INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/317

BOTSWANA

August, 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND 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 2023 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 28, 2023, consideration of the staff report that concluded the Article IV consultation with Botswana.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 28, 2023, following discussions that ended on July 14, 2023, 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 26, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2023 Article IV Consultation with Botswana

FOR IMMEDIATE RELEASE

- Botswana's growth is expected to slow to 3.8 percent in 2023 due to a projected decline in diamond production, before picking up over the following two years. Inflation has fallen since August 2022, and is now below the lower bound of the central bank's objective range.
- The authorities plan a fiscal expansion in FY2023 followed by two years of substantial fiscal adjustment to reach a small fiscal surplus by FY2025. This adjustment should support rebuilding of foreign exchange reserves and government cash deposits.
- The financial sector is broadly sound, stable, and resilient.

Washington, DC – **August 31, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Botswana. This also included a discussion of the findings of the Financial Sector Assessment Program (FSAP) exercise for Botswana.[2]

Following a strong recovery of almost 12 percent growth in 2021, Botswana's economy grew by 5.8 percent in 2022, significantly above the long-run average of 4 percent. The ongoing recovery from the pandemic primarily reflects elevated mining production. Inflation has declined sharply since August of 2022. After declining in 2022, FX reserves have stabilized and remained at adequate levels at end-2022. The unemployment rate remains elevated at 25 percent.

Botswana's growth is expected to slow to 3.8 percent in 2023 due to the projected decline in diamond production and the weaker global environment. Growth is forecast to rebound gradually in 2024 and 2025, to above 4 percent, due to higher prices and quantities of diamonds produced. Inflation is projected to revert to and remain within the central bank's objective range.

The authorities plan a fiscal expansion in FY2023 followed by two years of substantial fiscal adjustment to reach a small fiscal surplus by FY2025. Together with a gradual recovery in diamond production and prices, FX reserves are projected to stabilize at 5 ½ months of imports over the medium term. The outlook remains heavily dependent on demand for diamonds and the global economic cycle.

As outlined in the Financial System Stability Assessment (FSSA), the financial sector appears broadly sound, stable, and resilient. However, it is essential to monitor contagion risk from banks to non-bank financial institutions due to the concentration of large non-bank deposits.

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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] Under the FSAP, the IMF assesses the stability of the financial system, and not that of individual institutions. The FSAP assists in identifying key sources of systemic risk and suggests policies to help enhance resilience to shocks and contagion. The last FSAP exercise for Botswana took place in 2007.

Banking supervision should be further enhanced on the basis of a risk-based framework and data gaps closed for requisite calibration of macroprudential tools. The crisis management and safety net framework has been strengthened significantly with the introduction of a deposit insurance scheme. The Financial Stability Council should play an important role in developing and coordinating a comprehensive framework for crisis management and resolution.

Executive Board Assessment[3]

Directors agreed with the thrust of the staff appraisal. They welcomed Botswana's prudent macroeconomic policies and strong recovery from the pandemic, but also highlighted the continued decline in external and fiscal buffers and the expected depletion of diamond reserves in coming decades. They noted the slowdown in economic activity this year and risks to the outlook, which include commodity price volatility and a sharper global slowdown. Directors welcomed Botswana's robust capacity development strategy.

Directors agreed that fiscal consolidation is critical to preserve fiscal sustainability and support the accumulation of foreign exchange reserves. They welcomed the authorities' medium-term plan to achieve a fiscal surplus by FY2025, noting the need for measures to contain expenditures and mobilize additional revenues. Some Directors urged cautious implementation of this year's planned fiscal expansion to avoid hindering disinflation and to support the rebuilding of fiscal buffers. Directors noted that the credibility of the medium- term adjustment path could be enhanced through the introduction of an expenditure rule.

Directors concurred that the monetary policy stance remains appropriate, noting the slowdown in inflation, but urged the authorities to stand ready to raise rates if inflationary pressures emerge. They welcomed the Bank of Botswana (BoB)'s efforts to strengthen its governance frameworks and encouraged the BoB to further enhance the monetary policy transmission mechanism. They supported refinements to the REER targeting exchange rate regime to bolster competitiveness and reduce potential frictions between monetary and exchange rate policies.

Directors welcomed the 2023 FSAP, which found that the financial sector is sound and resilient to a wide range of shocks. They positively noted the good progress in strengthening legal and regulatory frameworks for financial stability and AML/CFT, and Botswana's removal from the FATF grey list. Directors concurred that enhancing the interbank and government bond markets would support financial sector development, strengthen public financial management, and improve monetary policy transmission. They stressed the need to enhance financial inclusion by strengthening digital financial services and the regulatory frameworks for lending to MSMEs.

Directors underscored the importance of advancing structural reforms to promote economic diversification and private sector development, thereby boosting growth and employment potential, and reducing inequality. They highlighted, as policy priorities, trade facilitation and integration, comprehensive SOE reforms, improving the business environment, enhancing climate change resilience, implementing the digitalization strategy, and more targeted support for high-productivity, export-led sectors.

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[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1. Botswana: Selected Economic and Social Indicators, 2019-2028 [1]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Act.	Act.	Act.	Est.	Projection					
	(Annual percent change, unless otherwise indicated)									
National Income and Prices										
Real GDP	3.0	-8.7	11.9	5.8	3.8	4.1	4.3	4.0	4.0	4.0
Mineral[2]	-3.7	-26.5	29.8	7.5	0.6	2.6	3.5	2.4	2.1	2.3
Nonmineral	5.2	-3.5	7.8	5.3	4.7	4.5	4.6	4.4	4.5	4.5
GDP per capita (US dollars)	6,679	5,863	7,239	7,738	7,741	8,013	8,417	8,943	9,446	10,034
GNI per capita (US dollars)[3]	6,329	5,868	7,169	7,515	7,538	7,793	8,188	8,693	9,193	9,761
Consumer prices (average)	2.7	1.9	6.7	12.2	5.9	4.7	4.5	4.5	4.5	4.5
Diamond production (millions of carats)	23.7	16.9	22.7	24.5	24.5	25.1	25.9	26.6	27.1	27.8
Money and Banking										
Monetary Base	5.7	-3.8	-8.8	14.0	9.7	7.6	8.9	8.4	9.2	9.2
Broad money (M2)	8.0	5.9	5.0	12.0	9.7	7.6	8.9	8.4	9.2	9.2
Credit to the private sector	7.1	5.3	5.4	14.7	8.9	8.4	8.7	8.8	8.7	8.7
	(Percent of GDP, unless otherwise indicated)									
Investment and Savings										
Gross investment (including change in inventories)	30.9	32.8	27.4	25.0	29.9	30.7	32.5	32.8	32.6	32.7
Public	7.8	6.5	5.5	5.4	7.2	7.3	7.1	6.8	6.6	6.6
Private	23.0	26.3	21.9	19.5	22.8	23.4	25.4	26.0	26.0	26.1
Gross savings	23.8	26.5	28.2	28.4	30.8	32.2	33.6	33.5	33.2	33.2
Public	0.5	-4.3	0.7	4.0	4.5	5.4	6.6	6.3	6.1	6.1
Private	23.3	30.8	27.5	24.4	26.2	26.8	27.0	27.2	27.1	27.1
Central Government Finances[4]										
Total revenue and grants	28.3	25.6	29.0	28.9	29.8	28.7	28.6	28.4	28.3	28.4
SACU receipts	7.9	9.1	6.5	5.4	8.7	7.5	7.2	7.0	7.0	7.0
Mineral revenue	8.2	5.3	10.6	13.2	9.7	9.6	9.8	9.9	9.7	9.6
Total expenditure and net lending	36.9	36.5	31.4	28.9	31.7	29.7	28.1	27.9	27.8	27.9
Overall balance (deficit –)	-8.6	-10.9	-2.4	0.0	-1.9	-1.0	0.5	0.5	0.5	0.5
Non-mineral primary balance[5]	-19.0	-18.5	-15.9	-16.3	-13.6	-12.5	-10.8	-10.9	-10.6	-10.5
Total central government debt[6]	21.5	23.5	22.1	20.8	21.3	20.3	18.9	18.4	18.2	17.9
Net Debt	5.3	15.3	12.8	11.6	13.0	13.1	11.7	10.3	9.2	8.0
External Sector										
Exports of goods and services, f.o.b. (% change)	-17.3	-25.3	70.3	11.9	-8.8	10.6	5.8	9.2	5.7	6.0
o/w diamonds	-19.8	-21.8	80.0	7.9	-13.3	10.4	5.2	10.6	4.0	4.5
Imports of goods and services, f.o.b. (% change)	4.5	-2.3	23.1	-6.4	2.8	7.8	5.6	9.6	6.1	6.1
Current account balance	-6.9	-10.4	-1.4	2.9	0.8	1.5	1.1	0.6	0.6	0.5
Overall Balance	-6.7	-11.7	-1.4	1.8	2.5	1.8	0.7	0.6	0.7	0.7
Nominal effective exchange rate (2018=100)[7]	98.2	94.0	94.1	90.8	-	-	-	-	-	-
Real effective exchange rate (2018=100)[7]	98.8	94.4	97.7	99.1	-	-	-	-	-	-
Terms of trade (2005=100)	143.4	140.6	178.9	161.2	145.5	150.5	150.5	159.1	158.5	156.7
External public debt[8]	12.5	11.8	11.1	9.6	10.0	8.6	7.2	6.5	5.9	5.3
o/w public and publicly guaranteed	3.9	4.0	2.9	2.2	1.9	1.6	1.4	1.2	1.1	1.0
	(Millions of US$, unless otherwise indicated)									
Change in reserves (increase –)										
Gross official reserves (end of period)	6,172	4,944	4,806	4,281	4,800	5,196	5,369	5,516	5,692	5,884
Months of imports of goods and services[9]	9.8	6.4	6.7	5.8	6.0	6.1	5.8	5.6	5.5	5.5
Months of non-diamond imports[9]	13.4	9.3	8.9	7.7	8.2	8.4	8.2	8.0	7.7	7.4
Percent of GDP	36.5	31.2	27.2	21.7	23.6	24.1	23.3	22.0	21.4	20.3

Sources: Botswana authorities and IMF staff estimates and projections.

[1] This table is based on calendar years 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] Fiscal variables are based on fiscal years (starting on 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] Includes guarantees.

[7] For 2019-2022, both effective exchange rates are from IMF INS database.

[8] External debt data measured in fiscal years.

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

INTERNATIONAL MONETARY FUND

BOTSWANA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

July 26, 2023

KEY ISSUES

Context. Growth is expected to slow in 2023 due to a projected decline in diamond production, with the weaker global environment likely to depress other exports. Inflation has fallen since August 2022, returning to the central bank's objective range. The authorities plan a fiscal expansion in FY2023 followed by two years of substantial fiscal adjustment to reach a small fiscal surplus by FY2025, but implementation risks are elevated. The external position should soften over the medium term, with FX reserves stabilizing at 5½ months of imports. The financial sector is broadly sound and stable.

Policy Recommendations.

- **Fiscal policy.** Consolidation is critical for fiscal sustainability given the large depletion of fiscal buffers in the past 15 years and the longer-term prospect of exhaustion of diamond resources. Fiscal adjustment, preferably supported by an expenditure rule, should also help to bolster the FX reserve position.

- **Monetary and exchange rate policy.** The monetary policy stance is appropriate, but the central bank should stand ready to raise the policy rate if inflation risks materialize. Some changes to the exchange rate regime could be contemplated to support competitiveness, and to reduce potential frictions between monetary and exchange rate policies.

- **Financial sector policies.** Deepening the interbank and bond markets will support financial sector development, while improving public financial management and monetary policy transmission. Financial stability should be strengthened by operationalizing the frameworks for emergency liquidity assistance, deposit insurance, and bank resolution.

- **Structural policies.** Structural transformation of the economy aims at diversifying production, increasing the relative size of the private sector, and enhancing resilience to external shocks. Policy priorities include trade facilitation and integration, SOE reform, more efficient and climate-resilient infrastructure investment, and more targeted support for high-productivity, export-oriented sectors.

Approved By
Andrea Richter Hume (AFR) and Peter Dohlman (SPR)

Discussions for the 2023 Article IV consultation took place in Gaborone during July 4–14, 2023. The team comprised Messrs. Luc Eyraud (head), Ian Stuart, Sergii Meleshchuk, Ms. Qianqian Zhang (all AFR) and Mr. Damien Puy (RES). Ms. Basutli (OED) participated in the discussions. Mr. Thordur Jonasson, head of the FSAP mission to Botswana, joined the team for the second week of the mission. Ms. Tiana Wang, Ms. Lixue Chen, and Mr. Erick Trejo Guevara provided research and editorial assistance for the preparation of this report. Ms. Andrea Richter Hume was the African Department reviewer for this document.

CONTENTS

ANNEXES

CONTEXT

1. **Botswana has made impressive strides in economic development and has the objective of reaching high-income status by 2036.** Since the early 2000s, supported by good governance and sound macroeconomic management, real per capita GDP has grown by one third, and today's GDP per capita is close to $7,000 (current US$). To a large extent, the country has succeeded in avoiding the "resource curse," by investing diamond revenues in a transparent and productive manner. Poverty rates are roughly half of sub-Saharan Africa's average. More recently, the government's COVID-19 vaccination campaign was among the most successful in Africa, with about 80 percent of the population vaccinated by May 2023.

2. **In recent years, however, macroeconomic imbalances have widened.** Botswana's relatively low gross debt-to-GDP ratio masks a large, long-term deterioration in the government's overall financial position, with its cash deposits at the central bank having declined by over 40 percent of GDP over the past 15 years. Despite strong export growth, the decline in foreign exchange reserves continued in 2022, bringing the import coverage ratio down to 5.9 months of imports in May 2023, from close to 10 months before the pandemic. Lower fiscal and external buffers make Botswana more vulnerable to external shocks, including diamond price volatility.

3. **Going forward, the authorities are rethinking their growth model, which requires confronting deep structural challenges**. The economy is heavily dependent on diamond mining (representing 90 percent of goods exports), but Botswana's diamond reserves may be exhausted in two to three decades. Growth has not been sufficiently inclusive to bring down unemployment and reduce inequality; the unemployment rate stood at 25 percent in 2022, while income inequality, as measured by the Gini index, is among the highest in the world. Finally, despite efforts to diversify and expand the role of the private sector, the economy remains dominated by the public sector.

RECENT ECONOMIC DEVELOPMENTS

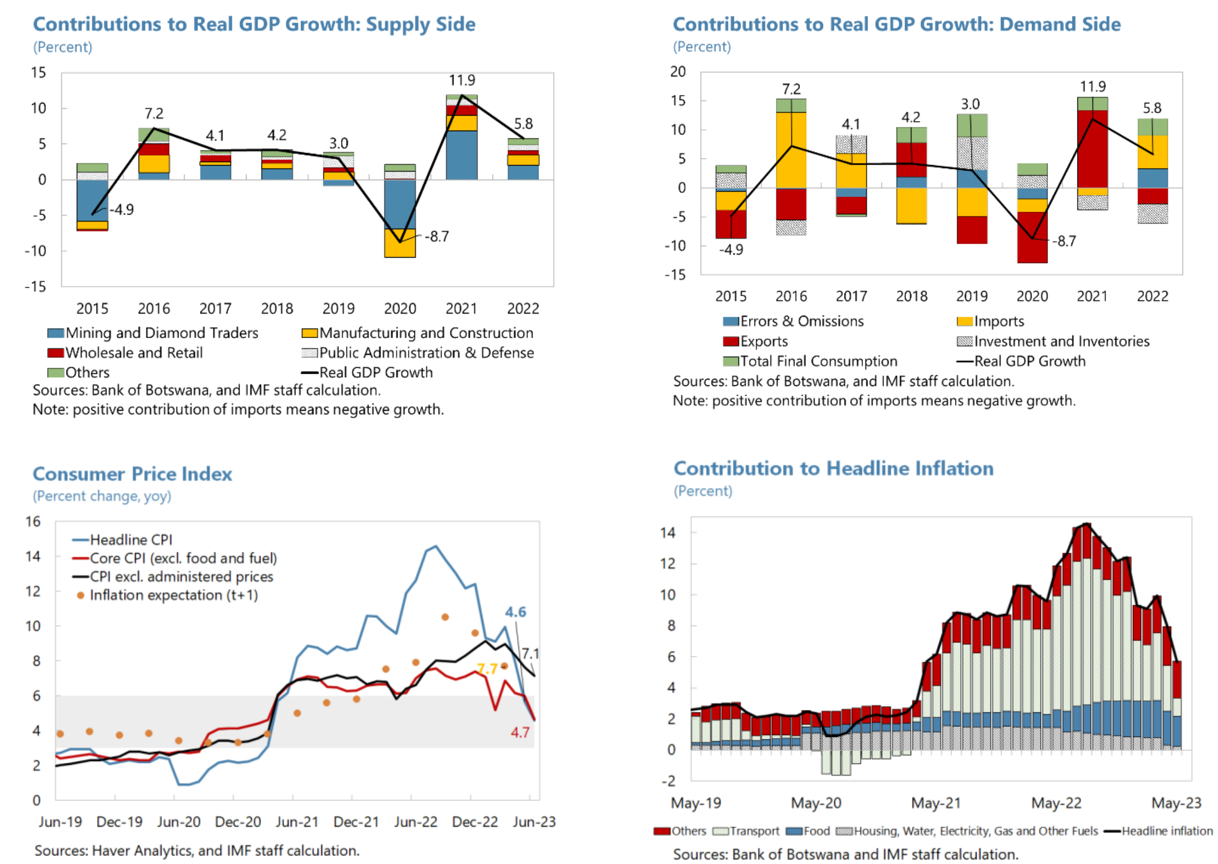
4. **Following a strong recovery of almost 12 percent in 2021, Botswana's economy grew by 5.8 percent in 2022, significantly above the long-run average of 4 percent.** The recovery from the pandemic primarily reflected elevated mining production, but also robust manufacturing and construction (Text Figure 1). From the expenditure side, the main driver of the rebound has been the very sharp increase in the contribution of external demand through both stronger exports and lower diamond imports.[1]

5. **After peaking at 14.6 percent in August 2022, inflation has fallen gradually to 4.6 percent in June 2023, returning to the central bank's objective range.** Annual CPI inflation increased sharply after April 2021, mainly due to higher fuel prices. Since then, falling fuel prices

[1] Botswana is a global diamond hub. In addition to its own domestic production, the country imports diamonds for sales events, known as "sights," in which buyers from all around the world come to see the new diamond batches. Diamonds are later re-exported.

have resulted in a steep decline in transport inflation, which has been the main driver behind the recent disinflation. Core inflation, which excludes fuel, had increased at a slower pace in 2021–22 before receding in recent months to 4.7 percent in June 2023. Despite the overall downward trend, food inflation is still at a historically-high level (13 percent in June). Inflation excluding regulated prices, which reflects underlying price pressures, has also been stickier.[2]

Text Figure 1. Selected Macroeconomic Indicators



6. The budgetary position improved from a 2.4 percent of GDP deficit in FY2021 to a balanced budget in FY2022, mainly due to a lower expenditure ratio and higher mineral revenue (Text Figure 2).[3] On the expenditure front, the wage bill ratio fell by 0.9 percent of GDP,[4] while grants and subventions declined by 1.7 percent of GDP. On the revenue side, the rise in mineral revenue reflected elevated diamond sales, while non-mining revenue fell by 1.9 percent of

[2] Regulated prices (including fuel, electricity, water, public transport fares, rental, and postal tariffs) account for about one third of the consumption basket. Fuel prices, which have the largest impact on CPI, were adjusted upwards several times during December 2021-July 2022, before starting a downward trajectory in September 2022. A few other regulated prices, like public transport fares, have been raised since early 2022, but not water or electricity.

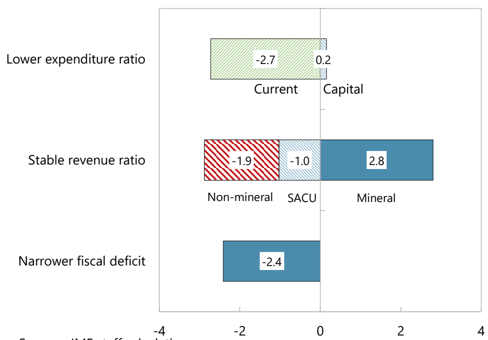
[3] In line with the IMF GFS 2014, large one-off transfers from the BoB to the budget are recorded below the line. In addition, staff uses a formula (75 percent of current calendar year and 25 percent of following calendar year) to estimate FY nominal GDP. As a result, the fiscal deficit numbers differ marginally from those of the authorities.

[4] In nominal terms, the wage bill grew by 7 percent, but nominal GDP growth was 17 percent.

GDP—partly because of efforts to cushion households against higher inflation.[5] The deficit was financed primarily through domestic debt issuance and external concessional financing, with gross debt (excluding guarantees) reaching 18 percent of GDP at end-FY2022.[6]

Text Figure 2. Change in Fiscal Balance Ratio Between FY2021 and FY2022

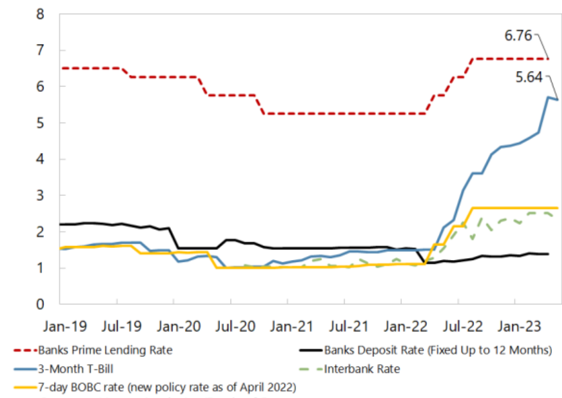
(Percent of GDP)



Sources: IMF staff calculation.

Text Figure 3. Interest Rates, 2019–2023

(Percent per annum)



Sources: Haver Analytics/Bank of Botswana.

7. The Bank of Botswana (BoB) has maintained the policy rate at 2.65 percent since August 2022. The Monetary Policy Rate (MoPR) was raised by a combined 151 basis points between April and August 2022. Prior to this, the policy rate had been kept low for 18 months. In general, market interest rates have moved up with the tightening policy stance, but passthrough differs between rates (Text Figure 3). In 2022, the interbank rate increased from around 1 to 2½ percent, while the prime lending rate increased by a similar margin. The deposit rate (which is affected by broader liquidity conditions and competition among banks) remained broadly unchanged.

8. The external position improved in 2022 due to strong diamond exports and capital inflows (Text Figure 4). The current account strengthened from a 1.4 percent of GDP deficit in 2021 to a 2.9 percent surplus in 2022—mainly reflecting higher volumes and prices of diamonds. The financial account also moved into surplus, supported by large portfolio inflows[7] and a modest recovery in foreign direct investment. Despite the stronger balance of payments, revaluation losses[8] reduced the central bank's FX reserves to USD 4.3 billion (5.8 months of imports) at end-2022, from 6.7 months in 2021. The BoB has reduced the nominal downward crawl rate of the exchange rate to 1.5 percent for 2023, from 2.9 percent in the previous two years.

[5] The authorities introduced a temporary VAT reduction—from 14 percent 12 percent from August 2022 to end-March 2023, and zero rating of cooking oil and liquid petroleum gas until end-February 2023.

