

Kingdom of Swaziland—Assessment Letter for Multilateral and Bilateral Donors

April 14, 2011

This letter provides an assessment of recent macroeconomic developments in Swaziland and an update on the discussions between IMF staff and the Swaziland authorities. Swaziland faces a fiscal crisis caused by an 11 percent of GDP drop in revenue payments from the Southern African Customs Union (SACU) and one of the largest wage bills in Africa. In response, the authorities have put in place an ambitious Fiscal Adjustment Roadmap and requested IMF staff to monitor its implementation. The IMF Managing Director approved a Staff-Monitored Program with Swaziland on April 4, 2011, that seeks to start the necessary fiscal adjustment, while protecting education, health, and pro-poor spending and improving public financial management. Securing adequate financing in 2011/12 will be critical to avert a more severe fiscal situation.

Recent Economic Developments

1. **The economic recovery from the global economic crisis in Swaziland has been hampered by large fiscal and external imbalances.** Real GDP growth is estimated to have reached 2 percent in 2010, on the back of a moderate recovery in South Africa. Inflation moderated in 2010, notwithstanding the increase in fuel prices in November 2010. Reflecting the sharp decline in SACU payments, the fiscal deficit reached about 13 percent of GDP in the budget year ending March 31, 2011. The external current account balance widened to about 18½ percent of GDP in 2010. As a result, gross official reserves have been steadily declining since January 2010 and covered only 2½ months of imports at end-March 2011.

2. **The fiscal crisis continues to deepen.** Notwithstanding significant expenditure cuts, the fiscal deficit on a commitment basis is estimated to have widened to 13 percent of GDP in 2010/11, compared with 7 percent in the previous fiscal year.¹ SACU revenue fell by 11 percent of GDP during the 2010/11 fiscal year. At the same time, the wage bill—one of the largest in sub-Saharan Africa—increased further, following an unbudgeted 4.5 percent wage increase granted to civil servants in 2010. While capital expenditure commitments have been halved in recent months to offset the impact of lower SACU revenue, this was partly reversed by a supplementary budget in November 2010 to regularize capital expenditure overruns of about E 350 million (1.3 percent of GDP) for a new airport project.

3. **The government is facing serious challenges in financing its large fiscal deficit.** In addition to issuing government bonds, the government has drawn down its deposits at the central bank and has incurred large domestic payment arrears, estimated at E 1.2 billion (US\$150 million; 4 percent of GDP) at end-March 2011. The central bank has also provided the

¹ The fiscal year starts on April 1 and ends on March 31 of the following year.

government with an emergency credit line of E 620 million (2.3 percent of GDP) in February 2011. Arrears are likely to rise further in the coming months, before external budget support becomes available in the second half of 2011 (see below). In addition, the government may not be in a position to pay public sector wages in the next few months, without further drawing on the gross international reserves of the central bank.

The Government Response to the Fiscal Crisis

4. **To address the fiscal crisis, the government adopted a Fiscal Adjustment Roadmap (FAR) in October 2010, with the objective to restore fiscal sustainability over the medium term.** The main objective of the FAR is to reduce the fiscal deficit to less than 3 percent of GDP by 2014/15, while accelerating structural reforms to increase sustainable growth and reduce poverty. The fiscal adjustment is predicated on revenue and expenditure measures aimed at offsetting the decline in SACU revenue with increases in domestic taxation and the reduction in the wage bill. On the revenue side, the government has already increased the fuel levies on gasoline and diesel to bring them in line with those in South Africa. It also plans to extend the sales tax on various products and services and to introduce a value added tax by April 2012. On the expenditure side, the government has implemented a wage and hiring freeze, and announced that its Enhanced Voluntary Early Retirement Scheme (EVERS) is expected to be fully implemented by March 2012. About 7,000 civil servants (20 percent of the civil service) are expected to be eligible for the EVERS program.

