	8.0
Amortization	-4.1	-1.5	-5.0	-10.0	-7.0	-11.3	-11.3	-7.0	-7.4	-7.7
Change in cash balance (- increase)	14.1	10.8	10.2	-6.5	-2.8	-1.2	-3.9	-4.5	-4.7	-4.8
Other domestic financing	-4.1	3.1	4.0	7.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Non-Mineral Primary Balance [5]	-27.1	-29.6	-28.9	-28.0	-31.6	-24.9	-25.3	-26.3	-26.6	-27.4
Excluding SACU revenue	-41.9	-43.5	-45.3	-42.1	-45.6	-44.7	-45.2	-47.1	-48.5	-50.5
GDP (fiscal year; billions of pula)	175.2	177.4	177.1	201.6	225.5	245.8	268.4	291.6	316.5	344.0

Sources: Ministry of Finance and Economic Development; and IMF staff estimates and projections.

[1] Fiscal year begins on April 1.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development

[4] These transactions reflect Botswana's SDR allocation and contribution to the IMF's

[5] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 3b. Botswana: Central Government Operations, 2018/19–2027/28[1]
(Percent of GDP, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Prel.			Projection			
			(Percent of GDP, unless otherwise indicated)							
Total Revenue and Grants	30.5	28.3	26.1	31.3	31.7	32.3	32.1	31.4	30.6	30.0
Total revenue	30.5	28.3	26.1	31.3	31.7	32.3	32.1	31.4	30.6	30.0
Tax revenue	21.6	21.4	21.6	22.8	22.4	23.9	23.4	23.1	22.7	22.4
Income taxes	8.6	8.6	7.6	10.0	10.4	10.0	10.1	10.0	9.8	9.7
Mineral	3.0	2.6	1.9	3.9	4.3	3.8	4.0	3.8	3.6	3.4
Nonmineral	5.7	6.1	5.7	6.1	6.1	6.1	6.1	6.2	6.2	6.2
Taxes on goods and services [2]	4.2	4.5	4.4	5.4	5.3	5.4	5.4	5.4	5.5	5.5
Customs Union receipts [3]	8.4	7.9	9.3	7.0	6.2	8.1	7.4	7.1	6.9	6.7
Other	0.3	0.3	0.3	0.3	0.5	0.5	0.5	0.5	0.5	0.5
Nontax revenue	8.9	6.9	4.5	8.5	9.3	8.4	8.7	8.3	7.9	7.6
Mineral royalties and dividends	7.6	5.6	3.5	7.6	8.4	7.4	7.7	7.4	7.0	6.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Expenditure and Net Lending	35.6	36.9	37.2	34.0	33.5	31.7	30.3	29.5	28.7	28.0
Current expenditure	27.0	29.2	31.4	28.1	27.4	26.0	24.9	24.1	23.4	22.8
Wages and salaries	12.6	14.8	16.2	14.7	13.6	13.2	12.9	12.8	12.7	12.5
Interest	0.6	0.7	0.7	0.6	0.8	0.9	0.8	0.6	0.6	0.5
Other	13.8	13.7	14.5	12.9	13.0	11.9	11.2	10.7	10.2	9.7
Of which: grants and subsidies	7.6	7.8	9.0	7.7	7.8	7.2	6.8	6.4	6.1	5.8
Capital expenditure	8.8	7.7	5.8	5.9	6.2	5.7	5.4	5.4	5.3	5.3
Net lending	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance (deficit -)	-4.9	-8.5	-10.9	-2.3	-1.3	1.2	2.3	2.2	2.2	2.2
Overall Balance (A)	-5.1	-8.6	-11.1	-2.7	-1.8	0.6	1.8	1.9	2.0	2.0
Financing (B)	5.1	8.6	11.1	2.7	1.8	-0.6	-1.8	-1.9	-2.0	-2.0
Foreign (net)	-0.6	-0.9	-0.9	0.9	2.0	-0.1	-0.7	-0.7	-0.7	-0.7
Domestic (net)	5.7	9.5	12.0	1.8	-0.1	-0.5	-1.1	-1.2	-1.3	-1.3
Change in cash balance (- increase)	8.1	6.1	5.8	-3.2	-1.3	-0.5	-1.5	-1.6	-1.5	-1.4
Memorandum Item:										
Non-Mineral Primary Balance [4]	-15.5	-16.7	-16.3	-13.9	-14.0	-10.1	-9.4	-9.0	-8.4	-8.0
Excluding SACU revenue	-23.9	-24.5	-25.6	-20.9	-20.2	-18.2	-16.9	-16.1	-15.3	-14.7
GDP (fiscal year; billions of pula)	175.2	177.4	177.1	201.6	225.5	245.8	268.4	291.6	316.5	344.0

Sources: Ministry of Finance and Economic Development; and IMF staff estimates and projections.

[1] Fiscal year begins on April 1.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development component

[4] The primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 3c. Botswana: Central Government Operations: 2018/19–2027/28[1]

(Percent of non-mineral GDP, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Prel.	Projection					
	(Percent of non-mineral GDP, unless otherwise indicated)									
Total Revenue and Grants	36.6	32.3	29.6	36.5	37.5	37.9	37.6	36.6	35.5	34.6
Total revenue	36.6	32.3	29.6	36.5	37.5	37.9	37.6	36.6	35.5	34.6
Tax revenue	25.9	24.4	24.5	26.6	26.5	28.0	27.5	26.9	26.3	25.8
Income taxes	10.3	9.9	8.6	11.7	12.3	11.7	11.9	11.6	11.4	11.2
Mineral	3.5	2.9	2.1	4.5	5.1	4.5	4.7	4.4	4.2	4.0
Nonmineral	6.8	6.9	6.5	7.2	7.2	7.2	7.2	7.2	7.2	7.2
Taxes on goods and services [2]	5.1	5.2	5.0	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Customs Union receipts [3]	10.1	9.0	10.5	8.2	7.3	9.5	8.7	8.3	8.0	7.7
Other	0.4	0.4	0.3	0.4	0.6	0.6	0.6	0.6	0.6	0.6
Nontax revenue	10.7	7.8	5.1	9.9	11.0	9.8	10.1	9.7	9.2	8.8
Mineral royalties and dividends	9.1	6.4	4.0	8.9	9.9	8.7	9.1	8.6	8.1	7.7
Grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Expenditure and Net Lending	42.7	42.1	42.2	39.6	39.7	37.2	35.5	34.3	33.2	32.3
Current expenditure	32.4	33.3	35.6	32.8	32.4	30.5	29.2	28.1	27.1	26.3
Wages and salaries	15.1	16.9	18.4	17.1	16.1	15.5	15.1	14.9	14.7	14.4
Interest	0.7	0.8	0.8	0.7	1.0	1.0	1.0	0.7	0.7	0.6
Other	16.5	15.7	16.5	15.0	15.4	13.9	13.1	12.5	11.8	11.2
Of which: grants and subsidies	9.1	8.9	10.2	9.0	9.3	8.5	7.9	7.5	7.0	6.7
Capital expenditure	10.6	8.8	6.5	6.8	7.3	6.7	6.3	6.3	6.1	6.1
Net lending	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance (deficit -)	-5.9	-9.7	-12.4	-2.7	-1.6	1.4	2.7	2.6	2.5	2.5
Overall Balance	-6.1	-9.8	-12.6	-3.1	-2.2	0.7	2.1	2.3	2.3	2.3
Memorandum Items:										
Non-Mineral Primary Balance [4]	-18.6	-19.0	-18.5	-16.2	-16.6	-11.9	-11.1	-10.5	-9.7	-9.2
Excluding SACU revenue	-28.7	-28.0	-29.0	-24.3	-24.0	-21.3	-19.8	-18.8	-17.8	-16.9
Non-Mineral GDP (fiscal year; billions of pu	145.9	155.4	156.1	173.1	190.3	209.4	229.0	250.2	273.1	298.1

Sources: Ministry of Finance and Economic Development; and IMF staff estimates and projections.

[1] Fiscal year begins on April 1.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development component derived

[4] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 4. Botswana: Monetary Survey, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.			Projection			
	(Billions of pula, end of period, unless otherwise indicated)									
Net Foreign Assets	80.1	73.7	63.0	65.2	68.9	74.7	84.0	95.5	109.7	127.0
Bank of Botswana	70.0	63.8	51.9	51.4	53.4	57.4	64.9	74.4	86.4	101.4
Assets	71.4	65.2	53.3	56.0	57.9	61.9	69.5	79.0	91.0	105.9
Liabilities	-1.4	-1.4	-1.4	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6
Commercial banks	10.2	9.9	11.0	13.8	15.5	17.4	19.2	21.1	23.2	25.6
Assets	13.3	13.1	14.3	17.6	19.4	21.2	23.0	25.0	27.1	29.5
Liabilities	-3.1	-3.2	-3.3	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
Net Domestic Assets	-6.2	6.0	21.2	22.7	24.9	33.2	34.3	32.5	31.7	27.6
Net domestic credit	33.0	45.1	66.7	70.1	77.9	84.8	90.3	96.0	101.9	108.4
Net claims on the government	-26.3	-18.6	-0.5	0.1	0.7	-0.3	-2.7	-6.1	-10.1	-14.5
Bank of Botswana	-29.7	-23.1	-7.0	-10.8	-14.5	-16.2	-19.4	-23.8	-28.5	-33.2
Commercial banks	3.4	4.6	6.4	10.8	15.2	15.8	16.7	17.7	18.4	18.8
Claims on parastatals	0.7	0.9	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Claims on nongovernment	58.5	62.8	66.3	69.7	76.8	84.7	92.7	101.8	111.6	122.5
Claims on the private sector	60.2	64.5	67.9	71.6	78.9	87.0	95.2	104.5	114.6	125.7
Other financial institutions	-1.7	-1.8	-1.7	-1.9	-2.1	-2.3	-2.5	-2.7	-2.9	-3.2
Other items (net)	-39.2	-39.2	-45.5	-47.4	-52.9	-51.6	-56.0	-63.5	-70.3	-80.8
Monetary Base	14.7	15.5	14.4	8.4	11.1	12.7	13.9	15.0	16.5	18.0
Broad Money (M2)	78.5	84.8	89.8	94.3	100.2	114.4	125.2	135.0	148.6	162.0
Money	17.3	20.0	23.5	24.4	25.9	29.6	32.4	34.9	38.5	41.9
Currency	1.8	1.9	2.4	2.4	3.4	4.0	4.3	4.7	5.2	5.6
Current deposits	15.5	18.1	21.1	22.0	22.6	25.6	28.0	30.3	33.3	36.3
Quasi-money	61.2	64.7	66.2	69.9	74.2	84.8	92.8	100.1	110.1	120.1
Memorandum Items:										
Nominal GDP (bn pula)	174	180	171	195	221	240	263	286	310	337
Nominal non-mineral GDP (bn pula)	146	155	156	173	190	209	229	250	273	298
Velocity (GDP to M2)	2.2	2.1	1.9	2.1	2.2	2.1	2.1	2.1	2.1	2.1
Velocity (non-mineral GDP to M2)	1.9	1.8	1.7	1.8	1.9	1.8	1.8	1.9	1.8	1.8
Money Multiplier	5.3	5.5	6.2	11.3	9.0	9.0	9.0	9.0	9.0	9.0
Base Money (annual % change)	17.5	5.4	-7.0	-42.1	33.2	14.3	9.4	7.9	10.1	9.0
Broad Money (annual % change)	8.3	8.0	5.9	5.0	6.3	14.3	9.4	7.9	10.1	9.0
Credit to the private sector (annual % change)	6.6	7.1	5.3	5.4	10.2	10.3	9.4	9.8	9.6	9.7
Private sector credit to GDP	34.7	35.9	39.7	36.7	35.8	36.2	36.2	36.6	37.0	37.3
Private sector credit to non-mineral GDP	41.3	41.5	43.5	41.4	41.5	41.6	41.6	41.8	42.0	42.2

Sources: Bank of Botswana and IMF staff estimates and projections.

Table 5. Botswana: Financial Soundness Indicators, 2015–22

	2015	2016	2017	2018	2019	2020	2021	Mar-22
(Percent, unless otherwise indicated)								
Banking Indicators								
Capital Adequacy								
Capital to assets	8.5	8.4	8.8	9.4	11.9	9.2	8.6	8.7
Regulatory capital to risk-weighted assets	20.0	19.2	21.9	17.9	18.5	20.0	17.4	18.1
Regulatory tier I capital to risk-weighted assets	14.1	13.2	15.0	13.2	13.4	13.8	12.5	13.0
Nonperforming loans net of provisions to capital	10.0	12.8	13.4	16.2	10.4	8.1	9.7	9.9
Asset Quality								
Large exposure to capital	170.0	147.7	90.2	112.8	83.4	92.8	117.7	97.9
Nonperforming loans to total gross loans	3.7	4.9	5.3	5.4	4.8	4.3	4.2	4.2
Bank provisions to nonperforming loans	54.7	57.1	...	...	...	...	...	...
Earnings and Profitability								
Trading income to total income	4.7	2.6	3.1	3.6	4.3	5.3	6.0	6.4
Return on assets	2.0	2.3	1.9	2.8	2.3	1.9	1.2	2.5
Return on equity	17.5	20.2	16.3	23.3	19.5	12.5	5.8	17.2
Interest margin to gross income	57.5	61.4	61.6	57.2	56.2	55.7	45.9	52.0
Noninterest expenses to gross income	61.1	57.1	59.9	58.5	58.1	61.6	71.1	61.0
Personnel expenses to noninterest expenses	40.6	43.2	44.5	44.4	45.4	45.2	46.4	45.2
Liquidity								
Liquid assets to total assets	15.4	16.3	13.4	6.1	5.8	14.7	12.7	12.1
Liquid assets to short-term liabilities	18.5	20.0	16.4	7.2	7.0	18.1	15.4	14.7
Customer deposits to total (non-interbank) loans	119.8	121.6	117.3	118.8	120.6	122.3	122.4	120.9
Exposure to Foreign Exchange Risk								
Net open position in foreign exchange to capital	-59.4	0.0	-66.0	-63.5	0.0	3.8	2.3	2.9
Foreign currency-denominated loans to total loans	6.7	7.5	7.0	7.8	6.2	4.9	3.5	3.9
Foreign currency-denominated liabilities to total liabilities	13.0	14.6	13.9	14.3	12.7	14.9	22.2	25.7

Sources: Bank of Botswana and IMF staff calculations.