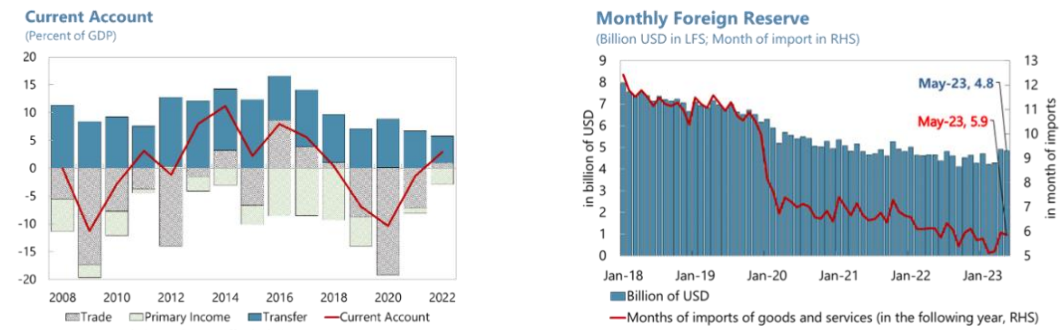
[6] Botswana's fiscal year runs from April 1 to March 31. FY2022 refers to April 1, 2022, to March 31, 2023.

[7] Large portfolio inflows are unusual by historical standards, most likely reflecting withdrawals by Botswana's pension funds to meet their local obligations.

[8] "Reevaluation losses" refer to the loss of value in equities and bonds held by the central bank in the context of higher interest rates.

9. The 2022 external position is assessed as stronger than suggested by fundamentals and desirable policies. As discussed in Annex I, the current account gap is estimated at around 3½ percent of GDP (implying a REER gap of -13 percent) mainly because of the strong rebound in diamond exports. End-2022 reserves, which are held mostly in the Pula fund, are adequate, representing 183 percent of the ARA metric.[9]

Text Figure 4. Balance of Payment Variables



Sources: Haver Analytics, and IMF staff calculation.

Sources: Haver/Botswana Financial Statistics, International Merchandise Trade Statistics, and annual import numbers from team's framework.

OUTLOOK AND RISKS

10. Growth is projected to slow to 3.8 percent in 2023, rebound in 2024 and 2025, before stabilizing at 4 percent over the medium term. The expected slowdown in 2023 reflects a decline in diamond production and prices this year, with weaker global growth likely to depress other exports (Text Figure 5).[10] This will be partly offset by growth in the non-mining sector, with the fiscal expansion supporting public investment. Growth is forecast to rebound gradually in 2024 and 2025 due to higher prices and quantities of diamonds produced. The outlook is consistent with recent business confidence surveys showing that Botswana firms are more optimistic about business conditions in 2024 than in 2023.

Text Figure 5. International Diamond Price Index

(Jan 2015 = 100)

Sources: Botswana Financial Statistics, and IMF staff calculation.

11. Annual inflation is projected to halve in 2023, to slightly below 6 percent. From May 2023 onward, monthly inflation is expected to remain within the BoB's objective range of 3–6 percent, mainly on account of the decline in

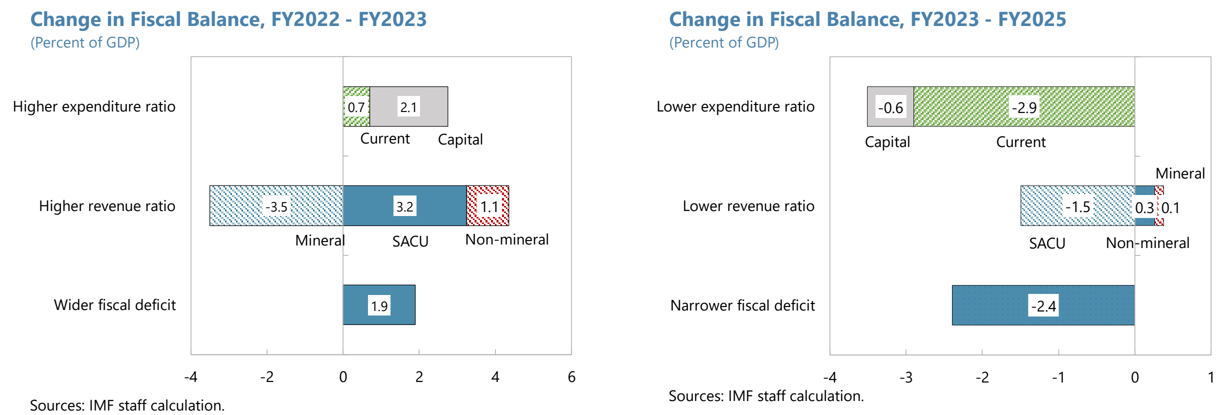
[9] The IMF's Assessing Reserve Adequacy (ARA) metric is discussed in Annex I.

[10] The diamond sector is a key driver of the economy, representing a quarter of GDP (through the mining and diamond trader sectors). Diamond revenues have spillovers to other sectors such as manufacturing, construction, transport, and wholesale and retail. Mineral taxes and dividends are also a central resource for the government's budget, indirectly impacting public wages and investment.

international oil prices, the smaller downward annual rate of crawl of the Pula announced in December 2022, positive real lending rates, and the prospect of regulated prices remaining unchanged.[11] These factors would more than offset the inflationary pressures coming from the fiscal expansion.

12. As part of their three-year medium term budget framework, the authorities plan a widening of the fiscal deficit in FY2023, before narrowing towards a small surplus by FY2025.[12] The higher deficit in FY2023 reflects mostly higher budgeted capital expenditure and lower mineral revenue (Text Figure 6, LHS). This is partially offset by a large increase in SACU transfers (by 72 percent compared to FY2022) due to a projected increase in the common revenue pool. Thereafter, in FY2024 and FY2025, the authorities project to reduce the fiscal deficit significantly by about 2½ percent of GDP and move to a small fiscal surplus by reducing the ratio of wages to GDP and transfers (including lower subventions to SOEs) (Text Figure 6, RHS). In these two years, base wages are expected to grow below inflation, while keeping headcounts unchanged.

Text Figure 6. Composition of the Medium-Term Fiscal Path



13. The debt ratio is projected to remain low in the medium term. The Debt Sustainability Analysis (DSA), presented in Annex II, assesses the overall sovereign stress risk as low. The main risks to the debt trajectory—identified in the 2021 IMF TA report on fiscal risk management—include the country's elevated macroeconomic volatility (due to uncertainty of mineral revenues), potential contingent liabilities related to SOEs, and weaknesses in budgeting processes. Other risks may emerge from delayed or insufficient fiscal consolidation. Finally, as noted in the recent Public Investment Management Assessment (PIMA), public financial management practices could be weakened by the recent decision to separate planning and budgeting functions (with the creation of the National Planning Commission (NPC) under the President's Office in 2022). Close coordination between the NPC and the Ministry of Finance will be key to ensure that future investment plans are

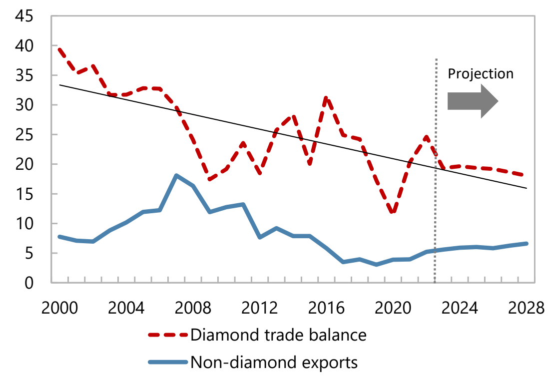
[11] With inflation projected at 5.9 percent in 2023, and the prime lending rate likely to remain at its April 2023 level of 6.8 percent, the (ex post) real prime rate should turn positive by end-2023. If prime rates remained unchanged next year, the real rate would rise to 2.1 percent in 2024 given lower inflation.

[12] The expenditure forecasts reflect the February 2023 medium-term budget, while revenues are projected by staff. The fiscal deficit path through FY2025 is closely aligned with the authorities.

conceived within a sustainable financing envelope and consistent with the medium-term budget framework.

14. Following a rebound in 2024, the external position is projected to soften over the medium term. In 2024, the current account should benefit from elevated SACU transfers and a recovery in diamond sales. However, it is projected to resume its long-term decline in the outer years, despite the import-compression effect of fiscal adjustment (Text Figure 7). As a result, the FX reserve coverage ratio is projected to initially increase before converging towards 5½ months of imports in the medium term.

Text Figure 7. Diamond and Non-diamond Trade, 2000–28
(Percent of GDP)



Sources: Bank of Botswana, and IMF staff calculation.

15. The outlook is uncertain, depending heavily on the path of diamond prices. The main risks are discussed in the Risk Assessment Matrix of Annex III:

- Supply disruptions and demand fluctuations at the global level could intensify *commodity price volatility*. Competition from synthetic diamonds could also affect demand and prices for diamonds.

- Possibly combined with the previous shock, an *abrupt global slowdown*, marked by recessions in some major economies, would have adverse spillovers to Botswana through trade and financial channels. A new bout of global financial tightening may lead to spiking risk premia, risk-off behaviors, and sudden capital outflows, which would widen external imbalances.

- *Climate shocks*, especially floods, continue to dim the outlook, posing a threat to agriculture, mining, and tourism.

- *Delays in planned fiscal consolidation* could further erode fiscal and external buffers, increasing Botswana's vulnerability to external shocks, and entail a sharper future adjustment with negative effects on growth. On the upside, successful implementation of the authorities' economic diversification plan[13] could lift medium-term growth prospects.

Authorities' Views

16. The authorities broadly agreed with staff's outlook and risks assessment. For the mining sector, the authorities noted that economic sanctions imposed on Russia, combined with the

[13] In September 2020, the authorities adopted the Economic Recovery and Transformational Plan (ERTP) which aims to move the economy to a more diversified and private sector-led growth model.

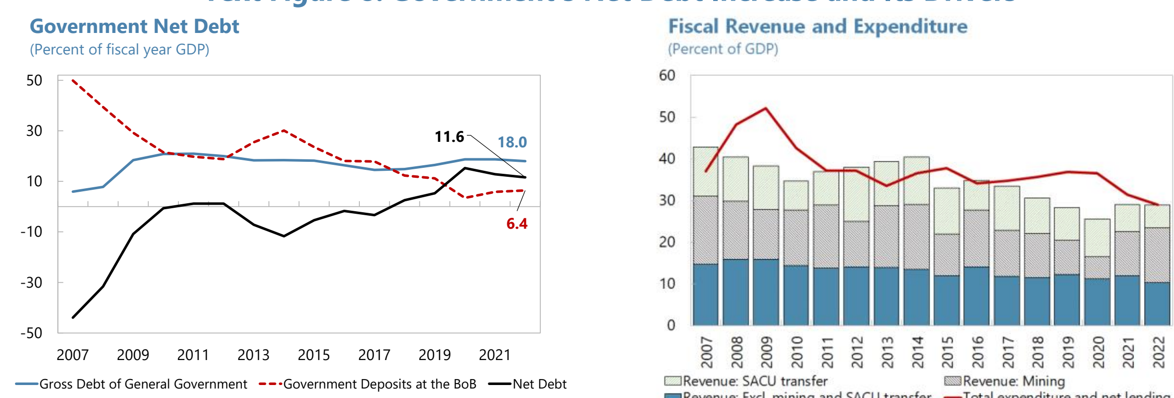
prolonged Russia-Ukraine war, have increased supply and demand uncertainty in the diamond sector. A shift towards synthetic diamonds due to supply shortages and increased prices for natural diamonds, would adversely impact the retail market. Further, pressures on household real income due to the global slowdown and higher inflation could reduce international demand for luxury goods. Difficulties related to the traceability of diamonds may also lower demand for Botswana's diamonds. These developments are monitored by the authorities to allow timely responses and minimize adverse effects on the economy.

POLICIES TO SUPPORT MACROECONOMIC RESILIENCE

A. Fiscal Policy: Halting the Decline in Buffers

17. Fiscal space has been severely eroded in the past 15 years. Historically, significant diamond revenues and sound macroeconomic management led to the accumulation of large fiscal buffers. But since 2007, government deposits at the central bank have been drawn down from 50 percent of GDP to 6 percent of GDP at end-FY2022 (Text Figure 8, LHS). This trend is partly explained by the long-term decline in Botswana's revenue-to-GDP ratio, which comes from both lower SACU customs and excise transfers and lower mining revenues (Text Figure 8, RHS). By contrast, expenditure remained broadly stable as a share of GDP between FY2011 and FY2020.

Text Figure 8. Government's Net Debt Increase and Its Drivers



Sources: Botswana Financial Statistics from Bank of Botswana and Ministry of Finance.

Sources: Minstry of Finance, and IMF staff calculation.

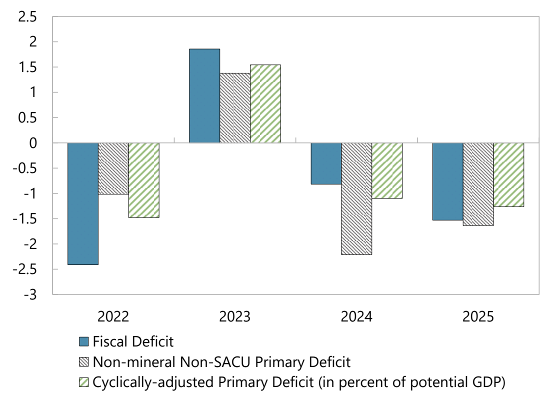
Note: All years refer to fiscal years in this box. The denominator of the ratios is the imputed fiscal year GDP.

18. The authorities' medium-term consolidation plan is critical to put a stop to the depletion of buffers. Fiscal sustainability is a key consideration for all countries in the world, but even more for commodity exporters like Botswana, where diamond reserves are expected to be depleted in two to three decades, while mineral revenue accounts today for about 40 percent of government revenue. In their latest medium-term budget framework, the authorities aim at achieving a small surplus by FY2025—which seems an appropriate target when measured against traditional sustainability benchmarks (see Annex IV). As shown in Annex II, this is a fairly ambitious, but realistic, adjustment by international standards.

19. The authorities' emphasis on lowering the expenditure-to-GDP ratio in the medium term is warranted. Botswana's public wage bill is large compared to other emerging market economies—both as share of GDP and public expenditure. Furthermore, despite Botswana's relatively large stock of public infrastructure, the 2023 PIMA report noted a large gap in infrastructure spending efficiency between Botswana and the most efficient countries with comparable income levels and public capital stock. There is scope to generate savings by improving project appraisal and selection, strengthening the pipeline of quality projects eligible for budget funding, and developing a central information system.

20. Given potential difficulties in containing expenditure growth, especially for politically-sensitive items like the wage bill, measures on the revenue side could also be considered. Botswana's tax ratio excluding SACU transfers is relatively low at around 13 percent of GDP—in line with SSA countries, but lower than other emerging and developing countries (median of 17 percent of GDP). Revenue gains could be achieved in the short-term by streamlining VAT exemptions and enhancing the progressivity of personal income tax through additional brackets for higher income earners, and, over the medium term, by raising the level and changing the modalities of property taxation.

Text Figure 9. Measures of Fiscal Impulse
(Percent of GDP, unless otherwise indicated)



Sources: Bank of Botswana, and IMF staff calculation.

Note: All years refer to fiscal years. Impulse indicators are measured as the change with the previous year. Positive impulse means fiscal expansion.

21. Nonetheless, this year's fiscal expansion may create undue demand pressures in the short term. The positive fiscal impulse in FY2023 occurs with the economy back at potential and still-elevated inflation excluding administered prices, which could hamper monetary-fiscal coordination (Text Figure 9). Output gaps based on HP and multivariate filters are close to zero, both for real GDP and non-mining GDP. In addition, a tighter fiscal stance in FY2023 would reduce future fiscal adjustment needs and enhance the credibility of the authorities' consolidation plan.

22. An expenditure rule could be used to anchor the fiscal adjustment trajectory. The authorities are considering a fiscal rule to automatically save a percentage of mineral revenue. Such revenue split rules are common in resource-rich countries but have not always been successful at stabilizing the debt ratio since they do not constrain spending nor the deficit. Thus, even if 100 percent of the revenues are saved, a country could still borrow to finance higher spending. An expenditure rule, for instance in the form of a cap on real spending growth, may be more effective at ensuring fiscal sustainability, while allowing automatic stabilizers to operate in case of shocks. The expenditure rule could be supplemented with a target path for government net financial assets (NFA).[14]

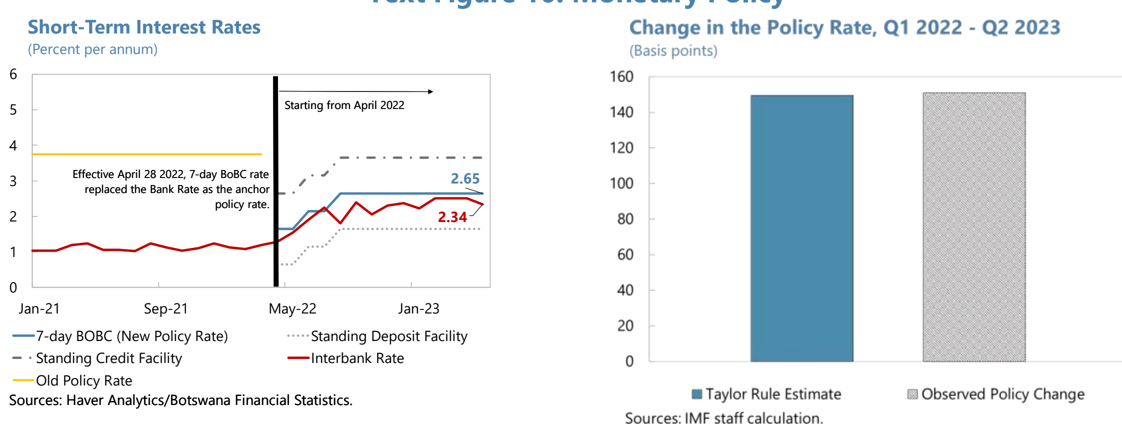
Authorities' Views

23. The authorities agreed with staff on the paramount importance of rebuilding fiscal buffers. They expressed their firm commitment to reach a fiscal surplus in the medium term. In their view, the temporary fiscal expansion in FY2023 is warranted to support the recovery and address the large development gaps in infrastructure. Regarding the fiscal rule, the authorities noted that the revenue split rule combined with a fiscal deficit ceiling would be sufficient to contain spending pressures. On the revenue side, they emphasized that critical revenue administration reforms were under way, which could yield important gains in the coming years, including the introduction of e-billing for VAT, the expansion of VAT to digital services, and the strengthening of audits.

B. Monetary and Exchange Rate Policy: Keeping Inflation within the Objective Range

24. The monetary policy stance is broadly adequate. The BoB last tightened the policy rate in August 2022, anticipating that inflation would revert to the objective range within 18 months. Thereafter, headline inflation decelerated quickly, while expectations also started to fall. Second round effects seem contained, as suggested by the softening of core inflation. The magnitude of the policy rate increase has, so far, been consistent with a modified Taylor rule, which includes the output gap and inflation expectations (Text Figure 10). Going forward, the projected decline in international oil and food prices (including from South Africa—a major exporter to Botswana) combined with positive domestic real interest rates should drive the continued disinflation, without the need for additional monetary tightening.

Text Figure 10. Monetary Policy



[14] The specific path depends on the policy objective. If the objective is, for instance, to build additional fiscal buffer against shocks of 8–16 percent of GDP as discussed in Annex IV, the authorities could target a zero NFA position in the medium term.

25. Nonetheless, risks to the inflation outlook remain high, and the BoB should stand ready to raise rates if necessary. Caution is warranted in assessing the recent disinflation trend. At 7.1 percent in June, inflation excluding regulated prices remains above the objective range, and inflation expectations continue to be elevated. Both the aggregate and non-mining GDP output gaps estimated by staff are close to zero. Fiscal expansion this year, including higher investment, may hamper the BoB's disinflationary effort. In addition, Botswana's increase in the policy rate since end-2021 has been lower than in most SSA countries and other EMDEs, which could put further pressure, in the future, on capital flows and foreign exchange reserves.[15]

26. There is scope to strengthen monetary policy transmission. The new monetary policy rate (MoPR), introduced in April 2022, is now the fixed rate at which 7-day Bank of Botswana certificates are auctioned. This ensures that short-term rates are more closely aligned to the policy rate. But monetary policy effectiveness remains limited due to multiple frictions along the transmission chain. At the start of the chain, the interbank rate does not adequately transmit the signal of the policy rate since banks are reluctant to lend to each other (some prefer to hold excess liquidity buffers, while others are concerned about credit risk). Low financial development and low public debt reduce the ability of interest rates to affect economic activity through credit markets. The experience of under-allocated government security auctions suggests that rates at the longer end of the government yield curve are managed and do not fully reflect market conditions. Finally, banks' wholesale deposit rates are broadly inelastic to the policy rate, with deposit rates responding primarily to liquidity conditions in the system and competition across banks. Reforms to develop both the interbank and the bond markets are discussed below in the section on financial policies.

27. Some changes could be contemplated to mitigate the risk of conflict between monetary policy and exchange rate policy. The real effective exchange rate (REER) targeting regime has served the country well in the past, but it may complicate the conduct of monetary policy when inflation is high (since the depreciation of the currency to maintain competitiveness adds to inflationary pressures) and it has not prevented a weakening of the competitiveness position. As discussed in the attached Selected Issues Paper (SIP), some changes to the current regime could mitigate these issues—for instance, by calibrating the nominal crawl rate to support the inflation objective (rather than to compensate the inflation differential with the main trading partners) or by modifying the weights used in the REER calculation to mirror trade patterns more closely.

Authorities' Views

28. There was broad agreement between authorities and staff on the orientation of monetary policy under the baseline, although the authorities saw the risks to inflation as being more symmetric. They noted that upside risks (from higher international commodity prices, persistence of supply chain constraints, global fragmentation, and upward adjustments in

[15] Since end-2021, the average policy rate increase in 60 EMDEs outside SSA has been around 450 basis points. The April 2023 *Regional Economic Outlook for sub-Saharan Africa* found that Botswana had the smallest policy rate increase among all SSA countries between end-2021 and February 2023.

administered prices) were broadly offset by the possibility of weaker economic activity, disinflationary effects of higher monetary policy rates globally, stronger-than-projected appreciation of the Pula against the rand, and lower commodity prices. Furthermore, the authorities estimated that the economy was still operating below capacity in the short term, limiting demand-driven inflationary pressures. If economic circumstances were to change, the central bank would respond appropriately. On monetary policy effectiveness, they noted that transmission to lending rates was strong and that transmission to the interbank market rate had improved following the 2022 reform of the monetary policy framework. They monitor the interest rate differential with other countries and are ready to take appropriate measures if capital outflows were to materialize, which has not happened thus far. On the REER regime assessment, the authorities agreed on the benefits of crawling pegs and welcomed staff analysis on international experience with transitional arrangements.

C. Financial Sector Policies for Market Stability, Depth, and Inclusion

29. Despite recent shocks, the financial sector has remained profitable and stable. At end-2022, the banking sector's capital-adequacy ratio—at 19.8 percent—was above the regulatory threshold, while NPLs declined to 3.8 percent of gross loans. All banks comply with prescribed liquidity ratios. The stress testing exercises of the 2023 Financial Sector Assessment Program (FSAP) found that the financial system appeared to be resilient to a wide range of shocks. Annex V summarizes the main FSAP findings and recommendations.

