September 2010
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Botswana: 2010 Article IV Consultation—Staff Report and Supplement; Public Information Notice on the Executive Board Discussion

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 2010 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 14, 2010, with the officials of Botswana on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 12, 2010. 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 July 12, 2010 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 27, 2010 discussion of the staff report that concluded the Article IV consultation.

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 2010 Article IV Consultation

Prepared by Staff Representatives for the 2010 Article IV Consultation with Botswana

Approved by Sharmini Coorey and Dhaneshwar Ghura

July 12, 2010

Mission. A staff team—Robert Burgess (head), Gonzalo Pastor, Dalmacio Benicio, and Irene Yackovlev (all AFR)—visited Gaborone June 1-14, 2010. Zeinab Partow (World Bank) also participated in some meetings.

Past advice. The 2009 Article IV consultation was concluded on July 20, 2009. The Fund commended the authorities for prudent macroeconomic management, supported by strong institutions and good governance, but warned that recent marked increases in public spending raised concerns about spending quality and fiscal sustainability.

Exchange rate regime. Crawling peg, in which the pula is pegged to a basket of currencies comprising the SDR and South African rand. The regime is implemented through continuous adjustment of the trade-weighted nominal effective exchange rate of the pula at a rate of crawl based on the differential between Botswana's inflation objective and the forecast inflation of trading partner countries. The rate of crawl is thus determined using a forward-looking approach and is revised on a regular basis. In this forward-looking scheme, the authorities periodically determine the rate of crawl for the subsequent period, such as the next 6 or 12 months.

Data provision. Botswana participates in the General Data Dissemination System; data provision is adequate for surveillance.

Consultation cycle. It is expected that the next Article IV consultation with Botswana will take place on the standard 12 month cycle.

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Staff Appraisal and Summary

1. **Botswana's economy is rebounding after a significant setback following the global financial crisis.** The economy entered the crisis from a position of considerable strength because of past prudent macroeconomic management. This facilitated a timely easing of fiscal and monetary policies, which helped cushion the impact on growth of the crisis and the subsequent collapse in demand for diamonds. The economy is likely to see some rebalancing beginning this year, as lower government spending dampens growth in the nonmining sector while recovery of the diamond sector accelerates.

2. Macroeconomic policies are being appropriately redirected away from short-term demand management toward medium-term considerations.

- **Substantial fiscal consolidation will be needed as recovery proceeds, to put the public finances back on a sustainable footing and to safeguard external stability.** Much of the adjustment will need to come from lower public spending, as mineral revenues are on a declining trend; and the scope for raising nonmineral taxes is limited by the size of the private sector. The budget for 2010/11 makes a good start on this process of adjustment. Plans to balance the budget by 2012/13 and register modest surpluses thereafter are ambitious but warranted. Recent increases in public debt, and the more challenging fiscal environment going forward, will require a clearer framework for management of the government's assets and liabilities.

- **Anchoring inflation expectations will also be important**, because inflation has not yet been brought down sustainably within the authorities' objective range of 3-6 percent. It will be important therefore to err on the side of caution before proceeding with further reductions in interest rates and to proceed with fiscal consolidation as envisaged.

3. **The medium-term outlook is favorable provided the authorities proceed with planned fiscal consolidation.** Staff projects that real GDP growth will average about 6 percent over the medium term, as diamond production gradually recovers towards pre-crisis levels and investment in the power sector boosts growth in the nonmining sector.

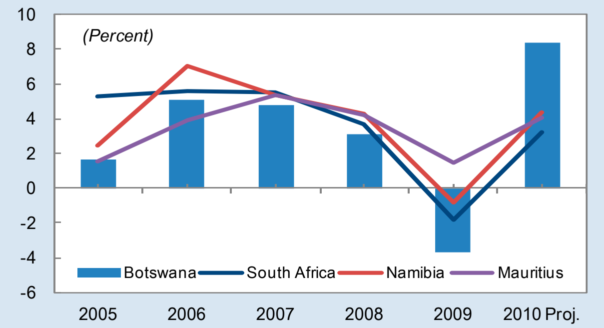
4. **Sustaining high growth rates will require an ambitious set of policies and reforms to create a leaner and more effective public sector and promote private sector-led growth**. The principle objectives of this economic reform agenda should be:

- **Doing more with less.** With the prospects of lower revenues looming over the medium-term fiscal environment, the authorities will have to find ways to increase the value for money of public spending programs. Doing so will require strengthening public financial management, including through a transition to program-based budgeting and implementation of a medium-term expenditure framework.

- **Letting the private sector lead the way.** Private sector-led growth will require structural reforms to encourage entrepreneurship and investment. The focus should be mainly on cross-cutting structural reforms that can benefit the whole economy. Current investments in power generation will address a key bottleneck to growth. With appropriate safeguards, plans to privatize selected parastatals, greater use of public–private partnerships, and rationalization of commercial services currently provided by the government could also mobilize greater private sector participation in the economy.

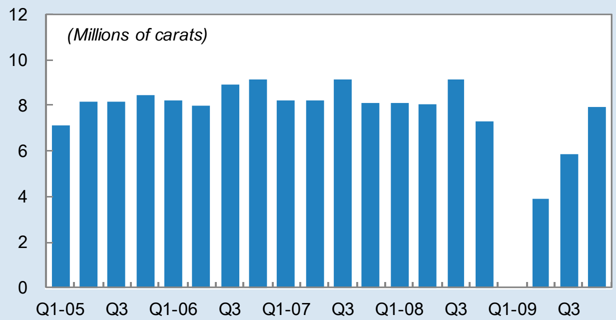
I. CONTEXT: EMERGING FROM RECESSION

5. **Botswana is recovering from its worst recession in at least 40 years.** The economy contracted by 3.7 percent last year as demand for diamonds collapsed in the wake of the global financial crisis. The prompt easing of fiscal and monetary policies cushioned the impact of difficulties in the mining sector on the rest of the economy such that the nonmining sector grew by a healthy 6.2 percent in 2009.



Selected Middle Income Countries: Real GDP Growth

Source: IMF, *African Department Database* and *Sub-Saharan Africa Regional Economic Outlook*, April 2010.



Botswana: Diamond Production

Source: Government of Botswana, Central Statistics Office.

6. **The economy will likely see some rebalancing this year and next as mining continues its gradual recovery while the nonmining sector decelerates as fiscal stimulus is withdrawn.** Overall GDP growth is projected to reach 8.4 percent in 2010, led by a rebound in diamond production. Nonmineral GDP growth, however, is expected to slow somewhat to 4.8 percent. After breaching the upper ceiling of the Bank of Botswana's inflation objective of 3–6 percent owing to increases in the rate of value-added tax (VAT), electricity tariffs and other administered prices, inflation is expected to fall within the objective band in mid-to-late 2011. The current account balance is set to improve gradually as recovery in the diamond market boosts export receipts.

Botswana: Summary of Medium-Term Macroeconomic Framework, 2007/08–2015/16

				Projections					
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Real GDP [1]	4.8	3.1	-3.7	8.4	4.8	7.2	7.4	5.1	5.3
Mineral	-2.0	-3.7	-20.9	16.8	8.4	6.1	7.7	4.3	4.7
Nonmineral	9.7	7.5	6.2	4.8	3.1	7.8	7.2	5.5	5.5
Consumer prices (average) [1]	7.1	12.6	8.1	6.7	6.3	5.6	5.4	5.3	5.2
Consumer prices (end of period)[1]	8.1	13.7	5.8	6.6	5.9	5.5	5.4	5.2	5.2
Diamond production (millions of carats)[1]	33.6	32.3	17.7	23.2	25.4	27.0	29.0	30.1	31.5
Nonmineral primary balance (in percent of nonmineral GDP)	-16.7	-28.5	-32.9	-24.2	-23.6	-16.7	-14.3	-12.8	-11.6
Overall balance (in percent GDP)	4.8	-5.2	-14.3	-6.4	-4.6	0.3	2.2	3.3	4.7
Current account balance [1]	14.5	3.5	-2.1	-0.3	0.7	2.5	3.6	4.3	5.1

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Calendar year.

Risks to the outlook are broadly balanced:

- Diamond production is projected to recover gradually, in line with the moderate recovery of consumption in advanced markets. However, a double-dip recession in advanced economies could prompt a further collapse in the market whereas new demand from China and India could drive a stronger recovery.

- Developments in South Africa will also be important: the strength of recovery there will largely determine the revenues that Botswana receives through Southern African Customs Union (SACU) revenue-sharing arrangements. The prospects for additional investment in the power sector are also tied to developments in South Africa (Box 1).

- Internally, the resilience of the nonmining private sector to fiscal tightening will depend on whether the government is able to enhance the efficiency and effectiveness of spending within a tighter overall spending envelope.

Box 1. Electricity-Generating Capacity: Addressing a Key Bottleneck to Growth

Botswana imports about 80 percent of its electricity from neighboring countries, principally South Africa. The rest is generated by the 25-year-old Morupule plant, which is becoming increasingly unreliable. As a result of the energy crisis in the region, neighboring countries are reducing their exports to Botswana, resulting in power cuts. The Morupule plant is being expanded to achieve energy generation self-sufficiency. Production is expected to begin in 2012. The feasibility of further investments in Morupule and an additional large plant at Mmamabula, which would allow Botswana to become a net exporter of electricity, depend on reaching power purchase agreements with South Africa's state-owned power utility. The likelihood of these agreements being reached is not clear and additional investments have not therefore been incorporated in the staff baseline.

7. **Despite strong growth in recent years, social challenges are significant.** Efforts to address HIV/AIDS are beginning to pay off: life expectancy is improving in response to increased availability of anti-retroviral drugs, and the rate of new HIV infections is declining. Nevertheless, the prevalence of HIV/AIDS is among the highest in Africa (at a national prevalence rate of 17.6 percent according to the 2008 Botswana AIDS Impact Study). Poverty, unemployment, and income inequality are also high, although outdated official estimates make it difficult to assess the impact of recent developments.[1]

II. Policies: Rebuilding Buffers and Promoting Private Sector Led Growth

With recovery now underway, policies are being appropriately redirected away from short-term demand management towards medium-term considerations. Policy discussions focused on four key priorities: (i) putting the public finances back onto a sustainable footing; (ii) locking in low inflation; (iii) improving the management of public finances to enable the government to "do more with less"; and (iv) reinvigorating structural reforms to encourage private sector-led growth.

A. Fiscal Policy: Restoring Sustainability After the Crisis

8. **Fiscal policy was strongly countercyclical during the past two years as the government ramped up spending despite a drop in revenues.** An ambitious roll out of development projects, including building of schools, hospitals, airport facilities, roads, dams, stadia, and power generating infrastructure, has seen development spending more than double in real terms in the past three years. The hiring of new teachers and medical personnel, and the introduction in 2008/09 of a retention allowance for civil servants with scarce

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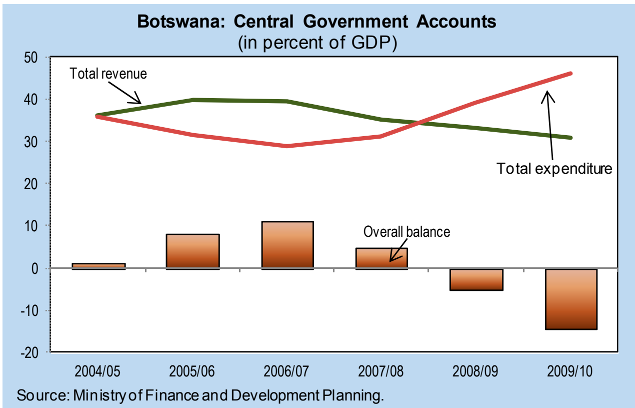
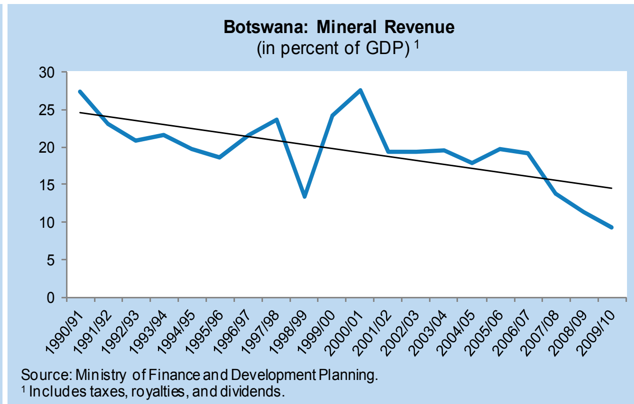
[1] According to the 2002/03 Household Income and Expenditure Survey (HIES), the poverty rate was 30.3 percent. A new HIES is being conducted this year. Unemployment was recorded at 17.5 percent in the 2005/06 Labor Force Survey.

skills, also pushed up the wages and salaries bill despite a public-service salary freeze in 2009/10. As a result, the nonmineral primary deficit—a good measure of the how fiscal policy affects the domestic economy—nearly doubled from 16.7 percent of nonmineral GDP in 2007/08 to 32.9 percent in 2009/10.





9. **As recovery gets underway, significant fiscal consolidation will be needed to ensure fiscal and external sustainability.** Staff estimates that reducing the nonmineral primary deficit to about 11–12 percent of nonmining GDP would preserve mineral wealth for future generations in real per capita terms and avoid the need for a sharp adjustment in the public finances when diamond production begins to decline sharply towards the middle of the next decade.[2]

10. **The bulk of adjustment will need to come from lower public spending.** SACU revenues may recover from temporarily low levels this year and next associated with repayments to the SACU Common Revenue Pool (CRP), but are unlikely to return to the levels seen before the crisis when imports to the region were booming (Box 2). Options for boosting non-SACU tax revenues include increasing specific duties on fuel, which have lagged far behind increases in prices; broadening the base for VAT by reducing exemptions and the number of zero-rated items; and taxing property. Tax administration could also be further improved by, for example, establishing a large-taxpayers unit. But the scope for fully offsetting the decline in mineral and SACU revenues is limited by the modest size of the nonmining private sector.

11. **The budget for 2010/11 makes a good start on this process of consolidation.** Adjustment is based on significant spending restraint, including a substantial cut in development spending as recent projects approach completion and a public service salary freeze. The VAT rate has also been increased from 10 to 12 percent. The budget is consistent with an improvement in the nonmineral primary deficit to 26.7 percent of nonmineral GDP. However, staff estimates that revenues could be higher than anticipated in the budget, in which case the resulting overperformance should be saved in the form of a lower deficit.

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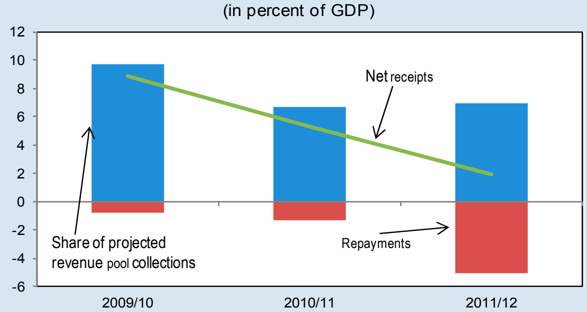
[2] This estimate is based on conservative assumptions about the value of diamond reserves, nonmineral revenues, and the return on financial assets. It does not take into account potentially significant positive returns from infrastructure spending and other investments.

