INTERNATIONAL MONETARY FUND

IMF Country Report No. 12/234

BOTSWANA

2012 ARTICLE IV CONSULTATION

August 2012

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 2012 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 1, 2012, 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 10, 2012. 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.
- **Informational Annex** prepared by the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board.

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

Selected Issues Paper

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

July 10, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

KEY ISSUES

Outlook and risks: Amidst a fragile global economic environment, real GDP growth is projected to moderate to 4 percent in 2012 from 5 percent in 2011. The uncertain external environment poses downside risks to mineral export demand and calls for a delicate balancing act in the implementation of macroeconomic policies.

Near-term policy mix and managing global spillovers: A tight fiscal stance, adopted in the FY2012/13 budget to help rebuild the policy buffers, combined with an accommodative monetary policy stance, is appropriate. In the event that further adverse global spillovers lead to a significant decline in diamond revenues, staff advises the authorities to allow the automatic stabilizers to operate on the revenue side.

Medium-term fiscal consolidation: Reining in spending is the main pillar of the authorities' fiscal consolidation strategy. Efforts to reduce the wage bill should be accompanied by reforms of government employment and wage policies. Broadening the tax base would provide a stronger foundation to the fiscal consolidation objectives.

Monetary operations, financial intermediation and stability: The government's domestic bond program should help to share the burden of sterilization costs between the Ministry of Finance and the Bank of Botswana. Efforts to broaden the population's access to financial services and deepen financial intermediation should be combined with adequate safeguards to preserve the stability of the financial system.

Inclusive growth, unemployment, and institutional and capacity development: Botswana faces long-term development and structural challenges that it needs to address to move the country to a higher level of development. Current redistributive aspects of fiscal policy should be complemented with policies that tackle inequality through fostering effective investment in education and health and enhancing financial inclusion. Faster economic growth, a change in public sector employment policies, and measures to address the skill mismatch in the labor market should help to reduce the unemployment rate. The authorities' ongoing mid-term review of their National Development Plan (NDP 10) provides an opportunity to consider measures that would foster institutional and capacity development in support of long-term growth.

Approved By
Anne-Marie Gulde-Wolf and Dhaneshwar Ghura

Discussions took place in Gaborone May 21– June 1, 2012. The team comprised Messrs. Leigh (head), David, Garcia-Verdu, Park and Stepanyan (all AFR). Ms. Otsuka from the World Bank also participated in some meetings.

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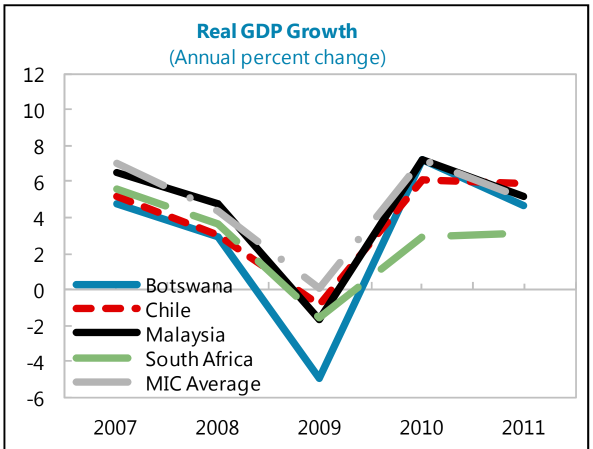
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

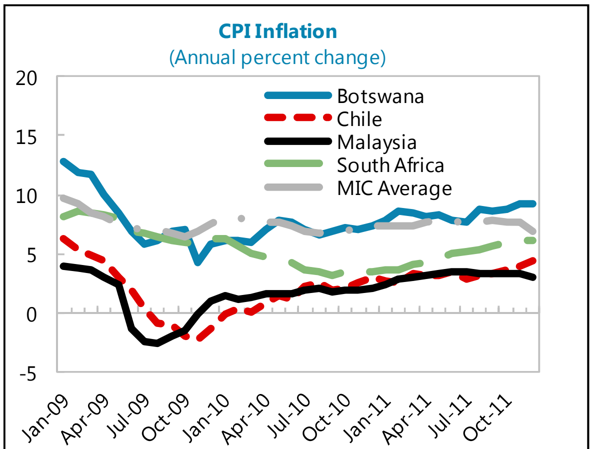
A. Recent Developments

1. Botswana's economic recovery after the 2008–09 financial crisis was one of the strongest among middle-income countries (MICs), but its growth weakened in the second half of 2011. Real GDP grew by 5.1 percent in 2011 (just below the average for its peer MIC group) compared with 7 percent growth in 2010 (Chart and Table 1). The growth deceleration was driven by a significant slowdown in diamond exports during the second half of the year. However, the non-mineral sector registered brisk growth during the year, despite a significant fiscal withdrawal. Diamond sales for the first quarter of 2012 showed only a very modest recovery.



Source: IMF World Economic Outlook.

2. At the same time, while receding, inflation remains relatively high. Consumer price inflation (year-on-year) declined from 9.2 percent in December 2011 to 7.7 percent in May 2012, which is higher than the upper end of the Bank of Botswana's (BoB) medium-term objective range of 3–6 percent. Core inflation (excluding food, fuel, and administered prices) has declined slightly in the last few months. Alternative measures, including the trimmed mean, also suggest a downward trend in core inflation.

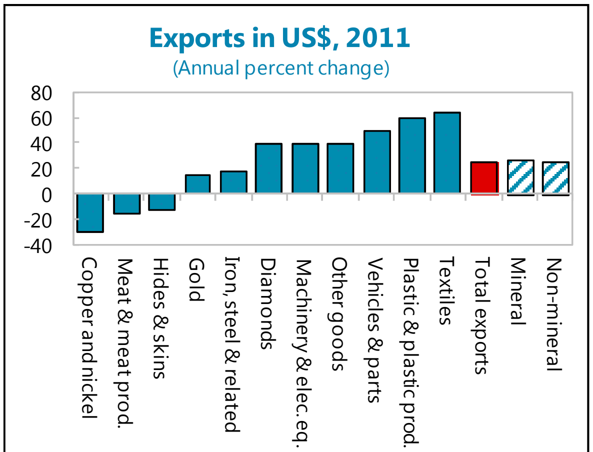


Sources: INS and IMF World Economic Outlook.

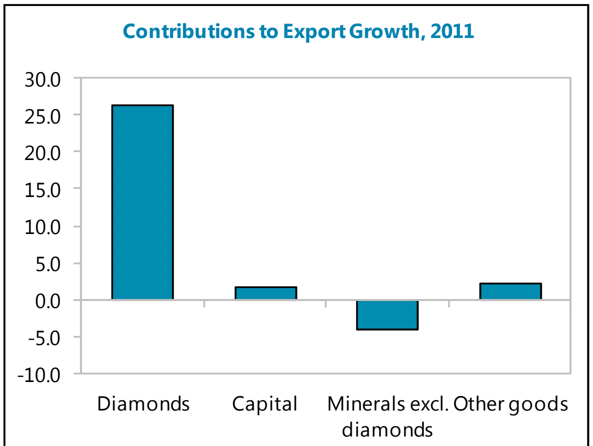
3. Notwithstanding the moderation in growth, conditions in financial markets have improved. Private sector credit growth is now approaching the precrisis level, supported by a strong growth in credit to businesses. Banks' nonperforming loans (NPLs) fell notably in the second half of 2011 because of a significant improvement in the quality of loans to households. Increased interest and non-interest income, combined with lower provisions for nonperforming loans, contributed to the rebound in banks' profitability.

4. The fiscal outcome was better than planned. The estimated fiscal deficit in FY2011/12 was about 2 percent of GDP, compared with the budget target of about 6 percent. The non-mineral primary deficit also declined from about 24 percent of non-mineral GDP in FY2010/11 to 17 percent in FY2011/12 (Table 2d). The adjustment reflects a sharp decline in government spending, mainly owing to savings generated in the education budget, because of the increase in the number of students admitted to local tertiary institutions, rationalization of student allowances and improved administration, as well as better prioritization of development spending. Higher-than-expected customs revenue from the Southern Africa Customs Union (SACU) Common Revenue Pool also contributed to the lower deficit.

5. The overall external position also strengthened in 2011. Annual export growth (in dollar terms) rebounded to about 66 percent in the first half of 2011 but declined sharply in the second half of the year to 20 percent. Exports grew faster than imports, turning the current account deficit into a surplus for the first time in the last three years (Table 3). Diamond exports benefited from higher diamond prices in the first half of 2011, which more than offset the poor performance of copper and nickel exports. Besides mining, plastic products and textile exports surged in 2011. However, exports of meat and meat products fell compared with 2010 because of the restriction on meat exports to the European Union related to the noncompliance with the EU's export requirements. The real effective exchange rate lost ground slightly during the last 12 months (Figure 1).



Sources: Botswana authorities and IMF staff estimates.

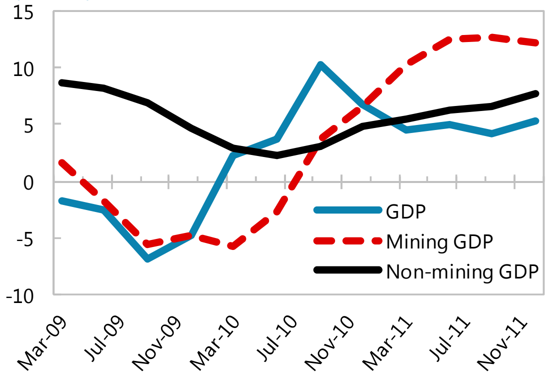


Sources: Botswana authorities and IMF staff estimates.

Figure 1. Botswana: Recent Economic Developments

During the first half of 2011, mining GDP recovered strongly...but weakened in the second half of the year.

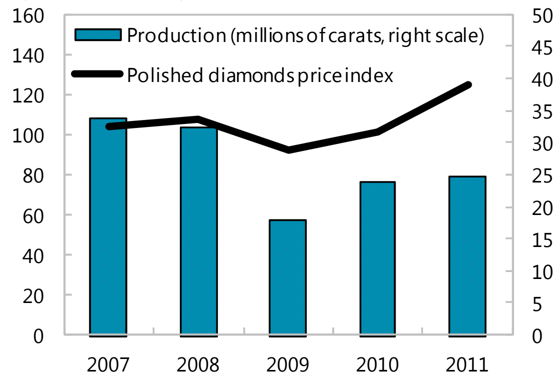
Real GDP Growth: Quarterly Annualized Rates
(Percent)



Sources: Botswana authorities and IMF staff estimates.

Thus, diamond production remained broadly unchanged in 2011, although world diamond prices recovered.

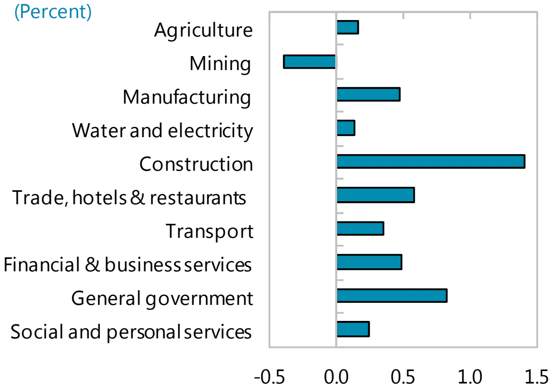
Diamond Production and Price Index
(Index, 2005 = 100)



Sources: Bloomberg and IMF staff estimates.

Non-mining GDP grew strongly, notably construction.

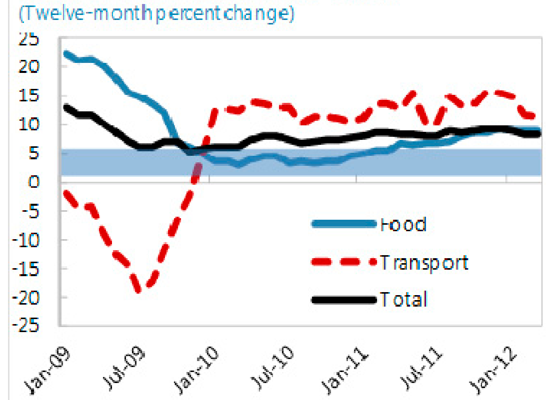
Non-Mining GDP: Contributions to Growth, 2011
(Percent)



Sources: Botswana authorities and IMF staff estimates.

Inflation rate remained above the BoB's medium term target.

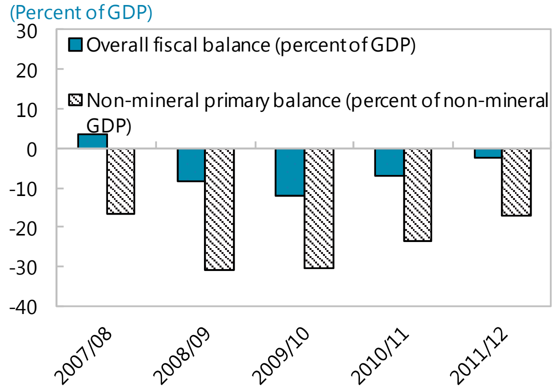
Consumer Price Inflation, Jan 09 – Mar 12
(Twelve-month percent change)



Source: Haver.

The fiscal position has continued to improve ...

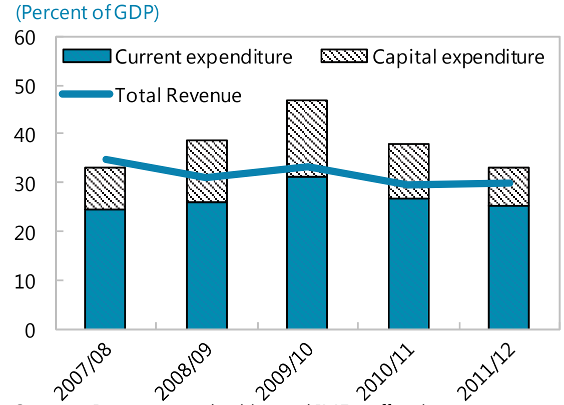
Fiscal Balances, FY08/09 –FY11/12
(Percent of GDP)



Sources: Botswana authorities and IMF staff estimates.

... helped by cuts in development spending.

Revenue and Expenditure, FY08/09 –FY11/12
(Percent of GDP)

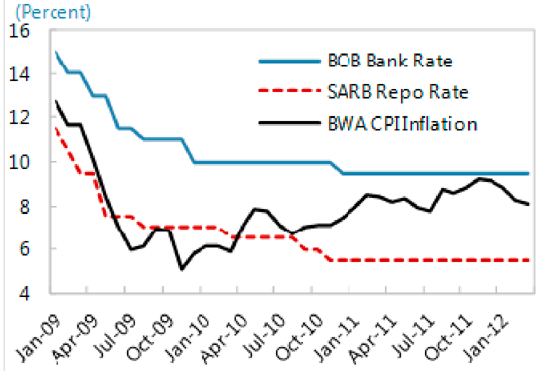


Sources: Botswana authorities and IMF staff estimates.

Figure 1. Botswana: Recent Economic Developments (concluded)

The BoB's Bank Rate was kept unchanged, while maintaining a wedge against the SARB's Repo Rate.

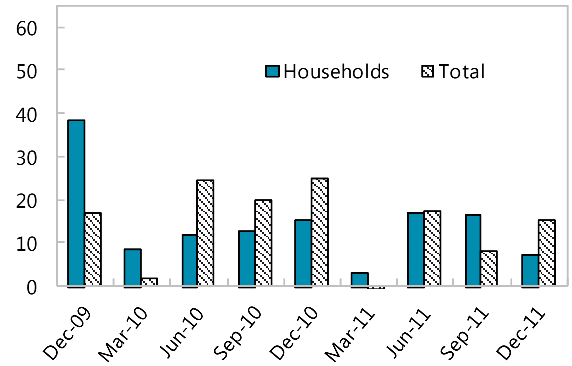
Botswana and South Africa: Leading Interest Rates, Jan 09 – Mar 12
(Percent)



Source: Haver.

Post 2008/09 crisis credit growth remained generally robust.

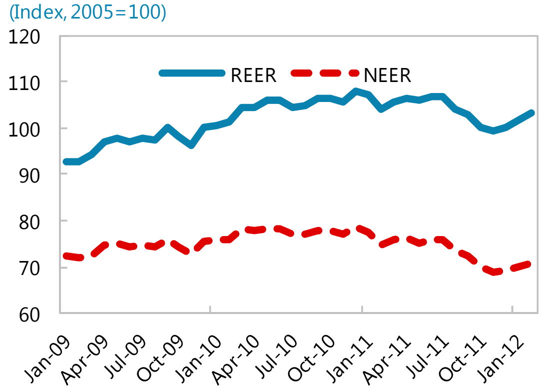
Bank Credit Growth, 2009–2011
(Q/Q annualized, percent)



Sources: Botswana authorities and IMF staff estimates.

The real effective exchange rate has remained broadly stable.

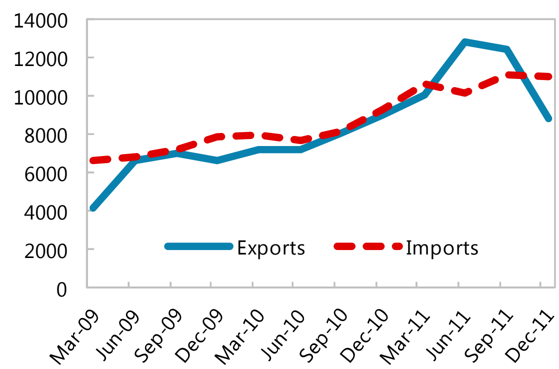
Effective Exchange Rates, Jan 09 – Feb 12
(Index, 2005=100)



Sources: International Financial Statistics.

A strong import growth has accompanied a strong recovery in exports.

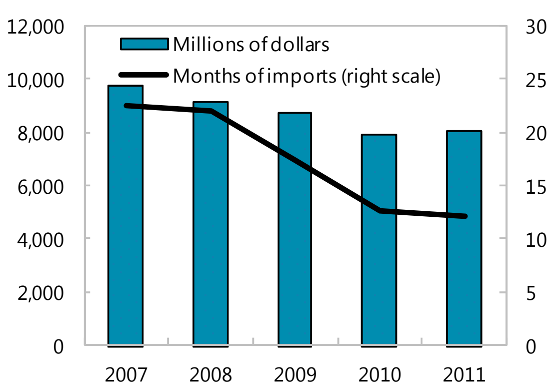
Trade Balance
(Millions of Pula)



Sources: Botswana authorities and IMF staff estimates.

International reserves have stabilized around 14 months of imports.

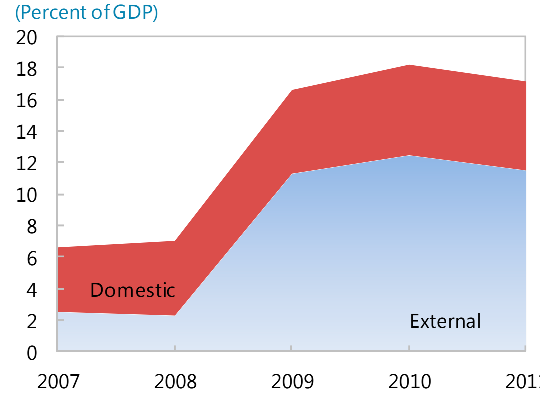
Foreign Exchange Reserves, 2007–11



Sources: Botswana authorities and IMF staff estimates.

Fiscal consolidation has contributed to the stabilization of public debt.

Central Government Debt, 2007–11
(Percent of GDP)



Sources: Botswana authorities and IMF staff estimates.

B. Outlook and Risks

6. Outlook

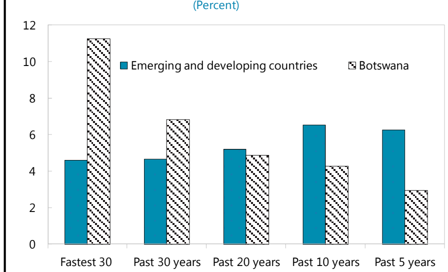
Output: Overall output growth is likely to moderate in 2012, reflecting subdued diamond exports. Staff projects that real GDP growth will decline to 4 percent in 2012 with non-mineral GDP decelerating to about 4 percent (Table 1). Medium-term GDP growth is forecast to average around 4.5 percent through 2017. The planned relocation of De Beers' diamond-sorting and sales activity from London to Botswana by end-2013 is expected to boost economic activity.

Inflation: While projected inflation remains slightly above the BoB's medium-term objective range, it is expected to converge to the upper end of the range in 2013. At the same time, a negative output gap is projected through 2013; and fiscal consolidation, underpinned by wage restraint, should help to constrain domestic demand.