30. Good progress has been made in strengthening legal and regulatory frameworks for financial stability, but the operationalization of new regulations and laws will be key. The FSAP found that key elements of the Basel III Framework were at an advanced stage of implementation. Both the recently adopted Bank of Botswana Amendment Act and the revised Banking Act should create a stronger legal basis for financial stability oversight and operations. Next steps include establishing the operational frameworks for emergency liquidity assistance, deposit insurance, and bank resolution. The Financial Stability Council's mandate should be expanded to include crisis preparedness and management.

31. Deepening the interbank and domestic bond markets is necessary to support financial sector development, strengthen public financial management, and improve monetary policy transmission. This will require coordinated efforts by the BoB and Ministry of Finance:

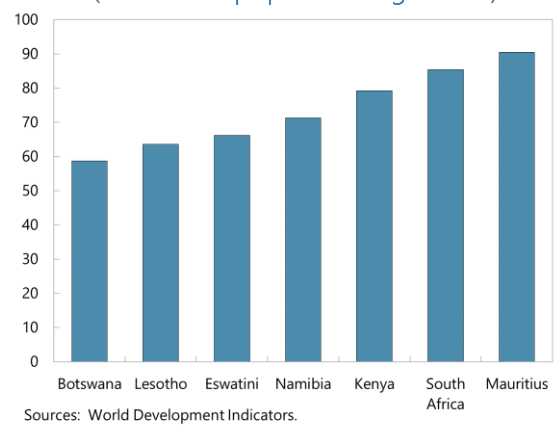
- The *interbank market* is fragmented and concentrated mostly among large banks. Unsecured transactions in the interbank market are more common. To expand the market, repo transactions should be encouraged by building capacity with banks, designing a robust legal framework to support contract enforceability, and establishing the supporting prudential regulation. In addition, transitioning to the Basel III liquidity framework would improve liquidity planning and monitoring, and expand the definition of liquid assets used as collateral for interbank market repo loans.

- The *government bond market* is fairly under-developed and illiquid. Auctions are often undersubscribed, and several factors hamper price discovery. Development of the bond market will require actions on two fronts: (1) making the primary bond auction system more efficient by improving transparency and predictability, accepting market-based pricing, and revisiting the primary dealer agreement; and (2) enhancing secondary market liquidity by expanding the investor base, enforcing quoting and reporting obligations of primary dealers, and improving market infrastructure for trading.

32. The rise in digital financial services (DFS) has driven recent improvements in financial inclusion, although there is scope for further progress. Botswana's financial inclusion compares favorably to many sub-Saharan African countries but lags regional leaders like South Africa and Mauritius (Text Figure 11). The 2023–2028 "Financial Inclusion Roadmap", to be published this year, will articulate the authorities' strategy, and set financial inclusion targets. To advance the reform process, the authorities could clarify the regulatory framework for DFS, improve interoperability (e.g., between mobile money and payment cards), foster innovation by introducing fast payment services, and allow the entry of new players. Furthermore, private sector credit to micro, small, and medium enterprises (MSMEs) remains limited. Measures to boost credit include reforming development finance institutions (DFIs) (whose subsidized credit tends to crowd out private lenders); introducing well-designed credit enhancement mechanisms; developing wholesale facilities to support financial institutions' on-lending to MSMEs; upgrading the regulatory framework for non-bank lenders (including microfinance institutions); and implementing credit infrastructure reforms to enable effective credit risk assessments.

Text Figure 11. Account Ownership at a Financial Institution or with a Mobile-Money-Service Provider, 2022

(Percent of population ages 15+)



Sources: World Development Indicators.

33. Botswana's exit from the Financial Action Task Force (FATF) grey list shows significant progress in strengthening the AML/CFT framework, but additional implementation challenges remain. As noted by the 2023 FSAP, the AML/CFT regime has undergone significant recent improvements, which led to the removal of Botswana from the FATF grey list in October 2021 and the European Union's blacklist of high-risk third countries in January 2022. The BoB is also allocating additional resources to AML/CFT, including on-site examinations and work on operationalizing risk-based supervision. Effective implementation of the new measures will require clarifying reporting requirements, increasing public awareness, building capacity, and ensuring that information on beneficial ownership of legal persons and arrangements is adequate, accurate, and up to date. Parallel work needs to be carried out in relation to non-bank financial institutions under the supervision of the NBFIRA: supervisory arrangements should be put in place for the newly regulated Virtual Asset Service Providers sector, which poses novel ML/TF risks.

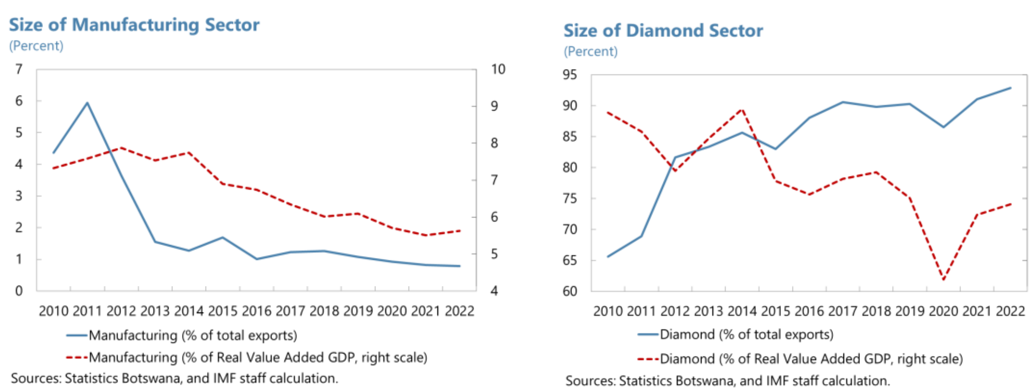
Authorities' Views

34. The authorities broadly agreed with staff's assessment and recommendations. They underlined the stability and resilience of the domestic financial system. They highlighted the expected benefits from revisions to the BoB and Banking Acts and reiterated their commitment to implement Basel III standards. They noted that the new government borrowing strategy and auction calendar, launched in June 2023, should enhance transparency in the market and contribute to building debt management capacity. They also underscored that significant progress had been made in strengthening the AML/CFT framework and addressing the recommendations of the last Financial Action Task Force assessment.

D. Structural Reforms: Transforming Botswana's Growth Model

35. The authorities are committed to transforming the drivers of growth. Significant changes are required to diversify the economy away from diamonds and grow the share of the private sector. Diamonds represent almost 90 percent of goods exports and a quarter of GDP, while the share of manufacturing has declined over the past decade (Text Figure 12). The public sector plays a dominant role in large parts of the economy, particularly through the SOEs, constraining private sector development; it represents 40 percent of formal employment and 50 percent of formal sector wages. Overall, economic transformation is critical to raising the growth potential, enhancing resilience to external shocks, and reducing the unemployment rate.

Text Figure 12. Diamond and Manufacturing Industry



Note: For the GDP share of the RHS chart, diamond includes mining and diamond traders.

36. Increasing the private sector's economic footprint will require, among other things, accelerating the SOE reform agenda and addressing infrastructure gaps.[16] SOEs play a large role in Botswana's economy, spanning transportation, energy, utilities, communication, and financial services. Performance has generally been weaker than international benchmarks. As discussed in the

[16] Other reforms to foster private sector development (discussed in previous Article IV reports) are still relevant, including reducing doing-business costs, strengthening export and investment promotion agencies, deepening financial markets, investing in human capital, lowering the public wage premium, and closing skill mismatches.

attached SIP, reforming SOEs could level the playing field for private companies, facilitate market access, improve resource allocation, and spur competition and innovation. As a first step, the authorities could accelerate the comprehensive analysis of the SOE sector and clarify oversight roles. In addition, recent international competitiveness surveys show that Botswana lags other upper middle-income countries in both physical and digital infrastructure, especially airport connectivity, utilities, and ICT, which imposes strong constraints on businesses. The 2023 PIMA found that there was still significant room to increase efficiency in public investment. The authorities are taking steps to address these challenges through a broad range of public financial management reforms, which should be beneficial for infrastructure governance. In addition, the 2023 budget foresees a large increase in infrastructure expenditure until end-March 2024. Overall, a greater role for the private sector would be conducive to job creation and contribute to lowering unemployment and poverty.

37. Diversifying the economy is a priority, but ongoing efforts could be more targeted. Diversification away from the diamond sector, which is capital-intensive and subject to external shocks, can make growth more robust, resilient, and inclusive. The authorities' strategy is centered on Special Economic Zones to promote private investment and value-chain development, but industrial policy appears broad, inward-looking, and with some emphasis on low-productivity sectors. Going beyond traditional comparative advantages towards more sophisticated sectors could foster potential growth and innovation capacity. Recent research shows that active policies promoting structural change can be warranted in the presence of market failures. To prevent potential adverse effects such as wasting budgetary resources or crowding out non-subsidized firms, these interventions should be well targeted and stimulate economic activities meeting the following criteria: (1) scope for high productivity gains, related to the ease of absorbing foreign technology, exposure to competition, and product sophistication; (2) extent of forward and backward linkages, especially a high content of intermediate inputs, to generate spillovers to other sectors; (3) potential for knowledge spillovers; (4) export orientation and tradability, possibly by placing the products in global value chains; (5) labor intensity to be able to absorb the labor force and reduce unemployment; and (6) relatively low skill intensity at the beginning, although building skills should be a priority.

38. There is great potential from trade integration, both within the African region and with the rest of the world. While tariffs in Botswana are lower than comparator countries, non-tariff barriers remain elevated, partly reflecting the landlocked country situation and gaps in trade and logistics infrastructure (Text Table 1). Leveraging platforms such as the African Continental Free Trade Area (AfCFTA), strengthening investment promotion agencies, upgrading infrastructure, and targeting products that complement those of other countries could help Botswana improve its trade performance. Simulations based on IMF (2023) show that real GDP per capita could increase by 5 percent after 10 years relative to baseline forecasts, provided that the AfCFTA is implemented, and Botswana achieves parity in trade infrastructure with the top quartile of upper-middle income countries.[17] Overall, greater trade integration would support the development of export-oriented industries, including manufacturing, which are critical for stimulating employment.

Text Table 1. Trade Restrictions and Constraints

	Tariffs 1/	NTMs 2/	Trade infrastructure index 3/
Botswana	0.8	93.2	0.32
SSA, top quartile	4.8	110.5	0.35
SSA, median	7.6	201.5	0.28
UMI countries, top quartile	1.4	135.7	0.44
UMI countries, median	3.5	181.6	0.34

1/ Trade weighted average tariffs, percent.
2/ Trade weighted average number of Non Tariff Measures, count.
3/ Trade infrastructure is a meta-indicator that captures quality of roads, ports, railroads, airports, and Logistics Performance Index. The variable is bounded between 0 (worst infrastructure) and 1 (best infrastructure).
Sources: IMF (2023) and staff calculations.

39. **A greener economy could also support economic resilience and inclusiveness.** Botswana's high vulnerability to climate change—including from drought, floods, and water supply quality—underscores the need for a greener and more sustainable growth model. Climate change is also likely to exacerbate inequality, by harming subsistence agriculture and reducing access to water and sanitation. The government signed the Paris Agreement in 2016 and has committed to developing a long-term low carbon development strategy and reducing carbon emissions by 15 percent by 2030. The authorities have formulated main goals and strategies in their 2021 Climate Change Policy, which is supported by an action plan setting targets for different sectors of the economy. The recent IMF Climate-PIMA report welcomed the ongoing initiatives and found that public investment management showed increasing awareness of climate considerations. However, the initiatives are generally at early stages of implementation and will need to be confirmed by sectoral actions. In particular, all sectoral strategies and regulations, including investment plans and building codes, should be updated to reflect climate change-related concerns.

Authorities' Views

40. **The authorities concurred that structural transformation of the economy was critical and highlighted ongoing actions to diversify the production patterns**. They noted that the new in-principle sales agreement, reached in July between the Government and De Beers, should expand Botswana's footprint across the diamond value chain by increasing the share of diamonds cut and polished domestically. Furthermore, the creation of a "Diamonds for Development" Fund, with gradual investments by De Beers totaling Pula 10 billion ($750 million) over the next 10 years,

[17] The simulation—building on the 2023 IMF Departmental Paper on *Trade Integration in Africa*—assumes that AfCFTA implementation results in a reduction in tariffs by 90 percent, and a decline in the number of non-tariff measures (NTMs) by half, among African countries. Botswana is also assumed to improve its trade infrastructure towards the top quartile of upper-middle income countries. The elasticity of real GDP per capita to trade openness is derived from Feyer (2019).

should boost economic diversification by supporting new activities in non-mining sectors like agriculture, solar, climate change, and tourism.

OTHER SURVEILLANCE ISSUES

41. Capacity development (CD). As discussed in Annex VI, the authorities receive CD in a broad range of areas and have a good track record in implementing proposed reforms—a recent example being the reform of the monetary policy framework with the new policy rate and corridor. The relationship with the FSAP team has also been strong. Future CD should support the authorities in their efforts to build fiscal buffers, enhance public financial management, improve monetary policy transmission, and strengthen financial supervision and regulation. The authorities are generally in agreement with past Article IV recommendations, although implementation has been slow in some areas (Annex VII).

42. Data provision is broadly adequate for surveillance. The authorities have continued to improve statistics, with IMF support. Notable progress includes rebasing national accounts estimates to 2016, constructing supply-and-use tables, and compiling monetary statistics for other financial corporations. Coverage of the PPI is being expanded, although gaps remain. Staff encourages the authorities to gradually transition to the GFSM 2014 framework. In addition, priority should be given to addressing GFS data gaps, including classification of current and capital expenditures, and expanding the coverage beyond the budgetary central government to include extrabudgetary units and local governments.

STAFF APPRAISAL

43. After a strong recovery from the Covid pandemic, Botswana, like most countries in the world, is expected to face an economic slowdown this year. Growth is projected to decelerate by 2 percentage points to 3.8 percent in 2023 due to the decline in diamond production and prices, with the weaker global environment likely to depress other exports.

44. Growth should pick up over the next two years, although risks to the outlook remain elevated. The rebound is mainly predicated on higher prices and demand for diamonds. Downside risks include volatility in commodity markets, a global economic slowdown, climate shocks, and delays in reform implementation.

45. In the longer term, the country's growth model will need to confront deep structural challenges. The economy is heavily dependent on diamond mining, but Botswana's diamond reserves may be exhausted in two to three decades. Growth has not been sufficiently inclusive to bring down unemployment and reduce inequality. Finally, despite efforts to diversify and expand the role of the private sector, the economy remains dominated by the public sector.

46. The authorities are facing these structural challenges with reduced fiscal and external buffers. Botswana's relatively low gross debt-to-GDP ratio masks a large, long-term deterioration in the government's financial position, with government cash deposits having fallen by over 40 percent of GDP over the past 15 years. The decline in foreign exchange reserves continued in 2022, bringing the import coverage ratio down to 5.9 months of imports in May 2023, from close to 10 months before the pandemic. Although the 2022 external position is stronger than implied by fundamentals and desirable policies, current account surpluses are projected to soften over the medium term.

47. The authorities' planned fiscal consolidation is critical to preserve fiscal sustainability and FX reserves. The large depletion of government deposits in recent years combined with the longer-term prospects of exhaustion of diamond resources call for fiscal prudence. Fiscal adjustment could be supported by an expenditure rule. The authorities' emphasis on lowering the expenditure-to-GDP ratio, including the wage bill, seems appropriate.

48. The monetary policy stance is broadly appropriate, but the central bank should stand ready to raise the policy rate if inflation risks materialize. Inflation has declined since August 2022 and is projected to remain within the central bank's objective range from May 2023 onwards. Nonetheless, the central bank should stand ready to respond if inflation bounces back or FX reserves continue to decline. Some changes to the exchange rate regime could also be contemplated to support competitiveness and to reduce potential frictions between monetary and exchange rate policies.

49. The financial sector is broadly sound, stable, and resilient. Financial stability could be further strengthened by operationalizing the frameworks for emergency liquidity assistance, deposit insurance, and bank resolution. Deepening the interbank and bond markets would support financial sector development, while improving public financial management and monetary policy transmission.

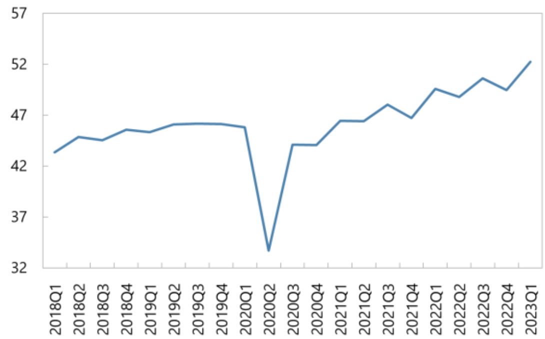
50. Supply-side structural reforms are necessary to support the diversification of the economy and increase the relative size of the private sector. This will help boost the economy's growth potential, enhance resilience to external shocks, and reduce the unemployment rate. Policy priorities include trade facilitation and integration, SOE reform, more efficient and climate-resilient infrastructure investment, and more targeted support for high-productivity, export-oriented sectors.

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

Figure 1. Botswana: Real Sector Developments

Real GDP recovery continued in 2022…

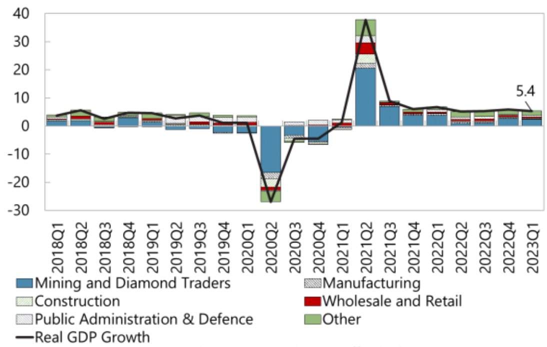
Real GDP
(Billion Pula, in constant 2016 price)



Sources: GDP Quarterly Release in Statistics Botswana.

… driven mainly by strong rebound in the mining sector, and also manufacturing and construction.

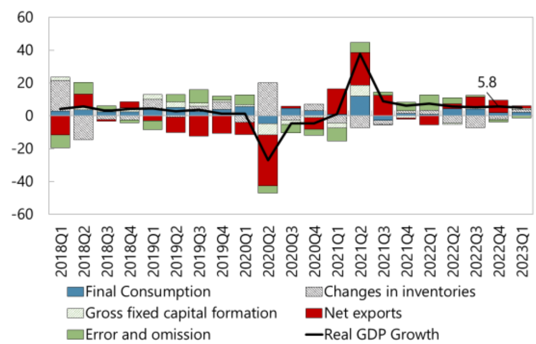
Real GDP Growth Breakdown by Selected Sectors
(Percent)



Sources: Botswana Financial Statistics, and IMF staff calculation.

Net exports have been the main contributor to the growth rebound.

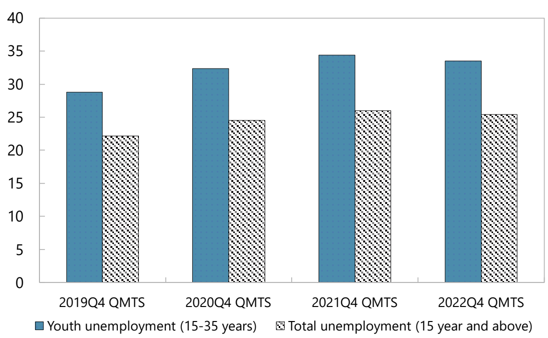
Real GDP Growth Breakdown by Type of Expenditure
(Percent)



Sources: Botswana Financial Statistics, and IMF staff calculation.

Youth and overall unemployment remain elevated.

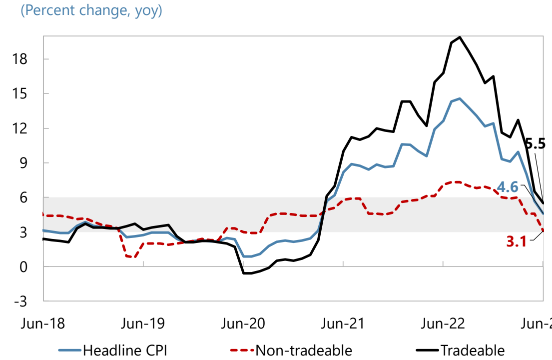
Unemployment Rate
(Percent of labor force)



Sources: Quarterly Multi-Topic Survey Report (QMTS)

Headline CPI has come down after peaking in August 2022…

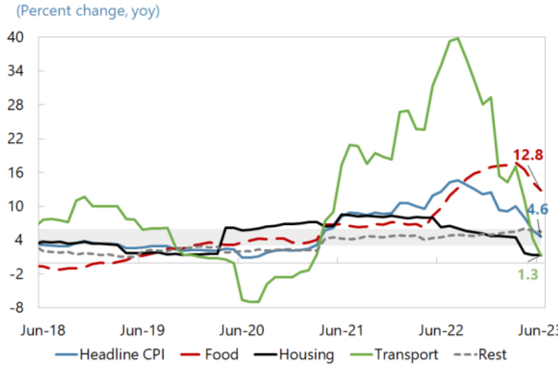
Consumer Price Index: Tradeable and Non-Tradeable
(Percent change, yoy)



Sources: Haver Analytics, and IMF staff calculation.

…with recent developments mainly driven by imported fuel prices that has passed through to transport inflation.

Consumer Price Index by Main Items
(Percent change, yoy)

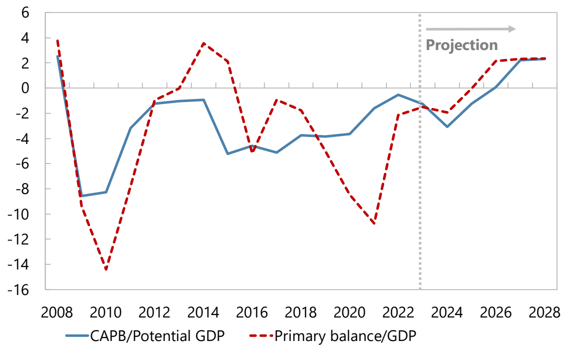


Sources: Haver Analytics, and IMF staff calculation.

Figure 2. Botswana: Fiscal Sector Developments

The fiscal deficit ratio is expected to widen in FY2023…

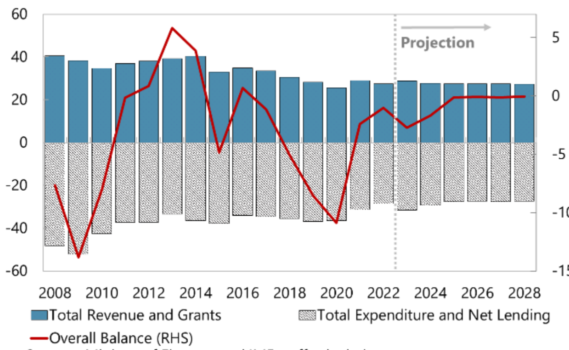
Primary Balance
(Percent of GDP)



Sources: IMF staff calculation.

…before narrowing over the medium term.