5. **The government decided to take bold actions in the 2011/12 budget, by containing the fiscal deficit on a commitment basis to 7.5 percent of GDP.** This significant fiscal adjustment will be achieved through tax increases as well as expenditure cuts, while protecting priority spending, including on education and health. On the revenue side, the government plans to reduce tax exemptions, increase tax rates on alcohol, gambling and tobacco, and improve tax administration. On the expenditure front, key measures include: 1) a reduction in the wage bill through the elimination of vacant positions, and a wage and hiring freeze; 2) a reduction by 20 percent of spending on goods and services; and 3) trimmed-down allocations for current transfers and nonpriority public investment. IMF staff considers the revenue projections in the budget optimistic and called for additional measures to reduce recurrent expenditures.

6. **The large fiscal adjustment in 2011 is projected to dampen real GDP growth to about 0.5 percent.** Inflation is expected to rise to about 8 percent in 2011, as higher taxes and the increase in international food and fuel prices pass through to higher consumer prices. The external current account deficit is projected to decline in line with the fiscal adjustment path. Accordingly, the gross international reserve position would strengthen to about three months of import cover.

The Staff-Monitored Program

7. **At the request of the authorities, IMF management approved the first ever Staff-Monitored Program (SMP) with Swaziland on April 4, 2011.** The SMP will cover the period

January-June 2011. The SMP is in line with the government's FAR and aims to build a strong track record of fiscal consolidation and structural reform to support the authorities' possible request for a formal Fund arrangement in late 2011. It is driven by four main objectives: (i) taking the first substantive steps towards reducing the deficit to below 3 percent of GDP by 2014/15, which will limit the debt-to-GDP ratio to around 35 percent; (ii) maintaining the gross international reserves at a sufficient level to safeguard external sustainability; (iii) strengthening public finance management; and (iv) protecting education and health spending in order to continue to make progress towards achieving the United Nations Millennium Development Goals. The fiscal program underlying the SMP includes a more realistic revenue target than under the government 2011/12 draft budget, with tax revenue projected to increase by 14.3 percent. In addition, understandings were reached between the authorities and Fund staff to cut the wage bill by 5 percent ($\frac{3}{4}$ percent of GDP) relative to 2011/12, through a graduated wage cut affecting mainly top-paid civil servants. IMF staff has advised the authorities to protect lower-paid civil servants from the necessary wage cuts. As part of the wage bill reduction, the government has already cut the salaries of government ministers by 10 percent, and is negotiating with parliamentarians and trade unions for wage cuts that are expected to reduce the wage bill by E 240 million (0.8 percent of GDP) in 2011/12. Moreover, the government is committed to repaying all arrears by March 2012. As a result, the overall fiscal deficit on a cash basis will reach 12.5 percent of GDP for 2011/12. Given the size of the fiscal deficit, the government will not be in a position to rely exclusively on domestic resources to finance its operations. Consequently, there is still a financing gap of about E 1.3 billion (about \$200 million), which the authorities hope to close through external assistance from the international community. This could be achieved through budget support from the African Development Bank, the European Union, bilateral donors, and a possible IMF arrangement in the second half of 2011.

8. **The SMP will also strengthen the capacity at the ministry of finance in the areas of revenue administration and public financial management (PFM).** On revenue administration, the Swaziland Revenue Authority (SRA) became operational in January 2011. The SRA is making significant progress in preparing for the introduction of a value added tax (VAT) in April 2012. The IMF provided technical assistance in January 2011 to the SRA, with the main recommendation of changing its structure along functional lines. On the PFM front, measures are related to (i) strengthening the hand of the ministry of finance in the budget elaboration process, notably by the removal of the Policy and Budget Committee; (ii) strengthening budget reporting on a cash and commitment basis; and (iii) improving transparency.

9. **The main risks to the SMP stem from a fragile political situation and limited implementation capacity.** These risks have been mitigated in the SMP by a set of prior actions aimed at frontloading the fiscal adjustment while safeguarding pro-poor spending and improving transparency.

