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Botswana: 2005 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statements by the Authorities of 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 2005 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 8, 2005, 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 May 13, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of June 17, 2005 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 22, 2005 discussion of the staff report that concluded the Article IV consultation.
- statements by the authorities of Botswana.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

BOTSWANA

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the
2005 Consultation with Botswana

Approved by Sharmini Coorey and Anthony Boote

May 13, 2005

- The 2005 Article IV consultation discussions were held in Gaborone during February 22–March 8, 2005. The staff met with Minister Gaolathe, Assistant Minister Mlazie, and Permanent Secretary Tumelo of the Ministry of Finance and Development Planning (MFDP); Governor Mohohlo of the Bank of Botswana (BoB); other senior government officials; and representatives of the private sector, NGOs, and the diplomatic and academic communities.
- The staff team comprised Mr. Heytens (head), Mr. Akatu, Mr. Iimi, Ms. Kim (all AFR), and Ms. Mbabazi-Moyo (MFD).
- The Executive Board concluded the 2003 Article IV consultation on March 24, 2004. Directors noted that Botswana's sound macroeconomic policies and good governance had contributed to sustained growth and low inflation, but emphasized the need to step up efforts to diversify the economy and allocate adequate budgetary resources to combat the HIV/AIDS pandemic while preserving macroeconomic stability.
- Botswana has accepted the obligations of Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system free of restrictions in the making of transfers and payments on current international transactions, except for a multiple currency practice that is expected to expire in 2006 as discussed in paragraph 45. Botswana also maintains a liberal regime for capital account transactions.
- Botswana's relations with the Fund, including recent technical assistance, and the World Bank group are summarized in Appendixes I and II, respectively. Statistical issues are discussed in Section IV and Appendix III, while the external and public debt sustainability analyses are presented in Appendixes IV and V, respectively.
- Botswana is a net creditor to the Fund and made a deposit of SDR 14.6 million to the ESAF-HIPC Trust in 1997.

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Executive Summary

Notwithstanding Botswana's strong track record of macroeconomic performance, the plateauing of diamond production and spread of HIV/AIDS are undermining past achievements. One of the key challenges facing Botswana is to facilitate the transition away from diamonds—which account for over one-third of GDP, 75 percent of exports, and 45 percent of government revenue—to a diversified economy that harnesses private sector initiative and makes more rapid progress in employment creation and poverty reduction while preserving macroeconomic stability. Compounding the difficulty of this task is the rapid spread of HIV/AIDS—the prevalence rate among adults could exceed 35 percent—which is necessitating increases in health spending at a time when budgetary resources are becoming more constrained.

Botswana's long-term growth prospects, therefore, hinge critically on efforts to accelerate structural reform and combat HIV/AIDS. The authorities are strengthening their structural reform agenda and moving ahead with sector-specific development programs (e.g., in tourism, agriculture, and mining outside the diamond enclave) with a view to sustaining annual growth in the 5–6 percent range as targeted in their current medium-term development plan. An interagency working group has initiated the integration of an updated strategy to address HIV/AIDS based on the National Strategic Framework into the medium-term budgetary framework. An allocation of about 1½ percent of GDP was made for HIV/AIDS programs in the 2005/06 budget (April–March), and annual spending levels could rise further over the next five years.

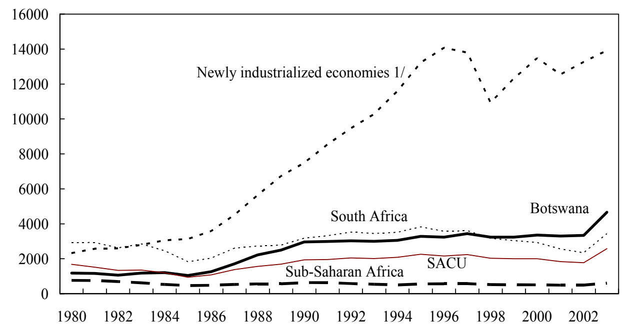
The authorities recognized the importance of fiscal adjustment to maintaining macroeconomic stability. They reiterated their commitment to achieving balanced budgets over the medium term and agreed with staff that significant additional fiscal adjustment (on the order of 4–5 percent of GDP) may be necessary to achieve this objective. In this context, the authorities indicated that fiscal adjustment would be stepped up in the context of the 2005/06 budget. To this end, cost recovery in the provision of some government services will be increased through the imposition of user fees, efficiency in the civil service enhanced by the introduction of a performance management system, and domestic tax collections increased by further developing the institutional framework of the recently established Botswana Unified Revenue Service.

The authorities have no plans to move away from the exchange rate peg in the near-term, but are exploring their options with regard to the monetary policy framework. They recognize that the conditions that have allowed them some measure of monetary independence—especially the limited arbitrage by economic agents owing to the embryonic state of financial market development—are unlikely to be sustained given the financial sector reforms that are now under way. The authorities have initiated efforts to better understand the monetary transmission mechanism, improve the functioning of the money market, and strengthen their inflation forecasting capacity in anticipation of this eventuality.

I. Introduction and Key Issues

1. **Botswana has been among the world's fastest-growing economies over the past three decades.** Real GDP growth has averaged over 8 percent per annum, facilitating Botswana's evolution from one of the poorest countries in the world to middle income status, with the highest sovereign credit rating in Africa (Moody's Investor Services and Standard and Poor's). Its success can be attributed to sound economic policies, particularly in the management of its vast diamond resources, as well as a stable political environment and good governance.

Figure 1. Botswana and Selected Countries: Per Capita GDP, 1980-2003
(In U.S. dollars)



Source: World Economic Outlook database.
1/ Hong Kong SAR, Taiwan Province of China, Korea, and Singapore.

2. **However, the improvement in Botswana's social indicators has not kept pace with its strong economic growth** (Box 1).[1] In particular, while poverty has fallen significantly over the past three decades, it remains relatively high with nearly a quarter of the population living below US$1 per day. Unemployment also remains stubbornly high at over 20 percent of the labor force and the distribution of income highly skewed.[2] These trends have been exacerbated by the

Share of Poorest Quintile in National Income in SACU Countries, 1990-2003
(In percent)

Botswana	2.2
Lesotho	1.5
Namibia	1.4
South Africa	3.5
Swaziland	2.7

Source: World Development Indicators database.

Selected Social Indicators in 2002

	Botswana	Sub-Saharan Africa	SACU 2/	Upper-middle-income countries	Lower-middle-income countries
Rank in UN Human Development Index (HDI) of 175 countries 1/	128	152	129	80	131
GDP per capita (US$, 2003 for Botswana)	4,660.0	464.0	1,363.5	5,110.0	1,184.0
Population below US$1 a day (percent, 2003 for Botswana)	30.0	46.5	29.6	…	…
Adult literacy rate (percent)	78.9	63.2	82.9	89.7	63.6
Net primary enrollment ratio (percent of relevant age group)	81.0	…	82.3	93.0	…
Infant mortality rate (per 1,000)	80.0	108.0	76.0	19.0	104.0
Fixed line and mobile telephones (per 1,000 people)	328.0	54.0	…	344.0	45.0
Life expectancy at birth (years) 3/	41.4	45.8	41.5	73.0	59.2

Sources: United Nations, Human Development Report 2004 and World Development Indicators database.

1/ Based on average of HDI value of group of countries except Botswana.
2/ Includes Lesotho, Namibia, South Africa and Swaziland.
3/ Life expectancy at birth was estimated at 55.6 years in the 2001 National Population Census.

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[1] To facilitate comparisons across countries and over time, social indicators from the United Nations and the World Bank's WDI database—which, in some instances, differ from national data—are generally used in this report.

[2] Botswana's Gini coefficient was estimated at 0.57 in the latest Household Survey (2002/03). Income distribution in countries with similar per capita income levels tends to be more equal, with coefficients in the 0.3–0.4 range.

Box 1. Botswana's Development Process

Botswana's growth performance over the past 40 years has been exemplary by global as well as regional standards. Botswana transformed itself from one of the poorest countries in the world at independence in the mid-1960s to middle-income status with a per capita GDP of over US$4,500. Through a combination of prudent economic policies and sound governance—Botswana is ranked 31 out of 146 countries globally in terms of transparency by Transparency International—the country has been able to avoid the "resource curse" that has befallen other similarly favorably endowed countries in Africa. In reflection of this, Botswana has been accorded the highest sovereign credit rating (A) in the region.

However, Botswana has not fully escaped the symptoms of "Dutch Disease," which has constrained growth outside the diamond enclave. In particular, the persistent tendency toward appreciation of the real exchange rate resulting from the large inflows of diamond receipts has hurt the country's competitiveness as both an exporter and a foreign investment destination. Botswana's unique geographic and demographic features—being a sparsely populated, mostly arid, landlocked country with a small domestic market—have also contributed to the lack of foreign investment and slow growth outside the mining sector. In addition, agro-climatic conditions are generally unfavorable to crop production, which has limited income-earning opportunities in smallholder agriculture and informal sector trade.

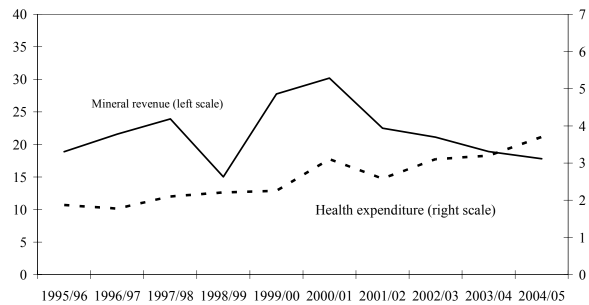
The growth process has therefore been driven by the capital-intensive diamond enclave, which has muted the socioeconomic benefits that typically result from rapid growth. While social indicators have improved, this was not as broad-based or as deep as in other countries with similar growth records (e.g., the newly industrialized countries of Asia). In particular, the capital intensity of diamond mining and lack of backward/forward linkages has meant that employment growth—the mining sector employs less than 5 percent of the labor force—was not commensurate with that of production. In addition, the slow development of labor-intensive industries as well as labor market rigidities and low skill levels have also contributed to persistently high unemployment and a skewed distribution of income. Further, foreign labor has also filled jobs at both the high and low ends of the skill mix, with the latter coming primarily from Botswana's lower-income neighbors (e.g., Zimbabwe).

Botswana's development process has also been hit hard by the HIV/AIDS pandemic. The incidence of HIV/AIDS is among the highest in the world, and Botswana's social indicators have declined over the past decade to levels broadly similar to those of countries with much lower per capita incomes. While the authorities' response to the pandemic thus far has been praised by the international community and held up as a model for other countries to follow, it is likely to be quite some time before these efforts will reverse the deterioration in social indicators.

spread of HIV/AIDS, which has sharply increased the number of orphans. As a result, Botswana's Human Development Index has fallen over the past decade from 0.675 in 1990 to 0.589 in 2002 (UN, *Human Development Report 2004*).

3. **At the same time, the leveling off of diamond production and the spread of HIV/AIDS are undermining past achievements.** Despite some recent progress in diversifying the economy and generating private sector activity, the diamond sector—which currently contributes about one third of GDP, 75 percent of exports, and 45 percent of government revenue—continues to dominate formal sector activity. At the same time, the prevalence of HIV/AIDS has risen over the past decade, intensifying pressures on expenditures at a time when budgetary resources are becoming more constrained.

Figure 2. Botswana: Government Finance, 1995/96-2004/05
(In percent of GDP)



Sources: Botswana authorities; and IMF staff estimates.

4. **Botswana's main challenges are to diversify the economic base and adapt fiscal policy to sustain high growth and reduce poverty while maintaining macroeconomic stability**. These challenges will have to be addressed in tandem with efforts to combat HIV/AIDS. The key questions in this regard include:

- In the near term, **how to initiate progress toward a balanced budget** in view of rising fiscal pressures and **keep inflation low in the face of ongoing pressures for real effective appreciation** in the context of a fixed exchange rate regime?

- **How to adapt fiscal policy over the medium term** given a declining revenue base (diamond receipts) and rising expenditure pressures (from HIV/AIDS and poverty reduction programs)?

- **How to sustain high growth and reduce poverty through structural reforms** to develop the private sector and increase Botswana's competitiveness and attractiveness as an investment destination (e.g., by increasing labor productivity)?

II. Recent Developments

5. **The political situation has remained stable in the wake of the recent elections**. The ruling Botswana Democratic Party won 44 out of 57 seats in the National Assembly, and its presidential candidate, incumbent President Festus Mogae, was reelected in the October 2004 election. This was the first election that a member state of the Southern African Development Community (SADC) conducted under new guidelines on democratic elections, and it was deemed to have been "free and fair" by international observers.

6. **A recent progress report on the Millennium Development Goals (MDGs) indicates that much remains to be done to improve social conditions in the country.** In particular, the impact of HIV/AIDS continues to exert a negative influence on social indicators, including the infant mortality rate, which has risen from 50 per 1,000 live births in 1995 to about 80 at present (see Tables 1 and 2). A recent AIDS impact survey undertaken by the Central Statistics Office (CSO) suggests that the incidence of the disease may be lower than earlier believed—25.3 percent of the population aged 15–49 years, in comparison to previous estimates that range over 35 percent for the same age group—but the survey results probably underestimate the true incidence.[3]

HIV/AIDS Prevalence in SACU
(In percentage of adult population, ages 15-49)

	End-2003
Botswana	37.3
Lesotho	28.9
Namibia	21.3
South Africa	21.5
Swaziland	38.8

Source: UNAIDS

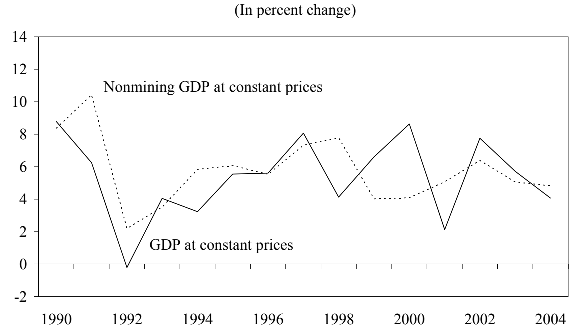
7. **Economic activity has slowed over the past year**. Real GDP growth decelerated to 5.7 percent in 2003/04 (July–June), from 7.8 percent in 2002/03, and is expected to slow further to 4–5 percent in 2004/05 as the productivity improvements from enhancements in the diamond-sorting process continue to level off (Tables 3 and 4). Growth in the nonmining sectors—including agriculture, manufacturing, trade, and tourism—has also slowed over the past year, reflecting a slowdown in public investment and the effects of the weak U.S. dollar.

Growth in SACU Countries, 1998–2004
(In percent change)

	1998	1999	2000	2001	2002	2003	2004	1998-2004 Average
Real GDP								
Botswana	4.1	6.6	8.6	2.1	7.8	5.7	4.1	5.9
Lesotho	-3.5	0.5	1.9	3.3	4.5	5.2	2.3	2.9
Namibia	3.3	3.4	3.5	2.2	2.5	3.7	4.4	3.3
South Africa	0.5	2.4	4.2	2.7	3.6	2.8	3.7	3.2
Swaziland	3.3	3.5	2.0	1.7	2.8	2.4	2.1	2.4
Real GDP per capita								
Botswana	4.3	4.2	6.5	4.4	4.6	6.4	5.3	5.2
Lesotho	-5.5	-1.7	0.0	1.1	2.6	2.9	0.5	0.9
Namibia	0.3	0.4	0.5	-0.8	-0.5	0.7	1.3	0.3
South Africa	-1.6	0.2	2.6	0.7	1.5	0.6	1.8	1.2
Swaziland	1.0	1.3	-0.1	-0.3	0.9	1.3	1.6	0.8

Sources: Botswana authorities; and WETA database.

Figure 3. Botswana: GDP Growth, 1990-2004
(In percent change)



Sources: Botswana authorities; and IMF staff estimates.

8. **Inflationary pressures picked up in late 2004**. The rise in inflation was triggered by the pass-through of higher oil prices, increased public utility charges, and the 7.5 percent devaluation of the pula in February 2004. While inflation declined to 7.3 percent in February and subsequently to 6.5 percent in March, from 8.0 percent in January, it still remains outside the Bank of Botswana's (BoB) target range of 3–6 percent.

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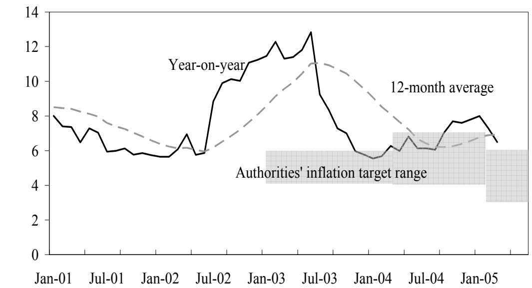
[3] The recent CSO estimate covers only those survey respondents (about 14,000 out of 24,000) who agreed to voluntary testing.

Inflation in SACU Countries, 2001–04
(In percent change)

	2001	2002	2003	2004
Botswana	6.6	8.1	9.6	6.6
Lesotho	6.9	11.2	7.6	5.5
Namibia	9.3	11.3	7.2	5.5
South Africa	5.7	9.2	5.8	1.4
Swaziland	7.5	11.7	7.4	3.5

Sources: Botswana authorities; and WETA database.

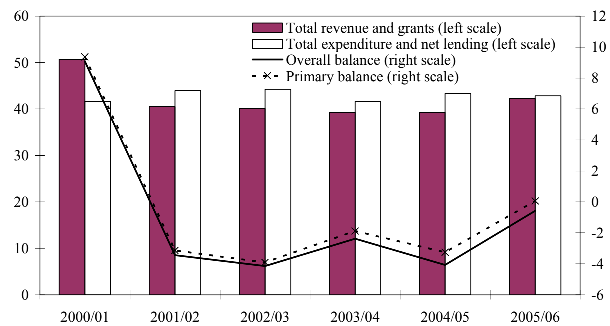
Figure 4. Botswana: CPI Inflation, 2001-05
(In percent change)



Source: Botswana authorities.

9. **The budget deficit is estimated to have widened from about 2½ percent of GDP in 2003/04 (April-March) to over 4 percent in 2004/05**. In 2003/04, revenue shortfalls—reflecting in part problems in VAT administration—were partly offset by scaling back capital expenditure, but not sufficiently to achieve the budget target of a small deficit (Table 5). The widening of the deficit in 2004/05 reflects lower mineral revenue (by about 2 percent of GDP) stemming from the weak US dollar, shortfalls in domestic tax collections, and a supplementary budget to restore some of the earlier cutbacks in capital spending. Cutbacks in current expenditure helped to contain the deficit, which was financed through a drawdown of government deposits.[4]

Figure 5. Botswana: Central Government Revenue, Expenditure, and Budget Balance, 2000/01-2005/06
(In percent of GDP)



Sources: Botswana authorities; and IMF staff

10. **The fiscal position is targeted to return to broad balance in 2005/06**. A small deficit of about ½ percent of GDP is targeted in the 2005/06 budget, predicated on a recovery of mineral receipts in pula terms (equivalent to 3 percent of GDP) owing to more favorable exchange rate developments and a new revenue sharing agreement on the proceeds of diamond exports, improvements in tax administration (½ percent of GDP), and efforts to cut nonpriority expenditures, as outlined below.