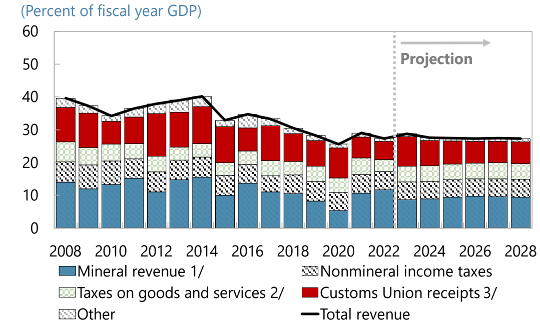
Fiscal Balance
(Percent of GDP; fiscal year)



Sources: Ministry of Finance, and IMF staff calculation.

Mineral revenues have declined significantly in the past decade due to lower diamond prices…

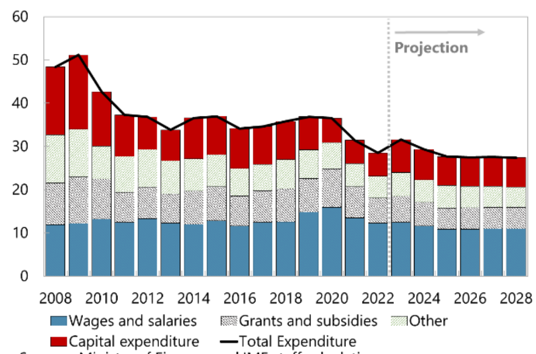
General Government Revenue
(Percent of fiscal year GDP)



Sources: Ministry of Finance, and IMF staff calculation.
1/Mineral income taxes + mineral royalties and dividend.
2/VAT.
3/SACU revenue.

… while the expenditure ratio was relatively stable between FY2011 and FY2020.

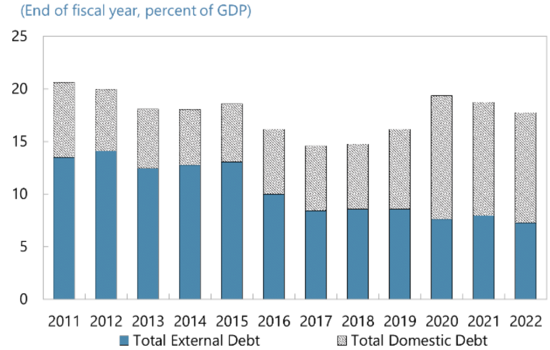
General Government Expenditure
(Percent of fiscal year GDP)



Sources: Ministry of Finance, and IMF staff calculation.

Gross debt ratio has been relatively stable over time, although the share of domestic debt has increased.

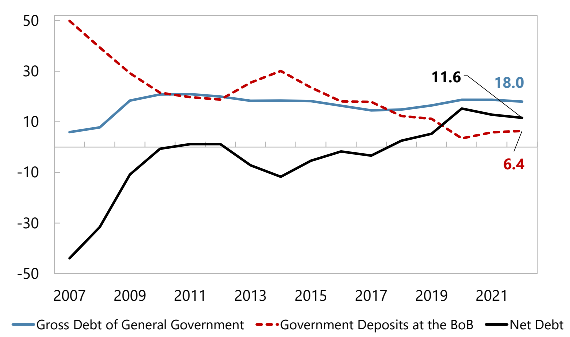
General Government Debt
(End of fiscal year, percent of GDP)



Sources: Botswana Financial Statistics, and IMF staff calculation.

Government deposits held at the BoB have fallen in the past 15 years.

Government Net Debt
(Percent of fiscal year GDP)



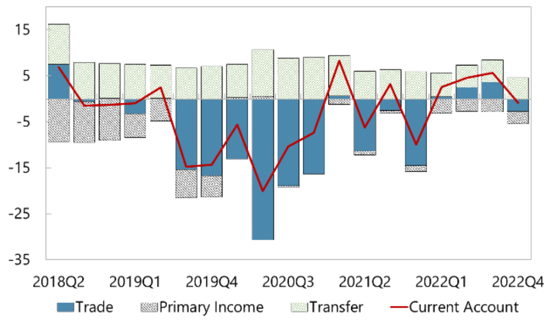
Sources: Botswana Financial Statistics from Bank of Botswana and Ministry of Finance.

Note: All years in this box refer to fiscal years. For instance, 2023 is FY2023, which runs from April 1, 2023 to March 31, 2024. In this box, GDP is also computed based on the fiscal year, to ensure consistency of the ratios.

Figure 3. Botswana: External Sector Developments

The current account balance moved into surplus in 2022…

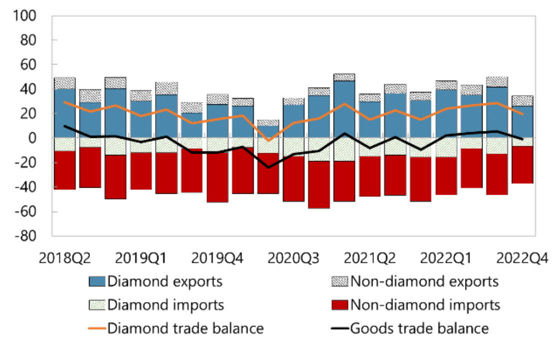
Current Account
(Percent of quarterly GDP)



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

… reflecting a substantial increase in diamond net exports…

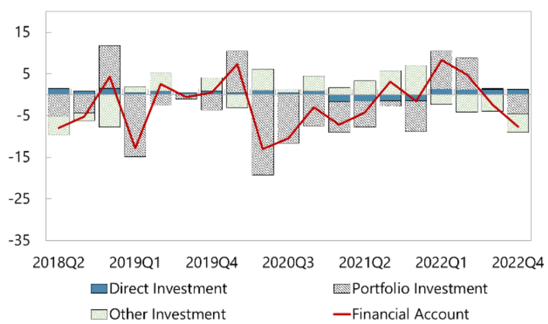
Goods and Diamond Trade
(Percent of GDP)



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

… while the financial account also recorded a surplus due to large portfolio inflows in the first half of 2022.

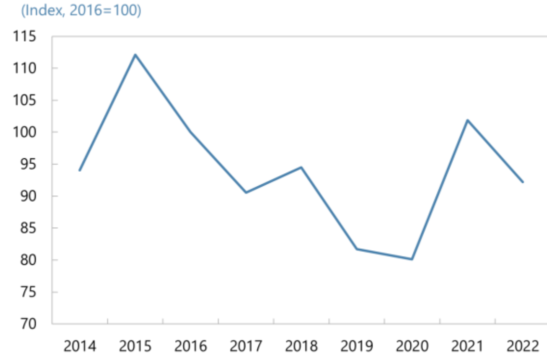
Financial Account
(Percent of quarterly GDP)



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

Terms of trade weakened in 2022 mainly due to fuel inflation and a decline in diamond prices.

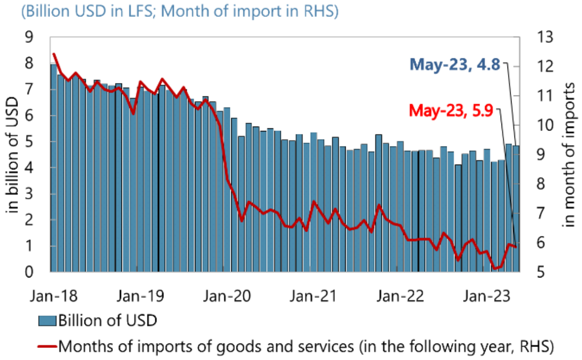
Terms of Trade
(Index, 2016=100)



Sources: Kimberley Process, and IMF staff calculation.

Reserves have declined over time, partly due to the impact of the pandemic.

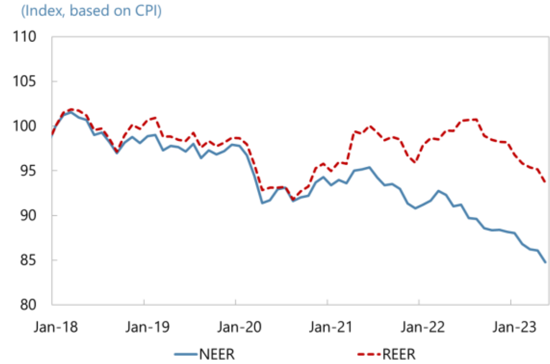
Monthly Foreign Reserve
(Billion USD in LFS; Month of import in RHS)



Sources: Haver/Botswana Financial Statistics, International Merchandise Trade Statistics, and annual import numbers from team's framework.

The NEER continued to depreciate in 2022 in line with the crawling peg. The REER has depreciated over the past 6 months, in line with the NEER and lower domestic inflation.

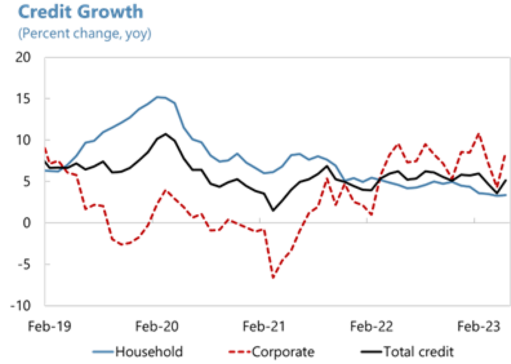
Botswana Effective Exchange Rate
(Index, based on CPI)



Sources: IMF INS database.

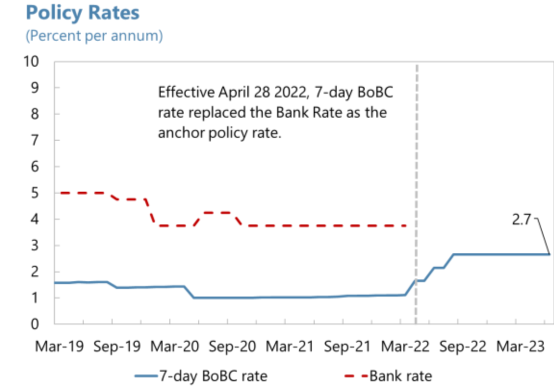
Figure 4. Botswana: Financial Sector Developments

Credit growth has bounced back after a deceleration during the pandemic.



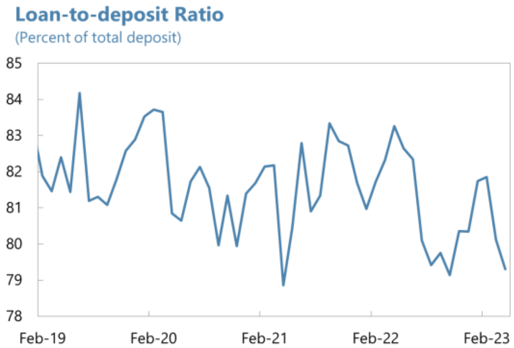
Sources: Haver Analytics.

The policy rate has remained unchanged since August 2022.



Sources: Haver Analytics/Bank of Botswana.

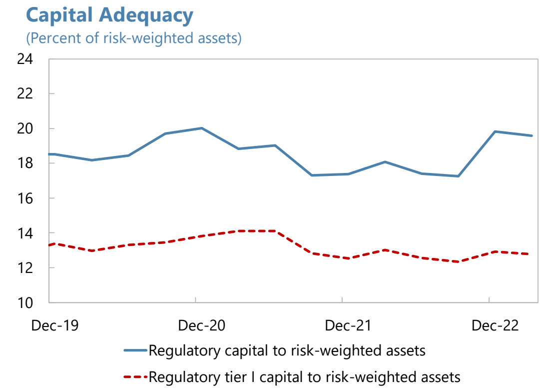
Bank liquidity remains adequate…



Sources: Botswana Financial Statistics.

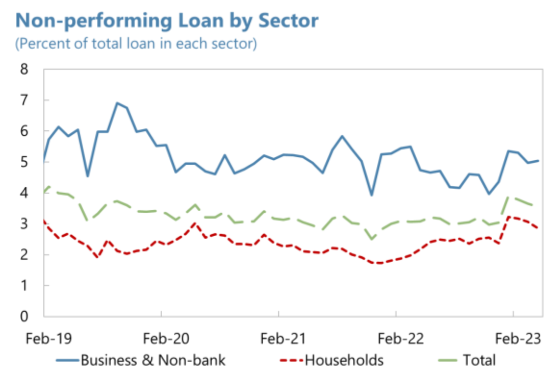
Note: Total loan and advances includes all loans and advances outstanding by government, households and business.

… and the banking sector remains well capitalized …



Sources: IMF FSI Database.

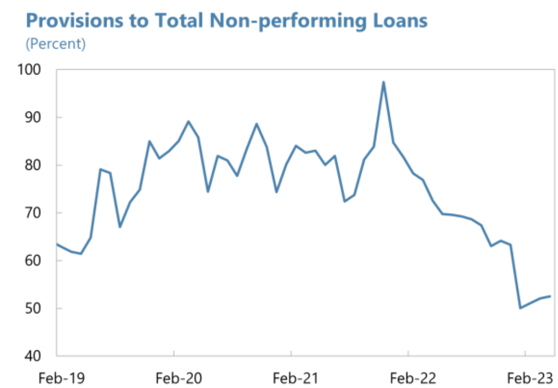
… with low and stable NPLs…



Sources: Botswana Financial Statistics.

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

… and declining but sufficient provisions.



Sources: Botswana Financial Statistics.

Table 1. Botswana: Selected Economic Indicators, 2019–28[1]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projection					
(Annual percent change, unless otherwise indicated)										
National Income and Prices										
Real GDP	3.0	-8.7	11.9	5.8	3.8	4.1	4.3	4.0	4.0	4.0
Mineral[2]	-3.7	-26.5	29.8	7.5	0.6	2.6	3.5	2.4	2.1	2.3
Nonmineral	5.2	-3.5	7.8	5.3	4.7	4.5	4.6	4.4	4.5	4.5
GDP per capita (US dollars)	6,679	5,863	7,239	7,738	7,741	8,013	8,417	8,943	9,446	10,034
GNI per capita (US dollars)[3]	6,329	5,868	7,169	7,515	7,538	7,793	8,188	8,693	9,193	9,761
Consumer prices (average)	2.7	1.9	6.7	12.2	5.9	4.7	4.5	4.5	4.5	4.5
Diamond production (millions of carats)	23.7	16.9	22.7	24.5	24.5	25.1	25.9	26.6	27.1	27.8
Money and Banking										
Monetary Base	5.7	-3.8	-8.8	14.0	9.7	7.6	8.9	8.4	9.2	9.2
Broad money (M2)	8.0	5.9	5.0	12.0	9.7	7.6	8.9	8.4	9.2	9.2
Credit to the private sector	7.1	5.3	5.4	14.7	8.9	8.4	8.7	8.8	8.7	8.7
(Percent of GDP, unless otherwise indicated)										
Investment and Savings										
Gross investment (including change in inventories)	30.9	32.8	27.4	25.0	29.9	30.7	32.5	32.8	32.6	32.7
Public	7.8	6.5	5.5	5.4	7.2	7.3	7.1	6.8	6.6	6.6
Private	23.0	26.3	21.9	19.5	22.8	23.4	25.4	26.0	26.0	26.1
Gross savings	23.8	26.5	28.2	28.4	30.8	32.2	33.6	33.5	33.2	33.2
Public	0.5	-4.3	0.7	4.0	4.5	5.4	6.6	6.3	6.1	6.1
Private	23.3	30.8	27.5	24.4	26.2	26.8	27.0	27.2	27.1	27.1
Central Government Finances[4]										
Total revenue and grants	28.3	25.6	29.0	28.9	29.8	28.7	28.6	28.4	28.3	28.4
SACU receipts	7.9	9.1	6.5	5.4	8.7	7.5	7.2	7.0	7.0	7.0
Mineral revenue	8.2	5.3	10.6	13.2	9.7	9.6	9.8	9.9	9.7	9.6
Total expenditure and net lending	36.9	36.5	31.4	28.9	31.7	29.7	28.1	27.9	27.8	27.9
Overall balance (deficit –)	-8.6	-10.9	-2.4	0.0	-1.9	-1.0	0.5	0.5	0.5	0.5
Non-mineral primary balance[5]	-19.0	-18.5	-15.9	-16.3	-13.6	-12.5	-10.8	-10.9	-10.6	-10.5
Total central government debt[6]	21.5	23.5	22.1	20.8	21.3	20.3	18.9	18.4	18.2	17.9
Net Debt	5.3	15.3	12.8	11.6	13.0	13.1	11.7	10.3	9.2	8.0
External Sector										
Exports of goods and services, f.o.b. (% change)	-17.3	-25.3	70.3	11.9	-8.8	10.6	5.8	9.2	5.7	6.0
o/w diamonds	-19.8	-21.8	80.0	7.9	-13.3	10.4	5.2	10.6	4.0	4.5
Imports of goods and services, f.o.b. (% change)	4.5	-2.3	23.1	-6.4	2.8	7.8	5.6	9.6	6.1	6.1
Current account balance	-6.9	-10.4	-1.4	2.9	0.8	1.5	1.1	0.6	0.6	0.5
Overall Balance	-6.7	-11.7	-1.4	1.8	2.5	1.8	0.7	0.6	0.7	0.7
Nominal effective exchange rate (2018=100)[7]	98.2	94.0	94.1	90.8	-	-	-	-	-	-
Real effective exchange rate (2018=100)[7]	98.8	94.4	97.7	99.1	-	-	-	-	-	-
Terms of trade (2005=100)	143.4	140.6	178.9	161.2	145.5	150.5	150.5	159.1	158.5	156.7
External public debt[8]	12.5	11.8	11.1	9.6	10.0	8.6	7.2	6.5	5.9	5.3
o/w public and publicly guaranteed	3.9	4.0	2.9	2.2	1.9	1.6	1.4	1.2	1.1	1.0
(Millions of US$, unless otherwise indicated)										
Gross official reserves (end of period)	6,172	4,944	4,806	4,281	4,800	5,196	5,369	5,516	5,692	5,884
Months of imports of goods and services[9]	9.8	6.4	6.7	5.8	6.0	6.1	5.8	5.6	5.5	5.5
Months of non-diamond imports[9]	13.4	9.3	8.9	7.7	8.2	8.4	8.2	8.0	7.7	7.6
Percent of GDP	36.5	31.2	27.2	21.7	23.6	24.1	23.3	22.0	21.4	20.3

Sources: Botswana authorities and IMF staff estimates and projections.

[1] This table is based on calendar years 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] Fiscal variables are based on fiscal years (starting on 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] Includes guarantees.

[7] For 2019-2022, both effective exchange rate are from IMF INS database.

[8] External debt data measured in fiscal years.

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

Table 2. Botswana: Balance of Payments, 2019–28[1]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projection					
(millions of U.S. dollars, unless otherwise indicated)										
Current Account Balance	-1,155	-1,548	-263	598	172	323	257	158	153	153
Trade balance	-1,066	-1,968	-652	548	-515	-388	-388	-434	-490	-522
Exports, f.o.b.	5,260	4,293	7,425	8,278	7,413	8,196	8,669	9,499	10,039	10,645
Diamonds	4,750	3,714	6,686	7,214	6,253	6,906	7,265	8,035	8,358	8,733
Other raw materials	52	90	183	399	643	744	819	873	1,027	1,249
Other	458	489	556	665	517	547	585	592	654	663
Imports, f.o.b	-6,326	-6,260	-8,077	-7,731	-7,929	-8,584	-9,058	-9,934	-10,529	-11,167
Diamonds	-1,864	-2,011	-2,880	-2,205	-2,251	-2,624	-2,761	-3,214	-3,343	-3,493
Other	-4,462	-4,249	-5,198	-5,526	-5,678	-5,960	-6,297	-6,720	-7,186	-7,674
Services	-401	-899	-684	-354	-307	-272	-290	-345	-378	-416
Transportation	-200	-214	-327	-287	-296	-309	-330	-359	-379	-401
Travel	414	27	197	271	363	421	446	459	472	485
Other services	-615	-712	-554	-338	-374	-384	-406	-445	-471	-499
Income	-876	12	-182	-589	-542	-599	-634	-699	-721	-788
Current transfers	1,190	1,305	1,253	988	1,537	1,582	1,570	1,636	1,742	1,878
SACU receipts	1,318	1,382	1,328	1,132	1,645	1,695	1,692	1,767	1,882	2,029
Capital and Financial Account	-436	-643	-442	116	347	72	-84	-11	23	39
Direct investment	113	100	-286	258	249	262	279	301	323	348
Portfolio investment	-927	-959	-1,042	595	31	-45	-81	-116	-114	-113
Other investment	378	216	886	-736	68	-144	-282	-196	-185	-196
Assets	458	265	282	-764	-140	-134	-143	-155	-170	-184
Liabilities	-83	-50	567	-6	208	-10	-139	-41	-16	-13
Net government long-term borrowing	-137	-140	211	158	133	-81	-179	-85	-51	-51
Other net private long-term borrowing	62	98	364	-157	82	78	48	53	44	47
Short-term borrowing	-9	-8	-8	-7	-7	-7	-8	-8	-9	-9
Net Errors and Omissions	473	440	447	-351	0	0	0	0	0	0
Overall Balance	-1,118	-1,751	-259	363	519	395	174	146	176	192
(Percent of GDP, unless otherwise indicated)										
Current Account	-6.9	-10.4	-1.4	2.9	0.8	1.5	1.1	0.6	0.6	0.5
Trade balance	-6.4	-13.2	-3.5	2.7	-2.5	-1.8	-1.7	-1.7	-1.8	-1.8
Exports of goods	31.5	28.8	39.6	40.7	35.8	37.6	37.3	37.9	37.3	36.7
Of which: diamonds	28.5	24.9	35.7	35.4	30.2	31.7	31.2	32.0	31.1	30.1
Imports of goods	37.9	41.9	43.1	38.0	38.3	39.4	38.9	39.6	39.1	38.5
Of which: diamonds	11.2	13.5	15.4	10.8	10.9	12.0	11.9	12.8	12.4	12.0
Services balance	-2.4	-6.0	-3.6	-1.7	-1.5	-1.2	-1.2	-1.4	-1.4	-1.4
Income and transfers balance	1.9	8.8	5.7	2.0	4.8	4.5	4.0	3.7	3.8	3.8
Financial Account	-2.6	-4.3	-2.4	0.6	1.7	0.3	-0.4	0.0	0.1	0.1
Direct investment	0.7	0.7	-1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Portfolio investment	-5.6	-6.4	-5.6	2.9	0.1	-0.2	-0.3	-0.5	-0.4	-0.4
Other investment	2.3	1.4	4.7	-3.6	0.3	-0.7	-1.2	-0.8	-0.7	-0.7
Net Errors and Omissions	2.8	2.9	2.4	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (increase reserves +)	-6.7	-11.7	-1.4	1.8	2.5	1.8	0.7	0.6	0.7	0.7
(Annual percentage change, unless otherwise indicated)										
Export Volumes	-9.5	-15.0	29.0	12.0	-2.7	4.9	3.9	2.6	4.7	4.5
Import Volumes	1.0	2.6	19.4	-11.1	5.9	7.3	3.7	9.2	4.2	5.2
Terms of Trade	-13.5	-2.0	27.3	-9.9	-9.8	3.5	0.0	5.7	-0.3	-1.2
End-of-Year Reserves (US$ millions)	6,172	4,944	4,806	4,281	4,800	5,196	5,369	5,516	5,692	5,884
Months of Imports of Goods and Services[2]	9.8	6.4	6.7	5.8	6.0	6.1	5.8	5.6	5.5	5.5
Months of Non-Diamond Imports	13.4	9.3	8.9	7.7	8.2	8.4	8.2	8.0	7.7	7.6
Nominal GDP (US$ millons)	16,696	14,930	18,737	20,352	20,709	21,793	23,260	25,095	26,908	29,001

Source: Bank of Botswana; IMF staff estimates.

