

Botswana: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities for Botswana

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 25, 2006, 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 December 4, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;
- a staff statement of December 13, 2006 updating information on recent developments;
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its December 13, 2006 discussion of the staff report that concluded the Article IV consultation; and
- a statement by the authorities for Botswana.

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

Selected Issues Paper and Statistical Appendix

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

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BOTSWANA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Botswana

Approved by Sharmini Coorey and Mark Plant

December 4, 2006

- The 2006 Article IV consultation discussions were held in Gaborone during June 6–20, 2006. The staff met with Minister of Finance and Development Planning Gaolathe, Bank of Botswana Governor Mohohlo, and other senior officials. The mission also met with representatives from the private sector, labor unions, civil society, and the diplomatic community. The staff team comprised Mr. Dorsey (PDR, head), Messrs. Basdevant and Iimi, and Ms. Kim (all AFR); Ms. Gesami (OED) joined the mission on June 19–20. Subsequent to the mission, the discussions continued with substantive correspondence from the authorities on monetary and exchange rate policies on October 6, and October 25.
- At the conclusion of 2005 Article IV consultation on June 22, 2005, Directors noted that Botswana's sound macroeconomic policies and good governance had contributed to sustained growth and low inflation, but emphasized the need to diversify the economy and allocate adequate budgetary resources to combat HIV/AIDS while preserving macroeconomic stability. In light of the adoption of the crawling peg exchange rate arrangement, Directors also stressed the need to move quickly to put in place supportive monetary and fiscal policies that would establish a clear nominal anchor and lend credibility to the new regime.
- Botswana is on the standard 12-month consultation cycle. Botswana has accepted the obligations of Article VIII; Botswana maintains a multiple currency practice relating to exchange rate guarantees on loans that will be outstanding until 2016 (see Appendix I). Annexes on Botswana's relations with the Fund, relations with the World Bank, statistical issues, debt sustainability, and the PIN background section are included in Appendices I–VI, respectively.

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EXECUTIVE SUMMARY

Botswana's macroeconomic performance has been generally good over the last two years, with the exception of inflation, which accelerated substantially following the May 2005 devaluation. Real GDP growth was strong in 2004/05, the 2005 current account surplus widened, and international reserves stood at the equivalent of 21 months of goods and services imports.

Botswana's growth has been fueled by continued increases in diamond production; however, real diamond output is projected to level off and then decline sharply after about fifteen years. Botswana's economic progress could be eroded unless the authorities successfully implement policies to diversify the economy. Botswana also has a very high HIV/AIDS infection rate which will continue to place a burden on human welfare and public finances.

The budget surplus for 2005/06 is estimated at more than eight percent of GDP, and the 2006/07 budget calls for another, albeit significantly smaller, surplus. These surpluses are a prudent response to the declining share of diamond revenues in GDP that is likely over the long-term, but the sharp drop in the 2006/07 surplus, due largely to projected expenditure increases, could add to inflationary pressures.

At the time of the 2005 devaluation, Botswana adopted a crawling peg exchange rate arrangement, which could provide the basis for a nominal anchor. However, because Botswana's inflation targets are very close to the inflation rates of countries represented in the exchange rate basket, only a very modest rate of crawl would be consistent with the authorities' targets.

Diversification of the economy will require implementation of substantial structural reforms, in particular the authorities' planned reforms in labor markets, the investment environment, and the role of parastatals.

I. INTRODUCTION

1. **Botswana has been among the world's fastest growing economies over the past 40 years.** Diamond-led growth combined with sound macroeconomic policies and good governance has moved Botswana from being one of the poorest countries in the world to the upper-middle income range and yielded the highest sovereign debt ratings and best Transparency International anti-corruption rank in Africa.

2. **Nevertheless, Botswana faces serious challenges to continued economic development.** The country remains heavily dependent on diamond production, which

accounts for about three-fourths of exports, one-third of GDP, and half of government revenue. However, diamond output, which almost doubled over the past decade, is projected to plateau at roughly at current production levels for the next decade and a half and decline sharply thereafter. Notwithstanding efforts by the authorities to diversify the economy, non-mining activity remains relatively weak (falling from 66 to 57 percent of GDP in the nine years to 2004/05) and, as a result, unemployment and poverty rates remain high.¹ Botswana also has one of the world's highest HIV/AIDS infection rates (estimated by UNAIDS at

Income Level of Botswana and Comparator Countries			
Country	Income per capita (US\$)	Income (BWA = 100)	PPP income (BWA = 100)
Mexico	6,790	156	101
Chile	5,220	120	111
Malaysia	4,520	104	101
Costa Rica	4,470	103	96
Botswana	4,360	100	100
Panama	4,210	97	70
Venezuela	4,030	92	61
Uruguay	3,900	89	94
Turkey	3,750	86	81
South Africa	3,630	83	114
Thailand	2,490	57	83
Namibia	2,380	55	78
Swaziland	1,660	38	59
Lesotho	730	17	34
Upper Middle Income average	4,769	109	106
Sub-Saharan Africa average	601	14	44

Source: World Bank, World Development Indicators, 2006.

over 35 percent of the adult population) and many of Botswana's other social indicators often lag behind those of countries at comparable income levels.

¹ The share of households below the national poverty line fell from 47 percent in 1993/94 to 30 percent in 2002/03.

Poverty and Unemployment			
Country	Gini coefficient	Poverty (percent below \$1/day standard)	Unemployment (percent)
Mexico	50	5	3
Chile	57	< 2	7
Malaysia	49	< 2	4
Costa Rica	50	2	7
Botswana (World Bank data) 1/	63	24	19
Botswana (national data) 1/	63	...	23
Panama	56	7	14
Venezuela	44	8	17
Uruguay	45	< 2	17
Turkey	44	3	10
South Africa	58	11	28
Thailand	42	< 2	2
Namibia	74	35	31
Swaziland	61	...	...
Lesotho	63	36	...
Upper Middle Income	...	...	12
Sub-Saharan Africa	...	44	...

Source: World Bank, World Development Indicators, 2006.

1/ World Bank WDI data for Botswana on the Gini coefficient and poverty are from a 1993 household survey and unemployment data are from the 2000-04 period. Botswana's national data on the Gini coefficient and unemployment are from a 2002/03 household survey.

Nutrition and Education						
Country	Population Malnutrition, 2001-03	Child Malnutrition (Stunting), 1995-2004	Youth Literacy: Male, 2002	Youth Literacy: Female, 2002	Primary school completion rate	Secondary school enrollment ratio
Mexico	5	18	98	97	97	79
Chile	4	1	99	99	97	88
Malaysia	3	16	97	97	95	70
Costa Rica	4	6	98	99	92	68
Botswana	30	23	85	93	92	74
Panama	25	18	97	96	97	70
Venezuela	18	13	96	98	98	72
Uruguay	3	...	99	99	94	106
Turkey	3	16	98	95	...	85
South Africa	...	25	...	...	96	90
Thailand	21	13	98	98	...	77
Namibia	23	24	87	92	81	58
Swaziland	19	30	87	89	61	42
Lesotho	12	46	...	...	71	36
Upper Middle Income	0	...	98	97	96	87
Sub-Saharan Africa	32	...	...	...	62	30

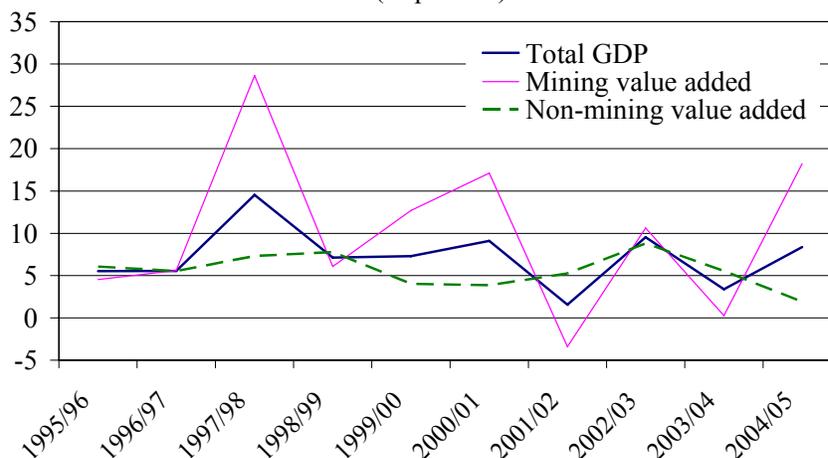
Source: World Bank, World Development Indicators, 2006.

3. **Botswana has had continuous democratic rule since independence in 1966.** The president and legislature were elected in 2004, and new elections are scheduled for 2009.

II. RECENT ECONOMIC DEVELOPMENTS

4. **Botswana's recent economic performance has also been generally good, apart from an upsurge in inflation following the May 2005 devaluation.** Real GDP growth has rebounded to more than eight percent in 2004/05 (July-June), mainly due to growth in the mining sector (Tables 1 and 2 and Figure 1). The current account surplus is estimated at fifteen percent of GDP in 2005, mainly reflecting increased exports of both diamonds and other goods.² The capital and financial accounts continued to show a modest but declining deficit, reflecting investments abroad by pension funds. International reserves increased to the equivalent of 21 months of goods and services imports by end-2005 (Table 3).

Figure 1. Botswana: Mining and Non-Mining Growth, 1995/96-2004/05
(In percent)



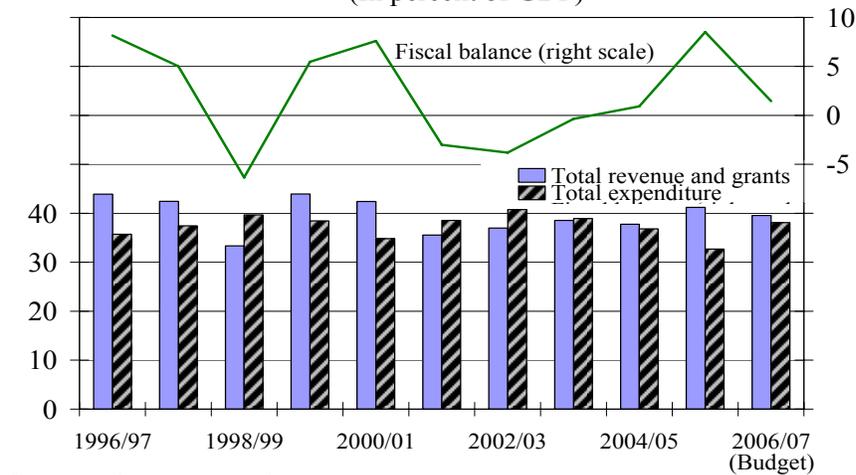
Source: Botswana authorities.

5. **The fiscal surplus rose sharply to more than eight percent of GDP in 2005/06.**³ Higher diamond revenues and lower-than-budgeted spending were the main factors behind the increased surplus (Table 4 and Figure 2). The 2006/07 budget (April-March) projects a much smaller surplus, with expenditures rebounding strongly and mineral revenue growth slowing. However, data for the first quarter of 2006/07 show a revenue-to-GDP ratio broadly in line with the first quarter of 2005/06 while expenditure-to-GDP ratio appears substantially below the level seen in the same quarter of 2005/06, implying a surplus for the first quarter of 2006/07 at an annual rate of five percent of GDP.

² Non-diamond exports roughly tripled in dollar terms and nearly doubled as a share of GDP between 2001 and 2005, reflecting both increased commodity prices and increased export volumes.

³ Final data on the 2005/06 fiscal year are not yet available; estimates for 2005/06 are based on information for eleven months and have been subject to large revisions after the close of the fiscal year.

Figure 2. Botswana: Fiscal Operations, 1996/97-2006/07
(In percent of GDP)



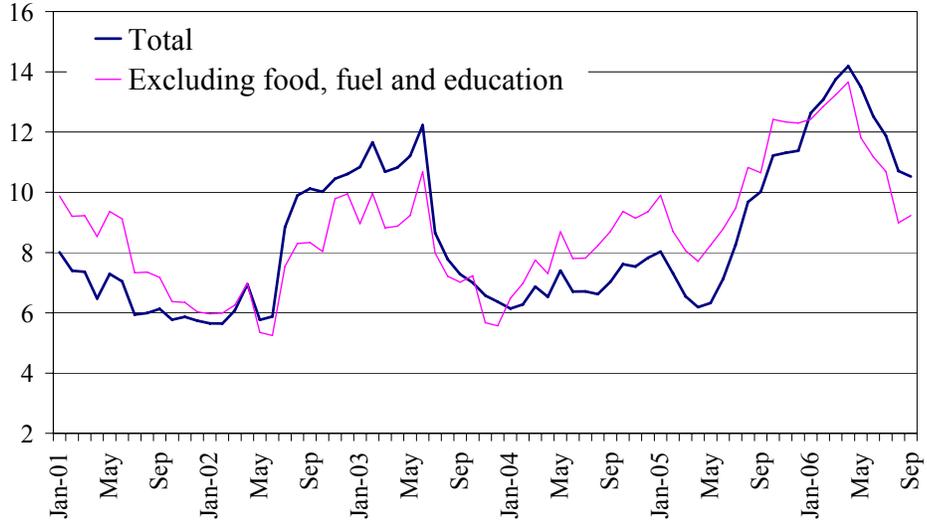
Source: Botswana authorities.

6. **The authorities announced a shift in the exchange rate regime from a fixed peg against a basket to a crawling peg against a basket comprising the South African rand and the SDR at the time of the May 2005 devaluation.** According to the 2006 Monetary Policy Statement of the Bank of Botswana (BoB), the rate of crawl is set at the difference between the inflation targets and projections of countries in the basket and Botswana's own inflation objectives of 4–7 percent for 2006 and an average of a 3–6 percent range for the 2006-08 period; these objectives were reaffirmed in the August 2006 Mid-term Review of the Monetary Policy Statement.⁴ The weights and the rate of crawl have not been announced.

7. **Coinciding with the devaluation and the change in exchange rate regime, inflation has accelerated (Figure 3).** Inflation had been on a downward trend in early 2005, but consumer price inflation accelerated from 6.3 percent in the 12 months to May 2005 and peaked at 14.2 percent in the 12 months to April 2006. Inflation in the first nine months of 2006 has reached 7.8 percent and already exceeds the authorities' objective of a 4 to 7 percent rate for the December 2005-December 2006 period. Monthly inflation rates between May and September 2006 have been equivalent to annual rates in the 7 to 9 percent range. Notwithstanding the crawl, the real effective exchange rate has appreciated since May 2005, offsetting some of the real effect of the devaluation in the period through September 2006 (Figures 4 and 5).