External position: With projected fiscal surpluses in FY2012/13 and beyond, the current account surplus is forecast to stabilize at about 2 percent of GDP (Table 1). Staff's assessment, which incorporates features appropriate for natural resource–rich economies, show that the current level of the real effective exchange rate (REER) is broadly in line with macroeconomic fundamentals from a medium-term perspective. However, these estimates have large confidence bands, suggesting a significant degree of uncertainty regarding the long-run equilibrium level of the REER (Appendix I). This said, overall the analysis suggests a medium-term balance of payments position that does not and is not likely to give rise to disruptive exchange rate movements under the crawling peg arrangement. Beyond this, Botswana's conduct of prudent domestic economic and financial policies will continue to promote external stability.

7. Risks. The main near-term risks relate to the highly uncertain external environment, which remains fragile and poses significant downside risks to mineral export demand. The associated outward spillovers could also be transmitted through Botswana's linkages with South Africa. Botswana also faces medium-term risks: most notably the sustainability of growth, as trend growth has slowed in the last decades (chart), highlighting the need to find new non-diamond growth engines. Another medium-term risk is that, like other countries in SACU, Botswana faces a possible decline in SACU revenue (which represents about 20 percent of total revenue) in the long-run, either owing to low global growth or changes in the SACU revenue-sharing formula currently under negotiation.

Real GDP Growth Rates, 1966–2011
(Percent)



Source: IMF World Economic Outlook.

POLICY DISCUSSIONS

The authorities agreed with the mission's assessment of recent economic developments, outlook, and prospects. Given the uncertain and fragile external environment, they shared staff's view that the period ahead requires a delicate balancing act in the implementation of macroeconomic policies.

With risk-based surveillance as the backdrop to the consultation, tailored to the policy challenges facing a small middle–income country (MIC) in sub-Saharan Africa (SSA), this year's consultation with Botswana used an issues-oriented surveillance framework. Thus, the policy discussions focused on four main themes: (i) Managing near-term macroeconomic policy mix and spillovers from the global economy; (ii) rebuilding policy buffers through high-quality medium-term fiscal consolidation to buttress external stability; (iii) strengthening monetary operations, financial intermediation and stability; and (iv) enhancing inclusive growth, reducing structural unemployment (relevant macro critical social issues), and fostering institutional and capacity development in support of long-term growth. The authorities' Vision 2016 and NDP10 also place emphasis on these policy challenges, which bodes well for gaining traction. They acknowledged that while mineral wealth has propelled Botswana to a high middle-income status, long-standing structural challenges which no longer exist in some of the other high middle-income countries and are often found in economies with much lower level of per capita income, remain. With some of these policy themes also relevant for other MICs in SSA, cross-country analysis and best practice policy advice underpinned by analytic work in a MIC clustered group featured prominently in the consultations (Figure 2).

A. Policy Theme 1: Managing the Near-Term Macroeconomic Policy Mix and Spillovers from the Global Economy

Background

8. ***Botswana's mineral-based and highly open economy makes it vulnerable to global shocks.*** A renewed escalation of the euro area crisis may lead to a more prolonged global slowdown than envisaged in staff's baseline scenario. Staff's analysis shows that the direct, immediate impact of a financial stress in Europe on Botswana's banking system will likely be small given its limited reliance on external funding, with bank funding being largely domestic, and low cross-border financial linkages. Indirect "real economy" channels through a collapse in diamond exports will thus be the main transmission channel. Staff simulations using the IMF's Global Integrated Monetary and Fiscal (GIMF) model, which explores both trade and financial channels, show that financial stress in the euro

area through further deleveraging would have limited and short-lived impact on real GDP growth in Botswana. However, the estimated impact on diamond prices is significant which could lead to a loss in fiscal revenues (Appendix II). A key focus of the consultation was to identify systemic risks and vulnerabilities and to discuss with the authorities the appropriate policy responses.

Staff recommendations

9. Near-term policy mix*:* Staff advised that a tight fiscal policy combined with an accommodative monetary policy stance is an appropriate macroeconomic policy mix that preserves external stability. Fiscal policy should be centered on further expenditure restraint, as laid out in the FY2012/13 Budget, while an accommodative monetary policy should be maintained as long as generalized price pressures are contained.

10. Managing global spillovers: Staff noted that if global financial markets become severely disrupted again or if world growth falters beyond what is envisaged in staff's baseline forecast, Botswana's policy framework is well positioned to respond to such shocks. In that scenario, staff advised that the authorities allow the automatic stabilizers to operate on the revenue side.[1]

Authorities' views

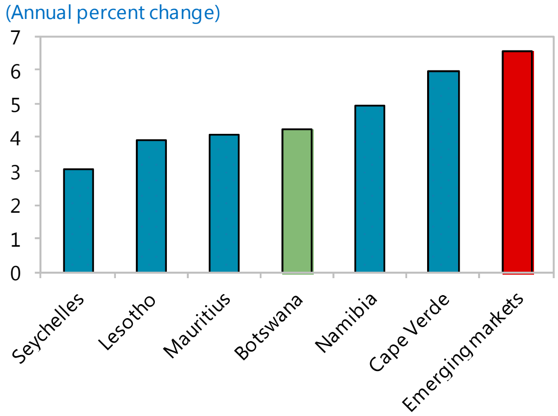
11. In response, the authorities noted that their macroeconomic policy responses would need to be flexible, measured, and proportional to pressures coming from the global economic environment. They emphasized the need for continued fiscal restraint without jeopardizing the sustainability of the recovery. The BoB will continue to remain vigilant and stand ready to take pre-emptive action on monetary policy if needed.

[1] Botswana does not have the traditional Keynesian automatic stabilizers on the expenditure side such as unemployment insurance.

Figure 2. Middle-Income Countries in Sub-Saharan Africa: Regional Comparison (Average 2002–2011, unless otherwise indicated)

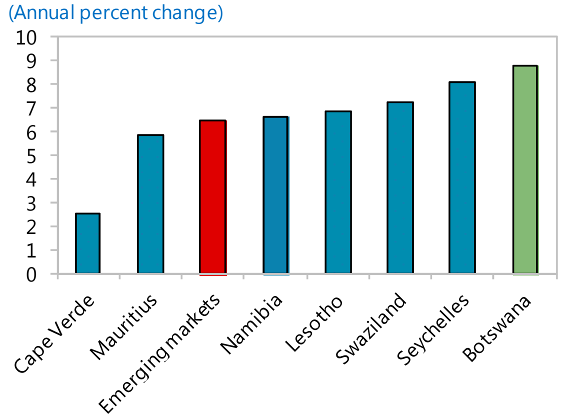
Although Botswana's economic growth was below emerging markets average growth…

Real GDP Growth
(Annual percent change)



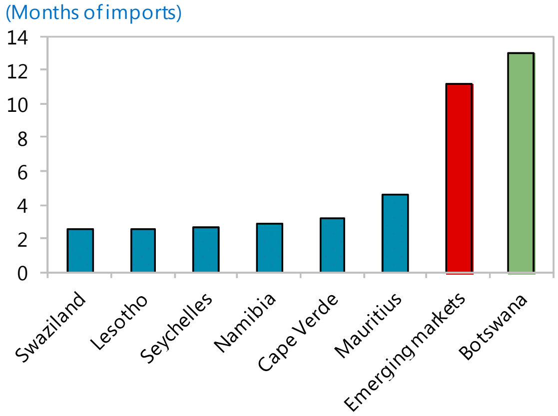
… its inflation remained elevated compared with middle-income peers.

CPI Inflation
(Annual percent change)



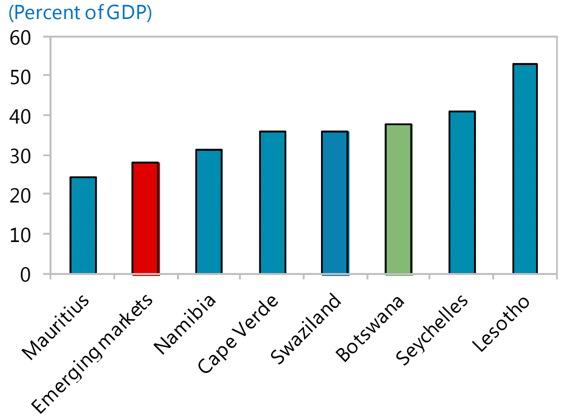
High diamond revenue combined with prudent macroeconomic management helped to build up policy buffers….

Gross Foreign Reserves, End-2010
(Months of imports)



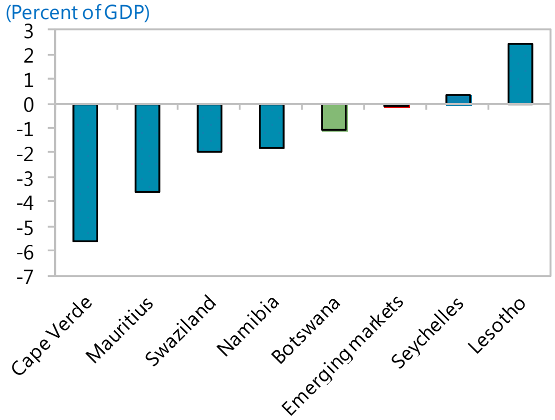
…and enabled Botswana to maintain higher than average expenditure….

General Government Expenditure
(Percent of GDP)



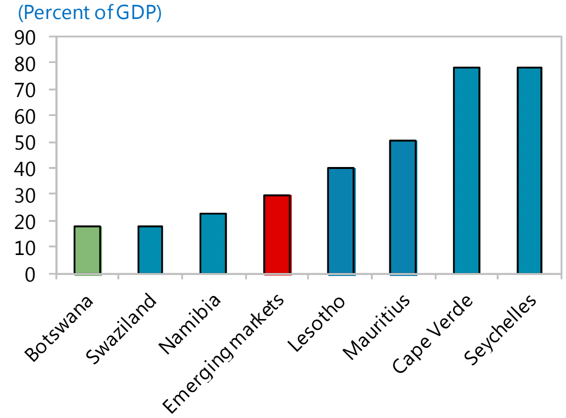
…without unduly widening the underlying fiscal balance…

Central Government Balances
(Percent of GDP)



… while maintaining a low level of public debt.

Total Public Debt, End-2010
(Percent of GDP)

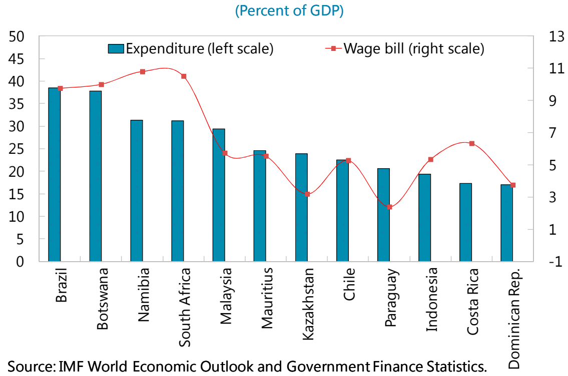


B. Policy Theme 2: Rebuilding Policy Buffers through High-Quality Medium-Term Fiscal Consolidation

Background

12. **The overriding fiscal policy challenge for Botswana is to reduce the size of the government (as a share of GDP).** The government remains the main employer in the economy. The government's expenditure envelope (above 30 percent GDP), including the wage bill, is high by international standards, thus warranting a thorough assessment of pockets of unproductive spending and ways to increase efficiencies. Both FY2011/12 and FY2012/13 Budgets have focused on addressing this key challenge.

Government Spending and Wage Bill, Average 2007–2011
(Percent of GDP)



Source: IMF World Economic Outlook and Government Finance Statistics.

13. **The Pula Fund served as a smoothing mechanism to support the government's countercyclical policy response to the 2008–09 global financial crisis.** It is a bedrock for the crawling peg mechanism and a tool for transferring mineral wealth across generations.

14. **The FY2012/13 budget targets a small fiscal surplus, which will help to rebuild the Pula Fund**. The budget is centered on further expenditure restraint, most notably of the wage bill, while improving the quality of spending consistent with past staff advice.[2] Staff's estimates of the implied fiscal impulse is more than minus 3 percentage points of GDP, and the budget will also reduce the non-mineral primary balance (NMPB) by more than 6 percentage points of non-mineral GDP, bringing it closer to its sustainable level. The budget targets an annual 5 percent reduction in the wage bill over the next three years. Staff's assessment, based on wage data provided by the authorities, show that the savings generated from the current measures such as outsourcing of low-skilled activities to the private sector, hiring and vacancy freeze and natural attrition will likely deliver at most one-fifth of the 5 percent targeted reduction in the wage bill.

15. **The FY2012/13 Budget is hesitant on tax reform.** Staff welcomed the abolition of the two-tier corporate tax system and

[2] The main expenditure measures in the budget include (i) a 3 percent annual salary increase for public officers (compared to a projected average inflation rate of 7.5 percent in 2012), (ii) a reduction of the wage bill by five percent each year for the next three years, and (iii) a 11 percent reduction in the budget appropriations for post-secondary education to ensure value for money in line with the last World Bank Public Expenditure Review (PER).

replacing it with a unified corporate tax rate of 22 percent and a withholding tax of 7.5 percent, as it should help to simplify the tax system. At the same time, the effective tax rates of the VAT and corporate income taxes continue to be significantly lower than the statutory rates on account of a number of tax exemptions. Beyond that, pressures remain in granting preferential tax regimes for businesses, particularly for the hubs.

16. Further fiscal consolidation is required to achieve medium-term fiscal sustainability. Staff's analysis, based on the permanent income hypothesis, suggests that in order to fully preserve mineral wealth for future generations, the non-mineral primary balance (NMPB) should be reduced to about 5 percent of non-mineral GDP from the current level of about 17 percent (Appendix III).[3] Staff's updated Debt Sustainability Analysis shows that Botswana's debt burden continues to be very low although sensitive to diamond revenue fluctuations that are crucial for overall economic growth and the primary deficit calculations (Informational Annex).

[3] Staff's intergenerational consumption smoothing baseline framework does not incorporate an investment function to determine the sustainable NMPB as Botswana's infrastructure gap is largely closed and the country is not the typical LIC/LMIC case in SSA with large development needs. Moreover, Botswana has capital market access, the only country in the region with an investment-grade rating across all rating agencies. Staff's analysis using Chile's structural balance approach yielded broadly similar conclusions on fiscal sustainability (Appendix III).

Central Government Operations, 2011/12–2015/16

	2011/12	2012/13	2013/14	2014/15	2015/16
(In percent of total GDP, unless otherwise indicated)					
Total revenue & grants	29.5	29.5	28.6	28.4	28.3
Total expenditure & net lending	31.7	29.2	27.8	27.4	26.9
Current	24.4	22.2	21.0	20.4	19.9
Capital	7.5	7.0	6.8	7.0	7.1
Overall balance[1]	-2.2	0.3	0.8	1.1	1.4
Overall balance excluding SACU	-9.0	-9.7	-7.9	-7.7	-7.3
Non-mineral primary balance[2]	-17.2	-10.9	-10.9	-10.0	-8.8
Non-mineral primary balance excluding SACU[2]	-27.3	-26.2	-24.1	-22.9	-21.6

Source: Botswana authorities and IMF staff estimates and projections.
[1] The kink in the overall balance in FY2013/14 represents the large windfall revenue from SACU in FY2012/13.
[2] In percent of non-mineral GDP.

Staff recommendations

17. Staff supports the authorities' FY2012/13 Budget given the emphasis to buttress medium-term fiscal consolidation and rebuild the fiscal buffers. Staff called for greater clarity on the linkage between the Pula Fund and fiscal policy, in particular the Fund's withdrawal and inflow rules and how they relate to fiscal developments.

18. Staff noted that the targeted reduction in the wage bill should be supported by a credible civil service and wage scale reform. In the short term, the current measures in the budget should be augmented with a streamlined system of non-wage payments, including tighter eligibility criteria for allowances. However, to achieve high-quality reforms of public sector employment and wages, short-term measures should be complemented with medium-term measures such as (i) Using economy-wide productivity gain as an additional indicator for public sector wage adjustment after a careful assessment of the various inputs from stakeholders; (ii) rationalizing the size and structure of government; (iii) tightening the link between pay and performance; and (iv) strengthening payroll systems. The revision of the wage scale, which pays a premium to low and middle pay grades relative to the private sector and where the concentration of large number of employees is in the civil service, would support fiscal sustainability. In addition, it would also contribute to reducing distortions in the labor market given that reservation wages are perceived to be high and unemployment remains a major challenge.

19. **Staff reiterated the need to broaden the tax base to provide a stronger foundation to the authorities' fiscal consolidation objectives.** This will also prepare the economy for a potential decline in SACU revenue over the medium term. The measures needed to attain this objective include a judicious rationalization of tax incentives to reduce the gap between the effective tax rate and the statutory rates on both the VAT and corporate income tax. The authorities should also avoid granting unwarranted preferential tax regimes for businesses. More broadly, staff noted that a comprehensive study on tax expenditure would inform policymakers about the magnitude of tax revenue that is lost through tax incentives and provide a solid foundation to streamline tax incentives to specific activities that absolutely need the incentives.

20. **Staff also advocated for delinking the fiscal policy stance from volatile diamond and SACU revenue**. Thus, the authorities should adopt either the NMPB or the structural fiscal balance (à la Chile) as an anchor in the formulation of fiscal policy. This should be supported by a medium-term fiscal framework (MTFF). Consistent with past staff advice, the government committed to put in place an MTFF by 2016 as part of its public financial management reform agenda.

Authorities' views

21. **The authorities affirmed their medium-term fiscal consolidation goals, centered on reducing the size of the government.** The main strategy behind the FY2012/13 Budget is for the government to focus spending on high priority and high return activities, including development expenditure, scale down spending on low return programs, and increase quality in the delivery of government services.

22. **On the linkage between the Pula Fund and fiscal policy, the authorities noted that the Pula Fund inflows and outflows are guided by their macroeconomic policy framework.** In particular, any resources the government is not able to invest in productive domestic investment are transferred to the Pula Fund thus treating the Fund as a residual. By the same token, current spending is generally financed by non-mineral revenue. They also clarified that in the event of external shocks, the first line of defense is through macroeconomic policy adjustments. If such measures prove to be insufficient to stabilize

the reserve level, the Pula Fund is used to bridge the residual gap. They emphasized that while these overarching principles that govern the Pula Fund lack specific linkage to fiscal developments, they do provide the needed flexibility that has served Botswana well over the years.

23. The authorities will consider the mission's advice on measures to support the targeted reduction of the wage bill. They agreed with the staff's analysis that measures included in the current budget for reducing the wage bill will likely not deliver the intended results. While in broad terms their focus continues to be to reduce the head count in the civil service, the government will consider augmenting its wage reduction measures with additional measures suggested by staff**.**

24. The authorities concurred that the negative externalities of tax incentives outweigh their marginal benefits. They expressed strong interest in conducting a full-fledged study on tax expenditure noting that doing such an analysis is timely because there are pressures to grant new tax incentives. To support the government's revenue-raising objective, a working group has been established to identify the areas of the tax system that require reforms. Consistent with staff's past advice, the Botswana Unified Revenue Service has just established a Large Taxpayer Unit and is also working to enhance tax administration through multitasking tax officers and scaling up tax auditors.

25. The authorities emphasized that they recognize the need for a fiscal anchor that deals with volatile revenue, although care needs to be taken in transitioning from the current fiscal objectives, which include mineral revenue, to a more constrained rule that excludes mineral revenue. They noted that thus far they have been able to deal with revenue volatilities through accumulating foreign exchange reserves during boom years and using them to compensate revenue shortfalls during economic downturns. The new fiscal anchor should take a long-term view of revenue, especially mining revenue that are likely to decline in the decades following the NDP10. Their Sustainable Budget Index rule in the NDP10 reserves mineral revenue for capital spending, leaving only non-mineral revenue to finance recurrent spending. The authorities also noted that they are reviewing the legal and regulatory framework for accommodating the MTFF and program based budgeting, developing a debt management strategy, and enhancing ministries' capacity in cash flow monitoring and forecasting to support the MTFF implementation by 2016.