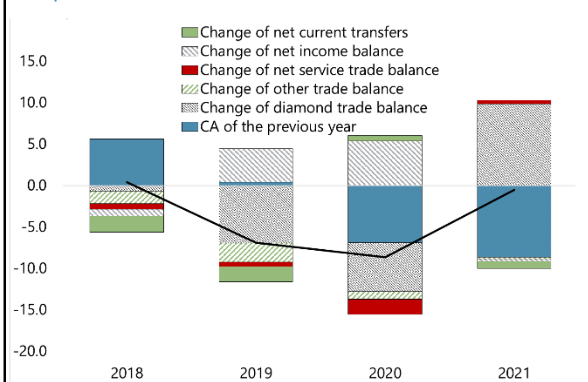
Annex I. External Stability Assessment

Botswana's external position is broadly in line with medium-term fundamentals and desired policies in 2021. Reserves are above the ARA metric adequacy levels. Over the medium term, the current account moves into surplus and reserves import coverage increases. Maintaining this outlook will require implementation of the planned fiscal consolidation, advancing structural reforms to strengthen competitiveness and promote diversification, and continuing to allow the real exchange rate to respond to changes in fundamentals.

Introduction

1. Botswana's current account deficit narrowed sharply in 2021, largely driven by an increase in diamond exports. After a steady decline from a sizable surplus in 2016 to a deficit of 8.7 percent of GDP in 2020, the current account deficit is narrowed to 0.5 percent of GDP in 2021, mostly due to higher demand for diamonds and the effects of fiscal contraction. Total goods exports increased by 13 percentage points of GDP, while goods imports increased by 3.3 percent of GDP, reflecting higher imports of almost all categories. In addition to diamonds, the recovery in trade from the COVID-19 crisis has been broad-based, with other exports and imports growing in 2021 by 25 and 20 percent respectively. The services trade balance remained in deficit at 3.8 percent of GDP in 2021 from 4.2 percent of GDP in 2020, reflecting some recovery in travel receipts and an increase in imports of transportation services, specifically road freight. The income and transfers balance declined from 7.9 percent to 6.7 percent of GDP between 2020 and 2021, reflecting lower SACU receipts and higher dividends distributed to nonresidents. The current account balance is expected to move into surplus in 2022, and average about 4.6 percent of GDP over the medium term, due to higher diamond production and the fiscal consolidation.

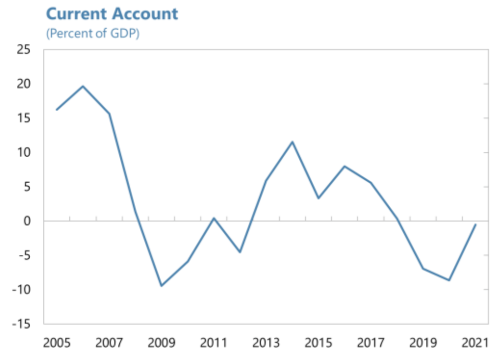
Current Account Decomposition
(In percent of GDP)



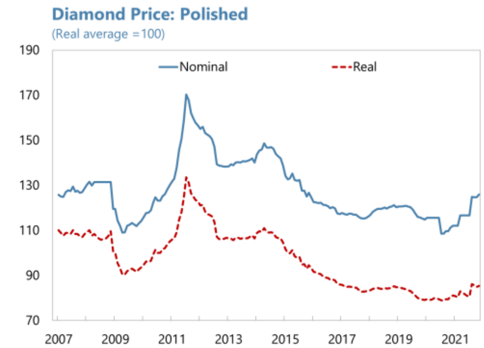
Sources: Bank of Botswana, and IMF staff calculations

2. The financial account deficit narrowed from 4.4 to 2.8 percent of GDP between 2020 and 2021. Foreign direct investment (FDI) in Botswana remained depressed and portfolio outflows remained fairly strong in 2021, mainly due to offshore investments by pension funds. At the same time, the other investment balance fell in 2021, reflecting an increase in proceeds being repatriated to foreign headquarters. Net foreign assets (NFA) declined from 36.8 percent of GDP in 2020 to 33.4 percent of GDP in 2021, reflecting drawdowns to finance the fiscal deficit, as well as strong growth in imports. NFA are expected to grow over the medium term, in line with smaller fiscal deficits and an improved trade balance.

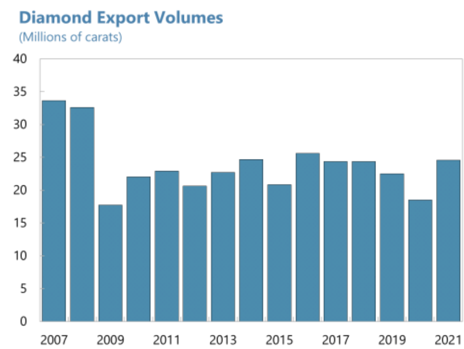
Figure AI.1. Botswana: Key External Sector Indicators



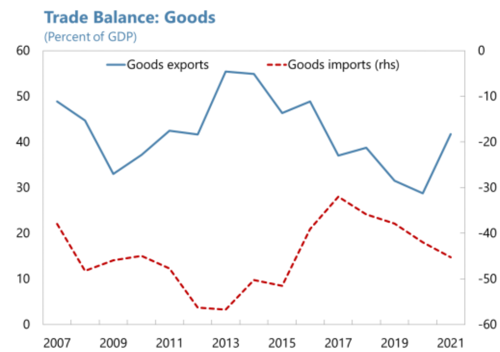
Sources: Bank of Botswana, and IMF staff calculations.



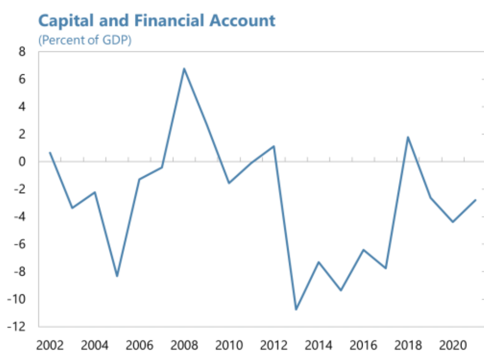
Sources: Bloomberg, and Bank of Botswana.



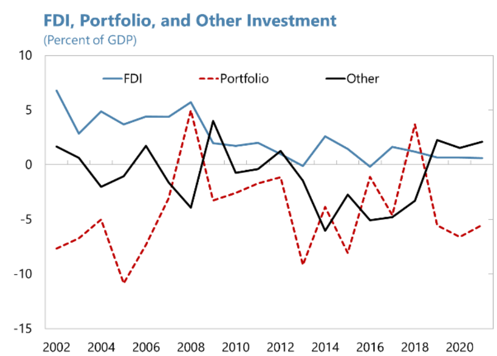
Sources: Bank of Botswana, and IMF staff calculations.



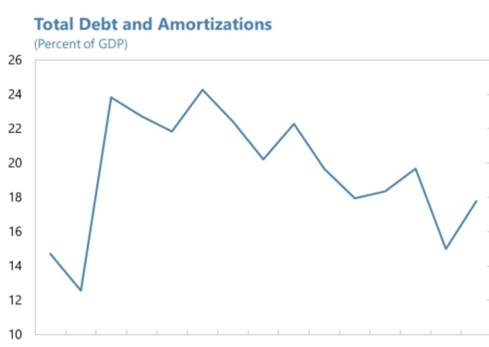
Sources: Bank of Botswana, and IMF staff calculations.



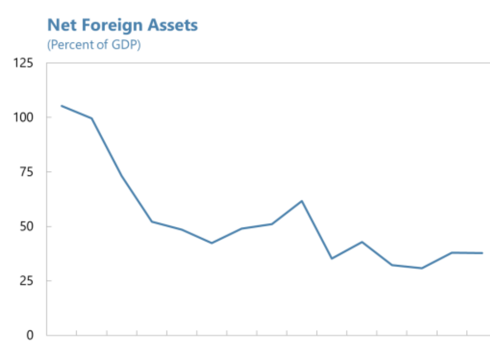
Sources: Bank of Botswana, and IMF staff calculations.



Sources: Bank of Botswana, and IMF staff calculations.

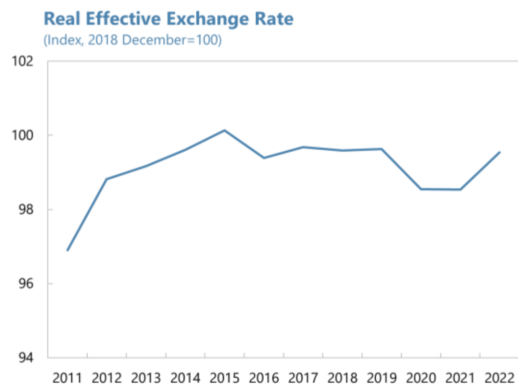


Sources: Bank of Botswana, and IMF staff calculations.

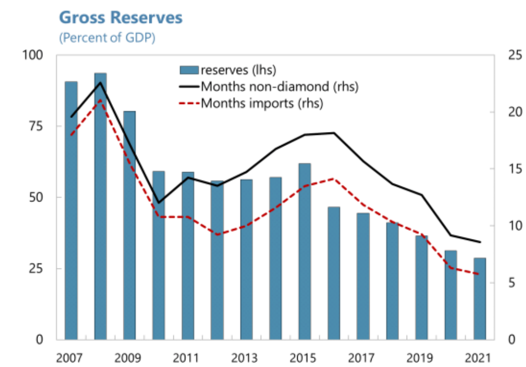


Sources: Bank of Botswana, and IMF staff calculations.

3. Botswana's real effective exchange rate (REER) appreciated in 2021 by 3 percent, mainly due to the rebound in diamond prices. Over the medium term, the REER is projected to remain unchanged. This reflects Botswana's relatively low capital mobility and the BoB's policy of adjusting the value of the pula in line with expected inflation differentials with major trading partners and basket weights (the basket comprises the SDR and the South African rand, with a 45 percent weight for the latter). The REER had depreciated by about 1 percent on average in 2020, following the decision to increase the crawl depreciation rate from -1.5 to -2.9 percent in May 2020.



Sources: Bank of Botswana.



Sources: Bank of Botswana, and IMF staff calculation.

4. Botswana's international reserves remained largely unchanged in 2021 and are projected to rise further over the medium term. Reserves amounted to US$4.8 billion (US$138 million lower than 2020), equivalent to 27 percent of GDP or 6 months of imports.[1] Under the baseline projections, import coverage is expected to increase moderately in the medium term, as diamond production increases and the government improves its fiscal balances.

Current Account and Exchange Rate Assessment

5. The assessment of Botswana's external position employs the External Balance Assessment (EBA)-lite models for the CA and REER.[2] The former approach assesses the current account relative to the position required to generate enough future returns for intergenerational equity purposes. The estimations assume that both the CA and REER are endogenous variables simultaneously determined as a function of domestic and external variables including fundamentals, policy variables, and cyclical conditions (these methodologies assess the CA and REER in

[1] The authorities preferred measure of reserve coverage takes the ratio to current year imports of goods and services excluding diamond imports for re-exporting purposes (which would amount to 9 months at end-2021).

[2] EBA-lite is an extension of EBA methodologies, uses annual data for 190 countries for the 1995–2016 period and incorporates fundamentals for low and middle-income countries. See further details of the EBA methodology in IMF (2019).

a multilaterally-consistent manner, as each country's variables are measured relative to a weighted-average of other countries' values).[3]

Botswana: Model Estimates for 2021 (in percent of GDP)	
	CA model
CA-Actual	**-0.5**
Cyclical contributions (from model) (-)	0.0
COVID-19 adjustor (+) 1/	0.6
Additional temporary/statistical factors (+)	0.0
Natural disasters and conflicts (-)	-0.1
Adjusted CA	**0.2**
CA Norm (from model) 2/	**0.7**
Adjustments to the norm (+)	0.0
Adjusted CA Norm	**0.7**
CA Gap	**-0.5**
o/w Relative policy gap	0.1
Elasticity	-0.34
REER Gap (in percent)	**1.5**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (2.48 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

6. **The EBA-lite suggests the Pula is broadly in line with fundamentals and desirable policies.** The CA-EBA lite approach estimates the CA gap to be equivalent to -½ percent of GDP, with a CA norm of 0.7 percent of GDP in 2021. Since the estimated elasticity of the trade balance to changes in the REER is -0.34, this methodology suggests that the REER would need to depreciate by 1.5 percent for the CA deficit to be reduced to the norm (see table above). From the perspective of the EBA-lite REER approach, the REER would need to depreciate by 14 percent to reach the norm. Staff gives more weight to the CA-EBA lite approach, which assesses the one-off factors driving some of the imbalances in 2020 and 2021 more directly than the REER approach.

Reserves Adequacy

7. **The IMF methodology to estimate reserves adequacy provides a rigorous way to assess the appropriate level of reserves.** Traditional metrics of adequacy—such as months of imports, cover of short-term debt plus debt service, or percent of broad money—are simple to understand, but can provide conflicting signals. Since a balance of payments crisis can arise from various sources, the IMF's metric for market access countries employs a risk-weighted measure of diverse sources of risk (see table below).[4]

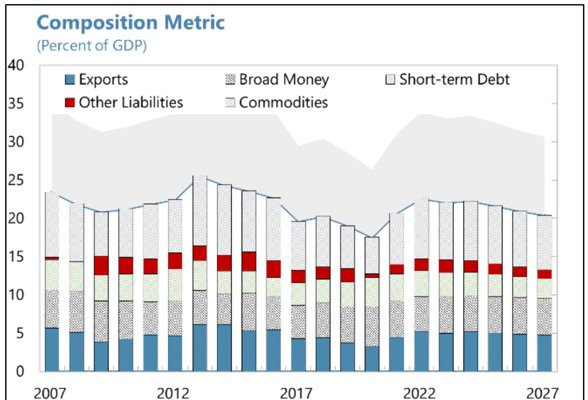
[3] Since the CA and ER are measured relative to other countries, they not only reflect a country's own characteristics but also external conditions within a simultaneously determined general equilibrium system. This also implicitly recognizes that developments in a small economy would mostly influence its own CA and REER, unlike those in a large country.