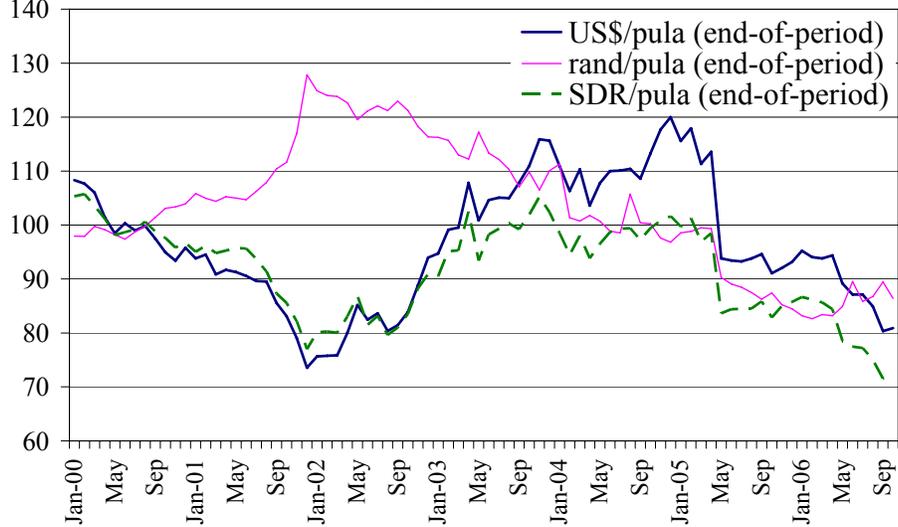
⁴ Exchange rate policy is set by the President on the recommendation of the Minister of Finance and Development Planning after consultation with the Bank of Botswana. See the supplement to the 2005 Article IV staff report for more information on the May 2005 devaluation.

Figure 3. Botswana: Inflation, Jan. 2001-Sept. 2006
(In 12-month percentage change)



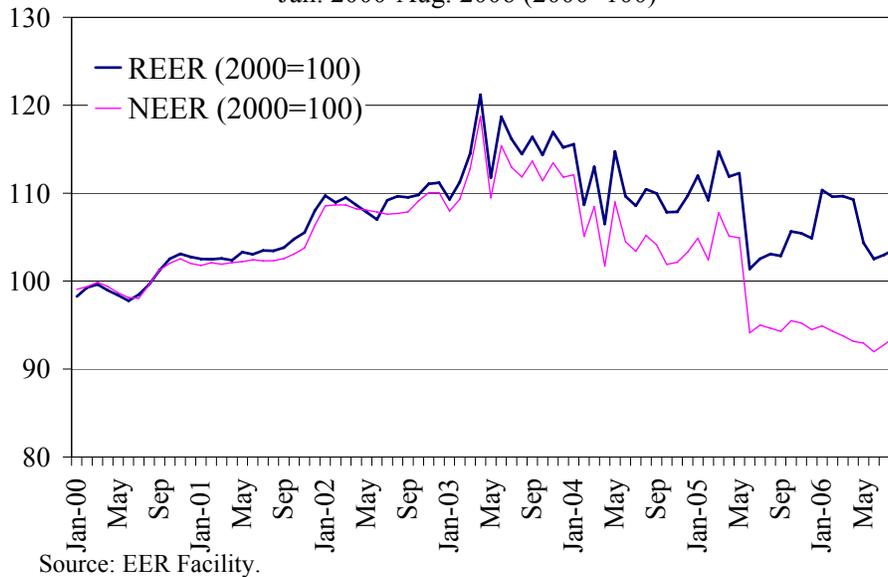
Sources: Botswana authorities and IMF staff estimate.

Figure 4. Botswana: Bilateral Exchange Rates,
Jan. 2000-Sept 2006 (2000=100)



Source: EDSS.

Figure 5. Botswana: Real and Nominal Effective Exchange Rates,
Jan. 2000-Aug. 2006 (2000=100)

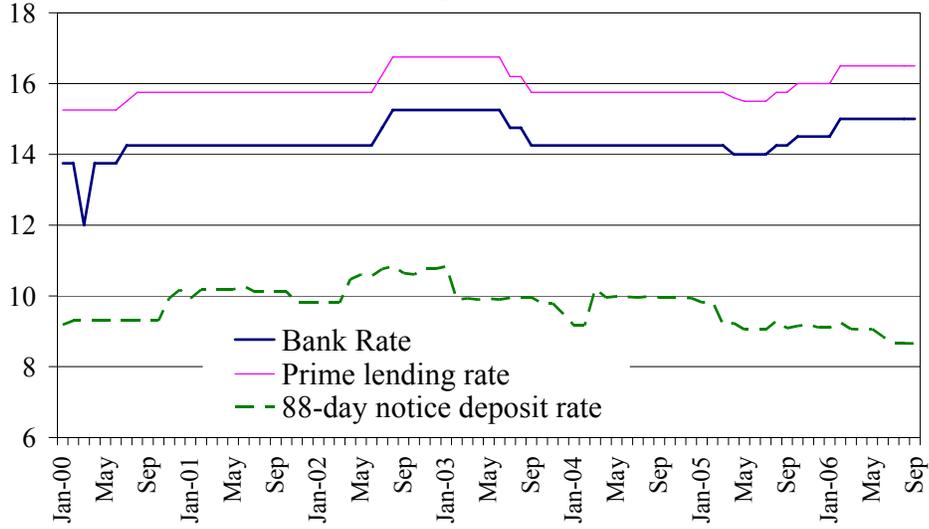


8. Money and credit trends have been mixed since May 2005 (Table 5). Real, domestic-currency money demand appears to have fallen significantly. Notwithstanding cumulative inflation of 15 percent in the fourteen months between May 2005 and July 2006, pula-denominated broad money (M3) has been almost unchanged in nominal terms while foreign currency deposits have more than doubled.⁵ Credit trends are less clear; real credit to the private sector fell in the last seven months of 2005 but rose in the first seven months of 2006. Interest rates remained broadly flat in nominal terms (Figure 6), and real interest rates are now negative for most deposit rates. The BoB increased its policy interest rates by a cumulative total of one percent since May 2005. However, banking system excess liquidity is high; credit to non-government is less than the commercial banks' holdings of Bank of Botswana Certificates (BoBCs).⁶ Notwithstanding Botswana's open capital account, interest rates also have a limited relationship with the exchange rate; the absence of organized forward markets in the pula and with very thin markets for pula-denominated fixed-income securities that can be held by non-banks makes it difficult to engage in covered interest arbitrage while prudential limits on banks' open position constrain them from taking advantage of interest differentials.

⁵ New regulations in early 2006 prohibiting non-banks from purchasing Bank of Botswana Certificates (BoBCs) resulted in an increase in deposits at commercial banks (included in M2) offset by a decline in BoBCs held by non-banks (included in M3 but not M2).

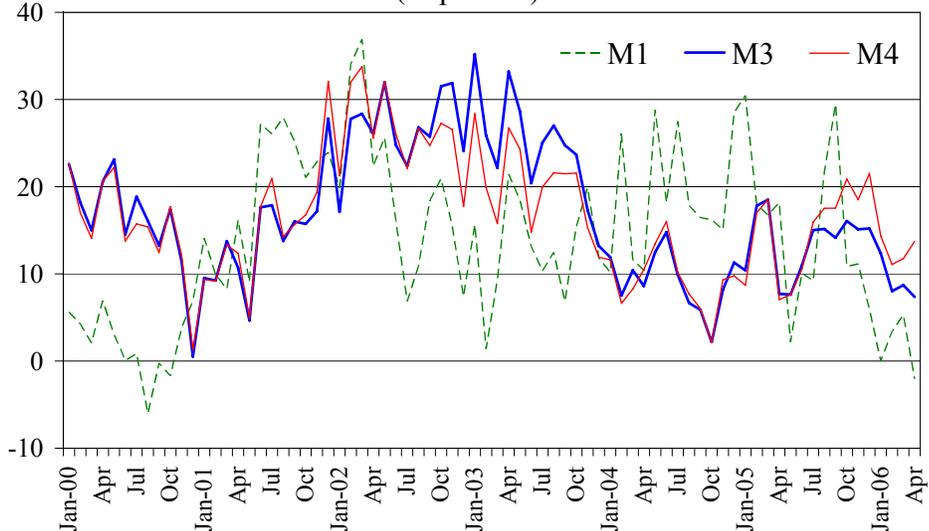
⁶ BoBCs are short-term securities issued by the BoB to absorb banking system liquidity and are the main pula-denominated asset available to commercial banks for their excess liquidity.

Figure 6. Botswana: Interest Rates, Jan. 2000-Sept. 2006
(In percent)



Source: Botswana authorities.

Figure 7. Botswana: Monetary Growth, Jan. 2000-Apr. 2006
(In percent)



Source: Botswana authorities.

III. POLICY DISCUSSIONS

9. **The policy discussion focused on how monetary/exchange rate policy, fiscal policy, and structural reforms can address the inter-related challenges of diversifying**

the economy, reducing unemployment and poverty, and caring for those infected with or affected by HIV/AIDS, all within an increasingly constrained fiscal resource envelope and while maintaining macroeconomic stability.

A. Monetary and Exchange Rate Policy

10. **The authorities attributed the sharp rise in inflation since May 2005 to several factors.** They noted that administered price increases, the introduction of school fees for secondary school students, and increased fuels costs were significant factors as well as the devaluation. They were of the view that the devaluation contributed only about three to four percentage points to 2005 inflation. The staff agreed that the devaluation was not the sole factor behind the acceleration of inflation, but took the view that exchange rate pass-through is likely to be very high in Botswana given the large share of imports in consumption. They noted that empirical work by staff implied a large role for the exchange rate in the determination of prices in Botswana and a more limited role for monetary aggregates and interest rates.⁷ The authorities noted that the high share of imports in consumption did not imply that there was no scope for demand management, and that data and methodological limitations and structural and policy shifts might affect empirical results.

11. **The authorities indicated that, while their current monetary policy framework is not equivalent to a full-fledged inflation targeting regime, the principal purpose of the annual inflation objective is to serve as a nominal anchor for inflation.**⁸ The authorities' indicated that they will meet their inflation target by actively regulating demand through interest rate changes. They noted that interest rate policy has been successful in regulating demand and influencing inflation expectations and attributed the relatively slow growth of private credit to the relatively high interest rates. The authorities further indicated that the objective of the exchange rate policy and mechanism is to maintain a stable real effective exchange rate as a way of achieving international competitiveness in support of the wider objective of economic diversification.

12. **In the view of the staff, the authorities' views on the appropriate nominal anchor and the use of the exchange rate policy to target a real effective exchange rate objective imply considerable tension between the authorities' objectives.** The staff take the view that it is not possible to independently set the nominal exchange rate path, the inflation rate, and the REER path for a sustained period. This is particularly true in a country like Botswana, which is small, highly integrated with the South African and world economies, and has open current and capital account regimes. In particular, given that the authorities are

⁷ See "A Note on Inflation" in the Selected Issues papers.

⁸ The authorities views on the appropriate nominal anchor were clarified through correspondence sent in October 2006 following discussions in Gaborone. This staff report reflects the staff's advice in light of this correspondence.

adhering to a crawling peg regime for the nominal exchange rate, they can target the inflation rate or the real exchange rate, but not both. If they are targeting the real exchange rate, then the inflation rate is no longer constrained by a nominal anchor and may destabilize the price level. Alternatively, if they are targeting the inflation rate, then the real effective exchange rate must necessarily be allowed to vary.

13. **Furthermore, even if it is possible to target inflation through monetary policy instruments in the context of Botswana's crawling peg, achieving the authorities' inflation target through interest rate management would imply a much more aggressive policy of monetary restraint than has been observed to date.** Nearly half of the CPI basket consists of imported goods and less than three-tenths of the basket consisting of nontradables. A rate of crawl that sets the inflation rate of imports (and tradable goods more generally) above the authorities' inflation target range would require a very tight monetary policy to keep inflation in nontradable goods low enough to offset the impact of the exchange rate on imports and domestically-produced tradables. However, notwithstanding the surge in inflation following the devaluation and adoption of a crawling peg, policy interest rates have been increased by only one percent, with the result that real interest rates in Botswana have fallen significantly. Possibly as a result, credit growth has accelerated in the first seven months of 2006; demand for pula-denominated money has weakened, and foreign currency deposits have surged since the May 2005 devaluation. In this context, if the authorities are determined to use monetary policy to achieve their inflation targets, the staff would urge a much tighter monetary policy to control inflation and a reduction in the rate of crawl of the exchange rate to allow a more balanced reduction in inflation across imports, domestic tradables, and nontradable goods.

14. **More generally, the staff took the view that an exchange rate anchor is appropriate for Botswana,** given that the high levels of banking system liquidity and the associated looseness of the relationship among monetary and credit aggregates and interest rates would complicate the operation of a money-based anchor. In this context, the staff urge the authorities to commit to using their crawling peg exchange rate regime to target the inflation rate rather than the real exchange rate. However, given partner country inflation targets and projections (i.e., a 3–6 percent target range for South Africa and projections for inflation for industrial countries of about 2–3 percent), the implied rate of crawl consistent with achieving Botswana's inflation objective would be two percent a year or less.⁹

15. **Staff noted that the current level of the exchange rate is broadly appropriate in light of the strong current account, growing non-diamond exports, and the high and stable level of reserves.** The authorities did not express a view on the appropriate level of the exchange rate. Staff urged the authorities to announce the weights and rate of crawl for the exchange rate regime to anchor expectations. The authorities appreciated that uncertainty

⁹Inflation rates would have to fall to annual rates of no more than 4.5 percent for the remainder of 2006–08 to stay within the upper bound of the 3 to 6 percent annual rate objective for the 2006–08 period as a whole.

about the parameters of the crawling peg mechanism might engender inflationary expectations, and they indicated that announcement of the parameters of the regime has been under review and might take place in due course.

B. Fiscal Policy and the Size of Government

16. **The authorities have maintained a conservative fiscal stance.** However, the 2006/07 surplus is budgeted to be much smaller than the surplus in 2005/06, as the authorities plan to increase development expenditure substantially and mineral revenue growth is expected to slow. Staff analysis suggests that surpluses of this size are consistent with a prudent medium-term fiscal position given the expected sharp decline in diamond revenue after 2021 (see paragraph 17). However, in view of the strong positive fiscal impulse (due to a possible 7 percentage point decline in the overall surplus) staff suggested that the authorities slow the pace of expenditure growth below budgeted levels until there is evidence that inflation pressures are abating.