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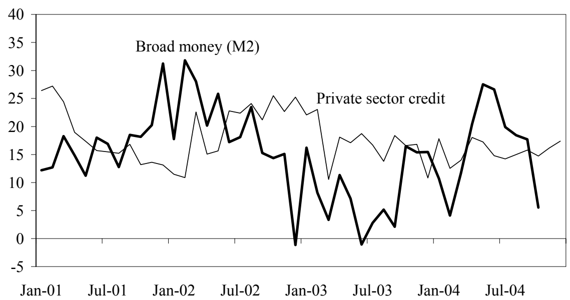
[4] Botswana's total public debt amounted to 10.2 percent of GDP, of which external debt was 4.4 percent of GDP, at end- 2004. Domestic public debt comprises bonds that were issued in 2003 to facilitate development of a domestic bond market (see paragraph 12), while external public debt largely reflects concessional borrowing incurred more than a decade ago prior to Botswana's emergence as a middle-income country.

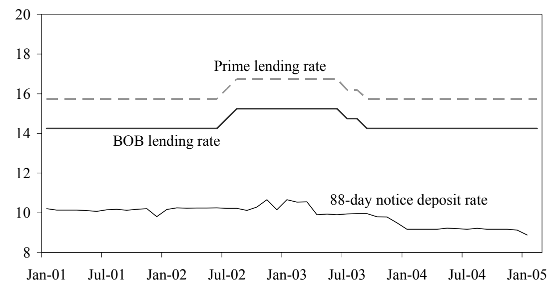
11. **The BoB lowered its inflation target to 3–6 percent in February despite the rise in inflationary pressures.**[5] Following an easing of monetary policy in late 2003, the overnight policy (or bank) rate was maintained at 14.25 percent until late April 2005, when it was lowered to 14 percent. Private sector credit growth has remained broadly within the BoB's target range of 12–15 percent over the past year, despite rapid growth in credit to households (Table 6). The BoB also continued to mop up excess liquidity from the ongoing privatization of the public pension system by issuing Bank of Botswana Certificates.

Figure 6. Botswana: Monetary Conditions, 2001-04
(In percent change)



Source: Botswana authorities.

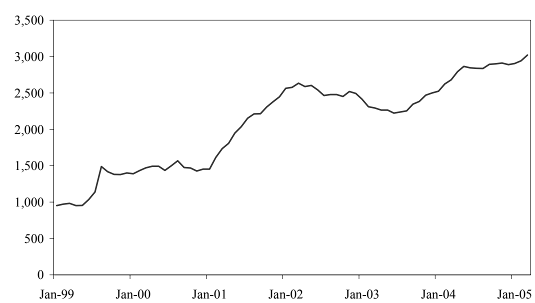
Figure 7. Botswana: Interest Rates, 2001-05
(In percent)



Source: Botswana authorities.

12. **The authorities have also taken steps to develop a domestic bond market**. In 2003, the government floated 2-, 5-, and 12-year bonds with a value of P 2.5 billion aimed at developing the domestic capital market.[6] These bonds were oversubscribed and, together with the P 1 billion resulting from the sale of the Public Debt Service Fund loan book, created a representative sovereign yield curve as a benchmark for private and parastatal issuers. The number of bonds issued by parastatals and private enterprises increased from 6 at end-2003 to 24 by January 2005, with a value of P 4.6 billion. There have been very few new stock listings on the BSE

Figure 8. Botswana: Stock Market Index, 1999-2005



Source: Bloomberg.

[5] The BoB's inflation target was raised to 4–7 percent last year to accommodate the impact of the pula devaluation in February 2004.

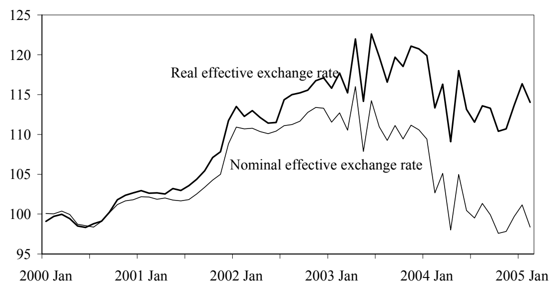
[6] These bonds were listed on the Botswana Stock Exchange (BSE) in January 2005 following the enactment of new regulations in December 2004 to cover the listing and trading of the government bonds. The two-year bond will mature in June 2005 and will not be replaced as it has accomplished the authorities' objective of establishing a yield curve.

in recent years, but share prices have risen steadily.

13. **The external current account strengthened significantly in 2004.** Preliminary estimates indicate that the current account surplus widened to about 9¾ percent of GDP in 2004, up from 6½ percent of GDP in 2003, underpinned by continued growth in diamond exports in US dollar terms (partly reflecting higher world prices) and tourism revenues as well as a large increase in Southern African Customs Union (SACU) receipts associated with the transition to the new agreement and increased regional trade (Table 8).[7] Imports also rose sharply, driven in large part by higher global oil prices.

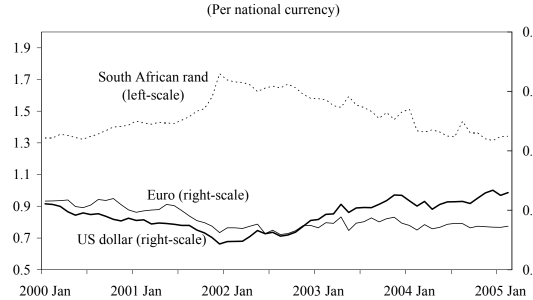
14. **The real effective exchange rate (REER) remains depreciated in comparison with predevaluation levels**.[8] While the impact of the February 2004 devaluation

Figure 9. Botswana: Effective Exchange Rates, 2000-05
(Base 2000=100)



Sources: Botswana authorities; and IMF staff estimates.

Figure 10. Botswana: Bilateral Exchange Rates, 2000-05
(Per national currency)



Sources: Botswana authorities; and IMF staff estimates.

has been partially offset—as a result of the weak U.S. dollar and the rise in inflation above trading partner levels—the REER remains about 5 percent more depreciated in comparison with predevaluation levels. The benefits of the devaluation to nondiamond exporters appear to have been limited, but the sharp appreciation of the pula against the US dollar eroded profit margins in any event, forcing some businesses to adjust (including through layoffs), particularly in the textile industry. In contrast, diamond exports continued to benefit from strong global demand, which has helped to counteract the impact on profitability.

15. **The deficit on the capital and financial accounts has remained sizable.** In particular, private pension managers continued to move funds abroad given the limited investment opportunities in domestic financial markets, though at a slower pace than in

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[7] See Box 1 of Country Report No. 05/97, January 27, 2005, www.imf.org for a description of the provisions of the new SACU agreement. Like other SACU members, Botswana is poised to lose revenue from the new agreement after a one-off increase in 2004. Staff projects that Botswana's annual receipts could fall by 1.5-2 percent of GDP over the next five years.

[8] The pula is pegged to a basket of currencies comprising the South African rand and the SDR, although the precise weights are not known by staff.

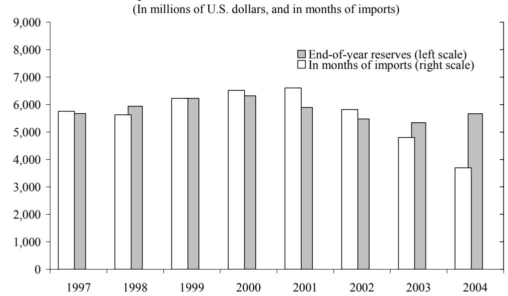
previous years.[9] Foreign reserves nevertheless remained broadly stable at about US$5.7 billion by end-2004, though import cover declined from the equivalent of about 24 months at end-2003 to 18½ months.

International Reserves, 2001–04
(In months of imports of goods and services)

	2001	2002	2003	2004
Botswana	33.0	29.1	24.0	18.5
Lesotho	6.5	5.6	4.8	4.9
Namibia	1.7	2.6	2.0	1.9
South Africa	2.4	2.3	1.9	2.8
Swaziland	2.4	3.0	1.9	1.8

Sources: Botswana authorities; World Economic Outlook database; and IMF staff estimates.

Figure 11. Botswana: International Reserves, 1997-2004
(In millions of U.S. dollars, and in months of imports)



Sources: Botswana authorities; and Fund staff estimates.

III. Policy Discussions

A. Overview

16. **The discussions took place as the authorities were embarking on the midterm review of the National Development Plan for 2003/04–2008/09 (NDP 9), which sets out their medium-term economic strategy**. The authorities explained that the midterm review would provide them the opportunity to reassess their strategies and policies to ensure that the challenges ahead would be effectively addressed, in particular combating the impacts of HIV/AIDS and accelerating progress in poverty reduction and employment generation.

17. **Botswana's policies have generally been consistent with Fund advice over the years.** In particular, the authorities have adhered to a prudent fiscal policy and have initiated steps to integrate a comprehensive strategy for HIV/AIDS into the medium-term budgetary framework. However, they have not made much headway in creating an environment conducive to private business, which has been underscored in previous discussions.

18. **Against this background, the discussions focused on** (i) short-term macroeconomic policies; (ii) the medium-term fiscal stance, including efforts to integrate a comprehensive strategy for HIV/AIDS into the budgetary framework; (iii) the appropriate monetary policy regime for Botswana; (iv) potential systemic risks in the financial system; and (v) the need to address structural impediments to growth so as to foster stronger private sector activity and combat high unemployment.

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[9] The government initiated privatization of the public pension system in 2001, which set in motion the transfer to private fund managers of P 10.5 billion (corresponding to about 27 percent of GDP) of accumulated pension benefits of civil servants opting to join the new system.

B. Economic Prospects

19. **The authorities expect annual growth to be sustained at 5–6 percent over the medium term as projected in NDP 9**. Such performance was predicated on Botswana making significant progress in diversifying the economy away from diamond production by accelerating structural reforms, continuing trade integration, and further exploiting its potential as a regional financial services hub. The authorities expect growth to become more broad-based, bolstered by greater activity in agriculture, manufacturing, services, tourism, and mining outside diamonds. Toward the end of the current decade, growth could also benefit from the anticipated development of a coal-fired power station.

20. **Staff noted that growth would slow to the 3–4 percent range over the medium term (Table 9) if the pace of structural reform was not accelerated and efforts to combat the HIV/AIDS pandemic were not successful**.[10] The authorities and staff agreed that the pace of economic activity outside the mining sector would need to pick up considerably to sustain rapid growth, given the expected plateauing of diamond output. They also agreed that lower growth would intensify pressures on the fiscal position and complicate efforts to reduce the high unemployment rate and accelerate progress on the MDGs. The authorities were nevertheless confident that the structural reform agenda and sector-specific development programs being formulated in the context of the midterm review of NDP 9 would facilitate achievement of the envisaged growth performance.

21. **The debt sustainability analysis undertaken by staff does not point to any immediate concerns about Botswana's external or public debt position (Appendixes IV and V)**. Current indicators of financial and external vulnerability suggest the same conclusion (Table 10).

C. Fiscal Policy

22. **The authorities reiterated their commitment to achieving balanced budgets over the medium term as set out in NDP 9**. Staff agreed that aiming for overall balance was a sufficiently ambitious objective given the government's comfortable net asset position. Moreover, since the erosion of mineral revenues relative to GDP is expected to be very gradual, with little prospect for complete exhaustion, there is no compelling need to run fiscal surpluses. Indeed, staff noted that small deficits would be acceptable over the longer term since they would result in only a slow deterioration of the government's net asset

Overall Fiscal Balance in SACU Countries, 2000-04 1/
(Including grants, in percent of GDP)

	2000	2001	2002	2003	2004 Est.
Botswana	9.1	-3.4	-4.1	-2.4	-4.1
Lesotho	-1.8	0.6	-4.2	0.7	3.3
Namibia	-1.4	-4.5	-3.5	-7.8	-2.0
South Africa	-1.9	-1.4	-1.1	-2.3	-2.3
Swaziland	-1.4	-3.1	-4.5	-2.8	-3.0

Sources: Botswana authorities; World Economic Outlook database; and IMF staff estimates.

1/ In fiscal years.

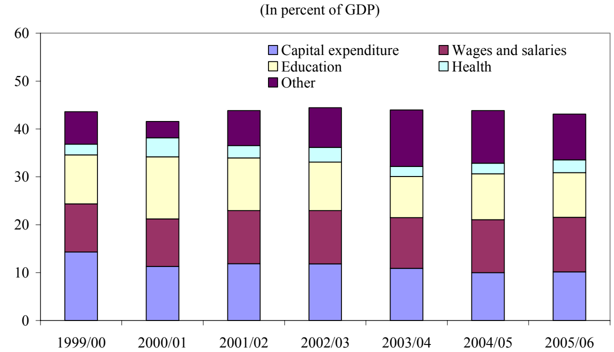
[10] Staff estimated that the impact of HIV/AIDS, if unchecked, could reduce GDP growth by 1–2 percentage points over the medium term, primarily through lower labor productivity (IMF Country Report No. 04/212, www.imf.org).

position (Box 2). However, in view of the uncertain impact of the HIV/AIDS pandemic on the future income of younger generations (many of whom have been orphaned), there was also agreement that a large erosion in the government's net asset position, implying a smaller cushion to absorb future shocks, would not be an optimal response.

23. **Botswana's fiscal challenges are intensifying as receipts from the country's main revenue sources plateau and expenditure pressures from HIV/AIDS increase.** The authorities and staff agreed that significant additional fiscal adjustment would be necessary over the medium term to achieve balanced budgets. Staff estimates that diamond revenue could decline by 2 percent of GDP relative to the 2005/06 budget target even under relatively optimistic assumptions on production and prices, while SACU receipts could erode by 1½–2 percent of GDP as a result of the new revenue-sharing agreement and the effects of trade liberalization. With HIV/AIDS-related expenditure still to be fully integrated into the medium-term fiscal framework, adjustment on the order of 4-5 percent of GDP may be required over the next five years to finance priority expenditure programs while gradually bringing the budget back into overall balance.

24. **Staff urged the authorities to begin taking measures in the context of the 2005/06 budget given the recent fiscal slippage**. The authorities recognized the urgency of fiscal adjustment and indicated that measures would be taken to bring the budget back into broad balance in 2005/06. Staff responded that it might be more prudent to aim to achieve this objective over several years, rather than continue to target (and fail to achieve) broad balance as in recent years. In the context of the 2005/06 budget, the authorities considered the targeted deficit of ½ percent of GDP to be achievable. However, staff indicated that a deficit of 1½–2 percent of GDP was more likely, given the anticipated need for supplementary spending to address the impact of the drought and based on a more conservative assessment of the potential for revenue gains in the near term from improvements in tax administration. Such an outcome would still represent significant progress toward the balanced budget objective given the starting point.

Figure 12. Botswana: Central Goverment Expenditure, 1999/00-2005/06
(In percent of GDP)



Sources: Botswana authorities; and IMF staff estimates.

Box 2. Medium-Term Fiscal Outlook

Staff explored two scenarios for the medium-term fiscal outlook. The baseline scenario assumes growth of about 3–4 percent due to slow progress on economic diversification. With no significant policy changes, only modest improvement in domestic revenue mobilization is envisaged, and the slight decline in current expenditure is more than offset by increased capital outlays on essential infrastructure that can no longer be postponed and higher spending on HIV/AIDS. Under this scenario, overall deficits in the 3–4 percent range would result and the government would virtually exhaust its deposits at the BoB by the end of the five-year period.

The alternative adjustment scenario illustrates the merits of proceeding with fiscal consolidation to achieve broad budget balance over the medium term. The scenario also benefits from higher annual growth of 5–6 percent, resulting from more vigorous structural reforms, though domestic revenue buoyancy from income growth is assumed to be neutral. The adjustment encompasses significant savings on nonessential current expenditure as well as increased cost recovery on some public services, which would provide greater fiscal space to accommodate higher HIV/AIDS spending. This would also allow for higher capital outlays, which would in turn enhance overall investment and growth. Under this scenario, government deposits would remain substantial at over 10 percent of GDP over the medium term.

Medium-Term Fiscal Operations (2004/05-2009/10)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	(In percent of GDP, unless otherwise indicated)					
Baseline scenario						
Total revenue and grants	39.2	41.6	40.8	40.2	39.6	39.1
Of which: mineral revenue	17.8	20.8	20.3	19.7	19.3	18.9
domestic revenue	9.7	9.9	10.4	10.7	11.0	11.2
Total expenditure and net lending	43.3	43.3	43.1	43.2	43.4	43.4
Of which: HIV/AIDS	1.5	1.5	1.7	1.9	2.2	2.5
Overall surplus or deficit (-)	-4.1	-1.7	-2.3	-3.1	-3.7	-4.3
Domestic Financing	4.3	3.6	2.5	3.1	3.8	4.3
Government deposits at BoB	21.5	16.7	12.7	8.4	3.9	0.0
Alternative scenario						
Total revenue and grants	39.2	41.3	40.8	40.4	40.2	39.8
Of which: mineral revenue	17.8	20.6	19.9	19.0	18.3	17.5
domestic revenue	9.7	9.8	11.0	12.0	12.9	13.7
Total expenditure and net lending	43.3	42.9	41.2	40.3	39.9	40.0
Of which: HIV/AIDS	1.5	1.5	1.6	1.8	2.0	2.3
Overall surplus or deficit (-)	-4.1	-1.7	-0.4	0.1	0.2	-0.2
Domestic financing	4.3	3.5	0.5	-0.1	-0.2	0.2
Government deposits at BoB	21.5	16.6	14.3	12.9	11.8	10.4

Source: IMF staff estimates and projections.

25. **The authorities intend to initiate steps to enhance expenditure efficiency and prioritization in the coming year**. In this context, staff commended plans to expand cost recovery in the provision of some government services, including through the broader imposition of means-tested user fees. Staff also encouraged the authorities to move quickly to strengthen budget systems and enhance their capacity to track expenditure on priority areas. The authorities indicated that their immediate priority was to complete the rollout of the new Government Accounting and Budgeting System. Once this was completed, they would consider the merits of establishing an expenditure-tracking system as recommended by staff, but noted that they would not be unduly constrained from reprioritizing expenditure in the meantime.

26. **The authorities intend to finish integrating an updated strategy for HIV/AIDS based on the National Strategic Framework into the medium-term budgetary framework in the coming year**. A joint working group drawn from the Ministry of Finance and Development Planning (MFDP) and National AIDS Coordination Agency has been established for this task in the context of the midterm review of NDP 9. An allocation of about 1½ percent of GDP was made for HIV/AIDS programs in the 2005/06 budget, which includes initiatives to expand the network for distributing free antiretroviral (ARV) drugs.[11] Preliminary estimates suggest that annual spending levels could rise by an additional 1 percent of GDP over the next five years, though MFDP was hopeful that the integration process could be made more cost-effective. The authorities reported that significant progress had also been made in accessing external financing, including from President Bush's Emergency Plan for HIV/AIDS and the Global Fund, as well as in identifying cheaper sources of ARV drugs.

27. **Staff advocated a clearer and more ambitious road map on public sector reform in order to support the reorientation of spending**. While supporting the recent introduction of a performance management system in the civil service, staff's view was that significantly greater efforts would be necessary to reduce the wage bill, including more closely linking staffing levels to identified priorities. The authorities did not see comprehensive civil service reform as an immediate priority, given the public sector's predominance in the labor market. In the near term, they noted that wage levels would not be increased, and expected additional savings through a hiring freeze on nontechnical positions and a tighter government travel budget. Over the medium term, the

Government Wages and Salaries, 1998-2003
(In percent of GDP)

	2000	2001	2002	2003
Botswana	9.2	10.8	12.8	13.1
SACU 1/	12.7	12.5	13.1	13.0
OECD Euro Zone countries	10.6	10.5	10.6	10.7
Newly Industrialized Asian Economies 2/	4.3	4.4	…	…
Average of African countries	7.1	7.1	7.5	7.6

Source: African Department database; and World Economic Outlook database.