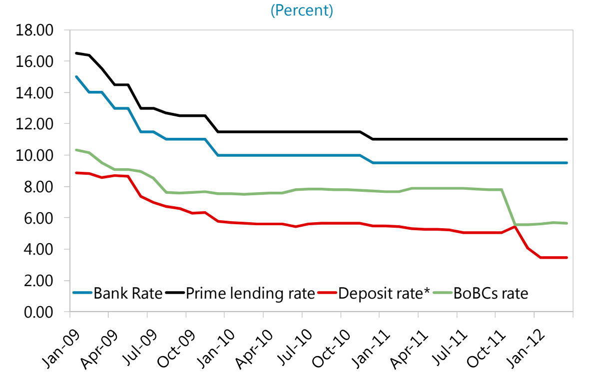
C. Policy Theme 3: Strengthening Monetary Operations, Financial Intermediation, and Stability

Background

26. **During the last six months, the BoB has enacted reforms in its liquidity management operations.** The key goal was to reduce sterilization costs that have severely affected the BoB's balance sheet in recent years, a challenge that many other central banks around the world have faced. The reforms should reduce the amount of liquidity absorbed through the issuance of the Bank of Botswana Certificates (BoBCs), the main instrument used to mop up excess bank liquidity. This resulted in a significant reduction in the quantity of BoBCs offered for auction. The reforms also included an increase in the reserve requirement for banks and more frequent use of reverse repo operations.

Botswana: Selected Nominal Interest Rates, Jan 09–Feb 12

(Percent)



Sources: International Financial Statistics.

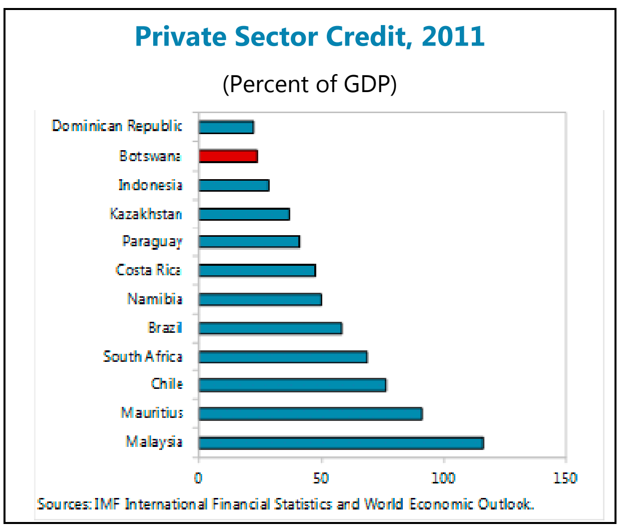
*Deposit rate refers to the 88-day notice deposit.

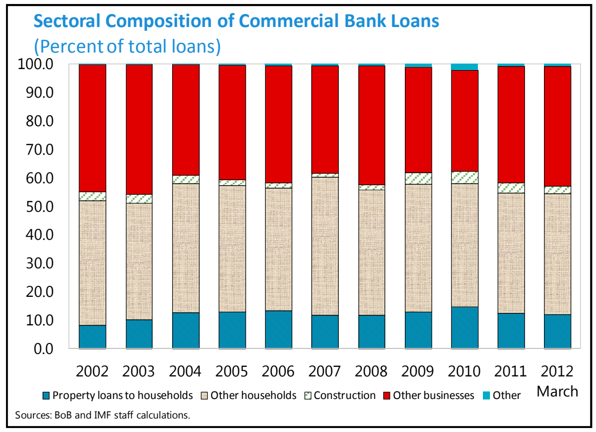
27. **At the same time, the reforms have posed transitional challenges for the BoB.** It severed the traditional link between the BoB's policy rate and other short-term interest rates in the economy, thus weakening the monetary transmission channel. The large reduction in the stock of BoBCs has, however, not translated into an outflow from the banking system through the balance of payments because increased reserve requirements and more active use of reserve repo instrument by the BoB partially absorbed the excess liquidity. In addition, commercial banks have increased lending to businesses. The fiscal withdrawal has also contributed to the sterilization of excess liquidity.

28. **While the banking system remains sound, the high level of exposure of banks to households is a potential source of vulnerability**. Although the recent entry of new domestic banks is expected to spur competition, the latest financial sector indicators show no discernible change. Commercial banks, the largest of which are subsidiaries of South African and British banks, appear to be well capitalized and profitable, and have little direct exposure to the current financial stress in the euro area. However, banks are still heavily exposed to households, which now account for 53 percent of bank lending and whose balance sheet is beginning to show signs of stress. Households' real incomes have declined in recent years given three years of public sector wage freeze, and they are now increasingly running down their savings. The excessive leveraged nature of households and the related financial stability issues are now becoming even more relevant

in light of the authorities' reform agenda on financial sector development.

29. Broadening the population's access to financial services and improving financial intermediation are key priorities for the authorities. The 2009 Finscope study found that a significant proportion of adults (about 60 percent) do not have a bank account—a feature that is reminiscent of economies with a much lower level of income per capita. Ongoing initiatives to broaden access include e-money, e-wallet, microfinance, and other innovative financial products. Botswana's financial system had grown and diversified considerably over the last decade. However, financial intermediation, while improving, remains low compared with other high middle-income countries.



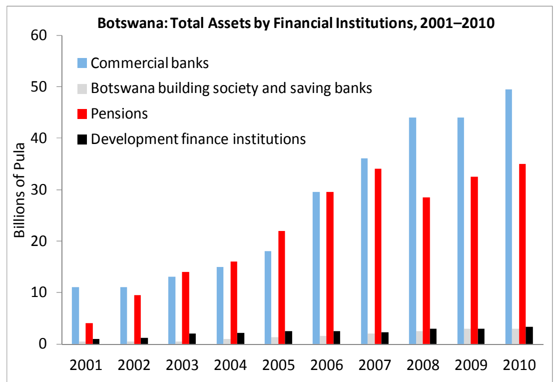


30. Non-bank financial institutions (NBFIs)—if overlooked—could increase vulnerabilities in the financial system. The current environment of low external and domestic interest rates may give rise to an aggressive search for yields. The asset size of NBFIs, which mainly include the pension funds, insurance institutions, and asset management companies, has experienced rapid expansion in recent years. Amidst paucity of reliable property market data, discussions with a broad section of market participants point to a significant price buildup in the real estate market. The acceleration of lending by NBFIs to households and for property market development, especially in the commercial segment of the real estate market in Gaborone, pose emerging risks to financial stability and require close monitoring. The Non-Bank Financial Institutions Regulatory Authority (NBFIRA), however, is not yet equipped to fully discharge its mandate because of delays in building a full complement of skilled and experienced staff. Moreover, a legal and regulatory infrastructure is not fully in place.

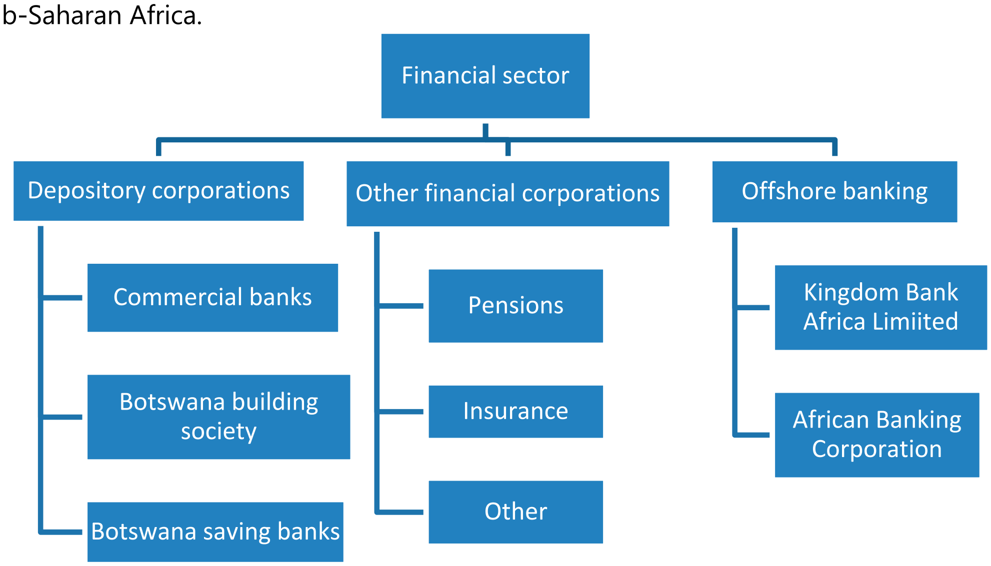
Box 1. Botswana: Structure and Performance of the Financial Sector

Botswana's financial sector has evolved over the years, and featured new entrants, mergers and acquisitions, and orderly exits. The banking sector has expanded from two to eight banks serving the domestic market and two banks operating as offshore banks. The banking system is profitable, liquid, and well capitalized with capital adequacy ratios well above prudential norms (Table 5). In addition to institutional movements, there has been a progressive widening of services, coverage and innovation, in the context of the authorities' financial sector development strategy and regulatory oversight, as well as global developments regarding the banking business model and information and communications technology. While financial exclusion decreased by 13 percentage points in 2009 compared with 2004, access to financial services remains low with estimates of financial exclusion at about 33 percent (number of adults without access to financial services).

Botswana's financial sector features three broad categories: depository corporations (commercial banks and other deposit taking institutions), other financial corporations (OFCs), and the offshore banking sector. OFCs, which are supervised by the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), include insurance companies, pension funds, and other institutions such as the Botswana Stock Exchange and stock brokerage firms, asset managers, micro finance institutions and collective investment undertakings. In addition, there are statutory development finance institutions, and the Motor Vehicle Accident Fund. The depository corporation segment of the financial sector (excluding BoB) is historically dominated by commercial banks, which on average held 98 percent of total deposits and 92 percent of total advances from 2001 to 2010. In the non-banking sector, life insurance companies and pension funds provide a wide range of savings and protection products and collectively constitute one of the largest and deepest non-bank financial sectors in sub-Saharan Africa.



Source: Bank of Botswana.



Source: Bank of Botswana

Staff recommendations

31. Staff supports the main thrust of the BoB's recent reforms in its liquidity management operations. The reforms will likely promote more financial intermediation and put the BoB's balance sheet on a sustainable footing. Staff discussed with the BoB various options to re-establish the traditional link between its policy rate and short-term interest rates, including the use of the reverse repo to credibly set the overnight rate corridor supported by a standing facility. This would enable market participants to respond appropriately to changes in the monetary policy stance, and anchor inflation expectations better. Increased issuance of treasury paper should facilitate the burden-sharing of sterilization costs and provide investment opportunities for nonbanks.

32. Although efforts to broaden financial inclusion and deepen intermediation are consistent with both Vision 2016 and NDP10, these need to be accompanied by adequate safeguards to preserve the stability of the financial system. The introduction of innovative products to broaden the population's access to financial services would require measures to contain possible risks, including money laundering. Staff called for efforts to develop a reliable property market index to help monitor price developments and take appropriate regulatory steps where needed. More broadly, staff recommended that the BoB use its newly established financial stability unit to put in place a macro-prudential framework and strengthen information sharing with foreign supervisors on cross-border flows.

33. Staff underscored the need to strengthen the regulatory and supervisory framework for NBFIs. The emphasis here is on the potential risks NBFIs pose to the domestic financial stability, including through regulatory arbitrage. The cross-linkages between the bank and non-bank parts of the financial system are significant. Thus, any large shock to the non-banking system could reverberate through the banking system and pose systemic stress across the financial system and thus to the broader macroeconomy.

Authorities' views

34. The BoB acknowledged the ongoing transitional challenges posed by their liquidity management reform. Thus, the central bank is exploring various options to re-establish the traditional link between its policy rate and short-term interest rates. To facilitate the implementation of the government's domestic bond program, two working groups have been established to look into the issues of coordination between monetary and debt management policies and more frequent issuance of government securities.

35. The authorities also recognize the stability challenges involved in broadening financial access and deepening financial intermediation. Steps are being considered to monitor the associated risks posed by new innovative products in the banking system. They noted that while households' portion of total bank lending has declined from about 61 percent to 53 percent, they are now beginning to borrow outside the banking system including through microfinance institutions. To monitor price developments in the real estate sector and take appropriate regulatory steps where warranted, the BoB has stepped up efforts to collect more information on the property market and develop a reliable property market index.

36. As highlighted in the FY2012/13 Budget speech, the government has placed emphasis on enhancing the capacity of the non-bank regulator. To start with, the government has put the appropriate regulation in place to allow the NBFIRA to collect supervisory levies from NBFIs to address some aspects of its funding problems. In addition, efforts by the government are ongoing to strengthen the supporting and enabling legislation for pension fund and insurance institutions. Moreover, progress toward signing a memorandum of understanding (MOU) between the BoB and NBFIRA is well advanced. This will facilitate the effective information sharing between the two supervisory agencies of the financial system, consistent with staff's past advice.

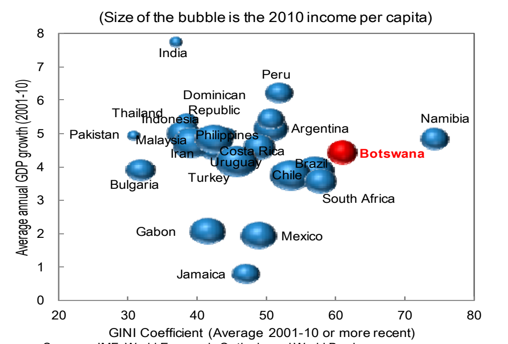
D. Policy Theme 4: Promoting Inclusive Growth, Addressing Unemployment, and Fostering Institutional and Capacity Development

Background

37. The poverty headcount rate declined sharply in recent years driven mostly by poverty reduction in rural areas. Preliminary estimates based on the Botswana Core Welfare Indicators Survey (BCWIS) 2009/10 show a significant decline in the poverty headcount rate, from 30.6 percent in 2002/03 to 20.7 percent in 2009/10 (Selected Issues Paper-Chapter 1*)*. The expansion of social programs, as well as continuing growth and urbanization, could be responsible for this marked reduction in the poverty rate.

38. Despite many years of robust economic growth, the distribution of income remains highly unequal in Botswana. Botswana has one of the highest income inequalities in the world especially when compared with other middle-income countries, with a Gini Index in excess of 0.5. Staff's estimates based on preliminary data from the 2009/10 Botswana Core Welfare Indicators Survey (BCWIS) compared with data from the 2002/03 Household Income and Expenditure Survey (HIES), suggest there was a decrease in inequality in the intervening period, as measured by a decline in the Gini coefficient. Staff analysis also shows that decreasing income inequality has the potential to extend growth spells in SACU countries (Selected Issues Paper-Chapter 1).

International Comparison: GINI Coefficient and Real Output Growth

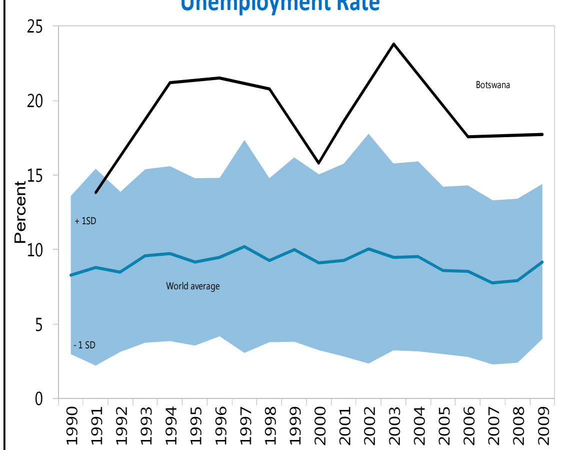


Sources: IMF, World Economic Outlook; and World Bank, World Development Indicators.

39. Nevertheless, middle-income households experienced more rapid growth than those in the lowest or in the highest percentiles of income distribution. The shape of the estimated growth incidence curve, which shows the growth rate of real consumption per capita for each percentile of the distribution, suggests that households between percentiles 15 and 75 of the distribution experienced more rapid growth than those in the lowest 15 percentile or in the highest 25 percentile. The results suggest that despite the expansion of the welfare programs in Botswana, they have been relatively less effective in terms of targeting the very poor when compared with other middle-income countries like Brazil, Chile, Mauritius and Indonesia. Staff analysis suggest that part of the significant decline in the preliminary poverty estimates by Statistics Botswana may be because the increase in the cost of the consumption basket (around 43 percent), during 2002/03-2009/10 on which the poverty line data is based, is smaller than the accumulated consumer price index inflation (around 58 percent).[4] It is important to underscore that these estimates are provisional and will be updated once the final official data are made available (Selected Issues Paper Chapter 1).

40. The unemployment rate has been persistently high driven by structural factors. Public sector wage and employment policies, their demonstration effect on the private sector and on reservation wages, and the interplay with skill mismatch in the labor market have all contributed to persistently high structural unemployment in Botswana and other SACU member countries (Selected Issues Paper Chapter 2).

Unemployment Rate



Source: World Bank World Development Indicators.

[4] However, the burden of inflation tax falls disproportionately on the very poor relative to the other quartile groups.

41. While Botswana's per capita income is well in the high middle-income category, capacity is unevenly distributed across the government and weaknesses are found in areas that crucially need to be addressed before the economy can move to a higher level of development. Government effectiveness indices prepared by the World Bank suggest that, for Botswana, the private sector's perceptions of the quality of public services and civil service bureaucracy are more positive than, for example, those for Cape Verde, Namibia, and Seychelles, but have remained broadly unchanged over the last decade. Botswana's relative weaknesses are in institutional effectiveness, excessive red tape, and poor allocation of public resources for rural development (Appendix IV).

42. Data quality is broadly adequate for surveillance, however, there is room for improvement. Staff's assessment shows weaknesses in the compilation of the national accounts data, including the expenditure side of GDP. There is also room for improvement in the compilation of the balance of payments statistics, including the services data.

Staff recommendations

43. Policies to enhance inclusive growth should target inequalities at their sources. Measures should include fostering effective investment in health and education and enhancing the population's access to financial services to support greater financial inclusion. This would complement the current redistributive aspects of fiscal policy including targeting a direct redistribution of income.

44. Tackling the high level of unemployment in Botswana will require faster economic growth and well–designed structural reforms. The structural measures should focus on changing public employment and wage policies (see Policy Theme 2) and aligning the curricula for university and tertiary education and vocational training to meet the demand for skilled labor in the broader economy. The government's Economic Diversification Drive (EDD), which will demand sizeable foreign direct investment in the non-diamond sector and measures to improve the business environment, should also enhance job creation. Like Botswana, Chile—a middle-income and mineral-based economy—has achieved relatively better employment outcomes and the lessons from this country's experience could be a useful case study for the authorities' job creation efforts, including measures on labor-intensive non-tradable sectors.

45. Reforming Botswana's public expenditure framework is warranted. The Public Expenditure and Financial Accountability (PEFA) report of 2009 provides some practical sequences of reforms to Botswana's public expenditure, procurement, and financial accountability systems (Appendix IV). Prompt action across the board is needed given the numerous low-ranking areas identified in the

PEFA report, especially when compared with ratings of other high middle-income countries.

46. The authorities need to take steps to improve the quality of macroeconomic statistics. Staff looks forward to the forthcoming IMF technical assistance missions on national accounts and balance of payments. The development of new high-frequency time series on inflation expectations, housing prices, and industrial production indicators would allow the BoB to act in a timely fashion in the event of second-round impacts on domestic inflation of commodity price increases or in the formation of asset price bubbles. These efforts should be accelerated to help propel Botswana toward subscribing to the IMF's Special Data Dissemination Standard (SDDS) and joining its middle-income peer countries such as Mauritius, which has recently subscribed to the SDDS.

Authorities' views

47. The authorities recognize the need to pursue policies to enhance inclusive growth, reduce unemployment, and deepen economic diversification including through an improvement of the business environment. They noted that considerable strides have been made toward reducing absolute poverty as reflected in the Botswana Core Welfare Indicators survey of 2009/10. The government's tertiary education reform program and the Human Resource Development Council are expected to become operational in 2012. This combined with the graduates' internship program would provide skills and on-the-job training needed to address the skill mismatch in the labor market. Under the EDD initiative, the authorities are pursuing a two-pronged diversification strategy: (i) diversifying within the mining sector beyond diamonds; and (ii) exploring the potential in cost-effective service sectors including financial and information technology sectors. The government has established the National Committee on Doing Business with the overall objective of improving the business climate.

48. The authorities acknowledged the need for fostering institutional and capacity development. The government is pursuing its public financial management reform agenda assisted by IMF and World Bank experts. The recent initiative to develop the e-government program would also contribute to improving the quality of publicly provided services. To enhance the government's capacity to collect and compile high quality statistics, Statistics Botswana has been transformed recently into a fully autonomous agency.

STAFF APPRAISAL

49. **The current fragile global economic environment is likely to delay the pace of recovery in Botswana.** Trend growth will likely moderate over the medium term as the historical success over diamond wealth continues to fade.

50. **Against this backdrop, the authorities' current policy mix of fiscal restraint and an accommodative monetary policy stance is appropriate.** In a more adverse global economic scenario, the authorities should allow the automatic stabilizers to operate on the revenue side.