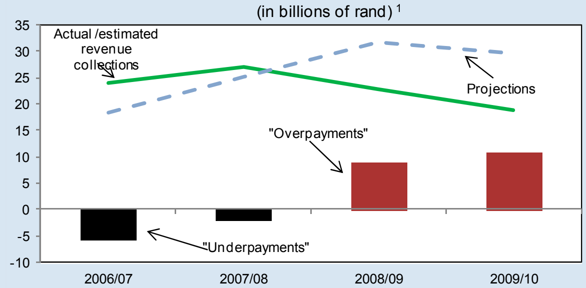
Box 2. Southern African Customs Union Revenues

Customs and excise duties in the Southern African Customs Union (SACU) are pooled and distributed according to a revenue-sharing formula. A key feature of these arrangements is that distributions to member states from the Common Revenue Pool (CRP) are made on the basis of projected revenue collections. Before the crisis, actual collections were higher than projected, reflecting booming import growth in the region and resulting in windfall “adjustment payments” to member states. Over the last two years, revenues (especially customs duty collections—see figure) have been lower than anticipated such that Botswana and other member states are required to make repayments to the CRP. This will temporarily reduce Botswana’s net receipts from the CRP in the near term. Receipts should recover thereafter, though perhaps not to pre-crisis boom levels. SACU member states have also recently agreed to review the revenue sharing formula.

Botswana: SACU Revenues
(in percent of GDP)



South Africa: Taxes on International Trade
(in billions of rand) [1]



[1] The dashed line shows the projections made in October of each year in the South African Medium-Term Budget Policy Statement for revenue collections in the following fiscal year, which form the basis for distributions from the Common Revenue Pool (CRP) to SACU member states. The solid line represents actual or estimated collections. If actual revenues are above (below) the projected amounts, this leads to a surplus (shortfall) in the CRP, which must then be paid to (collected from) SACU member states.
Sources: IMF staff estimates and South African Medium-Term Budget Policy Statements and National Budget Reviews.

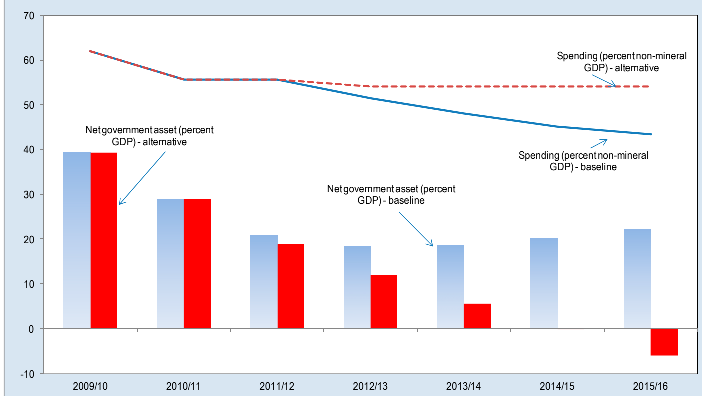
Botswana: Summary Central Government Operations, 2007/08–2015/16

	2007/08	2008/09	2009/10	2010/11 Budget	2010/11 Projection	2011/12	2012/13	2013/14	2014/15	2015/16
	(Percent of nonmineral GDP, unless indicated otherwise)									
Revenue	58.9	53.3	41.4	38.0	46.6	44.9	48.0	47.5	47.2	47.6
Mineral	23.1	18.2	12.6	9.2	15.3	17.0	16.9	16.9	16.7	17.2
SACU	16.5	13.8	12.5	7.2	8.6	5.7	9.0	8.5	8.4	8.3
Other	19.3	21.3	16.4	21.5	22.7	22.1	22.1	22.1	22.1	22.1
Expenditure	52.2	62.8	62.0	55.6	55.6	51.4	48.0	45.1	43.4	42.0
Current	39.0	42.7	40.3	38.5	38.5	37.5	35.1	33.0	31.4	30.1
Wages and salaries	14.4	15.5	15.0	16.9	16.9	16.2	15.0	13.9	13.2	12.6
Capital	13.8	20.5	20.4	17.3	17.3	14.1	13.0	12.2	12.1	12.1
Nonmineral primary balance	-16.7	-28.5	-32.9	-26.7	-24.2	-23.6	-16.7	-14.3	-12.8	-11.6
Overall balance (Percent of GDP)	4.8	-5.2	-14.3	-12.8	-6.4	-4.6	0.3	2.2	3.3	4.7
Memorandum items:										
Real primary spending (Percent change)	17.1	25.2	3.3	-6.9	-6.9	-4.1	0.6	0.8	1.9	1.8
Current	8.2	13.5	-0.9	-0.6	-0.6	1.6	1.6	1.0	0.6	0.5
Capital	50.1	54.4	4.6	-11.9	-11.9	-14.8	0.0	0.9	4.8	4.4
Public debt (Percent of GDP)	4.6	6.4	14.5	11.7	17.2	17.1	15.3	13.7	11.9	10.3
External	2.4	2.3	10.5	10.9	10.9	10.0	9.1	8.1	6.8	5.7
Domestic	2.2	4.0	4.1	0.8	6.3	7.1	6.3	5.6	5.1	4.7
Pula fund (Percent of GDP) [1]	57.5	58.0	53.9	34.3	46.2	38.7	34.7	33.1	32.9	34.2

Sources: Botswanan authorities and IMF Staff estimates and projections.
[1] Assumes that coverage of overall financing needs are split one-third domestic T-bills/bonds issuance and two-thirds drawdown from the pula fund. Does not include valuation change.

12. **The authorities' announced intention to balance the budget by 2012/13 and register modest surpluses thereafter is welcome.** Such a path would be broadly consistent with achieving the sustainable nonmineral primary deficit target recommended by staff (above). Delivering the spending restraint necessary to achieve this will be challenging and will require further improvements to public financial management (see Section D). Major slippages from this path, however, would risk depleting accumulated government savings in the Pula Fund and undermining the exchange rate regime. For example, staff estimates that the government would become a net debtor by 2015/16 if development spending returned to its pre-crisis (2007/08) level and recurrent spending remained at current (2009/10) levels relative to nonmineral GDP.[3,4]

Botswana: Implications of Fiscal Slippage



Source: IMF staff estimates.

13. **The framework for managing the government's assets and liabilities needs strengthening to cope with a more challenging fiscal environment.** Going into the crisis, public debt levels were negligible and the government had accumulated substantial savings in the Pula Fund. Recent deficits have therefore been comfortably financed through a combination of increased borrowing and drawing on savings. Gross public debt, though still very low by international standards, increased to an estimated 14.5 percent of GDP by March 2010 (or 17.7 percent of GDP including publicly guaranteed debt). The system for recording debt and debt service obligations, however, is weak, and a clearly articulated medium-term debt strategy is not in place. In Botswana's circumstances, this strategy would best be determined within a broader framework for asset and liability management (Box 3).

Box 3. A Framework for Asset and Liability Management

Botswana has a number of objectives in its management of assets and liabilities, including the need to: (i) finance significant fiscal deficits in the short to medium term; (ii) manage substantial foreign exchange assets and preserve wealth for future generations; and (iii) develop currently shallow domestic capital markets for debt. There are also implications for monetary policy in terms of the role of government debt and central bank paper in absorbing excess domestic liquidity. Decisions on how best to meet these objectives would best be determined within a comprehensive framework for asset and liability management. This needs to be supported by well-defined institutional arrangements, including a clear division of responsibilities between the Ministry of Finance and Development Planning and the Bank of Botswana.

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[3] The risk of a rapid decline in the government's net asset position was among the factors prompting Standard and Poor's to downgrade Botswana by one notch to A- following the release of this year's budget. Moody's, however, maintained its rating of A2.

[4] The declining path for public debt to GDP in the staff baseline is robust to various shocks, though holding the fiscal deficit constant at current levels results in an unsustainable debt path (**See Informational Annex**).

Authorities' Views

14. The authorities emphasized their commitment to restoring sustainability in public finances over the medium term. Allowing large fiscal deficits to emerge was an exceptional response to an unprecedented loss of national income and government revenue and helped to mitigate the adverse impact of the economic downturn. The authorities concurred that spending levels were unsustainably high and indicated that substantial reductions in expenditure over the next three years would form the basis for achieving a balanced budget by 2012/13. Spending would shift toward maintaining existing infrastructure, and capital spending would decrease from recent exceptionally high levels. Recurrent spending would be held in check, in part by allowing no net new hiring into the public service.

15. The authorities indicated that they were seeking to improve tax collection in a number of areas. The VAT threshold has been increased, which will simplify administration. A budget proposal to abolish the current two tier corporate tax system would also be an additional simplification. The authorities have embarked upon a three-year program, with the support of the Swedish tax authorities, to modernize and increase the efficiency of tax administration. They agreed that there was some scope for broadening the tax base, for example by reducing the numbers of goods and services that are zero rated or exempt from VAT. They also shared the staff's concern that tax incentives do little to encourage additional new investment and activity but risk significantly eroding fiscal space. In both cases, however, they noted that the pressure from business was for more exemptions and incentives.

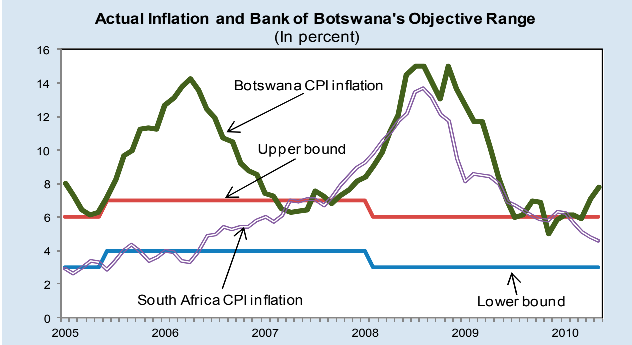
16. The authorities are reviewing fiscal rules that might help to ensure fiscal discipline. They acknowledged that the spending ceiling of 40 percent of GDP introduced in 2006 is too high to keep spending at sustainable levels. While agreeing that the nonmineral primary deficit is a useful measure of the fiscal stance, which they would monitor, the authorities noted that they would continue to focus on the overall balance. The authorities' targeted overall balance is broadly consistent with staff's estimate of the sustainable nonmineral primary balance over the medium term.

17. Having recently completed a two-year domestic debt issuance program, the authorities are planning to announce a medium-term debt strategy within the next few months. They have been working with the World Bank to develop the strategy and have also received support from the Commonwealth Secretariat on debt recording. They agreed that the institutional structure for debt management needs strengthening: there is a debt management unit within the Ministry of Finance and Development Planning, but its capacity is weak. They also saw the merits of a comprehensive framework for asset and liability management, which could build on existing reform efforts.

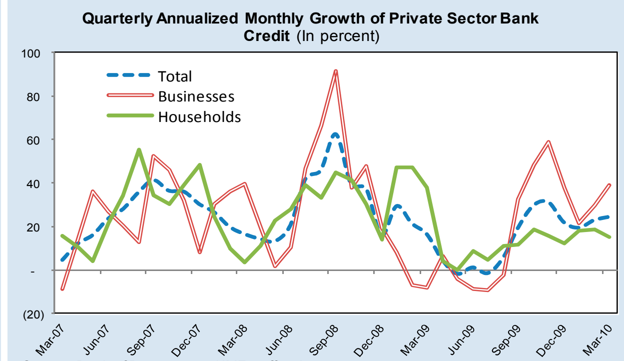
B. Monetary and Exchange Rate Policies: Locking in Low Inflation

18. **Monetary policy has been eased as inflation decelerated towards the upper end of the Bank of Botswana's 3–6 percent objective range.** Inflation fell from a peak of 15 percent in late-2008 to an average 6 percent between September 2009 and March 2010, as a sharp deceleration in food price inflation more than offset increases in international fuel prices. The disinflation process also reflects lower imported inflation from South Africa, which is Botswana's main source for consumer goods. The expansion of monetary and credit aggregates slowed, with quarterly private credit growth briefly turning negative in mid-2009 in response to weaker demand for borrowing and a tightening in banks' lending standards before recovering toward the end of the year. In response, the Bank of Botswana reduced policy rates by 550 basis points to 10 percent, broadly in line with policy easing in South Africa.

19. **Inflation has accelerated recently in response to temporary factors but should fall back within the objective range during 2011.** Inflation increased to 7.8 percent in May 2010 because of higher VAT and a 30 percent adjustment in electricity tariffs. The rate may increase a little further in the coming months, in response to additional administered price increases, before falling back within the objective range during 2011. This is contingent on fiscal consolidation proceeding as anticipated.



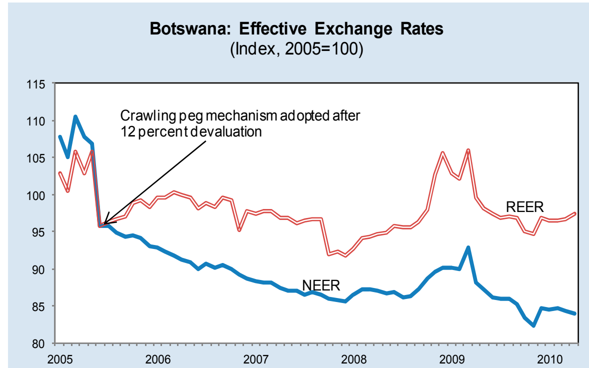
Source: Bank of Botswana and IMF staff estimates.



Source: Bank of Botswana and IMF staff estimates.

20. **Inflation has not yet been brought within the Bank of Botswana's objective range for a sustained period; monetary and exchange rate policies will therefore need to be calibrated to ensure that inflation expectations become more firmly anchored.** The business survey measure of inflation expectations has declined but remains high at around 10 percent; and market participants indicate that lingering concerns about inflation partly explained limited demand for long-dated government bonds at prices close to benchmark rates on South African bonds of similar maturity. Anchoring inflation expectations well inside the objective band would promote domestic savings and help to reduce borrowing costs (including for government). With this in mind, it will be important to err on the side of caution before proceeding with further reductions in interest rates. It will be similarly important to continue to take a forward-looking approach when determining the rate of crawl for the exchange rate to ensure that it contributes to meeting the inflation objective rather than accommodating past inflation. Publishing the basket weights and rate of crawl could also contribute to anchoring market expectations.

21. **Exchange rate policy continues to be implemented through the crawling peg regime.** The annual rate of crawl is determined on based on the differential between Botswana's inflation objective and forecast inflation in trading partner countries with a view to maintaining international competitiveness by stabilizing the real effective exchange rate.



Source: IMF staff estimates.

22. **The real value of the pula has been stable over the past 3–4 years, in line with the crawling peg regime.** Staff estimates that the exchange rate is broadly in line with its medium-term equilibrium level (see Appendix 2). This assessment assumes that fiscal consolidation proceeds as anticipated and that the budget balance returns to a moderate surplus over the medium term. However, in the event of significant fiscal slippage, or a sustained structural weakening in demand for diamonds, the resources in the Pula Fund would be drained; and the exchange rate peg would be under pressure.

Authorities' Views

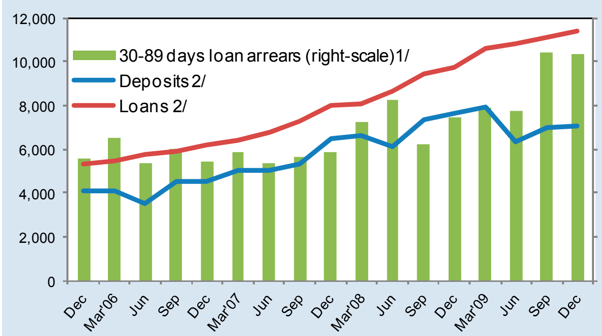
23. **The authorities anticipate that inflation will fall back within the objective range on a sustained basis by mid-2011.** Benign external price pressures and subdued domestic demand will help to keep underlying inflationary pressures in check. They noted that the survey of business expectations of inflation was based on a small sample but agreed that inflation expectations were likely above the 3–6 percent objective range. The public service salary freeze could play an important signaling role and help to curb private sector wage settlements. Continued regular communication of the strategy for bringing inflation within the 3–6 percent band would also help to anchor expectations. The authorities are continuing to refine their inflation forecasting framework but are not yet ready to move to formal inflation targeting as the sole anchor for monetary policy which, they agree, would also require greater exchange rate flexibility.