[4] See further details in IMF (2011, 2013 and 2014). A separate methodology is used for non-market access countries but is not relevant for Botswana which is an upper middle-income country with little external debt and an investment grade rating.

8. The IMF's metric encompasses four specific vulnerabilities: (i) export earnings to capture potential losses from terms of trade shocks; (ii) short term debt at remaining maturity (short term debt plus debt service) to reflect rollover risk; (iii) portfolio investments plus medium and long-term debt to account for drains from non-residents' investment; and (iv) broad money as a proxy for residents' capital flight. The weights for the risks in the metric are computed as the financial outflows at the tenth percentile of the estimated annual distributions of percentage changes of each of the items discussed above during periods of exchange market pressures.[5] Separate distributions are estimated for countries with fixed exchange rates or capital controls.[6] The weights for countries with a fixed exchange rate (assumed for Botswana) are:[7]

	Short-term Debt	Other Liabilities	Broad Money	Exports
Weights	30%	20%	10%	10%

9. Foreign reserves are under the control of the Bank of Botswana —with about four-fifths kept in a sovereign wealth fund (the Pula Fund) and one-fifth in a "liquidity" portfolio (used as a short-term liquidity buffer). Within the Pula Fund, about 80 percent is currently owned by the BoB and the remainder by the government (kept separately in a "Government Investment Account" held at the BoB in domestic currency). The share held by government has declined over time, reflecting drawdowns to finance the deficit.



Sources: BoB and IMF staff estimates.

10. As a result of drawdowns on reserves, Botswana's reserves have declined, but remain adequate at 205 percent of the standard ARA metric in 2021. Reserves would represent 139 percent of the adjusted ARA metric if Botswana's dependence on volatile diamond receipts is reflected by increasing the weight of exports to 25 percent (instead of 10 percent) in the ARA calculation.

[5] As in Eichengreen et. al. (1997), an exchange market pressure (EMP) index is constructed as the weighted average of reserve losses, exchange rate depreciation, and increases in interest rates. An episode of EMP occurs when the index deviates more than 1.5 times standard deviations from its average.

[6] Additional buffers are suggested for countries with commodity exports that exceed 50 percent of total exports. Botswana's commodity exports account for 80 percent of exports of goods and services (90 percent of goods exports). However, the IMF's methodology for commodity exporters relies on futures' prices which are unavailable for diamonds. Nonetheless, considering the decrease in diamond exports and the market weakness and depressed diamond price, staff considers that a weight of 25 percent for exports could be appropriately used to reflect volatility in diamond prices.

[7] Botswana's pula is pegged to a basket of currencies that comprises the South Africa's rand and the SDR (with a 45 percent weight for the former). While not exactly a fixed exchange rate regime, its operational details are closer to it than to a flexible exchange rate regime. Using the weights for flexible exchange rates would, by design, yield a lower level of adequate reserves compared to the weights for fixed exchange regimes.

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Annex II. Risk Assessment Matrix[1]

Source of risks	Likelihood	Expected impact if realized	Possible Policy Response
Global Risks			
Abrupt growth slowdown in China. A combination of extended Covid-19 lockdowns, rising geopolitical tensions, a sharper-than-expected slowdown in the property sector, and/or inadequate policy responses result in a sharp slowdown of economic activity, with spillovers affecting other countries through supply chain disruptions, trade, commodity-price, and financial channels.	Medium	High Lower global growth may affect demand for diamond, and other commodity exports (particularly to China) and slow the rebound in tourism. But reduced global diamond supply from sanctions against Russia should support diamond prices. A slowdown in neighboring countries could lower SACU revenue, affecting external and fiscal balances, foreign reserves and putting pressure on the Pula.	Accelerate structural agenda enhancing competitiveness and diversify the economy to build resilience against external shocks. Continue with the planned fiscal consolidation. Enhance regional integration. Consider more flexibility in exchange rate response to external shocks and slow the fiscal consolidation if the global growth impact of the war is more severe than expected.
Rising and volatile food and energy prices. Commodity prices are volatile and trend up amid supply constraints, war in Ukraine, export restrictions, and currency depreciations. This leads to short-run disruptions in the green transition, bouts of price and real sector volatility, food insecurity, social unrest, and acute food and energy crises (especially in EMDEs with lack of fiscal space).	High	Medium As an oil and food importer, inflation is likely to increase further, and inequality and poverty could rise. Both the current and financial accounts are likely to weaken, leading to a slower recovery in reserves. There are increasing demands for fiscal interventions to offset price increases. But the large share of South African imports, administered prices, and the crawling peg exchange rate, should limit the increase in prices and volatility.	Stand ready to raise the policy rate more rapidly. Provide targeted, short-term fiscal support to vulnerable households to cushion the impact of higher food prices.
Natural disasters related to climate change. Higher frequency of natural disasters cause severe economic damage to smaller vulnerable economies and accelerate emigration. Severe events in large economies hitting key infrastructure reduce global GDP, cause further supply chain disruptions and inflationary pressures, and prompt a recalculation of risk and growth prospects.	Medium	Medium More frequent/severe droughts in Southern Africa could disrupt water provision and reduce crop production, tourism activity, weaken strategic sectors (e.g. mining), and have debilitating effects on the poor. This would also lead to higher fiscal deficits, lower growth, and higher unemployment and inequality.	Implement climate change mitigation/adaptation measures, including low-carbon energy generation. Adapt spatial development strategies to long-term climate challenges and constraints. Enhance regional coordination to mitigate climate change shocks.
Domestic Risks			
Delays in implementing fiscal consolidation due to political economy constraints, capacity limitations or lack of effort on medium-term outcomes.	Medium	Medium Protracted low competitiveness, high fiscal and external deficits. Increase in public debt and/or erosion of buffers would jeopardize fiscal sustainability and threaten macroeconomic and external stability as well as social stability.	Advance fiscal reform by defining a long-term anchor and operational medium-term guidance for fiscal policy. Improve the efficiency of spending and preserve productive capital and social spending.
Delays in implementing key structural reforms to accelerate economic diversification, reduce the government's economic footprint, and enhance the business environment due to political economy constraints, capacity limitations or lack of effort on medium-term outcomes.	Medium	High Growth remains too low to reduce unemployment and inequality. Fiscal deficit and public financing needs are likely to increase over time. Buffers don't recover as rapidly, and the economy becomes increasingly dependent on diamonds.	Ensure implementation of macroeconomic reforms including fiscal consolidation and lower subventions to SOEs. Implement reforms to improve monetary transmission and deepen financial markets. Allow a greater role for the private sector in diversifying the economy (e.g., digitalization). Use the flexibility afforded by the current exchange rate regime.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Debt Sustainability Analysis

Botswana's public debt ratio is projected to remain low through the medium term. Risks around the public debt path are mainly related to the implementation of the planned fiscal consolidation and mineral revenues. Standard stress tests suggest the country's risk of debt distress remains low.

1. The strong recovery in mineral revenue and containment of the wage bill in FY2021–22 is expected to sharply lower public gross financing needs. Financing needs are projected to narrow to 8.4 percent of GDP in FY2021–22 from 14.8 percent in FY2020–21 (Table A3.1)[1], mainly driven by a strong rebound in mineral revenue, substantial domestic revenue mobilization and containment of public sector wage bill. Greater reliance on domestic bond issuance and external concessional financing has increased the public debt-to-GDP ratio slightly to 24.6 percent from 23.9 percent in FY2020–21. The long-term bonds financing came at an average cost of 8.5 percent in late-2021, compared with 5.1 percent pre-pandemic.

2. The medium-term baseline macroeconomic scenario envisages substantial fiscal consolidation and continued recovery in mining and non-mining revenues. The consolidation is expected to reduce public expenditure from 34 percent of GDP to 31.7 percent of GDP through FY2022–24. The overall fiscal balance is expected to turn into a surplus at 0.5 percent of GDP by 2024 as mineral revenue continues to recover and consolidation advances. Under current policies, the surplus is expected to reach 1¾ percent of GDP by the end of the medium term. As a result, the gross financing needs are projected to decline from 8.4 percent in FY2021–22 to 4.7 percent in FY2023–24, and to an average of about 1.9 percent of GDP over the medium term. The gross financing needs are assumed to be filled by continued issuance of domestic debt, which has the benefit of helping deepen the domestic bond market, and external debt including from multilateral institutions and bilateral loans. Public debt is estimated to have peaked at 24½ percent of GDP in FY2021–22 and will decline to 12½ percent in FY2026–27.

3. The war in Ukraine is not expected to have material impact on Botswana's debt dynamics. Shocks to global financial markets do not significantly affect Botswana's external debt, which is mostly in the form of bilateral and multilateral loans. In addition, as discussed in the text, although the war could weaken Botswana's economic growth in the short-term, it could also increase the demand for and prices of Botswana's diamond, thus raising mineral revenue. On balance, given Botswana's low debt position, the impact of the war on its debt dynamics is estimated to be small.

4. Standard shocks and stress test scenarios indicate favorable public debt dynamics.

- ***Growth shock.*** This scenario considers lower real GDP growth because of slower than anticipated recovery, reducing the real GDP growth by one standard deviation (about 4 percent) for two consecutive years. Under this scenario, public debt ratio would peak at

[1] Public debt is defined as central government debt (and guarantees) only. Botswana doesn't produce consolidated debt data for the overall public sector (including local governments, extra-budgetary funds, and parastatals).

30 percent, still under Botswana's debt ceiling of 40 percent of GDP and gross financing needs peak at a level lower than 10 percent of GDP.

- ***Primary balance shock.*** This shock considers a higher primary deficit by about 2.5 percent of GDP in FY2022–23 and by about 1 percent of GDP in FY2023–24. This scenario corresponds to, for instance, a lower than anticipated mineral revenue or absence of fiscal consolidation. Under this scenario, debt-to-GDP ratio and financing needs could be elevated but still peak at relative low levels.

- ***Combined macro-fiscal shock.*** This shock considers the most severe scenario of lower growth, higher primary deficit, and the associated higher interest rate. Under this scenario, public debt would remain below the debt limit of 40 percent of GDP and stabilize at about 25 percent of GDP in FY2026–27. Gross financing need would peak at around the 10 percent of GDP threshold by FY2022–23 but decline rapidly and stabilize below 5 percent of GDP.

- ***Contingent liabilities shock.*** This shock considers that a large share of contingent liabilities related to SOEs' debt is called. The scenario assumes a one standard-deviation shock to growth, with associated deterioration of the primary balance (as in the standard contingent liability shock scenario in the MAC DSA template), and a slight increase in interest rates. Under this scenario, debt would rise to about 27 percent of GDP in FY2022–23 (vs. baseline of 24 percent of GDP).

5. Realism of Baseline Assumptions:

- Projections of real GDP growth in 2020 and past primary balance show optimistic bias mainly reflecting the impact of the COVID-19 shock, and volatility in the diamond revenue and SACU receipts. The forecast errors in the primary balance also reflect the need for improving the authorities' fiscal consolidation plans.

- The projected 3-year adjustment in the cyclically adjusted primary balance (CAPM) is relatively strong, while the average size of adjustment is close to the mean (with a percentile rank of 44 percent) of the historical experience for high-debt market access countries. This reflects the front-loaded fiscal consolidation and elevated diamond revenue in FY2021–2022.

Table AIII.1. Botswana: Public Sector Debt Sustainability Analysis – Baseline Scenario

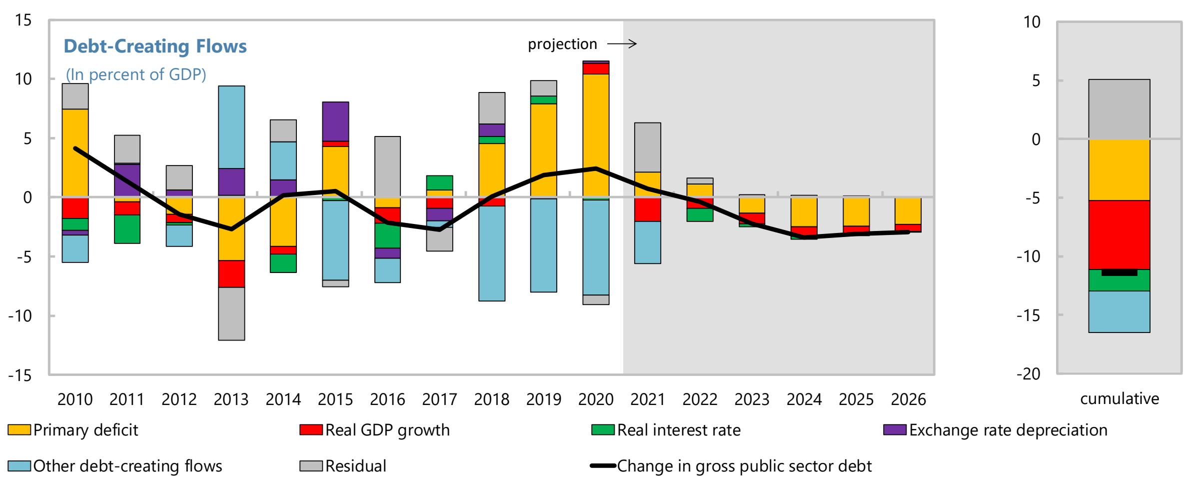
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 26, 2022		
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	23.8	21.5	23.9	24.6	24.2	22.0	18.6	15.5	12.5	EMBIG (bp) 3/		541
Public gross financing needs	3.5	10.3	14.8	8.4	5.6	4.7	3.2	1.3	1.2	5Y CDS (bp)		N/A
Net public debt												
Real GDP growth (in percent)	4.7	0.0	-4.0	9.5	4.2	4.0	4.0	4.0	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.3	0.3	4.4	2.5	8.1	4.8	5.2	4.5	4.4	Moody's	A3	A3
Nominal GDP growth (in percent)	9.9	1.3	-0.2	13.8	11.7	9.1	9.2	8.6	8.5	S&Ps	BBB+	BBB+
Effective interest rate (in percent) [4/]	2.6	3.5	3.1	2.7	3.3	3.8	4.0	4.0	4.4	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.3	1.9	2.4	0.7	-0.4	-2.3	-3.4	-3.1	-3.0	-11.4	
Identified debt-creating flows	-1.3	0.6	3.2	-3.4	-0.9	-2.5	-3.6	-3.2	-2.9	-16.5	
Primary deficit	0.5	7.9	10.4	2.1	1.1	-1.3	-2.5	-2.4	-2.3	-5.3	-0.6
Primary (noninterest) revenue and grants	35.5	28.3	26.1	31.3	31.6	32.2	32.0	31.3	30.5	188.9	
Primary (noninterest) expenditure	36.0	36.2	36.5	33.4	32.7	30.8	29.5	28.9	28.2	183.7	
Automatic debt dynamics [5/]	-0.6	0.5	0.8	-2.0	-2.0	-1.2	-1.1	-0.8	-0.6	-7.7	
Interest rate/growth differential [6/]	-1.6	0.6	0.6	-2.0	-2.0	-1.2	-1.1	-0.8	-0.6	-7.7	
Of which: real interest rate	-0.6	0.6	-0.2	0.0	-1.1	-0.3	-0.3	-0.1	0.0	-1.8	
Of which: real GDP growth	-1.0	0.0	0.9	-2.0	-0.9	-0.9	-0.8	-0.7	-0.6	-5.9	
Exchange rate depreciation [7/]	1.0	-0.1	0.2	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.2	-7.8	-8.0	-3.6	0.0	0.0	0.0	0.0	0.0	-3.6	
Privatization/Drawdown of Deposits (negative)	-1.2	-6.1	-5.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	-1.8	-2.3	-3.6	0.0	0.0	0.0	0.0	0.0	-3.6	
Residual, including asset changes [8/]	1.0	1.3	-0.8	4.1	0.5	0.2	0.2	0.1	-0.1	5.1	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