51. **Bolder measures are required to achieve the targeted reduction in the wage bill.** Such measures include streamlining the system of non-wage payments, rationalizing the size and structure of government, tightening the link between pay and performance, strengthening payroll systems, and revising the wage scale.

52. **Broadening the tax base should be an integral part of the authorities' fiscal consolidation strategy**. Staff strongly recommends conducting a full-fledged study on tax expenditure to provide a solid foundation for streamlining tax incentives to specific activities that absolutely need it.

53. **The authorities should adopt a fiscal anchor that delinks the fiscal stance from volatile mineral revenue and SACU receipts**. Thus, staff reiterates the need to adopt either the non-mineral primary balance or the structural fiscal balance (à la Chile) in the formulation of fiscal policy.

54. **Staff supports the main thrust of the Bank of Botswana's recent reform in its liquidity management framework.** Greater coordination between monetary operations and debt management through enhanced issuance of treasury securities should help to support the needed burden-sharing of sterilization costs.

55. **The authorities should pay close attention to macro-financial linkages.** The high level of exposure of the banking system to household debt is a significant source of vulnerability and warrants close monitoring.

56. **There is an urgent need to strengthen the capacity of the non-bank financial institutions' regulator.** The rapid expansion of these institutions has propelled them into a systemically important component of the financial system, while the capacity of the non-bank regulator to supervise these large institutions lags behind. The cross-linkages between the bank and non-bank parts of the financial system constitute potentially an additional risk to the financial system.

57. **Botswana faces long-term development and structural challenges that it needs to address to move the country to**

a higher level of development. Current redistributive aspects of fiscal policy should be complemented with policies that tackle inequality through fostering effective investment in education and health and enhancing financial inclusion. As one of the largest employers in the economy, the government has an important effect on economy-wide wage settlements and job creation. Thus the reform of the public sector employment policies is critical to enhancing job creation in the broader economy. Fostering deeper institutional and capacity development should be an important part of the government's reform agenda to support long-term growth.

58. Staff judges the level of the real effective exchange rate as broadly in line with fundamentals from a medium-term perspective.

59. Staff recommends that the next Article IV consultation with Botswana take place on the standard 12-month cycle.

Table 1. Botswana: Selected Economic and Social Indicators, 2008–2017

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Annual percentage change, unless otherwise indicated)									
National income and prices										
Real GDP [1]	3.0	-4.7	7.0	5.1	3.8	4.2	4.2	4.3	4.4	4.7
Mineral	-3.8	-20.7	6.7	-1.3	2.7	1.8	1.8	2.1	2.0	2.0
Nonmineral [2]	7.9	4.6	5.2	7.3	3.9	4.9	4.9	5.0	5.0	5.4
Consumer prices	12.6	5.8	7.4	9.2	6.4	6.0	5.7	5.5	5.4	5.4
Diamond production (millions of carats)	32.3	17.7	22.8	23.0	23.5	23.8	24.1	24.6	25.1	25.6
External sector										
Exports of goods and services, f.o.b. (US$)	-2.9	-34.0	30.3	39.1	-2.9	1.5	2.0	2.4	2.1	2.2
Of which: diamonds	-8.1	-30.3	49.9	38.3	3.4	0.0	1.0	1.5	1.5	1.6
Imports of goods and services, f.o.b. (US$)	18.2	-4.3	21.1	25.1	-1.9	4.0	2.3	3.1	3.5	7.0
Terms of trade	2.6	5.9	-6.3	-0.2	-2.0	1.4	1.9	1.5	2.5	2.6
Nominal effective exchange rate	0.6	4.2	4.3	0.1	...	...	...	...	...	...
Real effective exchange rate	4.0	12.4	8.1	0.6	...	...	...	...	...	...
	(Percentage change with respect to M2 at the beginning of the period)									
Money and banking										
Net foreign assets	37.8	-34.3	-17.5	25.4	37.5	36.6	33.2	32.4	11.9	13.2
Net domestic assets	-16.1	33.0	29.9	-21.0	-30.8	-26.8	-24.9	-24.2	-5.3	-4.1
Broad money (M2)	21.7	-1.3	12.4	4.3	6.8	9.8	8.4	8.2	6.6	9.0
Velocity (nonmineral GDP relative to M3)	1.4	1.6	1.6	1.8	1.9	1.9	2.0	2.0	2.1	2.2
Credit to the private sector	12.6	5.1	6.1	11.8	6.8	7.8	8.5	8.6	9.1	10.6
	(In percent of GDP, unless otherwise indicated)									
Investment and savings [1]										
Gross investment (including change in inventories)	30.8	31.8	31.8	33.4	25.7	26.7	27.0	27.1	27.3	28.0
Gross savings	37.6	26.6	30.3	33.9	28.7	29.4	29.2	29.3	29.2	31.5
Central government finances [3]										
Total revenue and grants	31.1	33.3	29.4	29.5	29.5	28.6	28.5	28.4	28.2	28.1
Total expenditure and net lending	39.2	45.3	36.2	31.8	29.2	27.8	27.4	26.9	26.2	25.7
Overall balance (deficit –)	-8.1	-12.0	-6.8	-2.2	0.3	0.8	1.1	1.4	2.0	2.4
Nonmineral primary balance[4]	-30.7	-30.4	-23.6	-17.2	-10.9	-11.0	-10.0	-8.8	-7.4	-6.2
Total central government debt	6.4	15.8	17.6	16.7	14.9	13.5	11.9	10.4	9.0	7.8
External sector										
Current account balance	6.9	-5.2	-2.0	1.6	3.0	2.7	2.2	2.2	1.9	2.2
Balance of payments	8.0	-5.5	-6.4	2.8	5.5	4.6	3.4	3.0	2.6	2.7
External public debt [5]	1.7	13.0	10.9	11.8	11.0	10.2	8.9	7.6	7.6	7.5
	(In millions of US$, unless otherwise indicated)									
Gross official reserves (end of period)	9,116	8,669	7,883	8,386	9,373	10,241	10,915	11,539	12,114	12,778
of which: Pula Fund	6,861	6,543	6,938	6,901						
Months of imports of goods and services [6]	22.0	17.3	12.6	13.0	14.9	17.1	18.8	20.4	19.3	19.1
Percent of GDP	67.2	74.8	52.9	45.3	53.2	59.3	64.1	68.1	65.4	60.5
Financial position in the Fund (as of May 31, 2012)										
Holdings of currency (percent of quota)	...	...	...	68.0	...	...	...	...	...	...
Holdings of SDRs (percent of allocation)	...	...	...	151.6	...	...	...	...	...	...
Quota (SDR millions)	...	...	...	87.8	...	...	...	...	...	...
Social indicators										
Per capita GDP (2010): US$8,117; Life expectancy at birth (2007): 51										
Poverty headcount ratio at national poverty line (percent of population, 2008): 30.3										

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Calendar year.

[2] Refers to the growth of value added of sectors other than mining, excluding statistical adjustments. The latter includes financial intermediation services indirectly measured (FISIM), taxes on products, and subsidies.

[3] Year beginning April 1.

[4] 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.

[5] Includes publicly guaranteed debt.

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

Table 2a. Central Government Operations, 2008/09–2016/17 [1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
				(Millions of pula)					
Total revenue and grants	27,851	29,023	31,210	36,956	42,126	45,157	49,258	53,734	58,709
Total revenue	27,229	28,254	30,881	36,646	41,778	44,765	48,821	53,247	58,195
Tax revenue	20,455	20,045	20,505	24,843	31,759	32,924	36,256	39,895	43,993
Income taxes	8,059	7,921	9,362	9,855	11,288	12,037	13,223	14,526	15,992
Mineral	3,451	2,360	2,949	2,717	3,524	3,289	3,462	3,649	3,848
Nonmineral	4,608	5,561	6,413	7,138	7,764	8,748	9,761	10,876	12,144
Taxes on goods and services [2]	4,377	3,943	4,638	6,212	5,995	6,755	7,537	8,398	9,377
Customs Union receipts [3]	7,750	7,931	6,207	8,441	14,170	13,787	15,111	16,542	18,145
Other	268	250	298	335	306	345	385	429	479
Nontax revenue	6,774	8,209	10,376	11,803	10,019	11,841	12,565	13,352	14,202
Mineral royalties and dividends	6,731	6,729	7,465	9,404	8,514	10,236	10,774	11,357	11,976
Interest	52	32	48	57	32	36	39	43	47
Property income	-1,058	211	1,209	436	127	54	60	67	74
Of which: BoB transfers	0	0	0	0	0	0	0	0	0
Fees and charges	1,049	1,237	1,654	1,906	1,346	1,516	1,692	1,885	2,105
Grants	623	769	329	310	348	392	437	488	515
Total expenditure and net lending	35,150	39,490	38,418	39,753	41,755	43,865	47,400	51,016	54,552
Current expenditure	23,889	25,732	27,090	30,525	31,751	33,135	35,309	37,621	39,788
Wages and salaries	8,701	9,252	11,899	12,140	12,128	12,886	13,646	14,417	14,936
Interest	282	370	524	557	1,592	821	796	846	928
Other	14,906	16,110	14,667	17,828	18,032	19,429	20,867	22,359	23,924
Of which: grants and subsidies	7,058	8,106	8,348	9,180	7,192	7,749	8,322	8,917	9,541
Capital expenditure	11,458	13,006	11,372	9,343	10,058	10,787	12,152	13,460	14,835
Net lending	-197	752	-44	-115	-54	-58	-61	-65	-71
Primary balance (deficit -)	-7,069	-10,129	-6,732	-2,297	1,931	2,077	2,616	3,521	5,039
Overall balance	-7,299	-10,467	-7,208	-2,797	371	1,292	1,859	2,718	4,158
Financing	4,696	10,467	7,208	2,797	-371	-1,292	-1,859	-2,718	-4,158
Foreign (net)	-174	6,852	3,004	1,048	335	-89	-853	-991	-961
Drawing	139	7,195	3,284	1,237	594	265	204	61	61
Amortization	-255	-343	-280	-189	-179	-275	-977	-972	-942
IMF transactions (net)[4]	-58	0	0	0	-80	-80	-80	-80	-80
Domestic	4,870	3,615	4,205	1,749	-706	-1,203	-1,006	-1,727	-3,196
Of which:									
Issuance	1,954	1,050	1,567	1,269	2,000	0	0	0	0
Amortization	-600	0	0	0	-2,001	0	0	0	0
Change in cash balance (- increase)	4,607	6,788	2,782	-1,826	-1,475	-1,203	-1,006	-1,727	-3,196
Memorandum items:									
Non-mineral primary balance [5]	-17,251	-19,218	-17,146	-14,418	-10,107	-11,448	-11,620	-11,486	-10,785

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

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

Table 2b. Central Government Operations, 2008/09–2016/17 (GFSM 2001 Classification)[1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	(Millions of pula)								
Revenue	27,851	29,023	31,210	36,956	42,126	45,157	49,258	53,734	58,709
Taxes	20,455	20,045	20,505	24,843	31,759	32,924	36,256	39,895	43,993
Taxes on income, profits, and capital gains	8,059	7,921	9,362	9,855	11,288	12,037	13,223	14,526	15,992
Payable in the mineral economy	3,451	2,360	2,949	2,717	3,524	3,289	3,462	3,649	3,848
Payable in the non-mineral economy	4,608	5,561	6,413	7,138	7,764	8,748	9,761	10,876	12,144
Taxes on property	26	27	21	24	37	42	47	52	58
Taxes on goods and services	4,618	4,166	4,913	6,521	6,264	7,058	7,875	8,775	9,798
Value added and sales tax	4,377	3,943	4,638	6,212	5,995	6,755	7,537	8,398	9,377
Motor vehicle taxes	188	189	241	270	219	247	275	307	342
Other	53	34	34	39	50	56	63	70	78
Taxes on international trade	7,752	7,931	6,209	8,443	14,171	13,788	15,112	16,543	18,145
Customs Union receipts [2]	7,750	7,931	6,207	8,441	14,170	13,787	15,111	16,542	18,145
Taxes on exports	2	1	2	2	1	1	1	1	1
Grants	623	769	329	310	348	392	437	488	515
Other receipts	6,774	8,209	10,376	11,803	10,019	11,841	12,565	13,352	14,202
Property income	5,725	6,972	8,722	9,897	8,673	10,325	10,873	11,467	12,097
Mineral royalties and dividends	6,731	6,729	7,465	9,404	8,514	10,236	10,774	11,357	11,976
Interest	-1,006	243	1,257	493	159	89	99	109	121
Property interest income [3]	-1,058	211	1,209	436	127	54	60	67	74
Other Interest	52	32	48	57	32	36	39	43	47
Fees and charges	1,049	1,237	1,654	1,906	1,346	1,516	1,692	1,885	2,105
Expense	23,889	25,732	27,090	30,525	31,751	33,135	35,309	37,621	39,788
Compensation of employees	8,701	9,252	11,899	12,140	12,128	12,886	13,646	14,417	14,936
Purchases of goods and services	7,848	8,004	6,319	8,648	10,840	11,680	12,544	13,441	14,382
Interest	282	370	524	557	1,592	821	796	846	928
Grants and subsidies	7,058	8,106	8,348	9,180	7,192	7,749	8,322	8,917	9,541
Gross Operating Balance	3,962	3,291	4,120	6,431	10,375	12,022	13,949	16,113	18,921
Net adquisition of nonfinancial assets	11,458	13,006	11,372	9,343	10,058	10,787	12,152	13,460	14,835
Net lending/borrowing	-7,496	-9,715	-7,252	-2,912	317	1,234	1,798	2,653	4,087
Transactions in financial assets and liabilities	-4,892	-9,715	-7,252	1,700	1,857	1,234	1,798	2,653	4,087
Net adquisition of financial assets	-4,804	-6,036	-2,826	1,711	1,421	1,145	945	1,662	3,126
Domestic	-4,804	-6,036	-2,826	1,711	1,421	1,145	945	1,662	3,126
Currency and deposits	-4,607	-6,788	-2,782	1,826	1,475	1,203	1,006	1,727	3,196
Loans (net lending)	-197	752	-44	-115	-54	-58	-61	-65	-71
Foreign	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities	88	3,679	4,426	11	-437	-89	-853	-991	-961
Domestic	262	-3,173	1,422	-1,037	-772	0	0	0	0
Loans	1,954	1,050	1,567	1,269	2,000	0	0	0	0
Amortization	-600	0	0	0	-2,001	0	0	0	0
Other	-1,093	-4,223	-145	-2,306	-770	0	0	0	0
Foreign	-174	6,852	3,004	1,048	335	-89	-853	-991	-961
Loans	139	7,195	3,284	1,237	594	265	204	61	61
Amortization due (paid)	-255	-343	-280	-189	-179	-275	-977	-972	-942
Other	-58	0	0	0	-80	-80	-80	-80	-80
Memo items:									
Overall balance	-4,695	-10,467	-7,208	1,815	1,911	1,292	1,859	2,718	4,158
Non-mineral primary balance [4]	-17,251	-19,218	-17,146	-14,418	-10,107	-11,448	-11,620	-11,486	-10,785

Source: Ministry of Finance and Development Planning and Fund staff estimates.

[1] Fiscal year begins on April 1.

[2] SACU receipts consist of taxes on international trade and excise on imported goods as well as the impact of a development component derived from excises.

[3] Includes transfers received from the Bank of Botswna (BoB) on account of interest income on government investments made by the BoB on behalf of the government.

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

Table 2c. Central Government Operations, 2008/09–2016/17[1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
				(Percent of GDP)					
Total revenue and grants	31.1	33.3	29.4	29.5	29.5	28.6	28.5	28.4	28.2
Total revenue	30.4	32.4	29.1	29.3	29.2	28.3	28.2	28.1	28.0
Tax revenue	22.8	23.0	19.3	19.8	22.2	20.8	20.9	21.1	21.2
Income taxes	9.0	9.1	8.8	7.9	7.9	7.6	7.6	7.7	7.7
Mineral	3.9	2.7	2.8	2.2	2.5	2.1	2.0	1.9	1.9
Nonmineral	5.1	6.4	6.0	5.7	5.4	5.5	5.6	5.7	5.8
Taxes on goods and services [2]	4.9	4.5	4.4	5.0	4.2	4.3	4.4	4.4	4.5
Customs Union receipts [3]	8.6	9.1	5.9	6.7	9.9	8.7	8.7	8.7	8.7
Other	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Nontax revenue	7.6	9.4	9.8	9.4	7.0	7.5	7.3	7.0	6.8
Mineral royalties and dividends	7.5	7.7	7.0	7.5	6.0	6.5	6.2	6.0	5.8
Interest	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property income	-1.2	0.2	1.1	0.3	0.1	0.0	0.0	0.0	0.0
Of which: BoB transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fees and charges	1.2	1.4	1.6	1.5	0.9	1.0	1.0	1.0	1.0
Grants	0.7	0.9	0.3	0.2	0.2	0.2	0.3	0.3	0.2
Total expenditure and net lending	39.2	45.3	36.2	31.8	29.2	27.8	27.4	26.9	26.2
Current expenditure	26.7	29.5	25.5	24.4	22.2	21.0	20.4	19.9	19.1
Wages and salaries	9.7	10.6	11.2	9.7	8.5	8.2	7.9	7.6	7.2
Interest	0.3	0.4	0.5	0.4	1.1	0.5	0.5	0.4	0.4
Other	16.6	18.5	13.8	14.2	12.6	12.3	12.1	11.8	11.5
Of which: grants and subsidies	7.9	9.3	7.9	7.3	5.0	4.9	4.8	4.7	4.6
Capital expenditure	12.8	14.9	10.7	7.5	7.0	6.8	7.0	7.1	7.1
Net lending	-0.2	0.9	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Primary balance (deficit -)	-7.9	-11.6	-6.3	-1.8	1.4	1.3	1.5	1.9	2.4
Overall balance	-8.1	-12.0	-6.8	-2.2	0.3	0.8	1.1	1.4	2.0
Financing	5.2	12.0	6.8	2.2	-0.3	-0.8	-1.1	-1.4	-2.0
Foreign (net)	-0.2	7.9	2.8	0.8	0.2	-0.1	-0.5	-0.5	-0.5
Drawing	0.2	8.2	3.1	1.0	0.4	0.2	0.1	0.0	0.0
Amortization	-0.3	-0.4	-0.3	-0.2	-0.1	-0.2	-0.6	-0.5	-0.5
IMF transactions	-0.1	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Domestic	5.4	4.1	4.0	1.4	-0.5	-0.8	-0.6	-0.9	-1.5
Of which:									
Issuance	2.2	1.2	1.5	1.0	1.4	0.0	0.0	0.0	0.0
Amortization	-0.7	0.0	0.0	0.0	-1.4	0.0	0.0	0.0	0.0
Change in cash balance (- increase)	5.1	7.8	2.6	-1.5	-1.0	-0.8	-0.6	-0.9	-1.5
Memorandum items:									
Nonmineral primary balance [4]	-30.7	-30.4	-23.6	-17.2	-10.9	-11.0	-10.0	-8.8	-7.4
Nominal GDP (in current of local currency)	90	87	106	125	143	158	173	190	208