24. **The authorities considered the current level of the real exchange rate broadly appropriate, but agreed that a sustained structural shift in the external position could change this assessment.** They also noted that, over the longer run, durable international competitiveness would depend on productivity improvements.

C. Financial Policies: Maintaining Stability

25. **The banking system remains fundamentally sound though recent increases in nonperforming loans in the household sector warrant vigilance on the part of supervisors.** The impact of the global financial crisis on the banking sector was largely indirect. Banks are not significantly exposed to the mining sector, which finances itself largely through retained earnings or foreign parent companies. However, banks are heavily exposed to households, which account for about 59 percent of bank lending to the private sector (or 23 percent of total bank assets).[5] This sector has come under pressure as a combination of diminished employment growth in some sectors and a freeze in public service salaries has squeezed household incomes. Lower interest rates have provided some respite, but nonperforming loans have risen (albeit from low levels). Household balance sheets will likely remain under pressure as fiscal support for the economy is withdrawn and increases in VAT and electricity tariffs erode real incomes. Banks have responded by increasing their provisions and tightening lending standards. As a result, profitability has declined though it remains high by international standards. Bank capital levels also remain well above the statutory 8 percent floor and prescribed prudential standard of 15 percent.

Households' Bank Deposits and Loans



Source: Bank of Botswana.
[1] In percent of outstanding loans.
[2] In millions of pula.

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[5] Some of the bank lending to households may be for small businesses.

International Comparison: Financial Soundness Indicators [1]
(Percent, unless otherwise indicated)

	Botswana [2]	Chile	Mexico	Turkey	Malaysia	Thailand	Lesotho	Namibia	South Africa	Swaziland
Capital adequacy:										
Regulatory capital to risk-weighted assets (RWA)	19.9	14.3	15.9	20.4	14.6	13.8	15	16.4	13.6	26.3
Asset quality:										
Nonperforming loans to total gross loans	3.3	1.4	3.4	5.7	3.8	5.7	4.0	2.9	5.5	8.1
Earnings and profitability:										
Return on assets (average) [3]	0.7	1.2	1.2	2.6	1.2	1.0	4.0	3.0	1.0	2.4
Return on equity (average) [3]	13.8	18.0	13.1	18.8	13	7.3	50	33.7	17.5	14.4

Source: Bank of Botswana and Global Financial Stability Report (GFSR), April 2010.
[1] Except for Botswana, all other data refer to latest data point as published in GFSR, April 2010.
[2] Data refer to March 2010.
[3] March 2010 figures for return on assets and return on equity are cumulative rather than annualized figures.

26. **Regulation of nonbank financial institutions is being strengthened as the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) ramps up its activities.** Non-bank financial institutions are a significant component of the financial system. The combined assets of pension and insurance companies account for 49.5 percent of GDP (compared with 41 percent of GDP for the banking sector's assets). NBFIRA was established in April 2008 and assumed full responsibility for regulating and supervising non-bank financial institutions in September 2009. Revisions to the Insurance and Pension Fund Acts, and accompanying prudential regulations, are going through industry consultation with implementation expected later this year. There is, however, a gap in the current regulatory framework, for micro lenders, that needs to be plugged expeditiously.

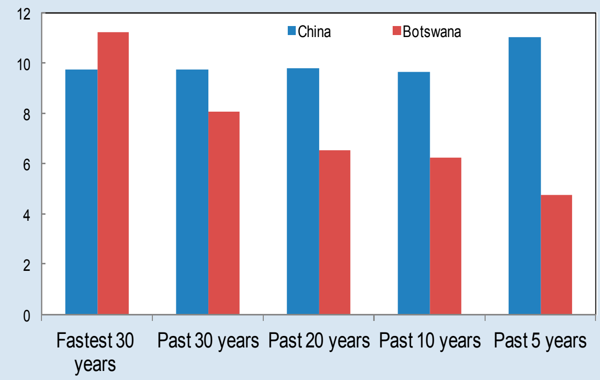
Authorities' Views

27. **The authorities agreed that concentration of bank lending on the retail sector was a concern and indicated that they would continue to monitor the sector closely.** Banks responded promptly and appropriately to elevated risks in the sector by raising provisions and tightening lending standards. The authorities indicated that they are committed to adopting Basel II prudential standards but also noted that the four largest banks (which account for over 90 percent of bank assets) are internationally owned and are at an advanced stage of Basel II implementation. They agreed that there was a need to develop a regulatory and supervisory framework for the micro lending sector and indicated that draft regulations have been prepared accordingly. NBFIRA is also working with development partners to develop a framework of risk-based supervision for non-banks, in line with international best practice. More broadly, the authorities are also planning to develop a financial stability framework for monitoring risks in the financial sector and resolving financial crises and, as a first step, the Bank of Botswana has reorganized its structure to include the establishment of a Financial Stability Division in the Bank.

D. Reforming Public Finances and Supporting Private Sector-Led Growth: "Doing More with Less"

28. **The global financial crisis has underscored the economy's vulnerability to external shocks and the need to develop a more diversified and competitive private sector**. Botswana's past achievements in managing natural resource wealth to promote sustained economic growth and improved social outcomes are remarkable. However, growth rates have declined steadily as the impetus from expanding natural resource exports has faded. The past approach to promoting diversification—through large scale public investment and other spending programs—also has run its course. Returns to public spending appear to be diminishing. Despite high spending levels, outcomes (for example, educational attainment) are often poorer than in other comparable countries (see Appendix 2). A large public sector, employing over 40 percent of the formal workforce and paying wages that, on average, are almost two-thirds higher than in the private sector, is exerting upward pressure on costs in the entire economy, particularly given a constrained skills base.

"Growth Booms: China Accelerates While Botswana Slows"
Real GDP Growth Rates, 1996-2007 (in percent)



Source: IMF World Economic Outlook; based on Hausmann and Klinger (2010)

29. **Changing the way in which the public finances are managed will help to ensure that the public sector can support broad-based growth in the economy.** There is a need for greater emphasis on expenditure prioritization and improvements in public financial management, including a transition to program-based budgeting and the adoption of a Medium-Term Expenditure Framework. This would help to mitigate a potential adverse impact on economic growth as public spending transitions to lower, more sustainable levels. Extra-budgetary and special funds, which in some cases are no longer serving their original purposes, also impede the efficiency of resource allocation within the budget and undermine transparency and accountability in government spending. These funds could be phased out or, at a minimum, their activities more transparently reported in the fiscal accounts and budget documentation. Many of these ideas have been under consideration in Botswana for some time.[6] But the need to move forward with reforms has become more pressing as the fiscal environment has become more challenging.

30. **Reflecting this, the budget for 2010/11 underscores the importance of transforming the role of the public sector in the economy and the need to focus on more efficient and effective ways of delivering public services.** With this in mind, the authorities have established a task force to develop a plan for public financial management reform. Steps envisaged in this area include introduction of results-based budgeting, implementation of a medium-term framework for budget formulation, and a move toward accrual accounting.

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[6] These issues are highlighted in IMF Technical Assistance reports on public financial management (2005, 2010); a Public Expenditure and Financial Accountability (PEFA) assessment (2009); and, most recently, World Bank Public Expenditure Review (2010).

31. **Further improvements to the business climate and other reforms to encourage private sector development will also be important**:

- Current investment in electricity generating capacity will help to address a key bottleneck to growth. Recent efforts to speed up the time it takes to register and license a business are also welcome. Other cross-cutting interventions that have the potential to further improve the business environment for the whole economy, such as speeding up the process for approving work permits, could also be explored (see Appendix 1).

- A number of initiatives have been launched to promote economic activity in specific areas where returns are thought likely to be high, including the establishment of "hubs" for agriculture, innovation, diamonds, education, health, and transport. When pursuing sector-specific interventions, it is important that these be transparent, subject to periodic independent evaluations to guard against rent-seeking by vested interests, and include clear criteria for discontinuing ineffective support.

- Efforts are also underway to mobilize private sector financing and entrepreneurship through, for example, privatization of selected parastatals (starting this year with Botswana Telecommunications Corporation) and outsourcing of some commercial activities currently provided "in-house" by government. A framework for public–private partnerships (PPPs) was established in June 2009 and a PPP unit to coordinate activity in this area is being established within the Ministry of Finance and Development Planning. It will be important that appropriate legal and regulatory frameworks are in place to ensure that fiscal risks are mitigated and value for money is maximized.

Authorities' Views

32. The authorities agreed that their development model would need to change. Stimulating private sector growth by creating additional infrastructure has become less relevant over time as a once large infrastructure gap has been closed. Reflecting this, the latest National Development Plan (NDP10), covering the period 2009–16, emphasizes the creation of a leaner more effective public sector, thereby reducing crowding out of the private sector, while at the same time seeking to support private sector activity through regulatory and other structural reforms. A major effort will be made during NDP10 to reduce regulatory burdens that hinder investment. For example, revisions to the Immigration and Citizenship and Employment of Non-Citizens Act will provide an opportunity to improve Botswana's skills base.

Table 1. Botswana: Selected Economic and Financial Indicators, 2007–2015

	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Real GDP [1]	4.8	3.1	-3.7	8.4	4.8	7.2	7.4	5.1	5.3
Mineral	-2.0	-3.7	-20.9	16.8	8.4	6.1	7.7	4.3	4.7
Nonmineral	9.7	7.5	6.2	4.8	3.1	7.8	7.2	5.5	5.5
Consumer prices (average)	7.1	12.6	8.1	6.7	6.3	5.6	5.4	5.3	5.2
Consumer prices (end of period)	8.1	13.7	5.8	6.6	5.9	5.5	5.4	5.2	5.2
Nominal GDP (billions of pula) [1]	76.0	91.7	83.2	92.7	101.7	114.7	129.4	142.2	156.4
Mineral	30.6	37.6	21.5	23.8	26.3	28.2	30.8	32.4	34.2
Nonmineral	45.4	54.1	61.7	68.9	75.4	86.4	98.6	109.8	122.2
Diamond production (millions of carats)	33.6	32.3	17.7	23.2	25.4	27.0	29.0	30.1	31.5
External sector									
Exports of goods and services, f.o.b. (US$)	11.1	-3.2	-23.0	14.9	7.2	4.4	5.5	3.9	4.4
Of which:									
Diamonds	-1.5	-8.1	-30.3	20.6	10.5	7.9	9.4	5.3	6.3
Imports of goods and services, f.o.b. (US$)	29.1	24.9	-9.7	10.0	1.4	3.3	3.2	2.2	2.4
Terms of trade	3.9	2.6	4.0	-0.6	-0.9	-1.6	-0.9	-0.9	-1.1
Nominal effective exchange rate	-4.1	0.6	-0.8	…	…	…	…	…	…
Real effective exchange rate	-3.2	1.0	2.0	…	…	…	…	…	…
Money and banking									
Net foreign assets	24.1	20.1	-18.5	6.6	14.6	15.9	16.6	15.4	15.7
Net domestic assets	17.0	19.0	-37.8	-10.8	26.7	18.4	18.1	18.9	24.0
Broad money (M3)	31.2	21.1	-1.8	16.1	9.5	14.6	15.9	13.6	11.3
Velocity (nonmineral GDP relative to M3)	1.4	1.4	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Credit to the private sector	25.7	26.6	10.3	11.4	9.1	7.7	6.5	8.3	8.2
	(Percent of GDP, unless otherwise indicated)								
Investment and savings [1]									
Gross investment (including change in inventories)	25.8	32.4	24.0	28.2	26.1	25.7	22.2	22.6	22.9
Public	7.8	11.2	15.1	13.3	11.1	10.0	9.4	9.4	9.4
Private	18.0	21.3	8.9	14.8	15.0	15.6	12.8	13.2	13.5
Gross savings	40.3	35.9	21.9	27.9	26.8	28.2	25.9	26.9	27.9
Public	20.1	15.1	12.0	14.5	14.7	17.4	18.9	19.9	21.0
Private	20.3	20.8	9.9	13.4	12.1	10.8	7.0	6.9	6.9
Saving–investment balance	14.5	3.5	-2.1	-0.3	0.7	2.5	3.6	4.3	5.1
Central government finances [2]									
Total revenue and grants	35.8	34.0	31.6	34.9	33.7	36.6	36.6	36.9	37.6
Total expenditure and net lending	31.1	39.3	46.0	41.3	38.3	36.3	34.5	33.6	32.9
Overall balance (deficit –)	4.8	-5.2	-14.3	-6.4	-4.6	0.3	2.2	3.3	4.7
Nonmineral primary balance (percent of nonmineral GDP) [3]	-16.7	-28.5	-32.9	-24.2	-23.6	-16.7	-14.3	-12.8	-11.6
Total central government debt	7.1	6.4	14.5	17.2	17.1	15.3	13.7	11.9	10.3
External sector									
Current account balance	14.5	3.5	-2.1	-0.3	0.7	2.5	3.6	4.3	5.1
Balance of payments	13.9	11.0	-12.9	5.4	5.3	6.8	7.6	7.4	8.0
Total external debt [4]	3.7	3.2	15.4	15.9	14.8	14.0	12.9	10.7	8.6
	(US$ millions, unless otherwise indicated)								
Change in reserves (increase –)	-1,718	-1,490	1,503	-678	-688	-947	-1,131	-1,173	-1,327
Gross official reserves (end of period)	9,743	9,125	8,678	9,382	10,070	11,018	12,149	13,322	14,649
In months of imports of goods and services [5]	20.9	21.7	18.8	20.0	20.8	22.1	23.8	25.5	30.3
In percent of GDP	78.7	67.5	74.3	75.1	77.8	79.2	81.1	84.5	88.3
Pula Fund (US$ millions)	6,614	6,866	6,523	…	…	…	…	…	
In months of imports of goods and services [5]	14.2	16.3	14.1	…	…	…	…	…	
Liquidity portfolio/ other reserves (US$ millions)	3,130	2,259	2,155	…	…	…	…	…	
In months of imports of goods and services [5]	6.7	5.4	4.7	…	…	…	…	…	

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Calendar year.
[2] Year beginning April 1.
[3] The nonmineral primary balance is computed as the difference between nonmineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.
[4] Includes private sector debt and medium- and long-term public and publicly guaranteed debt.
[5] Based on imports of goods and services for the following year.