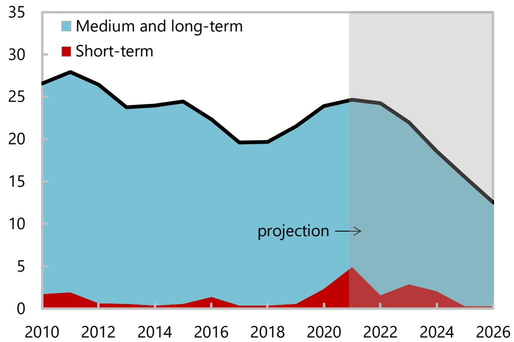
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure AIII.1. Botswana: Public Debt Sustainability Analysis – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

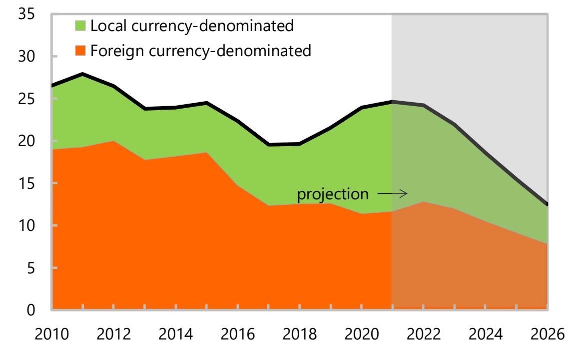
By Maturity

(In percent of GDP)



By Currency

(in percent of GDP)

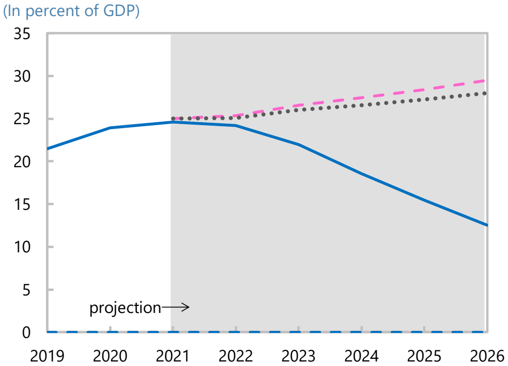


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

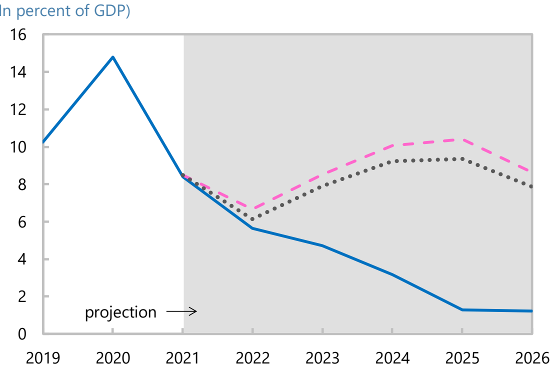
Gross Nominal Public Debt

(In percent of GDP)



Public Gross Financing Needs

(In percent of GDP)



Underlying Assumptions

(In percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	9.5	4.2	4.0	4.0	4.0	4.0
Inflation	2.5	8.1	4.8	5.2	4.5	4.4
Primary Balance	-2.1	-1.1	1.3	2.5	2.4	2.3
Effective interest rate	2.7	3.3	3.8	4.0	4.0	4.4
Constant Primary Balance Scenario						
Real GDP growth	9.5	4.2	4.0	4.0	4.0	4.0
Inflation	2.5	8.1	4.8	5.2	4.5	4.4
Primary Balance	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.7	3.3	3.7	3.7	3.6	4.7

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	9.5	2.9	2.9	2.9	2.9	2.9
Inflation	2.5	8.1	4.8	5.2	4.5	4.4
Primary Balance	-2.1	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	2.7	3.3	3.7	3.7	3.5	4.5

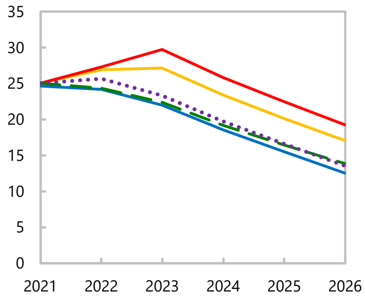
Source: International Monetary Fund, country desk data, and staff estimates.

Figure AIII.2. Botswana: Public Sector Debt Sustainability Analysis – Stress Tests

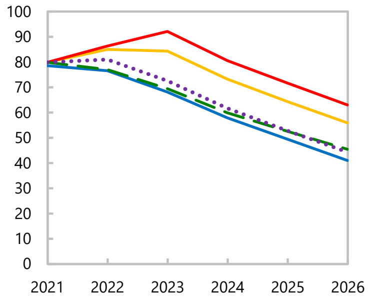
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

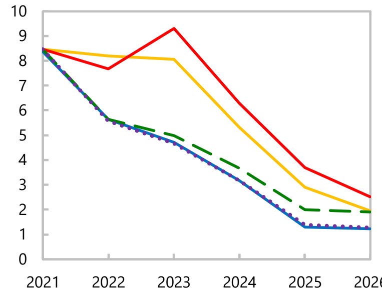
Gross Nominal Public Debt
(In percent of GDP)



Gross Nominal Public Debt
(In percent of revenue)



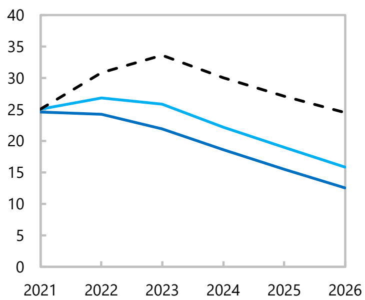
Public Gross Financing Needs
(In percent of GDP)



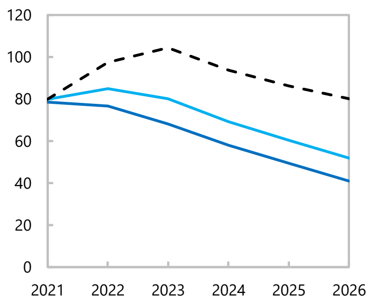
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock
Contingent Liability Shock

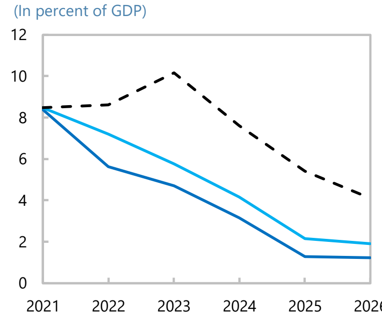
Gross Nominal Public Debt
(In percent of GDP)



Gross Nominal Public Debt
(In percent of revenue)



Public Gross Financing Needs
(In percent of GDP)



Underlying Assumptions

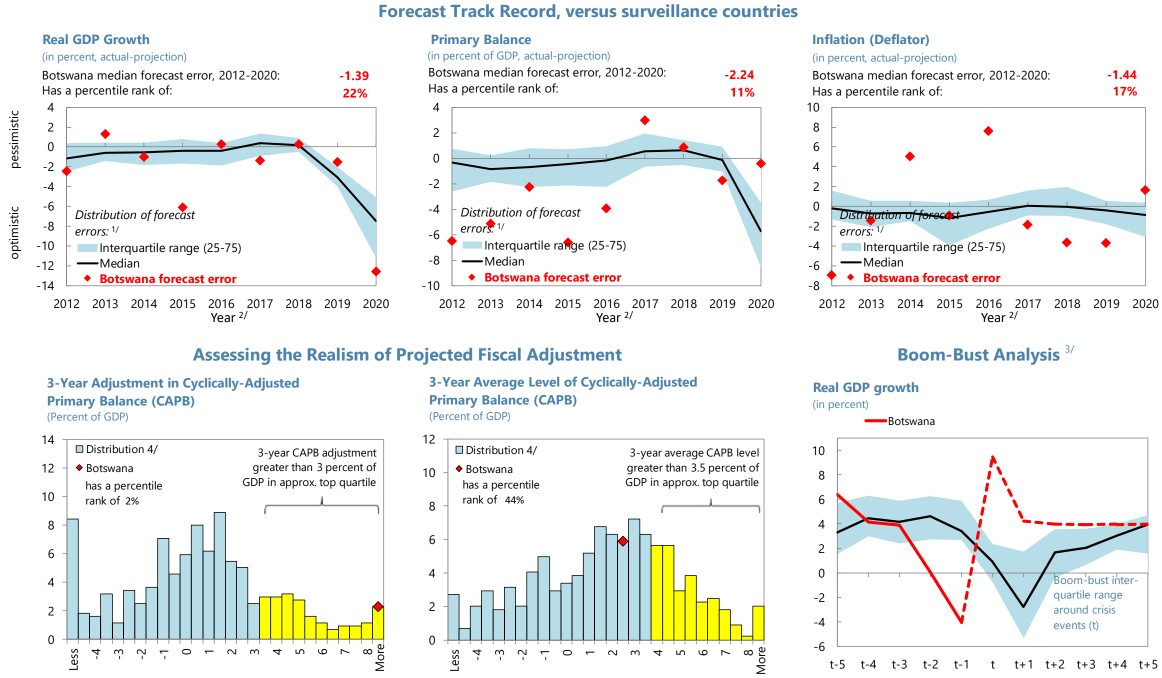
(In percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	9.5	4.2	4.0	4.0	4.0	4.0
Inflation	2.5	8.1	4.8	5.2	4.5	4.4
Primary balance	-2.1	-3.7	-1.2	2.5	2.4	2.3
Effective interest rate	2.7	3.3	3.8	3.9	4.0	4.7
Real Interest Rate Shock						
Real GDP growth	9.5	4.2	4.0	4.0	4.0	4.0
Inflation	2.5	8.1	4.8	5.2	4.5	4.4
Primary balance	-2.1	-1.1	1.3	2.5	2.4	2.3
Effective interest rate	2.7	3.3	4.9	5.7	6.1	7.3
Combined Shock						
Real GDP growth	9.5	0.2	0.0	4.0	4.0	4.0
Inflation	2.5	7.1	3.8	5.2	4.5	4.4
Primary balance	-2.1	-3.7	-2.0	2.5	2.4	2.3
Effective interest rate	2.7	3.5	4.8	5.4	6.1	7.9

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	9.5	0.2	0.0	4.0	4.0	4.0
Inflation	2.5	7.1	3.8	5.2	4.5	4.4
Primary balance	-2.1	-2.9	-2.0	2.5	2.4	2.3
Effective interest rate	2.7	3.3	3.8	3.9	4.0	4.7
Real Exchange Rate Shock						
Real GDP growth	9.5	4.2	4.0	4.0	4.0	4.0
Inflation	2.5	14.1	4.8	5.2	4.5	4.4
Primary balance	-2.1	-1.1	1.3	2.5	2.4	2.3
Effective interest rate	2.7	3.5	3.5	3.8	3.8	4.2
Contingent Liability Shock						
Real GDP growth	9.5	0.2	0.0	4.0	4.0	4.0
Inflation	2.5	7.1	3.8	5.2	4.5	4.4
Primary balance	-2.1	-2.4	1.3	2.5	2.4	2.3
Effective interest rate	2.7	3.5	3.8	4.0	4.0	4.5

Source: IMF staff.

Figure AIII.3. Botswana Public Debt Sustainability Analysis – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

For Botswana, t corresponds to 2021; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex IV. Summary of Capacity Development Strategy

Background

1. **Despite Botswana's strong recovery, long-standing challenges remain.** Lower financial and fiscal buffers leave Botswana more exposed to external shocks (e.g., climate change). Despite an improving fiscal outlook, expenditure on wages continues to run ahead of budgeted amounts. The financial sector appears sound, but the impact of higher rates, declining liquidity and the recent monetary policy reform will have to be monitored. Persistently high unemployment and inequality mostly reflect the lack of opportunities in the mining-dependent economy.