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

Table 2d. Central Government Operations, 2008/09–2016/17[1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
				(Percent of GDP)					
Total revenue and grants	31.1	33.3	29.4	29.5	29.5	28.6	28.5	28.4	28.2
Total revenue	30.4	32.4	29.1	29.3	29.2	28.3	28.2	28.1	28.0
Tax revenue	22.8	23.0	19.3	19.8	22.2	20.8	20.9	21.1	21.2
Income taxes	9.0	9.1	8.8	7.9	7.9	7.6	7.6	7.7	7.7
Mineral	3.9	2.7	2.8	2.2	2.5	2.1	2.0	1.9	1.9
Nonmineral	5.1	6.4	6.0	5.7	5.4	5.5	5.6	5.7	5.8
Taxes on goods and services [2]	4.9	4.5	4.4	5.0	4.2	4.3	4.4	4.4	4.5
Customs Union receipts [3]	8.6	9.1	5.9	6.7	9.9	8.7	8.7	8.7	8.7
Other	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Nontax revenue	7.6	9.4	9.8	9.4	7.0	7.5	7.3	7.0	6.8
Mineral royalties and dividends	7.5	7.7	7.0	7.5	6.0	6.5	6.2	6.0	5.8
Interest	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property income	-1.2	0.2	1.1	0.3	0.1	0.0	0.0	0.0	0.0
Of which: BoB transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fees and charges	1.2	1.4	1.6	1.5	0.9	1.0	1.0	1.0	1.0
Grants	0.7	0.9	0.3	0.2	0.2	0.2	0.3	0.3	0.2
Total expenditure and net lending	39.2	45.3	36.2	31.8	29.2	27.8	27.4	26.9	26.2
Current expenditure	26.7	29.5	25.5	24.4	22.2	21.0	20.4	19.9	19.1
Wages and salaries	9.7	10.6	11.2	9.7	8.5	8.2	7.9	7.6	7.2
Interest	0.3	0.4	0.5	0.4	1.1	0.5	0.5	0.4	0.4
Other	16.6	18.5	13.8	14.2	12.6	12.3	12.1	11.8	11.5
Of which: grants and subsidies	7.9	9.3	7.9	7.3	5.0	4.9	4.8	4.7	4.6
Capital expenditure	12.8	14.9	10.7	7.5	7.0	6.8	7.0	7.1	7.1
Net lending	-0.2	0.9	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Primary balance (deficit -)	-7.9	-11.6	-6.3	-1.8	1.4	1.3	1.5	1.9	2.4
Overall balance	-8.1	-12.0	-6.8	-2.2	0.3	0.8	1.1	1.4	2.0
Financing	5.2	12.0	6.8	2.2	-0.3	-0.8	-1.1	-1.4	-2.0
Foreign (net)	-0.2	7.9	2.8	0.8	0.2	-0.1	-0.5	-0.5	-0.5
Drawing	0.2	8.2	3.1	1.0	0.4	0.2	0.1	0.0	0.0
Amortization	-0.3	-0.4	-0.3	-0.2	-0.1	-0.2	-0.6	-0.5	-0.5
IMF transactions	-0.1	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Domestic	5.4	4.1	4.0	1.4	-0.5	-0.8	-0.6	-0.9	-1.5
Of which:									
Issuance	2.2	1.2	1.5	1.0	1.4	0.0	0.0	0.0	0.0
Amortization	-0.7	0.0	0.0	0.0	-1.4	0.0	0.0	0.0	0.0
Change in cash balance (- increase)	5.1	7.8	2.6	-1.5	-1.0	-0.8	-0.6	-0.9	-1.5
Memorandum items:									
Non-mineral primary balance [4]	-30.7	-30.4	-23.6	-17.2	-10.9	-11.0	-10.0	-8.8	-7.4
Nominal GDP (in current of local currency)	90	87	106	125	143	158	173	190	208

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

Table 2e. Central Government Partial Balance Sheet, 2005–2012

	2005	2006	2007	2008	2009	2010	2011	2012
	(Millions of pula, as of end-December)							
Net Worth	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Nonfinancial assets	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Net Financial Worth[1]	**29,754**	**46,224**	**57,797**	**67,198**	**46,205**	**27,931**	**39,827**	**50,245**
Financial assets	**33,846**	**49,939**	**62,982**	**72,892**	**57,960**	**45,348**	**60,196**	**71,502**
Domestic								
Currency and deposits w/BoB	13,223	21,236	27,871	31,768	23,252	14,882	24,075	25,662
Securities other than shares								
Loans								
Shares and other equity[1]	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Insurance technical reserves								
Financial derivatives								
Other accounts receivable								
Foreign								
Monetary gold and SDRs								
Currency and deposits (Pula fund; 60% gross reserves)	20,623	28,703	35,111	41,124	34,708	30,466	36,121	45,840
Debt securities								
Loans								
Equity and investment fund shares[1]	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Insurance, pensions, and standardized guarantee schemes								
Financial derivatives and employee stock options								
Other accounts receivable								
Financial liabilities	**4,092**	**3,716**	**5,184**	**5,694**	**11,755**	**17,417**	**20,368**	**21,258**
Domestic								
Currency and deposits								
Securities other than shares[2]	1,953	1,561	3,219	3,647	4,265	5,665	7,010	7,326
Loans								
Shares and other equity								
Insurance technical reserves								
Financial derivatives								
Other accounts payable								
Foreign								
SDRs								
Currency and deposits								
Debt securities								
Loans[3]	2,139	2,155	1,966	2,047	7,490	11,752	13,359	13,932
Equity and investment fund shares								
Insurance, pensions, and standardized guarantee schemes								
Financial derivatives and employee stock options								
Other accounts payable								

Source: Botswana authorities and Fund staff estimates.

[1] Information is not available on existing government investments.

[2] Using market value of the government debt.

[3] Using nominal value of existing foreign loans.

Table 3. Balance of Payments, 2008–2017

	2008	2009	2010	Est. 2011	Projections 2012	2013	2014	2015	2016	2017
	(US$ millions, unless otherwise indicated)									
Current account balance	931.9	-606.0	-296.8	283.9	544.5	503.4	439.5	454.2	426.7	542.2
Trade balance	440.1	-565.8	-237.1	183.1	7.9	-215.8	-263.6	-331.3	-443.4	-685.5
Exports, f.o.b.	4,835.9	3,451.4	4,635.5	6,475.2	6,245.2	6,303.7	6,399.7	6,518.4	6,638.0	6,772.0
Diamonds	3,068.7	2,139.5	3,207.8	4,435.2	4,584.4	4,605.0	4,651.4	4,720.9	4,793.6	4,872.4
Other raw materials	948.8	582.4	699.1	495.2	743.1	754.0	770.8	784.6	794.3	810.7
Other	818.5	729.5	728.5	1,544.7	917.7	944.6	977.5	1,012.9	1,050.1	1,088.9
Imports, f.o.b	-4,395.8	-4,017.3	-4,872.6	-6,292.1	-6,237.3	-6,519.4	-6,663.3	-6,849.7	-7,081.4	-7,457.5
Services	80.3	-633.0	-869.7	-881.4	-760.8	-734.7	-727.7	-737.2	-762.3	-942.6
Transportation	-382.1	-273.0	-277.9	-289.4	-299.9	-302.2	-311.5	-334.2	-358.3	-459.9
Travel	171.6	317.0	150.5	200.8	230.2	240.6	247.5	253.3	245.3	159.7
Other services	290.7	-677.0	-742.3	-792.9	-691.2	-673.1	-663.7	-656.3	-649.3	-642.4
Income	-636.8	-40.7	-206.3	-230.3	-398.7	-366.0	-441.0	-459.7	-460.9	-50.2
Current transfers	1,048.3	633.6	1,016.4	1,212.6	1,696.2	1,819.8	1,871.8	1,982.3	2,093.3	2,220.5
SACU receipts	1,146.9	1,159.1	977.7	1,155.8	1,638.7	1,693.5	1,730.9	1,824.9	1,927.2	2,044.2
Capital and financial account	833.3	872.0	165.5	976.5	442.8	363.9	234.8	169.9	148.3	121.9
Capital account	103.7	115.0	22.0	64.8	82.5	92.4	96.0	95.5	92.7	106.4
Financial account	729.6	757.0	143.5	911.7	360.3	271.5	138.8	74.4	55.7	15.4
Direct investment	624.2	601.3	556.1	585.0	546.9	566.0	577.8	591.1	609.1	629.7
Portfolio investment	531.7	-331.7	-402.4	-201.7	-220.5	-260.3	-299.0	-344.5	-397.3	-458.3
Other investment	-426.3	487.4	-10.2	528.4	33.9	-34.2	-140.0	-172.1	-156.2	-156.0
Assets	-355.6	-581.7	-353.0	-1.7	-110.0	-84.1	-79.9	-82.7	-87.4	-99.6
Liabilities	-70.6	1,069.1	342.8	530.1	143.9	49.8	-60.0	-89.5	-68.8	-56.4
Net government long-term borrowing	-13.4	936.2	31.9	445.3	73.7	11.8	-68.2	-98.8	-96.5	-92.4
Other net private long-term borrowing	-109.5	228.7	66.5	65.4	62.6	40.8	1.5	5.9	25.4	32.2
Short-term borrowing	52.3	42.4	-38.1	19.4	7.5	-2.7	6.6	3.5	2.3	3.8
Reserve assets (increase –)	-1,089.3	639.3	960.4	-503.1	-987.3	-867.3	-674.2	-624.0	-575.0	-664.1
Net errors and omissions	-675.9	-905.3	-829.1	-757.3	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:	(Percent of GDP, unless otherwise indicated)									
Balance of payments	8.0	-5.5	-6.4	2.8	5.5	4.6	3.4	3.0	2.6	2.8
Current account	6.9	-5.2	-2.0	1.6	3.0	2.7	2.2	2.2	1.9	2.3
Trade balance	3.2	-4.9	-1.6	1.0	0.0	-1.1	-1.3	-1.6	-2.0	-2.9
Exports of goods	35.6	29.8	31.1	36.6	34.9	33.5	32.3	31.2	30.2	29.0
Of which: diamonds	22.6	18.5	21.5	25.1	25.6	24.5	23.5	22.6	21.8	20.8
Imports of goods	-32.4	-34.7	-32.7	-35.6	-34.8	-34.7	-33.6	-32.8	-32.2	-31.9
Services balance	0.6	-5.5	-5.8	-5.0	-4.2	-3.9	-3.7	-3.5	-3.5	-4.0
Income and transfers balance	3.0	5.1	5.4	5.6	7.2	7.7	7.2	7.3	7.4	9.3
Financial account	5.4	6.5	1.0	5.2	2.0	1.4	0.7	0.4	0.3	0.1
Direct investment	4.6	5.2	3.7	3.3	3.1	3.0	2.9	2.8	2.8	2.7
Portfolio investment	3.9	-2.9	-2.7	-1.1	-1.2	-1.4	-1.5	-1.7	-1.8	-2.0
Other investment	-3.1	4.2	-0.1	3.0	0.2	-0.2	-0.7	-0.8	-0.7	-0.7
	(Annual percentage change, unless otherwise indicated)									
Export volumes	-13.4	-28.8	19.8	11.2	7.2	-0.1	0.5	0.9	0.9	1.0
Import volumes	20.6	-3.5	1.4	13.8	-2.5	4.9	3.1	3.4	5.1	7.0
Terms of trade	2.6	5.9	-6.3	-0.2	-2.0	1.4	1.9	1.5	2.5	2.6
End-of-year reserves (US$ millions)	9,115.6	8,668.8	7,883.1	8,386.1	9,373.4	10,240.7	10,914.9	11,539.0	12,114.0	12,778.1
(Months of imports of goods and services) [1]	22.0	17.3	12.6	13.0	14.9	17.1	18.8	20.4	19.3	19.1

Source: Bank of Botswana; and IMF staff estimates.

[1] Months of prospective imports.

Table 4. Monetary Survey, 2008–2017

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Millions of pula, end of period)									
Net foreign assets	72,781	59,312	52,550	63,596	80,650	98,397	116,085	134,747	142,201	150,972
Bank of Botswana	68,364	56,823	49,585	58,885	75,084	92,143	109,148	127,078	133,727	141,545
Assets	68,541	57,847	50,776	60,201	76,401	93,459	110,464	128,394	135,043	142,862
Liabilities	-127	-421	-612	-641	-641	-641	-641	-641	-641	-641
Commercial banks	4,416	2,489	2,965	4,710	5,565	6,254	6,937	7,670	8,474	9,426
Assets	6,059	3,855	5,838	5,524	6,378	7,068	7,750	8,483	9,288	10,239
Liabilities	-1,642	-1,365	-2,873	-813	-813	-813	-813	-813	-813	-813
Net domestic assets	-33,553	-20,596	-9,016	-18,174	-32,160	-45,170	-58,397	-72,335	-75,659	-78,417
Net domestic credit	-11,721	-2,251	7,956	8,177	10,208	13,145	17,019	20,898	24,228	27,777
Net claims on the government	-29,730	-22,404	-14,580	-22,726	-24,104	-25,207	-26,095	-27,463	-30,095	-33,992
Bank of Botswana	-31,768	-23,252	-14,882	-24,075	-25,662	-26,933	-27,988	-29,534	-32,363	-36,493
Commercial banks	2,038	848	302	1,349	1,558	1,726	1,892	2,071	2,268	2,500
Claims on parastatals	102	303	386	1,021	1,179	1,306	1,432	1,568	1,716	1,892
Claims on nongovernment	17,907	19,850	22,150	29,882	33,133	37,046	41,682	46,793	52,607	59,877
Claims on the private sector	19,268	21,254	23,622	28,781	31,862	35,637	40,137	45,102	50,755	57,835
Other financial institutions	-1,361	-1,404	-1,472	1,101	1,272	1,409	1,545	1,691	1,852	2,041
Other items (net) [2]	-21,832	-18,345	-16,972	-26,351	-42,368	-58,316	-75,417	-93,233	-99,887	-106,194
Money plus quasi-money (M2)	39,228	38,717	43,534	45,422	48,490	53,226	57,687	62,413	66,542	72,555
Money	7,768	7,108	9,938	9,334	11,069	12,151	13,169	14,248	15,190	16,563
Currency	1,103	1,145	1,916	2,089	2,134	2,342	2,538	2,746	2,928	3,193
Current deposits	6,666	5,963	8,023	7,244	8,936	9,809	10,631	11,501	12,262	13,370
Quasi-money	31,459	31,609	33,596	36,088	37,420	41,076	44,518	48,165	51,351	55,992
	(Contribution to growth in M2)									
Net foreign assets	37.8	-34.3	-17.5	25.4	37.5	36.6	33.2	32.4	11.9	13.2
Bank of Botswana	30.9	-29.4	-18.7	21.4	35.7	35.2	31.9	31.1	10.7	11.7
Commercial banks	6.9	-4.9	1.2	4.0	1.9	1.4	1.3	1.3	1.3	1.4
Net domestic assets	-16.1	33.0	29.9	-21.0	-30.8	-26.8	-24.9	-24.2	-5.3	-4.1
Net domestic credit	6.0	24.1	26.4	0.5	4.5	6.1	7.3	6.7	5.3	5.3
Net claims on the government	-5.9	18.7	20.2	-18.7	-3.0	-2.3	-1.7	-2.4	-4.2	-5.9
Of which: Bank of Botswana	-12.1	21.7	21.6	-21.1	-3.5	-2.6	-2.0	-2.7	-4.5	-6.2
Claims on nongovernment	12.1	5.0	5.9	17.8	7.2	8.1	8.7	8.9	9.3	10.9
Claims on parastatals	-0.2	0.5	0.2	1.5	0.3	0.3	0.2	0.2	0.2	0.3
Claims on the private sector	12.6	5.1	6.1	11.8	6.8	7.8	8.5	8.6	9.1	10.6
Other items (net)	-22.1	8.9	3.5	-21.5	-35.3	-32.9	-32.1	-30.9	-10.7	-9.5
Memorandum items:										
Nominal GDP (calendar year)	91,981	82,548	101,256	120,542	139,194	154,231	169,123	185,120	202,678	223,452
Nominal non-mineral GDP (calendar year)	54,466	61,010	69,618	81,664	89,795	101,524	113,333	126,295	140,710	158,028
Velocity (GDP relative to broad money, M2)	2.3	2.1	2.3	2.7	2.9	2.9	2.9	3.0	3.0	3.1
Velocity (non-mineral GDP relative to broad money, M2)	1.4	1.6	1.6	1.8	1.9	1.9	2.0	2.0	2.1	2.2
Private sector credit to GDP	20.9	25.7	23.3	23.9	22.9	23.1	23.7	24.4	25.0	25.9
Private sector credit to non-mineral GDP	35.4	34.8	33.9	35.2	35.5	35.1	35.4	35.7	36.1	36.6

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

Table 5. Botswana: Banking System Prudential Indicators, 2005–2012[1]

	2005	2006	2007	2008	2009	2010	2011	2012 March
	(Percent, unless otherwise indicated)							
Regulatory capital (millions of pula) [2]	1,568.6	1,743.2	2,020.6	2,991.6	3,670.7	4,582.0	5,418.9	5,778.0
Tier 1 capital (millions of pula)	961.4	1,071.3	1,185.4	1,832.2	2,191.6	2,692.0	3,394.4	3,559.9
Risk weighted assets (in millions Pula)	9,065.6	10,404.2	10,947.2	17,694.4	18,734.7	22,311.8	26,844.0	28,187.9
Total assets (in millions Pula)	17,760.6	29,255.5	33,988.1	45,317.7	44,090.1	49,067.9	51,756.5	54,672.7
Regulatory capital to risk-weighted assets [3]	17.3	16.8	18.5	16.9	19.6	20.5	20.2	20.5
Regulatory Tier I capital to risk-weighted assets [4]	10.6	10.3	10.8	10.4	11.7	12.1	12.7	12.6
Capital-to-assets	8.8	6.0	5.9	6.6	8.3	9.3	10.7	10.6
Asset composition and quality								
Loans-to-assets	51.2	36.9	33.9	39.7	44.8	43.9	52.8	51.9
Nonperforming loans (NPLs)-to-gross loans [5]	0.9	1.5	1.3	1.6	3.2	6.1	2.3	2.4
Compromised assets-to-gross loans [5]	2.6	3.2	3.3	0.9	0.9	2.7	4.1	2.4
NPLs net of specific provisions-to-gross loans [5]	0.0	0.0	1.4	-0.3	0.3	3.7	0.3	0.3
NPLs net of specific provisions-to-tier I capital [5]	0.0	0.0	0.1	-2.5	3.0	4.2	10.8	11.6
Profitability								
Return on average assets	5.5	6.1	2.6	2.9	2.8	0.9	0.4	0.3
Return on average equity	62.5	66.9	43.2	45.4	56.5	9.1	6.4	5.9
Net interest margin to gross income	38.2	31.8	65.4	65.2	67.5	39.8	46.2	52.6
Non-interest income to gross income	23.2	17.8	34.6	34.8	32.5	69.9	32.4	24.7
Non-interest expenses to gross income	27.1	20.2	45.2	45.5	45.3	24.6	39.4	34.1
Liquidity								
Liquid assets to total assets	26.1	47.0	47.2	50.5	39.6	34.4	18.9	21.2
Of which: BoBCs to Total Assets	19.6	43.4	45.3	38.7	37.3	34.6	19.7	21.9
Liquid assets to short-term liabilities	35.5	60.4	59.5	56.9	45.3	41.7	22.2	24.9
Foreign currency denominated loans to total loans	7.7	12.1	12.1	9.2	7.2	8.5	7.8	8.5
Foreign currency deposits to total deposits	17.9	24.8	32.7	26.9	12.9	14.8	15.4	15.0
Foreign currency denominated liabilities to total liabilities	22.5	29.1	41.6	34.8	34.2	13.8	14.6	14.2
Deposits-to-assets	74.5	79.0	83.2	85.2	86.0	82.4	85.4	85.4
Loans-to-deposits	68.7	46.7	40.8	46.6	52.1	53.3	61.9	60.8
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	15.4	17.3	10.6
Contingent foreign exchange (FX) assets-to-regulatory capital	70.7	258.2	327.1	132.7	31.8	39.9	39.2	41.7
Contingent foreign exchange (FX) liabilities-to-regulatory capital	52.4	88.4	18.7	60.9	74.2	130.5	125.3	120.9

Source: Bank of Botswana and 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, 1990–2011

	1990	1995	2000	2007	2008	2009	2010	2011
Goal 1: Eradicate extreme poverty and hunger								
Income share held by lowest 20 percent	...	...	...	...	...	...	...	...
Malnutrition prevalence, weight for age (percent of children under 5)	...	...	10.7	...	11.2	...	...	...
Poverty gap at $1.25 a day (PPP) (percent of population)	...	...	...	...	...	...	...	...
Poverty headcount ratio at $1.25 a day (PPP) (percent of population)	...	...	...	...	...	...	...	...
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)	...	...	...	...	25	...	...	...
Goal 2: Achieve universal primary education								
Literacy rate, youth total (percent of people ages 15–24)	...	...	...	...	...	95	...	...
Persistence to grade 5, total (percent of cohort)	...	...	84	...	...	...	...	...
Primary completion rate, total (percent of relevant age group)	90	92	89	94	...	...	...	...
School enrollment, primary (percent net)	87	78	81	86	...	...	...	...
Goal 3: Promote gender equality and empower women								
Proportion of seats held by women in national parliament (percent)	5	...	...	11	11	11	8	8
Ratio of girls to boys in primary and secondary education (percent)	108	104	102	100	...	...	...	...
Ratio of young literate females to males (percent ages 15–24)	...	...	...	...	...	...	...	...
Share of women employed in the nonagricultural sector (percent of total nonagricultural employment)	34	38	43	43	...	45	...	...
Goal 4: Reduce child mortality								
Immunization, measles (percent of children ages 12–23 months)	87	89	91	94	94	94	94	...
Mortality rate, infant (per 1,000 live births)	46	56	64	39	39	37	36	...
Mortality rate, under-5 (per 1,000)	59	76	95	52	52	49	48	...
Goal 5: Improve maternal health								
Births attended by skilled health staff (percent of total)	...	...	94	95	...	...	...	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	83	130	310	...	190	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases								
Contraceptive prevalence (percent of women ages 15–24)	...	...	44	53	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	533	855	918	645	596	545	503	...
Prevalence of HIV, female (percent ages 15–24)	...	...	...	...	...	12	...	...
Prevalence of HIV, total (percent of population ages 15–49)	4	17	26	25.1	24.9	25	...	...
Tuberculosis cases detected under DOTS (percent)	...	...	...	...	...	...	...	...
Goal 7: Ensure environmental sustainability								
CO2 emissions (metric tons per capita)	1.6	2.2	2.4	2.4	3	...	...	...
Forest area (percent of land area)	24	...	22	...	...	...	20	...
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	8	8	9	12	11	11	...	...
Improved sanitation facilities (percent of population with access)	38	46	52	...	...	...	62	...
Improved water source (percent of population with access)	93	94	95	...	...	...	...	...
Nationally protected areas (percent of total land area)	19.0	19.0	19.0	19	19	19	19	...
Goal 8: Develop a global partnership for development								
Aid per capita (current US$)	...	...	...	...	...	...	...	...
Debt service (PPG and IMF only, percent of exports, excl. workers' remittances)	...	...	...	...	...	...	...	...
Telephone lines (per 100 people)	2	4	8	7	7	7	7	...
Mobile cellular subscriptions (per 100 people)	0	0	13	60	76	95	118	...
Internet users (per 100 people)	0.0	0.1	2.9	5.3	6.3	6.2	6.0	...
Personal computers (per 1,000 people)	...	...	...	...	...	...	...	...
Unemployment, youth female (percent of female labor force ages 15–24)	...	...	14.0	...	...	...	...	...
Unemployment, youth male (percent of male labor force ages 15–24)	...	...	13.2	...	...	...	...	...
Unemployment, youth total (percent of total labor force ages 15–24)	...	...	13.6	...	...	...	...	...
Other								
Fertility rate, total (births per woman)	4.7	4.0	3.4	2.9	2.9	2.8	2.8	...
GNI per capita, Atlas method (current US$)	2,540	3,000	3,120	5,950	6450	6300	6740	...
GNI, Atlas method (current US$ billions)	3.5	4.8	5.4	11.5	12.6	12.5	13.5	...
Gross capital formation (percent of GDP)	...	...	...	...	...	...	...	...
Life expectancy at birth, total (years)	64	59	51	52	53	53	53	...
Literacy rate, adult total (percent of people ages 15 and above)	...	...	...	...	...	84	...	...
Population, total (millions)	1.4	1.6	1.8	1.9	2.0	2.0	2.0	...
Trade (percent of GDP)	104.8	89.0	94.5	82.9	83.4	79.3	72.4	...