1/ Excludes South Africa
2/ Includes Korea, Thailand and Singapore.

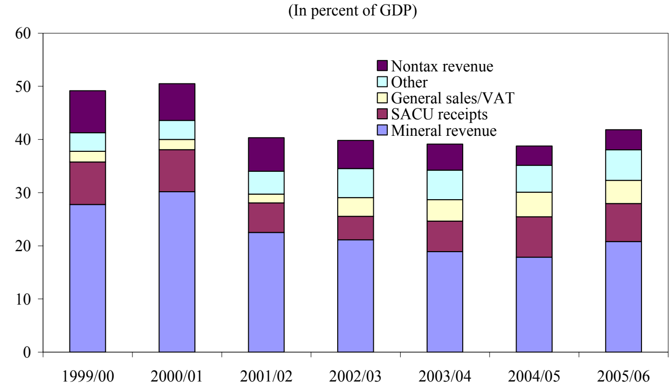
[11] This figure does not include the cost of HIV/AIDS programs that are being implemented by line ministries for their employees or of the treatment provided to HIV/AIDS patients through the general health budget.

authorities expected to achieve expenditure savings through a more streamlined social safety net and greater efficiency in the delivery of government services. Staff concurred that better targeting of the social safety net and more cost-effective provision of public services, particularly in tertiary education, could result in significant expenditure savings over the medium term.[12]

28. **The authorities have unveiled their Privatization Master Plan and other initiatives to improve the performance of enterprises that remain in the public sector**. Staff welcomed these initiatives, but cautioned that progress in this regard (based on experience in other countries) could prove to be problematic in the absence of a comprehensive legal framework for the sale of government assets. The authorities pointed out that various pieces of legislation that supported divestiture were in place and that the Master Plan had been endorsed by the Cabinet and should be able to proceed unimpeded. They also emphasized that it would be important for all citizens to benefit from privatization and that a measured pace of divestiture would be required to achieve political consensus.

29. **On the revenue side, the authorities indicated that sustained efforts were being made to strengthen tax administration and broaden the domestic tax base**. They noted in this regard the recent establishment of the Botswana Unified Revenue Service (BURS) as well as ongoing efforts to strengthen its administrative capacity and round out its institutional framework. However, the authorities were noncommittal on whether they would move ahead to establish a large taxpayers' unit, as earlier recommended by Fund technical assistance. The authorities also indicated that concerted efforts were being made to improve tax compliance through strengthened audit and enforcement procedures, including stronger legal sanctions against tax evaders. Staff welcomed these efforts, but noted that there could also be a need for additional measures—such as an increase in the VAT rate—to boost domestic revenues over the medium term.

Figure 13. Botswana: Central Government Revenue, 1999/00-2005/06
(In percent of GDP)



Sources: Botswana authorities; and IMF staff estimates.

[12] South Africa's efforts to improve expenditure management and reprioritize spending in the post-apartheid period could be a useful model in this context.

D. Monetary and Exchange Rate Policies

30. **In the near term, the authorities were focused on bringing inflation back within the target range**. The authorities and staff discussed the case for preemptive tightening given that core inflation (at 7.8 percent in January) was also outside the target range and the fiscal stance had been loosened recently. The authorities saw no need in the near term to raise interest rates to bring inflation down, noting that the recent rise in headline inflation stemmed primarily from factors other than domestic demand pressures (e.g., adjustments in administered prices and the impact of the pula devaluation). Staff concurred that inflation had been affected by one-off factors over the past year, but cautioned that interest rates should not be lowered until inflation has been brought down durably to within the target range. Staff noted in any event that the authorities should stand ready to raise interest rates in the event that inflation does not decline as they expect in the coming months.[13]

31. **Monetary policy continues to be anchored by an exchange rate pegged to a basket of currencies comprising the South African rand and the SDR**. The authorities have at the same time sought to support the national objectives of economic diversification and export competitiveness by setting an inflation target range based on average inflation in trading partner countries in an attempt to keep the real effective exchange rate stable. Given the authorities' success in maintaining relatively low and stable inflation, staff observed that the exchange rate peg has provided a credible nominal anchor for monetary policy and has thus served Botswana well.

32. **The authorities were nevertheless exploring their options with regard to the monetary policy framework, including a possible move to inflation targeting**. They recognized that the conditions that have allowed some measure of short-term monetary independence are unlikely to be sustained given the financial sector reforms that are under way—e.g., the privatization of the public pension fund and the creation of an offshore financial center. In this context, the authorities were developing a short-term inflation forecasting model and undertaking a study to improve their understanding of the monetary transmission mechanism. While staff supported these efforts as well as the BoB's recent progress in developing leading indicators to better inform the conduct of monetary policy, they emphasized there was no compelling need to move away from the exchange rate peg.

33. **The authorities indicated that any exchange rate regime change would require further development of the interbank market for foreign exchange in any event**. At present, the interbank market is largely dormant, due to the lumpiness of Botswana's foreign exchange flows—e.g., diamond receipts are transmitted directly to the BoB in only a couple of tranches per year—and the narrow bid/ask spread. The authorities were investigating the scope for widening the pula's trading band around the peg with a view to facilitating a more active interbank market.

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[13] Following the discussions, the BoB in late April cut interest rates by ¼ percent, citing what it termed "generally positive" inflation prospects (see paragraph 11).

34. **Finally, the authorities noted that the tendency toward appreciation of the REER was an ongoing challenge**. The authorities and staff agreed that this pointed to the need for an acceleration of structural reforms to facilitate external competitiveness and economic diversification over the medium to long term. In the interim period as these reforms were taking hold, competitiveness concerns would have to continue to be addressed through adjustments in the exchange rate level, which appeared to be broadly appropriate at present. The authorities agreed, in line with past staff advice, that realigning the weights in the currency basket to trading partners might also help to maintain competitiveness.

E. Financial Sector Policies

35. **Overall, the banking sector appears to be generally sound and prudential supervision broadly adequate**. Key financial soundness indicators up to end-2004 indicate that the banks are well capitalized as evidenced by a regulatory capital to risk-weighted assets ratio of 20.6 percent, well in excess of the statutory 15 percent, while nonperforming loans are low at 2.8 percent (Table 11). However, the high exposure of the banking sector to households (loan concentration is about 58½ percent) needs to be monitored closely. The authorities confirmed their interest in the Financial Sector Assessment Program (FSAP), though they could not commit to a specific time frame for their participation.

36. **An area of concern that needs to be addressed with some urgency is the establishment of a financial supervisory authority (FSA) for nonbanks**. Initial work in this regard under the Financial Sector Reform and Strengthening initiative has been completed and its recommendations are under consideration by MFDP. The drafting of legislation to establish the FSA is expected to begin in July 2005 following formal endorsement of the recommendations. Given the rapid growth of the nonbank sector—particularly of the pension funds, where total assets now exceed those of the onshore banks—it is imperative that this process proceed without delay.

37. **Staff supported the BoB's vigilance in vetting applications for the International Financial Services Center (IFSC), an offshore financial center**. The IFSC was established in 1999 with a view to making Botswana the financial services hub for sub-Saharan Africa. However, its development has been slower than the authorities expected, with only 26 companies accredited to date, of which only 11 are operational. Staff urged the BoB to continue to closely vet applications for the IFSC in order to avoid reputational damage.

38. **The authorities have developed a draft AML/CFT strategy to bring their legal framework more in line with international standards**. The authorities have not yet decided whether to extend the mandate of the Directorate on Corruption and Economic Crime (DCEC) to address money laundering activities. Staff noted that, in the event that they do so, priority would need to be accorded to the DCEC's restructuring and strengthening so that it could operate as a full-fledged financial intelligence unit fulfilling both its AML/CFT role as well as its anti-corruption mandate.

F. Structural Issues

39. **There was agreement that the pace of structural reform needed to accelerate significantly to sustain Botswana's strong economic performance**. The authorities noted that this was a major focus of the midterm review of NDP 9, and that the National Employment, Manpower and Incomes Council had been reformulated to devise a more intensive reform program. In formulating an agenda, staff encouraged the authorities to pay particular attention to the recommendations set out in a recent Foreign Investment Advisory Service review of the business environment.

40. **The authorities acknowledged that rigidities in the labor market were an impediment to private sector activity**. They noted in particular that a lack of skilled labor and skill mismatches were a significant barrier, particularly from the perspective of foreign investors, and indicated that steps were being taken to reorient the educational system toward vocational training and establish a technical university. In addition, procedures have been developed to expedite the processing of work and residence permits to facilitate the import of skilled labor. The authorities were also hopeful that the introduction of a performance management system in the civil service and public enterprise divestiture would translate into greater flexibility and productivity in the labor market.

41. **The authorities also acknowledged that there are other impediments to private business**. Key among these is the shortage of serviced land—i.e., with utility connections and other supporting infrastructure (e.g., road access, telecommunications links)—and a multiplicity of regulations and required permits. On the former, steps were being taken to accelerate land development in urban centers and broaden private sector provision of basic services (including telecommunications), particularly through the formation of public/private partnerships. On the latter, the authorities were reviewing the regulatory environment in order to streamline procedures and enhance efficiency.

42. **At the same time, programs have been created to facilitate private entrepreneurship**. Budgetary funds were allocated in 2002 to launch three such programs managed by the Citizens Entrepreneurial Development Agency (CEDA) aimed at supporting small and medium-scale enterprises. Under its main program, CEDA provides credit at highly subsidized interest rates along with managerial training and mentoring services to domestic enterprises. A venture capital fund that provides credit at commercial interest rates and a credit guarantee fund to encourage bank lending to small businesses have also been established. Total lending by CEDA through August 2004 amounted to P 674 million (1½ percent of GDP), with nonperforming loans accounting for just over 2 percent of outstanding credit.

43. **The authorities have also stepped up various development programs in agriculture and tourism**. Efforts to improve agricultural productivity, as articulated in a national development plan launched in October 2002, have been focused on increasing investment in irrigation and water recycling systems. The Botswana Meat Commission is being restructured, and a tracking system created, to facilitate compliance with the EU's

"food origin" requirements in order to maintain market access for beef exports. Finally, a Tourism Board was launched last October to promote Botswana as a travel destination.

G. Trade Policy and Exchange Regime

44. **Botswana is committed to further trade liberalization along with other SACU and SADC members (see Country Report No. 05/97, January 27, 2005, www.imf.org)**. Botswana's simple average tariff has been reduced to 11.4 percent, compared with over 20 percent a decade ago, and has been accompanied by a simplification of the tariff structure. However, Botswana maintains a number of nontariff barriers, including a state monopoly on beef exports, import permit requirements for a range of food products, and seasonal agricultural trade bans that should be removed.

45. **The authorities confirmed their intention to eliminate the multiple currency practice arising from the Foreign Exchange Risk-Sharing Scheme (FERS)**. The scheme was abandoned in 1990, and the last loan under the arrangement matures in 2006.

IV. Data and Other Issues

46. **While economic data are generally adequate for surveillance purposes, there is significant room for improvement (Appendix III)**. In particular, national accounts and final (as opposed to provisional) balance of payments data need to be more timely. As in past consultations, the authorities were strongly encouraged to synchronize the data accounting periods for the government sector and national accounts with those of the financial statistics and balance of payments, and to establish an autonomous CSO to further improve the quality and transparency of the statistical base. Staff also encouraged the authorities to adopt as quickly as possible the 2001 GFS methodology in compiling fiscal data.

47. **Staff saw merit in Botswana continuing to receive technical assistance (TA) in the establishment of a FSA for nonbanks and in inflation modeling**. The authorities were very grateful for past Fund TA and wished to see ongoing initiatives continued.

V. Staff Appraisal

48. **Botswana has been among the world's fastest-growing economies over the past three decades, but the leveling off of diamond production and the spread of HIV/AIDS are undermining its considerable achievements**. Real GDP growth has averaged over 8 percent per annum since the 1970s, facilitating Botswana's evolution from one of the poorest countries in the world to middle income status and the highest sovereign credit rating in Africa. This success can be attributed to sound policies, particularly in the management of Botswana's vast diamond resources, as well as a stable political environment and strong commitment to good governance. Nevertheless, despite some progress in diversifying the economy and generating private sector activity, the diamond sector continues to dominate macroeconomic activity and the formal sector of the economy. At the same time, the prevalence of HIV/AIDS has risen, steadily eroding social indicators and intensifying

pressures on health expenditures at a time when budgetary resources are becoming more constrained.

49. **The key challenge is to preserve macroeconomic stability while facilitating the transition to a more diversified economy that harnesses private sector initiative and makes deeper inroads into poverty reduction**. In the near term, progress will have to be initiated toward a balanced budget despite rising fiscal pressures and inflation kept low in the face of persistent pressures for real effective appreciation in the context of the fixed exchange rate regime. Over the medium term, fiscal policy and the composition of expenditure will have to be adapted as revenues decline and spending pressures increase. Structural reforms to develop the domestic private sector and attract foreign direct investment will also have to be accelerated, and broad-based efforts to prevent and combat HIV/AIDS reinforced, to sustain rapid growth, further reduce poverty, and reverse the decline in social indicators.

50. **The authorities' commitment to achieving balanced budgets over the medium term is commendable**. As the government's net asset position is very comfortable, with little prospect for complete exhaustion of diamond revenues, there does not appear to be compelling need for Botswana to run fiscal surpluses. At the same time, given the uncertain impact of HIV/AIDS on future generations, large deficits would also not be prudent at this stage. The authorities' first response should therefore be to significantly strengthen fiscal efforts, beginning with the 2005/06 budget, and aim for overall balance over the next several years, in anticipation that small deficits may be inevitable over the longer term. For 2005/06, a deficit target of 1½-2 percent of GDP might be more realistic given the anticipated need for supplementary spending due to the drought and the limited prospects in the near term for significantly raising domestic revenue collections.

51. **Significant additional fiscal adjustment will be necessary to achieve budget balance over the medium term**. With HIV/AIDS-related expenditure still to be fully integrated into the medium-term fiscal framework, fiscal adjustment on the order of 4–5 percent of GDP may be required—starting in the current fiscal year—over the next five years to finance priority expenditures while bringing the budget back into balance.

52. **To this end, clearer road maps for expenditure reprioritization and public sector reform are needed**. Botswana's wage bill is high by international standards, which constrains the scope for reprioritization. Efforts to strengthen budget systems and track expenditure need to be strengthened with some urgency to facilitate efficient and effective reprioritization of spending.

53. **Sustained efforts will also be needed to strengthen tax administration and broaden the domestic tax base**. The establishment of the BURS is a welcome step, but further efforts are needed to strengthen its administrative capacity and round out its institutional framework, including establishment of a large taxpayers' unit. Concerted efforts must also be made to improve tax compliance through strengthened audit and enforcement procedures, including stronger legal actions against tax evaders.

54. **There is a need to be cautious on monetary policy in the near term given the recent fiscal loosening**. The authorities should avoid lowering interest rates until inflation has been brought down sustainably to within the target range. In this context, staff believes the recent rate cut was premature.

55. **The exchange rate peg to the currency basket has provided a credible nominal anchor for monetary policy and there is no compelling need for a regime change**. Staff nevertheless supports the authorities' efforts to better understand their future options in terms of a possible transition to an alternative monetary framework. Over the medium to long term, competitiveness concerns will need to be addressed through deeper structural reforms, though there may be a need for periodic exchange rate adjustments in the interim.

56. **The financial system appears to be broadly sound and adequately supervised, with no apparent systemic risks**. In particular, the available data suggest that banks are well capitalized and nonperforming loans low, with adequate provisioning. However, the high exposure of the banking sector to households as indicated by the high loan concentration merits close monitoring. An area of concern that also needs to be addressed with some urgency is the establishment of a FSA for nonbanks. The authorities are encouraged to participate in the FSAP.

57. **Botswana's commitment to trade liberalization is commendable**. The new SACU framework will provide Botswana with the opportunity to help shape trade negotiations and policies. The staff welcomes the progress made in negotiating free trade agreements and lowering tariffs, but urges the authorities to remove nontariff barriers.

58. **The staff notes the authorities' intention to eliminate by 2006 the multiple currency practice arising out of the FERS**. In light of this, staff recommend that the Board approve the retention of the measure until June 30, 2006, or the conclusion of the next Article IV consultation with Botswana, whichever is earlier.

59. It is proposed that Botswana remain on the standard 12-month consultation cycle.

Table 1. Botswana: Millennium Development Goals

	1990	1995	2001	2002
Goal 1: Eradicate extreme poverty and hunger 1/				
Population below US$ 1 dollar a day (in percent)	...	23.5	...	...
Poverty gap at US$ 1 dollar a day (in percent)	...	7.7	...	...
Percentage share of income or consumption held by poorest 20 percent	...	2.2	...	...
Prevalence of child malnutrition (percent of children under 5)	...	17.2	12.5	...
Population below minimum level of dietary energy consumption (in percent)	18.0	22.0	24.0	...
Goal 2: Achieve universal primary education 2/				
Net primary enrollment ratio (percent of relevant age group)	93.3	81.3	80.9	...
Percentage of cohort reaching grade 5 (in percent)	97.0	90.0	89.5	...
Youth literacy rate (percent ages 15–24)	83.3	86.1	88.7	89.1
Goal 3: Promote gender equality 3/				
Ratio of girls to boys in primary and secondary education (in percent)	107.8	103.4	102.1	...
Ratio of young literate females to males (percent ages 15–24)	110.0	109.6	108.7	108.5
Share of women employed in the nonagricultural sector (in percent)	46.5	46.6	44.8	...
Proportion of seats held by women in national parliament (in percent)	...	9.0	...	...
Goal 4: Reduce child mortality 4/				
Under 5 mortality rate (per 1,000)	58.0	66.0	101.0	110.0
Infant mortality rate (per 1,000 live births)	45.0	50.0	74.0	80.0
Immunization, measles (percent of children under 12 months)	87.0	89.0	90.0	90.0
Goal 5: Improve maternal health 5/				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	100.0	...
Births attended by skilled health staff (percent of total)	77.5	87.0	98.5	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases 6/				
Prevalence of HIV, female (percent ages 15-24)	...	...	37.5	...
Contraceptive prevalence rate (percent of women ages 15-49)	33.0	...	...	...
Number of children orphaned by HIV/AIDS	...	...	69,000.0	...
Incidence of tuberculosis (per 100,000 people)	...	...	664.0	656.7
Tuberculosis cases detected under DOTS (in percent)	...	70.0	75.0	72.8
Goal 7: Ensure environmental sustainability 7/				
Forest area (percent of total land area)	24.0	...	21.9	...
Nationally protected areas (percent of total land area)	...	18.5	18.5	18.5
GDP per unit of energy use (PPP US$ per kg oil equivalent)	...	...	...	...
CO2 emissions (metric tons per capita)	1.7	2.3	2.3	...
Access to an improved water source (percent of population)	93.0	...	95.0	...
Access to improved sanitation (percent of population)	60.0	...	66.0	...
Access to secure tenure (percent of population)	...	...	...	...
Goal 8: Develop a Global Partnership for Development 8/				
Youth unemployment rate (percent of total labor force ages 15–24)	25.6	...	...	...
Fixed line and mobile telephones (per 1,000 people)	20.6	40.9	272.8	328.5
Personal computers (per 1,000 people)	...	10.3	38.7	40.7

Source: *World Development Indicators* database, April 2004.

Note: In some cases the data are for earlier or later years than those stated.

1/ Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

2/ Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

3/ Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

4/ Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

5/ Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

6/ Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

7/ Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

8/ Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the special seeds of the least developed countries. Address the special needs of landlocked countries and small island developing economies.