17. **The discussions also covered the authorities' medium-term plans (through FY 2008/09), as set out in the Mid-Term Review (MTR) of the Ninth National Development Plan (NDP 9).** These plans include a fiscal rule that sets a ceiling on expenditure and a target for revenue and grants, both at 40 percent of GDP. Additional revenue from user fees and tax administration improvements will be used to meet the projected revenue target and offset the decline in the GDP share of revenues and grants resulting from a plateauing of diamond production. Should revenues fall short of the target, the intention is to reduce expenditure in order to maintain a balanced budget over the medium term, rather than raise tax rates.

Government Spending Ratios (percent of GDP)				
Country	Total government expenditure, 2004	Government consumption, 2004	Education spending, 2003	Public Health spending, 2003
Mexico	23	12	5.3	2.9
Chile	22	12	4.1	3.0
Malaysia	30	13	8.1	2.2
Costa Rica	21	14	4.9	5.8
Botswana	39	33	10.6	4.6
Panama	25	11	3.9	5.0
Venezuela	32	14	4.4	2.0
Uruguay	29	11	2.6	2.7
Turkey	44	13	3.6	5.4
South Africa	27	20	5.4	3.2
Thailand	20	10	4.2	2.0
Namibia	35	29	7.2	4.7
Swaziland	34	23	6.2	3.3
Lesotho	43	34	9.0	3.1
Upper Middle Income	...	...	4.5	3.7
Sub-Saharan Africa	...	...	...	2.4

Sources: IMF WEO database, and World Bank, World Development Indicators, 2006

18. **The authorities' expenditure plans also envisage increased development expenditure and HIV/AIDS-related expenditure.** They intend to increase development expenditure from 25 to 30 percent of total spending by 2008/09, although they noted that expenditure might fall short of budgeted amounts because the government is unwilling to compromise procurement standards or project quality to meet the development spending targets. While HIV/AIDS-related costs are expected to continue to increase, the authorities expect that international official and private financing will cover some of the costs.¹⁰

19. **The staff broadly agreed with these policies, but expressed the view that a contraction of the relative size of government would be desirable, and is probably inevitable.** Medium-term (2006-11) baseline and alternative scenarios prepared by the staff are based on the policies and growth assumptions of the MTR's baseline and reform case scenarios, respectively (Tables 7 and 8). The alternative scenario also assumes that central

¹⁰ The government provides free anti-retroviral drugs through its public health system and support to orphans from HIV/AIDS (and other causes). Health care expenditures more than doubled as a share of GDP between 2000/01 and 2005/06, in substantial part because of HIV/AIDS-related spending.

government expenditure declines by one percent of GDP per year annually in addition to the structural reforms envisaged by the authorities (e.g., removal of administrative bottlenecks to business and investment, increased development expenditure, and parastatal reform), resulting in the higher growth assumed in that scenario.

- In the **baseline** scenario, the expenditure-to-GDP ratio declines due to the indexation of the wage bill at half of the rate of inflation, but the revenue-to-GDP ratio declines faster, creating budget deficits or necessitating new revenues to maintain a balance budget. Maintaining revenue at the 40 percent of GDP objective would require much larger increases in user fees or other non-mineral revenue.
- In the **alternative** scenario, the declining expenditure-to-GDP ratio together with faster growth are slightly more than enough to keep pace with the declining revenue ratio and eventually lead to small fiscal surpluses.

20. **The discussions also looked forward to the post-diamond era.**¹¹ Based on discussions with the authorities and Debswana (Botswana's joint venture with DeBeers), staff projections imply that government revenue from diamond production would decline from approximately 20 percent of GDP in recent years to less than 15 percent of GDP by 2010 and stabilize at roughly that level before declining sharply to less than five percent of GDP after 2021. The authorities noted that, while diamond production is likely to plateau at *current* mining operations, there is significant prospecting activity underway for diamonds and other minerals. Staff projections imply the need for a fiscal adjustment in other revenue and expenditure items of at least 13 percent of GDP relative to 2006/07 to maintain balanced budgets after 2021, although substantial fiscal surpluses over the next fifteen years could ease the fiscal shock associated with the decline in diamond revenue. While Botswana's government-expenditure-to-GDP ratio is high for a middle-income country, the very large reduction in government expenditure needed over the medium-term to offset declining diamond revenue suggests that increases in tax rates (e.g., VAT rates) might contribute to maintaining overall government expenditures.

21. **The authorities indicated that their economic policies recognize the need to adjust to the decline in diamond revenues.** Their efforts to diversify the economy (e.g., in tourism, non-diamond mining, mineral-related manufacturing, and financial services) have been undertaken to prepare for the depletion of the diamond resource as well as to achieve broad-based development and growth in the economy and for the more immediate objectives of reducing unemployment and poverty. The buildup of large foreign exchange reserves has also been a response to the need to prepare for the post-diamond era. They recognized that

¹¹ The sharp decline in revenue in revenue shares after fifteen years reflects both an expected lower yield of diamonds and higher extraction costs as major mines shift from open pit to underground mining. The fiscal implications of the long-term outlook for diamond revenue are discussed in more detail in the Selected Issues paper "Are Diamonds Forever?"

reducing the share of government expenditure in GDP or changes in tax rates could offset some of the decline in diamond revenues, but they intended to rely on broadening the tax base through economic diversification to the maximum extent possible.

C. Structural Reforms

22. There was agreement between the authorities and the staff that sustained improvements in competitiveness and diversification of the economy -- and the associated reductions in unemployment and poverty--will require substantial structural reforms, in particular in labor markets, the investment environment, and the role of parastatals in the economy.

Labor markets

23. On labor market institutions, there was agreement that the large and relatively well-paid government civil service in the non-professional ranks has created a situation in which many potential employees have a reservation wage that is above market clearing levels (the government accounts for two-fifths of formal sector employment in 2005 and central government wages exceeded those of the private sector by 62 percent in 2003).¹² The authorities indicated that Botswana does not have stringent institutional or legal labor market rigidities or cash assistance to the unemployed, although there are sector-specific minimum wages that largely affect the behavior of some smaller employers. Nevertheless, the government has taken or planned some new measures to improve the operation of labor markets. The most recent public sector pay increase offset only half of the change in the cost of living, and that policy is expected to continue for future pay increases. The government plans to expand vocational training and increase the capacity of senior secondary schools (i.e., grades 11 and 12) which currently have space for less than two thirds of the students graduating from junior secondary schools. To help control the costs of education initiatives, the government recently introduced means-tested school fees equal to five percent of secondary school cost. The government decision to establish a second university, focusing on science and technology, should also reduce the costs of tertiary education relative to study abroad.

Investment environment and privatization

24. The authorities have been implementing reforms to the investment environment, where Botswana's international rankings are broadly on par with other upper-middle income countries. The backlog of applications for work and residence permits for investors, a key concern of investors identified in a recent FIAS report, has now been eliminated. However, less has been achieved on investor access to land serviced by utilities (another key

¹² Labor market issues are discussed in more detail in the Selected Issues paper "Narrow Economy and High Unemployment: Twin Distress in Botswana."

concern) due to the long time needed to develop and extend infrastructure to industrial land. Some improvements have been observed in expediting company registration, streamlining business licensing, ratifying international agreements on industrial property, and streamlining the tax system, but more work is needed to achieve the authorities' objectives in these areas.

25. **The authorities noted that privatization has been slower than originally expected.** However, the privatization of Botswana Telecommunications Corporation (BTC) has been approved by Cabinet, and Botswana Power Corporation's majority privatization may now take place in the context of a public-private partnership to create substantial new generating capacity. They hope that privatization of BTC and Air Botswana will take place by the end of the next fiscal year. The authorities also noted that their privatization strategy also includes outsourcing, which has progressed more rapidly.

Business Environment							
Country	Days to register property	Days to Start a business	Cost of starting a business (% of PC income)	Hiring/firing difficulty 1/	Telecom cost 2/	WEF Quality of Business environment rank 1/	Corruption (Transparency International Rank) 1/
Mexico	74	58	16	51	3.04	62	70
Chile	31	27	10	24	1.93	29	20
Malaysia	143	30	21	10	0.71	23	44
Costa Rica	21	77	24	39	1.93	53	55
Botswana	69	108	11	30	2.88	50	37
Panama	44	19	25	63	3.64	61	84
Venezuela	33	116	16	38	1.95	97	138
Uruguay	66	45	44	31	0.52	66	28
Turkey	9	9	28	55	2.09	51	60
South Africa	23	46	9	52	0.79	30	51
Thailand	2	33	6	18	0.67	37	63
Namibia	28	95	19	27	4.28	72	55
Swaziland	...	...	...	...	2.97	...	121
Lesotho	101	92	56	42	3.28	...	79
Upper Middle Income	99	42	18	38	1.06	...	...
Sub-Saharan Africa	118	64	215	53	2.43	...	...

Sources: World Bank, World Development Indicators, 2006; Transparency International, 2006 CPI; and World Economic Forum (WEF).

1/ Lower numbers imply a better business environment for these rankings.

2/ Cost in US dollars of a three minute call to the U.S. in 2004.

Other issues

26. **Botswana's financial sector regulation and supervision is being broadened to cover new institutions and issues.** Botswana's banking sector has been relatively well regulated and supervised, and it continues to be profitable. However, capacity to supervise non-bank financial institutions (NBFIs) has been limited, and comprehensive legislation to establish a new regulator for NBFIs is being finalized by government. On anti-money laundering and the combating the financing of terrorism (AML/CFT), draft legislation has been endorsed by the National Task Force on AML/CFT, and should be enacted before the end of the year. The FSAP mission scheduled for early 2007 will provide an opportunity for more detailed discussions on the financial sector, including on AML/CFT.

27. **Trade policy developments over the past year are largely developments in ongoing negotiations.** Negotiations between the EU and the Southern African Development Community (SADC) group on an Economic Partnership Agreement (EPA) have continued but are complicated by the diversity in levels of development among SADC members. Negotiations toward a U.S.-Southern African Customs Union free trade agreement have stalled, and both sides have agreed to consult on reaching a Trade and Investment Cooperation Agreement instead.

28. **Botswana's economic statistics are generally good and are adequate for surveillance, but some weaknesses in national accounts have come to light.** Most importantly, recently published data show implausibly large inventory accumulation over the last five years and anomalies in some deflators. The authorities agreed that these problems are a serious concern and reported that the government has already allocated additional funds to address this problem. Botswana's data would also benefit more timely final data on the fiscal accounts and from synchronization between the annual data for fiscal (April-March), national accounts (July-June), and other, calendar year, data. In addition, the staff welcomes the planned update to the weights in the CPI basket later this year.

IV. STAFF APPRAISAL

29. **Botswana's macroeconomic performance has been generally good over the last two years, with the exception of inflation, which accelerated substantially following the May 2005 devaluation.**

30. **The current level of the exchange rate appears broadly appropriate in light of the strong current account, growing non-diamond exports, and the high and stable level of reserves.**

31. **Botswana's crawling peg could provide the basis for a nominal anchor.** However, because Botswana's inflation targets are very close to the targets and projected inflation rates of countries represented in the basket, the annual rate of crawl needs to be consistent with the authorities' medium-term objective. Specifically, with inflationary pressures persisting, the authorities should set the annual rate of crawl at one or two percent a year to improve the chances of meeting their inflation targets. Announcement of the parameters of the regime

should also help to increase transparency and anchor exchange rate and inflation expectations.

32. **However, the authorities' announced policy of using interest rates and monetary policy to achieve the inflation target while at the same time using the crawling peg exchange rate regime to target a real effective exchange rate level imply considerable tensions among policy objectives.** In this context, the authorities should give priority to the inflation objective in setting the rate of crawl and avoid trying to achieve a real exchange rate target. Given the authorities' intent to use interest rates and monetary policy to rein in inflation, a much tighter monetary policy would be needed in the present circumstances.

33. **While the authorities' policy of budget balance is prudent, they should consider measures to put the share of government expenditure on a sustained, downward path to anticipate the projected decline in diamond revenues.** For 2006/07, in view of the large fiscal impulse implied by the budget, the authorities should slow the pace of expenditure growth below budgeted levels until inflationary pressures subside. For the medium-term, fiscal surpluses associated with a declining expenditure path should be used to cushion the long-term impact of declining diamond revenues unless alternate sources of revenue are found. Efforts to broaden the tax base, improve tax administration, and implement user fees are welcome, but increases in tax rates should not be ruled out in light of the scale of the projected decline in diamond revenue.

34. **The authorities' plans for labor market-related reforms, privatization, and improvements in the investment environment are welcome and should help promote competitiveness and diversification of the economy, and the associated reductions in unemployment and poverty.**

35. **Botswana maintains a multiple currency practice (MCP) relating to exchange rate guarantees on certain loans.** The authorities previously indicated that the scheme applied only to loans undertaken before October 1990, the last of which would mature in 2006; on that basis, the Fund previously approved this MCP. However, a recent communication from the authorities now indicate that the loans will be outstanding until 2016. Absent additional information on whether the conditions for Fund approval of the MCP apply, in light of the recent communication, staff does not recommend approval of the MCP.