Source: World Bank.

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

Appendix I. Botswana: Exchange Rate and External Balance Assessment

1. This Appendix provides an assessment of Botswana's exchange rate based on CGER methodologies adapted to country-specific circumstances.[1] Botswana follows a crawling peg exchange rate regime with the objective of stabilizing the real exchange rate. The pula is pegged to a basket of currencies. The regime is implemented through continuous adjustment of the trade-weighted nominal effective exchange rate at a rate of crawl based on the differential between Botswana's medium-term inflation objective and the forecast inflation of trading partner countries.

2. The analysis indicates that the pula is broadly in line with medium-term fundamentals. Table 1 presents the results of an analysis of exchange rate misalignments in Botswana based on four different methodologies. Taking into account the confidence bands surrounding the various estimates, staff concludes that the real effective exchange rate (REER) is broadly in line with macroeconomic fundamentals from a medium-term perspective. The estimates obtained are diverse, with one measure indicating no exchange rate misalignment, two measures suggesting that there is evidence of some degree of overvaluation, ranging from eight to ten percent and another measure pointing to a minor undervaluation.

3. The macroeconomic balance approach: This is a two-stage methodology. Firstly, the equilibrium current account norm is estimated based on panel regressions for a dataset covering 184 economies over the period 1973–2011. The current account norm is then compared to underlying current account projections and the degree of exchange rate misalignment is determined by the size of the gap between the two current account measures and the elasticity of the current account relative to the real effective exchange rate. This elasticity is assumed to be -0.5 based on country-specific estimated import and export elasticities for Botswana.[2] This approach yields a current account norm for Botswana of 0.2 percent of GDP in 2017, which is close to the underlying current account balance, but indicates a small undervaluation of close to 4 percent. Nevertheless, the estimated misalignment is not statistically significant.

4. The external sustainability approach: This approach also estimates exchange rate misalignments as the exchange rate adjustment required to close the external gap. Nevertheless, this approach is tailored to

[1] Prepared by Antonio David.

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

the characteristics of a resource-rich economy by defining the current account norm in a forward-looking way based on a normative path for net foreign assets (NFA) consistent with a rule for the inter-temporal allocation of the revenue from nonrenewable resources. The target path of NFA (of 70% of GDP by 2017) was based on the fiscal sustainability analysis for Botswana undertaken by IMF staff in 2012. Using the same elasticities as in the macroeconomic balance approach would suggest that the real exchange rate is overvalued by close to eight percent.

Table 1. Estimated Real Exchange Rate Misalignments

	Lower Bound	Mean	Upper Bound
Macroeconomic Balance	-24.4	-4.2	15.8
Equilibrium Real Effective Exchange Rate	-10.6	0.0	10.5
External Sustainability	...	8.3	...
Purchasing Power Parity	-3.7	9.5	26.8

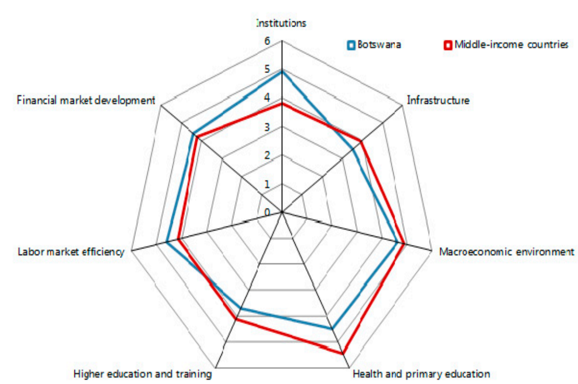
5. The equilibrium real exchange rate approach: This approach estimates panel regressions of the level of the real exchange rate on macroeconomic fundamentals and then compares the fitted values to the observed real exchange rate to calculate the misalignment. It suggests that the real exchange rate is broadly in line with macroeconomic fundamentals.

6. The purchasing power parity approach (PPP): In this approach, we estimate panel regressions of the ratio of the PPP exchange rate to the market exchange rate as a function of GDP per capita at "PPP dollars" and subsequently evaluate the residuals of the regressions to determine the degree of exchange rate misalignment. The PPP approach indicates that the exchange rate is overvalued by about 10 percent in the medium-term, but the large confidence intervals around the mean estimate indicate that evidence of overvaluation should be interpreted with caution.

7. Non-price competitiveness indicators suggest that Botswana performs well relative to its peers, but important challenges persist. Botswana performs better than other middle-income countries in terms of strength of institutions, but on other metrics such as health, education as well as infrastructure, the country is lagging behind comparators (Figure 1). These indicators reinforce the need to prioritize investments in infrastructure and human capital to address constraints to improvements in competitiveness.

Figure 1

Botswana and Other Middle-Income Countries: Competitiveness Indicators, 2011
(Score from 1 [less competitive] to 7 [more competitive])



Source: World Economic Forum.

Appendix II. Botswana: Responding to Spillovers from the Global Economy

1. **This appendix assesses potential spillovers from deterioration in the global economic outlook on Botswana's economy.**[1] As a mineral-based and highly open economy Botswana is potentially vulnerable to a range of global shocks. The appendix presents econometric results as well as model simulations quantifying the impact of global shocks on international diamond prices and on Botswana's economy more generally. In particular, it focuses on shocks to output growth in advanced economies, on deterioration in financial conditions in Europe, and on an increase in international oil prices. The analysis looks at the propagation of these shocks through financial and trade channels. Also possible second-round effects of these shocks were considered, including the transmission channel through South Africa.

2. **Outward spillovers from South Africa to other members of the Southern Africa Customs Union (SACU) could, in principle, be particularly strong.** Customs revenue heavily depends on South African imports and account for a substantial amount of fiscal revenue in most SACU countries. In addition, most SACU members, except Botswana, peg their currencies to the South African rand, in practice, adopting monetary policy decisions from the South African Reserve Bank. Anecdotal evidence suggests that remittances from South Africa to some SACU members may also be significant. Moreover, South African financial groups are the dominant players in the financial markets of the region, spanning banking, pension, insurance, and wealth management services, whose treasury and risk management decisions tend to be centralized in Johannesburg. These institutions may help channel foreign direct investment from South Africa into the rest of the region.

3. **Results from econometric models indicate that diamond prices are sensitive to shocks to growth rates in advanced economies.** Staff estimated Vector Autoregressive models to quantify the impact of shocks to growth in advanced economies on international diamond prices (impulse response functions are depicted in Figure 1). Overall, the results indicate that, a one standard deviation (positive) shock to output growth in advanced economies increases diamond prices by about 2 percent on impact. Nevertheless, the effects of shocks are not very persistent. A variance decomposition analysis suggests that shocks to US growth rates are particularly important in explaining the variation in diamond prices.

4. **The Global Integrated Monetary and Fiscal (GIMF) model was used to simulate**

[1] Prepared by Antonio C. David (AFR) based on joint work with Dirk Muir (RES) and Manuk Ghazanchyan (AFR).

the impact of financial distress in Europe and increases in international oil prices. Staff constructed a four region version of the IMF's GIMF model comprising Botswana, Europe, the United States, and the rest of the world. The analysis simulated a deterioration of financing conditions in Europe, namely a temporary, but persistent increase in corporate credit spreads (surpassing 2 percentage points) combined with a one percentage point increase in the sovereign risk premium for this region. The simulated financial distress in Europe would spillover to other regions included in the model both through trade and financial channels. These shocks were combined with an increase in international oil prices over two years, thus negatively affecting all oil-importing regions.

5. **Results of the model simulation indicate that the impact on real GDP growth in Botswana would be limited and rather short lived (Figure 2).** This result is mainly due to limited direct exposure to Europe through trade channels. Real GDP growth is projected to decline by close to 1 percentage point before recovering the following year. Exports would decline in real terms relative to the baseline (by about 1 percent) due to lower global demand. The real exchange rate would also appreciate following the shock.[2]

6. **In this context, monetary and fiscal policies would only play a limited role in addressing spillovers.** Core inflation is projected to decline marginally relative to baseline, as economic activity decelerates, leaving space for some reduction in policy interest rates (which is incorporated in the simulations). Nevertheless, due to the need to buttress medium-term consolidation and the small fiscal multipliers in a highly open economy, staff believes that the appropriate fiscal response would be to let automatic stabilizers work rather than pursuing more active fiscal stimulus measures. While this might delay the fiscal consolidation path envisaged under the FY2012/13 budget, it should not undermine medium-term fiscal sustainability.

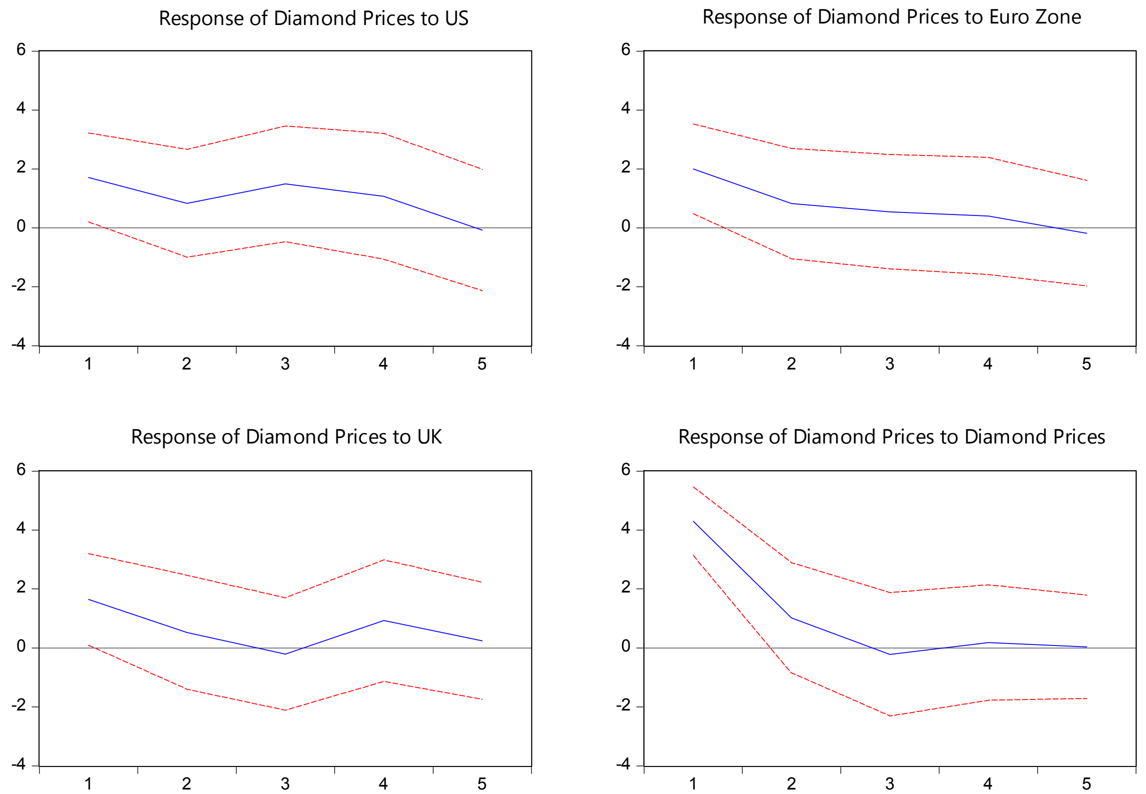
7. **In conclusion, the analysis suggests that spillovers from the global economy are mostly transmitted through trade channels.** The impact of global developments on diamond demand and prices seems particularly important. In general, the results do not indicate that the impact of global shocks on Botswana's economy is likely to be persistent.

[2] In terms of transmission of shocks through South Africa, outward growth spillovers, however, are not very evident. Preliminary results suggest that the external environment and domestic fiscal policies explain output fluctuations in the other four SACU countries, and that controlling for these, output developments in South Africa do not seem to amplify or cushion those effects on the region as a whole (using a panel data approach).

(continued)

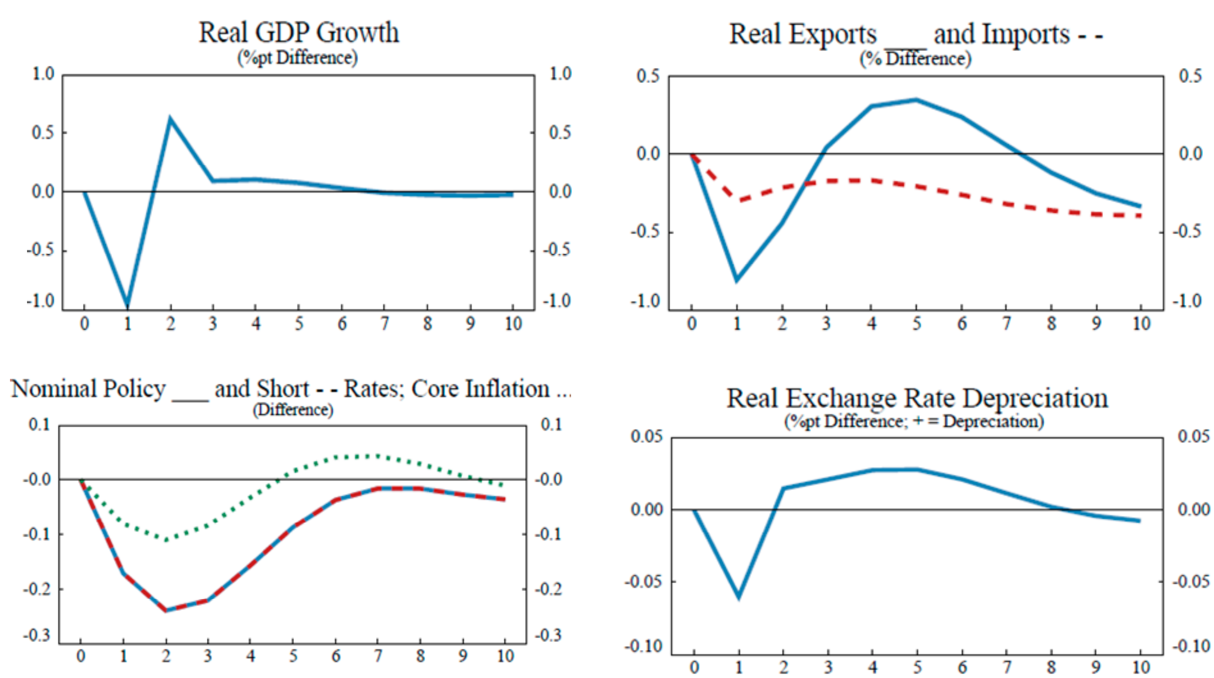
Figure 1. Generalized Impulse Response Functions

Response to Generalized One S.D. Innovations ± 2 S.E.



Source: WEO, Bloomberg; and IMF staff estimates.

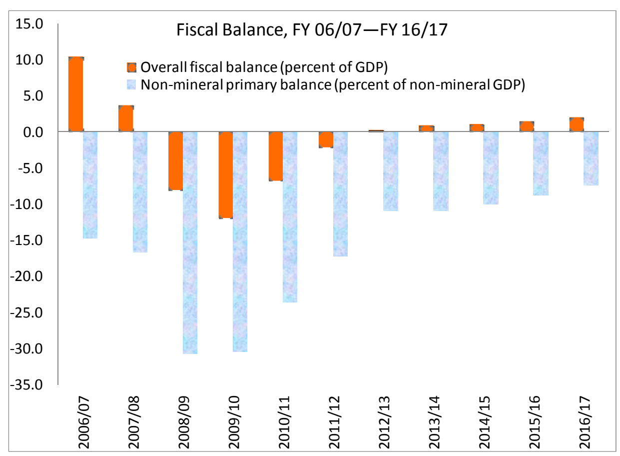
Figure 2. Spillovers to Botswana



Appendix III. Botswana: Long-Term Fiscal Sustainability Benchmarks

1. This appendix derives numerical benchmarks to guide Botswana's medium-term fiscal policy based on the Permanent Income Hypothesis (PIH) framework.[1, 2] A key long-term fiscal challenge facing producers of exhaustible natural resources is to decide how to allocate government wealth (including mineral wealth) across generations. This challenge is met by targeting a fiscal policy that preserves the government wealth. The standard permanent income hypothesis argues that the preservation of wealth would require that spending in each period be limited to the permanent income or the implicit return on government wealth. To compute this "permanent" income, the projected stream of mineral revenue is transformed into a hypothetical annuity with the same net present value as the revenue. The annuity reflects the permanent portion of the country's mineral wealth. The benchmark amount of spending that the government can then permanently sustain is equal to the sum of the annuity and non-mineral revenue. The benchmark fiscal balance is then calculated by setting annual expenditure equal to this level and saving the difference between actual and the hypothetical annuitized mineral revenue.

2. The judgment on the sustainability of current fiscal position is made based on the comparison of the staff's medium-term fiscal projections (which are consistent with the government's fiscal framework) against the fiscal benchmarks derived from the PIH approach. The staff projections assumed the attainment of a small surplus in FY2012/13 consistent with the Budget, along a steady, but gradual, diamond market recovery.



3. The benchmarks derived from the PIH suggest that further fiscal adjustment is required to achieve sustainability. Under the baseline scenario (scenario (a) in Table 1 below) in which the annuity is held constant as a share of non-mineral GDP, the sustainable non-mineral primary deficit is 4.9 percent of non-mineral GDP. This deficit is consistent with

[1] Prepared by Lamin Leigh and Ara Stepanyan.

[2] This follows the same methodology used by Clausen (2008) and applied to Botswana in the Article IV staff reports since 2007.

a spending level of 26 percent of GDP on average from FY2012/13 to FY2016/17, which is lower than the staff's medium-term expenditure projections of 29 percent of GDP for the same period. The benchmarks non-mineral primary deficits average about 6.7 percent of GDP between FY2011/12 and FY2015/16, when we assume a more optimistic rate of return on mineral wealth (scenario (b)) or higher non-mineral revenue (scenario (c)). When the annuity is held constant in real per capita terms (scenario (d)), or simply in real terms (scenario (e)), the sustainable non-mineral primary deficits are wider initially, but narrow gradually to a range of 7 to 9 percent of non-mineral GDP by 2016–17. The assumptions used to calculate the benchmarks are summarized in Box 1.