Table 2. Botswana: Social and Demographic Indicators, 2004

	Botswana	South Africa	Sub-Saharan Africa
Area (in thousands of square kilometers)	566.7	1,221.0	24,266.0
Population (2002)			
Total (in millions)	1.7	45.3	710.0
Annual rate of growth (percent)	1.0	1.2	2.2
Population characteristics			
Density (per square kilometer)	3.0	37.1	29.2
Urban (percent of total)	49.9	58.4	33.1
Age structure (percent of total)			
0–14 years	41.3	31.5	43.8
15–64 years	55.3	62.2	53.3
65 years and above	2.2	4.4	3.0
Income distribution 1/			
Share held by highest 20 percent	70.3	66.5	...
Share held by lowest 20 percent	2.2	2.0	...
Access to safe water (percent of population, 2000)			
Total	95.0	86.0	58.2
Rural	90.0	73.0	46.5
Urban	100.0	99.0	41.9
Health (2002)			
Life expectancy at birth 2/	41.4	46.5	45.8
Infant mortality (per 1,000 live births)	80.0	52.0	103.1
People living with HIV/AIDS 3/	35.4	...	...
GDP per capita (constant 1995 U.S. dollars)	4,102.0	4,019.9	474.6
Labor force (2002)			
Total (in millions)	0.8	18.1	305.1
Female (percent of total population)	45.1	37.9	42.0
Education (2001)			
School enrolment (percent, gross)			
Primary	103.3	105.1	86.9
Secondary	72.7	86.4	...
Tertiary	4.7	14.6	...
Adult literacy rate	78.9	86.0	64.9

Source: *World Development Indicators* database, April 2004.

1/ Based on 1993/94 household income and expenditure survey for Botswana.
2/ Based on United Nations, *Human Development Report 2004* .
3/ Reflects prevalence rate in the 2002 HIV sentinel survey.

Table 3. Botswana: Selected Economic and Financial Indicators, 2001–05

	2001	2002	2003	2004 Est.	2005 Proj.
	(Annual percentage change, unless otherwise indicated)				
National income and prices					
Real GDP 1/	2.1	7.8	5.7	4.1	3.7
Consumer prices (average)	6.6	8.1	9.6	6.6	8.0
Consumer prices (end of year)	5.7	11.2	5.8	7.8	6.5
Nominal GDP (in billions of pula) 1/	31.9	36.7	39.9	44.3	48.9
External sector					
Exports of goods, f.o.b. (in U.S. dollar terms)	-13.3	1.2	26.5	17.7	9.8
Of which: diamonds	-13.4	2.2	20.0	13.9	8.5
Imports of goods, f.o.b. (in U.S. dollar terms)	-9.4	7.7	16.3	42.2	6.1
Terms of trade	0.1	-16.8	-5.3	-2.9	3.5
Nominal effective exchange rate (depreciation -) 2/	6.9	4.1	-2.4	-9.8	...
Real effective exchange rate (depreciation -) 2/	8.8	4.7	3.1	-5.9	...
Nominal exchange rate (pula per U.S. dollar), avg	5.9	6.3	4.9	4.6	...
Nominal exchange rate (pula per U.S. dollar), eop	7.0	5.5	4.4	4.3	...
Central government finance 3/					
Total revenue and grants	-10.3	13.0	7.8	10.5	17.1
Of which: mineral revenue	-16.4	7.2	-1.5	4.3	28.7
Total expenditure and net lending	18.5	14.9	3.6	15.0	10.3
	(Twelve-month percentage change, unless otherwise indicated)				
Money and banking					
Net foreign assets	22.7	-27.5	-19.2	1.1	4.5
Net domestic assets	20.4	-35.0	-34.4	-10.3	-2.0
Net domestic credit	-16.2	55.8	-64.9	-63.5	-151.8
Net claims on government	-15.1	40.6	-35.3	-9.0	-9.6
Claims on private sector	11.4	23.7	10.7	17.4	12.5
Other items (net)	-29.9	-6.6	-9.0	6.7	3.1
Money and quasi money (M2)	31.2	-1.1	15.5	16.0	10.9
Broad money (M3) 4/	33.7	16.3	14.8	13.5	14.5
Velocity (GDP relative to M2)	3.6	3.6	3.5	3.3	3.3
	(In percent)				
Interest and credit 5/					
Bank of Botswana lending rate	14.3	15.3	14.3	14.3	...
Commercial banks					
Prime lending rate	15.8	16.8	15.8	15.8	...
Deposit rate (88-day notice)	9.8	10.2	9.5	9.2	...
	(In percent of GDP, unless otherwise indicated)				
Investment and savings 6/					
Gross investment	23.0	27.8	29.6	28.1	27.2
Of which: public	11.9	11.6	11.0	10.4	10.2
Gross national savings	36.4	32.6	33.8	37.6	38.9
Of which: public	8.2	8.2	7.5	8.7	8.5
Saving-investment balance	13.3	4.8	4.1	9.5	11.7
Central government finance 3/					
Total revenue and grants	40.5	40.1	39.3	39.2	41.6
Total expenditure and net lending	44.0	44.2	41.6	43.3	43.3
Current expenditure	31.9	32.6	33.1	33.8	33.3
Capital expenditure	11.9	11.8	10.9	10.0	10.2
Net lending	0.1	-0.2	-2.3	-0.5	-0.3
Overall balance (including grants)	-3.4	-4.1	-2.4	-4.1	-1.7
Domestic financing	4.0	6.1	2.7	4.3	3.6
Foreign financing	-0.6	-0.7	-0.3	-0.2	-1.9
External sector					
External current account balance (deficit -) 6/	11.5	2.2	6.5	9.8	8.5
External public debt in percent of GDP 7/	8.0	8.5	5.7	4.5	2.6
External public debt in percent of total exports	15.6	16.3	12.3	9.5	5.9
	(In millions of U.S. dollars, unless otherwise indicated)				
Change in reserves (increase -)	421.4	423.7	134.9	-328.4	-257.6
Gross official reserves (end of period)	5,897	5,474	5,339	5,667	5,925
(In months of imports of goods and services)	33.0	29.1	24.0	18.5	18.2

Sources: Botswana authorities; and IMF staff estimates and projections.

1/ Year beginning July 1.
2/ Annual average.
3/ Year beginning April 1.
4/ Money and quasi money (M2) plus Bank of Botswana certificates equivalent to M3.
5/ For 2004, as of end-October.
6/ The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology. The figures in the table differ from those in Table 2 due to differentials in periods.
7/ Medium- and long-term public and publicly guaranteed debt outstanding.

Table 4: Botswana: Sectoral GDP and Savings-Investment Balances, 2000/01–2004/05 1/

	2000/01	2001/02	2002/03	2003/04	2004/05 Est.
			(In millions of pula)		
Consumption	17,180	19,860	22,503	25,167	27,754
Public	8,742	10,553	12,167	13,692	14,949
Private	8,439	9,308	10,336	11,475	12,805
Gross investment	5,607	8,351	10,737	11,967	11,665
Public	3,372	3,824	4,150	4,274	4,459
Private (including changes in stock)	2,235	4,527	6,587	7,693	7,206
Net exports of goods and services	6,749	3,826	3,820	3,007	4,909
Exports of goods and services	17,555	15,564	16,132	15,864	20,170
Imports of goods and services	-10,806	-11,738	-12,313	-12,857	-15,261
Gross domestic savings	4,310	5,742	6,757	9,615	10,063
Public	1,715	3,009	2,433	3,089	3,936
Private	2,595	2,732	4,324	6,525	6,128
GDP at market prices	28,636	31,922	36,715	39,881	44,327
			(In percent of GDP)		
Consumption	60.0	62.2	61.3	63.1	62.6
Public	30.5	33.1	33.1	34.3	33.7
Private	29.5	29.2	28.2	28.8	28.9
Gross investment	19.6	26.2	29.2	30.0	26.3
Public	11.8	12.0	11.3	10.7	10.1
Private (Including changes in stock)	7.8	14.2	17.9	19.3	16.3
Net exports of goods and services	23.6	12.0	10.4	7.5	11.1
Exports of goods and services	61.3	48.8	43.9	39.8	45.5
Imports of goods and services	-37.7	-36.8	-33.5	-32.2	-34.4
Gross domestic savings	15.1	18.0	18.4	24.1	22.7
Public	6.0	9.4	6.6	7.7	8.9
Private	9.1	8.6	11.8	16.4	13.8
			(Annual change in percent, unless otherwise indicated)		
Real GDP	8.6	2.1	7.8	5.7	4.1
Of which: nonmining real GDP	4.1	5.1	6.4	5.1	4.8
Agriculture	9.9	-2.6	1.9	1.1	-0.5
Mining	17.6	-3.0	10.3	6.9	2.7
Manufacturing	-0.3	0.0	3.1	-0.5	4.0
Water and electricity	5.4	3.7	9.5	3.9	3.0
Construction	1.6	4.7	0.6	4.9	5.5
Trade and hotels	6.5	8.2	3.4	2.9	6.5
Transport	5.0	0.3	0.9	1.2	2.0
Finance and business services	5.1	7.1	2.6	5.0	6.0
General government	6.7	8.3	3.7	4.6	5.0
Nominal GDP (billions of pula)	28.6	31.9	36.7	39.9	44.3
Consumer prices (end of period) 2/	8.5	5.7	11.2	5.8	7.8

Sources: Botswana authorities; and IMF staff estimates.

1/ Historical data are based on export and import data from the national accounts, which differ significantly from balance of payments data.
2/ Calendar year.

Table 5: Botswana: Central Government Operations, 2001/02–2005/06 1/ 2/

	2001/02	2002/03	2003/04	2004/05 Original Budget	2004/05 Staff Proj.	2005/06 Original Budget	2005/06 Staff Proj.
				(In millions of pula)			
Total revenue and grants	12,601	14,240	15,348	17,876	16,961	20,179	19,856
Total revenue	12,542	14,155	15,287	17,676	16,761	19,959	19,636
Tax revenue	10,582	12,259	13,376	16,097	15,192	18,157	17,832
Mineral revenue	6,996	7,503	7,393	8,070	7,713	9,926	9,926
Customs Union receipts	1,732	1,569	2,246	3,294	3,292	3,407	3,200
General sales tax/VAT	520	1,255	1,573	2,070	2,000	2,100	2,100
Other	1,334	1,933	2,165	2,663	2,187	2,724	2,606
Nontax revenue	1,960	1,896	1,911	1,579	1,570	1,802	1,804
Interest	189	227	208	59	165	75	75
Property income	1,170	1,064	969	470	572	462	561
Of which: BoB	1,142	1,029	755	434	434	420	420
Other	601	605	733	1,051	833	1,265	1,168
Grants	59	84	61	200	200	220	220
Total expenditure and net lending	13,671	15,710	16,275	18,140	18,720	20,454	20,654
Current expenditure	9,935	11,581	12,934	14,571	14,625	15,720	15,920
Wages and salaries	3,446	3,947	4,142	4,776	4,776	5,436	5,436
Interest	94	81	193	353	353	305	305
Other	6,394	7,553	8,600	9,442	9,496	9,979	10,179
Capital expenditure	3,698	4,200	4,256	3,610	4,327	4,858	4,858
Of which: HIV/AIDS	0	0	425	415	630	650	700
Net lending	38	-71	-916	-40	-232	-124	-124
Primary balance (deficit -)	-975	-1,389	-734	422	-1,405	30	-493
Overall surplus or deficit (-)	-1,069	-1,471	-927	-264	-1,758	-275	-798
Financing 3/	-1,069	1,932	927	264	1,758	273	798
Foreign (net)	-184	-250	-113	-90	-90	-906	-906
Drawing	60	24	62	97	97	97	97
Amortization	-244	-274	-174	-187	-187	-1,003	-1,003
Domestic	1,254	2,182	1,040	354	1,848	1,179	1,704
Memorandum items							
Expenditure on: education	3,409	3,597	3,932	...	4,711	5,122	5,122
health	803	1,103	1,634	...	2,041	2,501	2,501
				(In percent of GDP)			
Total revenue and grants	40.5	40.1	39.3	43.9	39.2	42.3	41.6
Total revenue	40.3	39.9	39.1	43.4	38.8	41.8	41.1
Tax revenue	34.0	34.5	34.2	39.6	35.2	38.0	37.4
Mineral revenue	22.5	21.1	18.9	19.8	17.8	20.8	20.8
Customs Union receipts	5.6	4.4	5.7	8.1	7.6	7.1	6.7
General sales tax/VAT	1.7	3.5	4.0	5.1	4.6	4.4	4.4
Other	4.3	5.4	5.5	6.5	5.1	5.7	5.5
Nontax revenue	6.3	5.3	4.9	3.9	3.6	3.8	3.8
Interest	0.6	0.6	0.5	0.1	0.4	0.2	0.2
Property income	3.8	3.0	2.5	1.2	1.3	1.0	1.2
Other	1.9	1.7	1.9	2.6	1.9	2.6	2.4
Grants	0.2	0.2	0.2	0.5	0.5	0.5	0.5
Total expenditure and net lending	44.0	44.2	41.6	44.6	43.3	42.8	43.3
Current expenditure	31.9	32.6	33.1	35.8	33.8	32.9	33.3
Wages and salaries	11.1	11.1	10.6	11.7	11.1	11.4	11.4
Interest	0.3	0.2	0.5	0.9	0.8	0.6	0.6
Other	20.6	21.3	22.0	23.2	22.0	20.9	21.3
Capital expenditure	11.9	11.8	10.9	8.9	10.0	10.2	10.2
Net lending	0.1	-0.2	-2.3	-0.1	-0.5	-0.3	-0.3
Primary balance (deficit -)	-3.1	-3.9	-1.9	1.0	-3.3	0.1	-1.0
Overall surplus or deficit (-)	-3.4	-4.1	-2.4	-0.6	-4.1	-0.6	-1.7
Memorandum items							
Expenditure on: education	11.0	10.1	10.1	...	10.9	10.7	10.7
health	2.6	3.1	4.2	...	4.7	5.2	5.2
GDP (fiscal year; in millions of pula)	31,101	35,517	39,089	40,690	43,216	47,743	47,743

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

1/ Fiscal year begins on April 1. Classified according to the 2001 GFS methodology.
2/ Original budget estimates adjusted for supplementary expenditure and revised outlook for revenue.
3/ The figures for 2002/03 include issuance of government bonds aimed at developing the domestic capital market.

Table 6. Monetary Survey, 2001–05

	2001	2002	2003	2004				2005
				Mar.	June	Sep.	Dec.	Proj.
	(In millions of pula; end of period)							
Net foreign assets	43,075	31,247	25,238	27,669	25,896	26,881	25,519	26,655
Bank of Botswana	41,211	29,984	23,887	26,206	24,312	25,561	24,368	25,477
Assets	41,211	29,984	23,887	26,206	24,312	25,561	24,368	25,477
Liabilities								
Commercial banks	1,863	1,263	1,351	1,463	1,584	1,320	1,152	1,178
Assets	2,231	1,555	1,772	1,794	1,921	1,695	1,485	1,578
Liabilities	-368	-292	-421	-331	-337	-375	-333	-400
Net domestic assets	-33,458	-21,740	-14,261	-16,202	-13,295	-14,419	-12,788	-12,533
Net domestic credit	-22,320	-9,870	-3,460	-4,759	-2,517	-2,575	-1,264	654
Net claims on the government	-27,778	-16,491	-10,662	-12,133	-10,276	-10,809	-9,705	-8,774
Bank of Botswana	-27,719	-16,433	-10,514	-11,950	-10,061	-10,597	-9,272	-8,624
Commercial banks	-60	-58	-148	-182	-215	-213	-433	-150
Claims on nongovernment	5,459	6,621	7,202	7,373	7,759	8,234	8,441	9,428
Claims on parastatals	480	462	381	380	354	408	433	420
Claims on the private sector	4,979	6,159	6,821	6,993	7,406	7,826	8,007	9,008
Of which: households	2,948	3,561	3,910	4,014	4,445	4,806	4,948	5,495
private enterprises	1,967	2,595	2,911	2,979	2,960	3,020	3,059	3,513
Other items (net)	-11,138	-11,870	-10,801	-11,443	-10,778	-11,844	-11,524	-11,879
Of which								
Bank of Botswana certificates	5,148	7,663	8,739	8,573	9,184	9,208	9,649	11,511
Money plus quasi-money	9,617	9,508	10,977	11,467	12,601	12,462	12,731	14,122
Money	2,351	2,524	2,822	3,041	3,523	3,391	3,626	3,870
Currency	481	470	533	558	633	716	637	710
Current deposits	1,869	2,054	2,290	2,482	2,890	2,675	2,989	3,160
Quasi money	7,266	6,984	8,155	8,427	9,078	9,071	9,105	10,963
Memorandum items:								
Broad money (M3)	14,764	17,171	19,717	20,040	21,785	21,670	22,380	25,634
Of which								
Bank of Botswana certificates 1/	1,303	2,425	2,780	2,655	3,179	2,664	3,023	3,346
Broad money (M4)	16,743	18,709	21,234	21,463	23,448	23,218	24,525	27,953
Of which:								
Foreign currency accounts	1,978	1,538	1,518	1,423	1,662	1,549	2,145	2,320
	(Twelve-month percentage change)							
Net foreign assets	22.7	-27.5	-19.2	-3.9	-9.3	0.7	1.1	4.5
Net domestic assets	20.4	-35.0	-34.4	-12.6	-28.5	-10.5	-10.3	-2.0
Net domestic credit	-16.2	55.8	64.9	42.4	66.0	41.7	63.5	-151.8
Net claims on the government	-15.1	40.6	35.3	18.1	27.8	7.1	9.0	-9.6
Claims on nongovernment	10.8	21.3	8.8	12.4	13.6	14.1	17.2	11.7
Claims on parastatals	4.8	-3.7	-17.5	-10.5	-7.1	-11.1	13.7	-3.1
Claims on the private sector	11.4	23.7	10.7	14.0	14.8	15.8	17.4	12.5
Of which: households	21.3	20.8	9.8	13.1	21.3	21.7	26.6	11.0
private enterprises	2.7	31.9	12.2	15.2	6.3	7.5	5.1	14.9
Other items (net)	29.9	6.6	-9.0	11.5	-3.7	1.4	6.7	3.1
Money plus quasi money (M2)	31.2	-1.1	15.5	11.7	26.6	17.7	16.0	10.9
Broad money (M3)	33.7	16.3	14.8	11.4	17.4	6.0	13.5	14.5
Broad money (M4)	36.9	11.7	13.5	9.4	18.4	6.2	15.5	14.0
	(Annual change in percent of beginning-of-year money stock)							
Net foreign assets	108.7	-123.0	-63.2	-10.9	-26.7	1.8	2.6	8.9
Net domestic assets	-77.5	121.9	78.7	22.7	53.3	15.9	13.4	2.0
Net domestic credit	-42.5	129.5	67.4	34.1	49.2	17.4	20.0	15.1
Net claims on the government	-49.8	117.4	61.3	26.2	39.8	7.8	8.7	7.3
Claims on nongovernment	7.3	12.1	6.1	7.9	9.3	9.6	11.3	7.8
Of which: households	7.1	6.4	3.7	4.5	7.8	8.1	9.5	4.3
private enterprises	0.7	6.5	3.3	3.8	1.8	2.0	1.3	3.6
Other items (net)	-34.9	-7.6	11.2	-11.5	4.2	-1.5	-6.6	-2.8
Money plus quasi money (M2)	31.2	-1.1	15.5	11.7	26.6	17.7	16.0	10.9
Broad money (M3)	50.8	25.0	26.8	20.0	32.5	11.7	24.3	25.6
Broad money (M4)	61.6	20.4	26.6	17.9	36.6	12.7	30.0	26.9
Memorandum items:								
Growth of nominal GDP	13.0	13.3	11.6	9.9	9.9	9.9	9.9	10.7
Velocity (GDP rel. to broad money, M2)	3.6	3.6	3.5	3.7	3.3	3.4	3.3	3.3

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

1/ Bank of Botswana certificates held by nonbanks.