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

Table 1. Botswana: Selected Economic and Financial Indicators, 2001–2006

	2001	2002	2003	2004 Rev.	2005 Prel.	2006 Proj.
(Annual percentage change, unless otherwise indicated)						
National income and prices						
Real GDP (July-June)	1.6	9.5	3.4	8.4	4.2	4.3
Real GDP (Jan.-Dec.)	5.2	5.6	6.3	5.9	6.2	4.2
Consumer prices (average)	6.6	8.0	9.3	6.9	8.6	11.3
Consumer prices (end of year)	5.7	10.6	6.4	7.8	11.4	8.6
Nominal GDP (in billions of pula) 1/	35.7	39.5	42.6	48.8	56.7	62.4
External sector						
Exports of goods, f.o.b. (in U.S. dollar terms)	-13.3	1.2	29.0	23.0	22.1	3.2
<i>Of which: diamonds</i>	-13.5	2.1	20.0	19.1	16.1	2.6
Imports of goods, f.o.b. (in U.S. dollar terms)	-9.4	2.0	29.9	35.5	-3.6	26.0
Terms of trade	-2.1	-10.6	-10.0	-1.6	2.5	-11.2
Nominal effective exchange rate (depreciation -) 2/	4.2	3.5	1.6	-7.6	-8.5	...
Real effective exchange rate (depreciation -) 2/	5.1	2.9	3.6	-4.8	-4.4	...
Nominal exchange rate, avg (in pula per U.S. dollar)	5.9	6.3	4.9	4.6	5.2	...
Nominal exchange rate, eop (in pula per U.S. dollar)	7.0	5.5	4.4	4.3	5.5	...
Central government finance 3/						
Total revenue and grants	-10.3	13.0	13.2	10.5	26.5	7.0
<i>Of which: mineral revenue</i>	-16.4	7.2	8.8	6.4	27.2	3.1
Total expenditure and net lending	18.5	14.9	3.6	6.8	2.9	29.9
(Twelve-month percentage change, unless otherwise indicated)						
Money and banking						
Net foreign assets	22.7	-27.5	-19.2	1.1	40.7	18.3
Net domestic assets	-20.4	35.0	34.4	10.3	-71.7	-21.8
Net domestic credit	-16.2	55.8	64.9	63.5	-181.3	-115.7
Net claims on government	-15.1	40.6	35.3	9.0	-30.0	-41.8
Claims on private sector	11.4	23.7	10.7	17.4	9.1	12.0
Broad money (M3) 4/	27.8	24.1	13.2	11.3	15.2	12.9
Velocity (GDP relative to M3)	2.8	2.4	2.4	2.4	2.4	2.4
(In percent)						
Interest and credit						
Bank of Botswana lending rate	14.3	15.3	14.3	14.3	14.5	...
Commercial banks						
Prime lending rate	15.8	16.8	16.3	15.8	15.7	...
Deposit rate (88-day notice)	9.8	10.2	9.9	9.9	9.3	...
(In percent of GDP, unless otherwise indicated)						
Investment and savings 5/						
Gross investment	40.4	40.2	41.3	38.7	31.3	29.9
<i>Of which: public</i>	10.2	10.6	10.1	8.8	7.9	9.0
Private	30.2	29.6	31.1	29.9	23.4	21.0
Gross national savings	53.0	46.9	44.8	45.6	45.4	44.2
<i>Of which: public</i>	14.2	15.5	15.4	15.8	13.3	12.1
Private	38.8	31.5	29.4	29.8	32.1	32.1
Saving-investment balance	12.6	6.7	3.5	6.8	14.1	14.3
Central government finance 3/						
Total revenue and grants	35.5	37.0	38.6	37.7	41.2	39.5
Mineral revenue	19.7	19.5	19.5	18.4	20.2	18.7
Customs union receipts	4.9	4.1	5.4	6.8	7.2	8.7
General sales tax/VAT	1.5	3.3	3.8	4.5	3.6	3.5
Total expenditure and net lending	38.5	40.8	38.9	36.8	32.7	38.1
Current expenditure	28.0	30.1	30.9	29.2	25.7	28.3
Development expenditure	10.4	10.9	10.2	8.3	7.0	9.9
Net lending	0.1	-0.2	-2.2	-0.6	-0.1	-0.1
Overall balance (including grants)	-3.0	-3.8	-0.4	0.9	8.5	1.4
Domestic financing	3.5	5.7	0.6	-0.6	-8.2	-1.4
Foreign financing	-0.5	-0.6	-0.3	-0.3	-0.3	-0.1
External sector						
External current account balance (deficit -) 5/	9.9	3.3	5.6	3.0	15.4	10.7
External public debt in percent of GDP 6/	6.9	7.8	5.3	4.4	4.2	3.6
External public debt in percent of total exports	15.6	16.3	12.1	9.5	7.9	7.0
(In millions of U.S. dollars, unless otherwise indicated)						
Change in reserves (increase -)	421	424	135	-327	-610	-931
Gross official reserves (end of period)	5,897	5,474	5,339	5,665	6,276	7,207
(In months of imports of goods and services)	33.0	30.3	23.0	18.4	20.8	19.5

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

1/ July-June.

2/ Annual average.

3/ April-March. For 2006, based on the 2006/07 Budget Speech.

4/ Money and quasi money (M2) plus Bank of Botswana certificates held by commercial banks for customers and non-banks.

5/ January-December. The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology. The figures in the table also differ from those in Table 2 due to differentials in periods.

6/ Medium- and long-term public and publicly guaranteed debt outstanding.

Table 2. Botswana: Sectoral GDP and Savings-Investment Balances, 2000/01–2005/06 1/ 2/

	2000/01	2001/02	2002/03	2003/04	2004/05 Est.	2005/06 Proj.
(In millions of pula)						
Consumption	14,956	16,656	19,303	21,188	24,633	30,878
Public	6,518	7,348	8,967	9,162	11,104	14,873
Private	8,439	9,308	10,336	12,027	13,529	16,005
Gross investment	13,710	14,798	15,457	18,401	16,958	16,049
Public	3,372	3,824	4,150	4,170	3,895	4,397
Private (including changes in stock)	10,338	10,974	11,307	14,231	13,063	11,652
Net exports of goods and services	7,021	4,355	4,273	3,251	7,162	9,773
Exports of goods and services	17,826	16,399	19,182	17,875	24,266	29,176
Imports of goods and services	-10,806	-12,044	-14,909	-14,624	-17,105	-19,403
Gross domestic savings	19,831	19,038	20,175	21,392	24,120	25,822
Public	3,742	6,025	5,446	7,031	7,085	6,407
Private	16,089	13,012	14,729	14,361	17,036	19,415
GDP at market prices 3/	34,787	35,693	39,478	42,580	48,753	56,700
(In percent of GDP)						
Consumption	43.0	46.7	48.9	49.8	50.5	54.5
Public	18.7	20.6	22.7	21.5	22.8	26.2
Private	24.3	26.1	26.2	28.2	27.8	28.2
Gross investment	39.4	41.5	39.2	43.2	34.8	28.3
Public	9.7	10.7	10.5	9.8	8.0	7.8
Private (including changes in stocks)	29.7	30.7	28.6	33.4	26.8	20.6
Net exports of goods and services	20.2	12.2	10.8	7.6	14.7	17.2
Exports of goods and services	51.2	45.9	48.6	42.0	49.8	51.5
Imports of goods and services	-31.1	-33.7	-37.8	-34.3	-35.1	-34.2
Gross domestic savings	57.0	53.3	51.1	50.2	49.5	45.5
Public	10.8	16.9	13.8	16.5	14.5	11.3
Private	46.3	36.5	37.3	33.7	34.9	34.2
(Annual change in percent, unless otherwise indicated)						
Real GDP	9.1	1.6	9.5	3.4	8.4	4.2
<i>Of which</i> : nonmining real GDP	3.9	5.3	8.8	5.5	1.9	5.6
Mining	17.1	-3.4	10.6	0.3	18.2	2.3
Manufacturing	-0.4	0.2	3.1	0.8	-2.6	5.0
Water and electricity	5.4	3.7	9.5	6.4	3.3	4.0
Construction	1.6	4.7	0.6	2.1	0.7	4.0
Trade and hotels	6.5	8.2	8.2	11.3	-6.6	8.0
Transport	1.7	3.3	0.9	-3.4	5.6	2.0
Finance and business services	5.1	7.1	2.6	2.4	4.1	5.5
General government	6.7	8.3	14.2	5.1	3.6	7.0
Nominal GDP (billions of pula)	34.8	35.7	39.5	42.6	48.8	56.7
Consumer prices (end of period) 4/	8.4	5.7	10.6	6.4	7.8	11.4

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

1/ July-June, unless otherwise indicated.

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

3/ GDP data do not match the sum of expenditure components due to errors and omissions.

4/ Calendar year.

Table 3. Botswana: Balance of Payments, 2001–2011
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Rev.	Prel.	Proj.					
Current account balance	600	197	464	291	1,565	1,159	1,020	995	924	636	516
Trade balance	713	710	900	840	1,769	1,192	1,067	1,069	1,044	692	538
Exports, f.o.b.	2,325	2,353	3,035	3,734	4,559	4,707	4,919	5,265	5,649	5,744	6,069
Of which											
Diamonds	1,936	1,978	2,374	2,827	3,284	3,367	3,464	3,703	3,938	3,861	4,001
Imports, f.o.b.	-1,611	-1,643	-2,135	-2,893	-2,791	-3,515	-3,852	-4,196	-4,604	-5,052	-5,532
Of which											
Food, beverages, and tobacco	-254	-329	-412	-474	-440	-413	-582	-641	-712	-791	-875
Chemical and rubber products	-187	-217	-290	-386	-381	-373	-409	-451	-501	-556	-615
Metal and metal products	-140	-161	-187	-271	-243	-241	-264	-291	-323	-359	-397
Machinery and electrical equipment	-357	-375	-448	-567	-523	-577	-634	-698	-776	-861	-952
Services	-174	-29	-9	-44	-8	-80	-121	-163	-218	-287	-356
Transportation	-155	-167	-180	-210	-236	-298	-331	-362	-400	-447	-493
Travel	26	136	228	276	276	288	297	306	314	322	330
Other services	-45	3	-57	-110	-49	-69	-87	-108	-133	-161	-192
Income	-138	-700	-718	-1,037	-724	-644	-584	-587	-650	-597	-580
Compensation of employees	-37	-39	-55	-60	-60	-67	-78	-91	-105	-121	-139
Investment income	-101	-662	-663	-977	-664	-577	-506	-496	-545	-476	-441
Current transfers	198	217	291	532	529	691	658	676	748	828	914
Capital and Financial Account	-506	-202	-358	-303	-139	-228	-267	-249	-218	-215	-219
Capital account	6	16	23	32	31	29	29	29	28	28	28
Financial account	-512	-218	-380	-335	-170	-258	-296	-277	-246	-243	-247
Direct investment	-351	362	213	434	285	266	263	258	255	251	247
Portfolio investment 1/	-63	-414	-522	-472	-369	-300	-343	-320	-288	-277	-265
Other investment 2/	-99	-165	-70	-297	-86	-224	-215	-216	-214	-217	-229
Of which											
Net government long-term borrowing	-17	-23	-22	-25	-10	-14	-9	-8	-8	-8	-8
Other net private long-term borrowing	2	2	3	4	5	3	3	3	3	3	3
Short-term borrowing	76	71	93	63	59	56	61	63	65	63	61
Reserve assets (increase -)	421	424	135	-327	-610	-931	-753	-746	-706	-420	-297
Net errors and omissions	-516	-419	-241	338	-816	0	0	0	0	0	0
Memorandum items:											
Current account (percent of GDP)	9.9	3.3	5.6	3.0	15.4	10.7	8.6	7.6	6.4	3.9	2.9
Trade balance (percent of GDP)	11.8	11.9	10.8	8.5	17.3	11.0	9.0	8.2	7.2	4.3	3.0
Exports of goods (percent of GDP)	38.4	39.5	36.5	38.0	44.7	43.6	41.5	40.3	38.9	35.6	34.0
Of which: diamonds	31.9	33.2	28.5	28.8	32.2	31.2	29.2	28.3	27.1	24.0	22.4
Imports of goods (percent of GDP)	-26.6	-27.6	-25.7	-29.4	-27.4	-32.5	-32.5	-32.1	-31.7	-31.3	-31.0
End-of-year reserves 3/	5,897.3	5,473.5	5,338.7	5,665.3	6,275.7	7,206.7	7,959.8	8,705.4	9,411.2	9,831.7	10,128.5
In months of imports of goods and services	33.0	30.3	23.0	18.4	20.8	19.5	19.8	19.9	19.6	18.7	17.6
Exchange rate											
Dollar/pula (period average)	0.1720	0.1585	0.2027	0.2153	0.1934	...	...	...	...	...	...
Dollar/pula (end of period)	0.1432	0.1829	0.2251	0.2336	0.1814	...	...	...	...	...	...

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

1/ The large outflows since 2001 reflect offshore investment activities by private fund managers following the privatization of pension scheme.

2/ The figures include net assets held by the government and the banks and net liabilities held by other sectors not included in the above financial account.

3/ Includes valuation adjustment.

Table 4. Botswana: Central Government Operations, 2001/02–2006/07 1/

	2001/02	2002/03	2003/04	2004/05 Rev.	2005/06 Bud.	2005/06 Est.	2006/07 Bud.
(In millions of pula)							
Total revenue and grants	12,601	14,240	16,119	17,819	20,179	22,535	24,105
Total revenue	12,542	14,155	16,057	17,472	19,959	22,244	23,742
Tax revenue	10,582	12,259	14,146	16,245	18,157	20,124	21,916
Mineral revenue	6,996	7,503	8,163	8,682	9,926	11,045	11,389
Customs Union receipts	1,732	1,569	2,246	3,226	3,407	3,930	5,300
General sales tax/VAT	520	1,255	1,573	2,116	2,100	1,978	2,118
Other	1,334	1,933	2,165	2,221	2,724	3,170	3,109
Nontax revenue	1,960	1,896	1,911	1,226	1,802	2,121	1,826
Interest	189	227	208	-97	75	78	36
Property income	1,170	1,064	969	433	462	913	704
<i>Of which</i> : BOB	1,142	1,029	755	388	420	741	550
Other	601	605	733	891	1,265	1,130	1,086
Grants	59	84	61	348	220	290	363
Total expenditure and net lending	13,671	15,710	16,275	17,383	20,454	17,881	23,223
Current expenditure	9,935	11,581	12,934	13,765	15,720	14,086	17,234
Wages and salaries	3,446	3,947	4,142	5,129	5,436	5,248	5,998
Interest	94	81	193	315	305	317	278
Other	6,394	7,553	8,600	8,322	9,979	8,520	10,959
Development expenditure	3,698	4,200	4,256	3,910	4,858	3,851	6,035
Net lending	38	-71	-916	-293	-124	-56	-47
Primary balance (deficit -)	-975	-1,389	36	751	30	4,971	1,160
Overall surplus or deficit (-)	-1,069	-1,471	-157	437	-275	4,654	882
Memorandum items:							
Investment expenditure 2/	7,229	8,023	8,440	8,651	10,585	9,578	12,067
<i>Of which</i> :							
Development expenditure	3,698	4,200	4,256	3,910	4,858	3,851	6,035
Recurrent spending on education	2,858	3,076	3,358	3,722	4,452	4,452	4,697
Recurrent spending on health	673	748	826	1,019	1,275	1,275	1,334
(In percent of GDP)							
Total revenue and grants	35.5	37.0	38.6	37.7	36.9	41.2	39.5
Total revenue	35.4	36.7	38.4	37.0	36.5	40.7	38.9
Tax revenue	29.8	31.8	33.8	34.4	33.2	36.8	35.9
Mineral revenue	19.7	19.5	19.5	18.4	18.1	20.2	18.7
Customs Union receipts	4.9	4.1	5.4	6.8	6.2	7.2	8.7
General sales tax/VAT	1.5	3.3	3.8	4.5	3.8	3.6	3.5
Other	3.8	5.0	5.2	4.7	5.0	5.8	5.1
Nontax revenue	5.5	4.9	4.6	2.6	3.3	3.9	3.0
Interest	0.5	0.6	0.5	-0.2	0.1	0.1	0.1
Property income	3.3	2.8	2.3	0.9	0.8	1.7	1.2
Other	1.7	1.6	1.8	1.9	2.3	2.1	1.8
Grants	0.2	0.2	0.1	0.7	0.4	0.5	0.6
Total expenditure and net lending	38.5	40.8	38.9	36.8	37.4	32.7	38.1
Current expenditure	28.0	30.1	30.9	29.2	28.7	25.7	28.3
Wages and salaries	9.7	10.2	9.9	10.9	9.9	9.6	9.8
Interest	0.3	0.2	0.5	0.7	0.6	0.6	0.5
Other	18.0	19.6	20.6	17.6	18.2	15.6	18.0
Development expenditure	10.4	10.9	10.2	8.3	8.9	7.0	9.9
Net lending	0.1	-0.2	-2.2	-0.6	-0.2	-0.1	-0.1
Primary balance (deficit -)	-2.7	-3.6	0.1	1.6	0.1	9.1	1.9
Overall surplus or deficit (-)	-3.0	-3.8	-0.4	0.9	-0.5	8.5	1.4
Memorandum items:							
Investment expenditure 2/	20.4	20.8	20.2	18.3	19.3	17.5	19.8
<i>Of which</i> :							
Development expenditure	10.4	10.9	10.2	8.3	8.9	7.0	9.9
Recurrent spending on education	8.1	8.0	8.0	7.9	8.1	8.1	7.7
Recurrent spending on health	1.9	1.9	2.0	2.2	2.3	2.3	2.2
GDP (fiscal year)	35,467	38,532	41,805	47,210	54,713	54,713	60,978

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

1/ Fiscal year begins on April 1. Classified according to the 2001 GFS methodology.