Table 1. Swaziland: Selected Economic Indicators, 2009–16

	2009	2010	2011	2012	2013	2014	2015	2016
	Projections							
	(percentage changes; unless otherwise indicated)							
National account and prices ¹								
GDP at constant prices	1.2	2.0	0.5	1.5	2.5	2.5	2.5	2.5
GDP per capita at constant prices	1.4	2.4	0.9	1.9	2.9	2.9	2.9	2.9
GDP deflator	5.4	6.2	7.8	6.3	3.3	4.5	4.1	4.1
GDP at market prices (Emalangenzi millions)	24,995	27,064	29,333	31,637	33,498	35,882	38,267	40,828
Consumer prices (average)								
Headline	7.5	4.5	7.9	6.1	5.3	5.2	4.8	4.5
Underlying (excluding food)	5.9	7.2	6.8	6.1	5.3	5.2	4.8	4.5
External sector								
Average exchange rate (local currency per US\$)	8.4	7.6	...	...	...	...	...	...
Nominal exchange rate change (– = depreciation) ²	12.7	5.4	...	...	...	...	...	...
Real effective exchange rate (– = depreciation) ²	13.2	5.1	...	...	...	...	...	...
Gross international reserves (months of imports)	3.9	2.6	2.9	3.4	4.1	4.9	5.0	4.9
(percent of reserve money)	496.5	383.8	338.1	264.4	225.6	204.0	207.0	204.8
Money and credit ³								
Domestic credit to the private sector	10.1	2.0	8.4	7.8	5.9	7.1	6.6	6.7
Reserve money	38.3	-10.2	31.2	50.8	48.2	39.7	6.6	6.7
M2	26.8	7.9	8.4	7.9	5.9	7.1	6.6	6.7
Interest rate (percent) ⁴	7.8	5.7	...	...	...	...	...	...
	(percent of GDP)							
National accounts								
Gross capital formation	14.4	12.4	11.6	12.6	13.3	13.5	14.0	14.0
Government	8.9	7.1	6.3	7.2	7.9	8.1	8.6	8.6
Private	5.5	5.3	5.3	5.4	5.4	5.4	5.4	5.4
National savings	0.3	-5.8	-2.0	2.1	5.4	8.3	9.0	9.0
Government	3.9	-3.4	-1.7	2.8	5.8	7.1	7.9	7.9
Private	-3.6	-2.4	-0.3	-0.7	-0.4	1.2	1.1	1.1
External sector								
Current account balance (including official grants)	-14.0	-18.2	-13.6	-10.5	-7.8	-5.2	-5.0	-5.0
(excluding official grants)	-18.1	-18.6	-12.9	-9.6	-7.5	-5.2	-5.2	-5.2
External public debt	12.0	12.1	18.0	23.3	26.5	28.3	29.8	30.4
Central government fiscal operations ⁵								
Overall balance (commitment basis) (excluding grants)	-7.1	-12.8	-7.9	-5.0	-2.9	-2.3	-2.2	-2.2
Revenue	35.7	24.5	25.8	27.1	29.4	30.5	31.6	32.1
Grants	0.5	1.1	0.9	0.7	0.7	0.7	0.7	0.7
Total expenditure and net lending	43.3	38.3	34.6	32.8	33.0	33.5	34.5	35.0
Public debt, gross	12.6	20.6	26.8	30.6	32.9	34.1	35.2	35.2
Public debt, net	-3.5	12.4	19.6	23.9	26.6	28.2	29.7	30.0

Sources: Swazi authorities; and Fund staff estimates and projections.

¹ The official GDP numbers from 1994 to 2006 were significantly revised in 2007, and recently in 2008.

² IMF Information Notice System trade-weighted; end of period.

³ Percent of beginning-of-period broad money; end-September for 2009.

⁴ 12-month time deposits rate.

⁵ The fiscal year runs from April 1 to March 31.