Table 7. Assets and Liabilities of the Bank of Botswana, 2001–05
(In millions of pula; end of period)

	2001	2002	2003	2004				2005
				Mar,	June	Sep.	Dec.	Proj.
Foreign assets 1/	41,211	29,984	23,887	26,206	24,312	25,561	24,368	25,477
Pula fund	32,176	25,524	19,246	20,632	20,215	20,885	20,013	19,357
Liquidity portfolio	8,534	3,985	4,055	4,209	3,465	4,072	3,827	5,612
Matched assets/liability portfolio	30	56	166	957	243	210	163	166
Fund accounts	472	419	421	409	390	395	365	343
Holding of SDRs	277	243	221	233	232	237	229	221
Reserve position	195	176	197	174	155	155	134	122
Loans and advances to financial institutions	0	0	0	0	0	0	0	0
Fixed assets	129	127	127	125	123	127	130	130
Other assets	0	-2	-5	-3	-4	-4	-5	-5
Unclassified assets	129	125	122	122	119	123	125	125
Assets = liabilities	41,341	30,109	24,009	26,329	24,431	25,684	24,493	25,603
Reserve money	970	1,050	1,338	1,297	1,229	1,405	1,262	1,329
Currency in circulation	701	759	818	751	847	890	911	960
Currency outside banks	481	470	533	558	633	716	637	671
Pula currency in banks	220	289	285	193	214	174	274	289
Bankers' deposits	268	291	520	546	382	515	351	370
Private sector time deposits	184	286	231	357	319	394	852	898
Bank of Botswana Certificates outstanding	5,148	7,663	8,739	8,573	9,184	9,208	9,649	11,511
Bankers	3,845	5,612	6,583	5,800	6,995	6,543	6,453	7,698
Others	1,303	2,425	2,780	2,655	3,179	2,664	3,023	3,606
Government deposits	27,719	16,433	10,514	11,950	10,061	10,597	9,272	8,624
Capital and reserves	6,630	4,075	2,730	3,807	3,302	3,735	3,026	3,100
Paid-up capital	25	25	25	25	25	25	25	25
General reserve	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600
Revaluation reserve	5,005	2,450	1,105	2,182	1,677	2,110	1,401	1,475
Other liabilities	692	602	457	345	336	347	432	140

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

1/ Effective January 1994, balances with banks and treasury bills and securities have been broken down into pula fund, liquidity portfolio, and matched assets/liabilities portfolio.

Table 8. Botswana: Balance of Payments, 2002–10 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
			Est.	Projections					
Current account balance	117.3	502.5	892.5	917.0	683.2	592.9	467.9	249.1	123.0
Trade balance	618.2	958.3	632.6	799.3	701.8	590.6	491.7	373.2	227.2
Exports, f.o.b.	2,353.2	2,975.8	3,502.2	3,844.6	3,994.8	4,169.3	4,370.5	4,585.3	4,813.8
Of which:									
Diamonds	1,978.4	2,373.5	2,702.7	2,931.4	3,090.2	3,253.6	3,419.1	3,591.8	3,775.9
Imports, f.o.b	-1,735.0	-2,017.5	-2,869.6	-3,045.2	-3,293.0	-3,578.7	-3,878.8	-4,212.1	-4,586.5
Of which:									
Food, beverages, and tobacco	-198.2	-273.3	-319.1	-380.9	-417.4	-459.2	-503.2	-551.6	-605.7
Chemical and rubber products	-129.1	-201.8	-235.6	-281.3	-308.2	-339.1	-371.6	-407.4	-447.3
Metal and metal products	-211.5	-150.7	-176.0	-210.0	-230.2	-253.2	-277.5	-304.2	-334.1
Machinery and electrical equipment	-79.1	-384.8	-449.2	-536.2	-587.6	-646.4	-708.4	-776.6	-852.8
Services	-28.9	-5.3	-18.4	30.2	54.9	55.1	22.5	-15.7	-60.2
Transportation	-167.2	-175.8	-267.1	-234.0	-233.8	-258.1	-283.2	-311.3	-343.1
Travel	135.7	228.0	263.2	287.2	325.8	366.1	375.8	385.5	395.5
Other services	2.5	-57.5	-14.5	-23.0	-37.0	-52.8	-70.1	-89.9	-112.7
Income	-700.4	-718.3	-364.1	-473.9	-611.0	-601.5	-607.1	-676.7	-618.4
Compensation of employees	-38.6	-55.3	-70.0	-80.2	-89.7	-100.6	-113.4	-127.3	-142.5
Investment income	-661.8	-662.9	-294.1	-393.8	-521.4	-500.9	-493.7	-549.4	-475.9
Current transfers	228.5	267.7	489.1	561.4	537.5	548.7	560.8	568.3	574.4
Capital and financial account	-202.2	-357.6	-724.8	-659.5	-315.9	-211.6	-191.9	-180.1	-173.4
Capital account	15.7	22.5	4.7	48.8	48.5	48.5	48.4	48.4	48.4
Financial account	-217.9	-380.2	-729.5	-708.2	-364.3	-260.1	-240.3	-228.5	-221.8
Direct investment	361.7	212.7	-238.6	49.9	49.5	49.3	49.2	49.0	48.8
Portfolio investment 2/	-414.4	-522.3	-397.7	-428.5	-177.4	-136.8	-119.4	-113.9	-108.8
Other investment 3/	-165.2	-70.5	-93.2	-329.5	-236.4	-172.6	-170.1	-163.6	-161.8
Of which:									
Net government long-term borrowing	-23.2	-23.8	-28.6	-162.9	-67.0	-6.6	-2.3	1.2	7.5
Other net private long-term borrowing	2.1	3.1	4.2	6.4	3.5	3.7	3.9	4.1	4.2
Short-term borrowing	71.4	93.2	63.0	70.8	71.6	78.1	81.7	85.1	82.9
Reserve assets (increase -)	423.7	134.9	-328.4	-257.6	-367.3	-381.3	-276.1	-69.0	50.4
Net errors and omissions	-338.8	-279.7	160.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	2.2	6.5	9.8	8.5	5.8	4.5	3.3	1.6	0.7
Trade balance (percent of GDP)	11.4	12.3	7.0	7.4	5.9	4.5	3.4	2.4	1.3
End-of-year reserves 4/	5,473.5	5,338.7	5,667.1	5,924.7	6,292.0	6,673.3	6,949.4	7,018.4	6,968.0
In months of imports of goods and services	29.1	24.0	18.5	18.2	18.0	17.6	16.9	15.8	14.4
Exchange rate									
Dollar/pula (period average)	0.1585	0.2027	0.2153	...	...	...	...	...	...
Dollar/pula (end of period)	0.1829	0.2251	0.2336	...	...	...	...	...	...

Sources: Botswana authorities; and IMF staff estimates and projections.

1/ Based on pula-denominated estimates converted at period-average exchange rate.
2/ The large outflows since 2001 reflect offshore investment activities by private fund managers following the privatization of pension scheme.
3/ The figures include net assets held by the government and the banks and net liabilities held by other sectors not included in the above financial account.
4/ Includes valuation adjustment.

Table 9. Botswana: Medium-Term Scenario, 2004–10
(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010
	Est.	Projections					
Baseline scenario							
National income and prices							
Real GDP (annual percentage change) 1/	4.1	3.7	3.6	3.6	3.4	3.3	3.3
Nominal GDP (in billions of pula) 1/	44.3	48.9	53.9	59.2	64.8	71.2	78.2
Investment and savings 3/							
Gross investment	28.1	27.2	28.9	30.4	31.4	32.3	33.6
Of which: public	10.4	10.2	10.4	10.6	10.8	10.9	10.9
Gross national savings	37.6	38.9	38.5	38.3	37.9	37.4	37.3
Of which: public	8.7	8.5	8.5	8.9	8.5	8.0	7.6
Saving-investment balance	9.5	11.7	9.6	7.9	6.5	5.1	3.8
Central government finance 2/							
Total revenue and grants	39.2	41.6	40.8	40.2	39.6	39.1	38.3
Total expenditure and net lending	43.3	43.3	43.1	43.2	43.4	43.4	43.0
Current expenditure	33.8	33.3	32.8	32.6	32.6	32.4	32.2
Capital expenditure	10.0	10.2	10.5	10.6	10.8	11.0	10.8
Net lending	-0.5	-0.3	-0.2	0.0	0.0	0.0	0.0
Overall balance (including grants)	-4.1	-1.7	-2.3	-3.1	-3.7	-4.3	-4.8
External sector							
External current account balance (deficit -) 3/	9.8	8.5	5.8	4.5	3.3	1.6	0.7
External public debt	4.5	2.6	1.8	1.6	1.4	1.3	1.2
(In percent of total exports)	9.5	5.9	4.3	3.9	3.7	3.6	3.5
Gross official reserves (in millions of U.S. dollars; end of period)	5,667	5,925	6,292	6,673	6,949	7,018	6,968
(In months of imports of goods and services)	18.5	18.2	18.0	17.6	16.9	15.8	14.4
Alternative scenario							
National income and prices							
Real GDP (annual percentage change) 1/	4.1	4.6	4.8	5.0	5.1	5.2	5.2
Nominal GDP (in billions of pula) 1/	44.3	49.4	55.1	61.5	68.6	77.0	86.5
Investment and savings 3/							
Gross investment	28.1	27.2	29.3	31.3	32.8	34.0	35.5
Of which: public	10.4	10.2	10.8	11.6	12.3	12.9	13.0
Gross national savings	37.8	39.6	39.8	40.4	40.7	40.7	40.9
Of which: public	8.7	8.8	9.8	11.8	12.6	12.8	12.9
Saving-investment balance	9.7	12.3	10.5	9.1	7.9	6.6	5.5
Central government finance 2/							
Total revenue and grants	39.2	41.3	40.8	40.4	40.2	39.8	39.4
Total expenditure and net lending	43.3	42.9	41.2	40.3	39.9	40.0	39.5
Current expenditure	33.8	33.1	30.4	28.6	27.4	27.0	26.5
Capital expenditure	10.0	10.1	11.0	11.7	12.5	13.0	13.0
Net lending	-0.5	-0.3	-0.2	0.0	0.0	0.0	0.0
Overall balance (including grants)	-4.1	-1.7	-0.4	0.1	0.2	-0.2	-0.1
External sector							
External current account balance (deficit -) 3/	9.8	9.1	6.7	5.7	4.7	3.2	2.6
External public debt	4.5	2.6	1.8	1.5	1.3	1.2	1.1
(In percent of total exports)	9.5	5.8	4.1	3.8	3.5	3.3	3.3
Gross official reserves (in millions of U.S. dollars; end of period)	5,667	5,930	6,426	6,987	7,502	7,860	8,166
(In months of imports of goods and services)	18.5	18.4	18.5	18.4	18.2	17.4	16.6

Sources: Botswana authorities; and IMF staff estimates and projections.

1/ Year beginning July 1.
2/ Year beginning April 1. Classified according to the 2001 GFS methodology.
3/ The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology.

Table 10. Botswana: Indicators of Financial and External Vulnerability, 1999–2004
(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004 Est.
Financial indicators						
Public sector debt of the central government 1/	10.1	8.8	7.8	10.6	12.0	10.2
Broad money (percent change, 12-month basis)	27.8	-3.6	33.7	16.3	23.4	13.5
Private sector credit (percent change, 12-month basis)	22.5	11.4	23.7	10.7	17.4	12.5
Bank of Botswana lending interest rate 2/	13.3	14.3	14.3	15.3	14.3	14.3
Bank of Botswana lending interest rate (real) 2/ 3/	4.9	5.8	8.5	4.0	8.5	6.5
External indicators						
Exports (percent change, 12-month basis in U.S. dollars)	27.6	-0.8	-10.8	6.1	27.3	18.6
Imports (percent change, 12-month basis in U.S. dollars)	-5.2	-3.1	-7.9	5.3	18.2	37.9
Terms of trade (percent change, 12-month basis)	1.5	-0.9	0.1	-16.8	-5.3	-2.9
Current account balance	12.3	10.4	11.5	2.2	6.5	9.8
Capital and financial account balance	-4.4	-3.1	-9.7	-3.7	-4.6	-8.0
Gross official reserves (in millions of U.S. dollars) 2/	6,229.2	6,318.6	5,897.3	5,473.5	5,338.7	5,667.1
Official reserves in months of imports of goods and services 2/	31.1	32.6	33.0	29.1	24.0	18.5
Broad money to reserves 2/	39.7	32.6	35.9	57.4	83.1	92.3
Total short term external debt to reserves (in percent) 2/	4.0	4.7	4.2	6.6	9.1	9.7
Total external debt (in millions of U.S. dollars) 2/	1,142.5	1,319.3	1,190.8	1,089.6	1,074.1	1,140.0
Of which: public sector debt (in millions of U.S. dollars) 2/	562.6	522.1	570.8	447.0	442.6	441.3
Total external debt to exports of goods and services 2/	37.8	46.2	53.3	33.2	26.7	24.5
Exchange rate (per U.S. dollar, period average)	4.6	5.1	5.8	6.3	4.9	4.6
Real effective exchange rate appreciation (+) (12-month basis)	5.9	3.8	8.8	4.7	3.1	-5.9
Financial market indicators						
Stock market index (domestic companies)	1,399.3	1,453.5	2,455.4	2,493.0	2,498.7	2,888.7

Sources: Botswana authorities; and IMF staff estimates.

1/ Year beginning July 1.
2/ End of period.
3/ Deflated by the percentage change in inflation.

Table 11. Botswana: Financial Soundness Indicators, 1999–2004
(In percent, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004 1/
Capital adequacy						
Regulatory capital to risk-weighted assets 2/	17.2	27.1	27.6	20.2	21.5	20.6
Tier 1 regulatory capital to risk-weighted assets	13.0	14.1	14.1	13.3	11.6	10.5
Capital to total assets	9.9	10.3	10.1	9.8	11.1	9.7
Asset quality						
Past due advances (NPL) to total advances 3/	3.9	1.7	4.1	3.5	3.7	2.8
Loan loss provisions to nonperforming loans	58.2	96.1	118.3	131.8	179.6	55.4
Bad debt provisions to advances	3.2	1.8	2.3	2.3	2.7	1.6
Loan concentration						
Households	47.6	49.3	54.0	53.7	53.6	58.5
Services	19.8	25.3	24.3	26.0	28.0	23.3
Government and parastatals	13.0	9.3	8.8	7.0	5.2	5.1
Mining	4.3	5.7	0.7	1.9	1.6	0.5
Manufacturing	5.2	4.1	4.8	5.0	5.3	4.2
Construction	2.0	2.0	2.4	3.2	3.0	2.7
Others	8.1	4.3	5.0	3.3	3.1	5.8
Earnings and profitability						
Return on average assets	3.8	4.7	4.6	4.3	4.2	4.0
Return on equity	45.1	45.2	46.7	43.8	44.3	36.0
Gross interest income to total gross income	79.6	79.3	78.2	77.4	74.0	71.3
Gross noninterest income to total gross income	16.2	16.5	22.0	27.0	22.1	21.9
Net spread	6.7	7.6	9.4	9.1	7.4	...
Net interest margin	6.5	6.3	6.8	7.0	6.7	...
Liquidity						
Liquid assets to total assets	27.5	21.5	23.7	19.6	20.1	22.9
Liquid assets to total short-term liabilities	28.4	23.5	22.6	22.5	22.8	25.2
Liquid assets to total deposits	37.9	33.1	29.3	25.9	26.3	28.3
Advance to deposit Ratio	60.2	68.4	57.7	71.4	67.5	70.0
Exposure to foreign currency						
Foreign currency loans to total gross loans	0.0	0.0	4.9	15.9	13.1	17.6
Foreign currency liabilities to total liabilities	13.4	13.9	18.0	13.7	11.7	11.9
Net open position in foreign exchange to capital	12.0	14.1	9.4	20.2	24.7	17.4
Exposure to households						
Household debt to GDP	8.6	9.1	9.7	10.4	10.2	9.5

Source: Bank of Botswana.

1/ Based on unaudited returns from banks
2/ Average capital adequacy ratio of banks in Botswana.
3/ Term loans that are in arrears for 30 days or more.

Botswana: Relations with the Fund
(As of March 31, 2005)

I. Membership Status Joined July 24, 1968; Article VIII

II.	**General Resources Account**	SDR(million)	% of Quota
	Quota	63.00	100.00
	Fund holdings of currency	43.09	68.40
	Reserve position in Fund	19.91	31.60
III.	**SDR Department**	SDR(million)	% of Quota
	Net cumulative allocation	4.36	100.00
	Holdings	34.70	795.98
IV.	**Outstanding purchases and loans**	None	
V.	**Financial arrangements**	None	
VI.	**Project obligations to Fund**	None	

VII. Contribution to funding of the Enhanced Structural Adjustment Facility

In July 1994, Botswana deposited with the Fund, as trustee, an amount equivalent to US$10 million for the benefit of the subsidy account of the Enhanced Structural Adjustment Facility (ESAF). In April 1997, Botswana made a five-year deposit of SDR 14.6 million in the ESAF-Heavily Indebted Poor Countries (HIPC) Trust.

VIII. Exchange rate arrangements

The exchange rate of the Botswana pula is determined on the basis of a basket of currencies. As of April 29, 2005, the exchange rate was US$1 = 4.5331, and the exchange rate of the South African rand to the pula was R 1 = P 0.7431.

IX. Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on March 24, 2004.

The Executive Board took the following decision:

1. The Fund takes this decision relating to Botswana's exchange measure subject to Article VIII, Section 3, in the light of the 1999 Article IV consultation with Botswana conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Botswana maintains a multiple currency practice arising from the Foreign Exchange Risk-Sharing Scheme (FERS) applicable to outstanding external loans obtained by certain public enterprises before October 1, 1990, which is subject to Fund approval under Article VIII, Section 3.

3. In view of Botswana's discontinuance of the FERS scheme in 1990, and of its intention to eliminate the multiple currency practice, the Fund encourages the authorities to allow the multiple currency practice to expire in 2006, when the last loan under the scheme will mature.

X. Technical assistance assignments/projects

Department	**Dates**	**Position**
MFD	1997	Central Banking Advisor
	1999-2000	Banking Supervision Advisor
STA	1997	Balance of Payments Advisor

XI. Technical assistance missions

Department	**Dates**	**Purpose**
MFD	January 2001	Banking supervision advisor
	February 2001	Monetary operations
	December 2001	MEFMI-Monetary operations
	August 2002	Banking supervision, anti-money laundering,
	July 2004	NBFI supervision
	August 2004	Money and banking statistics follow-up
FAD	November 1997	Introduction of a value-added-tax (VAT)
	September 2000	Implementation of VAT next steps
	February 2002	Tax administration (SADC Region)
	November 2004	Public expenditure management
STA	May 2001	Inspection for visit of long-term BOP Advisor
	April 2002	ROSC data module
	July 2002	BOP statistics: peripatetic visit
	August 2003	TA on monetary and financial statistics using the GDDS
	October 2004	GDDS national accounts mission

Botswana: Relations with the World Bank Group
(As of February 28, 2004)

1. Botswana became a member of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) in 1968, and is now a contributor to IDA. Cumulative commitments from IDA to Botswana include US$17 million for six development credits for infrastructural development and the livestock sector. The last credit was extended in 1974. Cumulative commitments from the IBRD to Botswana amount to US$281 million for 22 loans, of which US$54 million was canceled. The loans were extended for infrastructural development, the financial sector, land management and livestock development, as well as for education and health projects. The last loan was extended in 1987. Currently, there are no active IBRD/IDA projects in Botswana.