Table 2a. Central Government Operations, 2007/08–2015/16 [1]

	2007/08	2008/09	2009/10	2010/11		2011/12	2012/13	2013/14	2014/15	2015/16
			Preliminary	Budget	Projection					
	(Millions of pula)									
Total revenue and grants	28,629	30,455	27,047	27,077	33,156	35,410	43,331	48,599	53,794	59,864
Total revenue	28,052	29,833	26,300	26,771	32,850	35,071	42,942	48,159	53,304	59,323
Tax revenue	17,267	20,455	17,249	18,472	21,746	22,899	29,087	32,456	35,942	39,747
Income taxes	6,342	8,059	5,796	8,513	10,170	11,763	13,429	15,218	16,887	18,831
Mineral	2,448	3,451	1,249	1,896	3,420	4,280	4,863	5,512	6,080	6,908
Nonmineral	3,894	4,608	4,547	6,618	6,750	7,483	8,566	9,706	10,807	11,923
Taxes on goods and services [2]	2,852	4,377	3,295	4,583	5,244	6,345	7,255	8,199	9,116	10,053
Customs Union receipts [3]	7,835	7,750	7,931	5,111	6,060	4,472	8,038	8,626	9,479	10,355
Other	238	268	227	265	271	318	365	413	460	507
Nontax revenue	10,785	9,378	9,050	8,299	11,105	12,172	13,856	15,703	17,362	19,576
Mineral royalties and dividends	8,564	6,731	6,729	4,586	7,391	9,023	10,251	11,621	12,817	14,563
Interest	67	52	20	48	49	53	60	68	74	81
Property income	1,125	1,546	1,211	2,005	2,006	961	1,100	1,246	1,387	1,531
Of which: BoB transfers	906	1,302	1,000	700	700	1,050	1,184	1,326	1,457	1,592
Fees and charges	1,029	1,049	1,090	1,660	1,660	2,135	2,444	2,769	3,083	3,402
Grants	577	623	748	306	306	339	388	440	490	540
Total expenditure and net lending	24,822	35,150	39,326	39,194	39,195	40,205	42,936	45,714	48,955	52,318
Current expenditure	18,579	23,889	25,599	27,143	27,143	29,307	31,430	33,466	35,434	37,457
Wages and salaries	6,850	8,701	9,547	11,935	11,935	12,688	13,396	14,125	14,873	15,645
Interest	248	282	370	500	500	763	1,055	1,183	1,170	1,123
Other	11,480	14,906	15,682	14,708	14,708	15,856	16,979	18,158	19,391	20,689
Of which: grants and subsidies	4,869	7,058	8,106	8,327	8,739	8,977	9,613	10,280	10,979	11,714
Capital expenditure	6,548	11,458	12,959	12,182	12,182	11,036	11,652	12,403	13,683	15,031
Net lending	-305	-197	768	-130	-130	-138	-146	-154	-162	-170
Primary balance (deficit -)	4,056	-4,413	-11,909	-11,618	-5,539	-4,032	1,450	4,067	6,009	8,669
Overall balance	3,808	-4,695	-12,279	-12,118	-6,039	-4,795	395	2,884	4,839	7,546
Financing	-3,808	4,696	11,987	12,117	6,039	4,795	-395	-2,884	-4,839	-7,546
Foreign (net)	-93	-174	6,442	1,274	1,274	112	116	-89	-853	-991
Domestic	-3,714	4,870	5,544	10,844	4,765	4,682	-511	-2,795	-3,986	-6,555
Of which:										
Change in cash balance (- increase)	-4,019	4,607	5,843	13,554	2,286	3,220	-511	-2,795	-3,986	-6,555
Memorandum items:										
Nonmineral primary balance [4]	-7,929	-15,949	-20,906	-18,848	-17,098	-18,438	-14,908	-14,459	-14,420	-14,475

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

[1] Fiscal year begins on April 1.
[2] Refers to sales tax and VAT.
[3] SACU receipts consist of external trade and excises on imported goods as well as a development component derived from excises.
[4] The nonmineral primary balance is computed as the difference between nonmineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 2b. Central Government Operations, 2007/08–2015/16 [1]

	2007/08	2008/09	2009/10	2010/11		2011/12	2012/13	2013/14	2014/15	2015/16
			Preliminary	Budget	Projection					
				(Percent of GDP)						
Total revenue and grants	35.8	34.0	31.6	28.5	34.9	33.7	36.6	36.6	36.9	37.6
Total revenue	35.1	33.3	30.7	28.2	34.6	33.4	36.3	36.3	36.6	37.3
Tax revenue	21.6	22.8	20.2	19.5	22.9	21.8	24.6	24.5	24.7	25.0
Income taxes	7.9	9.0	6.8	9.0	10.7	11.2	11.3	11.5	11.6	11.8
Mineral	3.1	3.9	1.5	2.0	3.6	4.1	4.1	4.2	4.2	4.3
Nonmineral	4.9	5.1	5.3	7.0	7.1	7.1	7.2	7.3	7.4	7.5
Taxes on goods and services [2]	3.6	4.9	3.9	4.8	5.5	6.0	6.1	6.2	6.3	6.3
Customs Union receipts [3]	9.8	8.7	9.3	5.4	6.4	4.3	6.8	6.5	6.5	6.5
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	13.5	10.5	10.6	8.7	11.7	11.6	11.7	11.8	11.9	12.3
Mineral royalties and dividends	10.7	7.5	7.9	4.8	7.8	8.6	8.7	8.8	8.8	9.1
Interest	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Property income	1.4	1.7	1.4	2.1	2.1	0.9	0.9	0.9	1.0	1.0
Of which: BoB transfers	1.1	1.5	1.2	0.7	0.7	1.0	1.0	1.0	1.0	1.0
Fees and charges	1.3	1.2	1.3	1.7	1.7	2.0	2.1	2.1	2.1	2.1
Grants	0.7	0.7	0.9	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total expenditure and net lending	31.1	39.3	46.0	41.3	41.3	38.3	36.3	34.5	33.6	32.9
Current expenditure	23.3	26.7	29.9	28.6	28.6	27.9	26.6	25.2	24.3	23.5
Wages and salaries	8.6	9.7	11.2	12.6	12.6	12.1	11.3	10.7	10.2	9.8
Interest	0.3	0.3	0.4	0.5	0.5	0.7	0.9	0.9	0.8	0.7
Other	14.4	16.6	18.3	15.5	15.5	15.1	14.3	13.7	13.3	13.0
Of which: grants and subsidies	6.1	7.9	9.5	8.8	9.2	8.6	8.1	7.8	7.5	7.4
Capital expenditure	8.2	12.8	15.1	12.8	12.8	10.5	9.8	9.4	9.4	9.4
Net lending	-0.4	-0.2	0.9	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Primary balance (deficit -)	5.1	-4.9	-13.9	-12.2	-5.8	-3.8	1.2	3.1	4.1	5.4
Overall balance	4.8	-5.2	-14.3	-12.8	-6.4	-4.6	0.3	2.2	3.3	4.7
Financing	-4.8	5.2	14.0	12.8	6.4	4.6	-0.3	-2.2	-3.3	-4.7
Foreign (net)	-0.1	-0.2	7.5	1.3	1.3	0.1	0.1	-0.1	-0.6	-0.6
Domestic	-4.6	5.4	6.5	11.4	5.0	4.5	-0.4	-2.1	-2.7	-4.1
Of which:										
Change in cash balance (- increase)	-5.0	5.1	6.8	14.3	2.4	3.1	-0.4	-2.1	-2.7	-4.1
Memorandum items:										
Nonmineral primary balance [4] (percent of non-mineral GDP)	-16.7	-28.5	-32.9	-26.7	-24.2	-23.6	-16.7	-14.3	-12.8	-11.6
GDP (fiscal year; millions of pula)	79,905	89,539	85,581	94,972	94,972	104,952	118,368	132,611	145,738	159,204

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

[1] Fiscal year begins on April 1.

[2] Refers to sales tax and VAT.

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

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

Table 2c. Central Government Operations, 2007/08–2015/16 [1]

	2007/08	2008/09	2009/10	2010/11		2011/12	2012/13	2013/14	2014/15	2015/16
			Preliminary	Budget	Projection					
	(Percent of nonmineral GDP)									
Total revenue and grants	60.2	54.4	42.6	38.4	47.0	45.3	48.4	47.9	47.7	48.1
Total revenue	58.9	53.3	41.4	38.0	46.6	44.9	48.0	47.5	47.2	47.6
Tax revenue	36.3	36.5	27.2	26.2	30.8	29.3	32.5	32.0	31.8	31.9
Income taxes	13.3	14.4	9.1	12.1	14.4	15.0	15.0	15.0	15.0	15.1
Mineral	5.1	6.2	2.0	2.7	4.8	5.5	5.4	5.4	5.4	5.5
Nonmineral	8.2	8.2	7.2	9.4	9.6	9.6	9.6	9.6	9.6	9.6
Taxes on goods and services [2]	6.0	7.8	5.2	6.5	7.4	8.1	8.1	8.1	8.1	8.1
Customs Union receipts [3]	16.5	13.8	12.5	7.2	8.6	5.7	9.0	8.5	8.4	8.3
Other	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	22.7	16.8	14.3	11.8	15.7	15.6	15.5	15.5	15.4	15.7
Mineral royalties and dividends	18.0	12.0	10.6	6.5	10.5	11.5	11.5	11.5	11.4	11.7
Interest	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Property income	2.4	2.8	1.9	2.8	2.8	1.2	1.2	1.2	1.2	1.2
Of which: BoB transfers	1.9	2.3	1.6	1.0	1.0	1.3	1.3	1.3	1.3	1.3
Fees and charges	2.2	1.9	1.7	2.4	2.4	2.7	2.7	2.7	2.7	2.7
Grants	1.2	1.1	1.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total expenditure and net lending	52.2	62.8	62.0	55.6	55.6	51.4	48.0	45.1	43.4	42.0
Current expenditure	39.0	42.7	40.3	38.5	38.5	37.5	35.1	33.0	31.4	30.1
Wages and salaries	14.4	15.5	15.0	16.9	16.9	16.2	15.0	13.9	13.2	12.6
Interest	0.5	0.5	0.6	0.7	0.7	1.0	1.2	1.2	1.0	0.9
Other	24.1	26.6	24.7	20.9	20.9	20.3	19.0	17.9	17.2	16.6
Of which: grants and subsidies	10.2	12.6	12.8	11.8	12.4	11.5	10.7	10.1	9.7	9.4
Capital expenditure	13.8	20.5	20.4	17.3	17.3	14.1	13.0	12.2	12.1	12.1
Net lending	-0.6	-0.4	1.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1
Primary balance (deficit -)	8.5	-7.9	-18.8	-16.5	-7.9	-5.2	1.6	4.0	5.3	7.0
Overall balance	8.0	-8.4	-19.3	-17.2	-8.6	-6.1	0.4	2.8	4.3	6.1
Memorandum items:										
Non-mineral revenue	37.0	36.2	30.1	29.2	31.7	28.3	31.5	31.0	30.9	30.8
Non-mineral primary balance [4]	-16.7	-28.5	-32.9	-26.7	-24.2	-23.6	-16.7	-14.3	-12.8	-11.6
Non-mineral GDP (fiscal year; millions of pula)	47,590	55,977	63,459	70,512	70,512	78,169	89,482	101,382	112,881	124,547

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

[1] Fiscal year begins on April 1.

[2] Refers to sales tax and VAT.

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

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

Table 3. Balance of Payments, 2007–2015 [1]

	2007	2008	2009	Projections 2010	2011	2012	2013	2014	2015
	(US$ millions, unless otherwise indicated)								
Current account balance	1,797	473	-243	-35	94	351	542	673	839
Trade balance	1,610	332	-659	-484	-245	-196	-73	16	134
Exports, f.o.b.	5,053	4,789	3,462	4,112	4,437	4,640	4,915	5,106	5,325
Diamonds	3,338	3,069	2,139	2,580	2,850	3,076	3,365	3,543	3,767
Other raw materials	977	949	582	867	869	833	827	819	803
Other	739	772	741	664	718	731	723	743	754
Imports, f.o.b	-3,444	-4,458	-4,121	-4,595	-4,682	-4,836	-4,988	-5,090	-5,191
Services	-180	-205	15	-4	42	46	48	61	70
Transportation	-317	-360	-273	-285	-301	-328	-346	-360	-386
Travel	265	271	317	309	371	401	421	448	483
Other services	-128	-116	-29	-28	-28	-27	-27	-27	-27
Income	-738	-702	-482	-86	-95	-106	-134	-197	-227
Current transfers	1,106	1,048	882	540	392	606	701	793	862
Capital and financial account	-147	639	1,307	713	594	596	590	500	487
Capital account	80	104	119	92	95	92	84	82	79
Financial account	-228	535	1,188	622	499	504	505	418	408
Direct investment	444	617	0	347	372	376	403	419	432
Portfolio investment	-413	288	489	149	148	148	149	149	150
Other investment	-259	-370	699	125	-20	-20	-46	-151	-173
Assets	-246	-285	-161	-47	-35	-51	-49	-48	-44
Liabilities	-13	-85	860	173	15	32	2	-103	-129
Net government long-term borrowing	-10	-13	918	180	24	24	5	-65	-93
Other net private long-term borrowing	-58	-124	-1	-54	-53	-33	-42	-76	-72
Short-term borrowing	55	52	47	46	44	41	40	38	36
Reserve assets (increase –)	-1,718	-1,490	1,503	-678	-688	-947	-1,131	-1,173	-1,327
Net errors and omissions	93	-12	-1,705	0	0	0	0	0	0
Memorandum items:	(Percent of GDP, unless otherwise indicated)								
Balance of payments	14.1	8.1	-5.5	5.4	5.3	6.8	7.6	7.4	8.0
Current account	14.5	3.5	-2.1	-0.3	0.7	2.5	3.6	4.3	5.1
Trade balance	13.0	2.5	-5.6	-3.9	-1.9	-1.4	-0.5	0.1	0.8
Exports of goods	40.8	35.4	29.6	32.9	34.3	33.4	32.8	32.4	32.1
Of which: Diamonds	27.0	22.7	18.3	20.6	22.0	22.1	22.5	22.5	22.7
Imports of goods	-27.8	-33.0	-35.3	-36.8	-36.2	-34.8	-33.3	-32.3	-31.3
Services balance	-1.5	-1.5	0.1	0.0	0.3	0.3	0.3	0.4	0.4
Income and transfers balance	3.0	2.6	3.4	3.6	2.3	3.6	3.8	3.8	3.8
Financial account	-1.8	4.0	10.2	5.0	3.9	3.6	3.4	2.7	2.5
Direct investment	3.6	4.6	0.0	2.8	2.9	2.7	2.7	2.7	2.6
Portfolio investment	-3.3	2.1	4.2	1.2	1.1	1.1	1.0	0.9	0.9
Other investment	-2.1	-2.7	6.0	1.0	-0.2	-0.1	-0.3	-1.0	-1.0
	(Annual percentage change, unless otherwise indicated)								
Export volumes	2.5	-14.7	-27.8	7.6	8.2	5.0	5.5	3.4	3.9
Import volumes	9.7	20.8	-4.1	0.7	1.1	2.0	1.8	0.7	0.5
Terms of trade	3.9	2.6	4.0	-0.6	-0.9	-1.6	-0.9	-0.9	-1.1
End-of-year reserves (US$ millions)	9,790	9,118	8,704	9,382	10,070	11,018	12,149	13,322	14,649
(Months of imports of goods and services) [2]	18.5	22.9	16.9	18.9	19.8	21.0	22.8	24.4	26.2

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Based on pula-denominated estimates converted at period-average exchange rate.