[1] This table is based on calendar years.

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

Table 3a. Botswana: Central Government Operations, FY2019–FY2028[1]

(Billions of Pula, unless otherwise indicated)

	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
							Projection			
	(Billions of pula, unless otherwise indicated)									
Total Revenue and Grants	50.2	46.2	63.4	74.1	82.0	85.7	93.0	100.2	108.3	117.8
Total revenue	50.2	46.2	63.4	74.1	82.0	85.7	92.9	100.1	108.2	117.8
Tax revenue	38.0	38.2	46.2	49.4	62.2	64.2	69.5	74.6	80.6	87.9
Income taxes	15.3	13.4	20.4	25.2	23.9	26.5	29.1	31.4	33.7	36.8
Mineral	4.5	3.3	7.9	10.9	8.9	9.5	10.8	11.8	12.3	13.2
Nonmineral	10.8	10.1	12.5	14.3	15.0	17.0	18.3	19.7	21.4	23.6
Taxes on goods and services [2]	8.1	7.8	11.0	9.4	13.4	14.4	16.0	17.3	18.9	20.6
Customs Union receipts [3]	14.0	16.5	14.1	14.0	24.0	22.4	23.4	24.7	26.7	29.1
Other	0.6	0.5	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.4
Nontax revenue	12.2	8.0	17.2	24.7	19.8	21.4	23.4	25.6	27.7	29.9
Mineral royalties and dividends	10.0	6.3	15.4	22.9	17.8	19.3	21.1	23.0	24.8	26.8
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	65.4	65.8	68.7	74.1	87.3	88.7	91.3	98.4	106.3	115.9
Current expenditure	51.8	55.6	56.9	59.7	66.1	67.1	68.5	74.6	81.1	88.3
Wages and salaries	26.3	28.7	29.6	31.8	34.4	35.1	35.6	38.3	41.7	45.3
Interest	1.2	1.2	1.2	1.6	2.4	2.7	3.0	3.2	3.5	3.8
Other	24.4	25.7	26.2	26.3	29.3	29.3	29.8	33.1	36.0	39.2
Of which: grants and subsidies	13.8	16.0	15.7	15.6	16.7	16.4	15.9	17.5	19.4	21.5
Capital expenditure	13.6	10.2	11.8	14.3	21.0	21.5	22.8	23.7	25.1	27.5
Net lending	-0.1	0.0	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Primary Balance (deficit -)	-15.0	-19.3	-4.6	1.2	-3.3	-0.8	4.1	4.3	4.7	5.0
Overall Balance (A)	-15.2	-19.6	-5.3	0.0	-5.2	-3.0	1.6	1.7	1.9	2.0
Financing (B)	15.2	19.6	5.3	0.0	5.2	3.0	-1.6	-1.7	-1.9	-2.0
Foreign (net)	-1.6	-1.6	3.7	1.4	2.1	-1.9	-2.4	-0.5	-0.5	-0.5
Drawing	0.1	0.2	5.1	3.2	4.0	0.2	0.2	0.3	0.3	0.3
Amortization	-1.5	-1.5	-1.5	-1.7	-1.8	-2.0	-2.4	-0.7	-0.7	-0.7
IMF transactions (net)[4]	-0.2	-0.2	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic (net)	16.8	21.2	1.6	-1.4	3.1	4.9	0.7	-1.2	-1.4	-1.4
Issuance	4.4	12.1	12.8	13.5	11.9	20.1	20.4	16.2	18.0	19.1
Amortization	-1.5	-5.0	-10.0	-9.8	-9.4	-16.2	-17.5	-12.2	-13.0	-13.8
Change in cash balance (- increase)	10.8	10.2	-6.6	-3.3	0.6	1.0	-2.2	-5.1	-6.4	-6.7
Other domestic financing	3.1	4.0	5.4	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Non-Mineral Primary Balance [5]	-29.6	-28.9	-27.8	-32.6	-30.0	-29.6	-27.7	-30.4	-32.4	-35.0
Excluding SACU revenue	-43.5	-45.3	-42.0	-46.6	-53.9	-51.9	-51.1	-55.1	-59.1	-64.0
GDP (fiscal year; billions of pula)	177.4	180.2	218.7	256.3	275.6	298.7	324.6	352.5	382.0	415.6

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

[1] This table is based on fiscal years. The fiscal year runs from April 1 to March 31. For instance, FY2023 runs from April 1, 2023 to March 31, 2024.

[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 from excise taxes.

[4] These transactions reflect Botswana's SDR allocation and contribution to the IMF's General Resource Account (GRA).

[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, FY2019–FY2028[1]
(Percent of GDP, unless otherwise indicated)

	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
							Projection			
(Percent of GDP, unless otherwise indicated)										
Total Revenue and Grants	28.3	25.6	29.0	28.9	29.8	28.7	28.6	28.4	28.3	28.4
Total revenue	28.3	25.6	29.0	28.9	29.8	28.7	28.6	28.4	28.3	28.3
Tax revenue	21.4	21.2	21.1	19.3	22.6	21.5	21.4	21.2	21.1	21.1
Income taxes	8.6	7.4	9.3	9.8	8.7	8.9	9.0	8.9	8.8	8.9
Mineral	2.6	1.8	3.6	4.3	3.2	3.2	3.3	3.3	3.2	3.2
Nonmineral	6.1	5.6	5.7	5.6	5.4	5.7	5.6	5.6	5.6	5.7
Taxes on goods and services [2]	4.5	4.3	5.0	3.7	4.9	4.8	4.9	4.9	4.9	5.0
Customs Union receipts [3]	7.9	9.1	6.5	5.4	8.7	7.5	7.2	7.0	7.0	7.0
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	6.9	4.4	7.8	9.6	7.2	7.2	7.2	7.2	7.2	7.2
Mineral royalties and dividends	5.6	3.5	7.0	8.9	6.5	6.4	6.5	6.5	6.5	6.5
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	36.9	36.5	31.4	28.9	31.7	29.7	28.1	27.9	27.8	27.9
Current expenditure	29.2	30.9	26.0	23.3	24.0	22.5	21.1	21.2	21.2	21.2
Wages and salaries	14.8	15.9	13.5	12.4	12.5	11.8	11.0	10.9	10.9	10.9
Interest	0.7	0.7	0.5	0.6	0.9	0.9	0.9	0.9	0.9	0.9
Other	13.7	14.3	12.0	10.3	10.6	9.8	9.2	9.4	9.4	9.4
Of which: grants and subsidies	7.8	8.9	7.2	6.1	6.1	5.5	4.9	5.0	5.1	5.2
Capital expenditure	7.7	5.7	5.4	5.6	7.6	7.2	7.0	6.7	6.6	6.6
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance (deficit -)	-8.5	-10.7	-2.1	0.5	-1.2	-0.3	1.3	1.2	1.2	1.2
Overall Balance (A)	-8.6	-10.9	-2.4	0.0	-1.9	-1.0	0.5	0.5	0.5	0.5
Financing (B)	8.6	10.9	2.4	0.0	1.9	1.0	-0.5	-0.5	-0.5	-0.5
Foreign (net)	-0.9	-0.9	1.7	0.5	0.8	-0.6	-0.7	-0.2	-0.1	-0.1
Domestic (net)	9.5	11.8	0.7	-0.5	1.1	1.6	0.2	-0.3	-0.4	-0.3
Change in cash balance (- increase)	6.1	5.7	-3.0	-1.3	0.2	0.3	-0.7	-1.5	-1.7	-1.6
Memorandum Item:										
Non-Mineral Primary Balance [4]	-19.0	-18.5	-15.9	-16.3	-13.6	-12.5	-10.8	-10.9	-10.6	-10.5
Excluding SACU revenue	-26.9	-27.6	-22.4	-21.7	-22.3	-20.0	-18.0	-17.9	-17.6	-17.5
GDP (fiscal year; billions of pula)	177.4	180.2	218.7	256.3	275.6	298.7	324.6	352.5	382.0	415.6

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

[1] This table is based on fiscal years. The fiscal year runs from April 1 to March 31. For instance, FY2023 runs from April 1, 2023 to March 31, 2024.

[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 from excise taxes.

[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, FY2019–FY2028[1]

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

	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
					Projection					
(Percent of non-mineral GDP, unless otherwise indicated)										
Total Revenue and Grants	32.3	29.6	36.2	36.9	37.3	36.2	36.0	35.8	35.5	35.3
Total revenue	32.3	29.6	36.2	36.9	37.3	36.2	36.0	35.8	35.4	35.3
Tax revenue	24.4	24.5	26.4	24.6	28.3	27.1	26.9	26.7	26.4	26.4
Income taxes	9.9	8.6	11.7	12.6	10.9	11.2	11.3	11.2	11.0	11.0
Mineral	2.9	2.1	4.5	5.4	4.0	4.0	4.2	4.2	4.0	4.0
Nonmineral	6.9	6.5	7.2	7.1	6.8	7.2	7.1	7.0	7.0	7.1
Taxes on goods and services [2]	5.2	5.0	6.3	4.7	6.1	6.1	6.2	6.2	6.2	6.2
Customs Union receipts [3]	9.0	10.5	8.1	7.0	10.9	9.4	9.1	8.8	8.7	8.7
Other	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	7.8	5.1	9.8	12.3	9.0	9.1	9.1	9.1	9.1	9.0
Mineral royalties and dividends	6.4	4.0	8.8	11.4	8.1	8.1	8.2	8.2	8.1	8.0
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	42.1	42.2	39.3	36.9	39.6	37.5	35.4	35.2	34.8	34.8
Current expenditure	33.3	35.6	32.5	29.8	30.1	28.3	26.5	26.7	26.6	26.5
Wages and salaries	16.9	18.4	16.9	15.8	15.7	14.8	13.8	13.7	13.6	13.6
Interest	0.8	0.8	0.7	0.8	1.1	1.1	1.2	1.1	1.1	1.1
Other	15.7	16.5	15.0	13.1	13.3	12.4	11.6	11.8	11.8	11.8
Of which: grants and subsidies	8.9	10.2	9.0	7.8	7.6	6.9	6.1	6.3	6.4	6.5
Capital expenditure	8.8	6.5	6.8	7.1	9.5	9.1	8.8	8.5	8.2	8.2
Net lending	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Primary Balance (deficit -)	-9.7	-12.4	-2.6	0.6	-1.5	-0.4	1.6	1.5	1.5	1.5
Overall Balance	-9.8	-12.6	-3.0	0.0	-2.4	-1.3	0.6	0.6	0.6	0.6
Memorandum Items:										
Non-Mineral Primary Balance [4]	-19.0	-18.5	-15.9	-16.3	-13.6	-12.5	-10.8	-10.9	-10.6	-10.5
Excluding SACU revenue	-28.0	-29.0	-24.0	-23.2	-24.5	-21.9	-19.8	-19.7	-19.4	-19.2
Non-Mineral GDP (fiscal year; billions of pula)	155.4	156.1	174.9	200.6	220.1	236.8	258.0	279.6	305.3	333.5

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

[1] This table is based on fiscal years. The fiscal year runs from April 1 to March 31. For instance, FY2023 runs from April 1, 2023 to March 31, 2024.

[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 from excises.

[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, 2019–28[1]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projection					
(Billions of pula, end of period, unless otherwise indicated)										
Net Foreign Assets	73.7	63.0	65.2	71.4	80.0	87.1	91.5	95.6	100.4	105.7
Bank of Botswana	63.8	51.9	51.4	55.9	62.7	68.0	70.3	72.4	74.8	77.5
Assets	65.2	53.3	56.0	60.5	67.2	72.5	74.9	76.9	79.4	82.1
Liabilities	-1.4	-1.4	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6
Commercial banks	9.9	11.0	13.8	15.5	17.4	19.2	21.1	23.2	25.6	28.2
Assets	13.1	14.3	17.6	19.4	21.2	23.0	25.0	27.1	29.5	32.0
Liabilities	-3.2	-3.3	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
Net Domestic Assets	6.0	21.2	22.7	27.8	29.2	30.7	37.3	44.3	52.8	62.1
Net domestic credit	45.1	66.7	70.1	79.7	88.8	100.6	110.6	118.9	127.3	136.4
Net claims on the government	-18.6	-0.5	0.1	-0.6	1.4	5.9	7.6	6.9	5.6	4.2
Bank of Botswana	-23.1	-7.0	-10.8	-14.9	-15.3	-14.4	-15.8	-20.2	-26.3	-32.9
Commercial banks	4.6	6.4	10.8	14.4	16.7	20.3	23.5	27.2	31.9	37.1
Claims on parastatals	0.9	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Claims on nongovernment	62.8	66.3	69.7	80.0	87.1	94.4	102.6	111.6	121.3	131.8
Claims on the private sector	64.5	67.9	71.6	82.1	89.4	96.9	105.3	114.6	124.5	135.3
Other financial institutions	-1.8	-1.7	-1.9	-2.1	-2.3	-2.5	-2.7	-2.9	-3.2	-3.5
Other items (net)	-39.2	-45.4	-47.4	-52.0	-59.6	-69.9	-73.3	-74.6	-74.4	-74.3
Monetary Base	6.9	6.6	6.1	6.9	7.6	8.1	8.9	9.6	10.5	11.5
Broad Money (M2)	84.8	89.8	94.3	105.6	115.8	124.6	135.8	147.2	160.7	175.5
Money	20.0	23.5	24.4	27.3	30.0	32.3	35.1	38.1	41.6	45.4
Currency	1.9	2.4	2.4	2.8	3.2	3.4	3.8	4.1	4.4	4.8
Current deposits	18.1	21.1	22.0	24.5	26.8	28.8	31.4	34.0	37.2	40.6
Quasi-money	64.7	66.2	69.9	78.2	85.8	92.4	100.6	109.1	119.1	130.1
Memorandum Items:										
Nominal GDP (bn pula)	180	171	208	252	270	292	318	345	374	407
Nominal non-mineral GDP (bn pula)	155	156	175	201	220	237	258	280	305	333
Velocity (GDP to M2)	2.1	1.9	2.2	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Velocity (non-mineral GDP to M2)	1.8	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Money Multiplier	12.3	13.5	15.6	15.3	15.3	15.3	15.3	15.3	15.3	15.3
Base Money (annual % change)	5.7	-3.8	-8.8	14.0	9.7	7.6	8.9	8.4	9.2	9.2
Broad Money (annual % change)	8.0	5.9	5.0	12.0	9.7	7.6	8.9	8.4	9.2	9.2
Credit to the private sector (annual % change)	7.1	5.3	5.4	14.7	8.9	8.4	8.7	8.8	8.7	8.7
Private sector credit to GDP	35.9	39.7	34.5	32.6	33.1	33.1	33.2	33.2	33.3	33.3
Private sector credit to non-mineral GDP	41.5	43.5	40.9	40.9	40.6	40.9	40.8	41.0	40.8	40.6

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

[1] This table is based on calendar years.

Table 5. Botswana: Financial Soundness Indicators, 2016–22[1]

	2016	2017	2018	2019	2020	2021	2022
(Percent, unless otherwise indicated)							
Banking Indicators							
Capital Adequacy							
Capital to assets	8.4	8.8	8.9	8.9	9.2	8.6	8.9
Regulatory capital to risk-weighted assets	19.2	21.9	17.9	18.5	20.0	17.4	19.8
Regulatory tier I capital to risk-weighted assets	13.2	15.0	13.2	13.4	13.8	12.5	12.9
Nonperforming loans net of provisions to capital	12.0	12.4	16.2	10.0	8.1	9.7	8.6
Asset Quality							
Large exposure to capital	214.6	131.3	153.6	115.5	92.8	117.7	131.2
Nonperforming loans to total gross loans	4.9	5.3	5.4	4.8	4.3	4.2	3.8
Bank provisions to nonperforming loans	51.5	53.7	42.7	59.0	60.2	56.6	51.0
Earnings and Profitability							
Trading income to total income	0.0	0.0	3.6	4.3	5.3	6.0	6.4
Return on assets	2.3	1.9	2.8	2.3	1.9	1.2	3.2
Return on equity	15.4	12.4	18.7	15.6	12.5	5.8	21.3
Interest margin to gross income	61.4	61.6	57.2	56.2	55.7	45.9	53.1
Noninterest expenses to gross income	57.1	59.9	58.5	58.1	61.6	71.1	57.0
Personnel expenses to noninterest expenses	43.2	44.5	44.4	45.4	45.2	46.4	45.3
Liquidity							
Liquid assets to total assets	16.3	13.4	14.3	14.7	14.7	12.7	13.4
Liquid assets to short-term liabilities	20.0	16.4	17.7	18.0	18.1	15.4	15.6
Customer deposits to total (non-interbank) loans	121.6	117.3	118.8	120.6	122.3	122.4	124.2
Exposure to Foreign Exchange Risk							
Net open position in foreign exchange to capital	3.5	5.7	8.1	5.0	3.8	2.3	5.0
Foreign currency-denominated loans to total loans	7.5	7.0	7.8	6.2	4.9	3.5	3.6
Foreign currency-denominated liabilities to total liabilities	14.6	14.0	14.4	12.7	14.9	22.2	31.2

Sources: Bank of Botswana and IMF staff calculations.

[1] This table is based on calendar years.

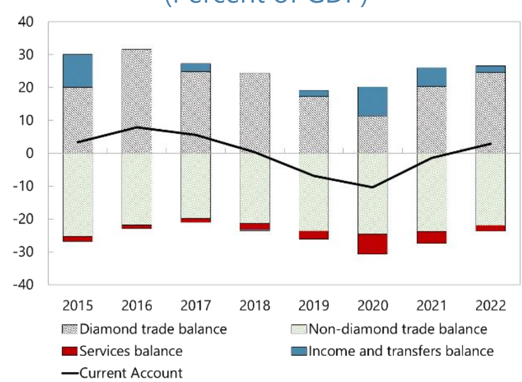
Annex I. External Stability Assessment

The 2022 external position is assessed to be stronger than implied by fundamentals and desired policies. Despite an improvement in the current account, reserves declined in 2022 due to revaluation losses on foreign investments held by the BoB. But reserves remain above ARA metric adequacy levels. In the medium term, smaller current account surpluses will result in a small decline in the reserves import coverage ratio. Going forward, a combination of fiscal consolidation and structural reforms to strengthen competitiveness and promote diversification will be key to supporting the external position.

A. Introduction

1. **Botswana's external position is characterized by a long-term deterioration in the current account balance and falling FX reserves.** The current account reached a high of almost 20 percent of GDP in 2006, before spiking again to a post-GFC high of 11.5 percent in 2014. Since 2015, however, the current account balance has averaged 0.2 percent of GDP against an average of 6 percent between 2000 and 2014. The decline is primarily due to a deterioration of the diamond trade balance: while diamond exports remained broadly unchanged as a share of GDP, diamond imports increased in line with the decision by De Beers to centralize a greater share of diamond sales in Botswana. Non-diamond commodity exports (e.g., gold) and non-commodity exports (e.g., meat and textiles) also declined as a share of GDP, while weaker tourism receipts and lower SACU transfers added to the deterioration.

Figure AI.1. Botswana: Current Account Decomposition
(Percent of GDP)



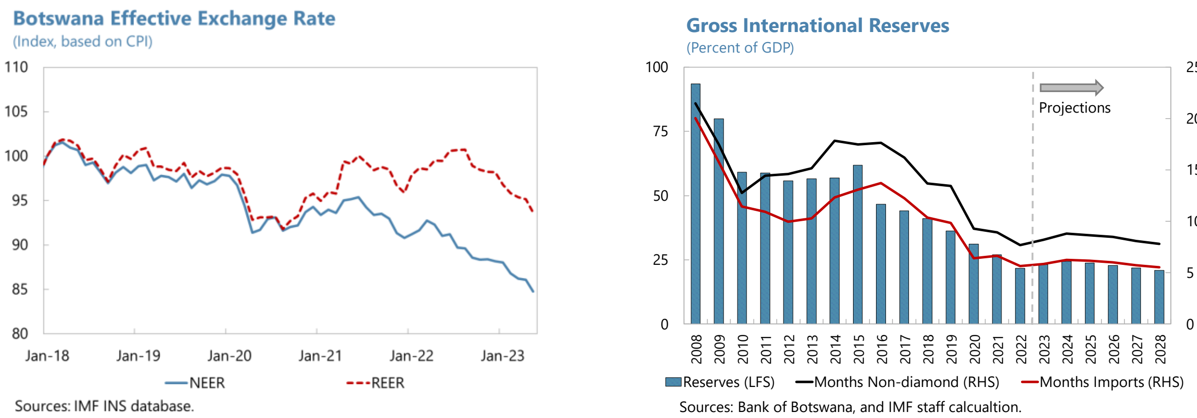
Sources: Bank of Botswana, and IMF staff calcualtion.

2. **The current account recovered to a surplus of 2.9 percent of GDP in 2022, mostly due to higher global demand for diamonds**. Total goods exports increased by 1.1 percent of GDP, with both diamond and non-diamond commodities growing strongly. The services trade deficit narrowed from 3.6 percent of GDP in 2021 to 1.7 percent in 2022, reflecting continued recovery in travel receipts and other services. The income and transfers balance weakened, from roughly 6 percent to around 2 percent of GDP between 2021 and 2022, as dividends and reinvested earnings paid to foreign investors moved closer to pre-pandemic levels.

3. **The financial account moved into a surplus of 0.6 percent of GDP 2022, from a deficit of 2.4 percent of GDP in 2021.** This swing was driven by positive net portfolio inflows (most likely reflecting withdrawals by pension funds to meet their local obligations) and a recovery in Foreign Direct Investment (FDI).

4. Despite the improvement in the balance of payments, the BoB's international reserves declined in 2022, because of revaluation losses[1] on foreign bonds and equities held by the BoB. At end-2022, reserves amounted to US$4.3 billion (US$502 million lower than 2021), equivalent to 21.7 percent of GDP or 5.8 months of imports,[2] a decline from 6.7 months of import coverage in 2021. Reevaluation losses amounted to about US$480 million in 2022. Note that, in 2021, FX reserves were increased by the IMF SDR allocation of US$274 million, equivalent to roughly 1.5 percent of GDP or 0.4 months of import coverage in that year.

Figure AI.2. Botswana: Exchange Rate and Gross International Reserves



5. Botswana's net international investment position (IIP)[3] declined from 31.3 to 25.4 percent of GDP between end-2021 and end-2022, due, in equal measure, to falling foreign assets and increasing foreign liabilities. Foreign assets declined mainly because of lower external portfolio investments by pensions funds, declining external FDI, and falling FX reserves at the BoB.[4] Higher foreign liabilities mainly reflected increased FDI investment into Botswana in 2022.

6. Botswana's real effective exchange rate (REER), as measured by the IMF, appreciated in 2022 by 1.8 percent. Despite a consistent depreciation of the NEER in recent years, the REER has appreciated since the Russian invasion of Ukraine, mainly due to high domestic inflation. The real appreciation trend has partially reversed over the past 8 months, in line with declining inflation. In January 2023, the authorities reduced the nominal crawl depreciation rate of the Pula from

[1] "Reevaluation losses" refer to market losses, which means that equities and bonds lost value in the context of higher interest rates. These losses may later reverse if global interest rates normalize.