2. Since the late 1980s, the Government of Botswana has not required external borrowing owing to its strong financial and international reserve position based on diamond mining receipts. Therefore, the Bank's involvement in Botswana has shifted to analytical and advisory activities. Recent analytic and advisory activities include: an IDF grant for home-based care of AIDS patients, which closed on August 5, 1999; an analysis of the development impact of HIV/AIDS on the economy in 2001; sharing of HIV/AIDS related information at technical meetings of the multi-country HIV/AIDS Programs; and a review of Botswana's experience in economic management in 1999. In 2003, an ESW on economic diversification and trade was initiated with the government and a local research group, Botswana Institute of Development Policy Analysis. In mid-2004, the Government, with analytical and advisory support from the Bank, launched a study on the viability and long-term development strategy for the livestock (beef) subsector. By request of the Government, the Public-Private Infrastructure Advisory Facility launched a study on reform of the regulatory framework for public utilities in 2003/04.

3. Botswana joined the International Finance Corporation (IFC) in 1979. There has been little private sector interest in Botswana in IFC financing as excess liquidity, brought about by the inflow of foreign exchange resources from diamond exports, which has made it relatively easy for the small private sector to raise funds in the domestic market. Cumulative IFC equity and loan commitments to Botswana total US$10.72 million in five tourism, financial, and mining enterprises. In FY99 and FY00, the IFC made two loan commitments amounting to US$1.75 million to Abercombie and Kent (Botswana) for accommodation and tourism services projects in the Okavango Delta. In FY01, the IFC made a quasi-equity investment of US$3 million in the African Banking Corporation aimed at diversifying its range of financial services and increasing its geographical coverage. In FY03, the IFC approved a US$2 million equity investment in Kalahari Diamonds Limited for diamond exploration in Botswana's Kalahari desert. The most recent IFC commitment, at the end of 2004, was an equity stake of US$3.97 million in a consumer finance company, which provides short- to medium-term micro loans to employees of governmental, quasi-governmental and private sector companies in Botswana. The IFC rendered advisory services

to the Government of Botswana on privatization of enterprises, and in FY03/04, the Public Enterprises Evaluation and Privatization Agency gave the IFC the privatization mandate for Air Botswana. In 2004, the Foreign Investment Advisory Services completed a review of the commercial legal framework, administrative and registration costs, and barriers to investment in Botswana.

4. Botswana joined the Multilateral Investment Guarantee Agency (MIGA) in 1988; MIGA has neither any exposure nor any active applications in Botswana. MIGA and the Botswana Export Development and Investment Authority (BEDIA) signed a cooperation agreement in July 2003. Specifically, BEDIA is providing investment information content to MIGA for distribution to potential investors via the FDI Xchange and other MIGA online services.

Botswana: Statistical Issues

1. The core statistical data required for surveillance are reported to the Fund with an acceptable degree of regularity and promptness. In general, the quality of these data is adequate to conduct surveillance. However, the time lag in compiling the national accounts and labor market data needs to be reduced. In addition, the current arrangements—according to which the balance of payments statistics are compiled on a calendar-year basis, and the national accounts and the budget on July-June and April-March bases, respectively—continue to impede the preparation of an integrated set of economic data. The data module of the Report on the Observance of Standards and Codes (ROSC) was conducted in October 2001. Among the priority recommendations of general applicability to the statistical system were to prepare GDDS metadata on current statistical production and dissemination practices and on detailed plans for improvements for all sectors; and to strengthen data sharing and coordination among major agencies, especially with a view to reconciling major data sets with different accounting periods.[14] A factual update to the data ROSC and an update of the response by the authorities to the original data ROSC were disseminated in March and July 2004, respectively.[15]

National Accounts and Prices

2. Annual and quarterly national accounts based primarily on the concepts and definitions recommended by the *1968 System of National Accounts (SNA)* are compiled using both the production and expenditure approaches. The authorities have indicated their strong commitment to strengthening national accounts data, including moving to the *1993 SNA,* and have been receiving Fund technical assistance. However, differences in the accounting periods and in the timing of recording between the national accounts, balance of payments, and the government finance statistics impair the accuracy of the estimates compiled. Staff has encouraged the authorities to step up the efforts to harmonize the accounting periods over the medium term as has been planned. As a priority measure, the data ROSC mission recommended advancing the work program for implementing *1993 SNA* with an increased focus on conceptual adherence, with implementation initially limited to GDP estimates.

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[14] In July 2004, the authorities provided an update of their initial response to the data ROSC that set out recent actions taken to implement the staff recommendations; see: http://www.imf.org/external/pubs/ft/scr/2004/cr04229.pdf.

[15] Botswana is participating in the General Data Dissemination System (GDDS) regional project for Anglophone African countries that is funded by the Department for International Development (DFID) of the United Kingdom. The authorities have prepared an initial set of metadata that include detailed plans for improvement over the short and medium term; these were posted on the Fund’s Data Standards Bulletin Board in October 2002. These metadata were subsequently updated in October/ November 2003.

3. The consumer price index is comprehensive and provides a breakdown of the index between urban and rural areas, as well as between tradables (domestic and imported) and nontradables. However, the authorities recognize the need to rebase the index to a more recent year and have indicated their intention to update the weights based on the 2002/03 Household Income and Expenditure Survey (HIES) by the second quarter of 2005. With respect to the producer price index, the data ROSC mission recommended redesigning the producer price index to accord with international standards as regards the sample size and validation procedures. Efforts should also be made to collect more comprehensive source data and adopt best practices for data compilation.

Labor statistics

4. Annual employment and wage information are available but are rarely reported to STA for publication in the *International Financial Statistics* (*IFS*). Employment data are collected periodically thorough a variety of sources, such as the HIES, the Demographic Survey, and the Labor Force Survey covering formal and informal sectors with different levels of comprehensiveness and scope. While the authorities have made efforts toward standardization among the surveys, more frequent and coherent data provision is needed to analyze employment and unemployment trends on a regular annual basis. For example, the latest 2002/03 HIES result was published 15 months after the fieldwork was completed. Indicators of wages, particularly average monthly earnings, are also provided with a considerable time lag, significantly diminishing their value for tracking recent developments. Over the medium term, the authorities plan to increase the frequency of employment and unemployment data from the present biannual to quarterly basis.

Fiscal accounts

5. Central government finance data are produced monthly, with a lag of three to four weeks, for use in the Ministry of Finance and Development Planning (MFDP). However, the level of accuracy is less than for audited annual fiscal data, and they are reported for publication in the *IFS* with a two- to three-month lag. Comprehensive annual government finance statistics on consolidated central government are published by the authorities with a 12-month lag after the end of the reference year in MFDP's Annual Statements of Accounts. However, no annual government finance data for publication in the *GFS Yearbook* (*GFSY*) have been reported since 1996.

6. The compilation and dissemination of central government finance data are largely based on the methodology of the IMF's *Government Finance Statistics Manual* (*GFSM 1986*) and cover all central government activities, including balances of financial assets and liabilities of central government units. The classification of revenue, expenditure, and financing data are broadly consistent with the 1986 GFS methodology, with a few exceptions. Most detailed data of the accounts are sufficiently detailed for GFS purposes, but source data could be improved to allow consolidation of general government statistics. In general, the published data have been audited by the Auditor General. Accuracy and

reliability are clearly favored at the expense of timeliness. As a priority, the data ROSC mission recommended the dissemination of monthly budgetary central government statistics within one month of the end of the reference period and central government debt data within one quarter of the end of the reference period. The authorities have indicated that they intend to move to the *2001 GFSM* in the course of the 2006/07 fiscal year.

Monetary accounts

7. In compiling the monetary survey, the Bank of Botswana broadly follows the methodology recommended in the Fund's *Monetary and Financial Statistics Manual* (*MFSM*). Following two technical assistance missions in August 2003 and August 2004, commercial banks started to implement the recommendation of the ROSC mission to classify their accounts into resident and nonresident accounts according to the principle of center of economic interest rather than nationality of the account holder as had been the practice. However, the monetary survey still does not cover three deposit-taking institutions (one merchant bank, one building society, and one savings bank), which account for about five percent of system deposits.

8. Monetary data for publication in *IFS* are reported on a regular basis. The timeliness of reporting has improved since 2002. However, data for the monetary authorities are still being reported to STA with a longer lag (one additional month) than those for the deposit money banks, and the published monetary data are still to be fully aligned with *IFS.* The authorities are working on a format that would eliminate these discrepancies.

External trade and balance of payments

9. Botswana reports data annually on the balance of payments and the international investment position. With Fund assistance during 1997 to 2000, Botswana has established *Balance of Payments Manual 5* as the basis for balance of payment statistics. However, delays in supplying source data are a major concern and hamper efforts to improve the timeliness of statistics. Delays with trade data in particular continue to lead to large revisions in published balance of payments data. Balance of payments statistics are compiled in conformity with internationally accepted statistical frameworks, but estimation methods need to be updated. As a priority, the data ROSC recommended the accelerated development of quarterly balance of payments statistics. An essential feature of this effort would be to put in place timely compilation of monthly merchandise trade statistics.

10. Technical assistance in the context of the GDDS project for Anglophone Africa enabled Botswana to establish a quarterly balance of payments framework, resolve discrepancies between the balance of payments and the national accounts, improve coverage of investment flows, and resolve issues on SACU-related payments in the balance of payments. The Bank of Botswana has advised the Fund that sufficient progress has been made in preparing reliable trade data and has requested further technical assistance to introduce quarterly balance of payments estimates and extend survey-based techniques for estimating trade in services.

Botswana: Table of Common Indicators Required for Surveillance
(As of April 21, 2005)

	Date of latest observation	Date received	Frequency of data[1]	Frequency of reporting[1]	Frequency of publication[1]	Memo items:	
						Data quality – methodological soundness[2]	Data quality – accuracy and reliability[3]
Exchange rates	Mar. 2005	4/1/2005	M	M	M		
International reserve assets and reserve liabilities of the monetary authorities[4]	Nov. 2004	2/4/2005	M	M	M		
Reserve/base money	Dec. 2004	4/5/2005	M	M	M	LO, LO, LO, O	LO, LO, LO, LO, LO
Broad money	Dec. 2004	4/5/2005	M	M	M		
Central bank balance sheet	Dec. 2004	4/5/2005	M	M	M		
Consolidated balance sheet of the banking system	Feb. 2005	4/5/2005	M		M		
Interest rates[5]	Feb. 2005	4/5/2005	M	M	M		
Consumer price index	Feb. 2005	Apr. 2005	M	M	M	O, LO, LO, O	LO, LO, O, O, NA
Revenue, expenditure, balance and composition of financing[6] – general government[7]	NA	NA				LO, LO, LO, LO	LO, O, LO, O, NA
Revenue, expenditure, balance and composition of financing[6] – central government	2002/03	Sep. 2003	A/Q	Q	Q		
Stocks of central government and central government-guaranteed debt[8]	NA	NA					

Botswana: Table of Common Indicators Required for Surveillance
(As of April 21, 2005)

(continued)

	Date of latest observation	Date received	Frequency of data[1]	Frequency of reporting[1]	Frequency of publication[1]	Memo items: Data quality – methodological soundness[2]	Memo items: Data quality – accuracy and reliability[3]
External current account balance	2002	Mar. 2004	A	A	A	O, LO, LO, O	LO, LO, LO, LO, LO
Exports and imports of goods and services	Q3 2004	Jan. 2005	M/Q	M	Q		
GDP/GNP	Q1 2005	Mar. 2005	AQ	AM	AM	LO, LO, LNO, LO	LO, LO, LO, LO, LNO
Gross external debt	Mar. 2003	Mar. 2003	A/Q	A	A		

[1] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[2] Reflects the assessment provided in the data ROSC published on April 2002 and based on the findings of the mission that took place during October 11-24, 2001, for the data set corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[3] Same as footnote 2, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.
[4] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[5] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[6] Foreign, domestic bank, and domestic nonbank financing.
[7] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.
[8] Including currency and maturity composition.

Botswana: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 7/**
External debt	25.1	22.9	20.0	13.8	12.6			**10.0**	**9.4**	**9.4**	**9.5**	**9.5**	**9.6**	**-0.7**
Change in external debt	2.3	-2.2	-2.8	-6.2	-1.3			-2.6	-0.6	0.0	0.0	0.1	0.1	
Identified external debt-creating flows (4+8+9)	-12.5	-11.4	-10.1	-18.3	-13.0			-10.2	-7.4	-6.1	-4.8	-2.9	-1.9	
Current account deficit, excluding interest payments	-11.9	-12.8	-3.3	-7.3	-11.1			-9.4	-6.7	-5.5	-4.3	-2.5	-1.5	
Deficit in balance of goods and services	-12.9	-10.4	-10.8	-12.3	-6.8			-7.9	-6.7	-5.4	-4.0	-2.6	-1.1	
Exports	57.1	51.5	52.3	46.6	47.4			44.9	44.0	43.1	42.1	41.3	40.5	
Imports	44.2	41.2	41.5	34.4	40.6			37.0	37.3	37.7	38.1	38.7	39.4	
Net non-debt creating capital inflows (negative)	-1.0	-0.7	-7.6	-5.5	-1.1			-1.1	-1.0	-0.9	-0.9	-0.8	-0.8	
Automatic debt dynamics 1/	0.4	2.1	0.8	-5.5	-0.7			0.3	0.3	0.3	0.4	0.4	0.4	
Contribution from nominal interest rate	1.6	1.3	1.1	0.8	1.3			0.7	0.7	0.7	0.7	0.7	0.7	
Contribution from real GDP growth	-1.6	-1.3	-1.1	-0.9	-0.6			-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	
Contribution from price and exchange rate changes 2/	0.5	2.1	0.8	-5.3	-1.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	14.8	9.2	7.2	12.1	11.7			7.6	6.8	6.1	4.8	3.0	1.9	
External debt-to-exports ratio (in percent)	43.9	44.4	38.3	29.7	26.5			22.3	21.5	21.9	22.5	23.0	23.6	
Gross external financing need (in billions of US dollars) 4/	0.0	0.1	0.5	0.3	0.1			0.4	0.7	0.9	1.1	1.5	1.8	
in percent of GDP	0.5	1.6	8.7	3.9	1.5	10-Year Historical Average	10-Year Standard Deviation	3.7	6.0	7.2	8.9	11.1	12.4	Projected Average
Key Macroeconomic Assumptions														
Real GDP growth (in percent)	7.6	5.2	5.0	6.6	4.9	5.8	1.0	3.8	3.6	3.6	3.5	3.4	3.3	3.5
GDP deflator in US dollars (change in percent)	-2.3	-7.9	-3.2	36.4	11.3	0.9	14.0	12.0	3.0	3.6	3.5	3.3	3.2	4.8
Nominal external interest rate (in percent)	7.2	5.1	5.1	5.6	11.0	6.9	1.7	6.9	7.0	7.5	7.9	8.3	7.7	7.6
Growth of exports (US dollar terms, in percent)	-0.8	-10.8	6.1	27.3	18.6	8.9	17.3	10.3	4.5	5.0	4.7	4.7	4.8	5.7
Growth of imports (US dollar terms, in percent)	-3.1	-7.9	5.3	18.2	37.9	9.3	17.1	6.1	7.4	8.5	8.2	8.4	8.7	7.9
Current account balance, excluding interest payments	11.9	12.8	3.3	7.3	11.1	10.0	3.9	9.4	6.7	5.5	4.3	2.5	1.5	5.0
Net non-debt creating capital inflows	1.0	0.7	7.6	5.5	1.1	2.4	2.3	1.1	1.0	0.9	0.9	0.8	0.8	0.9
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 7/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								**10.0**	**4.7**	**-1.2**	**-8.5**	**-17.6**	**-27.9**	**-2.5**
A2. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 6/								**10.0**	**9.2**	**8.9**	**8.7**	**8.4**	**8.2**	**-0.9**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**10.0**	**9.8**	**10.0**	**10.0**	**10.1**	**10.1**	**-0.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**10.0**	**9.4**	**9.3**	**9.3**	**9.4**	**9.4**	**-0.7**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**10.0**	**16.1**	**28.4**	**32.9**	**35.7**	**37.4**	**-1.2**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**10.0**	**13.9**	**17.1**	**17.2**	**17.4**	**17.5**	**-0.6**
B5. Combination of B1-B4 using one standard deviation shocks								**10.0**	**12.9**	**16.9**	**16.9**	**17.1**	**17.2**	**-0.9**
B6. One time 30 percent nominal depreciation in 2005								**10.0**	**16.2**	**18.5**	**20.4**	**21.6**	**22.4**	**-0.9**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ The implied change in other key variables under this scenario is discussed in the text.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Botswana: Public Sector Debt Sustainability Framework, 1999/00-2009/10
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	1999/00	2000/01	2001/02	2002/03	2003/04			2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	
								I. Baseline Projections						**Debt-stabilizing primary balance 10/**
Public sector debt 1/	10.1	8.8	7.8	10.6	12.0			**10.2**	**6.2**	**5.0**	**3.1**	**2.8**	**2.5**	**-0.2**
o/w foreign-currency denominated	10.1	8.8	7.8	8.2	5.6			4.4	2.5	1.7	1.5	1.4	1.2	
Change in public sector debt	0.8	-1.3	-1.0	2.8	1.4			-1.9	-4.0	-1.1	-2.0	-0.3	-0.2	
Identified debt-creating flows (4+7+12)	-7.2	-9.2	4.6	1.4	-2.2			1.9	-0.4	1.8	2.7	3.5	4.1	
Primary deficit	-6.8	-9.4	3.1	3.9	1.9			3.3	1.0	2.2	3.0	3.7	4.3	
Revenue and grants	49.7	50.7	40.5	40.1	39.3			39.2	41.6	40.8	40.1	39.6	39.0	
Primary (noninterest) expenditure	42.9	41.3	43.7	44.0	41.1			42.5	42.6	43.0	43.2	43.3	43.4	
Automatic debt dynamics 2/	-0.4	0.4	1.8	-2.3	-1.9			-0.6	-0.7	-0.4	-0.4	-0.2	-0.2	
Contribution from interest rate/growth differential 3/	-0.7	-1.0	-0.7	-0.7	-0.5			-0.3	-0.3	-0.4	-0.4	-0.2	-0.2	
Of which contribution from real interest rate	-0.2	-0.4	-0.2	-0.4	0.1			0.2	0.0	-0.2	-0.2	-0.1	-0.1	
Of which contribution from real GDP growth	-0.5	-0.6	-0.4	-0.4	-0.6			-0.5	-0.3	-0.2	-0.2	-0.1	-0.1	
Contribution from exchange rate depreciation 4/	0.3	1.4	2.5	-1.6	-1.4			-0.3	-0.3	0.0	0.0	0.0	0.0	
Other identified debt-creating flows	0.0	-0.2	-0.3	-0.2	-2.2			-0.8	-0.8	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	-0.2	-0.3	-0.2	-2.2			-0.8	-0.8	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3)	7.9	7.9	-5.6	1.4	3.6			-3.7	-3.6	-2.9	-4.6	-3.8	-4.4	
Public sector debt-to-revenue ratio 1/	20.3	17.3	19.3	26.5	30.6			25.9	14.8	12.3	7.6	7.0	6.5	
Gross financing need 5/	-5.8	-8.3	4.1	4.8	2.9			4.6	2.1	2.9	3.6	4.3	4.8	
in billions of U.S. dollars	-0.3	-0.5	0.2	0.3	0.2			0.4	0.2	0.4	0.5	0.6	0.8	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	6.0	7.0	5.2	5.4	6.2	5.7	0.9	4.6	3.8	3.6	3.5	3.5	3.4	3.7
Average nominal interest rate on public debt (in percent) 6/	4.7	3.4	3.9	3.3	5.1	5.3	1.6	7.5	6.9	2.3	1.6	2.1	2.2	3.8
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-2.6	-4.1	-2.8	-5.0	1.5	-2.6	3.4	1.8	0.5	-4.1	-4.5	-3.8	-4.1	-2.4
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.7	-13.6	-23.2	27.7	23.1	-4.1	17.2	5.1	8.5	0.1	0.0	0.0	0.0	2.3
Change in implicit GDP deflator (in percent)	7.3	7.5	6.7	8.3	3.6	7.9	3.7	5.7	6.4	6.4	6.1	5.9	6.2	6.1
Growth of real primary spending (deflated by GDP deflator, in percent)	8.7	3.1	11.1	6.3	-0.7	5.7	9.4	8.1	4.1	4.5	3.9	3.8	3.5	4.7
Primary deficit	-6.8	-9.4	3.1	3.9	1.9	-2.2	5.5	3.3	1.0	2.2	3.0	3.7	4.3	2.9
								II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 7/								**10.2**	**2.7**	**-2.4**	**-8.8**	**-13.9**	**-19.2**	**1.2**
A2. Primary balance under no policy change in 2005-09								**10.2**	**6.5**	**5.4**	**3.4**	**3.1**	**2.8**	**-0.2**
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of two standard deviation 8/								**10.2**	**6.3**	**5.1**	**3.1**	**2.8**	**2.6**	**-0.2**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**10.2**	**6.5**	**5.8**	**3.8**	**3.4**	**3.2**	**-0.2**
B2. Real GDP growth is at historical average minus three standard deviations in 2005 and 2006								**10.2**	**6.6**	**6.1**	**4.7**	**4.9**	**5.2**	**-0.4**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**10.2**	**13.9**	**18.8**	**15.8**	**14.6**	**13.6**	**-0.9**
B4. Combination of 2-4 using one standard deviation shocks								**10.2**	**8.4**	**8.6**	**6.4**	**6.0**	**5.6**	**-0.4**
B5. One time 30 percent real depreciation in 2005 9/								**10.2**	**8.9**	**7.6**	**5.4**	**5.0**	**4.6**	**-0.3**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**10.2**	**16.2**	**14.3**	**11.6**	**10.8**	**10.0**	**-0.7**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ The implied change in other key variables under this scenario is discussed in the text.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
10/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