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

Table 4. Monetary Survey, 2006–2011 [1]

	2006	2007	2008	2009	2010 Proj.	2011 Proj.
			(Millions of pula, end of period)			
Net foreign assets	48,812	60,589	72,781	59,312	63,203	72,418
Bank of Botswana	47,720	58,392	68,414	57,427	61,101	70,113
Assets	47,839	58,518	68,541	57,847	61,570	70,627
Liabilities	123	126	127	421	469	514
Commercial banks	1,093	2,177	4,416	2,489	2,774	3,043
Assets	2,863	3,751	6,059	3,855	4,296	4,712
Liabilities	1,771	1,574	1,642	1,365	1,522	1,669
Net other foreign assets	4	20	-50	-603	-672	-737
Net domestic assets	-24,245	-28,364	-33,741	-20,985	-18,722	-23,721
Net domestic credit	-9,878	-13,656	-11,721	-2,248	3,319	8,423
Net claims on the government	-22,246	-27,833	-29,730	-22,404	-19,131	-16,053
Bank of Botswana	-21,236	-27,871	-31,768	-23,252	-20,077	-17,090
Commercial banks	12	38	2,038	848	945	1,037
Other financial institutions	-1,022	-1,212	-1,361	-1,401	-1,562	-1,713
Claims on nongovernment	12,368	14,008	17,907	19,853	22,112	24,106
Claims on parastatals	261	168	102	303	338	370
Claims on the private sector	12,108	15,220	19,268	21,254	23,674	25,819
Other items (net) [2]	-14,367	-14,707	-22,021	-18,737	-22,041	-32,144
Broad money (M3)	24,568	32,226	39,039	38,328	44,480	48,697
Money	5,157	6,167	7,580	6,719	8,513	9,320
Currency	753	908	1,103	1,145	1,253	1,371
Current deposits	4,404	5,260	6,477	5,574	7,260	7,948
Quasi-money	19,411	26,058	31,459	31,609	35,968	39,377
			(12-month percentage change)			
Net foreign assets	36.0	24.1	20.1	-18.5	6.6	14.6
Bank of Botswana	38.8	22.4	17.2	-16.1	6.4	14.7
Commercial banks	-28.6	99.3	102.8	-43.6	11.5	9.7
Net domestic assets	81.5	17.0	19.0	-37.8	-10.8	26.7
Net domestic credit	189.6	38.3	-14.2	-80.8	-247.6	153.8
Net claims on the government	62.3	25.1	6.8	-24.6	-14.6	-16.1
of which: Bank of Botswana	60.6	31.2	14.0	-26.8	-13.7	-14.9
Claims on nongovernment	20.2	13.3	27.8	10.9	11.4	9.0
Claims on parastatals	-0.6	-35.4	-39.6	198.0	11.5	9.7
Claims on the private sector	20.7	25.7	26.6	10.3	11.4	9.1
Other items (net)	44.5	2.4	49.7	-14.9	17.6	45.8
Broad money (M3)	9.0	31.2	21.1	-1.8	16.1	9.5
			(Contribution to growth in M3)			
Net foreign assets	57.3	47.9	37.8	-34.5	10.2	20.7
Bank of Botswana	59.2	43.4	31.1	-28.1	9.6	20.3
Commercial banks	-1.9	4.4	6.9	-4.9	0.7	0.6
Net domestic assets	-48.3	-16.8	-16.7	32.7	5.9	-11.2
Net domestic credit	-28.7	-15.4	6.0	24.3	14.5	11.5
Net claims on the government	-37.9	-22.7	-5.9	18.8	8.5	6.9
of which: Bank of Botswana	-35.5	-27.0	-12.1	21.8	8.3	6.7
Claims on nongovernment	9.2	6.7	12.1	5.0	5.9	4.5
Claims on parastatals	0.0	-0.4	-0.2	0.5	0.1	0.1
Claims on the private sector	9.2	12.7	12.6	5.1	6.3	4.8
Other items (net)	-19.6	-1.4	-22.7	8.4	-8.6	-22.7
Memorandum items:						
Nominal GDP (calendar year)	65,692	75,989	91,653	83,200	92,727	101,708
Nominal nonmineral GDP (calendar year)	37,781	45,425	54,085	61,652	68,879	75,409
Velocity (nonmineral GDP relative to broad money, M3)	1.5	1.4	1.4	1.6	1.5	1.5
Private sector credit to GDP	18.4	20.0	21.0	25.5	25.5	25.4
Private sector credit to non-mineral GDP	32.0	33.5	35.6	34.5	34.4	34.2

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

[1] This table represents a depository corporations survey, and the data are for end of period.
[2] Includes valuation adjustments reflecting gains and losses arising from the valuation of foreign exchange reserves.

Table 5. Banking System Prudential Indicators, 2005–2010 [1]

	2005	2006	2007	2008	2009	2010 March
(Percent, unless otherwise indicated)						
Capital adequacy						
Regulatory capital (millions of pula) [2]	1,568.6	1,743.2	2,020.6	2,991.6	3,670.7	3,989.6
Tier 1 capital (millions of pula)	961.4	1,071.3	1,185.4	1,832.2	2,191.6	2,253.5
Risk weighted assets (in millions pula)	9,065.6	10,404.2	10,947.2	17,694.4	18,734.7	20,044.4
Total Assets (in millions pula)	17,760.6	29,255.5	33,988.1	45,317.7	44,090.1	46,368.7
Regulatory capital to risk-weighted assets [3]	17.3	16.8	18.5	16.9	19.6	19.9
Regulatory Tier I capital to risk-weighted assets [4]	10.6	10.3	10.8	10.4	11.7	11.2
Capital-to-assets	8.8	6.0	5.9	6.6	8.3	8.6
Asset composition and quality						
Loans-to-assets	51.2	36.9	33.9	39.7	44.8	45.1
Nonperforming loans (NPLs)-to-gross loans [5]	0.9	1.5	1.3	1.6	3.2	3.3
Compromised assets-to-gross loans [5]	2.6	3.2	3.3	0.9	0.9	1.1
NPLs net of specific provisions-to-gross loans [5]	0.0	0.0	1.4	-0.3	0.3	0.3
NPLs net of specific provisions-to-Tier I capital [5]	0.0	0.0	0.1	-2.5	3.0	3.2
Profitability						
Return on average assets	5.5	6.1	2.6	2.9	2.8	0.7
Return on average equity	62.5	66.9	43.2	45.4	56.5	13.8
Net interest Margin to gross income	38.2	31.8	65.4	65.2	67.5	65.8
Noninterest income to gross income	23.2	17.8	34.6	34.8	32.5	34.2
Noninterest expenses to gross income	27.1	20.2	45.2	45.5	45.3	46.9
Liquidity						
Liquid assets to total assets	26.1	47.0	47.2	50.5	39.6	37.1
of which:						
BoBCs to Total Assets	19.6	43.4	45.3	38.7	37.3	34.6
Liquid assets to short-term liabilities	35.5	60.4	59.5	56.9	45.3	44.4
Foreign currency denominated loans to total loans	7.7	12.1	12.1	9.2	7.2	8.0
Foreign currency deposits to total deposits	17.9	24.8	32.7	26.9	12.9	14.0
Foreign currency denominated liabilities to total liabilities	22.5	29.1	41.6	34.8	34.2	35.9
Deposits-to-assets	74.5	79.0	83.2	85.2	86.0	80.7
Loans-to-deposits	68.7	46.7	40.8	46.6	52.1	55.8
Sensitivity to market risk						
Net open foreign exchange (FX) position as percent of regulatory capital [6]	8.3	-18.1	-8.1	28.7	22.5	23.4
Contingent foreign exchange (FX) assets-to-regulatory capital	70.7	258.2	327.1	132.7	31.8	47.8
Contingent foreign exchange (FX) liabilities-to-regulatory capital	52.4	88.4	18.7	60.9	74.2	95.9

Source: Bank of Botswana and Financial Sector Assessment Program (FSAP) estimates.

[1] The compilation methodology has changed somewhat since 2006; the number of banks has increased since 2007.

[2] Regulatory capital refers to the total of Tier 1 and Tier 2 capital, less investments in subsidiaries and associates.

[3] The minimum capital requirement is 15 percent of risk weighted assets.

[4] The minimum capital requirement is 7.5 percent of risk weighted assets.

[5] NPLs are defined as credits with interest past due of 182 days or more; compromised assets are defined as credits with interest past due of 91 days or more.

[6] Foreign currency liabilities less foreign currency assets as a percent of regulatory capital.

Table 6. Millennium Development Goals, 1990-2009

	1990	1995	2000	2007	2008	2009
Goal 1: Eradicate extreme poverty and hunger						
Income share held by lowest 20 percent	...	*3.1*	...	…	…	…
Malnutrition prevalence, weight for age (percent of children under 5)	...	*17.2*	12.5	10.7	4.3	4.1
Poverty gap at $1.25 a day (PPP) (percent of population)	...	*11*	...	...	...	...
Poverty headcount ratio at $1.25 a day (PPP) (percent of population)	...	*31*	...	…	23.5	23.5
Poverty headcount ratio at national poverty line (percent of population) [1]	...	47.0	47.0	30.3	30.3	...
Prevalence of undernourishment (percent of population)	*20*	*24*	...	*26*	...	...
Goal 2: Achieve universal primary education						
Literacy rate, youth total (percent of people ages 15–24)	89	...	...	*94*	*94*	*94*
Persistence to grade 5, total (percent of cohort)	*77*	...	85	*86*	*88*	*86*
Primary completion rate, total (percent of relevant age group)	89	91	90	95	...	...
School enrollment, primary (percent net) [2]	…	...	83	84	86	86
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliament (percent)	5	*9*	*17*	11	11	7
Ratio of girls to boys in primary and secondary education (percent)	…	...	74	100	103	102
Ratio of young literate females to males (percent ages 15–24)	110.0	...	...	...	...	...
Share of women employed in the nonagricultural sector (percent of total nonagricultural employment)	33.5	38.4	39.4	*43.4*	*41.2*	...
Goal 4: Reduce child mortality						
Immunization, measles (percent of children ages 12–23 months)	87	89	90	90	91	93
Mortality rate, infant (per 1,000 live births) [2]	45	53	64	33	57	57
Mortality rate, under-5 (per 1,000) [2]	57	70	87	40	76	76
Goal 5: Improve maternal health						
Births attended by skilled health staff (percent of total)	*77*	*87*	94	99	98	98
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	…	193	198	198
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Contraceptive prevalence (percent of women ages 15–24)						
Incidence of tuberculosis (per 100,000 people)	307	444	640	731	513	...
Prevalence of HIV, female (percent ages 15–24)	…	...	…	15.3	10.7	...
Prevalence of HIV, total (percent of population ages 15–49) [3]	...	...	...	...	17.6	...
Tuberculosis cases detected under DOTS (percent) [4]	...	70	73	57	63	...
Goal 7: Ensure environmental sustainability						
CO2 emissions (metric tons per capita)	1.6	2.2	2.5	*2.5*	...	...
Forest area (percent of land area)	24	23	22	21	...	...
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	6	6	7			
Improved sanitation facilities (percent of population with access)	38	42	45	*47*	...	*80*
Improved water source (percent of population with access)	93	94	95	*96*	*96*	...
Nationally protected areas (percent of total land area)	...	...	...	*19*	...	...
Goal 8: Develop a global partnership for development						
Aid per capita (current US$)	106	57	18	56	...	...
Debt service (PPG and IMF only, percent of exports, excl. workers' remittances)	4	3	2	1	...	...
Telephone lines (per 100 people)	2	4	8	7	8	8
Mobile cellular subscriptions (per 100 people)	0	0	13	61	91	105
Internet users (per 100 people)	0	0.1	2.9	5.3	4.0	4.0
Personal computers (per 1,000 people)	...	9.0	34.0	...	...	...
Total debt service (percent of exports of goods, services and income)	4.3	3.1	2.0	...	...	...
Unemployment, youth female (percent of female labor force ages 15–24)	*33.4*	*42.4*	14.0	...	...	...
Unemployment, youth male (percent of male labor force ages 15–24)	*20.2*	*33.5*	13.2	...	...	...
Unemployment, youth total (percent of total labor force ages 15–24)	*25.6*	*37.9*	13.6	...	...	...
Other						
Fertility rate, total (births per woman)	4.6	3.9	3.4	2.9	...	2.5
GNI per capita, Atlas method (current US$)	2,560	3,040	3,310	6,120	...	...
GNI, Atlas method (current US$ billions)	3.5	4.8	5.7	11.5	...	...
Gross capital formation (percent of GDP)	37.4	24.6	35.0	40.7	...	...
Life expectancy at birth, total (years) [2]	63	57	49	51	...	...
Literacy rate, adult total (percent of people ages 15 and above)	69	...	...	*83*	...	...
Population, total (millions)	1.4	1.6	1.7	1.9	...	...
Trade (percent of GDP)	104.8	89	86.2	83.7	...	...

Source: Botswana authorities and World Bank World Development Indicators, 2009.

Note: Figures in italics refer to periods other than those specified; … refers to "not available."

1 Poverty headcount ratio at national poverty line updated from the Botswana 2002–2003 HIES.

2 Data taken from the *Botswana Millennium Development Goals, Status Report* , 2004.

3 Data as reported in the 2008 Botswana AIDS Impact Study.

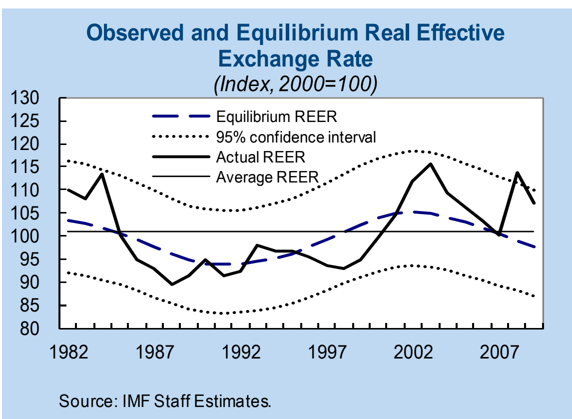
4 The Directly Observed Treatment, Short-course (DOTS) is a WHO-recommended strategy for detection and cure of TB.

Appendix 1. Exchange Rate Assessment

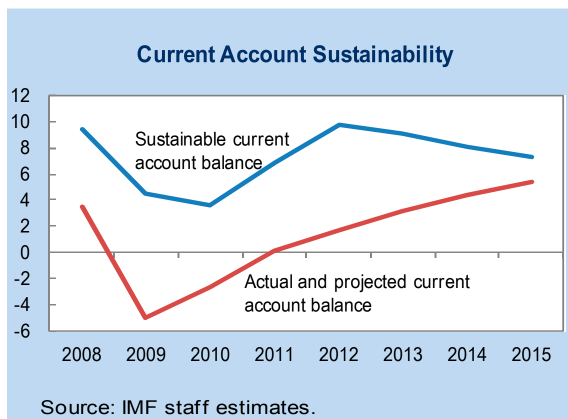
Assessment of Botswana's exchange rate is based on the IMF's Consultative Group on Exchange Rate Issues (CGER) methodology, adapted for Botswana's circumstances.

Macroeconomic balance approach: Using coefficients relating current account balances to macroeconomic fundamentals, estimated from a sample of low- and middle-income countries, yields a current account norm for Botswana of 5.5 to 4.8 percent of GDP in 2015, depending on the precise model specification. This compares with an underlying current account balance in Botswana (measured by the projected current account balance in 2015 in the staff baseline, by which point temporary factors and exogenous shocks have dissipated) of 5.1 percent of GDP. The elasticity of the current account relative to the real effective exchange rate is assumed to be -0.5 based on estimated import and export elasticities for Botswana. This suggests that, by 2015, the exchange rate is expected to be in line with equilibrium under the baseline scenario, deviating by less than 0.5 percent. Under an alternative scenario where the fiscal position does not recover and the current account remains negative, the model predicts an overvaluation of 9 to 10 percent by 2015.

Equilibrium real exchange rate approach: This approach estimates the level of the equilibrium real exchange rate based on macroeconomic fundamentals (for example, relative productivity, real interest rate differentials, terms of trade, and government consumption). It suggests that, as of March 2010, the exchange rate was overvalued by about 7 percent, although the confidence intervals around this estimate are large.



Source: IMF Staff Estimates.