2/ Investment expenditure includes development expenditure and human capital investment (i.e., education and health spendings).

Table 5. Monetary Survey, 2002–2006

	2002	2003	2004	2005								2006	
				Jan	Feb	May	Jun	Jul	Aug	Sep	Dec	Mar	Jul
(In millions of pula; end of period)													
Net foreign assets	31,247	25,238	25,519	27,719	27,997	33,602	33,510	35,106	35,621	34,883	35,916	36,786	44,080
Bank of Botswana	29,984	23,887	24,368	26,251	26,415	31,980	32,285	33,635	34,046	33,681	34,751	36,709	44,032
Assets	29,984	23,887	24,368	26,251	26,415	31,980	32,285	33,635	34,046	33,681	34,751	36,709	44,032
Liabilities													
Commercial banks	1,263	1,351	1,152	1,467	1,581	1,622	1,224	1,471	1,575	1,202	1,166	76	48
Assets	1,555	1,772	1,485	1,819	1,914	2,015	1,969	2,274	2,660	2,875	2,843	2,092	1,969
Liabilities	-292	-421	-333	-352	-333	-393	-744	-803	-1,085	-1,673	-1,677	-2,016	1,921
Net domestic assets	-21,740	-14,261	-12,788	-14,449	-14,687	-19,979	-20,405	-21,424	-20,349	-21,956	-17,975	...	...
Net domestic credit	-9,508	-2,868	-197	-1,543	-1,052	-1,941	-1,160	-1,979	-1,899	-2,752	-2,644	-3,193	...
Net claims on the government	-16,605	-10,677	-9,851	-11,145	-10,456	-11,683	-11,088	-11,757	-11,955	-12,885	-12,992	-14,224	-18,240
Bank of Botswana	-16,548	-10,529	-9,418	-10,724	-9,693	-11,215	-10,703	-11,533	-11,822	-12,571	-12,827	-14,051	18,240
Commercial banks	-58	-148	-433	-421	-763	-468	-385	-225	-132	-314	-165	-174	...
Claims on nongovernment	7,097	7,809	9,654	9,602	9,405	9,742	9,928	9,779	10,056	10,133	10,348	11,031	...
Claims on parastatals	462	381	433	422	392	408	365	396	385	386	318	286	162
Claims on the private sector	6,635	7,428	9,221	9,179	9,013	9,333	9,563	9,382	9,671	9,747	10,030	10,745	...
Of which : households	3,561	3,910	4,948	4,962	4,967	5,053	5,073	4,974	5,058	5,214	5,320	5,453	...
private enterprises	2,595	2,911	3,059	3,087	3,072	3,067	3,257	3,307	3,285	3,367	3,419	3,596	...
Other items (net)	-12,232	-11,392	-12,592	-12,906	-13,635	-18,038	-19,245	-19,445	-19,443	-17,597	-19,312	-14,782	-12,081
Of which													
Bank of Botswana certificates	7,663	8,739	9,649	10,081	10,999	11,203	12,195	12,337	12,403	11,480	12,416	13,176	...
Money (M1)	2,524	2,822	3,626	3,671	3,660	3,756	3,878	3,741	4,056	4,390	3,842	3,744	4,014
Currency	470	533	637	595	630	645	688	702	664	730	632	669	765
Current deposits	2,054	2,290	2,989	3,077	3,031	3,111	3,189	3,039	3,392	3,661	3,210	3,075	3,250
Quasi money	6,984	8,155	9,105	9,598	9,650	9,867	9,227	9,942	10,223	10,144	10,118	15,067	15,187
Money plus quasi-money (M2)	9,508	10,977	12,731	13,270	13,310	13,623	13,105	13,682	14,279	14,534	13,960	18,811	19,201
Memorandum items:													
Broad money (M3, nat'l definition)	13,662	15,776	17,773	20,076	19,109	19,107	19,363	19,907	19,909	19,293	19,078	19,522	19,531
Of which													
Bank of Botswana certificates 1/	5,887	6,451	6,664	6,806	7,648	7,705	8,251	8,587	8,306	7,513	8,387	3,547	330
Broad money (M4, nat'l definition)	15,199	17,294	19,180	21,673	20,745	21,090	21,120	22,013	22,322	21,769	22,009	22,050	23,584
Of which													
Foreign currency accounts	1,538	1,518	1,406	1,597	1,636	1,983	1,757	2,106	2,412	2,476	2,932	2,528	4,052
(Twelve-month percentage change)													
Net foreign assets	-27.5	-19.2	1.1	4.8	2.2	20.1	29.4	34.0	30.5	29.8	40.7	26.2	25.6
Net domestic assets	35.0	34.4	10.3	2.7	9.5	-39.7	-53.5	-56.2	-47.7	-41.1	-71.7	-13.0	...
Net domestic credit	57.1	69.8	93.1	28.3	57.5	3.7	26.2	-48.0	-63.5	-99.5	-1245.4	-128.0	...
Net claims on the government	40.6	35.7	7.7	-3.3	5.4	-7.5	-6.7	-14.5	-15.0	-17.9	-31.9	-30.6	-55.1
Claims on nongovernment	22.4	10.0	23.6	11.2	9.6	10.0	12.5	9.4	8.9	6.1	7.2	16.2	...
Claims on parastatals	-3.7	-17.5	13.7	16.7	2.2	-1.2	3.2	5.1	-0.9	-5.5	-26.7	-27.1	-59.1
Claims on the private sector	24.8	11.9	24.1	11.0	10.0	10.6	12.9	9.6	9.4	6.6	8.8	18.1	...
Of which : households	20.8	9.8	26.6	23.3	24.2	14.7	14.1	9.7	8.3	8.5	7.5	9.8	...
private enterprises	31.9	12.2	5.1	1.2	2.5	5.5	10.0	16.9	12.9	11.5	11.8	16.6	...
Other items (net)	-8.1	6.9	-10.5	-1.7	0.9	-46.8	-64.2	-57.1	-46.3	-34.9	-53.4	-1.9	37.9
Money (M1)	7.4	11.8	28.5	30.5	17.9	2.2	10.1	9.2	21.8	29.5	6.0	5.4	7.3
Broad money (M3)	10.1	15.5	12.7	23.4	19.0	7.4	11.2	13.7	12.0	9.8	7.3	2.9	-1.9
Broad money (M4)	5.7	13.8	10.9	20.2	18.0	7.4	10.7	14.8	14.9	13.8	14.8	6.8	7.1
Memorandum items:													
Growth of nominal GDP	6.7	9.2	11.3	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	12.9	...
Velocity (GDP rel. to broad money, M3)	2.4	2.4	2.4	2.6	2.5	2.5	2.5	2.4	2.3	2.4	2.4	2.7	...

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

1/ Excludes the Bank of Botswana Certificates held by commercial banks on their own accounts.

Table 6. Assets and Liabilities of the Bank of Botswana, 2002–2006
(In millions of pula; end of period)

	2002	2003	2004	2005				2006	
				Mar	Jun	Sep	Dec	Mar	July
Foreign assets	29,984	23,887	24,368	27,612	32,285	33,681	34,751	36,709	44,032
Pula Fund	25,524	19,246	20,013	21,750	25,942	26,200	24,867	25,660	28,240
Liquidity portfolio	3,985	4,055	3,827	5,315	5,620	6,941	9,404	10,536	15,412
Matched assets/liability portfolio	56	166	163	167	298	146	141	175	...
Fund accounts	419	421	365	381	425	394	339	339	380
Holding of SDRs	243	221	229	242	280	278	280	283	...
Reserve position	176	197	134	137	145	116	58	56	...
Loans and advances to financial institu	0	0	0	0	0	0	0	0	0
Fixed assets	127	127	130	132	134	134	128	128	130
Other assets	-2	-5	-5	-5	1	0	1	1	0
Unclassified assets	125	122	125	127	135	134	128	129	158
Assets = liabilities	30,109	24,009	24,493	27,739	32,420	33,815	34,879	36,839	44,320
Reserve money	1,050	1,338	1,262	1,739	1,334	1,523	1,388	1,611	1,875
Currency in circulation	759	818	911	865	874	928	935	851	953
Currency outside banks	470	533	637	634	688	730	632	669	...
Pula currency in banks	289	285	274	231	185	199	303	182	...
Bankers' deposits	291	520	351	874	460	595	453	761	922
Private sector time deposits	286	231	852	727	286	535	526	635	746
Bank of Botswana Certificates outstanding	2,425	2,780	3,023	3,317	3,416	3,378	3,742	1,657	14,165
Bankers	5,612	6,583	6,453	7,660	8,008	8,595	8,541	10,172	13,835
Others	2,425	2,780	3,023	3,317	3,416	3,378	3,742	1,657	330
Government deposits	16,548	10,529	9,418	10,441	10,703	12,571	12,827	14,051	18,129
Capital and reserves	4,075	2,730	3,026	4,073	7,683	7,495	7,168	7,243	9,240
Paid-up capital	25	25	25	25	25	25	25	25	25
General reserve	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600
Revaluation reserve	2,450	1,105	1,401	2,448	6,058	5,870	5,543	5,618	7,615
Other liabilities	487	441	286	227	220	211	554	123	164

Source: Bank of Botswana

Table 7. Botswana: Medium-Term Scenario, 2004–2011
(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011
	Rev.	Proj.						
Baseline scenario								
National income and prices								
Real GDP (annual percentage change) 1/	8.4	4.2	4.3	4.4	4.4	3.7	3.5	3.4
Of which: mining	18.2	2.3	2.3	2.4	2.4	2.3	2.3	2.2
non-mining	1.9	5.6	5.7	5.7	5.7	4.6	4.3	4.1
Nominal GDP (in billions of pula) 1/	48.8	56.7	62.4	69.3	77.6	86.8	97.0	107.7
Investment and savings 3/								
Gross investment (including net inventories)	38.7	31.3	29.9	32.4	33.4	34.8	37.2	38.8
Of which: public	8.8	7.9	9.0	10.4	11.2	11.8	12.0	12.0
Gross national savings	45.6	45.4	44.2	43.8	44.3	44.8	45.3	45.7
Of which: public	15.8	13.3	12.1	11.9	11.4	11.3	11.0	10.7
Saving-investment balance	6.8	14.1	14.3	11.4	10.9	10.0	8.1	6.9
Central government finance 2/								
Total revenue and grants	37.7	41.2	39.5	37.8	37.6	36.7	35.3	35.1
Mineral revenue	18.4	20.2	18.7	18.2	17.5	16.1	14.6	14.2
Customs Union receipts	6.8	7.2	8.7	7.1	7.1	7.1	7.1	7.1
General sales tax/VAT	4.5	3.6	3.5	3.5	3.5	3.5	3.4	3.4
Income/other taxes	4.7	5.8	5.1	5.3	5.6	5.9	6.1	6.4
Nontax revenue	2.6	3.9	3.0	3.1	3.4	3.7	3.6	3.5
Total expenditure and net lending	36.8	32.7	38.1	38.1	37.8	37.9	37.3	36.9
Current expenditure	29.2	25.7	28.3	27.6	26.5	25.9	25.3	24.9
Development expenditure	8.3	7.0	9.9	10.5	11.3	12.0	12.0	12.0
Net lending	-0.6	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
User fees, tax administration and expenditure cuts	...	...	...	-0.3	-0.2	-1.2	-2.0	-1.8
Overall balance (including grants)	0.9	8.5	1.4	0.0	0.0	0.0	0.0	0.0
External sector								
External current account balance (deficit -) 3/	3.0	15.4	10.7	8.6	7.6	6.4	3.9	2.9
Exports of goods	38.0	44.7	43.6	41.5	40.3	38.9	35.6	34.0
Of which: diamonds	28.8	32.2	31.2	29.2	28.3	27.1	24.0	22.4
Imports of goods	-29.4	-27.4	-32.5	-32.5	-32.1	-31.7	-31.3	-31.0
External public debt	4.4	4.2	3.6	2.9	2.9	2.6	2.3	2.0
(In percent of total exports)	9.5	7.9	7.0	5.9	6.2	5.6	5.4	5.0
Gross official reserves (in millions of U.S. dollars; end of per	5,665	6,276	7,207	7,960	8,705	9,411	9,832	10,129
(In months of imports of goods and services)	18.4	20.8	19.5	19.8	19.9	19.6	18.7	17.6

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

1/ July-June.

2/ April-March. Classified according to the 2001 GFS methodology. The 2005 figures are preliminary, and the 2006 figures are based on the budget.

3/ January-December. The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology.