2. **Responding to these challenges will require stronger institutional frameworks.** The primary TA requirements will be targeted towards strengthening fiscal institutions (including spending efficiency and revenue mobilization), enhancing the effectiveness of monetary policy, improving financial sector oversight, and broadening statistical reporting,

Capacity Development Assessment

3. **Cooperation between the Fund and Botswana on technical assistance (TA) and training continues to be strong**. The authorities have expressed appreciation for completed and ongoing TA (e.g., monetary operations, stress testing, banking supervision topics and payments systems). The authorities have shown ownership of the reform processes in many areas and have generally followed up on TA recommendations. Implementation of recommendations has been relatively good on financial sector, monetary policy, and BOP statistics. Progress in the areas of public financial management, national accounts and fiscal statistics has been more mixed.

4. **There is a need for strong involvement and prioritization of human and financial resources by the authorities in the areas of TA provisioning**. Despite good progress, the effectiveness of TA has been hampered by staffing shortages, limited absorption capacity, and lack of expertise in drafting regulations. TA activities could achieve greater results by relying more on hands-on support, resident advisors, peer-to-peer exchange, and engagement, as well as comparisons with international best practices to complement written recommendations. Frameworks and systems are required that ensures the sustainability of data compilation and dissemination within the prescribed frequency and timelines (e.g., through introduction of government e-services). Coordination within the Fund could also strengthen the effectiveness of TA.

5. **Several large projects and initiatives are planned for the coming year**. The authorities have reiterated their aim of subscribing to the IMF's Special Data Dissemination Standard (SDDS) and noted outstanding challenges with compilation of the industrial production index (IPI) and government finance statistics (GFS). Botswana is part of the Cyber Risk Regulation and Supervision Capacity Development Initiative, which will require TA support from the Fund.

The BoB's longstanding request for a resident expert on monetary operation and debt market development has been granted. In addition, the FSAP consultations will begin in mid-2022.

Capacity Development Priorities

6. **The TA priorities listed below are consistent with the country's macroeconomic priorities.** The Fund has already delivered some assistance on the items below and further assistance is expected to be forthcoming. The authorities have made additional TA requests in FY2022 in the areas such as economic forecasting, taxation of the digital economy, PIMA updates (including climate risks), fintech strategy monitoring and regulation, crisis preparedness, and drafting of legislation.

Surveillance Priorities	CD Objectives
General Macroeconomic Analysis	- Refine near-term forecasting tool using a composite index of leading indicators
Revenue mobilization and administration	- Provide training to Tax Policy Section staff on legal drafting - Assist with drafting of a policy document on taxation of the digital economy - Assist with preparing a roadmap for the introduction of electronic billing machines (EBMs), including proposals for necessary legal reforms, technology options and public education. - Provide training in negotiation and implementation of Double Taxation Avoidance Agreements
Public financial management	- Improve coverage and quality of fiscal reporting - Strengthen identification, monitoring, and management of fiscal risks - Improve laws and effective PFM institutions - Strengthen fiscal risks management framework
Fiscal framework	- Provide training for building DSA capacity. - Assist the authorities in designing and calibrating a new fiscal rule. - Assist with developing a framework for dealing with various contingent liabilities, including those stemming from PPPs - Strengthen identification, monitoring, and management of fiscal risks - Improve laws and effective PFM institutions - Improve fiscal policies and institutional frameworks to combat climate change and its impacts
Central bank operations	- Strengthen efficient implementation of monetary policy under the existing regime - Assist with drafting of Central Bank / Macroprudential Oversight Law - Ensure autonomy and good governance of central bank
Financial supervision and regulation	- Review planned LCR NSFR regulation - Assist with stress-testing NBFIs. - Review cybersecurity regulation, and undertake cybersecurity risk examination

Surveillance Priorities	CD Objectives
	- Assist in developing a liquidity risk regulatory and supervisory framework, incorporating the Basel III requirements. - Conduct a financial stability assessment (FSAP) - Strengthen crisis preparedness and bank resolution framework - Design optimal arrangements regarding fintech for better oversight and national coordination
Monetary and macroprudential policy implementation and operations	- Strengthen the operational framework including the liquidity forecasting. - Assist with the concept paper, policy design and legal drafting for a Deposit Protection Fund - Recalibrate the existing stress testing model to accommodate macro-financial stress-testing. - Strengthen efficient implementation of monetary policy and exchange rate management under the existing regime - Modernize the liquidity management framework and strengthen forecasting capacities. - Provide training on local currency bond market development.
Improve the quality of statistics	- Develop the PPI and owner occupier housing component of the CPI. - Complete the migration to GFSM 2014 and extend the coverage to general government. - Improve the BOP and IIP data to conform with BPM6 requirements. - Extend the coverage of monetary and financial statistics to include other financial corporations' sector.

Annex V. Designing a Fiscal Rule for Botswana[1]

Background

7. **Despite low debt, Botswana's current 40 percent of GDP gross debt limit does not effectively guide fiscal policy.** Public and publicly guaranteed debt is around 24 percent of GDP in FY2021/22, but hides a steep decline in financial assets, with the Government Investment Account at the Bank of Botswana falling from 45 percent of GDP in 2007/08 to 6 percent of GDP in 2021/22. Foreign reserves fell from 68 to 26 percent of GDP over the same period. Continuing this path will make Botswana less resilient to external shocks and may be unfair to future generations.

8. **Botswana's weakening fiscal position over the past five years underscores the need for more binding fiscal rules.** The fiscal balance moved from a surplus of 13 percent of GDP in FY2006/07 to deficits averaging 6 percent of GDP in the past five years. Total revenues have fallen from more than 43 percent of GDP in 2007/08 to around 32 percent of GDP in 2021/22. Around half of this decline is due to falling mineral revenues, compounded with declining non-mineral and South African Customs Union (SACU) revenues. In contrast, expenditure has averaged 37 percent of GDP over the past decade – much higher than other resource-rich and upper-middle income peers, with its wage bill particularly high at around 14 percent of GDP on average.

9. **A well-designed fiscal rule, coupled with clear fiscal objectives, could help benefit future generations, build buffers against shocks, while preserving space for development spending.** This annex describes an expenditure rule combined with a floor on liquid financial assets as an operational rule, and outlines practical steps, including PFM reforms, to put this framework into practice.

Fiscal Anchor and Operational Rules

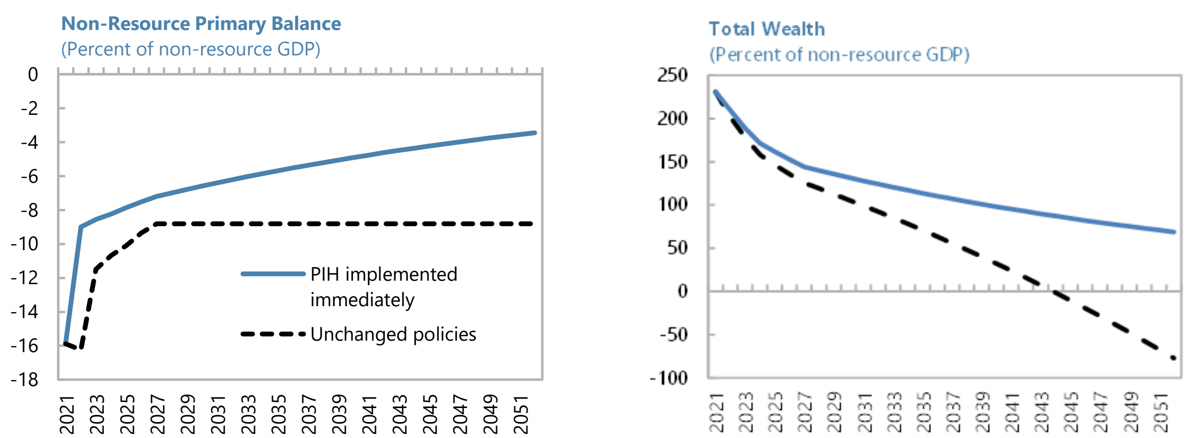
10. **The permanent income hypothesis (PIH) model can provide a suitable long-term anchor for fiscal policy, around which Botswana could develop a medium-term operational rule.** Fundamentally, the PIH provides an anchor by taking the net financial wealth of the country (existing financial assets, net present value of future resource revenue, minus public debt) and turning this wealth into a constant stream of income. This income can in turn finance a non-resource deficit on a permanent basis. Significant challenges in implementing the PIH include uncertainty on its underlying parameters (notably on future resource revenue), and the typically large fiscal adjustments required to reach the recommended non-resource fiscal balance.

11. **There are multiple adjustment paths to reach the PIH norm with different adjustment speeds.** For the next thirty years, assuming diamond production averaging 22 million carats per year and constant diamond prices in real Pula terms gives a net present

[1] Contributed by Olivier Basdevant and Mark Griffiths (IMF Fiscal Affairs Department).

value of Botswana's diamond wealth of about 210 percent of non-resource GDP in 2021/22 (with a total wealth of 230 percent of non-resource GDP). Assuming a 5 percent real interest rate, and that the stream of income derived from the financial wealth is constant in pula terms[2], implementing the PIH immediately would require the non-mineral deficit to decline to 9.5 percent of non-mining GDP in FY2022/23, and to about 3.5 percent by FY2050/51, before slowly converging towards zero (Figure A5.1). A more gradual approach, which follows the staff baseline over the medium term, would require additional adjustment of a ¼ percent of non-resource GDP annually beyond the medium term (over the period 2027–52), bringing the primary balance from -8.8 percent of non-resource GDP to -1.1 percent (Figure A5.2). Compared to the immediate implementation of the PIH, this gradual adjustment would have the advantage of providing more fiscal space throughout the medium term for public spending that could support diversification and growth objectives. On the other hand, it comes with a cost of running larger non-mining primary deficits throughout the medium term, building financial wealth more slowly. Lower financial wealth would in turn finance a smaller non-mining fiscal balance. This reduced fiscal space, however, could be compensated by a permanently higher non-mining GDP, to the extent that development spending is efficient and raises growth potential.[3]

Figure AV.1. Botswana: Immediate Implementation of the PIH vs. the Current Framework

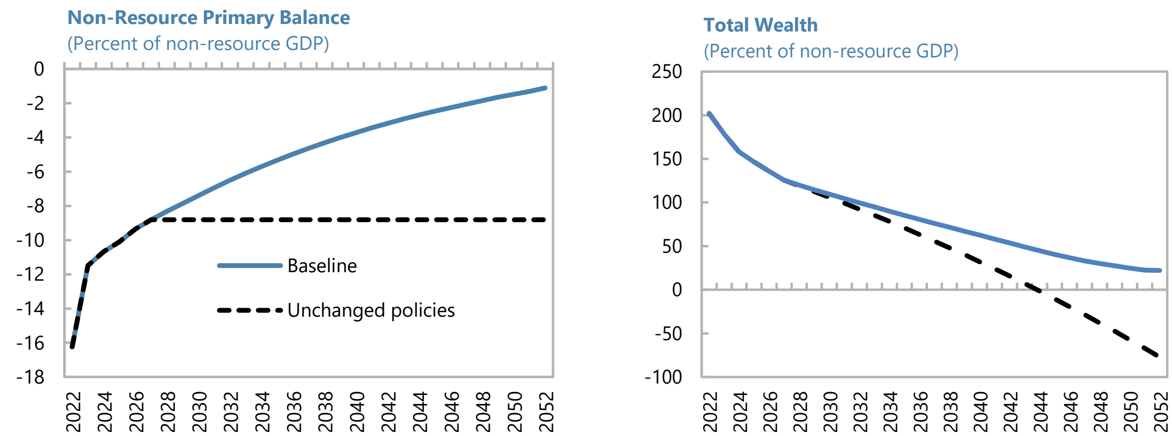


Source: Botswana authorities and IMF staff projections

[2] The additional assumptions are non-mining GDP grows at 3 percent per year, with nominal GDP growing at 6.1 percent. Annual population growth Is assumed to be 1 percent.

[3] The main reason why the sustainable deficit declines as a percent of the non-resource GDP is because it is held constant in real terms, while non-resource GDP is assumed to grow at 3 percent per year in real terms.

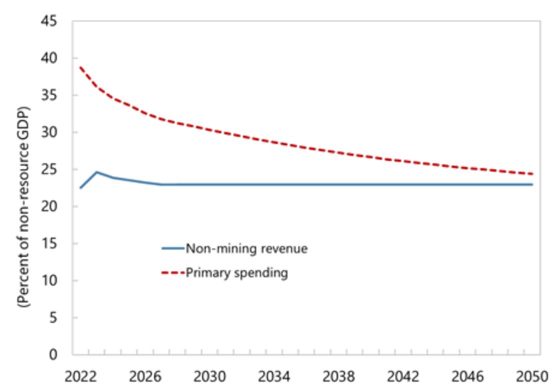
Figure AV.2. Botswana: A Gradual Adjustment to the PIH Norm



Source: Botswana authorities and IMF staff projections

12. In practice, a well-calibrated expenditure path can help achieve the target path for non-mining primary deficits.[4] For example, under the gradual approach, a bulk of the adjustment is expected to be delivered by fiscal consolidation in the staff baseline until 2027. Beyond the medium term, real expenditure growth could be capped at about 2 percent annually, which would be sufficient to meet the target, under the assumption of 3 percent GDP growth per year.[5]

A Gradual Adjustment to the PIH Norm



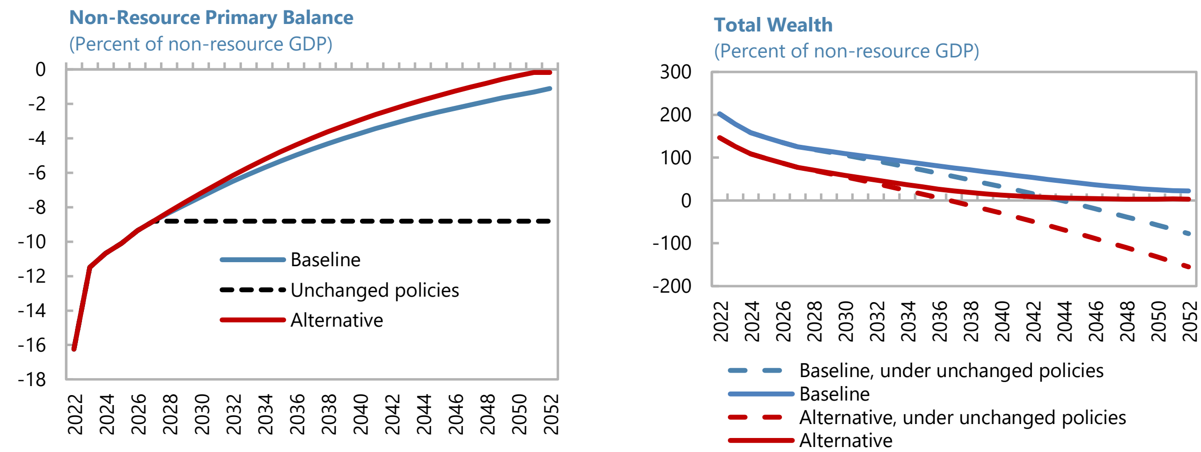
Sources: Botswana authorities, and IMF staff projections.