Source: IMF staff estimates.

External sustainability approach: Following previous work on Botswana, this approach calculates the norm current account balance consistent with a buildup of net foreign assets that takes into account the need to accumulate savings ahead of declining diamond receipts.[7] The resulting "sustainable current account balance" is calculated as about 7.3 percent of GDP in 2015, compared with staff's projected underlying current account balance of 5.1 percent of GDP. Using the same elasticities as in the macroeconomic balance approach suggests that the exchange rate is overvalued by about 4 percent.

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[7] Deléchat, C. and M. Gaertner, 2008, "Exchange Rate Assessment in a Resource - Dependent Economy: The Case of Botswana", IMF Working Paper No. 08/83.

Structural measures of competitiveness suggest that Botswana continues to lead a large number of countries in the world in various aspects of political and economic governance. But challenges persist. Entrepreneurs in Botswana must overcome a high cost of trading across its borders and dealing with construction permits, and difficulties in employing workers and enforcing contracts.

Selected Competitiveness Indicators

Bostwana scores well in aggregate…

Doing Business	Rank
Singapore	1
Mauritius	17
South Africa	34
Botswana	45
Chile	49
Namibia	66
Zambia	90
Lesotho	130
Mozambique	135

Source: World Bank Doing Business, 2010

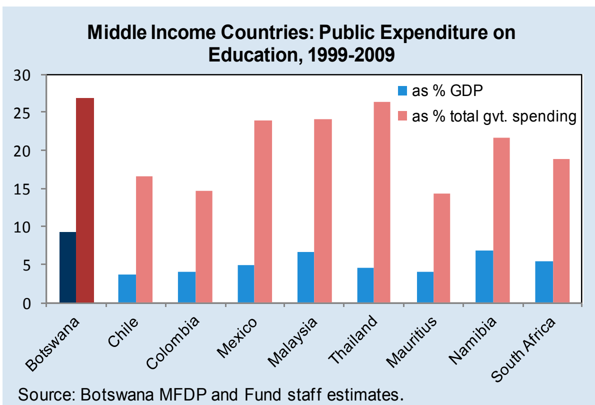
…but lags behind in dealing with construction permits and trading across borders.

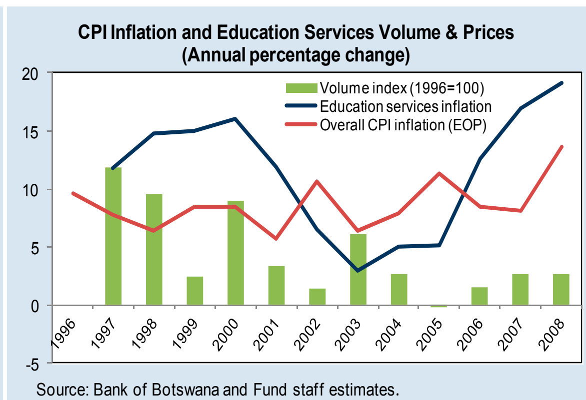
Indicator	Rank
Paying Taxes	18
Closing a Business	27
Protecting Investors	41
Getting Credit	43
Registering Property	44
Ease of Doing Business Rank	45
Employing Workers	71
Enforcing Contracts	79
Starting a Business	83
Dealing with Construction Permits	123
Trading Across Borders	150

Source: World Bank Doing Business, 2010

Appendix 2. Diminishing Returns to Public Expenditure[8]

Botswana's rapid economic growth during the 1970s and 1980s was largely the result of high public investment in human and physical capital. The associated gains in terms of the building of basic infrastructure and the provision of health, education, and other services—where virtually none existed at independence in 1966—are remarkable. Over time, however, public investment has become less efficient in promoting long-term growth. Returns have declined as the public sector has grown and engaged in a widening range of public investment that extends well beyond the provision of core public goods. Simultaneously, the attention paid to project appraisal and evaluation has weakened as project implementation capacity has become stretched and buoyant diamond revenues and repeated budget surpluses relaxed the government budget constraint. The postponement of maintenance expenditures and a loose definition of what constitutes investment have further debilitated the quality and efficiency of public investment spending.





Education is one area where returns to public spending appear to be lower than in some other middle-income countries. Botswana allocates nearly a quarter of its annual public spending to education, and spending per student is significantly higher than in other middle-income countries. High rates of literacy and enrollment in secondary schools have been among the system's accomplishments. However, less than 60 percent of those enrolling in secondary school complete their schooling. Other measures of educational attainment are also no better than average compared with other countries in the region despite higher spending. Costs are also increasing, as measured by the high and rising implicit price deflator for education services.

Social safety nets are another area where value for money appears weak. Social safety net programs account for about 10 percent of government spending, or 3-4 percent of GDP, and are designed to address risks related to malnutrition, HIV/AIDS, unemployment, disability, and old age. However, they cover only a small portion of the poor (19 percent) and many beneficiaries are nonpoor households (57 percent). Better and more regular information (for example, poverty assessments and household income and expenditure surveys) is needed to improve targeting of beneficiaries.

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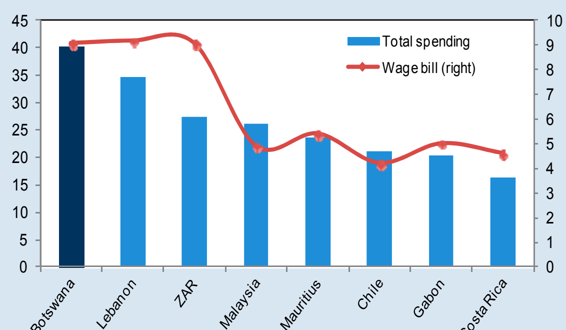
[8] This appendix was prepared jointly with the World Bank staff and draws on the World Bank Public Expenditure Review (2010).

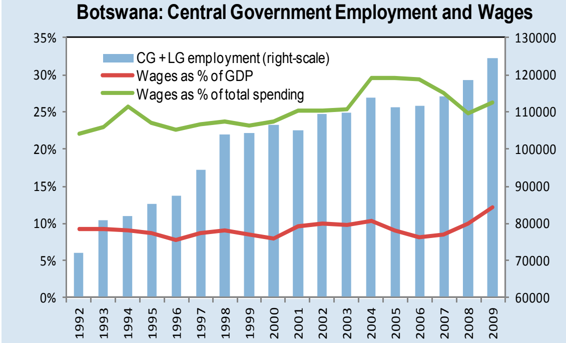
The large size of the public sector is undermining the competitiveness of the economy as a whole, by increasing costs, particularly wages. Government spending, averaging 35 percent of GDP during the past decade, is among the largest in Africa. The public sector outbids the private sector for available labor, exerting upward pressure on economy-wide labor costs, and contributes to high unit labor costs and unemployment. While government workers constitute 40 percent of the total formal workforce, they claim more than 54 percent of total wages paid. The reservation wage that workers demand before accepting employment has risen as workers expect salaries significantly higher than the market clearing levels in the non-government sectors of the economy.

Botswana: Central Government Total Spending and Wage Bill



Source: Botswana MFDP and Fund staff estimates.

Botswana: Central Government Employment and Wages



Source: Botswana MFDP and Fund staff estimates.

INTERNATIONAL MONETARY FUND

BOTSWANA

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the African Department

July 12, 2010

Contents Page

I. RELATIONS WITH THE FUND

(As of July 9, 2010)

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

II. General resources account	SDR (million)	Percent of Quota
Quota	63.00	100.00
Fund holdings of currency	54.53	86.56
Reserve position in Fund	8.48	13.45

III. SDR department	SDR (million)	Percent of Quota
Net cumulative allocation	4.36	100.00
Holdings	39.66	909.81

IV. Outstanding purchases and loans None

V. Financial arrangements None

VI. Project obligations to Fund None

VII. Implementation of HIPC initiative None

VIII. Exchange rate arrangements

The exchange rate of the Botswana pula is a crawling peg arrangement against a basket of currencies. As of July 9, 2010, the exchange rate of the U.S. dollar to the pula was US$1= P6.983, and that of the South African rand to the pula was R1=P0.92353.

Botswana accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement, as of November 17, 1995, and maintains an exchange rate system free of restrictions in the making of transfers and payments of current account transactions.

IX. Article IV consultation

Botswana is on a standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on July 20, 2009.

X. Technical assistance

Department	**Dates**	**Purpose**
FAD	September 2000	Implementation of VAT next steps
	February 2002	Tax administration (Southern Africa Development Community Region)
	November 2004	Public expenditure management
	February 2010	Public financial management (scoping mission)

LEG	January 2006	Review of amended VAT provisions
	July 2006	Review of central bank law
	June 2007	Review of VAT laws
STA	May 2001	Inspection for visit of long-term balance of payments advisor
	April 2002	Report on Standards and Code (ROSC) data module
	July 2002	BOP statistics: peripatetic visit
	August 2003	Monetary and financial statistics using the General Data Dissemination Standard (GDDS)
	June 2004	GDDS project for Anglophone Africa: National accounts statistics
	August 2004	Follow-up mission: Money and banking statistics
	October 2004	GDDS: National accounts mission
	June 2005	Follow-up on monetary and financial statistics using the GDDS
	August 2005	Follow-up mission: GDDS quarterly balance of payments statistics
	March 2006	GDDS project for Anglophone Africa: balance of payments statistics
	March 2006	GDDS project for Anglophone Africa: national accounts statistics
	October 2006	ROSC data module covering GDDS and Data Quality Assessment Framework (DQAF)
	October 2007	Monetary and financial statistics
	November 2007	Real sector statistics (resident regional advisor)
	November 2008	Money and banking statistics
	February 2009	Phase II Special Data Dissemination Standard (SDDS)—Balance of Payments Statistics
	June 2009	Real sector statistics (resident regional advisor)
	February 2010	Money and banking statistics
MCM	January 2001	Banking supervision advisor
	February 2001	Monetary operations
	December 2001	Macroeconomic and Financial Management Institute MEFMI—Monetary operations
	August 2002	Banking supervision, anti-money laundering
	July 2004	Non-bank Financial Institution (NBFI) supervision
	August 2004	Money and banking statistics follow-up
	January, March 2007	IMF–World Bank Financial Sector Assessment Program (FSAP)
	March, September, December 2004, July 2006, December 2008 and 2009	Inflation forecasting and modeling
	January 2009	Risk management framework
	February 2009	Payments systems (LT Resident Expert Assignment)
	June 2009	Risk management
	July 2009	Monetary operations

II. Joint World Bank and IMF Work Program

(As of June 21, 2010)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual Information on Relevant Work Programs			
World Bank indicative work program in the next 12 months	1. Morupule B Generation and Transmission Power Project (SIL/PCG		FY10 (approved)
	2. HIV/AIDS Project		Bank Board Q1, FY09 (approved)
	3. Integrated Transport Project		Bank Board Q4, FY09 (approved)
	4. Statistics/Capacity-building		
	• Strengthening Monitoring and Evaluation capacity for Vision 2016 Council (IDF Grant)		FY10; Ongoing
	• Strengthening Institute & Accountants (IDF Grant)		FY10; Ongoing
	5. Carbon Capture and Storage TA		FY11
	6. Post ICA Follow-up—Microenterprises		FY10
	7. Public Expenditure Review		FY 2010
	8. FBSA Technical Advisory Services (Phases 1 & 2)		Phase 1 completed FY10, Phase 2 ongoing FY11
	9. Sustainable Development (SDN) Policy Notes		FY11; ongoing
	10. PER/PFM Reform (TA)		FY11
	11. Development Policy Review (DPR): Competitiveness, Diversification and Growth		FY12
	12. Skills Gap/Labor Markets		FY11

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	13. Capacity Building in NonBank Financial Institutions (TA)		FY10
	14. Issues Note on Accrual Accounting		FY11; ongoing
	15. Country Program Strategy (CPS) Progress Report		FY11
	16. Medium Term Debt Management Strategy (MTDS)		FY10
	17. Debt Management Performance Assessment (DeMPA)		FY11
IMF work program in the next 12 months	STA TA on balance of payments and government financial statistics	Ongoing FY 2011	
	MCM TA on nonbank supervision, central bank risk management, and monetary operations, including assistance in moving to inflation targeting.	Ongoing FY 2011	
	FAD TA Follow up on PFM scoping mission	Expected FY 2011	
	Article IV consultation	June 2011	
B. Requests for Work Program Inputs			
Fund request to Bank	Periodic update on progress		
Bank request to Fund	Periodic macro update		

III. Statistical Issues

As of June, 2010

I. Assessment of Data Adequacy for Surveillance
General: Macroeconomic data are adequate for surveillance, but some shortcomings exist in terms of accuracy and reliability of the source data and the statistical techniques used in the compilation of national accounts, government finance, and balance of payments statistics. The timeliness of the central bank survey and detailed government expenditure data by economic classification needs to be increased to better support economic analysis and prepare Botswana for an eventual subscription to the Special Data Dissemination Standard (SDDS). Further improvements would include dissemination of readily available information on monthly production of diamonds and quarterly aggregate financial soundness indicators. The authorities are working on a number of fronts to improve data quality and dissemination: (i) source data and methodologies are being reviewed for those data with obvious estimation problems/gaps, (ii) stronger collaboration is being sought among source data producers to secure consistency and reconcile discrepancies across data sets; (iii) the production of leading economic indicators is currently underway; and (iv) staff shortages are being addressed within budget constraints.
National Accounts: National accounts estimation has not kept pace with changes to the structure of the economy and needs to be rebased (the current base year is 1993/94). The Household Income and Expenditure Survey (HIES) (2002/03) and Labor Force Survey (2005/06) are out of date. More frequent surveys would support a more robust estimation of private consumption and a better understanding of poverty and unemployment.
Price Statistics: The official monthly consumer price index (CPI) is available on a timely basis in the CSO's website. The index is comprehensive and provides breakdowns between urban and rural price data, and between prices of tradable (domestic and imported) and nontradable goods and services. Estimates from an outdated HIES are currently used for the weights of market expenditure for goods and services. Compilation challenges include undertaking a new HIES (ongoing) and the eventual inclusion of owner-occupied housing price data in the CPI. Compilation of producer or wholesale prices has been discontinued.
Government Finance Statistics: The concepts and definitions used in compiling government finance statistics generally follow the guidelines of the IMF's *1986 Government Finance Statistics Manual* (*GFSM 1986*) but cover only budgetary central government activities. No fiscal statistics are compiled for extra budgetary institutions, consolidated central government, or consolidated general government. No decision has been made by the authorities on adopting a "migration path" to the *GFSM 2001* methodology. Recurrent and development expenditure data are published in an aggregate form. Development spending comprises a mixture of current and capital spending.
Monetary and Financial Statistics: Compilation practices are consistent with the Fund's *Monetary and Financial Statistics Manual*. The central bank survey is currently available with a lag of about three months, which is well short of the two-week period recommended in the SDDS. STA's recommendation is to make preliminary data available with clear identification of data status. The authorities prefer a more cautious approach to data dissemination to avoid reputation damage if the data require revisions. The BoB is seeking to expand the coverage of financial statistics to include the operations of nonbank financial intermediaries (NBFI), such as pension funds, insurance companies, and other financial corporations, such as unit trusts, finance companies, and financial auxiliaries. STA's recommendation is to focus on data collection in a handful of large institutions within each NBFI category.