Table 8. Botswana: Alternative Medium-Term Scenario, 2004–2011
(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011
	Rev.	Proj.						
Alternative scenario								
National income and prices								
Real GDP (annual percentage change) 1/	8.4	4.2	5.9	6.4	6.9	5.1	4.2	4.2
<i>Of which</i> : mining	18.2	2.3	2.3	2.4	2.4	2.3	2.3	2.2
non-mining	1.9	5.6	8.5	9.1	9.8	6.9	5.3	5.3
Nominal GDP (in billions of pula) 1/	48.8	56.7	63.5	72.2	83.2	94.7	106.9	120.0
Investment and savings 3/								
Gross investment (including net inventories)	38.7	30.2	27.0	28.7	29.9	31.5	33.9	35.7
<i>Of which</i> : public	8.8	7.9	9.0	10.4	11.2	11.8	12.0	12.0
Gross national savings	45.6	45.5	44.8	45.6	47.3	48.9	50.4	51.5
<i>Of which</i> : public	15.8	13.3	12.0	11.9	11.4	11.6	11.9	12.0
Saving-investment balance	6.8	15.3	17.8	16.9	17.4	17.4	16.5	15.9
Central government finance 2/								
Total revenue and grants	37.7	41.2	39.0	36.3	35.6	34.5	33.1	32.8
Mineral revenue	18.4	20.2	18.4	17.0	15.9	14.3	12.8	12.4
Customs Union receipts	6.8	7.2	8.6	7.0	7.0	7.0	7.0	7.0
General sales tax/VAT	4.5	3.6	3.4	3.5	3.5	3.4	3.4	3.4
Income/other taxes	4.7	5.8	5.0	5.3	5.5	5.8	6.0	6.3
Nontax revenue	2.6	3.9	3.0	3.0	3.3	3.5	3.5	3.4
Total expenditure and net lending	36.8	32.7	37.6	36.4	35.6	34.7	33.7	32.6
Current expenditure	29.2	25.7	27.9	25.9	24.3	22.7	21.7	20.6
Development expenditure	8.3	7.0	9.8	10.5	11.3	12.0	12.0	12.0
Net lending	-0.6	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
User fees, tax administration and expenditure cuts	...	...	...	-0.1	0.0	-0.2	-0.5	0.0
Overall balance (including grants)	0.9	8.5	1.4	0.0	0.0	0.0	0.0	0.2
External sector								
External current account balance (deficit -) 3/	3.0	15.4	15.1	14.4	14.5	14.2	12.9	12.5
Exports of goods	38.0	44.7	44.0	43.2	42.5	41.4	38.7	37.2
<i>Of which</i> : diamonds	28.8	31.3	29.9	27.4	25.9	24.2	21.1	19.6
Imports of goods	-29.4	-27.4	-29.2	-29.1	-28.4	-27.7	-27.0	-26.4
External public debt	4.4	4.2	3.6	2.8	2.7	2.4	2.0	1.8
(In percent of total exports)	9.5	7.9	6.9	5.6	5.6	5.0	4.6	4.2
Gross official reserves (in millions of U.S. dollars; end of period)	5,665	6,283	7,701	9,207	10,975	12,994	15,064	17,331
(In months of imports of goods and services)	18.4	20.8	22.7	24.4	26.3	28.1	29.7	31.3

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

1/ July-June.

2/ April-March. Classified according to the 2001 GFS methodology. The 2005 figures are preliminary, and the 2006 figures are based on the budget.

3/ January-December. The domestic savings-investment balance in the national accounts differs from external current account balance due to differences in timing and methodology.

Table 9. Botswana: Millennium Development Goals

	1990	1994	1997	2000	2003	2004
Goal 1: Eradicate extreme poverty and hunger 1/						
Population below 1 U.S. dollar a day (in percent)	...	30.7	...	...	...	...
Poverty gap at 1 U.S. dollar a day (in percent)	...	12.7	...	...	...	...
Percentage share of income or consumption held by poorest 20 percent	...	2.2	...	...	...	...
Prevalence of child malnutrition (percent of children under 5)	...	...	17.2	12.5	...	...
Population below minimum level of dietary energy consumption (in percent)	...	...	27.0	...	32.0	...
Goal 2: Achieve universal primary education 2/						
Net primary enrollment ratio (percent of relevant age group)	84.9	...	78.7	79.6	80.9	...
Primary completion rate (percent of relevant age group)	90.8	96.8	95.3	90.5	91.4	...
Percentage of cohort reaching grade 5 (in percent)	96.6	...	87.6	89.5	...	...
Youth literacy rate (percent ages 15–24)	...	...	...	...	89.1	...
Goal 3: Promote gender equality 3/						
Ratio of girls to boys in primary and secondary education (in percent)	108.6	...	103.1	102.4	102.1	...
Ratio of young literate females to males (percent ages 15–24)	...	...	...	...	108.5	...
Share of women employed in the nonagricultural sector (in percent)	40.7	43.9	46.3	44.8	47.0	47.0
Proportion of seats held by women in national parliament (in percent)	5.0	...	9.0	17.0	17.0	17.0
Goal 4: Reduce child mortality 4/						
Under 5 mortality rate (per 1,000)	58.0	66.0	...	101.0	112.0	112.0
Infant mortality rate (per 1,000 live births)	45.0	50.0	...	74.0	82.0	82.0
Immunization, measles (percent of children under 12 months)	87.0	88.0	89.0	90.0	90.0	90.0
Goal 5: Improve maternal health 5/						
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	100.0	...	...
Births attended by skilled health staff (percent of total)	...	...	87.0	98.5	...	...
Goal 6: Combat HIV/AIDS, malaria and other diseases 6/						
Prevalence of HIV, female (percent ages 15–24)	...	...	...	38.0	37.3	37.3
Contraceptive prevalence rate (percent of women ages 15–49)	...	...	...	48.0	...	...
Number of children orphaned by HIV/AIDS	...	...	...	95,000	120,000	120,000
Incidence of tuberculosis (per 100,000 people)	241.1	372.9	503.0	598.0	633.4	633.4
Tuberculosis cases detected under DOTS (in percent)	...	75.6	87.3	75.8	68.3	68.3
Goal 7: Ensure environmental sustainability 7/						
Forest area (percent of total land area)	24.0	...	...	21.9	...	...
Nationally protected areas (percent of total land area)	...	...	...	...	18.5	18.5
GDP per unit of energy use (PPP U.S. dollar per kg oil equivalent)	...	...	...	...	...	...
CO2 emissions (metric tons per capita)	1.7	2.4	2.1	2.3	...	...
Access to an improved water source (percent of population)	93.0	...	...	...	95.0	...
Access to improved sanitation (percent of population)	38.0	...	...	...	41.0	...
Access to secure tenure (percent of population)	...	...	...	...	...	...
Goal 8: Develop a Global Partnership for Development 8/						
Youth unemployment rate (percent of total labor force ages 15–24)	25.6	...	42.5	...	...	...
Male	20.2	...	38.0	...	...	...
Female	33.4	...	47.4	...	...	...
Fixed line and mobile telephones (per 1,000 people)	20.6	35.4	55.9	204.4	371.9	371.9
Personal computers (per 1,000 people)	...	7.0	19.6	15.2	34.9	...
Internet users (per 1,000 people)	0.0	0.7	3.3	15.2	34.9	...
Aid per capita (in U.S. dollars)	115.1	59.1	77.1	18.3	17.5	17.5
Other						
Fertility rate (births per woman)	5.1	...	4.3	...	3.7	3.7
Life expectancy at birth (years)	56.8	...	47.3	39.4	38.0	38.0

Source: World Development Indicators database, April 2005

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

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

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

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

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

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

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

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

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

Appendix I: Botswana: Relations with the Fund

(As of October 31, 2006)

I. Membership Status	Joined July 24, 1968; Article VIII	
II. General Resources Account	<u>SDR(million)</u>	<u>% of Quota</u>
Quota	63.00	100.00
Fund holdings of currency	56.77	90.11
Reserve position in Fund	6.25	9.91
III. SDR Department	<u>SDR(million)</u>	<u>% of Quota</u>
Net cumulative allocation	4.36	100.00
Holdings	36.54	838.28
IV. Outstanding purchases and loans	None	
V. Financial arrangements	None	
VI. Project obligations to Fund	None	
VII. Exchange rate arrangements		

The exchange rate of the Botswana pula is crawling peg arrangement against a basket of currencies. As of November 15, 2006, the exchange rate was US\$1=P6.21, and the exchange rate of the South African rand to the pula was R1=P0.852.

VIII. Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on June 22, 2005. Botswana maintains a multiple currency practice (MCP) relating to exchange rate guarantees on certain loans. The authorities previously indicated that the scheme applied only to loans undertaken before October 1990, the last of which would mature in 2006; on that basis, the Fund previously approved this MCP. However, a recent communication from the authorities now indicate that the loans will be outstanding until 2016. Absent additional information on whether the conditions for Fund approval of the MCP apply, in light of the recent communication, staff does not recommend approval of the MCP.

With regard to the multiple currency practice, the Executive Board took the following decision in the context of the 2005 Article IV consultation:

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

2. As described in IMF Country Report No. 06/66, May 13, 2005, Botswana maintained a multiple currency practice subject to Fund approval under Article VIII, Sections 2(a) and 3 arising from the Foreign Exchange Risk-Sharing Scheme (FERS) applicable to outstanding external loans obtained by certain public enterprises before October 1, 1990. In the circumstances of Botswana, the Fund grants approval of the retention of this multiple currency practice until June 30, 2006, or the conclusion of the next Article IV consultation, whichever is earlier.

IX. Technical assistance assignments/projects

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

X. Technical assistance missions

Department	Dates	Purpose
MFD	January 2001	Banking supervision advisor
	February 2001	Monetary operations
	December 2001	MEFMI-Monetary operations
	August 2002	Banking supervision, anti-money laundering,
	July 2004	NBFI supervision
	August 2004	Money and banking statistics follow-up
FAD	November 1997	Introduction of a value-added-tax (VAT)
	September 2000	Implementation of VAT next steps
	February 2002	Tax administration (SADC Region)
	November 2004	Public expenditure management
LEG	January 2006	Review of amended VAT provisions

STA	May 2001	Inspection for visit of long-term BOP Advisor
	April 2002	ROSC data module
	July 2002	BOP statistics: peripatetic visit
	August 2003	TA on monetary and financial statistics using the GDDS
	June 2004	GDDS project for Anglophone Africa: National accounts statistics
	August 2004	Follow-up mission: Money and banking statistics
	October 2004	GDDS: National accounts mission
	June 2005	Follow-up TA on monetary and financial statistics using the GDDS
	August 2005	Follow-up mission: GDDS quarterly balance of payments statistics
	March 2006	GDDS project for Anglophone Africa: Balance of payments statistics
	March-April 2006	GDDS project for Anglophone Africa: National accounts statistics

Appendix II: Botswana: Relations with the World Bank Group
(As of July 13, 2006)

1. Botswana became a member of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) in 1968. Cumulative commitments from IDA to Botswana include US\$17 million for six development credits for infrastructural development and the livestock sector. The last credit was extended in 1974. Cumulative commitments from the IBRD to Botswana amount to US\$281 million for 22 loans, of which US\$54 million was canceled. The loans were extended for infrastructural development, the financial sector, land management and livestock development, as well as for education and health projects. The last loan was extended in 1987. Since the late 1980s, the Government of Botswana has not required external borrowing owing to its strong financial and international reserve position based on diamond mining receipts. Currently, there are no active IBRD/IDA projects in Botswana. Therefore, the Bank's involvement in Botswana has shifted to analytical and advisory activities.
2. Botswana joined the International Finance Corporation (IFC) in 1979. There has been little private sector interest in Botswana in IFC financing as excess liquidity, brought about by the inflow of foreign exchange resources from diamond exports, which has made it relatively easy for the small private sector to raise funds in the domestic market. Cumulative IFC equity and loan commitments to Botswana total US\$10.72 million in five tourism, financial, and mining enterprises. In FY99 and FY00, the IFC made two loan commitments amounting to US\$1.75 million to Abercombie and Kent (Botswana) for accommodation and tourism services projects in the Okavango Delta. In FY01, the IFC made a quasi-equity investment of US\$3 million in the African Banking Corporation aimed at diversifying its range of financial services and increasing its geographical coverage. In FY03, the IFC approved a US\$2 million equity investment in Kalahari Diamonds Limited for diamond exploration in Botswana's Kalahari desert. The most recent IFC commitment, at the end of 2004, was an equity stake of US\$3.97 million in a consumer finance company, which provides short- to medium-term micro loans to employees of governmental, quasi-governmental and private sector companies in Botswana. The IFC rendered advisory services to the Government of Botswana on privatization of enterprises, and in FY03/04, the Public Enterprises Evaluation and Privatization Agency gave the IFC the privatization mandate for Air Botswana. In 2004, the Foreign Investment Advisory Services completed a review of the commercial legal framework, administrative and registration costs, and barriers to investment in Botswana.
3. Botswana joined the Multilateral Investment Guarantee Agency (MIGA) in 1988; MIGA has neither any exposure nor any active applications in Botswana. MIGA and the Botswana Export Development and Investment Authority (BEDIA) signed a cooperation agreement in July 2003. Specifically, BEDIA is providing investment information content to MIGA for distribution to potential investors via the FDI Xchange and other MIGA online services.

4. An ESW on economic diversification and trade was initiated with the government and a local research group, Botswana Institute of Development Policy Analysis, in 2003. The report was completed and presented to the Government in 2005 and is due for publication shortly. The Bank is providing technical support for the dissemination of the report in FY2007. In mid-2004, the Government, with analytical and advisory support from the Bank, launched a study on the viability and long-term development strategy for the livestock (beef) sub-sector. The content and recommendations of the report are expected to be reviewed at the Cabinet level during May/June 2006 to chart the outline of a new strategy for Botswana's livestock sector. At the Government's request, the Public-Private Infrastructure Advisory Facility launched a study on reform of the regulatory framework for public utilities in 2003/04. The Government has also expressed interest in exploring Bank support for infrastructure development. The Bank is actively engaged in trying to identify potential scope and focus for support. At the request of the Government, the Bank will lead the work on the mid-term review of the current National Strategic Framework for fighting HIV/AIDS—a proposal for an IDF grant will be submitted to the Africa committee shortly. The Bank is currently undertaking an Investment Climate Assessment (ICA) in the country with a report due out in FY2007.

5. Past analytic and advisory activities include: a review of Botswana's experience in economic management in 1999; an IDF grant for home-based care of AIDS patients, which closed on August 5, 1999; an analysis of the development impact of HIV/AIDS on the economy in 2001; and sharing of HIV/AIDS related information at technical meetings of the multi-country HIV/AIDS Programs.