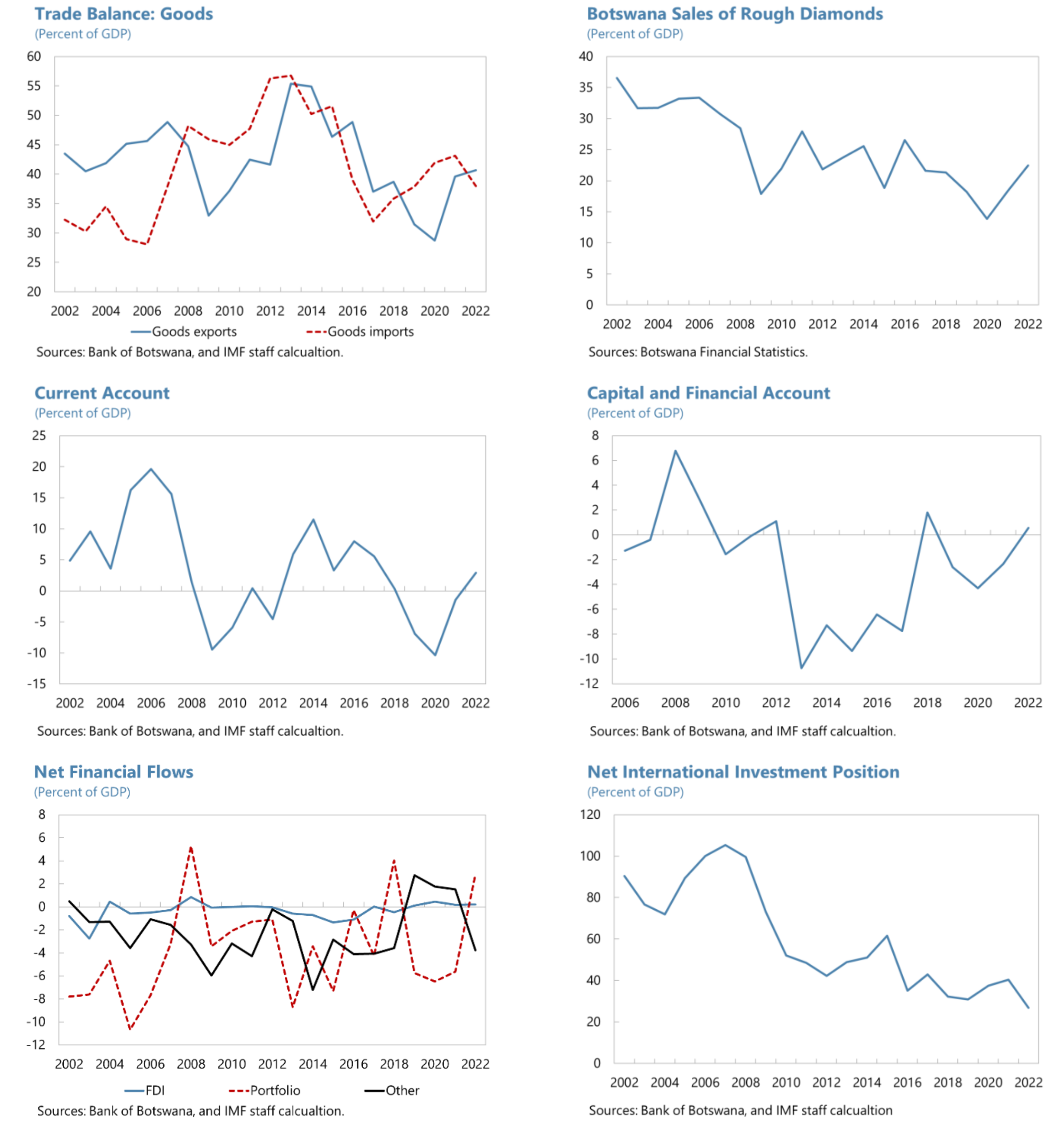
[2] The authorities preferred measure of reserve coverage takes the ratio to current year imports of goods and services excluding diamond imports for re-exporting purposes (which would amount to 7.9 months at end-2022).

[3] Net IIP is the sum of foreign assets held by monetary authorities and deposit money banks, less their foreign liabilities. NFA can be computed by taking the previous year's stock of assets and liabilities, and adding the current year's flows of FDI, portfolio investment and reserve assets. Thus, NIIP is broader concept than FX reserves discussed in the previous paragraph.

[4] Botswana's foreign assets include the foreign exchange reserves of the BoB, which now account for 30 percent of total foreign assets (compared to 68 percent in 2008).

-2.9 to -1.5 percent per year, to reflect the smaller projected inflation differential between Botswana and its trading partners.

Figure AI.3. Botswana: Key External Sector Indicators



7. **Over the medium term, smaller current account surpluses imply a marginal decline in reserves import coverage ratio.** The current account is expected to weaken in 2023 and strengthen in 2024, in line with global demand for diamonds and other mining exports. Over the longer term, the current account surplus is projected to decline, reflecting lower diamond trade balances and a weak recovery in non-diamond exports (despite the import compression effect of the fiscal

consolidation). The financial account path primarily reflects assumptions on the government's external borrowing and repayment schedule, with initially significant drawdowns in 2023 followed by amortizations mostly concentrated in 2024–25. The coverage of FX reserves is expected to converge towards 5½ months of imports by 2028.

B. Current Account and Exchange Rate Assessments

8. The assessment of Botswana's external position employs the External Balance Assessment (EBA)-lite models for the CA.[5] The CA-EBA lite model assumes that the CA is an endogenous variable determined as a function of domestic and external variables including fundamentals, policy variables, and cyclical conditions.

Botswana: Model Estimates for 2022

	CA model 1/ (in percent of GDP)
CA-Actual	**2.9**
Cyclical contributions (from model) (-)	-1.8
COVID-19 adjustors (-) 2/	0.5
Additional temporary/statistical factors (-)	0.0
Natural disasters and conflicts (-)	0.0
Adjusted CA	**4.2**
CA Norm (from model) 3/	**0.6**
Adjustments to the norm (-)	0.0
Adjusted CA Norm	**0.6**
CA Gap	**3.6**
o/w Relative policy gap	1.0
Elasticity	-0.3
REER Gap (in percent)	**-13.4**

1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the impact of the pandemic on tourism
3/ Cyclically adjusted, including multilateral consistency adjustments.

9. The CA EBA-lite suggests that Botswana's external position in 2022 is assessed to be stronger than suggested by fundamentals and desired policies. The CA-EBA lite approach estimates the CA gap to be equivalent to 3.6 percent of GDP, with a CA norm of 0.6 percent of GDP in 2022. Since the estimated elasticity of the trade balance to changes in the REER is -0.3, this

[5] 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).

methodology suggests that the pula is currently undervalued, and that the REER would need to appreciate by roughly 13 percent for the CA deficit to be reduced to the norm (see table above).[6]

10. Nonetheless, a more comprehensive assessment should take into account the long-term deterioration of the current account as well as the situation of the non-diamond balance, which point to a weaker external position. The previous assessment is not deemed very informative in the case of Botswana where the CA balance is highly volatile and mainly driven by diamond trade, which is not sensitive to changes in the real exchange rate.[7] While the CA balance rebounded strongly in 2022 due to higher demand for diamonds, it has been structurally declining over time, and is expected to moderate over the medium term. Excluding diamond trade from the overall balance would also significantly change the overall assessment of the external position, with a non-diamond trade deficit estimated around 22 percent of GDP in 2022 (against a 2.7 percent overall trade surplus in 2022). Taken together, those facts suggest that the pula could be in fact mildly overvalued. This assessment is supported by the SIP investigating the REER targeting regime and in line with recent research from BoB (Bank of Botswana, 2021).

C. Reserves Adequacy

11. Foreign reserves are under the control of the Bank of Botswana—with about 80–90 percent kept in the Pula Fund and the remainder in a "liquidity" portfolio (used as a short-term liquidity buffer).[8] Over time, reserves have declined from almost 117 percent of GDP in 2000 to 22 percent of GDP in 2022, mainly reflecting falling current account surpluses.

12. The IMF methodology to estimate reserves adequacy (ARA) 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 multidimensional metric for market access countries employs a risk-weighted measure of diverse sources of risk.[9]

13. The IMF's ARA metric encompasses four specific sources of vulnerability: (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

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[6] A qualitatively similar result is obtained using the REER model from the "EBA-Lite" method, resulting in a REER gap of -5% (i.e., an undervaluation of 5%).

[7] Botswana's sales of diamonds are mainly demand determined and sensitive to economic developments in the US and China.

[8] The liquidity portfolio is used for standard foreign exchange transactions, while the Pula Fund is the savings element, invested in stocks and bonds.

[9] 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.

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. Separate distributions are estimated for countries with fixed exchange rates[10] or capital controls.[11]

14. Botswana's characteristics requires that different weightings are applied to these vulnerability measures. The weights for countries with a fixed exchange rate (assumed for Botswana) are 30 percent of short-term debt, 20 percent for other liabilities, 10 percent for broad money, and 10 percent for exports. 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. Staff considers that a weight of 25 percent for exports could appropriately reflect volatility in diamond prices.

15. Botswana's reserves at end-2022 remain adequate at 183 percent of the standard ARA metric. This is the baseline estimate. Nonetheless, if Botswana's dependence on volatile diamond receipts is taken into account by increasing the weight of exports to 25 percent (instead of 10 percent) in the ARA calculation, reserves would represent 118 percent of the adjusted ARA metric, which is still sufficient. In addition, the longer-term decline in FX reserve coverage is a source of potential risk, which should be mitigated by the authorities' fiscal adjustment plan (Box AI.1).

[10] 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.

[11] 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. Staff considers that a weight of 25 percent for exports could be appropriately used to reflect volatility in diamond prices.

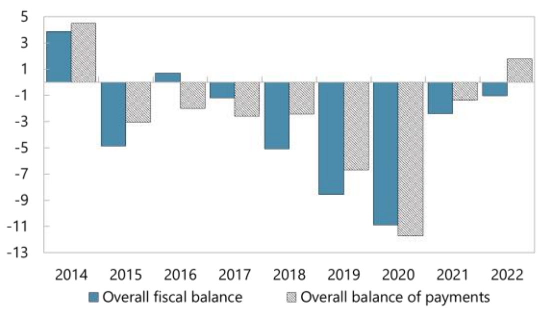
Box AI.1. Twin Deficits in Botswana?

Evidence points to the emergence of twin deficits in Botswana in the past decade and, more generally, to a close connection between the fiscal balance and BoP balance (LHS chart). Drawdowns on government balances at the Bank of Botswana have also tracked closely changes in FX reserves since 2014 (RHS chart).

This tight link suggests that the planned fiscal consolidation should help support the FX reserve position going forward. Based on regression analysis, staff estimates that a 1 percent of GDP fiscal impulse is associated, on average, with a 1.2 percentage point decrease in the reserves-to-GDP ratio, implying that authorities' current fiscal consolation plans should increase FX reserves by 0.6 percent of GDP (equivalent to roughly a quarter of a month of imports) by the end of the forecast horizon, all else equal.[1]

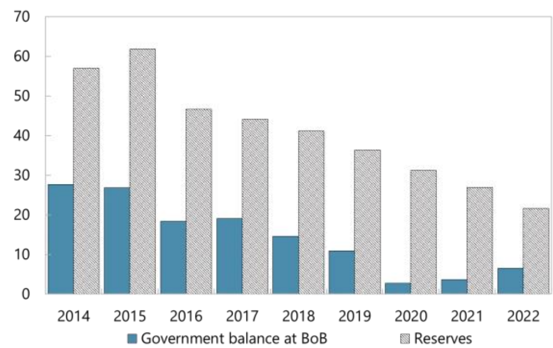
Nonetheless, both the reserve-to-GDP ratio and the import coverage of FX reserves are expected to remain relatively stable over the period, reflecting the offsetting effect of lower diamond trade balances and still weak non-diamond exports.

Flows: Twin Deficits Since 2014
(Percent of GDP)



Sources: Bank of Botswana, Ministry of Finance, and IMF staff calculation.
Note: "Overall balance of payments" is the sum of the current account balance, capital and financial account balance, and errors and omissions.

Stocks: Government Balances at BoB and Reserves
(Percent of GDP)



Sources: Bank of Botswana, and IMF staff calculation.

[1] The cumulative effect is estimated by regressing the change in FX reserves (excluding valuation effects) on two measures of fiscal impulse (the change in overall balance and the change in CAPB) and after accounting for lags. Results are quantitatively similar across measures of fiscal impulse. The fiscal adjustment between FY2022 and FY2025 is about 0.5 percent of GDP.

References

International Monetary Fund. 2013. "The External Balance Approach." IMF policy paper.

________________. 2011. "Assessing Reserve Adequacy." IMF policy paper.

________________. 2013. "Assessing Reserve Adequacy–Further Considerations." IMF policy paper.

________________. 2014. "Assessing Reserve Adequacy–Specific Proposals." IMF policy paper.

Annex II. Debt Sustainability Analysis

Figure AII.1. Botswana: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near-term and low levels of vulnerability over medium-, and long-term horizons.
Near Term 1/	n/a	n/a	n/a
Medium Term	Low	Low	Medium-term risks are assessed as low, reflecting a relatively low debt-to-GDP ratio, the size of the fiscal consolidation, strength of institutions, and the depth of the investor pool. Debt is projected to decline mainly due to continued strong real GDP growth and primary surpluses. Medium-term liquidity risks, as analyzed by the GFN Financeability Module, are low, given the relatively low share of government debt in total commercial bank assets. This conclusion holds even under a commodity price shock and a natural disaster scenario (which were chosen to reflect Botswana's dependence on commodity exports and vulnerability to climate shocks). The fanchart module shows a low risk rating due to forecasted improvement in the fiscal balance.
Fanchart	Low	...	
GFN	Low	...	
Stress test	...	...	
Long Term	...	Low	Long-term risks are low, with the baseline debt-to-GDP ratio continuing to decline. One risk stems from a long-term decline in diamond production, which may result in lower revenues and higher debt. Reducing potential risks from declining long-term diamond production will require acceleration of diversification reforms.
Debt Stabilization in the Baseline			Yes

DSA Summary Assessment

Commentary: Botswana has a low overall risk of sovereign stress. The projected decline in the debt-to-GDP ratio depends on successful implementation of the planned fiscal consolidation, which is fairly ambitious but achievable by international standards. The baseline long-term risk outlook is low, but a negative shock to commodity revenues may put upward pressure on debt issuance. Reducing potential risks from declining long-term diamond production will require acceleration of diversification reforms.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

Figure AII.2. Botswana: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/

CG	GG	NFPS	CPS	Other

1a. If central government, are non-central government entities insignificant? n.a.

2. Subsectors included in the chosen coverage in (1) above:

	Subsectors captured in the baseline	Inclusion	Comments
1	Budgetary central government	Yes	
2	Extra budgetary funds (EBFs)	No	Not applicable
3	Social security funds (SSFs)	No	
4	State governments	Yes	
5	Local governments	Yes	
6	Public nonfinancial corporations	No	
7	Central bank	No	
8	Other public financial corporations	No	

(Row groupings: CG = 1–3; GG: expected = 1–5; NFPS = 1–6; CPS = 1–8)

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:

Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-government Debt Holdings

Issuer \ Holder		Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									0
6	Nonfin pub. corp.									0
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	0	0	0	0	0	0	0	0	0

(Row groupings: CG = 1–3; GG: expected = 1–5; NFPS = 1–6; CPS = 1–8)

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

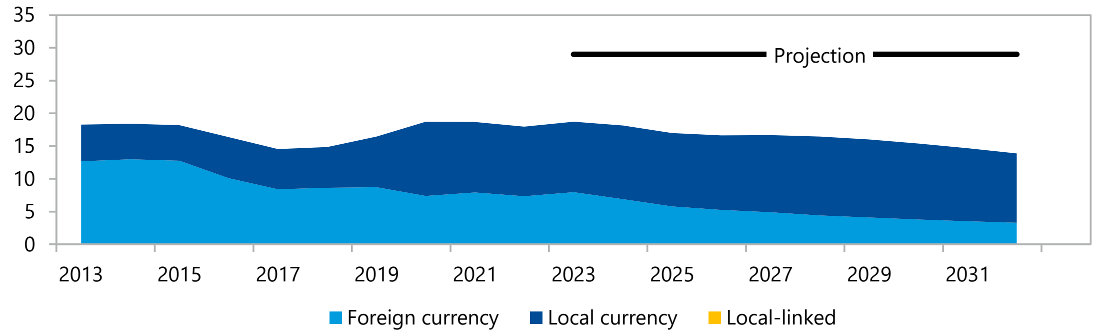
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The data coverage is for the general government, but only the central government has authority to borrow. Intra-government debt holdings data are not available.

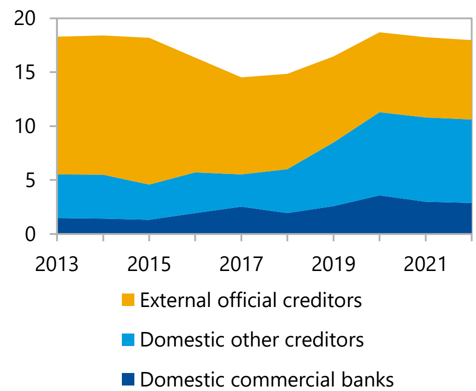
Figure AII.3. Botswana: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



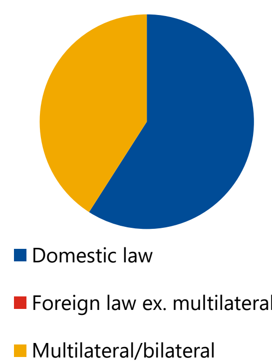
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



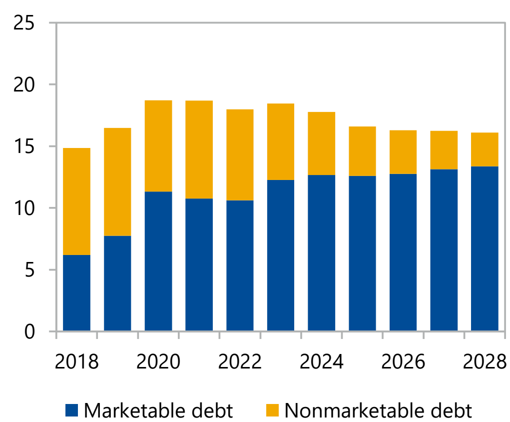
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2022 (Percent)



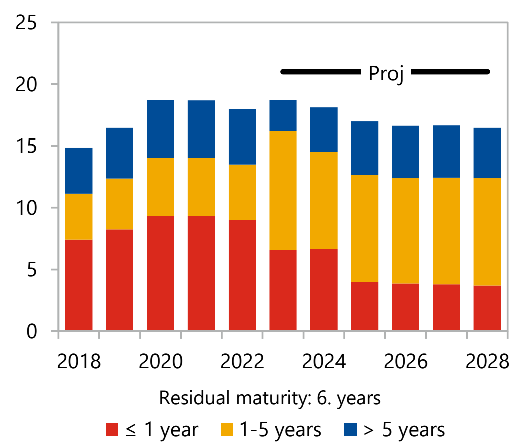
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



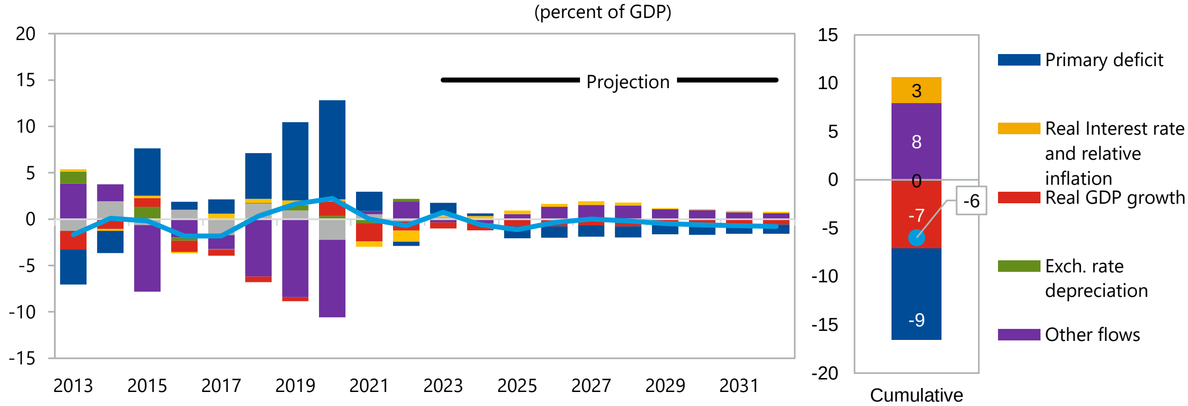
Note: The perimeter shown is general government.

Commentary: Since 2018, an increasing share of Botswana's debt has been held by domestic banks and other domestic creditors (e.g. pension funds), while the share held by external official creditors has declined. Long-term (i.e. 5+ year maturity) debt inititally increases over the medium-term due to higher multilateral borrowing but stabilizes over the meduim-term.