Balance of Payments and International Investment Position Statistics: Annual and quarterly balance of payments data are published in the Botswana Financial Statistics (*BF)* and the BoB's Annual Report. Preliminary data are generally disseminated within two months of the end of the reporting period, while revised (final) data are available after nine months. The concepts, structure, and definitions of the balance of payments statistics follow the fifth edition of the *Balance of Payments Statistics Manual* (BPM5). Source data are adequate, but the International Transaction Reporting System (ITRS) data—as opposed to alternative survey data on services and transfer items in the current account—has become unreliable. Data compilation, estimation, and adjustments mostly employ sound techniques, but the methods used for estimating missing data (for example, unrecorded trade), f.o.b. /c.i.f. adjustment factors to import values, and flows from stock data are inadequate. Discrepancies exist in national accounts data concerning: (i) the valuation of diamond exports and (ii) imports, exports, and payments related to settlements within the Southern African Customs Union (SACU). Large errors and omissions in the 2009 balance of payments statistics have complicated the assessment of external sustainability. The BoB conducts an annual survey of Botswana's investment and international investment position (IIP). A quarterly IIP survey is also produced for internal use with data from the ITRS. **External Debt:** Public external debt data are of good quality and but timeliness could be improved (the latest published data is for March 2009).
II. Data Standards and Quality
Botswana has participated in the GDDS since late 2002. A Data ROSC and its updates were published in April 2002, March 2004, and April 2007, respectively.
III. Reporting to STA
Monetary data are reported for publication in *International Financial Statistics* using *Standardized Report Forms*. No government financial statistics are currently reported for publication in the *Government Finance Statistics Yearbook.*

Table 1. Botswana: Common Indicators Required for Surveillance

(As of July 9, 2010)

	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]
Exchange rates	7/09/2010	7/09/2010	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities [4]	Feb 2010	April 2010	M	M	M		
Reserve/base money	Feb 2010	April 2010	M	M	M	O, O, LO, O	LNO, O, LO, LO, LO
Broad money	Feb 2010	April 2010	M	M	M		
Central bank balance sheet	Feb 2010	April 2010	M	M	M		
Consolidated balance sheet of the banking system	Feb 2010	April 2010	M		M		
Interest rates [5]	7/09/2010	7/09/2010	D	D	D		
Consumer price index	May 2010	June 2010	M	M	M	O, LO, O, O	LO, LO, LO, LO, O
Revenue, expenditure, balance, and composition of financing [6]—general government [7]	NA	NA				LO, LNO, LNO, LO	LO, O, LO, LO, LNO
Revenue, expenditure, balance, and composition of financing [6]—central government	March 2010	May 2010	A/Q/M	Q	Q		
Stocks of central government and central government-guaranteed debt [8]	March 2009	April 2010	A	A	A		
External current account balance	2009 Q3	May 2010	A/Q	A	A	O, O, O, LO	LO, LO, LNO, O, LO
Exports and imports of goods	March 2010	May 2010	M	M	M		
GDP/GNP	2010 Q1	June 2010	A/Q	A/Q	A/Q	LO, LO, LNO, LO	LO, LO, LNO, LO, LO
Gross external debt	March 2009	May 2010	A/Q	A	A		

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

[2] Reflects the assessment provided in the data ROSC published on April 6, 2007, and based on the findings of the mission that took place from October 31 to November 13, 2006, 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), not observed (NO), or not available (NA).

[3] Same as footnote 2, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, 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, money market, treasury bill, note, and bond rates.

[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.

IV. MEDIUM-TERM PUBLIC DEBT SUSTAINABILITY ANALYSIS[1]

Botswana's gross public debt rose sharply to 15 percent of GDP in 2009/10 albeit from a very low base. Under the staff baseline scenario, the public debt ratio-to-GDP increases to 17.6 percent of GDP in 2010/11 before falling to 10.5 percent of GDP by 2015/16. However, as the government draws on its savings to finance fiscal deficits in the near term, its net asset position declines from 39.1 percent of GDP in 2009 to 20.8 percent of GDP in 2012 before increasing gradually thereafter. This declining path for public debt is robust to various shocks, though holding the fiscal deficit constant at current levels results in an unsustainable debt path, underscoring the need for substantial expenditure reduction.

Botswana's gross public debt rose sharply from US$0.7 billion (6.2 percent of GDP) in 2008/09 to about US$2 billion (15 percent of GDP) in 2009/10. About 72 percent of the debt is owed to bilateral and multilateral foreign creditors, while the rest is domestic debt. Botswana has had a historically low level of public debt, thanks to prudent fiscal policies, which has led to fiscal surpluses and a significant accumulation of government reserves including the Pula Fund. However, the global financial crisis and the resulting lower demand for diamonds have contributed to a sharp decline in government mineral revenues. This, combined with a significant rise in public spending, resulted in a fiscal deficit of 14.2 percent of GDP in FY 2009/10, which was financed through a drawdown in reserves, a budget support loan from the African Development Bank (AfDB) of US$1.5 billion (of which US$1 billion has so far been drawn), and other borrowing.

The baseline scenario underlying the macroeconomic framework assumes that revenue and grants increase from a low of 31.6 percent of GDP in 2009/10 and stabilize at around 37 percent of GDP in the medium term. Primary expenditure is projected to fall as recent stimulus spending is unwound and as ongoing infrastructure projects are completed. As a result, the overall balance gradually improves to a surplus of 4.7 percent of GDP in 2015/16. Staff assumes that about one-third of the deficits from 2010/11 through 2012/13 will be financed by domestic borrowing with the remaining two-thirds financed by drawing down savings in the Pula Fund. As a result, gross debt-to-GDP is projected to fall to 10.5 percent of GDP by 2015/16.

[1] Prepared by Dalmacio Benicio.

The government's net creditor position deteriorates somewhat over the medium term, declining from 39.1 percent of GDP in 2009/10 to 20.8 percent of GDP in 2012/13 before recovering to 25.1 percent of GDP by 2015/16.

Table 1 presents two additional scenarios. The first scenario shows the fiscal outcome if real GDP growth, real interest rates, and the primary balance are maintained at their historical 10-year averages. In this case, the public debt-to-GDP ratio would drop to 8.7 percent of GDP by 2013/14, reflecting strong economic growth and the prudent fiscal stance in the recent past. The second scenario shows the outcome if the government's policies remain unchanged from 2010/11, in the sense that the fiscal balance is held constant at its 2010/11 level. In this case, debt indicators would worsen considerably, with public debt rising to 56.3 percent of GDP by the end of the forecast period, underscoring the downside risk of delay or failure to reduce expenditure to sustainable levels.

The bounds tests illustrate the sensitivity of the fiscal position to exogenous shocks (Figure 1). The debt-to-GDP ratio would increase by between 1 to 17 percentage points of GDP depending on the shock. The most benign shock is that from the real interest rate, which results in a 4 percentage points increase in the debt-to- GDP ratio relative to the baseline scenario, while a worsening in the 10 year historical average primary balance by one standard deviation results in a 17 percentage points increase in the debt-to-GDP ratio.

Table 2. Botswana: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of calendar-year GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing primary balance [10]
Baseline: Public sector debt [1,2]	7.4	5.6	7.5	6.2	15.0	**17.6**	**17.6**	**15.8**	**14.0**	**12.2**	**10.5**	**-0.1**
o/w foreign-currency denominated	4.2	3.3	2.5	2.3	10.8	11.1	10.3	9.3	8.3	7.0	5.8	
Change in public sector debt	-2.5	-1.9	1.9	-1.3	8.7	2.6	0.1	-1.8	-1.8	-1.8	-1.7	
Identified debt-creating flows (4+7+12)	-6.8	-11.7	-7.0	2.1	12.8	6.7	3.5	-1.2	-3.5	-4.3	-5.5	
Primary deficit	-7.5	-10.9	-6.6	2.5	12.1	7.7	4.3	-0.1	-2.6	-3.9	-5.1	
Revenue and grants	40.4	39.8	37.3	32.7	33.5	34.1	34.3	36.1	36.5	36.9	37.3	
Primary (noninterest) expenditure	32.9	28.9	30.7	35.2	45.6	41.8	38.6	36.0	33.9	33.0	32.2	
Automatic debt dynamics [3]	0.7	-0.8	-0.4	-0.4	0.8	-1.0	-0.9	-1.1	-0.9	-0.4	-0.4	
Contribution from interest rate/growth differential [4]	-0.4	-1.1	-0.4	-1.0	1.0	-1.0	-0.9	-1.1	-0.9	-0.4	-0.4	
Of which contribution from real interest rate	-0.3	-0.8	-0.2	-0.8	0.8	0.1	-0.1	0.0	0.1	0.2	0.2	
Of which contribution from real GDP growth	-0.1	-0.3	-0.2	-0.2	0.3	-1.1	-0.8	-1.1	-1.0	-0.6	-0.6	
Contribution from exchange rate depreciation [5]	1.1	0.3	0.0	0.5	-0.3	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	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) [6]	4.2	9.8	9.0	-3.3	-4.1	-4.1	-3.4	-0.6	1.7	2.5	3.8	
Public sector debt-to-revenue ratio [1]	18.4	14.0	20.1	19.0	44.6	51.5	51.5	43.9	38.3	33.1	28.2	
Gross financing need [7]	-6.6	-10.2	-6.0	3.1	13.1	9.6	6.3	1.9	-0.8	-1.8	-3.1	
in billions of U.S. dollars	-0.7	-1.2	-0.7	0.4	1.5	1.2	0.8	0.3	-0.1	-0.3	-0.5	
Scenario with key variables at their historical averages [8]						**17.6**	**11.4**	**8.2**	**7.7**	**8.0**	**9.9**	**-0.4**
Scenario with no policy change (constant primary balance) in 2010-2015						**17.6**	**20.3**	**26.2**	**34.4**	**44.0**	**54.9**	**-0.4**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	1.6	5.1	4.8	3.1	-3.7	8.4	4.8	7.2	7.4	5.1	5.3	
Average nominal interest rate on public debt (in percent) [9]	6.8	6.6	6.7	4.8	6.1	3.8	4.3	5.5	6.3	6.5	6.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-2.7	-12.6	-3.7	-12.2	11.9	0.9	-0.4	0.3	1.3	1.9	2.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-22.3	-8.6	0.4	-20.1	12.7	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	9.4	19.1	10.4	17.0	-5.8	2.8	4.7	5.2	5.1	4.5	4.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	-6.3	-7.8	11.4	18.5	24.7	-0.6	-3.2	0.0	1.2	2.4	2.5	
Primary deficit	-7.5	-10.9	-6.6	2.5	12.1	7.7	4.3	-0.1	-2.6	-3.9	-5.1	

[1] The public sector coverage refers to the central government. Gross debt is used.

[2] Discrepancies in debt-to-GDP ratios reported in this table and those reported in the Staff Report (pages 7 and 15) reflect the use of calendar year versus fiscal year GDP estimates.

[3] 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).

[4] 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.

[5] The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

[6] For projections, this line includes exchange rate changes.

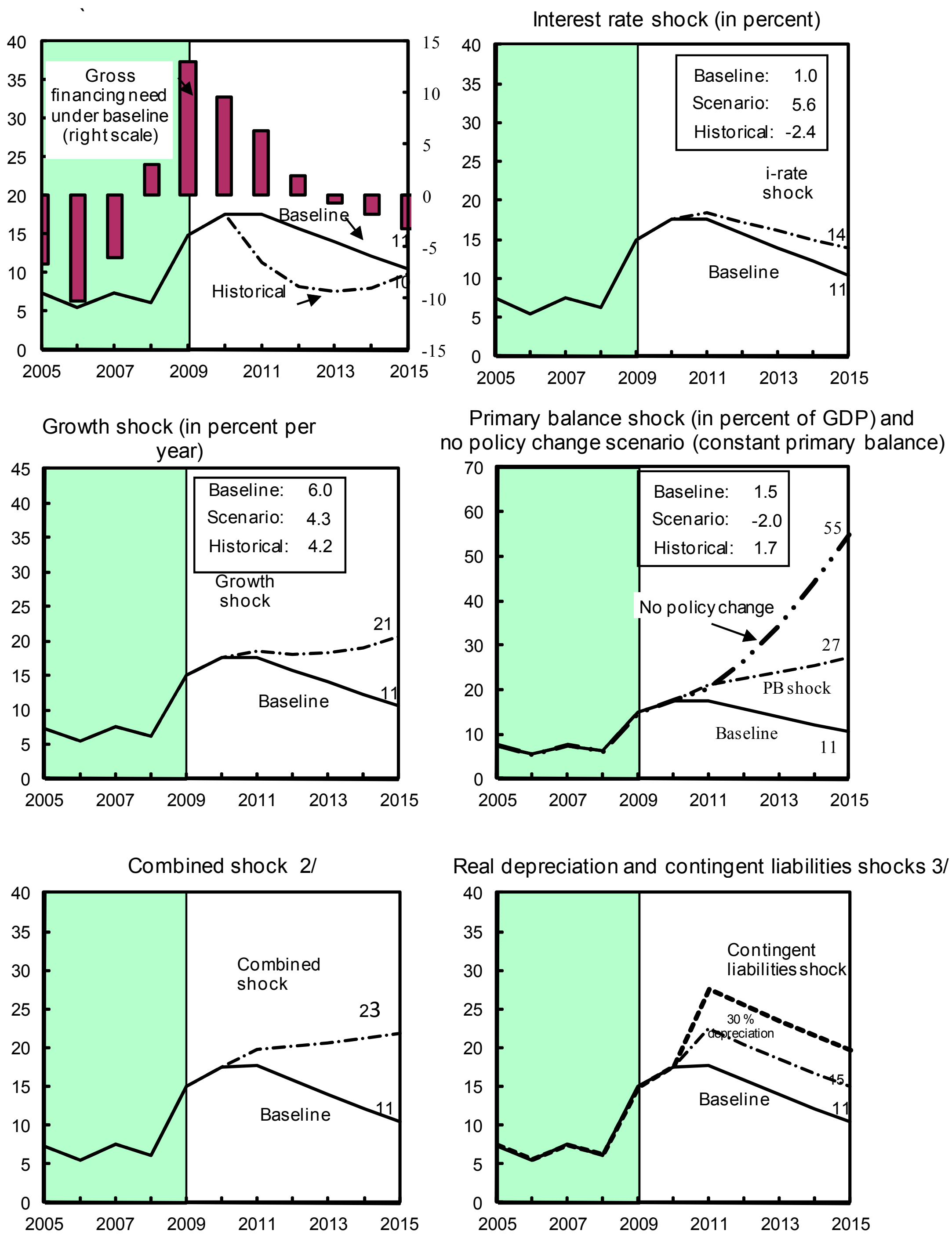
[7] Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

[8] The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

[9] Derived as nominal interest expenditure divided by previous period debt stock.

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

Figure 1. Botswana: Public Debt Sustainability: Bound Tests [1]
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
[1] Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
[2] Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
[3] One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

V. Medium-Term External Debt Sustainability Analysis[1]

Botswana's gross external debt increased from $0.4 billion (3.2 percent of GDP) in 2008 to $1.9 billion (15.4 percent of GDP) at the end of 2009. The increase largely reflects increased external borrowing by the public sector to finance a large fiscal deficit as well as (government-guaranteed) borrowing by the Botswana Power Corporation to finance the expansion of the Morupule power plant. As a result, public and publicly-guaranteed debt rose six-fold between end-2008 and end-2009, to 14.1 percent of GDP.

External Debt Indicators, 2009

	2009
Gross external debt (in millions of U.S. dollars)	1,918
(in percent of GDP)	15.4
Of which:	
Public and publicly guaranteed debt	1,763
(in percent of GDP)	14.1
Short-term debt (in millions of U.S.dollars)	297
(in percent of GDP)	2.4
Gross official reserves (in millions of U.S. dollars)	8,704
(ratio to short-term debt)	29.3
(ratio to reserve money)	2.9
Memorandum items:	
GDP at current market prices (in million U.S.dollars)	12,468
Reserve money (in million U.S. dollars)	3,051

Sources: Bank of Botswana and Fund staff estimates.