13. However, it would be important to err on the side of caution (Figure A5.4). The deficit target consistent with the PIH objective depends on forecast parameters. Although having buffers could partly mitigate negative temporary shocks, it would be inadequate for more permanent shocks. As an illustration, we present below the implication of a permanent negative shock on mining revenue that corresponds to a loss of 25 percent of the net present value of future diamond revenue. In this scenario, almost all financial wealth would be depleted by the transition period, allowing for a sustainable deficit of only 0.5 percent of non-resource GDP (and declining) beyond 2041. The required real expenditure growth cap in this scenario would be more stringent at about 1 percent over the period 2027–41.

[4] For simplicity, non-mineral revenues are assumed to grow in line with non-mineral GDP. Adding together the deficit and revenue gives the appropriate level of expenditures, consistent with the target for the non-resource primary deficit.

[5] Note though that asymptotically, the expenditure growth cap could be gradually relaxed, as the non-resource primary balance would reach zero and so would the financial wealth, thus leaving real expenditure growth converging towards 3 percent, the growth of the non-resource GDP.

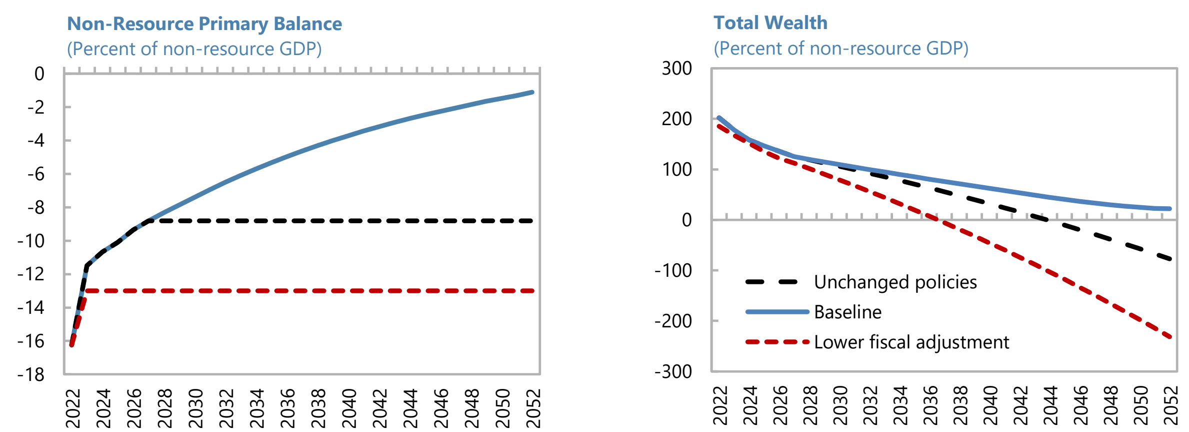
Figure AV.4. Botswana: Contrasting the Impact of a Negative Shock on Resource Revenue



Source: Botswana authorities and IMF staff projections

14. Stress-testing the fiscal adjustment plan is also critical for ensuring fiscal sustainability (Figure A5.5). For example, if the planned fiscal consolidation stalled after reaching a deficit of 13 percent of non-resource GDP, Botswana would end up with negative total wealth within 10 years, lowering future living standards and putting the country on an unsustainable path.

Figure AV.5. Botswana: Stress-Testing the Fiscal Adjustment Plan



Source: Botswana authorities and IMF staff projections

15. Sufficient fiscal buffers are also needed to guard against economic shocks. Over the past ten years, Botswana's mineral revenues have constituted about 40 percent of total revenues (14 percent of non-mining GDP) and have been volatile, with a standard deviation of 3.3 percent of non-resource GDP. This underscores the desirability of having a buffer to protect the budget against swings in diamond prices and production, as well as volatility in SACU transfers.

16. The size of the desired buffer depends on the risk attitude, the country characteristics, and the opportunity cost of keeping the buffer as liquid asset. One simple approach would be to have a buffer covering one-standard deviation of mining revenues

(3.3 percent of non-resource GDP) for each year. A more prudent approach could be to have buffers that cover the whole duration of an NDP, requiring buffers of about 20 percent of non-resource GDP. A significant likelihood of tail risk materializing warrants larger buffers.

17. Although some countries can borrow when buffers are required, others struggle to access external financing in times of need. A more secure way of obtaining buffers would be to accumulate financial assets and keep part of these in liquid assets. Doing so would not preclude the government from issuing public debt to support domestic financial market development and liquidity, while sticking to the desired path for net financial assets.

Institutions to Support a Fiscal Rule

18. Communication is key as fiscal rules typically need to have broad support (e.g., civil society and the private sector). The government should communicate its new fiscal objectives, how the fiscal rule will achieve these objectives and how it will make sure that the rule will be followed. Clear communication can also help in emergencies where, for example, escape clauses are invoked.

19. The fiscal rule should be included in each National Development Plan (NDP), especially in its quantitative objectives, and set out in legislation.

- Botswana has made considerable efforts to develop a medium-term fiscal framework (MTFF). The work could continue, with the view of ultimately provide an institutional support to a fiscal rule. Annual budgets should be anchored on the MTFF (outlined in NDPs), with potential deviations from the fiscal rule explained and potentially corrected in subsequent budgets.

- The Ministry of Finance must be able to ensure that the Ministries, Special Funds and Extra-Budgetary Institutions adhere to aggregate expenditure ceilings. Reporting on SOEs should also be strengthened, as well as revenue forecasting.

- The principles of the fiscal rule should be set out in legislation. The law should also include transparent escape clauses, to provide flexibility in the event of shocks. Ideally the legislation would be introduced simultaneously with the next NDP.

- To improve accountability and oversight, the authorities may consider creating an independent fiscal council, requesting reviews from outside fiscal experts from academia or non-partisan think tanks or establishing some form of independent fiscal unit with the Office of the Auditor General. One binding constraint might be a lack of capacity

20. To avoid potential circumvention of the rule, the coverage of fiscal accounts, and corresponding financial supervision, should be as broad as possible. Comprehensive, reliable, and accessible fiscal statistics are required implement a rule and increase accountability. The Accountant General should approve the new Chart of Accounts (informed by the

Government Finance Statistic Manual of 2014), and then consolidate the Special Funds, below-the-line accounts, and the Extra-Budgetary Units into the Central Government fiscal accounts. To improve reliability and availability, the authorities should publish time series of its fiscal statistics in an accessible manner, including the financial accounts of local authorities and state-owned enterprises and an annual tax expenditure report.

Annex VI. Multivariate Filter Estimation of Potential Output for Botswana[1]

1. **This annex applies the multivariate filter (MVF) to estimate potential output and output gap for Botswana.** Potential output is defined as the level of output that an economy can sustain without generating inflationary pressure. The MVF method was originally developed by Laxton and Tetlow (1992)[2] and modified by Alichi, et al. (2015)[3]. It includes basic economic identification restrictions, relating the output gap to the labor market conditions (Okun's law) and inflationary pressures (Philips curve). Relative to estimates of potential output from the Hodrick-Prescott (HP) filter, the MVF has proven to provide more accurate real-time estimates of potential output (Laxton and Tetlow, 1992).

2. **A mining block is included in the model to capture the mining sector.** The mining sector, especially the diamond industry, plays a crucial role in Botswana's economy. While its production accounts for less than 1/5 of overall GDP, its export contributes to 90 percent of goods export. On average, about 1/3 of the government's fiscal revenue comes from the mining revenue. Performance of the mining sector affects public expenditure and domestic demand, as the public sector employs half of the formal labor force and government consumption contributes to more than 30 percent of GDP. However, the mining sector is highly susceptible to external shocks with high volatility observed in the past of international prices and demand.

3. **Based on Bayesian estimation techniques, staff estimated the MVF model with the following specification,** allowing for supply-side shocks to the mining and non-mining sectors to operate independently.

Output Gap: $$Y_t = \varphi \cdot Y_{t-1} + r \cdot M_{gap_t} + \varepsilon_Y$$

Phillips Curve: $$\pi_t = \lambda \cdot \pi_{t+1} + (1-\lambda) \cdot \pi_{t-1} + \beta \cdot Y_t + \varepsilon_\pi$$

Okun's Law: $$u_{gap_t} = \tau_1 \cdot u_{gap_{t-1}} + \tau_2 \cdot Y_t + \varepsilon_{u_{gap}}$$

Mining Block: $$M_t = M_{trend_t} + M_{gap_t}$$

$$M_{trend_t} = (1-\mu) \cdot M_{trend_{t-1}} + \mu \cdot M_{trend}^{SS} + \varepsilon_{M_{trend}}$$

$$M_{gap_t} = r_1 \cdot M_{gap_{t-1}} + \varepsilon_{M_{gap}}$$

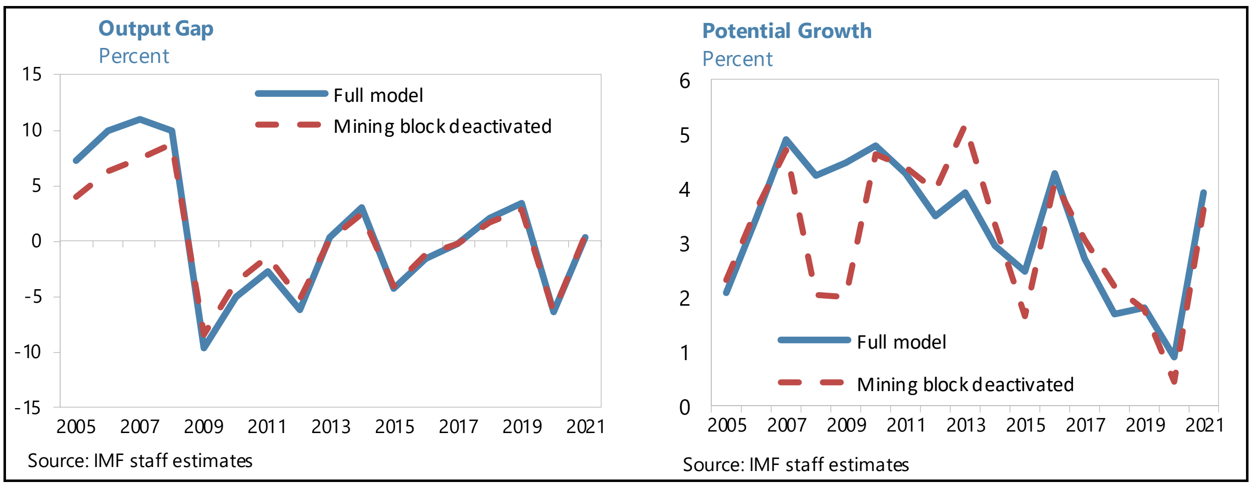
[1] Prepared by Kadir Tanyeri (IMF, Information Technology Department).

[2] Laxton, D., and R. Tetlow, 1992, "A Simple Multivariate Filter for the Measurement of Potential Output," Technical Report No. 59 (Ottawa: Bank of Canada).

[3] Alichi, A., O. Bizimana, S. Domit, E. Fernandez Corugedo, D. Laxton, K. Tanyeri, H. Wang, and F. Zhang, "Multivariate Filter Estimation of Potential Output for the Euro Area and the United States," IMF Working Paper WP/15/253.

Where Y is the output gap, π is inflation, u indicates the unemployment rate and M stands for mining. Output gap and mining gap refer to deviations for each corresponding variable from their long-term trend. The model parameter values and the variances of shocks for these equations are estimated using Bayesian estimation techniques, with annual data on nominal GDP, CPI inflation, the unemployment rate and mining output for the period 1990–2021. The model has capability to deactivate the mining block which will assess the combined economic activity in both mining and non-mining sector. This model assigns some variation in the observed GDP to level shocks to potential output during periods of sharp declines in GDP growth. This allows potential output growth to be flexible, which improves real-time accuracy of the estimates, and also minimizes revisions to historical estimates. In addition, this swifter adjustment of potential output is consistent with the idea that the business cycle in emerging market and developing economies tends to be driven, to an important degree, by shocks to potential output (Aguiar and Gopinath, 2007).[4]

4. Results. Staff estimates the model with and without the mining block. The results show a significant deterioration throughout the economy in 2020 with the onset of the pandemic. They also show a good bit of a recovery in 2021. This recovery is partially due to a quick recovery in mining sector. The output gap for 2021 is 0.22 percent with the full model and 0.50 percent with mining block deactivated.



[4] Aguiar, M., and G. Gopinath, 2007, "Emerging Market Business Cycles: The Cycle Is the Trend", Journal of Political Economy, University of Chicago Press, vol. 115, pp. 69–102.

Annex VII. Tourism in Botswana: Recent Development and Post-Pandemic Policy Options[1]

1. **Botswana's tourism sector provides the second largest source of export earnings and is a critical sector for employment and poverty reduction**. According to the latest update of Botswana's latest available tourism satellite accounts (TSA) compiled by UN World Tourism Organization (UNWTO), it directly accounted for 4.9 percent of GDP in 2016[2]. With close interlinkages with other sectors and supply chains, tourism's *indirect contribution* (including capital investment, government spending, and supply chain effect) and *induced contribution* (including spending by those directly or indirectly employed by tourism) could be sizable. The total contribution of tourism was estimated at 7.6 percent of GDP in 2016. The World Travel and Tourism Council (WTTC) TSA estimated an even higher total contribution of tourism to GDP at 11.6 percent in 2016. Tourism also contributes significantly to employment, providing about 74,000 jobs directly and indirectly (18 percent of total formal employment). It brings economic activity to rural areas and communities with limited alternatives. It also employs a high share of young workers and women.