Figure AII.4. Botswana: Baseline Scenario
(Percent of GDP unless otherwise)

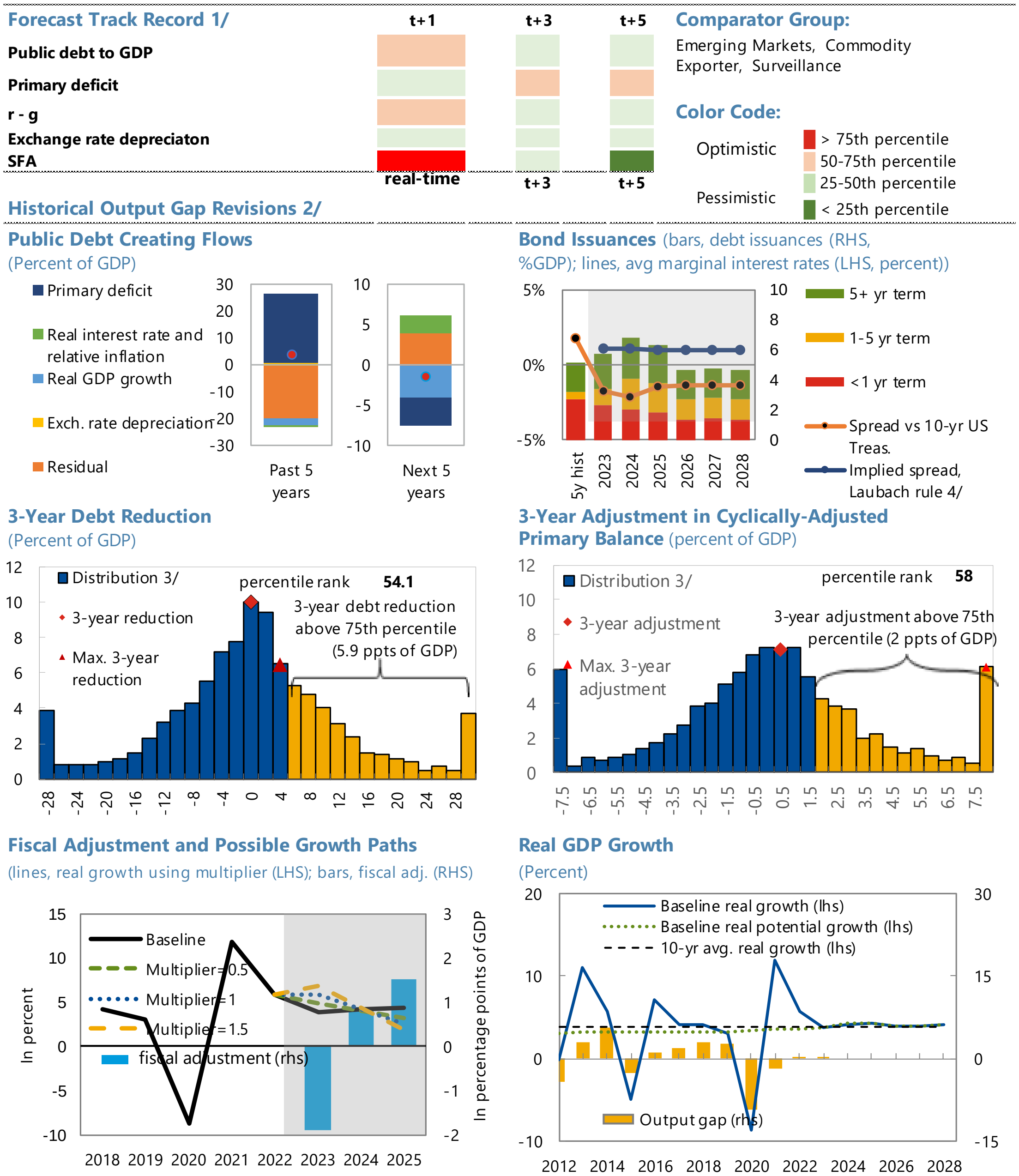
	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public Debt	18.0	18.7	18.1	17.0	16.6	16.7	16.5	16.0	15.4	14.7	13.9
Change in Public Debt	-0.7	0.7	-0.6	-1.1	-0.4	0.0	-0.2	-0.5	-0.6	-0.7	-0.8
Contribution of Identified Flows	-0.5	0.5	-0.6	-1.1	-0.2	0.0	-0.1	-0.5	-0.6	-0.7	-0.8
Primary deficit	-0.5	1.2	0.3	-1.3	-1.2	-1.2	-1.2	-1.0	-1.1	-1.0	-1.0
Noninterest revenues	28.7	29.6	28.5	28.5	28.2	28.2	28.2	27.9	27.9	27.9	28.0
Noninterest expenditures	28.3	30.8	28.8	27.2	27.0	26.9	27.0	26.9	26.8	26.9	26.9
Automatic debt dynamics	-1.9	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3	-0.5	-0.5	-0.5	-0.4
Real interest rate and relative inflation	-1.2	0.3	0.3	0.4	0.3	0.4	0.3	0.1	0.1	0.1	0.1
Real interest rate	-1.6	0.3	0.2	0.2	0.2	0.3	0.2	0.0	0.0	0.0	0.0
Relative inflation	0.5	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real growth rate	-1.0	-0.7	-0.7	-0.8	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Real exchange rate	0.3	...	...	...	...	...	...	...	...	...	...
Other identified flows	1.9	-0.4	-0.5	0.5	1.3	1.5	1.5	1.1	1.0	0.7	0.7
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions	2.0	-0.2	-0.3	0.7	1.5	1.7	1.6	1.2	1.1	0.9	0.8
Contribution of Residual	-0.2	0.3	0.0	0.0	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0
Gross Financing Needs	4.6	5.9	7.1	5.6	3.2	3.1	3.0	2.9	2.8	2.7	2.6
of which: debt service	5.1	4.9	7.0	7.1	4.6	4.5	4.4	4.1	4.0	3.9	3.8
Local currency	4.3	4.1	6.3	6.2	4.3	4.2	4.2	3.9	3.8	3.7	3.6
Foreign currency	0.8	0.8	0.7	0.8	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Memo:											
Real GDP growth (percent)	5.8	3.8	4.1	4.3	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Inflation (GDP deflator; percent)	14.6	3.3	4.0	4.1	4.5	4.1	4.6	4.6	4.6	4.6	4.6
Nominal GDP growth (percent)	17.2	7.5	8.4	8.7	8.6	8.4	8.8	8.8	8.8	8.8	8.8
Effective interest rate (percent)	4.0	5.2	5.2	5.6	5.8	5.9	6.0	4.6	4.7	4.8	4.9

Contribution to Change in Public Debt
(percent of GDP)



Commentary: Over the past five years, the authorities have limited the increase in debt by drawing down on cash reserves. The strong economic recovery has helped to close the fiscal deficit. Debt is projected to increase in FY2023 due to higher external borrowing. Over the medium term, debt is projected to decline as a result of primary surpluses and continued economic growth.

Figure AII.5. Botswana: Realism of Baseline Assumptions



Commentary: Botswana's adjustment is realistic when measured against international comparators. The growth outlook underpinning the debt projections are in line with historical averages, including after taking into account of the growth effects of the fiscal consolidation. One risk, however, is that the primary deficit initally widens in FY2023, before rapidly moving into surplus over the next two years. This two-year change in the primary balance is approximately 2.5 percent of GDP, making it a more ambitious consolidation by international standards.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest April WEO) in the total distribution of revisions across the data sample.

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

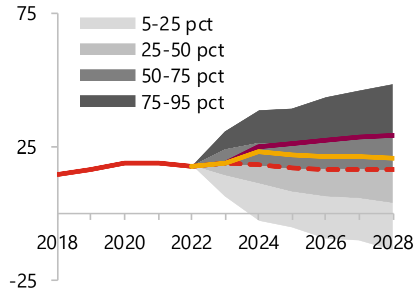
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure AII.6. Botswana: Medium-Term Risk Analysis

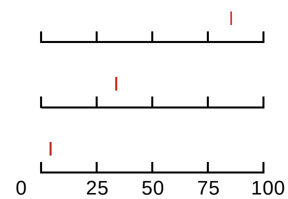
	Value	Contrib [1/]	Percentile in peer group [2/]

Debt fanchart module

Final Fanchart (Percent of GDP)

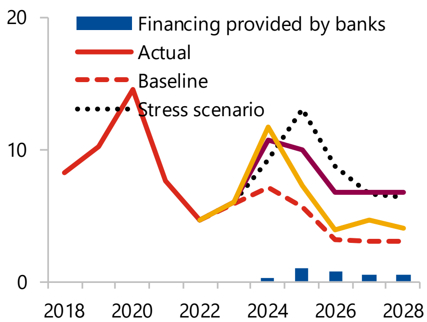


	Value	Contrib [1/]
Fanchart width *(percent of GDP)*	61.9	0.9
Probability of debt non-stabilization *(percent)*	4.6	0.0
Terminal debt-to-GDP x institutions index	7.7	0.2
Debt fanchart index (DFI)		1.1
Risk signal: [3/]		Low

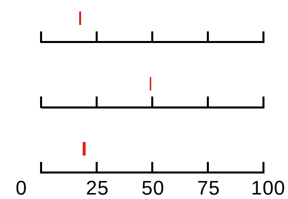


Gross financing needs (GFN) module

Gross Financing Needs (Percent of GDP)

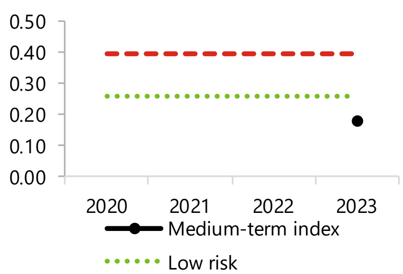


	Value	Contrib [1/]
Average baseline GFN *(percent of GDP)*	4.7	1.6
Banks' claims on the ge govt *(pct bank assets)*	9.1	2.9
Chg. In banks' claims in stress *(pct banks' assets)*	4.2	1.4
GFN financeability index (GFI)		5.9
Risk signal: [4/]		Low



Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index (Index number)



Medium-term risk analysis

	Value	Norm. Value	Weight	Contribution
Debt fanchart index	1.10	0.25	0.50	0.12
GFN finaceability index	5.93	0.11	0.50	0.06
Medium-term index		0.2		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2023-2028, if stress not predicted: 9.1 pct.

Prob. of false alarms, 2023-2028, if stress predicted: 58.0 pct.

Commentary: The medium term-index, which includes the debt fanchart and gross financing needs, has a low overall risk assessment. The medium-term tools and the Debt Fanchart Module both point to a low risk due to forecasted improvement of the fiscal balance. The GFN Financeability Module indicates low liquidity risks, with declining gross financing needs over the medium-term. To test the robustness of the baseline, a commodity price shock or natural disaster shock are applied to the model, to reflect Botswana's vulnerabilities. Under both scenarios, gross financing needs trend downwards over the medium term, and the path of debt is stable or declining.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is emerging markets, commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure AII.7. Botswana: Long-Term Risk Analysis

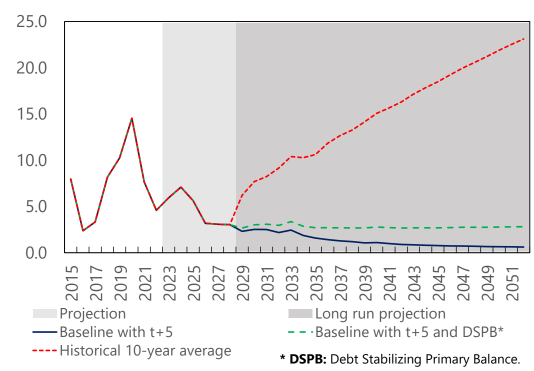
Large Amortization Trigger

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	

Overall Risk Indication	

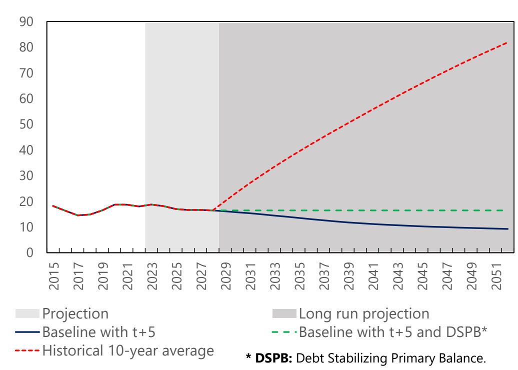
Alternative Baseline Long-term Projections

GFN-to-GDP ratio



*** DSPB:** Debt Stabilizing Primary Balance.

Total public debt-to-GDP ratio

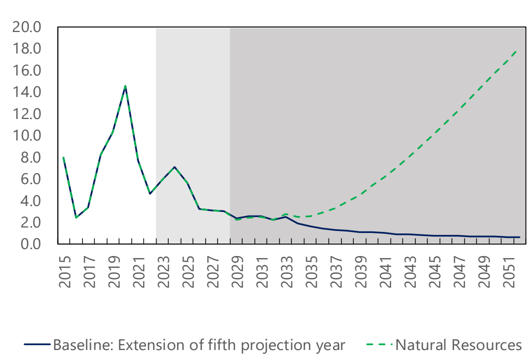


*** DSPB:** Debt Stabilizing Primary Balance.

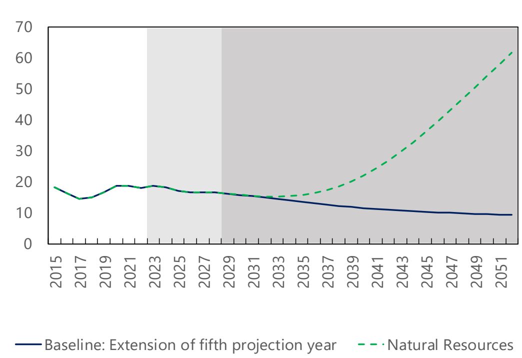
Commentary: The overall long-run risk indicator is low. Under the baseline, debt follows a long-term downward trend, reflecting continued small primary surpluses. If historical 10-year averages are used, however, then debt could rise from around 20 percent to approximately 85 percent of GDP by 2050; this simulation reflects historically elevated gross financing needs, including the impact of the COVID-19 pandemic, which had been covered primarily by depleting cash deposits over the past decade. One source of risk is from amortization, where large, lumpy future repayments may pose a roll-over risk.

Natural Resources

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Commentary: One source of risk is from declining diamond production leading to lower mineral revenue. Over the long-term, if commodity revenues start to decline with falling diamond production, the baseline scenario may be too optimistic. Under this 'natural resources' scenario, however, debt could approach 60 percent of GDP by 2050.

Annex III. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Expected Impact if Realized	Possible Policy Response
Global Risks			
Abrupt global growth slowdown or recession. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn. In EMDEs, a new bout of global financial tightening leads to spiking risk premia and sudden capital stops. An escalation of Ukraine war could worsen the energy crisis and supply disruptions.	Medium	**High.** Lower global growth may affect demand and prices for diamond and other commodity exports (e.g., copper) and slow the rebound in tourism. A slowdown in neighboring countries could lower SACU revenues, affecting fiscal balances, foreign reserves, and putting pressure on the Pula.	Apply countercyclical fiscal policy, while continuing with a credible fiscal consolidation in the medium term. Accelerate structural agenda to enhance competitiveness and diversify the economy to build resilience against external shocks. Consider more flexibility in exchange rate response to external shocks.
Commodity (oil and food) price volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility.	Medium	**Medium.** Botswana is an oil and food importer. Commodity price volatility could lead to price and real sector volatility, budgetary pressures, and aggravate the cost-of-living crisis. But the large share of South African imports (with regulated petroleum prices and large agriculture sector), administered prices, and the crawling peg exchange rate could help limit sharp swings in prices.	Stand ready to tighten monetary policy cautiously until inflation is firmly on a downward trajectory, and inflation returns within the target band. Provide targeted, short-term fiscal support to vulnerable households to cushion the impact of higher food prices.
Systemic financial instability caused by the banking turmoil in advanced economies, doubled with the quandary of containing inflation. Large swings in risk premia and assets repricing could bring market dislocations and adverse cross-border spillovers.	Medium	**Low.** Concerns about the global financial system could prompt investors to reduce exposure to EMDEs. Risk-off sentiment and rising risk premiums for African bonds could strain financing options, although Botswana's external borrowing needs are limited, and capital flows display low mobility.	Adapt to an environment with tighter financing conditions. Continue consolidating public finances, improving domestic revenue mobilization, and deepening domestic financial market. Effective debt management and financial regulations could help mitigate financing risks.
Domestic Risks			
Delays in implementing fiscal consolidation and structural reforms due to political economy constraints, capacity limitations, or reform fatigue.	Medium	**Medium.** Higher public debt and/or erosion of deposits would undermine fiscal sustainability as well as macroeconomic and external stability. Growth would remain too low to significantly reduce unemployment and inequality. The economy becomes increasingly dependent on diamonds.	Advance fiscal reform by defining a long-term anchor for fiscal policy. Improve efficiency and better prioritize spending, while preserving productive capital and social spending. Reinvigorate the reform agenda by accelerating some key reforms like SOE reform, digitalization, or trade integration.
Extreme weather events. Botswana is exposed to highly variable rainfall, which leads to floods and droughts, causing severe economic damage and amplify supply disruptions.	Medium	**Medium.** More frequent or severe weather events could disrupt water provision and reduce crop production, tourism activity, weaken strategic sectors (e.g., mining), and have adverse effects on the poor, including due to higher inflation. This could also lead to higher fiscal deficits, lower growth, and higher unemployment and inequality.	Implement climate change mitigation and adaptation measures, including low-carbon energy generation. Adapt spatial development strategies to long-term climate challenges and constraints. Develop local capacity to access climate finance (including from international sources), by developing a pipeline of climate projects and actions.

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 IV. Estimating Medium-Term Fiscal Benchmarks

1. **Over the coming decade, the credibility of the fiscal adjustment would be enhanced through clear and transparent medium-term targets.** This Annex computes various fiscal benchmarks, consistent with fiscal sustainability and insurance against shocks, which could be considered by the authorities in their fiscal strategy.

2. **The calibration of the medium-term adjustment path depends crucially on the choice of the fiscal anchor that the authorities wish to pursue**. The fiscal anchor is a stock variable, which serves as reference point for the whole fiscal framework and is used to set the main fiscal targets. Several (alternative) anchors could be considered. First, given the large reduction in government deposits in recent years, the authorities may aim at halting the depletion of buffers by stabilizing net debt at its current value. In this case, the anchor would be the net debt ratio calibrated at its end-FY2022 value. Another, more ambitious, option would be to target an improvement (not just stabilization) in net debt to build sufficient buffers to accommodate future shocks. In this case, the anchor would still be net debt, but its ceiling would have to account for the additional buffer. Third, a traditional anchor derived from the Permanent Income Hypothesis (PIH) is to stabilize net wealth (including resource wealth) at its current value, with the objective of maintaining the country's overall amount of wealth across generations. In this last case, the "net wealth" anchor is a broader concept than "net debt." As discussed below, the choice of the anchor and its threshold will impact the medium-term fiscal deficit targets, and indirectly the expenditure envelopes.

3. **Option 1: Stabilizing the net debt-to-GDP ratio at its end-FY2022 level would be consistent with a fiscal deficit of about 1 percent of GDP.** The first benchmark is computed under the objective of stopping the deterioration of net financial assets observed in the past decade. Given that net debt was equal to 12 percent of GDP at end-FY2022, the net debt-stabilizing deficit would amount to 1 percent of GDP, assuming real growth of 4 percent and inflation at the mid-point of the objective range of 4.5 percent.[1]

4. **Option 2: Building buffers to insure against future fiscal risks would require maintaining a fiscal surplus of between 0 and 1 percent of GDP over a decade**. The 2022 IMF TA report on "Strengthening the Fiscal Rule Framework" estimates that a buffer of 10 to 20 percent of non-resource GDP (equivalent to 8 to 16 percent of GDP)[2] would be sufficient to protect the budget against major economic shocks over several years (either 3 years or a full National Development Plan). Using the same assumption on nominal growth as in the previous paragraph, we find that the authorities should maintain, over the next 10 years, a fiscal surplus

[1] Using the assumptions of the 2022 IMF TA report on fiscal rules (3 percent real growth and 3 percent inflation) would give a fiscal deficit target of 0.7 percent of GDP.

[2] Assuming a ratio of 80 percent of non-resource GDP to resource GDP, which is the current share.

of (1) 0.3 percent of GDP to improve the net debt ratio by 8 percent of GDP, and (2) 1.4 percent of GDP for an improvement of 16 percent of GDP.[3]

5. Option 3: **To maintain wealth for future generations in line with the PIH, a fiscal surplus would be required, although its specific size is sensitive to the underlying assumptions.** The 2022 TA report estimates total wealth of 200 percent of non-mining GDP at end-FY2021 (equivalent to 160 percent of GDP). The PIH model's formulas can be used to estimate the fiscal balance needed to stabilize total wealth either in real terms or in percent of GDP. Results are very sensitive to the underlying assumptions and the policy objective:

- *Stabilizing wealth in percent of GDP* in future years is the most demanding option, and probably an unrealistic policy objective. The assumption on the interest rate-growth differential affects the results markedly: for instance, a positive differential of 1 percent implies a non-resource primary deficit of 1.6 percent of GDP, whereas a negative differential of 1 percent results in a surplus of 1.6 percent of GDP.[4] Assuming that financial assets are invested in foreign government bonds, like US bonds, at 4 percent and that the Pula depreciates against the US dollar by 6 percent a year (average over the past decade), this would deliver a 10 percent return in nominal terms, compared to nominal GDP growth of 8.5 percent. The positive interest-growth differential of 1.5 percent results in a non-resource primary surplus of 2 percent of GDP, equivalent to 7 percent surplus for the overall balance (assuming 10 percent of GDP for mineral revenues, and 1 percent of GDP for the interest bill).[5]

- *Stabilizing wealth in real terms* (rather than in percent of GDP) would require relatively less fiscal effort. The 2022 IMF TA report finds that the non-resource primary deficit would need to be around 8-9 percent of non-resource GDP in the coming years (6½-7 percent of GDP), equivalent to a fiscal surplus of 2 percent of GDP—using the same assumptions as in the previous paragraph.

6. This range of estimates shows that consistent small deficits or even fiscal surpluses will be required in the medium to long term, regardless of the choice of the anchor. Although this is in line with the authorities' medium-term budget plan (published in February 2023), this represents a significant tightening in the fiscal position relative to the past. By comparison, over the past five years, the fiscal deficit averaged 5.4 percent of GDP. In the five years before the pandemic, the deficit averaged 3.8 percent of GDP.

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[3] Using the nominal growth assumption of the 2022 IMF TA report would imply a surplus of 0.4 to 1.4 percent of GDP.

[4] The non-resource primary balance ratio target is equal to minus the interest rate-growth differential times the most recent wealth-to-GDP ratio: $nrpb_{t+i} \approx -(i - \mathrm{g}).w_{t-1}$.

[5] Using the assumption of the 2022 TA report on the interest rate-growth differential (5 percent real interest rate and 3 percent growth), the non-resource primary surplus would be 3 percent of GDP, equivalent to an 8 percent surplus for the overall balance.

Annex V. The Botswana Financial Sector Assessment Program[1]

The Financial Sector Assessment Program (FSAP) aims to assist countries in identifying and addressing systemic risks in their financial sectors, thereby enhancing their resilience to shocks and contagion. The assessment for Botswana was conducted from June 2022 to February 2023, and the main findings are described in this Annex.

1. **Botswana has made significant progress in strengthening the supervisory and regulatory framework of the financial system since the previous FSAP in 2007**. During the pandemic, the financial sector performed well due to policy measures and its strong financial position. The financial system faces certain structural and emerging global risks. These include high volatility in diamond prices, geopolitical developments, and tightening global financial conditions. The realization of these risks could negatively impact economic recovery, weaken the external position, and put pressure on reserves.

2. **Botswana's financial system demonstrates resilience to a wide range of shocks, and most banks would withstand severe stress.** Even under the adverse scenario, the banking system would remain above the required regulatory thresholds due to well-capitalized banks and strong net income performance. Similarly, insurance companies in the non-bank financial sector are well capitalized and would not face a capital shortfall under severe stress. Banks maintain adequate capital and liquidity, with moderate profitability. However, the concentration of large, short-term deposits from non-bank financial institutions requires close monitoring of funding and liquidity risks, which can be done more effectively with the implementation of the Basel III liquidity standards. Additionally, efforts should be made to enhance the development of money and bond markets.

3. **The presence of large foreign banks closely integrated with the non-bank financial system underscores the importance of monitoring interconnectedness and contagion channels.** To address these risks, it is crucial to adopt a risk-based supervisory framework; develop capacity to conduct consolidated supervision; strengthen regulatory guidance for problem assets, provisioning, liquidity, and interest rate risk; and enhance banks' corporate governance oversight. Additionally, tools for reviewing and assessing banks' internal capital adequacy and risks should be incorporated into the supervisory review process and the operational independence of Bank of Botswana's supervision should be strengthened.

4. **Macroprudential policy and household indebtedness warrant attention.** The authorities have made notable progress in further strengthening the institutional framework for conducting macroprudential policy. The recent implementation of the Bank of Botswana Amendment Act and revisions to the Banking Act are acknowledged as key steps in strengthening BoB’s capacity to meet its financial stability mandate. To address potential risks stemming from rapid growth in household

[1] This annex was prepared by the FSAP team.

indebtedness, additional macroprudential tools should be developed, contingent upon systematic data collection for calibration.