After a sharp rise last year due to the deterioration in the fiscal and current account balances, external debt should stabilize this year at 15.9 percent of GDP under the baseline scenario. The fiscal and current account balances should return to a surplus by 2011, at which time external debt should also begin to decline steadily. Consistent with the macroeconomic framework, the recovery in the baseline scenario is predicated on a rebound in diamond exports and declining imports as the power plant projects near completion. Risks to the baseline include higher than envisaged investment in power projects, a substantial element of which would be financed through external borrowing, or a delay of the planned fiscal consolidation.

Simulations suggest that Botswana's external debt-to-GDP ratio is robust to growth interest rate, and currency shocks. It appears more susceptible to a current account shock and to a combination of growth, interest rate and current account shocks. The ratio could rise significantly in the event of a current account shock, but would still remain below 30 percent of GDP. However, neither scenario is very likely under current circumstances absent a further collapse in the diamond market.

[1] Prepared by Irene Yackovlev.

Table 3. Botswana: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	6.1	4.9	3.7	3.2	15.4	**15.9**	**14.8**	**14.0**	**12.9**	**10.7**	**8.6**	**-2.3**
Change in external debt	0.4	-1.2	-1.1	-0.5	12.2	0.6	-1.1	-0.8	-1.1	-2.1	-2.1	
Identified external debt-creating flows (4+8+9)	-13.4	-16.3	-16.1	-10.6	-1.4	-5.0	-5.3	-7.0	-7.9	-8.1	-8.6	
Current account deficit, excluding interest payments	-17.0	-19.1	-16.2	-4.3	1.1	-1.3	-2.3	-4.0	-5.0	-6.0	-6.6	
Deficit in balance of goods and services	-16.8	-16.3	-11.5	-0.9	5.5	3.9	1.5	1.0	0.2	-0.5	-1.2	
Exports	51.4	47.0	47.7	42.2	37.7	40.1	40.4	39.0	38.1	37.3	36.6	
Imports	34.6	30.7	36.1	41.3	43.2	44.0	41.9	40.1	38.3	36.8	35.5	
Net non-debt creating capital inflows (negative)	0.9	1.7	-0.9	-7.2	-3.3	-4.0	-3.9	-3.7	-3.6	-3.4	-3.3	
Automatic debt dynamics 1/	2.7	1.1	1.0	1.0	0.8	0.3	0.9	0.6	0.7	1.3	1.3	
Contribution from nominal interest rate	1.8	1.8	1.7	0.9	0.9	1.6	1.6	1.6	1.6	1.9	1.8	
Contribution from real GDP growth	-0.1	-0.3	-0.2	-0.1	0.1	-1.3	-0.7	-1.0	-0.9	-0.6	-0.5	
Contribution from price and exchange rate changes 2/	1.0	-0.5	-0.5	0.3	-0.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	13.7	15.0	14.9	10.1	13.6	5.6	4.2	6.2	6.8	5.9	6.4	
External debt-to-exports ratio (in percent)	11.9	10.4	7.9	7.6	40.8	39.8	36.8	35.9	33.8	28.8	23.6	
Gross external financing need (in billions of US dollars) 4/	-0.8	-1.0	-0.9	-0.2	0.6	0.4	0.3	0.1	0.0	0.0	-0.1	
in percent of GDP	-8.4	-9.0	-6.8	-1.3	4.8	3.3	2.5	1.0	0.0	-0.1	-0.7	
Scenario with key variables at their historical averages 5/						**15.9**	**12.4**	**10.5**	**8.9**	**6.0**	**2.9**	**0.3**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	1.6	5.1	4.8	3.1	-3.7	8.4	4.8	7.2	7.4	5.1	5.3	
GDP deflator in US dollars (change in percent)	-15.0	8.9	10.8	-6.6	8.9	-6.7	1.6	0.6	0.6	1.1	1.0	
Nominal external interest rate (in percent)	27.2	34.5	39.5	21.9	30.7	10.5	11.0	11.9	12.7	16.7	19.1	
Growth of exports (US dollar terms, in percent)	0.4	4.7	17.8	-14.6	-8.8	7.7	7.2	4.4	5.5	3.9	4.4	
Growth of imports (US dollar terms, in percent)	-18.0	1.5	36.8	10.2	6.9	3.0	1.4	3.3	3.2	2.2	2.4	
Current account balance, excluding interest payments	17.0	19.1	16.2	4.3	-1.1	1.3	2.3	4.0	5.0	6.0	6.6	
Net non-debt creating capital inflows	-0.9	-1.7	0.9	7.2	3.3	4.0	3.9	3.7	3.6	3.4	3.3	

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).

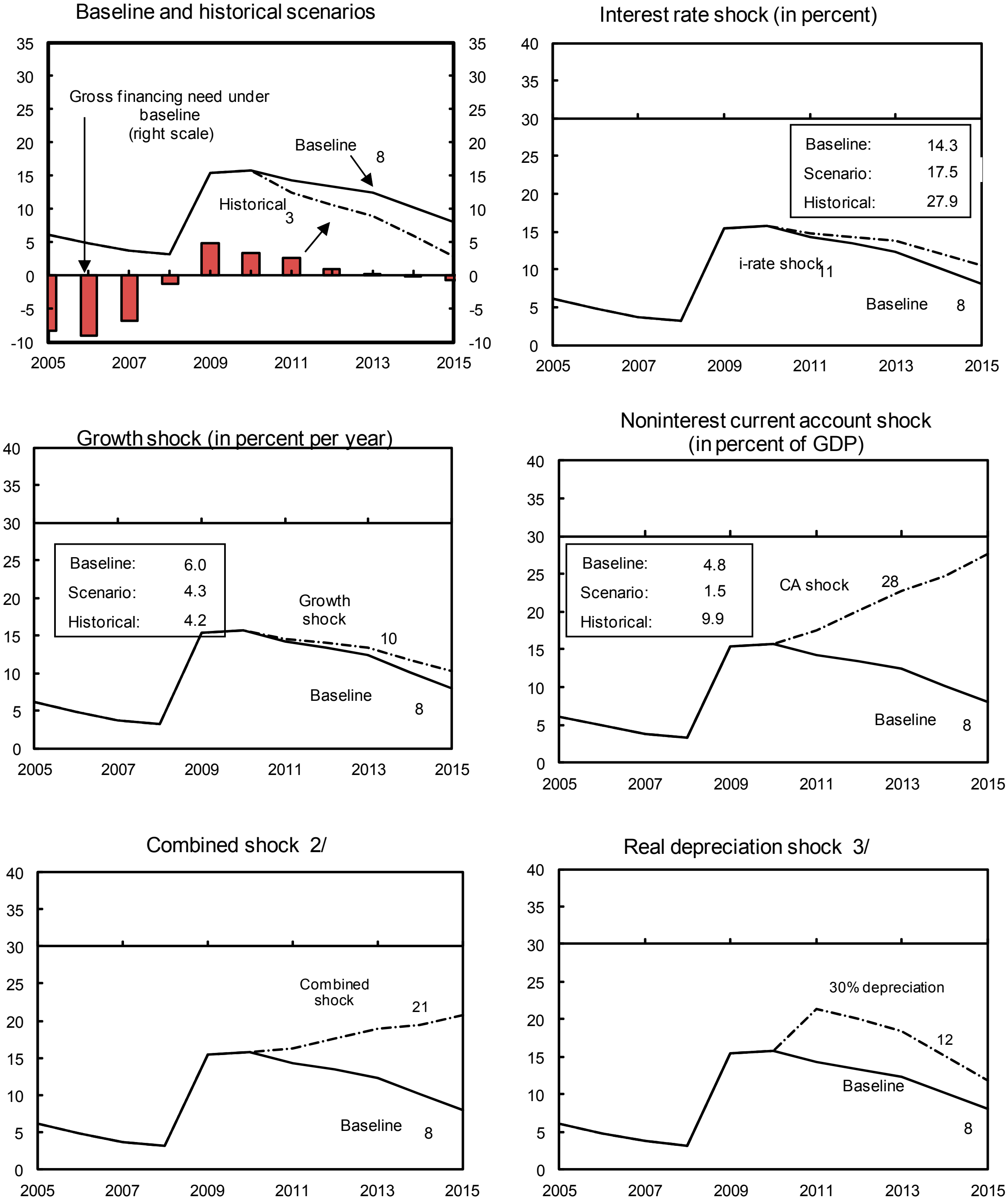
3/ For projection, line includes the impact of price and exchange rate changes.

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/ 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.

Figure 2. Botswana: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Botswana desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

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IMF Executive Board Concludes 2010 Article IV Consultation with Botswana

On July 27, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Botswana on a lapse of time basis. Under the IMF's lapse of time procedures, the Executive Board completes the Article IV consultations without convening formal discussions.[1]

Background

Botswana is recovering from its worst recession in at least 40 years. The economy contracted by 3.7 percent last year as demand for diamonds collapsed in the wake of the global financial crisis. The prompt easing of fiscal and monetary policies cushioned the impact of difficulties in the mining sector on the rest of the economy such that the nonmining sector grew by a healthy 6.2 percent in 2009. The domestic banking system has remained profitable, liquid and well capitalized, although there have been some recent increases in nonperforming loans to households.

The economy will likely see some rebalancing this year and next as mining continues its gradual recovery while the nonmining sector decelerates as fiscal stimulus is withdrawn. Overall GDP growth is projected to reach 8.4 percent in 2010, led by a rebound in diamond production. Nonmineral GDP growth, however, is expected to slow somewhat to 4.8 percent. Inflation

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

increased to 7.8 percent in May 2010 because of increases in the rate of value added tax (VAT) and adjustments in administered prices. It may increase a little further in the coming months, in response to additional administered price increases, before falling back within the Bank of Botswana's inflation objective of 3–6 percent in mid-to-late 2011. The current account balance is set to improve gradually as recovery in the diamond market boosts export receipts.

Risks to the outlook are broadly balanced. A double-dip recession in advanced economies could trigger renewed difficulties in the diamond market. In contrast, new demand from China and India could drive a stronger recovery in the diamonds sector. Developments in South Africa will also be important as the strength of South Africa's recovery will largely determine the revenues that Botswana receives through the Southern African Customs Union (SACU) revenue-sharing arrangement. The prospects for additional investment in the power sector are also tied to developments in South Africa.

Executive Board Assessment

In concluding the 2010 Article IV consultation with Botswana, Executive Directors endorsed the staff's appraisal, as follows:

Botswana's economy is rebounding after a significant setback following the global financial crisis. The economy entered the crisis from a position of considerable strength because of past prudent macroeconomic management. This facilitated a timely easing of fiscal and monetary policies, which helped cushion the impact on growth of the crisis and the subsequent collapse in demand for diamonds. The economy is likely to see some rebalancing beginning this year, as lower government spending dampens growth in the nonmining sector while recovery of the diamond sector accelerates.

Macroeconomic policies are being appropriately redirected away from short-term demand management toward medium-term considerations. Substantial fiscal consolidation will be needed as recovery proceeds, to put the public finances back on a sustainable footing and to safeguard external stability. Much of the adjustment will need to come from lower public spending, as mineral revenues are on a declining trend; and the scope for raising nonmineral taxes is limited by the size of the private sector. The budget for 2010/11 makes a good start on this process of adjustment. Plans to balance the budget by 2012/13 and register modest surpluses thereafter are ambitious but warranted. Recent increases in public debt, and the more challenging fiscal environment going forward, will require a clearer framework for management of the government's assets and liabilities. Anchoring inflation expectations will also be important, because inflation has not yet been brought down sustainably within the authorities' objective range of 3-6 percent. It will be important therefore to err on the side of caution before proceeding with further reductions in interest rates and to proceed with fiscal consolidation as envisaged.

The medium-term outlook is favorable provided the authorities proceed with planned fiscal consolidation. Staff projects that real GDP growth will average about 6 percent over the medium term, as diamond production gradually recovers towards pre-crisis levels and investment in the power sector boosts growth in the nonmining sector.

Sustaining high growth rates will require an ambitious set of policies and reforms to create a leaner and more effective public sector and promote private sector-led growth. The principle objectives of this economic reform agenda should be: *Doing more with less*. With the prospects of lower revenues looming over the medium-term fiscal environment, the authorities will have to find ways to increase the value for money of public spending programs. Doing so will require strengthening public financial management, including through a transition to program-based budgeting and implementation of a medium-term expenditure framework. *Letting the private sector lead the way*. Private sector-led growth will require structural reforms to encourage entrepreneurship and investment. The focus should be mainly on cross-cutting structural reforms that can benefit the whole economy. Current investments in power generation will address a key bottleneck to growth. With appropriate safeguards, plans to privatize selected parastatals, greater use of public–private partnerships, and rationalization of commercial services currently provided by the government could also mobilize greater private sector participation in the economy.

Botswana: Selected Economic and Financial Indicators, 2007- 2010

	2007	2008	2009 Prel.	2010 Proj.
(Annual percentage change, unless otherwise indicated)				
National income and prices				
Real GDP[1]	4.8	3.1	-3.7	8.4
Minerals	-2.0	-3.7	-20.9	16.8
Non-mineral	9.7	7.5	6.2	4.8
Consumer prices (average)	7.1	12.6	8.1	6.7
Consumer prices (end of period)	8.1	13.7	5.8	6.6
Nominal GDP (billions of pula)[1]	76.0	91.7	83.2	92.7
Diamond production (millions of carats)	33.6	32.3	17.7	23.2
External sector				
Exports of goods and services f.o.b. (US$)	11.1	-3.2	-23	14.9
Of which:				
Diamonds	-1.5	-8.1	-30.3	20.6
Imports of goods and services f.o.b. (US$)	29.1	24.9	-9.7	10.0
Money and banking				
Net foreign assets	24.1	20.1	-18.5	6.6
Net domestic assets	17.0	19.0	-37.8	-10.8
Broad money (M3)	31.2	21.1	-1.8	16.1
Velocity (nominal GDP relative to M3)	1.4	1.4	1.6	1.5
Credit to the private sector	25.7	26.6	10.3	11.4
(Percent of GDP, unless otherwise indicated)				
Central government finance[2]				
Total revenue and grants	35.8	34.0	31.6	34.9
Total expenditure and net lending	31.1	39.3	46.0	41.3
Overall balance (deficit –)	4.8	-5.2	-14.3	-6.4
Non-mineral primary balance (percent of non-mineral GDP) [3]	-16.7	-28.5	-32.9	-24.2
External sector				
Current account balance	14.5	3.5	-2.1	-0.3
Balance of payments	13.9	11.0	-12.9	5.4
Total external debt [4]	3.7	3.2	15.4	15.9
(in millions of US Dollars, unless otherwise indicated)				
Change in reserves (increase –)	-1,718	-1,490	1,503	-678
Gross official reserves (end of period)	9,743	9,125	8,678	9,382
in months of imports of goods and services[5]	20.9	21.7	18.8	20.0
In percent of GDP	78.7	67.5	74.3	75.1

Sources: Botswana authorities and IMF staff estimates and projections.
[1] Calendar year.
[2] Year beginning April 1.
[3] The nonmineral primary balance is computed as the difference between nonmineral revenue and expenditure (excluding interest receipts and interest payments), divided by nonmineral GDP.
[4] Includes private sector debt and medium- and long-term public and publicly guaranteed debt.
[5] Based on imports of goods and services for following year.