4. The robustness of the PIH benchmarks was confirmed against structural budget deficit estimates prepared using Chile's structural fiscal balance approach. Staff estimates suggest that the sustainable structural balance (SB) path for Botswana is closely correlated with the path for the non-mineral primary deficit derived using the PIH framework (Table 2). The structural balance is defined as the difference between the expected structural mining revenue and the expected structural expenditures. Expected structural mining revenue is derived by assuming that the economy is operating at its potential and diamond prices are at their long-term levels.

Table 1. Medium-Term Fiscal Outlook and Sustainability Benchmarks

	Nonmining Primary Balance		Overall Balance	
	2012/13	2016/17	2012/13	2016/17
	(Percent of nonmining GDP)		(Percent of GDP)	
Staff projections	-8.6	-7.0	1.1	1.2
Sustainability benchmarks:				
Revenue projections minus expenditure that follows "permanent" income				
(a) Baseline assumptions	-4.9	-4.9	5.1	3.5
Baseline revenues and baseline interest rate assumption				
(b) Conservative assumptions	-6.7	-6.7	3.9	2.1
Baseline revenues and optimistic interest rate assumption				
(c) Optimistic assumptions	-6.8	-6.8	3.8	0.7
Optimistic mineral and non-mineral revenues and optimistic interest rate assumption				
(d) Constant per capita purchasing power	-10.6	-8.9	1.2	0.5
Baseline assumptions				
(e) Constant real purchase power	-8.2	-6.6	2.9	2.2
Baseline assumptions				

Source: IMF staff calculations.

Table 2. Structural Balance Estimates, 2009/10–2015/16

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	(percent of non-mining GDP)						
Estimated Structural Revenues	36.9	33.0	35.4	38.2	39.4	40.1	40.5
Estimated Structural Expenditures	63.5	51.6	50.3	45.7	47.3	45.8	45.0
Estimated Structural Balance	-26.6	-18.6	-14.9	-7.5	-7.9	-5.7	-4.5
Rolling correlation with NMPB	0.712	0.744	0.718	0.705	0.748	0.767	0.772

Sources: Staff estimates and projections. Potential output is estimated using both HP and Kalman filters.

$SBt = E(SRt) - E(SEt)$.

Box 1. Assumptions used to calculate benchmarks

- Production of diamonds reaches a pick of 30.5 million carats in 2020 and begins sharp decline from 2024.
- Nominal US dollar price of diamond is adjusted annually by the rate of change in the CPI of the advanced economies, so that stays constant in real terms. The dollar price is converted to pula using period average nominal exchange rate.
- The initial stock of wealth accumulated into the pula fund is 50.6 percent of GDP at end-December 2011. This is added to the value of mineral wealth still in the ground in calculating the total value of mineral wealth.
- The real return on mineral wealth is 4.2 percent, based on the average real return of the Norwegian Pension Fund over the last ten years.
- The income from annuitized diamond revenue is spread until 2050.
- The annuity is assumed to stay constant in terms of real non-mining GDP.
- Non-mineral real GDP growth averages about 5 percent from 2012/13 to 2016/17 before declining gradually and to a steady state rate of 3 percent.

Appendix IV. Botswana: Strengthening Government Institutions

1. Strong government institutions are critical for supporting high economic growth.[1] The importance of effective governmental institutions lies in their capacity to raise the return to private sector investment and, thus, overall economic growth. While the principal public-sector investments that are needed to support growth are education and infrastructure, the international evidence suggests the complementary role of regulations and the effectiveness of public institutions in supporting the materialization of potential private sector outlays for increasing the tangible and intangible asset base of the economy.[2]

2. Information on the World Bank's Government Effectiveness indices point to a number of challenges for Botswana (Figures 1 and 2). While the country ranks significantly higher than other middle-income countries in SSA (i.e., Cape Verde, Namibia and Seychelles) in terms of the quality of government institutions, its absolute level of performance has remained broadly stagnant for about a decade (2000–2010). This average performance contrasts with that of Mauritius, which is an outstanding example of government institution-building throughout the same period. A detailed analysis points at Botswana's relative weaknesses in terms of institutional effectiveness (due to a perceived low quality of its public sector bureaucracy), excessive red tape, and poor allocation of public resources for rural development according to the survey data compiled by the World Bank for computing the government effectiveness indices. Moreover, in terms of quality of public institutions, Botswana ranks somewhat below comparators with similar gross national income (GNI) per capita.

3. Building efficient and accountable public financial management (PFM) systems could be a useful way to address challenges and strengthening government institutions. In this regard, Botswana's Public Expenditure and Financial Accountability (PEFA) report of February 2009 provides some practical sequence of reforms to budgetary practices, procurement, and financial accountability systems. Low-cost reforms that could trigger an overall improvement in Botswana's PEFA ratings include, in particular, aspects regarding: a comprehensive monitoring of debt levels of sub-national governments; the development of a multi-year perspective in fiscal planning and execution; more frequent reconciliation of tax assessments and collections; strong compliance of competitive bidding procurement processes, and enhanced quality and timeliness of the production and

[1] Prepared by Gonzalo Pastor.

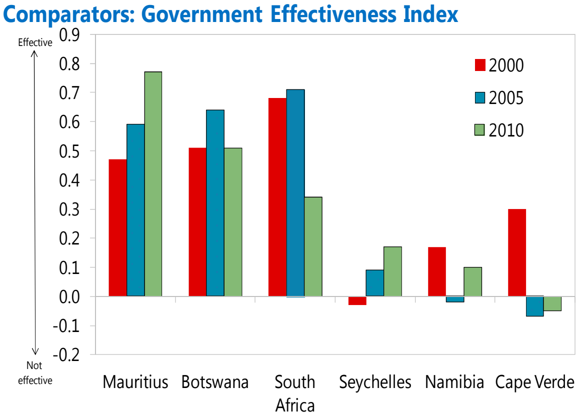
[2] A number of studies have suggested the centrality of governance to economic development. See, for example, Gupta, S., Powell R., and Yang Y. (2005) "Macroeconomic Challenges of Scaling Up Aid to Africa," IMF Working Paper, No. WP/05/179.

dissemination of central government annual financial statements and internal audit reports.

4. **The government's support in strengthening the local financial sector is yet another venue to support domestic savings and high economic growth**. In general, Botswana's overall macroeconomic stability and the resilience that has been attained in financial systems during the 2008/09 global financial crisis offer a favorable setting for further developing the depth, efficiency and competitiveness of the financial sector. This is one on the main messages of assessments under the 2007 Financial Sector Assessment Program (FSAP) and the Botswana Financial Sector Development Strategy of 2011. The latter, in particular, stresses the large size of the unbanked population, and the need for the authorities to search for measures to fill the financial access gap through the development of microfinance and e-money, for example, while taking appropriate steps to limit regulatory risks. A deepening of the government bond market would be yet another venue for the government to support domestic savings to finance investment.

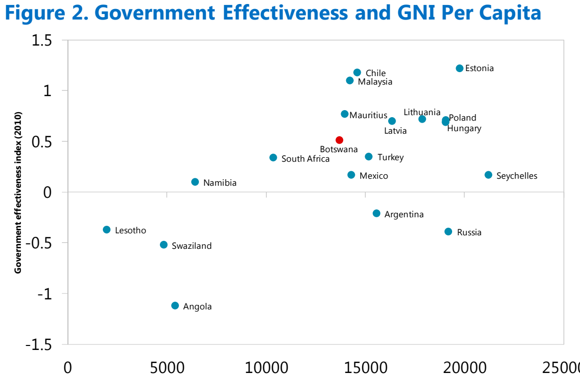
5. **Finally, it is important to underscore that assessing the quality of institutional effectiveness is a complex undertaking and the analysis above only addresses a limited number of issues for Botswana**. That said, they do highlight that while mineral wealth has propelled Botswana to high middle-income status, there are spots of institutional weaknesses, which do not exist in some of the other high middle-income countries and are often found in economies with much lower level of per capita income.

Figure 1. Botswana and Sub-Saharan African Comparators: Government Effectiveness Index



Source: World Bank Worldwide Governance Indicators, http://info.worldbank.org/governance/wgi/.

Figure 2. Government Effectiveness and GNI Per Capita



Source: World Bank Worldwide Governance Indicators and World Bank World Development Indicators.

INTERNATIONAL MONETARY FUND

BOTSWANA

July 10, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By African Department

CONTENTS

FUND RELATIONS

As of May 31, 2012

Membership Status

Joined July 24, 1968; Article VIII

General resources account	SDR (million)	Percent of Quota
Quota	87.80	100.00
Fund holdings of currenty	59.73	68.03
Reserve position in Fund	28.08	31.98

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	57.43	100.00
Holdings	87.04	151.56

Outstanding Purchases and Loans None

Financial Arrangements None

Project Obligations to Fund None

Implementation of HIPC Initiative None

Exchange Rate Arrangements

The exchange rate of the Botswana pula is a crawling peg arrangement against a basket of currencies. As of June 18, 2012, the exchange rate of the U.S. dollar to the pula was US$1= P7.96, and that of the South African rand to the pula was R1=P0.9308.

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 for current international transactions.

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 29, 2011.

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
	September 2010	Macro-fiscal framework, asset management, and accrual accounting
LEG	January 2006	Review of amended VAT provisions
	July 2006	Review of central bank law
	June 2007	Review of VAT laws
	July 2010	Technical assistance in Fiscal Law
STA	May 2001	Inspection for visit of long-term balance of payments advisor
	October 2001	Report on Standards and Code (ROSC) data module
	July 2002; Feb. 2003	BOP statistics: peripatetic visit
	August 2003	Monetary and financial statistics using the General Data Dissemination Standard (GDDS)
	March 2004	GDDS project for Anglophone Africa: Government Finance Stat.
	June 2004	GDDS project for Anglophone Africa: National accounts statistics
	August 2004	Follow-up mission: Money and banking statistics
	Oct. 2004; May 2005	GDDS project for Anglophone Africa: 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
	December 2005	Technical assistance evaluation mission
	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
	Nov. 2007 – Nov. 2008	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 – June 2010	Real sector statistics (resident regional advisor)
	February 2010	Money and banking statistics
	February 2010	Regional Data Harmonization
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	Inflation forecasting and modeling
July 2006	
December 2008	
December 2009	
January 2009	Risk management framework
February 2009	Payments systems (LT Resident Expert Assignment)
June 2009	Risk management
July 2009	Monetary operations
January 2011	Risk management
February 2011	Continuation of support on inflation forecasting and modeling
April 2011	Implementation of central bank risk management

JOINT WORLD BANK AND IMF WORK PROGRAM

As of June 19, 2012

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		Approved in FY10; ongoing
	2. HIV/AIDS Project		Approved FY09; ongoing
	3. Integrated Transport Project		Approved FY09; ongoing
	4. Northern Botswana Human-Wildlife Coexistence (Global Environment Facility)		Approved FY10; ongoing
	5. Development Policy Review (DPR): Competitiveness, Diversification and Growth		FY12; completed
	6. Fee-Based Technical Advisory Services for Water Sector Reform (Phase 3)		FY13 (preparation)
	7. Fee-Based Technical Advisory Services for Economic Diversification and Competitiveness		FY13 (preparation)
	8. Skills for Economic Diversification		FY12; completed
	9. Social Safety Net Assessment for Botswana		FY13; ongoing
	10. Poverty Assessment for Botswana		FY13 (preparation)
	11. Public Sector Management- Justice and Law System TA		FY12; ongoing
	12. Wealth Accounting and Valuation of Ecosystem Services for Botswana		FY12; ongoing
IMF work program in the next 12 months	STA TA on balance of payments, national accounts, consumer price index, and standardized reporting	Ongoing FY 2012	
	MCM TA on financial stability,nonbank	Ongoing FY	

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	supervision, central bank risk management, payment system modernization, and reviewing banking legislation.	2012	
	FAD TA PFM, overall tax policy review,cash management and trade facilitation	Expected FY 2012	
	FAD Macro-fiscal advisor	May 2012-May 2013	
	LEG TA on banking and fiscal laws	FY 2012	
	Article IV Consultation	May 2013	

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: On November 30, 2010, the government of Botswana gazetted the commencement of the Statistics Act of 2009. Under the Act, the Central Statistics Office (CSO), which had been a department of the Ministry of Finance and Development Planning, was transformed into Statistics Botswana (SB), responsible for the country's statistical system. SB will operate independently of the Ministry of Finance and Development Planning, with its own board of Directors. 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. A national population census is scheduled to begin the current fiscal year.
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. Preliminary estimates based on the Botswana Core Welfare Indicators Survey (BCWIS) 2009/10 were realeased in late 2011. 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 SB'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, although the authorities are working with the Fund Statistics Department (STA) toward that endeavor. 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 usually 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 2008–2010 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* and Botswana reports annual balance of payments and IIP data to STA. 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 June 19, 2012)

	Date of Latest Observation	Date Received	Frequency of Data [1]	Frequency of Reporting [1]	Frequency of Publication [1]	Memo Items	
						Data Quality—Methodological Soundness [2]	Data Quality—Accuracy and Reliability [3]
Exchange rates	6/19/2012	6/19/2012	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities [4]	Mar 2012	May 2012	M	M	M		
Reserve/base money	Mar 2012	May 2012	M	M	M	O, O, LO, O	LNO, O, LO, LO, LO
Broad money	Mar 2012	June 2012	M	M	M		
Central bank balance sheet	Mar 2012	April 2012	M	M	M		
Consolidated balance sheet of the banking system	Mar 2012	June 2012	M		M		
Interest rates [5]	6/19/2012	6/19/2012	D	D	D		
Consumer price index	May 2012	June 2012	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	Feb 2012	April 2012	A/Q/M	Q	Q		
Stocks of central government and central government-guaranteed debt [8]	March 2012	May 2012	A	A	A		
External current account balance	2011 Q4	April 2012	A/Q	A	A	O, O, O, LO	LO, LO, LNO, O, LO
Exports and imports of goods	March 2012	May 2012	M	M	M		
GDP/GNP	2011 Q4	April 2012	A/Q	A/Q	A/Q	LO, LO, LNO, LO	LO, LO, LNO, LO, LO
Gross external debt	March 2012	May 2012	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.

INTERNATIONAL MONETARY FUND

BOTSWANA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITYANALYSIS

July 10, 2012

Approved By
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Prepared by the Staff Representatives for the 2012 Consultation with Botswana

MEDIUM-TERM PUBLIC DEBT SUSTAINABILITY

Botswana's gross public debt increased in pula values in 2011/12 compared with 2010/11, while it fell by one percentage point relative to GDP. Domestic and external borrowing contributed to the increase in gross public debt. The share of external debt in total debt increased sharply to 67 percent in 2009/10 driven by the government borrowing to finance its countercyclical fiscal policy.

The Botswana's historically low level of public debt reflects the authorities' prudent macroeconomic policies. This resulted in a significant reserve accumulation, which allowed them to face the Great Recession with strong policy buffers. Therefore, countercyclical policies were successfully implemented without much debt accumulation.

The baseline scenario, underlying the staff's macroeconomic framework, assumes continuing fiscal consolidation with the primary balance turning from a deficit of 6.6 percent of GDP in 2010/11 into a surplus of 1.3 percent of GDP on average for the period of 2012/13–17/18. The main burden of fiscal adjustment falls on primary expenditure. By 2017/18, the stock of gross public debt is projected at 8 percent of GDP.

Table 1 shows two alternative scenarios:

- The first scenario aims to demonstrate what would be the fiscal outcome if the main macro-variables are maintained at their historical 10-year averages. In this scenario, debt-to-GDP ratio increases and stabilizes at a level much higher than suggested by the baseline scenario. The main driver of this kind of dynamics is the deteriorated primary balances due to countercyclical fiscal policy response to the 2008-09 financial crisis.

- The second scenario assumes no change in the policy and holds the primary fiscal balance constant at its 2012/13 level (1.4 percent of GDP) throughout the medium-term. In this case, public debt decreases to 7.2 percent of GDP by 2017/18. The outcome of this scenario is similar to that of the baseline scenario since primary fiscal balance in 2012/13 is very close the average primary balance for the period of 2012/13–17/18. Relatively unfavorable outcome of the first scenario underscores the downside risk of delay or failure to implement committed fiscal consolidation.

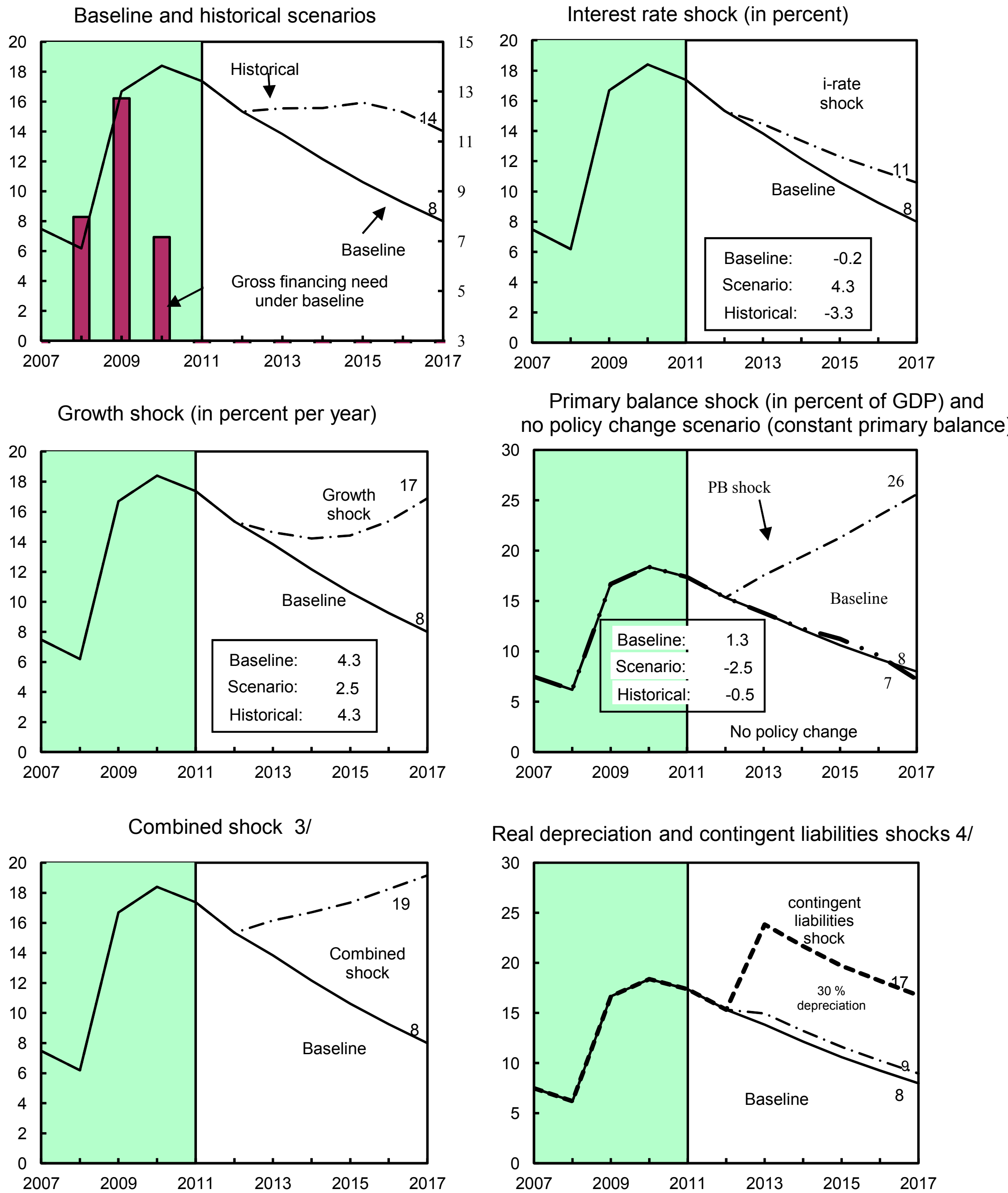
The bounds tests illustrate the sensitivity of the public debt-to-GDP ratio to exogenous shocks (Figure 1). The most benign shock is that stemming from keeping fiscal policy unchanged. Public debt is relatively vulnerable to primary fiscal balance and growth shocks. These shocks generate an increase in debt-to-GDP ratio by 18 and 9 percentage points respectively.