5. Enhancements are recommended for the financial safety net and crisis management. The Financial Stability Council should be expanded to include crisis preparedness and management responsibilities through the establishment of crisis management protocols. The FSAP suggests strengthening the existing crisis management framework, operationalizing financial safety net arrangements, establishing regulations in line with international practices for the Botswana Deposit Insurance Scheme, and implementing the emergency liquidity framework. Preserving financial integrity necessitates continued strengthening of anti-money laundering and countering the financing of terrorism (AML/CFT) risk-based supervision for banks and non-bank financial institutions. This includes ensuring timely availability of information on beneficial ownership of legal entities, increasing public awareness, and capacity building.

6. Addressing development issues is crucial for the financial sector. A well-coordinated financial sector development strategy is needed to deepen the sector and effectively channel resources. However, DFIs have not achieved the expected results despite significant financial resources, and they currently hold high levels of non-performing assets.

Annex VI. Capacity Development Strategy

1. This annex takes stock of the Fund technical assistance (TA) recently provided and updates the near-term capacity development (CD) strategy. AFRITAC South, as well as the Monetary and Capital Markets Department (MCM), the Fiscal Affairs Department (FAD), and the Statistics Department (STA) are the main Fund TA providers to Botswana. Other CD activities such as training, webinars, workshops, and online courses are also provided by the AFRITAC South and headquarter experts from FAD, MCM, STA, LEG, and ICD.

Capacity Development Assessment

2. CD provided by the IMF has generally focused on strengthening core macroeconomic competencies of the ministry of finance, central bank, and financial sector supervision and regulation bodies. In recent years, CD has spanned a wide range of areas, including fiscal frameworks and public financial management, central bank operations, financial policy, and quality of statistics and data reporting. The main highlights of the past two years include a review of the public investment management (PIMA and C-PIMA), a TA on local bond market development, TA on fiscal rules, and the FSAP missions, which took place between June 2022 and May 2023 and reviewed laws, regulations, and risks to the financial sector, while making several reform recommendations. The two SIPs produced for this consultation on SOE reforms and exchange rate regime also resonate with the authorities' TA needs.

3. Cooperation between the Fund and Botswana on TA and training continues to be strong. The authorities received extensive Fund TA and have expressed appreciation for the continuous support. The authorities noted that the recent TA and FSAP missions had been timely and useful. The authorities have shown ownership of the reform processes and have generally followed up on TA recommendations. Implementation of recommendations has been relatively good on financial sector and monetary policy, including the recommended transition of the policy rate to the MoPR and introduction of an interest rate corridor. Implementation has also been good on improving data reporting of national account and price statistics. The fiscal rule previously designed for Botswana is yet to be implemented.

4. Several large projects and initiatives are planned for the coming year, in response to authorities' requests. On strengthening statistical compilation and dissemination, work is planned for national account rebasing in FY2024, and updating CPI and expanding PPI baskets. TA on debt sustainability analysis (DSA) and macroeconomic forecasting and analysis (MFA) are ongoing, and an overview of domestic tax system is planned for FY2024. Following the FSAP consultation, work to strengthen the legal framework and establishing the Botswana Deposit Insurance Scheme (BDIS) and resolution framework is planned. The BoB's longstanding request for a peripatetic monetary policy expert has been addressed and the expert, a former IMF staff, is visiting the country periodically.

Capacity Development Priorities

5. The CD objectives listed below are consistent with the country's macroeconomic priorities. The CD Strategy developed for the 2022 consultation remains broadly appropriate. It should continue to support the authorities' goals of building fiscal buffers, enhancing public financial management, improving monetary policy transmission, developing domestic financial markets, and strengthening financial supervision. The IMF has delivered some assistance on the items below and further assistance is expected to be forthcoming. The authorities have made additional TA requests for FY2024 including in the areas of revenue forecasting, statistics production, comprehensive review of income tax and VAT, fintech strategy (including a CBDC feasibility study), and drafting of legislations such as the payment law. The Article IV discussions will identify other areas where TA is needed. Ongoing development of human and financial capacity will support the implementation of TA proposals.

Surveillance Priorities	**CD Objectives**
General Macroeconomic Analysis	- Refine nowcasting tool using a composite index of leading indicators
Revenue Mobilization and Administration	- Provide comprehensive review of the domestic tax system - Assist with tax legal framework according to international best practices - Provide training on best practices of revenue forecasting
Public Financial Management	- Improve coverage and quality of fiscal reporting - Improve public investment management and build capacity on project appraisal, project, risk, costing and management - 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 - Build capacity in the development of medium-term debt strategy (MTDS) and annual borrowing plans - Assist with developing a framework for dealing with various contingent liabilities, including those stemming from PPPs - Improve fiscal policies and institutional frameworks to combat climate change and its impacts
Central Bank Operations	- Develop and strengthen the central bank's capacity to provide Lender of Last Report (LOLR) - Strengthen efficient implementation of monetary policy under the existing regime - Assist with the drafting of the national payment law
Financial Supervision and Regulation	- Assist with the structural and legal form of the Deposit Protection Fund - Review cybersecurity regulation, and undertake cybersecurity risk examination - Strengthen crisis preparedness and bank resolution framework - Design optimal arrangements regarding fintech, including a feasibility study for CBDC, for better oversight and national coordination - Strengthen the legal framework to facilitate the establishment of the Botswana Deposit Insurance Scheme (BDIS) - Assist in developing the resolution framework

Surveillance Priorities	CD Objectives
Monetary and Macroprudential Policy Implementation and Operations	- Build capacity to effectively communicate the monetary policy mandate and objectives - Assist with drafting of Central Bank/Macroprudential Oversight Law - Modernize the liquidity management framework and strengthen forecasting capacities - Provide training on local currency bond market development
Improve the Quality of Statistics	- Prepare national account rebasing for 2024 - Update and strengthen compilation and dissemination of external account and price statistics - Expand the coverage of government finance statistics to include extrabudgetary entities and local governments, and improve the classification of current and capital expenditures.

Annex VII. Authorities' Responses to Past Recommendations

	2022 Article IV Recommendations	Authorities' Responses
Policy Mix	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.	The authorities project a wider deficit in FY2023, but still intend to implement a strong fiscal consolidation in the following two years. The authorities are considering the introduction of a fiscal rule to save a larger share of mineral revenue. To reduce the impact of higher inflation, the authorities introduced a temporary VAT reduction—from 14 percent 12 percent from August 2022 to end-March 2023, and zero rating of cooking oil and liquid petroleum gas until end-February 2023.
Monetary 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.	The authorities have kept interest rates unchanged, but this proved to be the right decision given the fast decline in inflation. A smaller inflation differential between Botswana and trading partners has allowed the authorities to reduce the nominal depreciation crawl rate from 2.9 in 2022 to 1.5 in 2023. The authorities are actively engaging with the recommendations of the FSAP team, including measures to strengthen monetary policy transmission.
Financial Sector Development	Implement proposals for financial deepening and inclusion, including development of the government bond market, fintech, and efficiency of development banks.	In line with IMF TA recommendations, the authorities have recently released a Government Borrowing Strategy and Government Securities Auction Calendar, to assist with bond market development. Several other complementary reforms are still to be implemented. The authorities have requested TA assistance with their fintech strategy (including a CBDC feasibility study). The authorities are considering options to consolidate development finance institutions and streamline their target markets.
Financial Regulation and Supervision	Maintain close financial oversight, enhance crisis preparedness, and adopt a bank resolution framework.	Financial oversight has been strengthened with the introduction of the BoBAA (2022) which gives additional powers to the Financial Stability Council. Amendments to the Banking Act, which will create a stronger legal basis for financial stability oversight, was approved by Parliament in April 2023. The AML/CFT regime has undergone significant improvements, and more resources are being put towards enforcement. Work on crisis preparedness and the bank resolution framework is ongoing.
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.	The 2023 Budget has proposed a significant increase in infrastructure investment, but the IMF PIMA found that additional efforts are required to improve the efficiency of investment. Reform of the SOE sector remains a policy priority, but progress to privatize these entities has been limited. Import restrictions on certain goods (e.g., vegetables) remain in place. The IMF C-PIMA report found that climate-related public investment initiatives are generally at early stages of implementation.

INTERNATIONAL MONETARY FUND

BOTSWANA

July 26, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by | African Department in Consultation with the Statistics Department

CONTENTS

RELATIONS WITH THE FUND

(As of June 13, 2023)

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	140.44	71.22
Reserve position in Fund	56.77	28.79

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	246.44	124.97
Holdings	249.21	126.37

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 exchange rate of the Botswana Pula is a crawling peg arrangement against a weighted basket of currencies comprising the SDR and the South African Rand. As of June 13, 2023, the exchange rate of the U.S. dollar to the Pula was US$1= P13.19, and that of the South African rand to the Pula was R1=P0.72.

As of November 17, 1995, Botswana accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. It maintains an exchange system 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 July 19, 2022.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: https://www.worldbank.org/en/country/botswana
- African Development Bank (AfDB): https://www.afdb.org/en/countries/southern-africa/botswana
- IMF Regional Technical Assistance Center for Southern Africa (AFRITAC South): http://www.southafritac.org/
- Japan International Cooperation Agency (JICA): https://www.jica.go.jp/english/overseas/botswana/office/index.html
- OPEC Fund for International Development (OFID): https://opecfund.org/operations/countries-a-z/africa/botswana

STATISTICAL ISSUES

As of June 2023
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings in national accounts, fiscal, monetary, and external sector statistics but is broadly adequate for surveillance.
National Accounts: Statistics Botswana (SB) rebased the national accounts in September 2021, updating the base year from 2006 to 2016 and conceived a strategic plan for future rebasing exercises, with the assistance of AFRITAC South. 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 SB's website. In addition to all items index, indexes are disseminated for urban and rural areas as well as special aggregations for tradables and non-tradables. An updated CPI was disseminated in March 2019, with weights derived from expenditure data reported in the 2015/16 Multi-Topic Household Survey. Owner-occupied housing (OOH) is currently excluded, and the SB continues efforts to expand CPI coverage to include OOH. The producer price index (PPI) is disseminated on an ad-hoc basis and is available through Q4:2022 on the Statistics Botswana website. In addition to mining and utilities, the PPI is being expanded to include other activities. AFRITAC South has provided assistance to expand CPI coverage to include OOH and expand PPI coverage to include agriculture and manufacturing.
Government Finance Statistics (GFS): The Ministry of Finance (MoF) compiles cash-based quarterly and annual budgetary central government data following the *Government Finance Statistics Manual 2014*. However, some gaps remain. Since 2018, data is available on expenditure by classification of functions of government (COFOG), but there is still no balance sheet data, and no data is compiled for extrabudgetary institutions, consolidated central government, and consolidated general government. As of April 2023, authorities were still working on collecting data for extrabudgetary units (non-market parastatals) which are government entities other than the budgetary 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 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 expenses, but challenges remain with distinguishing between current and capital outlays in the development budget. Ongoing work for the development of a revised chart of accounts could help to improve data quality. 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. Data for other financial corporations has been expanded to cover the pension funds, insurance companies, and the non-money market fund. The

BoB reports data on several series and indicators to the Financial Access Survey (FAS), including mobile and internet banking, mobile money, gender-disaggregated data, and the two indicators adopted by the UN (commercial bank branches per 100,000 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 quarterly breakdown is published in the Botswana Economic and Financial Statistics and the BoB's Annual Report in an aggregated format. Preliminary BOP data is disseminated within three 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) (preliminary data with a nine-month lag). The BoB compiles BOP and IIP statistics in line with the sixth edition of the *Balance of Payments and International Investment Position Manual* (BPM6). With the technical support of the IMF, the BoB has made significant progress in improving source data over recent years. Several 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 net errors and omissions (NEOs). While the complete elimination of NEOs is not plausible, additional required measures include: (i) the adjustment of imports 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) the increase in coverage of current and capital transfers by including data on government grants and TA/investment projects; and (iv) the coverage of foreign assets of asset managers, pension funds, and insurance companies. In June 2023, the BoB started disseminating the International Reserves and Foreign Currency Liquidity Data Template (IRFCL).
II. Data Standards and Quality
Botswana has implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS) and currently disseminates 13 of the 15 encouraged data categories on its National Summary Data Page (NSDP). Areas for improvement include improving the periodicity and timeliness of data dissemination on the NSDP for several data categories (reserve assets, producer price index, central government operations, depository corporations survey, central bank survey, BOP, IIP, and production index) and continuing to build capacity to compile and disseminate data on general government operations and external debt.

Botswana: Table of Common Indicators Required for Surveillance
(As of June 13, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	May 2023	06/02/2023	A/M	A/M	A/M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Feb 2023	5/30/2023	A/M	A/M	A/M
Reserve/Base Money	Feb 2023	5/30/2023	A/M	A/M	A/M
Broad Money	Mar 2023	5/10/2023	M	M	M
Central Bank Balance Sheet	Feb 2023	5/30/2023	A/M	A/M	A/M
Consolidated Balance Sheet of the Banking System	Mar 2023	5/30/2023	A/M	A/M	A/M
Interest Rates[3]	May 2023	6/7/2023	M	M	M
Consumer Price Index	Apr 2023	5/30/2023	A/Q/M	A/Q/M	A/Q/M
Revenue, Expenditure, Balance, and Composition of Financing[4]—General Government[5]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance, and Composition of Financing[4]—Budgetary Central Government	Feb 2023	4/30/2023	A/Q/M	A/Q/M	A/Q/M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	2022Q4	4/30/2023	A/Q	A/Q	A/Q
External Current Account Balance	2022Q4	5/30/2023	A/Q	A/Q	A/Q
Exports and Imports of Goods	2022Q4	4/30/2023	A/Q	A/Q	A/Q
GDP/GNP	2022Q4	4/6/2023	A/Q	A/Q	A/Q
Gross External Debt	2022	4/30/2023	A	A	A
International Investment Position[7]	2022	4/30/2023	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, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Mr. Willie Nakunyada Executive Director for Botswana and Ms. Gonaya Basutli Senior Advisor to the Executive Director for Botswana
August 28, 2023

Botswana successfully weathered the recent external shocks from the COVID-19 pandemic and the war in Ukraine, benefitting from historically robust fiscal and external buffers. The economy rebounded strongly and registered one of the highest growth rates in sub-Saharan Africa, while the authorities' efforts to curb inflation have yielded the desired results. To reverse the erosion of buffers occasioned by the multiple shocks, the authorities have mapped out an ambitious plan to rebuild fiscal and external reserve buffers and accelerate economic transformation, leveraging on their track record of sound macroeconomic management and fiscal prudence. They have also undertaken significant legal reforms to strengthen the financial sector and plan to use the recommendations of the recently completed Financial Sector Assessment Program (FSAP) to formulate a Financial Sector Development Strategy (2024–2029).

Introduction

1. On behalf of our Botswana authorities, we thank staff for their constructive engagement during the recent Article IV and FSAP missions. Our authorities broadly share the thrust of staff's appraisal and policy recommendations.

2. Botswana's recovery from the effects of the pandemic continues to firm up, building on the strong growth performance realized in 2021 and 2022. While macroeconomic fundamentals remain strong, the need to rebuild buffers to strengthen resilience to shocks continues to rank high on the authorities' reform priorities. To further consolidate the recovery, the authorities are undertaking various reforms and remain committed to the achievement of high-income status by 2036. They recognize the need for economic transformation that should precede this goal and, as such, adopted a two-year Transitional National Development Plan (TNDP) as a successor to the National Development Plan 11 (NDP 11) which ended in March 2023. At the same time, the TNDP prioritizes digital transformation, business environment reform, infrastructure development, value chain development, sustaining livelihoods as well as climate change mitigation and adaptation efforts. Importantly, the TNDP will allow the authorities to catch up on infrastructure development and bridge the attendant gaps that widened during the pandemic.

Recent Economic Developments and Outlook

3. Real GDP grew by 5.8 percent in 2022 and exceeded the pre-pandemic levels as well as the long-term average of 4 percent. The recovery of economic activity was largely driven by strong growth in both the mining and non-mining sectors. Nonetheless, growth in output is projected to slow down to 3.8 percent in 2023, reflecting the expected decline in diamond production, and a weaker global environment which could adversely impact other exports. Going forward, economic growth is expected to pick up slightly to 4.1 percent in 2024, as the mining sector recovers. Non-mining sector performance is also expected to improve, buoyed by government actions to support economic activity. This notwithstanding, the growth outlook remains highly uncertain and dependent on diamond market developments, while climate shocks continue to challenge growth prospects, posing a threat to activity in agriculture, mining, and tourism.

4. Meanwhile, inflation declined from a peak of 14.6 percent in August 2022 to 4.6 percent in June 2023 and further to 1.5 percent in July 2023. The much higher inflation in 2022 was due to significant upward adjustments to administered prices and associated second-round effects. Inflation has now breached the lower bound of the Bank of Botswana's (BoB) medium-term objective range of 3–6 percent and is forecast to remain within the objective range into the medium term. Further, the external position improved in 2022, reflecting strong diamond exports and capital flows. As such, the current account strengthened from a deficit of 1.4 percent of GDP in 2021 to a surplus of 2.9 percent of GDP in 2022, mainly reflecting higher volumes and prices of diamonds. As at May 2023, foreign exchange reserves stood at 5.9 months of prospective imports, as estimated by staff.[1]

Fiscal Policy

5. Our authorities concur with staff on the importance of fiscal consolidation and the need to ensure medium-term debt sustainability. Considering attendant expenditure inefficiencies and weaknesses in revenue collection, they are exploring several remedial measures, including strengthening tax audit capabilities, public private partnerships (PPPs), and using the Development Manager Model.

6. Reflecting expenditure rationalization efforts and improved tax revenue, the fiscal outturn improved from a deficit of 2.4 percent of GDP in FY2021, to a balanced budget in FY2022. This notwithstanding, the authorities project a widening of the fiscal deficit in FY2023. The worsening fiscal position reflects higher budgeted capital expenditure to fill the gap created by delayed infrastructure developments. This is in recognition of the fact that infrastructure is crucial for enhanced productivity and is necessary to unlock constraints to sustainable economic growth. The targeted projects are also intended to allow for inclusive participation of the private sector, women, and youth. Thereafter, the fiscal deficit should narrow, with a small surplus planned for FY2025.

7. The authorities have stepped up revenue mobilization efforts to raise the tax revenue/GDP ratio. Also at the top of the authorities' priorities is the rebuilding of fiscal

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[1] The authorities estimate foreign exchange reserves to be 9.2 months of actual imports.

buffers and preservation of wealth for future generations. As such, supportive legislature is being actively developed to help ensure inter-generational equity. Consistent with these efforts, the authorities continue to consider the right fiscal rule to adopt. Presently they are considering the fiscal rule to automatically save 40 percent of mineral revenues, combined with a deficit rule to constrain spending and ensure the revenue split rule works. Similarly, even though Botswana's debt is assessed at low risk of distress, the authorities attach a high premium to debt management, and they seek to build more capacity in this area. Relatedly, they launched a Government Borrowing Strategy, with a calendar for FY2023/24, which is expected to enhance transparency and the predictability of government borrowing.

Monetary and Exchange Rate Policies

8. The Bank of Botswana remains committed to medium-term price stability. They project inflation to remain lower in the short-to-medium term than in 2022 due to several factors, including the projected lower international commodity prices, and the waning impact of the increase in administered prices in 2022. Therefore, the Monetary Policy Committee (MPC) has maintained the Monetary Policy Rate (MoPR) at 2.65 percent thus far, following a cumulative 151 basis points policy rate increase in 2022. While this rate increase was lower when compared to rate increases in other SSA countries and emerging market and developing economies (EMDEs), the authorities have not experienced any adverse capital flow changes.

9. The authorities continue to review the appropriateness of the current crawling band exchange rate regime to ensure continued alignment with the maintenance of a stable real effective exchange rate to support international competitiveness of domestic firms. They, therefore, value the inherent flexibility in the exchange rate framework that facilitates the necessary adjustments.

Financial Sector Policies

10. Botswana's financial sector remains profitable and stable, with adequately capitalized banks and low NPLs. That said, the authorities are strengthening legal and regulatory frameworks for financial stability, with the recently adopted Bank of Botswana Amendment Act and revised Banking Act now operational.

11. The authorities value the recommendations of the recent FSAP and will collaborate with the World Bank to develop a Financial Sector Development Strategy (FSDS) that will run from 2024 to 2029 taking a cue from the FSDS 2012–2016 that benefitted from the 2007 FSAP. The strategy should help in the achievement of broader macro-economic goals. Meanwhile, the authorities are advancing work on some of the FSAP recommendations. They have seen noticeable improvements in the operation of the interbank market and policy transmission, following the implementation of monetary operations reforms last year. The Deposit Insurance Scheme that was established within the auspices of the BoB Amendment Act is now operational. The regulations covering the governance of the scheme, membership and premiums contributions, coverage of deposits and funding modalities were published in July 2023.

12. The authorities continue to make improvements to the AML/CFT framework, by addressing outstanding actions. Ahead of the 2026 mutual evaluation, they aim to conduct a mock evaluation that will help them assess their progress and the timely addressing of deficiencies.

Structural Reforms

13. The authorities view accelerating structural reform implementation as articulated in the Reset Agenda and the TNDP, as key to transforming Botswana's economy into high income status by 2036. Specifically, they view reforms to diversify the economy as important to unlock the economy's growth potential, enhance resilience to external shocks, and address the high unemployment rate. In that regard, they are prioritizing trade facilitation and integration, more efficient and climate-resilient infrastructure investment, and support for high-productivity, and export-oriented sectors.

14. Going forward, the in-principle sales and mining agreement reached with De Beers Mining Company is expected to contribute to economic diversification. This will be achieved through value-chain enhancement and the creation of a P10 billion ($750 million) Fund over the next 10 years that will support new initiatives in non-mining sectors like agriculture, solar, climate change, and tourism. Additionally, work in the Special Economic Zones continues, including in agro-processing, mineral beneficiation and cargo, freight, and logistics. To improve food security, the country's grain storage capacity has been tripled to allow higher production. Further, the Power Corporation has put in place measures to meet the country's electricity demand, including with plans for renewable power plants (solar and wind) to augment existing coal plants and diesel run peak plants.

15. Climate change considerations continue to play a role in the authorities' key decisions, guided by the National Climate Change Policy. This is imperative, given the country's vulnerability to prolonged droughts, water shortages and animal diseases, which have now been exacerbated by climate change. Notwithstanding the country's huge conservation efforts (more than 45 percent of the land mass is used for conservation – national parks and game reserves), climate change has worsened the animal-human conflict. The authorities are, therefore, making efforts to balance these considerations. In this regard, they appreciate the Fund's technical support through the C-PIMA and are reviewing the recommendations with a view to embed climate change into sectoral and infrastructure development plans.

Conclusion

16. Our Botswana authorities remain committed to safeguarding macroeconomic stability while positioning the economy to attain high-income status by 2036. Their efforts are geared to help build resilience, strengthen inclusiveness, and accelerate growth. They look forward to Directors' advice and support in concluding the 2023 Article IV consultation, as well as continued Fund engagement and technical assistance to help advance the reform agenda.