INTERNATIONAL MONETARY FUND

BOTSWANA

Staff Report for the 2005 Article IV Consultation
Supplementary Information

Prepared by the African Department
(In consultation with the Policy Development and Review Department)

Approved by Sharmini Coorey and Anthony Boote

June 17, 2005

1. **This supplement provides an update on developments since the issuance of the staff report[16] and reflects discussions with the authorities and private sector representatives during a staff visit from June 9–10**. The staff appraisal (see below) has been updated in light of these discussions and recent policy changes.

VI. Recent Economic Developments and Policies

2. **Headline inflation fell further to 6.2 percent in April (from 6.5 percent in March), just above the upper end of the Bank of Botswana's (BoB) inflation target range of 3–6 percent.** The decline in the price index was driven primarily by a fall in food prices, which moderated to 2.5 percent year-on-year from 3.0 percent in March. However, administered prices of fuel, which directly affect nearly a quarter of the consumer price index, were raised by an average of about 5 percent in early May.

3. **Fiscal data through February 2005 suggest that the budget deficit for 2004/05 (April–March) will be considerably smaller than the 4.1 percent of GDP projected earlier.** Preliminary staff estimates indicate an overall deficit on the order of about 1 percent of GDP, with both current and capital spending running well below earlier projections. The lower spending results in part from transitory factors, including a mandated 5 percent across-the-board reduction in recurrent expenditure, as well as slower-than-expected implementation of investment projects. Mineral revenue and domestic tax collections were also somewhat below earlier projections. These developments do not alter staff's view that significant fiscal adjustment will be required over the medium term to achieve broad budget balance.

4. **On May 29, the authorities announced that the pula would be devalued by 12 percent against the currency basket effective the following business day, citing the need to maintain a "stable and competitive real exchange rate."** The authorities also announced in this context that the exchange rate of the pula would be adjusted continuously

[16] May 13, 2005.

rather than in discrete steps against the basket in a "crawling peg" type of arrangement. The rate of crawl will be forward looking and aligned with the differential between expected inflation in Botswana and that in major trading partner countries. Finally, the spread between the buy and sell rates of the pula was widened from 0.125 percent to 0.5 percent in order to encourage further development of the interbank market for foreign exchange.

VII. Devaluation and Exchange Rate Regime Change

A. Impact on Near-Term Economic Prospects

5. **The economic effects of the recent devaluation and change in exchange rate regime are likely to be mixed** (Table 1). Staff estimates a direct inflation pass through from the devaluation of 4–6 percentage points over the next 12 months, with further knock on effects on the order of 1–2 percentage points from the exchange rate crawl, which could push inflation up to the 10 percent level over the next 12 months. The impact on growth and exports is expected to be modest, given that trends in key sectors (e.g., diamonds, beef, textiles, and tourism) have largely been driven by structural factors in recent years. The production of import substitutes, such as poultry and bricks, could rise more significantly in the near-term as import prices rise. The medium-term macroeconomic outlook would remain essentially as described in the staff report, provided the authorities tighten monetary and fiscal policy and follow through on their strategy to raise productivity through structural reform.

6. **The authorities have not yet fully assessed the impact on the 2005/06 budget, but staff's preliminary assessment suggests a broadly neutral effect relative to the projection in the staff report**. The impact on revenues is expected to be positive, given their large foreign currency component. However, pressures on spending could also potentially be significant, given that a number of high-priority expenditure items (e.g., antiretroviral drugs) are imported. Further, government-financed development projects also tend to have a high import component, which could push capital spending above budgeted levels if project implementation proceeds as planned.

7. **The recent devaluation caught the business community, wage earners, and foreign investors by surprise**. In discussions, private sector representatives indicated that they were unclear about the reasons for the devaluation and how the crawling peg regime would be implemented, as well as its implications for inflation.

B. Policy Discussions

8. **Staff inquired into the rationale for the devaluation, given that recent developments—in particular, declining inflation and the continued strength of the external position—did not appear to warrant such a move.** The authorities explained that a devaluation had been under consideration for quite some time, and was aimed at reversing the erosion in Botswana's international competitiveness over the last several years, which would in turn enhance the country's growth prospects and facilitate more rapid progress on poverty reduction and employment generation. In making this move, they were mindful of

Botswana's still very favorable balance of payments prospects and the benign inflation outlook for 2005, but were more concerned to lay a solid foundation for strong growth over the medium to long term against the backdrop of slowing economic activity.

9. **With regard to the exchange rate regime change, the authorities acknowledged that the fixed peg had provided a credible nominal anchor and achieved a measure of success, but noted that it had not adequately stabilized the real effective exchange rate.** They explained that sizeable periodic adjustments in the exchange rate level had therefore been necessary over the years, which had tended to be disruptive to economic activity. The crawling peg, by contrast, would involve continuous and more predictable adjustments in the exchange rate level, and would therefore facilitate a more stable economic environment for growth and investment. The authorities explained that the devaluation was not an intrinsic element of the regime change, but nevertheless would put it on a solid foundation by eliminating the cumulative overvaluation of the pula.[17]

10. **Staff cautioned the authorities against using monetary and exchange rate policy to pursue multiple objectives and stressed the need to define a nominal anchor for prices.** In particular, the rate of crawl itself could translate quickly to inflation given Botswana's highly open economy (see paragraph 8 of the staff report) and in the absence of a clearly defined nominal anchor. In this context, staff strongly encouraged the authorities to pre-announce the rate of crawl in order to guide monetary policy and anchor inflation expectations. In addition, staff noted that the rate of crawl would need to be low enough to be consistent with maintaining low inflation. The authorities replied that the BoB's current inflation target range could possibly play a role in anchoring expectations, but indicated that the matter was still under review and that they remained open to staff's advice in this regard.

11. **Staff noted that Botswana's strong real exchange rate to a large extent reflected a strong diamond sector (see Box 1 of the staff report)—possibly compounded in recent years by fiscal deficits**. Concerns about the competitiveness of the small non-diamond private sector and the need to sustain high growth were better addressed through structural reform to diversify the economic base, develop the private sector, improve labor force skills, and attract foreign direct investment (see paragraphs 39–43 of the staff report).

12. **Staff also emphasized the need for tighter macroeconomic policies in order to contain inflation as well as to lend credibility to the new exchange rate regime**. In

[17] The authorities' estimate of the extent of overvaluation was based on the appreciation of the real exchange rate relative to its average level during 1991–2000, which was considered to be a period when the exchange market was in broad equilibrium. They indicated that a similar exercise based on measurements of shifts in purchasing power parity had yielded comparable estimates. However, it should be noted that the appreciation of the real exchange rate could reflect the strong diamond sector and the emergence of fiscal deficits in recent years.

particular, interest rates would need to be raised and fiscal policy tightened to achieve balance in 2005/06.[18] A coordinated set of monetary, fiscal, and structural policies would be required in this context, including steps to reassure the private business community that the BoB has sufficient operational independence to pursue low inflation. The authorities replied that their policy responses were still being formulated, but reassured staff that they remained committed to timely policy action to minimize the second round effects on inflation. The BoB expected to set out the implications for the conduct of monetary policy in the context of its mid-year policy statement, which might be advanced from its usual late July time frame, while the Ministry of Finance and Development Planning indicated that it remained committed to achieving a balanced budget in the current fiscal year.

13. **The authorities indicated that the adoption of the crawling peg as well as the widening of the trading band around the pula was a first step toward greater exchange rate flexibility**. The BoB has identified additional changes in practices and regulations that would help to foster further development of the interbank foreign exchange market and is discussing their implementation with commercial banks. As discussed with staff during the Article IV mission in February-March, the authorities will continue to explore their options with regard to the monetary policy framework in the period ahead, including whether the necessary pre-conditions can be put in place for an eventual move to formal inflation targeting at some point in the future.

VIII. Staff Appraisal

14. **With Botswana's inflation rate still above the authorities' target range and in light of the April interest rate cut, there is a need for decisive policy action to contain inflationary pressures from the recent devaluation**. In particular, monetary policy should be tightened promptly, including through higher interest rates, to minimize the second round effects on inflation. The authorities should also redouble efforts to achieve fiscal balance in 2005/06, in particular through cuts in nonessential expenditure, in order to minimize any upward pressures on aggregate demand and the real exchange rate. Staff supports the need to sustain growth and underscores its earlier view that, over the medium to long term, competitiveness concerns outside the diamond sector will have to be addressed through deeper structural reform in order to raise productivity.

15. **The authorities also need to move quickly to put in place a supportive policy and operational framework to establish a clear nominal anchor and to lend credibility to the new more flexible exchange rate regime**. Indeed, the early establishment of such a framework will enhance transparency and smooth the transition toward greater exchange rate

[18] Such a tightening is consistent with the staff report's support for a broadly-balanced medium-term fiscal position. With regard to the medium-term fiscal outlook, while broad balance will be achieved a year earlier than indicated in the alternative scenario set out in Box 2 of the staff report, the need for significant adjustment remains owing to the erosion of mineral revenue and to accommodate higher HIV/AIDs expenditure (see Table 2).

flexibility. Staff strongly encourage the authorities to pre-announce the rate of crawl—set at a pace consistent with maintaining low inflation—in order to provide the new regime with a credible nominal anchor. It will also be important to ensure that fiscal and monetary policies are closely coordinated and kept consistent with the rate of crawl in order to sustain low inflation.

Table 1. Botswana: Revised Macroeconomic Projections, 2004-2005

	2004	2005	
	Est.	Staff Report	Revised
	(Annual percentage change, unless otherwise indicated)		
National income and prices			
Real GDP 1/	4.1	3.7	3.6
Consumer prices (end of year)	7.8	6.5	8.1
Nominal GDP (in billions of pula) 1/	44.3	48.9	51.2
Money and banking			
Net foreign assets	1.1	4.5	6.4
Money and quasi money (M2)	16.0	10.9	13.7
	(In percent of GDP)		
Investment and savings 2/			
Gross investment	27.9	27.2	27.5
Of which: public	10.1	10.2	10.4
Gross national savings	37.7	38.9	40.3
Of which: public	9.4	8.5	9.1
Saving-investment balance	9.8	11.7	12.8
Central government finance 3/			
Total revenue and grants	39.2	41.6	43.0
Total expenditure and net lending	40.4	43.3	44.3
Current expenditure	31.9	33.3	33.2
Capital expenditure	9.0	10.2	11.3
Net lending	-0.5	-0.3	-0.3
Overall balance (including grants)	-1.1	-1.7	-1.2
	(In percent of GDP, unless otherwise indicated)		
External sector			
External current account balance (deficit -) 2/	9.5	8.5	9.3
External public debt	4.5	2.6	2.6
(In percent of total exports)	9.5	5.9	5.9
Gross official reserves (in millions of U.S. dollars; end of period)	5,667	5,925	5,987
(In months of imports of goods and services)	18.5	18.2	18.6

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

1/ Year beginning July 1.
2/ The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology.
3/ Year beginning April 1.

Table 2. Botswana: Medium-Term Fiscal Operations, 2004/05-2009/10

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	(In percent of GDP, unless othewise indicated)					
Baseline scenario						
Total revenue and grants	39.2	43.0	40.6	39.7	39.3	38.9
Of which: mineral revenue	17.8	22.1	21.3	20.5	20.0	19.3
domestic revenue	9.7	9.3	10.0	10.3	10.5	10.7
Total expenditure and net lending	40.4	44.3	42.5	42.3	42.8	43.1
Of which: HIV/AIDS	1.4	1.4	1.6	1.7	2.2	2.5
Overall surplus or deficit (-)	-1.1	-1.2	-1.9	-2.7	-3.5	-4.2
Domestic Financing	1.3	3.0	2.1	2.7	3.5	4.2
Government deposits at BoB	21.5	16.1	12.0	7.9	3.6	0.0
Alternative scenario						
Total revenue and grants	39.2	42.2	40.9	40.5	40.9	40.3
Of which: mineral revenue	17.8	21.7	20.7	19.8	19.1	18.4
domestic revenue	9.7	9.2	11.0	11.9	12.9	13.5
Total expenditure and net lending	40.4	42.3	41.1	40.4	40.7	40.4
Of which: HIV/AIDS	1.4	1.4	1.4	1.7	2.0	2.3
Overall surplus or deficit (-)	-1.1	-0.1	-0.1	0.1	0.2	-0.1
Domestic financing	1.3	1.9	0.3	-0.1	-0.2	0.1
Government deposits at BoB	21.5	16.1	13.8	12.6	11.6	10.2

Source: IMF staff estimates and projections.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN)
February 22, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2005 Article IV Consultation with Botswana

On June 22, 2005 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Botswana.[19] The Botswana authorities' view is published in a bundle together with this notice.

Background

Botswana has been among the world's best performing economies over the past three decades. Real GDP growth averaged over 8 percent per year, facilitating Botswana's evolution from one of the poorest countries in the world to middle income status and the highest sovereign credit rating in Africa. This success can be attributed to sound economic policies, particularly in the management of its vast diamond resources, as well as a stable political environment and strong commitment to good governance. However, the leveling off of diamond production and the spread of HIV/AIDS—which has resulted in the erosion of key social indicators, such as life expectancy and mortality rates—threaten to undermine past achievements. The diamond sector—which presently contributes about one third of GDP and 75 percent of exports—continues to dominate macroeconomic activity. At the same time, the prevalence of HIV/AIDS has risen over the past decade, intensifying pressures on expenditures at a time when budgetary resources are becoming more constrained.

[19] 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. 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. This PIN summarizes the views of the Executive Board as expressed during the June 22 Executive Board discussion based on the staff report.

Economic activity has slowed over the past year. Real GDP growth decelerated to 5.7 percent in 2003/04 (July–June), from 7.8 percent in 2002/03, and is expected to slow further to 4–5 percent in 2004/05 as the productivity improvements from enhancements in the diamond-sorting process continue to level off. Growth in key nonmining sectors—including manufacturing, trade, and tourism—has also slowed over the past year, reflecting a slowdown in public investment and the effects of the weak U.S. dollar. Inflationary pressures picked up in late 2004, reflecting the impact of higher world oil prices, increased public utility charges, and the pass through from the 7.5 percent devaluation of the pula in February 2004. Inflation has declined in recent months, falling to 6.2 percent in April, from a peak of 8.0 percent in January.

The budget deficit is estimated by staff to have narrowed from about 2½ percent of GDP in 2003/04 (April–March) to about 1 percent in 2004/05. In 2003/04, revenue shortfalls—reflecting problems in VAT administration—were partly offset by scaling back capital expenditure, but not sufficiently to achieve the budget target of a small deficit. The improved outturn in 2004/05 stems primarily from lower-than-projected current and capital spending. The lower spending results in part from transitory factors, including a mandated 5 percent across-the-board reduction in recurrent expenditure, as well as slower-than-expected implementation of investment projects. The expenditure savings were partially offset by lower mineral revenues resulting from the weak U.S. dollar and shortfalls in domestic tax collections.

The Bank of Botswana lowered its inflation target to 3–6 percent in February 2005 in anticipation of an improved inflation outlook. The Bank rate was maintained at 14.25 percent from late 2003 until late April 2005, when it was lowered to 14 percent. Private sector credit growth has remained broadly within the BoB's target range—which was lowered to 10-13 percent in February 2005, from 12–15 percent—over the past year, despite rapid growth in credit to households. The BoB also continued to mop up excess liquidity from the ongoing privatization of the public pension system through issuance of Bank of Botswana Certificates.

External performance has remained very strong. The current account surplus widened to about 9½ percent of GDP in 2004, up from 6½ percent of GDP in 2003, underpinned by continued growth in diamond exports in U.S. dollar terms (partly reflecting higher world prices) and tourism revenues as well as a large increase in Southern African Customs Union receipts and increased regional trade. Foreign reserves were US$5.7 billion at end-2004 (about 18½ months of imports).

On May 29, the government of Botswana announced that the pula would be devalued by 12 percent against the currency basket effective the following business day, citing the need to maintain a "stable and competitive real exchange rate" and to "achieve sustained and diversified growth." The authorities at the same time announced that the exchange rate of the pula would be adjusted continuously rather than in discrete steps against the basket in a "crawling peg" type of arrangement. The rate of crawl will be forward looking and aligned with the differential between the inflation objective in Botswana and expected inflation in trading partner countries. The spread between the buy and sell rates of the pula was also widened from 0.125 percent to 0.5 percent in order to encourage further development of the interbank market for foreign exchange.