Table 1. Country: Public Sector Debt Sustainability Framework, 2007–2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	7.5	6.2	16.7	18.4	17.4	**15.3**	**13.8**	**12.2**	**10.6**	**9.3**	**8.0**	**-0.2**
o/w foreign-currency denominated	1.7	1.2	3.2	2.9	2.6	2.3	2.0	1.8	1.5	1.2	0.6	
Change in public sector debt	1.9	-1.3	10.5	1.7	-1.0	-2.0	-1.5	-1.7	-1.5	-1.4	-1.3	
Identified debt-creating flows (4+7+12)	-4.6	7.0	13.2	3.9	-0.2	-2.6	-2.3	-2.3	-2.5	-1.4	-0.6	
Primary deficit	-4.1	7.6	12.2	6.6	1.9	-1.4	-1.4	-1.6	-1.9	-1.1	-0.3	
Revenue and grants	36.5	30.3	35.2	30.8	30.7	30.3	29.3	29.1	29.0	29.0	28.8	
Primary (noninterest) expenditure	32.3	37.9	47.4	37.4	32.5	28.8	27.9	27.6	27.1	27.8	28.5	
Automatic debt dynamics 2/	-0.4	-0.6	1.0	-2.7	-2.1	-1.2	-1.0	-0.7	-0.6	-0.2	-0.3	
Contribution from interest rate/growth differential 3/	-0.4	-1.0	1.2	-2.6	-2.5	-1.2	-1.0	-0.7	-0.6	-0.2	-0.3	
Of which contribution from real interest rate	-0.2	-0.8	0.8	-1.6	-1.7	-0.6	-0.4	-0.2	-0.1	0.2	0.1	
Of which contribution from real GDP growth	-0.2	-0.2	0.3	-1.0	-0.8	-0.6	-0.6	-0.5	-0.5	-0.4	-0.4	
Contribution from exchange rate depreciation 4/	0.0	0.4	-0.2	-0.1	0.4	...	...	...	...	...	...	
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) 5/	6.5	-8.3	-2.7	-2.2	-0.8	0.6	0.8	0.6	1.0	0.0	-0.7	
Public sector debt-to-revenue ratio 1/	20.5	20.4	47.5	59.7	56.7	50.7	47.3	41.8	36.6	32.0	27.8	
Gross financing need 6/	-2.7	8.0	12.7	7.2	2.3	-0.2	-0.8	-1.0	-1.4	-0.4	0.4	
in billions of U.S. dollars	-336.3	1082.5	1476.3	1068.1	414.6	-44.7	-153.8	-206.1	-292.9	-87.0	82.0	
Scenario with key variables at their historical averages 7/						**15.3**	**15.6**	**15.6**	**15.9**	**15.3**	**14.0**	**-1.0**
Scenario with no policy change (constant primary balance) in 2012-2017						**15.3**	**13.8**	**12.3**	**11.3**	**9.6**	**7.2**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.8	3.0	-4.7	7.0	5.1	3.8	4.2	4.2	4.3	4.4	4.7	
Average nominal interest rate on public debt (in percent) 8/	6.8	5.0	6.5	3.8	3.0	7.6	3.9	3.7	4.1	7.1	7.1	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-3.6	-12.6	12.3	-10.8	-10.3	-3.7	-2.6	-1.5	-0.8	2.2	1.7	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.4	-20.1	12.7	3.6	-14.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	10.4	17.6	-5.8	14.6	13.3	11.3	6.4	5.3	4.9	4.9	5.3	
Growth of real primary spending (deflated by GDP deflator, in percent)	14.2	20.7	19.1	-15.5	-8.7	-7.9	0.8	2.9	2.6	7.1	7.2	
Primary deficit	-4.1	7.6	12.2	6.6	1.9	-1.4	-1.4	-1.6	-1.9	-1.1	-0.3	

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

Figure 1. Country: Public Debt Sustainability: Bound Tests 1/ 2/
(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ 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).

MEDIUM–TERM EXTERNAL DEBT SUSTAINABILITY

Botswana’s gross external debt increased from US$2.6 billion in 2009 to US$3.1 billion in 2011 but fell by 5 percentage points relative to GDP. The nominal increase in the debt mainly reflects external borrowing by the Botswana Power Corporation to finance the construction of the Moropule B energy plant and loan disbursements from the World Bank to cover an array of social and institution-building programs. The latter included, among others, the development of databases at Statistics Botswana, capacity-building initiatives at NBFIRA, and a medium-term debt strategy at the Ministry of Finance and Development Planning.

The stock of Botswana’s gross external debt is projected to decline gradually from a peak of about 23 percent of GDP in 2009 to about 6 percent of GDP in 2017 (Table 2).

Ongoing fiscal consolidation in an environment of export growth, supported by a steady improvement in international terms of trade, and stable FDI inflows should support a reduction in the external debt ratio.

An alternative scenario, with key debt-creating variables at their historical levels, suggests that Botswana could become a net creditor vis-à-vis the rest of the world over the medium-term. This is a notable improvement over the baseline projections (Figure 2).

Simulations suggest that Botswana’s external debt-to-GDP ratio is sensitive only to current account shock. Real depreciation shock, while increases the debt-to-GDP ratio initially, have only marginal impact on the medium-term debt dynamics. Moreover, Botswana’s external debt is not sensitive to the shock of interest rates and economic activity.

Table 2. Country: External Debt Sustainability Framework, 2008–2017
(In percent of GDP, unless otherwise indicated)

	Actual				Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing non-interest current account 6/
Baseline: External debt	8.1	22.9	19.6	17.9	**17.7**	**16.6**	**15.1**	**13.5**	**11.5**	**6.0**	**-2.6**
Change in external debt	-2.0	14.7	-3.2	-1.8	-0.2	-1.1	-1.6	-1.6	-2.0	-5.5	
Identified external debt-creating flows (4+8+9)	-11.4	0.9	-6.9	-8.0	-6.8	-6.4	-5.8	-5.6	-5.2	-5.5	
Current account deficit, excluding interest payments	-7.7	4.3	1.7	-2.7	-4.2	-3.8	-3.3	-3.2	-2.9	-3.2	
Deficit in balance of goods and services	-3.8	10.3	7.4	4.0	4.2	5.1	5.0	5.1	5.5	7.0	
Exports	42.0	32.5	32.9	38.6	37.0	35.7	34.6	33.6	32.5	31.3	
Imports	38.2	42.8	40.3	42.5	41.2	40.8	39.6	38.8	38.0	38.3	
Net non-debt creating capital inflows (negative)	-3.6	-5.8	-3.8	-3.3	-3.1	-3.0	-2.9	-2.8	-2.8	-2.7	
Net foreign direct investment, equity	3.9	5.6	3.8	3.3	3.1	3.0	3.0	2.9	2.8	2.7	
Net portfolio investment,equity	-0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Automatic debt dynamics 1/	-0.1	2.4	-4.8	-2.0	0.5	0.5	0.5	0.5	0.4	0.4	
Contribution from nominal interest rate	0.8	1.0	0.3	1.1	1.1	1.2	1.1	1.1	1.0	0.9	
Contribution from real GDP growth	-0.3	0.5	-1.2	-0.8	-0.7	-0.7	-0.7	-0.6	-0.6	-0.5	
Contribution from price and exchange rate changes 2/	-0.6	0.9	-3.8	-2.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	9.4	13.9	3.7	6.2	6.7	5.3	4.2	4.1	3.2	0.0	
External debt-to-exports ratio (in percent)	19.3	70.4	59.7	46.3	47.9	46.6	43.6	40.2	35.3	19.2	
Gross external financing need (in billions of US dollars) 4/	-895.9	651.1	340.4	-252.8	-520.7	-471.6	-343.8	-341.7	-320.1	-439.9	
in percent of GDP	-6.6	5.6	2.3	-1.4	-2.9	-2.5	-1.7	-1.6	-1.5	-1.9	
Scenario with key variables at their historical averages 5/					**17.7**	**10.5**	**2.4**	**-5.7**	**-14.4**	**-25.2**	**-3.4**
Key Macroeconomic Assumptions Underlying Baseline											
Real GDP growth (in percent)	3.0	-4.7	7.0	5.1	3.8	4.2	4.2	4.3	4.4	4.7	
GDP deflator in US dollars (change in percent)	6.5	-10.3	20.2	12.8	-2.4	0.9	1.0	1.0	1.0	1.4	
Nominal external interest rate (in percent)	8.5	10.2	1.7	6.6	6.4	7.0	7.1	7.5	7.7	8.6	
Growth of exports (US dollar terms, in percent)	-2.9	-34.0	30.3	39.1	-2.9	1.5	2.0	2.4	2.0	2.2	
Growth of imports (US dollar terms, in percent)	18.2	-4.3	21.1	25.1	-1.9	4.0	2.3	3.1	3.5	6.9	
Current account balance, excluding interest payments	7.7	-4.3	-1.7	2.7	4.2	3.8	3.3	3.2	2.9	3.2	
Net non-debt creating capital inflows	3.6	5.8	3.8	3.3	3.1	3.0	2.9	2.8	2.8	2.7	

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).

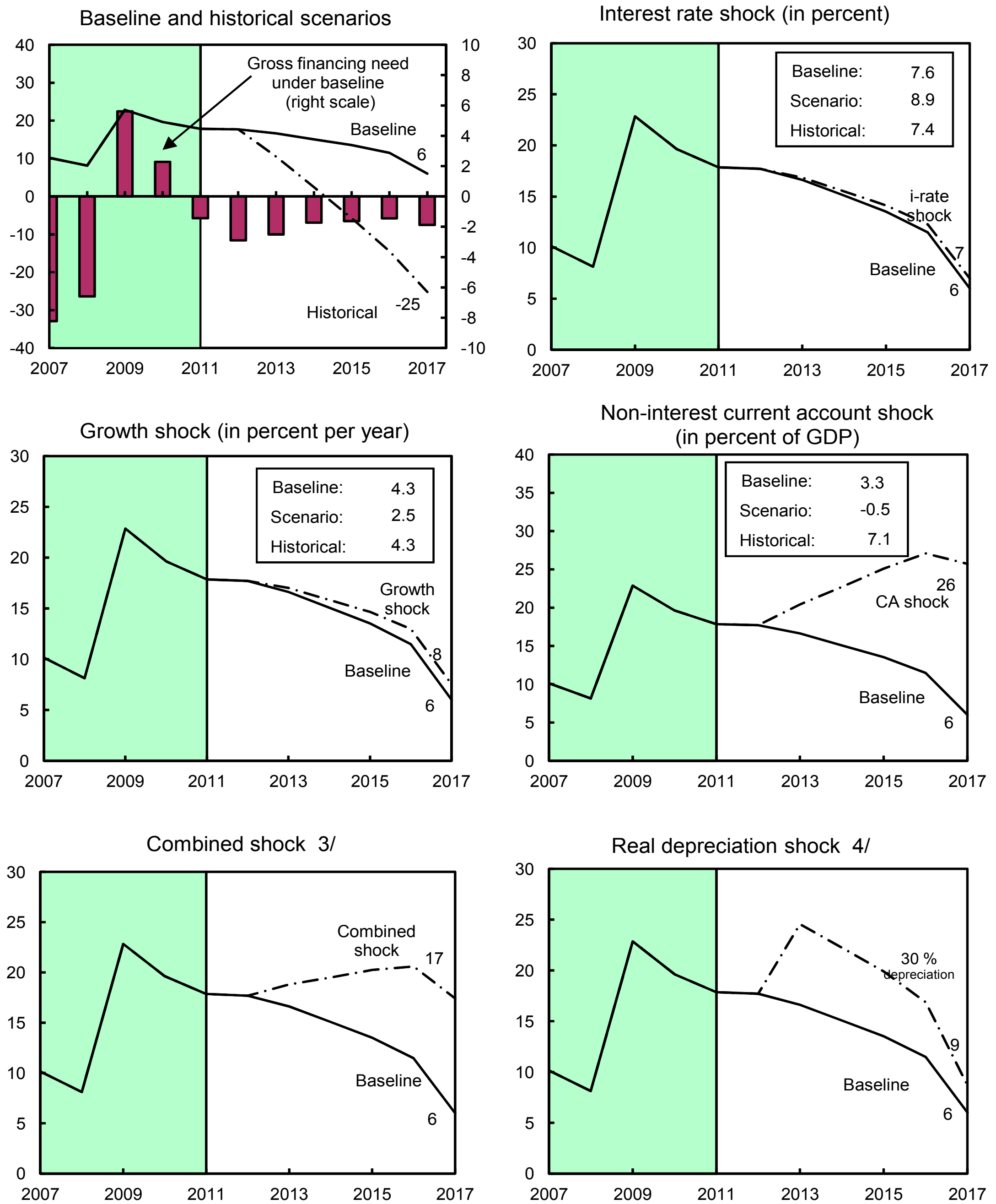
3/ For projection, line includes the impact of price and exchange rate changes.

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. Country: External Debt Sustainability: Bound Tests 1/ 2/
(External 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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND
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Public Information Notice (PIN) No. 12/91
FOR IMMEDIATE RELEASE
July 31, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with Botswana

On July 25, 2012, 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's economic recovery after the 2008–09 financial crisis was one of the strongest among middle-income countries (MICs), but its growth weakened in the second half of 2011. Real GDP grew by 5.1 percent in 2011 (just below the average for its peer MIC group) compared with 7 percent growth in 2010. The growth deceleration was driven by a significant slowdown in diamond exports during the second half of the year. However, the non-mineral sector registered a brisk growth during the year, despite a significant fiscal withdrawal. Diamond sales for the first quarter of 2012 showed only a very modest recovery.

At the same time, while receding, inflation remains relatively high. Consumer price inflation (year on year) declined from 9.2 percent in December 2011 to 7.7 percent in May 2012, which is higher than the upper end of Bank of Botswana's (BoB) medium-term objective range of 3–6 percent. Core inflation (excluding food, fuel and administered prices) has declined slightly in the last few months. Alternative measures, including the trimmed mean, also suggest a downward trend in core inflation.

Notwithstanding the moderation in growth, conditions in financial markets have improved. Private sector credit growth is now approaching pre-crisis level, supported by a strong growth in

[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.

credit to businesses. Bank's nonperforming loans fell notably in the second half of 2011 because of a significant improvement in the quality of loans to households. Increased interest and non-interest income, combined with lower provisions for nonperforming loans, contributed to the rebound in banks' profitability.

The fiscal outcome was better than planned. The overall fiscal deficit in FY2011/12 was about 2 percent of GDP, compared with the budget target of about 6 percent. The non-mineral primary deficit also declined from about 24 percent of non-mineral GDP in FY2010/11 to 17 percent in FY2011/12. The adjustment reflects a sharp decline in government spending mainly due to savings generated in the education budget owing to the increase in the number of students admitted to local tertiary institutions, rationalization of student allowances and improved administration, as well as better prioritization of development spending. Higher-than-expected customs revenue from the Southern Africa Customs Union (SACU) Common Revenue Pool also contributed to the lower deficit.

The overall external position also strengthened in 2011, with annual export growth (in dollar terms) of about 40 percent. Exports grew faster than imports turning the current account deficit into a surplus for the first time in the last three years. Diamond exports benefited from higher diamond prices in the first half of 2011, which more than offset the poor performance of copper and nickel exports. Besides mining, plastic products and textile exports surged in 2011. However, exports of meat and meat products fell compared with 2010 because of the restriction on meat exports to the European Union related to the non-compliance with the EU's export requirements. The real effective exchange rate lost ground slightly over the last 12 months.

The fragile global economic environment suggests that Botswana's growth will likely moderate in 2012. Over the medium term, real GDP growth is expected to stabilize at around 4.5 percent, while inflation is expected to converge to the upper band of the BoB's medium-term objective range in 2013. With projected fiscal surpluses in FY2012/13 and beyond, the current account surplus is forecast to stabilize at about 2 percent of GDP. The main near-term risks relate to the highly uncertain external environment, which remains fragile and poses significant downside risks to mineral export demand.

Executive Board Assessment

In concluding the 2012 Article IV Consultation with Botswana, Executive Directors endorsed staff's appraisal, as follows:

The current fragile global economic environment is likely to delay the pace of recovery in Botswana. Trend growth will likely moderate over the medium term as the historical success over diamond wealth continues to fade.

Against this backdrop, the authorities' current policy mix of fiscal restraint and an accommodative monetary policy stance is appropriate. In a more adverse global economic scenario, the authorities should allow the automatic stabilizers to operate on the revenue side.

Bolder measures are required to achieve the targeted reduction in the wage bill. Such measures include streamlining the system of non-wage payments, rationalizing the size and structure of government, tightening the link between pay and performance, strengthening payroll systems, and revising the wage scale.

Broadening the tax base should be an integral part of the authorities' fiscal consolidation strategy. Staff strongly recommends conducting a full-fledged study on tax expenditure to provide a solid foundation for streamlining tax incentives to specific activities that absolutely need it.

The authorities should adopt a fiscal anchor that delinks the fiscal stance from volatile mineral revenue and SACU receipts. Thus, staff reiterates the need to adopt either the non-mineral primary balance or the structural fiscal balance (à la Chile) in the formulation of fiscal policy.

Staff supports the main thrust of the Bank of Botswana's recent reform in its liquidity management framework. Greater coordination between monetary operations and debt management through enhanced issuance of treasury securities should help to support the needed burden-sharing of sterilization costs.

The authorities should pay close attention to macro-financial linkages. The high level of exposure of the banking system to household debt is a significant source of vulnerability and warrants close monitoring.

There is an urgent need to strengthen the capacity of the non-bank financial institutions' regulator. The rapid expansion of these institutions has propelled them into a systemically important component of the financial system, while the capacity of the non-bank regulator to supervise these large institutions lags behind. The cross-linkages between the bank and non-bank parts of the financial system constitute potentially an additional risk to the financial system.

Botswana faces long-term development and structural challenges that it needs to address to move the country to a higher level of development. Current redistributive aspects of fiscal policy should be complemented with policies that tackle inequality through fostering effective investment in education and health and enhancing financial inclusion. As one of the largest employers in the economy, the government has an important effect on economy-wide wage settlements and job creation. Thus the reform of the public sector employment policies is critical to enhancing job creation in the broader economy. Fostering deeper institutional and capacity development should be an important part of the government's reform agenda to support long-term growth.

Staff judges the level of the real effective exchange rate as broadly in line with fundamentals from a medium-term perspective.

Botswana: Selected Economic and Financial Indicators, 2009–2012

	2009	2010	2011 Prel.	2012 Proj.
(Annual percentage change, unless otherwise indicated)				
National income and prices				
Real GDP [1]	-4.7	7.0	5.1	3.8
Mineral	-20.7	6.7	-1.3	2.7
Non-mineral [2]	4.6	5.2	7.3	3.9
Consumer prices (average)	8.1	6.9	8.5	7.5
Consumer prices (end of period)	5.8	7.4	9.2	6.4
Nominal GDP (billions of pula) [1]	82.5	101.3	120.5	139.2
Diamond production (millions of carats)	17.7	22.8	23.0	23.5
External sector				
Exports of goods and services, f.o.b. (US$)	-34.0	30.3	39.1	-2.9
Of which:				
Diamonds	-30.3	49.9	38.3	3.4
Imports of goods and services, f.o.b. (US$)	-4.3	21.1	25.1	-1.9
(Percentage change with respect to M2 at the beginning of the period)				
Money and banking				
Net foreign assets	-34.3	-17.5	25.4	37.5
Net domestic assets	33.0	29.9	-21.0	-30.8
Broad money (M2)	-1.3	12.4	4.3	6.8
Velocity (nonmineral GDP relative to M3)	1.6	1.6	1.8	1.9
Credit to the private sector	5.1	6.1	11.8	6.8
(In percent of GDP, unless otherwise indicated)				
Central government finances [3]				
Total revenue and grants	33.3	29.4	29.5	29.5
Total expenditure and net lending	45.3	36.2	31.7	29.2
Overall balance (deficit –)	-12.0	-6.8	-2.2	0.3
Nonmineral primary balance[4]	-30.4	-23.6	-17.2	-10.9
Total central government debt	15.8	17.6	16.7	14.9
External sector				
Current account balance	-5.2	-2.0	1.6	3.0
Balance of payments	-5.5	-6.4	2.8	5.5
External Public debt [5]	13.0	10.9	11.8	11.0
(In millions of US$, unless otherwise indicated)				
Change in reserves (increase –)	447	786	-503	-987
Gross official reserves (end of period)	8,669	7,883	8,386	9,373
In months of imports of goods and services [6]	17.3	12.6	13.0	14.9
In percent of GDP	74.8	52.9	45.3	53.2

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Calendar year.

[2] Refers to the growth of value added of sectors other than mining, excluding statistical adjustments. The latter includes financial intermediation services indirectly measured (FISIM), taxes on products, and subsidies.

[3] Year beginning April 1.

[4] 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.

[5] Includes publicly guaranteed debt.

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