World Bank Contact: Ms. Ritva Reinikka, Country Director, at 27-12-431 3100.

Appendix III: Botswana: Statistical Issues

1. Data required for surveillance is reported to the Fund with an acceptable degree of regularity and timeliness, and the overall quality is adequate to conduct surveillance. However, some shortcomings remain. The accuracy of preliminary data, particularly in national accounts and balance of payments, needs improvement. The time lag in compiling the national accounts and labor market data could also be reduced. In addition, the current arrangements—according to which the balance of payments statistics are compiled on a calendar-year basis, and the national accounts and the budget on July-June and April-March bases, respectively—impede the preparation of an integrated set of economic data. In addition, the authorities have been slow in developing quarterly balance of payments accounts, in large part because of delays in the availability of monthly trade data.
2. The data module of the Report on the Observance of Standards and Codes (ROSC) was published in April 2002. Priority recommendations of general applicability included strengthening data sharing and coordination among agencies, especially with a view to reconciling major data sets with different accounting periods.¹³ A factual update to the data ROSC and an update of the response by the authorities to the original data ROSC were disseminated in March and July 2004, respectively.¹⁴ A new data ROSC reassessment mission took place during October 31-November 13, 2006; the mission's report and recommendations will be published in due course..

National Accounts and Prices

3. Annual and quarterly national accounts are based primarily on the concepts and definitions recommended by the *1968 System of National Accounts (SNA)* and are compiled using the production and expenditure approaches. The authorities have indicated their strong commitment to strengthening national accounts data, including migration to the *1993 SNA*, and have been receiving technical assistance from the Fund. Most importantly, recently published data show implausibly large inventory accumulation over the last five years and anomalies in some deflators. The authorities agreed that these problems are a serious concern. Differences in the accounting periods and in the timing of recording between national accounts, balance of payments, and government finance statistics impair the

¹³ Botswana participates in the General Data Dissemination System (GDDS) regional project for Anglophone African countries that is funded by the U.K. Department for International Development (DFID). The authorities have prepared an initial set of metadata that include detailed plans for improvement over the short and medium term; these were posted on the Fund's Data Standards Bulletin Board in October 2002. Most of these metadata were updated in May 2006.

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

usefulness and accuracy of estimates. Staff have encouraged the authorities to step up efforts to harmonize the accounting periods over the medium term as planned. As a priority measure, the 2001 data ROSC mission recommended advancing the work program for implementing *1993 SNA* with an increased focus on conceptual adherence, with implementation initially limited to GDP estimates.

4. The consumer price index is comprehensive and provides a breakdown of the index between urban and rural areas, as well as between tradables (domestic and imported) and nontradables. The base year has been changed to 2002/3 = 100 based on 2002/3 Household Income and Expenditure survey (HIES). The old CPI, 1996 =100 is expected to be linked with the new CPI 2002/3 =100, for November 2006. With respect to the producer price index, the 2001 data ROSC mission recommended redesigning the producer price index to conform to international standards regarding sample size and validation procedures. Efforts should also be made to collect more comprehensive source data and adopt best practices for data compilation.

Labor statistics

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

Fiscal accounts

6. Central government finance data are produced monthly, with a lag of three to four weeks, for use in the Ministry of Finance and Development Planning (MFDP). However, the level of accuracy is less than for audited annual fiscal data. Annual and quarterly central government finance statistics (excluding extrabudgetary accounts) are published by the authorities with a 9- to 12-month lag after the end of the reference year in the MFDP's Annual Statements of Accounts. The authorities report monthly data for publication in IFS.

7. The compilation and dissemination of central government finance data are largely based on the methodology of the IMF's *Government Finance Statistics Manual (GFSM 1986)* and cover central government activities but not extrabudgetary accounts, and include balances of financial assets and liabilities. The classification of revenue, expenditure, and

financing is broadly consistent with the *GFSM 1986* methodology, with a few exceptions. Most of the data are sufficiently detailed for GFS purposes, but source data could be improved to allow coverage of all activities and consolidation of general government statistics. In general, the published data have been audited by the Auditor General. Accuracy and reliability are clearly favored at the expense of timeliness. The 2001 data ROSC mission recommended the dissemination of monthly budgetary central government statistics within one month of the end of the reference period and central government debt data within one quarter of the end of the reference period.

Monetary accounts

8. In compiling the monetary survey, the Bank of Botswana (BoB) broadly follows the methodology recommended in the Fund's *Monetary and Financial Statistics Manual (MFSM)*. Three STA technical assistance missions have visited the country in recent years (August 2003, August 2004, and June 2005). Commercial banks classify their accounts into resident and nonresident accounts according to the principle of center of economic interest. Botswana has started compiling monetary statistics based on the Standardized Report Forms (SFRs), which provide improved classification and sectorization of the accounts, and reported these data to STA starting in 2001. The data reported include full coverage of the depository corporations sector.

9. Monetary data for publication in *IFS* are reported on a regular basis. Although the timeliness of reporting has improved, data concerning the monetary authorities are still being reported to STA with a longer lag (one additional month) than those for the other depository corporations.

External sector statistics

10. The BoB reports annual data on the balance of payments and the international investment position. The most recent data reported to STA pertain to 2005. There are some inconsistencies between the balance of payments and the IIP data.

11. STA has provided considerable technical assistance to develop quarterly balance of payments accounts. In March 2006, a technical assistance mission under the GDDS regional project for Anglophone African countries found that the problems caused by the new computer system have been solved and timely trade data of what seems to be an acceptable quality are being produced. Quarterly balance of payments estimates are being compiled but are not yet disseminated as they are not fully consistent with the annual data and there are concerns about coverage.

**BOTSWANA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF JULY 13, 2006)**

	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	Apr. 2006	5/2/2006	M	M	M		
International reserve assets and reserve liabilities of the monetary authorities ⁴	Dec. 2005	[]	M	M	M		
Reserve/base money	Jan. 2006	5/15/2006	M	M	M	LO, LO, LO, O	LO, LO, LO, LO, LO
Broad money	Jan. 2006	5/15/2006	M	M	M		
Central bank balance sheet	Jan. 2006	5/15/2006	M	M	M		
Consolidated balance sheet of the banking system	Feb. 2006	5/5/2006	M		M		
Interest rates ⁵	Mar. 2006	5/5/2006	M	M	M		
Consumer price index	May 2006	July 2006	M	M	M	O, LO, LO, O	LO, LO, O, O, NA
Revenue, expenditure, balance and composition of financing ⁶ – general government ⁷	NA	NA				LO, LO, LO, LO	LO, O, LO, O, NA
Revenue, expenditure, balance and composition of financing ⁶ – central government	2002/03	Sep. 2003	A/Q	Q	Q		
Stocks of central government and central government-guaranteed debt ⁸	NA	NA					
External current account balance	2003	[]	A	A	A	O, LO, LO, O	LO, LO, LO, LO, LO
Exports and imports of goods and services	2005 Q4	April 2006	M/Q	M	Q		
GDP/GNP	2005 Q4	April 2006	AQ	AM	AM	LO, LO, LNO, LO	LO, LO, LO, LO, LNO
Gross external debt	Mar. 2003	Mar. 2003	A/Q	A	A		

¹ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

² Reflects the assessment provided in the data ROSC published on April 2002 and based on the findings of the mission that took place during October 11-24, 2001, for the data set corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).

³ Same as footnote 2, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

⁴ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

⁵ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

⁶ Foreign, domestic bank, and domestic nonbank financing.

⁷ The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

⁸ Including currency and maturity composition.

Appendix IV. External Debt Sustainability Framework, 2001-2011
(in percent of GDP, unless otherwise indicated)

	Actual			Projections							Debt-stabilizing non-interest current account 6/	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010		2011
External debt	23.6	15.8	11.6	10.0	11.5	11.0	10.8	10.5	10.2	10.0	9.8	-2.3
Change in external debt	1.2	-7.7	-4.2	-1.6	1.5	-0.5	-0.2	-0.3	-0.3	-0.2	-0.2	-0.2
Identified external debt-creating flows (4+8+9)	-8.6	-15.9	-14.2	-8.1	-19.1	-15.5	-13.1	-12.0	-10.6	-7.8	-6.5	-6.5
Current account deficit, excluding interest payments	-13.2	-3.7	-5.7	-3.8	-17.1	-11.9	-9.9	-9.0	-7.9	-4.2	-4.2	-4.2
Deficit in balance of goods and services	-10.7	-9.9	-9.6	-7.5	-18.4	-10.7	-8.5	-7.5	-6.4	-2.9	-1.2	-1.2
Exports	53.2	41.4	39.9	42.1	56.3	53.3	52.0	51.2	51.0	48.8	48.4	48.4
Imports	42.5	31.5	30.2	34.6	37.9	42.6	43.5	43.7	44.6	45.8	47.2	47.2
Net non-debt creating capital inflows (negative)	-0.7	-6.0	-4.7	-3.7	-4.2	-3.4	-3.2	-2.9	-2.7	-2.5	-2.4	-2.4
Automatic debt dynamics 1/	5.3	-6.2	-3.8	-0.5	2.2	-0.2	0.0	-0.1	0.1	0.1	0.1	0.1
Contribution from nominal interest rate	1.3	0.8	0.6	1.1	0.8	0.7	0.7	0.8	0.8	0.7	0.7	0.7
Contribution from real GDP growth	-1.4	-0.9	-0.7	-0.6	-0.7	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Contribution from price and exchange rate changes 2/	5.3	-6.1	-3.7	-1.0	2.1	-0.5	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3
Residual, incl. change in gross foreign assets (2-3)	9.8	8.2	9.9	6.5	20.6	15.0	12.8	11.7	10.3	7.6	6.3	6.3
External debt-to-exports ratio (in percent)	44.4	38.3	29.2	23.8	20.5	20.7	20.8	20.5	20.1	20.5	20.3	20.3
Gross external financing need (in billions of US dollars) 3/	0.1	0.4	0.3	0.7	-0.5	0.1	0.3	0.5	0.7	1.1	1.3	1.3
in percent of GDP	1.7	5.7	3.7	6.9	-4.9	0.5	2.8	3.8	5.1	7.8	9.0	9.0
Key Macroeconomic Assumptions												
Real GDP growth (in percent)	5.2	5.6	6.3	5.9	6.2	4.2	4.3	4.4	4.0	3.6	3.4	3.9
Exchange rate appreciation (US dollar value of local currency, change in percent)	-23.2	27.7	23.1	3.8	-22.3	-5.0	-1.7	-0.7	-0.7	-0.7	-0.7	-0.9
GDP deflator in US dollars (change in percent)	-19.2	34.9	30.9	9.9	-17.5	1.7	19.3	3.6	3.3	2.9	2.7	3.0
Nominal external interest rate (in percent)	5.1	5.1	5.6	11.0	6.8	6.9	7.2	7.6	8.0	7.4	7.5	7.6
Growth of exports (US dollar terms, in percent)	-10.8	6.1	29.3	22.0	19.9	9.8	18.0	2.9	4.4	6.6	2.0	5.4
Growth of imports (US dollar terms, in percent)	-7.9	1.0	28.9	32.4	-1.9	7.0	17.0	22.2	9.3	8.7	9.5	9.3
Current account balance, excluding interest payments	13.2	3.7	5.7	3.8	17.1	11.9	9.9	9.0	7.9	5.3	4.2	7.3
Net non-debt creating capital inflows	0.7	6.0	4.7	3.7	4.2	3.4	3.2	2.9	2.7	2.5	2.4	2.7
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2006-10 4/	11.0	10.7	9.0	6.0	0.2	11.0	10.7	9.0	6.0	0.2	-6.8	-2.6
B. Bound Tests												
B1. Nominal interest rate is at baseline plus one-half standard deviation	11.0	10.9	10.7	10.5	10.4	11.0	10.9	10.7	10.5	10.4	10.2	-2.2
B2. Real GDP growth is at baseline minus one-half standard deviation	11.0	11.0	10.9	11.1	11.2	11.0	11.0	10.9	11.0	11.1	11.2	-2.3
B3. Non-interest current account is at baseline minus one-half standard deviations	11.0	11.0	13.3	15.5	17.7	20.1	20.1	17.7	20.1	22.5	22.5	-2.1
B4. Combination of B1-B3 using 1/4 standard deviation shocks	11.0	11.0	12.2	13.3	14.5	15.8	15.8	14.5	15.8	17.2	17.2	-2.1
B5. One time 30 percent real depreciation in 2007	11.0	11.0	21.1	25.1	28.7	31.1	28.7	31.1	28.7	31.1	33.1	-3.2

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+g)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms.

g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+g)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ 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.

5/ The implied change in other key variables under this scenario is discussed in the text.

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.