Executive Board Assessment

Directors commended the Botswana authorities for their sound economic policies, continued prudent management of Botswana's vast diamond resources, and commitment to good governance, which have underpinned the country's remarkable growth performance over the past three decades. They also welcomed the authorities' recent efforts to increase resource commitments in the fight against HIV/AIDS. At the same time, however, diamond production is leveling off, while the spread of HIV/AIDS has steadily eroded social indicators and intensified expenditure pressures at a time when budgetary resources are becoming more constrained.

Against this background, Directors underscored the importance of strengthened efforts to diversify the economic base and to build on Botswana's sound macroeconomic fundamentals and positive economic prospects to achieve broad-based social improvements and poverty reduction. They therefore welcomed the ongoing assessment of Botswana's economic policies and reform agenda in the context of the mid-term review of the National Development Plan (NDP 9). In particular, Directors called for structural reforms aimed at developing the domestic private sector and attracting foreign direct investment, coupled with broad-based efforts to prevent and combat HIV/AIDS. They noted that fiscal policy would also have to be adapted as revenues decline and spending pressures increase.

Directors commended the authorities' continued commitment to a prudent fiscal policy aimed at achieving balanced budgets over the medium term. While the net asset position of the government is set to remain comfortable, they agreed that a move toward overall balance would be desirable in anticipation that small deficits may be inevitable over the longer term, given the uncertain impact of HIV/AIDS on future generations.

Directors stressed that significant additional fiscal adjustment will be needed to maintain budget balance over the medium term. They urged the authorities to set out clearer road maps for expenditure reprioritization and public sector reform, including a reduction in the public sector wage bill. Efforts will also need to be accelerated to strengthen budget systems and improve capacity to track expenditure in priority areas, particularly on HIV/AIDS. In this regard, Directors welcomed steps to integrate a comprehensive strategy for HIV/AIDS into the medium-term budgetary framework. On the revenue side, Directors stressed the need to strengthen tax administration, improve tax compliance, and broaden the tax base. The institutional structure of the Botswana Unified Revenue Service should be further developed, and stronger legal sanctions should be taken against tax evaders. Consideration should also be given to the establishment of a large taxpayers unit and an increase in the value-added tax rate.

Directors noted that the recent devaluation of the pula and move to a "crawling peg" arrangement would need to be accompanied by appropriate supportive measures to minimize the near-term costs and enhance the longer-term benefits for sustained economic growth and poverty reduction. With Botswana's inflation rate still above the authorities' target range and in light of the interest rate cut in April, they urged decisive policy action to contain inflationary pressures from the devaluation. In particular, monetary policy should be tightened expeditiously, including through higher interest rates, and efforts should be stepped up to achieve fiscal balance in 2005/06, through cuts in nonessential expenditure, in order to minimize any upward pressures on aggregate demand and the real exchange rate.

Directors also urged the authorities to move quickly to put in place a supportive policy and operational framework that would establish a clear nominal anchor and lend credibility to the new exchange rate regime. They encouraged the authorities to pre-announce the rate of crawl—set at a pace consistent with maintaining low inflation—and to ensure that fiscal and monetary policies are closely coordinated and kept consistent with the rate of crawl. Going forward, a move toward greater exchange rate flexibility will require the development of tools and institutions for effective monetary policy management.

Directors agreed that Botswana's banking sector is generally sound and prudential supervision broadly adequate. They welcomed the initial progress made under the Financial Sector Reform and Strengthening Initiative, and commended the authorities for their vigilance in overseeing the activities of the offshore financial center. Directors noted, however, that the high exposure of the banking sector to households warrants close monitoring. They urged the authorities to expedite action on establishing a financial supervisory agency for nonbank financial institutions, given their rapid growth in recent years. They also looked forward to continued efforts to bring the AML/CFT regime more in line with international standards. Directors encouraged the authorities to participate in the Financial Sector Assessment Program at an early opportunity.

Directors highlighted the importance of faster and deeper structural reforms to promote an enabling environment for private business activity and facilitate economic diversification, by increasing productivity and addressing competitiveness concerns in the nondiamond sector. Directors welcomed efforts to remove labor market rigidities and encouraged the authorities to deepen labor market reforms to enhance flexibility and skills. Comprehensive reform of the legal and regulatory framework will also be crucial to the successful development of public/private partnerships and implementation of the Privatization Master Plan.

Directors commended the authorities' continued commitment to trade liberalization, and the progress made in negotiating free trade agreements and lowering tariffs, while calling for faster progress with the removal of nontariff barriers. They also welcomed the authorities' intention to eliminate the multiple currency practice arising from the Foreign Exchange Risk-Sharing Scheme in 2006.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Botswana: Selected Economic and Financial Indicators, 2000–2004

	2000	2001	2002	2003	2004 Est.
Output and Prices (change in percent)					
Real GDP 1/	8.6	2.1	7.8	5.7	4.1
Of which: private nonmining GDP	4.1	5.1	6.4	5.1	4.8
Consumer prices (period average) 2/	8.5	6.6	8.0	9.3	6.9
Investment and savings (percent of GDP) 2/					
Gross investment	20.0	23.0	27.8	29.6	27.9
Public	11.8	11.9	11.6	11.0	10.1
Private	8.2	11.2	16.2	18.6	17.9
Gross national savings	38.3	36.4	32.6	33.8	37.7
Public	6.4	8.2	8.2	7.5	9.4
Private	31.9	28.2	24.4	26.3	28.3
Central government finance (percent of GDP) 3/					
Total revenue and grants	50.7	40.5	40.1	39.3	39.2
Total expenditure and net lending	41.6	44.0	44.2	41.6	40.4
Overall balance (excluding grants)	8.8	-3.6	-4.4	-2.5	-1.6
Overall balance (including grants)	9.1	-3.4	-4.1	-2.4	-1.1
Primary balance	9.4	-3.1	-3.9	-1.9	-0.3
Total public debt	9.1	8.0	8.5	5.7	4.5
Money and credit 2/					
Money and quasi money (end year; percentage change)	1.4	31.2	-1.1	15.5	16.0
Bank of Botswana lending rate (end year; in percent)	14.3	14.3	15.3	14.3	14.3
External sector (millions of U.S. dollar) 2/					
Trade balance	904.5	713.5	618.2	958.3	632.6
Current account balance	546.7	600.4	117.3	502.5	857.9
Gross official reserves	6,318.6	5,897.3	5,473.5	5,338.7	5,667.1
Botswana pula per U.S. dollar (period average)	5.1	5.9	6.3	4.9	4.6
Real effective exchange rate (depreciation -)	3.8	8.8	4.7	3.1	-5.9

Sources: Data provided by the Botswana authorities; and IMF estimates.

1/ National accounts year beginning July 1; figures for 2004 are estimates.
2/ Calendar year.
3/ Fiscal year beginning April 1.

Statement by the Botswana Authorities

Right of reply document

The published report of the discussion of the IMF Executive Board contained in the Public Information Notice (PIN) is a short summary of the many issues raised by Board members and does not cover all aspects of the discussion. However, while much of the assessment is positive and supportive, in this instance it is the view of the Botswana authorities that the Notice does not truly reflect the economic situation in the country in important respects. For this reason, the authorities have taken the decision to issue a separate statement.

In doing so, the authorities stress the high value that is placed on the annual Article IV consultations and, more generally, the various areas of successful cooperation between Botswana and the Fund. As part of the Article IV process, it is fully recognised that the Executive Board should make an objective and independent assessment including policy advice, and that this cannot be expected always to coincide with the views of the national authorities.

It is also recognised that the Botswana economy currently faces difficult challenges, the extent of which should not be downplayed, and which must be met if the process of development is to continue successfully. Growth has slowed and remains overly dependent on the mining sector; and there are concerns that unemployment is an increasingly serious problem. Moreover, there are substantial costs that are required to effectively tackle the HIV/AIDS pandemic and this is placing a severe strain on the resources available to the public sector at a time when slower revenue growth is anticipated.

However, the assessment of the Board, as recorded in the PIN, goes too far in painting a picture of economic malaise and this is reflected in the accompanying policy recommendations which call for major adjustments at the macroeconomic level. In particular, suggestions that the government should consider raising the rate of VAT and reducing the public sector wage bill would be appropriate for a situation of severe fiscal imbalance. However, while the period where the government budget in Botswana was consistently in surplus may have passed, so far there is no need for the significant fiscal adjustment called for in the Board assessment. Recently, there have been some technical difficulties experienced in the timely collection of fiscal data. It is clear, nevertheless, that the final budget for 2004/05 was in approximate balance. The Government has made a strong commitment to maintain a balanced budget over the course of the economic cycle, and institutional measures to support this are being put in place.

Policy formulation in Botswana has consistently been based on careful consideration of the relevant issues and consultation, and this approach will continue, as indicated by the presentation of the Mid-Term Review of National Development Plan 9 to Parliament, in November 2005. In line with this approach, the decision taken in May 2005 to devalue the Pula was a measured reaction to a situation where all the evidence pointed to a serious overvaluation of the Pula. The consequences for both fiscal and monetary policy had already been considered carefully, in particular the need to ensure that inevitable upward pressures on costs were constrained from developing into broader inflationary pressures. The authorities' subsequent actions have been consistent with this, with the necessary adjustments to monetary policy being made in the context of the scheduled mid-year review of the annual monetary policy statement. In contrast, the Board's assessment that there is a need for 'decisive policy action' was more relevant to an unforeseen economic shock where the appropriate policy response has to be developed quickly. Moreover, since the devaluation was undertaken in order to help improve national competitiveness in support of economic diversification, rather than to correct external imbalance, the call for additional fiscal restraint to curb domestic demand does not seem appropriate, especially given the direct impact of the devaluation on purchasing power.

The Board's assessment is correct to focus on areas where further structural reform could improve the functioning of the economy and encourage private sector development. However, the call for comprehensive reform of the legal and regulatory framework as a necessary precursor to privatisation is too sweeping. This is especially so in the context of the more detailed Staff Report, which explicitly noted progress on necessary legal reforms. Such a judgment could cast doubt on the Government's capacity to implement a privatisation programme, especially as the Botswana Privatisation Masterplan, which was published in August 2005, includes an extensive list of public enterprises which are explicitly identified as being ready for privatisation without further work in these areas.

The authorities look forward to continued good relations with the Fund, including the discussions during the next Article IV consultation that will take place in 2006.

Statement by Peter Gakunu, Alternate Executive Director for Botswana and Bhadala T. Mamba, Advisor to Executive Director June 1, 2005

Introduction and Background

1. The Botswana authorities would like to thank the Fund management and staff for the valuable advice provided over the years, the open dialogue and the frank exchange of views during the 2005 Article IV consultation discussions. The government, though not a user of Fund resources, has benefited immensely from the Fund technical assistance, which has helped it hone the policies that have been essential for the achievements made in continued macroeconomic stabilization of the economy and consistently charting a positive growth path.

2. Botswana has been among the top economic performers in the world during the last three decades. This occurred despite initial adverse conditions, including minimal investment during the colonial period. Over the years, Botswana has been able to balance provision of social services with good economic management as evidenced by the high sovereign credit ratings awarded by both Moody's and Standard and Poor' rating agencies in the A grade for a third year in a row. Botswana's ratings, which are the highest in Africa, are indicative of the firm commitment of Government to prudent fiscal and monetary policy, as well as continuing political and macroeconomic stability.

3. Notwithstanding this accomplishment, the authorities are aware that the country faces difficult developmental challenges, including further diversification of the economic base, the pressing challenge of the HIV/AIDS pandemic, further reduction of the prevalence of poverty by maintaining high economic growth rates so as to meet the Millennium Development Goals (MDGs) and the country's vision 2016 objectives. The authorities have already made good progress in responding to these challenges, and their strategy going forward is sound. The ruling party was re-elected and formed a new government in the latter part of 2004 and has re-committed itself to continue pursuing sound macroeconomic policies, ensure stability and build on the achievements already made.

Recent Economic Developments and Prospects

4. The economy has continued to register positive growth rates in 2003/04 albeit at a lower pace than the previous years and growth is expected to decelerate further in 2004/05. Economic performance is expected to fall slightly in 2004 to 4 percent compared to 5.7 percent the year before, largely due to a general decline in the performance of the mining and the non-mining sectors. The fiscal position is expected to improve with the budget deficit set at 0.5 percent of GDP in fiscal year 2005/06. The fiscal performance will be supported by an expected improvement in mineral receipts and improvement in tax administration.

5. Employment has been growing and about 11 000 formal sector jobs were added to the labor market in 2004, which is double the additional formal sector jobs added in the previous

year. This positive development notwithstanding, unemployment estimated at 23.8 percent, remains a major challenge that the authorities are addressing actively. They believe that sustained economic growth and development can only be achieved through a greater degree of self reliance by the private sector and through the reduction of the role of the state in economic activity.

6. It is in this vein that the Botswana Development Corporation (BDC) has promoted a number of new projects in several sectors including concrete crushing, electrical cable manufacturing, plastic recycling amongst others and has a number of projects being finalized. Every effort is being made to diversify the economy and accelerate the structural reforms necessary to support this initiative. Consequently, economic growth is forecast to be between 5-6 percent in the medium term as projected in the ninth National Development Plan (NDP 9). They are committed to regional economic integration efforts particularly on the trade front and further developing the country as a regional financial hub.

Fiscal Policy

7. The Botswana authorities will continue to pursue prudent fiscal management based on the overarching principle of fiscal sustainability. The authorities' fiscal strategy is premised on achieving a balanced budget while they are also willing to run minimum and manageable budget deficits under given unique circumstances in future. The authorities, however, recognize the challenges they face arising from dwindling revenues as a result of the gradual slowdown of the diamond sector, projected further declines in SACU receipts and increased expenditure on HIV/AIDS. The fiscal position is expected to improve with the budget deficit estimated to be 0.5 percent of GDP in the 2005/2006 fiscal year. The fiscal performance will be supported by an expected improvement in mineral receipts and improvement in tax administration.

8. A new budget has been introduced that captures all expenditures and ensures that they are brought in line with the NDP 9 objectives. The authorities are in the process of rollingout the Budget Accounting and Budgeting System. This is part of a broader effort to improve public sector productivity, including the introduction of Performance Management System (PMS) and computerization of government activities. The authorities recently established a Unified Revenue Service (BURS), which will assist in improving revenue administration capacity.

Monetary, Exchange Rate and Financial Sector Issues

9. While the country's monetary stance is anchored on the exchange rate peg, the authorities are exploring ways to further strengthen the monetary policy framework including a possible move to inflation targeting, which would aim at arresting inflationary pressures, maintain competitiveness and rein in macro economic stability. In this regard, the authorities have initiated efforts to improve the understanding of the monetary policy transmission mechanisms while developing management systems in the short-term inflation forecasting capacity. The effects of the devaluation were temporary and did not cause any significant disruption to the economy. The inflation rate has been declining since November 2004, with

the six month annualized average inflation hovering around 5 percent. The authorities achieved their inflation rate target of 4-7 percent, hence feel that their decision to lower the bank rate recently from 14.25 to 14 percent was appropriate.

10. The authorities are working tirelessly to improve the financial sector and deal with the sizeable deficit on the capital and financial account. Efforts to develop the domestic bond market are still on-going though the economy is still experiencing excess liquidity arising from the privatization of the public pension system. Moreover, the Bank of Botswana is using monetary policy tools to deal with the excess liquidity by issuing central bank certificates. In line with its objective of building a prosperous and innovative nation, the government has established the International Financial Services Centre (IFSC) aimed at attracting sustainable investments into the country. To improve the quality of supervision and reduce vulnerability in the finance sector, the authorities intend to establish a Financial Supervisory authority for non-banks. In this respect, they have recently completed a Financial Sector Reform and Strengthening Initiative and the recommendations are currently under consideration by the Ministry of Finance and Development Planning. The country has completed its draft AMLC/CFT strategy aimed at bringing the framework in line with international standards, and is considering the merits of applying for an FSAP to further strengthen the financial system.

Structural Issues

11. The Botswana authorities remain committed to structural reforms in order to achieve the transformation of the economy and set a sustainable growth path. In this respect, the National Employment, Manpower and Incomes Council, an umbrella body with the responsibility to oversee the structural reform process as enshrined in the NDP 9, has been reconstituted with a broader reform agenda. The authorities have announced a Privatization Master Plan and other initiatives aimed at improving performance of the public enterprises. They believe that the privatization process should be orderly and that it should benefit all citizens through garnering political consensus on the pace of the divesture process.

12. To also improve tax administration and revenue collection, the authorities have embarked on an extensive follow-up on tax evaders and are improving the legal framework to ensure that more people are brought into the formal tax net and comply with the laws of the land. In this regard the authorities intend to improve the audit and enforcement procedures.

13. Special focus and support has also been given to small scale enterprises through the Citizens Entrepreneurial Development Agency (CEDA). During 2004, the government undertook a study to review Revised National Policy on Incomes, Employment, Prices and Profits of 1990. The government is currently considering the recommendations of the study before they are presented to Parliament.

14. The government is committed to creating an enabling environment necessary to attract Foreign Direct Investments (FDI) into the country. The authorities are forging links with other regional partners on trade and investment, and have adopted a Foreign Direct

Investment Strategy, a new Competition Policy and are revising the legal operating environment supportive of this initiative. Several other pieces of legislation aimed at improving the country's image as an attractive investment destination are currently being introduced, reviewed or modernized. The authorities are also in the process of implementing the recommendations of the FIAS study on administrative barriers to investment.

Health and HIV/AIDS

15. The country launched its Millennium Development Goals Status Report in September 2004, which indicated that a lot needed to be done to improve the country's health situation, most notably with regards to HIV/AIDS and malaria. The authorities have committed themselves to providing a comprehensive and accessible health care and services to its populace throughout the country. The authorities are also committed to achieve the target of reducing mother to child HIV infection by 2015. In this respect, they have devised a comprehensive strategy to deal with the pandemic, which includes catering for orphans, sourcing and distribution of drugs, provision of food for affected vulnerable groups, clothing and school uniforms and other related necessities. Thanks to the authorities determined efforts and assistance of the international community, there are currently encouraging signs that the incidence rate of HIV/AIDS may have already begun to level off as the latest official statistics show that the incidence of the disease among those 18 months of age and older is 17.3 percent, while the incidence for the population aged 15 to 49 years is 25.3 percent. The country, while focusing on fighting the HIV/AIDS pandemic, has had to deal with a rising mortality rate. The authorities have embarked on a country-wide endeavor to provide health services and are introducing a number of infrastructural developments, including building new facilities and upgrading existing ones. The government has intensified its efforts to train nationals in the health sector to deal with the acute shortage.

Other Issues

16. The government is committed to fight poverty. Though some gains have been made in recent years, there still remains a substantial number of people (23.4 percent of the population) below the poverty line. The government has established a Rural Development Council whose work is guided by the Revised National Policy for Rural Development and supported by a substantial allocation of the development budget to ensure that the plight of the rural poor are properly addressed and that rural development institutions are adequately funded so that they can play their rightful role in this effort.

Conclusion

17. The authorities are fully cognizant of the changing economic environment and are committed to taking appropriate steps to deal with these challenges driven by the need to be self reliant and meet the MDGs. Not only is the international environment unpredictable, but the domestic economic environment has also been equally challenging as shown by the decline in the contribution of the diamond sector and the deteriorating social indicators exacerbated by the HIV/AIDS pandemic. It is in this respect that the authorities have embarked on a broad-based structural reform agenda, realigned the budget with a focus on

social issues and fight against poverty, while ensuring that it remains balanced and does not pose long-term threats to the economy. The authorities recognize the need to prioritize government expenditure and foster prudent fiscal management of public resources given the limited resource envelope, while promoting growth and diversifying the economy.