Text Table AVII.1. Botswana: Performance of Tourism

	UNWTO			WTTC		
Indicator	**2006**	**2009**	**2016**	**2006**	**2009**	**2016**
Internal Tourism Expenditure (P' billion)	4.1	5.8	14.5	5.9	5.6	13.0
Tourism Direct Gross Value Added (P' billion)	1.9	2.9	7.7	1.8	2.8	6.5
Tourism *direct* contribution to GDP (percent of GDP)	3.4	3.7	4.9	3.1	3.8	3.8
Tourism *total* contribution to GDP (percent of GDP)	4.2-6.0	4.6-6.5	7.6	9.9	11.5	11.6

Source: UNWTO, WTTC, Department of Tourism

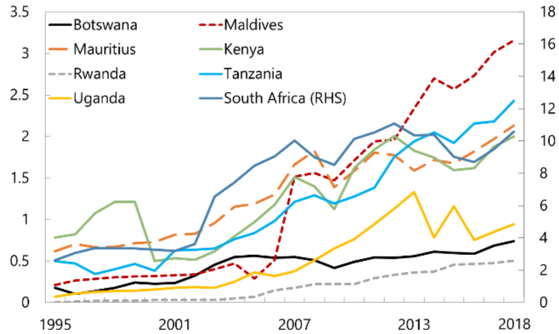
2. **The tourism sector has been growing steadily in the past decade but at a rate lower than its peers.** Botswana's unique natural resources, coupled with its high level of safety and security, have made it an attractive tourist destination. However, compared to peers, growth has been limited amid low competitiveness. Export earnings have been growing slower than those of other Sub-Saharan African countries with niche tourism such as Kenya, Maldives South Africa,

[1] This analysis relies on third-party indicators which intend to provide country-level measures as consistent as possible. Nevertheless, they should be interpreted with caution due to the use of benchmarking and the limited cross-country adoption of full TSAs, and accuracy of the TTDI can be biased by the experts' views as input into the index (instead of only facts).

[2] The most recent detailed work on Botswana's TSAs was compiled by the UN World Tourism Organization (UNWTO) and the Department of Tourism for 2016. An update is currently on-going. This direct contribution "includes GDP generated by industries that deal directly with tourists, including hotels, travel agents, airlines and other passenger transport services, as well as the activities of restaurants and leisure industries that deal directly with tourists."

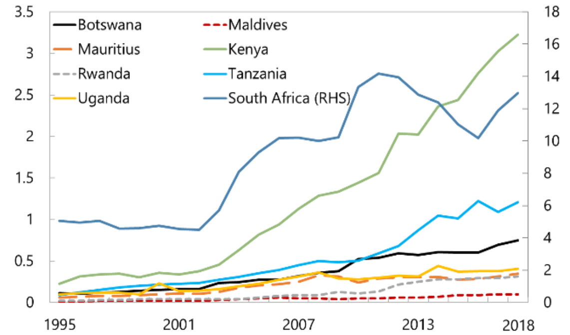
Tanzania, and Uganda. In addition, by source, more than half of leisure tourists came from neighboring states (South Africa, Zambia, Namibia), followed by U.S., Canada, Australia, and Europe. Few tourists came from Asia (esp. China and India), even though Asian tourists now account for ¼ of global tourism spending and tourist arrivals.

Export Earnings, 1995-2018
(Billions of USD)



Sources: World Travel and Tourism Council.

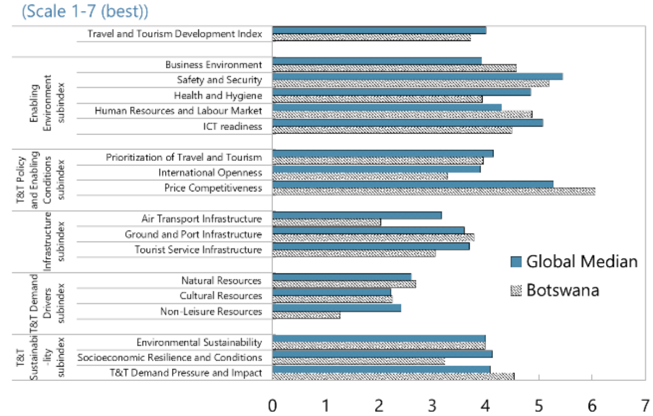
Domestic Tourism Spending, 1995-2018
(Billions of USD)



Sources: World Travel and Tourism Council.

3. **The resilience and sustainability of Botswana's tourism have improved in recent years**. According to the World Economic Forum's Travel and Tourism Development Index (TTDI, 2021), its score improved somewhat in 2021 compared to 2019 but still lags peers (especially those in other regions). The main barriers to growth of the tourism sector have been identified as: inadequate product range and diversity (e.g., lack of cultural resources), shortcomings and limited access to air travel, and service infrastructure, inadequate local participation and ownership, weakness in tourism planning, lack of international openness (e.g., low availability of air connections to the country) and low qualification of the labor force.

Travel & Tourism Development Index Scores 2021
(Scale 1-7 (best))



Sources: Travel & Tourism Development Index 2021, World Economic Forum.

4. **Hit hard by the COVID-19 pandemic, Botswana's tourism is expected to recover strongly this year.** As elsewhere, tourism in Botswana came to a halt during the first eight months following the outbreak of the COVID-19 crisis. International tourist arrivals declined by 80½ percent in 2020 relative to the pre-pandemic level. This translates into an estimated loss in visitor spending of around USD 400 million according to the WTTC. The sector's total contribution to GDP dropped from 10.4 percent of GDP in 2019 to 5.5 percent of GDP in 2020 with an eastimated job loss of 17,000. However, in late-2020 Botswana's inbound tourism started recovering despite slowly, thanks to its existing high-value, low-volume, nature-based tourism strategy that limits the number of vistors. This positioning, although restricting tourism expansion in the past, has allowed Botswana's tourism to recover faster than other countries. In addition, a large share of tourism companies are (partially) foreign owned, and have some buffers and access to finance in the face of shocks. The government also put in place a large fiscal relief

package, including the Industry Support Loan Facility of P1.3 billion that benefitted the tourism industry. Driven by high domestic vaccination rate, pent-up demand for travelling and loosening of restrictions globally, tourism is expected to rebound in 2022 and back to the pre-COVID level in 2023.

5. The government has recently stepped up its effort to diversify the tourism sector. The 2020 revised tourism policy seeks to broaden its product base by adding more forms of tourism – such as sports, health, religious, MICE (Meetings, Incentives, Conferences and Exhibitions), game farming and research – and increasing the geographic spread of tourism (outside of the Okavango Delta and Chobe National Park areas). The UNWTO, the Ministry of Environment, Natural Resources Conservation and Tourism of Botswana are currently collaborating on a National Tourism Strategy and Master plan for 2022–2032.

6. Post-pandemic policy options. While recovery of the tourism industry will depend on global health and economic developments, policy and institutional choices will also play a critical role. Botswana's travel and tourism sector needs a clear strategy for the post-pandemic world to improve its competitiveness and unlock its potential.

- Strengthening Botswana's health system can enhance its attractiveness in a post-COVID era. As shown by the 2019 TTCI, Botswana's health and hygiene score is still low (3.3 well below the world median of 5.4) partly driven by HIV-related issues.

- Continued support for low-density and eco-sustainable tourism services can help reduce health risks and build a more-resilient and environment-friendly economy. This include improving access to ecotourism sites, providing business development advisory to enhance the quality of services, and increasing its social and local impact.

- Increasing specialized training can develop domestic skilled tourism labor and improve service quality. Training institutions focusing on hospitality/tourism with specific knowledge on business management, customer service, marketing, and tourism-related technology are needed.

- Leveraging digital technology to shift services onshore and adapt to different customer services can secure a greater share of the value chain and boost tourism earnings. For example, some companies have achieved this by shifting the booking service online to directly interact with consumers rather than through other overseas booking agents. Digitalization can also help facilitate greater access to opportunities to women (e.g., through telework), broadening inclusion.

- Diversification of tourism by further broadening product range, geographic focuses, as well as visitor origins (e.g., attracting visitors from Asia).

- Continued efforts to enhance the country's infrastructure (air connections) and address remaining issues raised in World Bank (2012)[3] (e.g., land access and conservation) are needed.

- Improving collection and analysis of data on the tourism sector is critical to track its economic impact and inform policy design, including compiling TSAs annually, collecting spending information by various categories of visitors (both domestic and international), financial statistics of tourism companies, and information on employment, ownership, and community engagement, as well as improving the quality of data on tourism exports.

[3] World Bank (2012) "Botswana: Systematic Country Diagnostic", Washington DC.

Annex VIII. Climate Financing – Path to a Greener, Resilient Future[1]

1. **Botswana is highly susceptible to climate shocks.** Variability in temperature and rainfall makes it vulnerable to droughts and floods, particularly as it has a high dependence on rain-fed agriculture. It is among the top three countries in Sub Saharan Africa in terms of expected increase in temperature by 2100 and in the top 2 in terms of expected annual decrease in rainfall (IMF 2020).[2, 3]

2. **At the same time, Botswana needs to moderate its carbon emission to meet its mitigation goals through investments in renewable energy.** Botswana is heavily reliant on coal for its power generation with about four-fifth of its power generating capacity residing in coal based Morupule A and B power plants. The remainder of power plants are diesel based. At present these plants are insufficient to meet the countries' rapidly growing energy demands which need to be met through import from neighboring countries.[4] Botswana has pledged to reduce its carbon emissions by 15 percent below 2010 level by 2030 in its Nationally Determined Contribution (NDC) in the Paris Agreement. Investment in renewable energy can thus help meet its mitigation pledges and at the same time help address its large energy needs.

3. **Reducing the carbon-intensity of its energy production can make its exports less susceptible to Border Carbon Adjustment (BCA) taxes.** A number of advanced economies (European Union, the UK and the US) are considering implementing BCA whereby imports would be penalized or taxed for higher carbon footprint than the standard within their jurisdiction. The European Union has already proposed BCA for four key industries – aluminum, steel, cement, and fertilizers – which will be in effect from 2023. While Botswana's share of exports of these items is very small, as the world moves towards a low carbon future, BCA could become increasingly more common and applied over a greater range of goods.

4. **Botswana has already made important strides in meeting its adaptation and mitigation goals.** Adaptation efforts are concentrated in seven sectors – meteorological services, water, livestock, crop production, biodiversity and ecosystems and human health – and are closely linked to the government's development goals. An Early Warning System for weather related disasters is already in place and the government is looking to improve it. On the mitigation front, the National Energy Policy was approved in April 2021 that provides a legislative framework for interventions in the energy sector including for green energy. In July 2021, the government issued a license to local energy firms to set up two 50 MW solar power plants. It also

[1] Prepared by Saad Quayyum (Regional Studies Division, IMF African Department)

[2] Temperature is expected to increase between 2.9–3.8 degrees Celsius by 2100 according to IPCC report.

[3] IMF (2020), "Botswana: Staff Report for the 2019 Article IV Consultation" IMF Country Report No. 20/78, March.

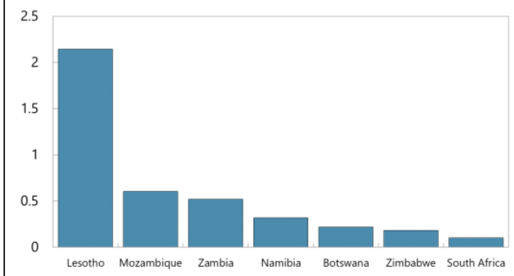
[4] Electricity consumption grew by 6.2 percent annually in the period 2016–19.

signed a MoU for a regional Mega Solar project with Namibia. The Environmental Performance Index suggests it is on track to reach net zero by 2050 based on current trends.[5]

5. Addressing climate challenges both on adaptation and mitigation fronts will require mobilizing financing from multiple sources.

- *Financing from climate funds.* Botswana secured about 38 million dollars (0.22 percent of GDP) of financing over the past five year from multilateral climate funds, of which 37 million was provided for restoration of vegetation in communal grazing lands that are particularly impacted by climate change.[6] The financing secured from multilateral sources as a percent of GDP was broadly in line with sub-Sahara Africa average of 0.17 percent over the last five years, but lower than a number of other countries in the Southern Africa region (see Figure below).[7] There is significant scope to mobilize more concessional financing from climate funds but will require the government to develop a pipeline of well-designed projects incorporated into its National Adaptation Plan. Moreover, getting accreditation from climate funds can help Botswana secure direct financing from these sources without having to go through another accredited intermediary.[8] Accreditation requires improving fiduciary standards through better public financial management, meeting environmental and social safeguards and compliance with other climate fund policies such as information disclosure procedures.

Multilateral Climate Finance Flow: 2017-2021
(Percent of GDP)



Sources: Climatefundsupdate.org and IMF staff calculations.
Note: multi-country and regional projects have not been included in the calculation.

- *Green bonds.* These fixed-income instruments with a climate or sustainability component, are useful mechanisms to channel private sector financing for low-carbon technologies, climate resilient infrastructure, and renewable energy productions. Namibia, for example, issued green bonds to finance greener building and renewable energy production in March 2022. Botswana Stock Exchange already have annual sustainability reports and authorities also provide guidance on environmental, social and governance reporting which could facilitate green bond issuance (Tyson, 2021).[9]

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[5] Botswana secured funding to support the design and implementation of a carbon tax. However, no specific implementation timeline has been established yet.

[6] The project grant from Green Climate Fund was approved in 2021 to be implemented with the help of Conservation International Foundation.

[7] The estimates are based on information from https://climatefundsupdate.org and IMF staff calculation.

[8] Some of Botswana's neighbors – Namibia, South African and Zimbabwe – already have accreditation which provides them direct access to climate financing.

[9] Tyson, Judith (2021), "Green bonds in sub-Saharan Africa," The ODI research series for financial development in Africa, Policy Brief 3.

- *Carbon credit market*. Setting up a carbon credit market can allow emissions to be traded by putting a price on carbon and allow government bodies, private sector, and development partners to purchase credit as needed. Credit markets work though a carbon registry which monitors and certifies carbon emission. Carbon credit markets can also be used to set up arrangements between development partners and local governments to preserve forests. Gabon, for example, has a multi-donor $150 million arrangement to receive financing in return for forest preservation.

- *Insurance*. Insurance can help mitigate risks from natural disasters. A collaboration with the UNDP, Global Environment Facility, Government of Ethiopia and Oromia Insurance, for example, provided weather-based insurance to vulnerable households in Ethiopia. Africa Risk Capacity also allows for risk pooling among African Union member states and provides insurance for weather-based calamities.

- *State-contingent debt instruments*. Bonds can be issued with clauses which allows for debt service relief when there is climate shock. These bonds typically will have a higher premium than regular bonds but can free up government resources when there is a natural disaster like flood, drought or a storm. Grenada for example introduced "hurricane clauses" in its bond which provides it debt service relief if it is hit by a large hurricane.

INTERNATIONAL MONETARY FUND

BOTSWANA

July 7, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by African Department in Consultation with the Statistics Department

CONTENTS

RELATIONS WITH THE FUND

As of May 31, 2022

Membership Status: Joined July 24, 1968; Article VIII

General Resources Account	SDR (million)	Percent of Quota
Quota	197.20	100.0
Fund holdings of currency	141.44	71.73
Reserve position in Fund	55.77	28.28

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	246.44	124.97
Holdings	248.42	125.97

Outstanding Purchases and Loans None

Financial Arrangements None

Project Obligations to Fund None

Implementation of HIPC Initiative Not Applicable

Implementation of Multilateral Debt Relief Initiative Not Applicable

Implementation of Catastrophe Containment and Relief Not Applicable

Exchange Rate Arrangement

The currency of Botswana is the Botswana pula. The de jure and de factor exchange rate arrangements are classified as a crawling peg. The official exchange rate of the pula is determined according to a weighted basket of currencies comprising the SDR and the South African Rand. As of June 21, 2022, the exchange rate of the U.S. dollar to the Pula was US$1= P12.25, and that of the South African rand to the Pula was R1=P0.76.

As of November 17, 1995, Botswana accepted the obligations under Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement. Botswana maintains an exchange regime free of restrictions on the making of payments and transfers for current international transactions and multiple currency practices.

Article IV Consultation

Botswana is on a standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on May 27, 2021.

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings in fiscal, monetary, and external sector statistics, but is broadly adequate for surveillance.
National Accounts. In September 2021, Statistics Botswana (SB), with the assistance of AFRITAC South, rebased the national accounts, updating the base year from 2006 to 2016. Areas for further improvement include the coverage of national accounts surveys, quarterly GDP estimates, and the estimation of GDP deflators.
Price Statistics. The monthly consumer price index (CPI) is available on a timely manner on the SB's website. The index is comprehensive and provides breakdowns between urban and rural price data and between prices of tradable and non-tradable goods and services. An updated CPI was disseminated in March 2019, with weights derived from expenditure data reported in the 2015/16 Multi-Topic Household Survey. There is need to include owner-occupied housing costs in the CPI. The producer price index is disseminated on an ad-hoc basis and is available through Q1:2021 on the Statistics Botswana website (as of June 2022). In addition to mining and utilities, the PPI is being expanded to include other activities. AFRITAC South provided assistance to expand CPI coverage to include owner-occupied housing, resume PPI dissemination, and expand PPI coverage to include agriculture and manufacturing.
Government Finance Statistics (GFS). The Ministry of Finance compiles cash-based quarterly and annual budgetary central government data following the *Government Finance Statistics Manual 2014*. Since 2018, data are available on expenditure by classification of functions of government (COFOG), but there is still no balance sheet data compiled, and no data is compiled for extrabudgetary institutions, consolidated central government, or consolidated general government. As of June 2022, authorities are still working on collecting data for extrabudgetary units (non-market parastatals) which are government entities other than the central government. This will be followed by compilation and consolidation of the collected data with the data for the budgetary central government and local government, but there is no clear timeframe for completion. There have been data quality improvements for the budgetary central government allowing the breakdown of transfers expense to distinguish grants, subsidies, social benefits, and other expense, but challenges remain with proper distinction between current and capital outlays in the development budget. Ongoing work for the development of a revised chart of accounts would help further improve data quality, and efforts undertaken recently to collect data for government entities other than the budgetary central government would help broaden the scope of GFS to include local governments and extrabudgetary units.
Monetary and Financial Statistics (MFS). The Bank of Botswana (BoB) compiles MFS data using standardized report forms consistent with the *Monetary and Financial Statistics Manual and Compilation Guide 2016*. The data covers the accounts of the central bank, other depository corporations, and other financial corporations. The data for other financial corporations is currently limited to pension funds only, but BoB seeks to expand the coverage of MFS to include other sub-sectors, such as insurance companies and non-money market funds. The BoB is committed to

submitting the reserves template to the IMF for validation and dissemination by first half of 2022 but is still pending as of mid-June 2022. The BoB reports data on several series and indicators to the Financial Access Survey (FAS), including the two indicators adopted by the UN (commercial bank branches per 100,00 adults and ATMs per 100,000 adults) to monitor Target 8.10 of the Sustainable Development Goals.
Financial Sector Surveillance. The BoB compiles and reports to STA quarterly data on financial soundness indicators, which include 12 core and 11 encouraged indicators for deposit-takers.
External Sector Statistics. Annual balance of payments (BOP) data with a quarterly breakdown is published in the Botswana Financial Statistics and the BoB's Annual Report in an aggregated format. Preliminary BOP data is disseminated within two months after the end of the reporting period, while revised (final) data becomes available after nine months. The BoB also compiles and disseminates the annual international investment position (IIP), with quarterly IIP data produced for internal use only. With technical support of the IMF, BoB is very close to compiling BOP and IIP statistics following the sixth *Balance of Payments Statistics Manual* (BPM6) replacing the current practice of converting data compiled based on *BPM5*. BoB made significant progress in the improvement of source data over the recent years—improvements in the International Transaction Reporting System (ITRS) is reaching its final stage and the annual BOP survey is significantly enhanced. Several other comprehensive surveys have been designed for collecting data from entities focusing on tourism, telecommunication, mining, money transfer, and other sectors. Good progress has been made in recent years in reducing errors and omissions (NEOs). While the complete elimination of NEOs is not plausible, additional required measures include: (i) adjustments of import of goods from neighbor countries for their reporting on f.o.b. valuation basis; (ii) further fine-tuning of estimation model for travel services; (iii) increase in coverage of current and capital transfers by including data on government grants and TA/investment projects; and (iv) coverage of foreign assets of assets managers, pension funds, and insurance companies. The BOB prepared a pilot version of the International Reserves and Foreign Currency Liquidity Data Template (IRFCL) and is committed to start reporting it to IMF for dissemination soon.
II. Data Standards and Quality
Botswana has implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS) and currently disseminates thirteen of the fifteen encouraged data categories on its National Summary Data Page (NSDP). Areas for improvement include periodicity and timeliness of data dissemination on the NSDP for several data categories, such as reserve assets, balance of payments, and production index, and continuing to build capacity to compile and disseminate data on general government operations and external debt.

Table 1. Botswana: Table of Common Indicators Required for Surveillance

(As of June 22, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	Apr 2022	5/31/2022	A/M	A/M	A/M
International reserve assets and reserve liabilities of the monetary authorities[2]	Mar 2022	6/2/2022	A/M	A/M	A/M
Reserve/base money	Mar 2022	6/16/2022	A/M	A/M	A/M
Broad money	Feb 2022	5/31/2022	A/M	A/M	A/M
Central bank balance sheet	Feb 2022	5/31/2022	A/M	A/M	A/M
Consolidated balance sheet of the banking system	Mar 2022	5/31/2022	A/M	A/M	A/M
Interest rates[3]	May 2022	6/16/2022	A/M	A/M	A/M
Consumer price index	May 2022	6/17/2022	A/Q/M	A/Q/M	A/Q/M
Revenue, expenditure, balance, and composition of financing[4]—general government[5]	N/A	N/A	N/A	N/A	N/A
Revenue, expenditure, balance, and composition of financing[4]—budgetary central government	Feb 2022	5/31/2022	A/Q/M	A/Q/M	A/Q/M
Stocks of central government and central government-guaranteed debt[6]	2021Q4	5/31/2022	A/Q	A/Q	A/Q
External current account balance	2021Q4	5/31/2022	A/Q	A/Q	A/Q
Exports and imports of goods	2021Q4	5/31/2022	A/Q	A/Q	A/Q
GDP/GNP	2021Q4	5/31/2022	A/Q	A/Q	A/Q
Gross external debt	2021Q4	5/31/2022	A/Q	A/Q	A/Q
International Investment Position[7]	2021	5/31/2022	A	A	A

[1] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).

[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[3] Both market-based and officially determined, including discount, money market, treasury bill, notes, and bond rates.

[4] Foreign, domestic banks, and domestic nonbank financing.

[5] The general government consists of the central government (budgetary funds), local governments and extrabudgetary units.

[6] Including currency and maturity composition.

[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

July 19, 2022

Green Statement by Ms. Mannathoko and Ms. Basutli on Botswana
to Executive Board
July 19, 2022

Our Botswana authorities appreciate the substantive, insightful and productive engagement with the staff team over the past couple of years. They value the effort made by IMF mission members to deepen their knowledge of the economy, which has led to the provision of high-quality analysis and tailored advice. On the authorities' behalf, we would like to thank staff for the excellent engagement over the past few years and the thoughtful and well-balanced report, addressing pertinent issues. Among other things, it is appropriately focused on rebuilding essential buffers that have been eroded by successive shocks and entrenching durable growth.

Our authorities broadly concur with the staff appraisal and recommendations. They continue to prioritize an effective COVID-19 response and improving livelihoods, aligning the government machinery to the Presidential Agenda, digitalization, value-chain development, and mindset change, to unlock opportunities in the private sector and address youth unemployment. These goals are clearly outlined in the Reset Agenda and reflect the aspirations of Vision 2036.

Our authorities continue to build on their track record of sound macroeconomic management, using this to exit the pandemic and achieve sustainable growth. Real GDP growth has rebounded to pre-COVID levels thanks to a rigorous vaccination campaign with over 95 percent of the eligible population fully vaccinated, and strong recovery in the mining sector. Output is expected to remain strong in the medium term, driven by higher prices and demand for diamonds, increased copper production, a general reopening of the economy, and recovery in tourism. The outlook is, however, subject to considerable risks, including the impact of the war in Ukraine and the path of the pandemic. In this context, the authorities agree that supporting vulnerable populations remains crucial. They view the current recently enhanced social safety net as appropriate to deal with the inflationary effects of the war, having increased social benefits in the 2022 budget. They however note the need to ensure sustainability of the support. The outlook is also subject to external inflationary pressures spilling over from the war in Ukraine, therefore going forward, reining in inflationary pressures will also be a policy priority. Inflation continues to trend upwards reaching 12.7 percent in June 2022, up from 10.6 percent in January 2022, significantly higher than 8.2 percent in June 2021, and an average 6.7 percent for 2021.

After substantial fiscal consolidation, improving revenue collection remains a key priority for Botswana. In that regard, the authorities intend to take measures to increase domestic revenue sources, while modernizing and strengthening tax collection. In addition they will rebuild fiscal buffers while managing fiscal expenditures, including by reducing subventions to commercial State-Owned Enterprises (SOEs) and reducing and effectively managing the public sector wage bill. With the help of Fund TA, they plan to adopt a fiscal rule that rebuilds buffers and strengthens the medium-term fiscal framework to anchor fiscal policy.

Inflationary pressures remain skewed to the upside, emanating from higher food and energy prices that could last longer than initially envisaged as the war in Ukraine continues, alongside the persistence of supply chain disruptions, and domestic factors including possible administered price increases and short-term impacts of import restrictions, among others. The central bank remains attentive to these pressures and committed to returning inflation to the objective range, while balancing price stability considerations with the need to support recovery. The Bank Rate was increased by 51 basis points and 50 basis points respectively, at the April and June 2022 meetings of the Monetary Policy Committee. In addition, reforms to monetary operations, including the introduction of the new monetary policy rate (MOPR) that took effect in April 2022 are expected to enhance monetary policy transmission and implementation. The authorities will also continue to allow flexibility within the current exchange rate regime to help the economy adjust to shocks, while facilitating structural transformation. The central bank continues to monitor developments in the financial sector for emerging risks to financial stability and looks forward to the upcoming Financial Sector Assessment Program that will reinforce this effort. Beyond this, the authorities remain committed to strengthening their AML/CFT framework having exited the FATF grey list in October 2021.

The authorities regard successful implementation of structural reforms as critical to their aspirations of attaining high income status by 2036. They agree with staff on the importance of accelerating the implementation of the Reset Agenda aimed at transforming Botswana's economy. In that regard, the recent restructuring of government ministries should help to enhance efficiency and service delivery while ensuring that the Reset Agenda is met. The authorities have also stepped-up efforts to rationalize parastatals and find private partners for some of them. Ensuring food security and addressing the country's long-standing high dependence on food imports also ranks high among priorities, with the consequences of this dependence painfully felt during the lockdown. In that connection, measures are being considered to encourage local production and reduce the import bill which weakens the external position. The authorities note the mission's reservations regarding excessive reliance on import substitution and restrictions to promote industrialization and have committed to monitor and review developments with a view to adapting as needed.

Plans are also underway to expedite digital connectivity countrywide through the Smart Botswana Strategy, and to migrate government services online, and leverage digitalization in education. The authorities also continue to work on building resilience to climate change with plans underway to contain ongoing water and agricultural impacts from recurring droughts and climate extremes. They have licensed one of two planned 50 megawatts of renewable energy capacity in a bid to increase renewable power generation.

The Botswana authorities appreciate and look forward to continued Fund engagement. They value the policy advice and technical assistance rendered by the Fund and have seen enhanced traction through more hands-on interaction. This could be further improved through resident advisors facilitated by the Fund.