Appendix V. Public Sector Debt Sustainability Framework, 2001/02-2011/12
(In percent of GDP, unless otherwise indicated)

	Actual			Projections										Debt-stabilizing primary balance 10/				
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	I. Baseline Projections						
Public sector debt 1/	8.2	5.7	10.7	9.9	7.1	6.0	5.8	4.0	3.5	3.1	2.8	3.1	2.8	2.8	2.5	2.2	1.9	-0.2
o/w foreign-currency denominated	8.2	5.7	4.8	4.6	3.9	3.1	3.2	2.8	2.5	2.2	1.9	2.2	1.9	2.2	1.9	1.9	1.9	-0.2
Change in public sector debt	0.9	-2.5	5.0	-0.8	-2.8	-1.1	-0.2	-1.8	-0.5	-0.4	-0.3	-0.4	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3
Identified debt-creating flows (4+7+12)	5.0	1.3	-1.2	-2.3	-8.5	-1.9	-0.3	-0.4	0.8	1.6	1.5	1.6	1.5	1.6	1.5	1.5	1.5	-0.3
Primary deficit	2.7	3.6	-0.1	-1.6	-9.1	-1.9	0.1	0.0	1.0	1.9	1.7	1.9	1.7	1.9	1.7	1.7	1.7	-0.3
Revenue and grants	35.5	37.0	38.6	37.7	41.2	39.5	37.8	37.6	36.7	35.3	35.1	35.3	35.1	35.3	35.1	35.1	35.1	-0.3
Primary (noninterest) expenditure	38.3	40.6	38.5	36.2	32.1	37.6	37.9	37.7	37.2	36.8	36.8	37.2	36.8	37.2	36.8	36.8	36.8	-0.3
Automatic debt dynamics 2/	2.3	-2.3	-1.1	-0.8	0.6	0.0	-0.4	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contribution from interest rate/growth differential 3/	-0.2	-0.4	0.0	-0.6	-0.8	-0.3	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Of which contribution from real interest rate	0.0	0.1	0.3	0.1	-0.3	0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Of which contribution from real GDP growth	-0.2	-0.6	-0.3	-0.7	-0.4	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Contribution from exchange rate depreciation 4/	2.5	-1.8	-1.1	-0.2	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
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	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	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	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	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3)	-4.1	-3.9	6.2	1.5	5.7	0.8	0.0	-1.4	-1.2	-2.1	-1.8	-1.4	-1.2	-2.1	-1.8	-1.8	-1.8	-1.8
Public sector debt-to-revenue ratio 1/	23.2	15.4	27.9	26.3	17.3	15.2	15.2	10.6	9.6	8.8	8.0	8.8	8.0	8.8	8.0	8.0	8.0	8.0
Gross financing need 5/	3.9	4.6	1.0	-0.5	-8.1	-1.1	0.6	0.5	1.4	2.2	2.0	2.2	2.0	2.2	2.0	2.0	2.0	2.0
in billions of U.S. dollars	0.2	0.3	0.1	-0.1	-0.9	-0.1	0.1	0.1	0.1	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Key Macroeconomic and Fiscal Assumptions																		
Real GDP growth (in percent)	3.3	7.6	4.8	7.2	5.2	4.2	4.3	4.4	3.8	3.6	3.4	3.6	3.4	3.6	3.4	3.4	3.4	3.4
Average nominal interest rate on public debt (in percent) 6/	3.9	2.8	8.8	7.0	6.8	7.1	3.3	3.3	4.4	4.5	3.1	4.4	3.1	4.5	3.1	3.7	3.7	3.7
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.4	1.8	5.3	1.6	-3.4	-2.1	-2.9	-3.8	-3.3	-3.5	-4.4	-3.3	-4.4	-3.5	-4.4	-3.6	-3.6	-3.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	-23.2	27.7	23.1	3.8	-22.3	-6.1	-0.8	-1.2	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8	-0.8	-0.8
Inflation rate (GDP deflator, in percent)	3.5	1.0	3.5	5.4	10.2	6.9	6.2	7.1	7.7	8.0	7.3	7.7	8.0	7.7	8.0	7.3	7.3	7.3
Growth of real primary spending (deflated by GDP deflator, in percent)	14.5	14.0	-0.6	0.7	-6.6	22.2	5.1	3.7	4.0	2.2	2.2	4.0	2.2	2.2	2.2	3.4	3.4	3.4
Primary deficit	2.7	3.6	-0.1	-1.6	-9.1	-1.9	0.1	0.0	1.0	1.9	1.7	1.9	1.7	1.9	1.7	1.7	1.7	1.7
A. Alternative Scenarios																		
A1. Key variables are at their historical averages in 2007/08-11/12 7/	6.0	2.9	-1.3	-4.9	-9.0	6.0	2.9	-1.3	-4.9	-9.0	-12.4	-9.0	-12.4	-9.0	-12.4	-9.0	-12.4	1.0
A2. No policy change (constant primary balance) in 2007/08-11/12	6.0	3.7	0.2	-3.0	-6.8	6.0	3.7	0.2	-3.0	-6.8	-10.0	-6.8	-10.0	-6.8	-10.0	-6.8	-10.0	0.7
B. Bound Tests																		
B1. Real interest rate is at baseline plus one standard deviation	6.0	5.9	4.2	3.9	3.5	6.0	5.9	4.2	3.9	3.5	3.3	3.5	3.3	3.5	3.3	3.3	3.3	-0.1
B2. Real GDP growth is at baseline minus one-half standard deviation	6.0	6.3	5.5	6.4	7.6	6.0	6.3	5.5	6.4	7.6	9.3	6.4	7.6	9.3	6.4	7.6	9.3	-0.5
B3. Primary balance is at baseline minus one-half standard deviation	6.0	8.5	9.3	11.3	13.1	6.0	8.5	9.3	11.3	13.1	14.9	9.3	11.3	14.9	9.3	11.3	14.9	-1.0
B4. Combination of B1-B3 using one-quarter standard deviation shocks	6.0	7.2	6.8	7.7	8.5	6.0	7.2	6.8	7.7	8.5	9.3	6.8	7.7	8.5	9.3	6.8	7.7	-0.5
B5. One time 30 percent real depreciation in 2006/07 9/	6.0	7.7	5.8	5.2	4.7	6.0	7.7	5.8	5.2	4.7	4.3	5.8	5.2	4.7	4.3	5.8	5.2	-0.3
B6. 10 percent of GDP increase in other debt-creating flows in 2006/07	6.0	15.8	13.3	12.3	11.3	6.0	15.8	13.3	12.3	11.3	10.5	13.3	12.3	11.3	10.5	13.3	12.3	-0.7

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

Statement by the IMF Staff Representative
December 13, 2006

This statement provides an update on recent economic developments reflecting information that has become available since the staff report was prepared. This information does not alter the thrust of the staff appraisal.

1. **Fiscal data for the full 2005/06 fiscal year (April/March) and the first half of the 2006/07 fiscal year have recently become available.** The 2005/06 fiscal outcome was broadly in line with staff estimates, with revenue and expenditure each roughly one-half percent of GDP lower than projected and the overall surplus in line with projections at 8.5 percent of GDP. For the first half of 2006/07, expenditure is running below budgeted levels and the overall surplus is approximately 3.4 percent of projected full-year GDP.

2. **The inflation outcome for October 2006 at 0.6 percent continues recent trends, bringing the twelve month rate to 9.2 percent (8.4 percent for the first ten months of 2006).** Also, starting with October 2006, monthly inflation data are calculated with the updated weights in the CPI basket that are referred to in the staff report (see ¶28 of the staff report). Some historical price data have been revised. However, the changes in the weights are minor and the revised series do not change any of the inflation rates referred to in the text of the staff report.



INTERNATIONAL MONETARY FUND

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

IMF Executive Board Concludes 2006 Article IV Consultation with Botswana

On December 13, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Botswana.¹

Background

Botswana has been among the world's fastest growing economies over the past 40 years. Diamond-led growth combined with sound macroeconomic policies and good governance has moved Botswana from being one of the poorest countries in the world to the upper-middle income range. Nevertheless, Botswana faces serious challenges to continued economic development. The country remains heavily dependent on the diamond production, which accounts for about three-fourths of exports, one-third of GDP, and half of government revenue. However, diamond output, which almost doubled over the past decade, is projected to plateau roughly at current production levels for the next decade and a half and decline sharply thereafter. Notwithstanding past efforts by the authorities to diversify the economy, activity in non-mining sectors remains weak and, as a result, unemployment and poverty rates remain high. The share of households below the poverty line stood at 30 percent in 2002/03. Botswana also has one of the world's highest HIV/AIDS infection rates (estimated by UNAIDS at over

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

35 percent of the adult population), which places a burden on human welfare and public finances.

Botswana's recent economic performance has been generally good, apart from an upsurge in inflation following the May 2005 devaluation and adoption of the crawling peg regime. Real GDP growth has rebounded in 2004/05 (July-June), mainly due to growth in the mining sector. The current account surplus has expanded in 2005, and international reserves rose to the equivalent of 21 months of goods and services imports. The fiscal surplus rose substantially in 2005/06 as a result of higher diamond revenues and lower-than-budgeted spending. (The authorities maintain a fiscal rule that sets a ceiling on expenditure at 40 percent of GDP.)

At the time of the May 2005 devaluation, the authorities announced a shift in the exchange rate regime from an adjustable peg against a basket to a crawling peg against a basket comprising the South African rand and the SDR. According to the 2006 Monetary Policy Statement of the Bank of Botswana (BoB), the rate of crawl is set as the difference between Botswana's inflation objectives (4–7 percent for 2006 and an average of a 3–6 percent range for the 2006–08 period) and forecast average inflation of the trading partner countries. The weights and the rate of crawl have not been announced.

Coinciding with the devaluation and the change in exchange rate regime, consumer price inflation accelerated from about 6 percent on a year-on-year basis to May 2005 and peaked at about 14 percent in April 2006. It began declining and was leveling off at about 8 percent in October 2006, above the authorities' objective range of 4 to 7 percent inflation for the December 2005–December 2006 period. The real effective exchange rate has appreciated with the increase in inflation, offsetting some of the real effect of the May 2005 devaluation in the period through September 2006.

Executive Board Assessment

Executive Directors commended Botswana's impressive record of prudent macroeconomic policy making, sound management of its diamond resources, and good governance, which has moved Botswana from one of the poorest countries in the world to the upper-middle income range. Directors noted that macroeconomic performance has continued to be strong over the last two years, with the exception of inflation, which accelerated substantially, partly as a result of the May 2005 devaluation and the introduction of a crawling peg. The current level of the exchange rate was also seen as broadly appropriate in light of the strong current account, growing non-diamond exports, and the high and stable level of reserves.

Notwithstanding this positive performance, Directors noted that Botswana still faces serious challenges to continued economic development and poverty reduction. Of particular importance are the country's heavy dependence on diamond production, which is projected to plateau over the next fifteen years and decline sharply thereafter, and the high prevalence of HIV/AIDS infection rates. Against this background, Directors stressed the need for vigorous efforts to diversify the economy and to continue the fight against the HIV/AIDS pandemic, while preserving macroeconomic stability.

Directors cautioned that the authorities' announced policy of using interest rates and monetary policy to achieve the inflation target while using the crawling peg exchange rate regime to target a real effective exchange rate level could generate conflict among policy objectives. In this context, most Directors recommended that the authorities give priority to meeting their inflation objective in setting the rate of crawl and not seek to achieve a real exchange rate target. Announcement of the parameters of the regime should also help to increase transparency and anchor exchange rate and inflation expectations. Further, given the authorities' intention to use interest rates and monetary policy to rein in inflation, Directors thought that a tighter monetary policy would be needed if inflation does not soon decline.

Directors considered the authorities' policy of maintaining a balanced budget to be prudent but, to anticipate the projected decline in diamond revenues, recommended that the authorities pursue measures aimed at putting the share of government expenditure on a sustained, downward path. For 2006/07, in view of the large fiscal impulse implied by the budget, Directors called on the authorities to maintain the pace of expenditure growth below budgeted levels until inflationary pressures subside, and for the medium term to target fiscal surpluses associated with a declining expenditure path. Reducing the size of government and the public sector wage bill should remain a priority, while preserving HIV/AIDS-related and development spending through reallocation from nonpriority areas as well as revenue increases. To this end, Directors welcomed the efforts to broaden the tax base, improve tax administration, and implement user fees, but advised that increases in tax rates should not be ruled out in light of the scale of the projected decline in diamond revenue.

Directors welcomed the authorities' plans for labor market-related reforms, privatization, and improvements in the investment environment, which should help promote competitiveness and diversification of the economy with attendant reductions in unemployment and poverty. Directors considered the banking sector sound, profitable, and generally well supervised, while welcoming the planned strengthening of supervision of the non-bank financial institutions. They looked forward to a further analysis of financial sector issues in the Financial Sector Assessment Program (FSAP) slated for early 2007, and welcomed the planned adoption of the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) legislation. Directors noted that Botswana maintains a multiple currency practice (MCP) relating to exchange rate guarantees on one loan, and urged the authorities to take early action to remove the practice.

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

Botswana: Selected Economic Indicators

	2001	2002	2003	2004 Rev.	2005 Prel.	2006 Proj.
Output and Price (change in percent)						
Real GDP 1/	1.6	9.5	3.4	8.4	4.2	4.3
<i>Of which: nonmining GDP</i>	5.3	8.8	5.5	1.9	5.6	5.7
Consumer prices (period average) 2/	6.6	8.0	9.3	6.9	8.6	...
Investment and savings (percent of GDP) 2/						
Gross investment	40.4	40.2	41.3	38.7	31.3	29.9
Public	10.2	10.6	10.1	8.8	7.9	9.0
Private	30.2	29.6	31.1	29.9	23.4	21.0
Gross national savings	53.0	46.9	44.8	45.6	45.4	44.2
Public	14.2	15.5	15.4	15.8	13.3	12.1
Private	38.8	31.5	29.4	29.8	32.1	32.1
Central government finance (percent of GDP) 3/						
Total revenue and grants	35.5	37.0	38.6	37.7	41.2	39.5
Total expenditure and net lending	38.5	40.8	38.9	36.8	32.7	38.1
Overall balance (excluding grants)	-3.2	-4.0	-0.5	0.2	8.1	0.8
Overall balance (including grants)	-3.0	-3.8	-0.4	0.9	8.5	1.4
Primary balance	-2.7	-3.6	0.1	1.6	9.1	1.9
Total public debt	6.9	7.8	5.3	4.4	4.2	3.6
External sector (millions of U.S. dollar) 2/						
Trade balance	713	710	900	840	1,769	1,192
Current account balance	600	197	464	291	1,565	1,159
Gross official reserves	5,897	5,474	5,339	5,665	6,276	7,207
Botswana pula per U.S. dollar (period average)	5.9	6.3	4.9	4.6	5.2	...
Real effective exchange rate (depreciation -)	5.1	2.9	3.6	-4.8	-4.4	...

Sources: Botswana authorities; and IMF estimates.

1/ National accounts year beginning July 1.

2/ Calendar year.

3/ Fiscal year beginning April 1.

2006 Article IV Report and Public Information Notice: Statement by the Botswana Authorities

The Botswana authorities acknowledge the publication of the 2006 Article IV Consultation Staff Report and the Public Information Notice (PIN). This statement complements these documents and articulates the authorities' perspective on monetary and exchange rate policies and their operation in Botswana.

Monetary policy in Botswana aims at achieving stable, low and predictable inflation. Among others, low inflation has a positive effect on savings, investment and international competitiveness. Botswana also operates a crawling band exchange rate arrangement with the currency (Pula) fixed to a trade-weighted basket comprising the SDR and the South African rand and is intended to allow for adjustment of the nominal exchange rate to achieve real effective exchange rate stability. The rate of crawl is determined annually as the differential between Botswana's inflation objective and the forecast inflation for the trading partner countries. The exchange rate is adjusted continuously (daily) in small steps.

The monetary policy framework involves publication of an annual objective range for inflation, which for 2006 was set at 4 - 7 percent. Ordinarily, the objective range is derived from the forecast range for trading partner inflation. This is equal to the Pula basket weighted average forecast inflation for the SDR countries and the South African rand. It is deemed that achieving inflation equal to that for the trading partner countries will contribute to stability of the real effective exchange rate without the need to adjust the nominal effective exchange rate.

At any particular time, conditions may be such that it would not be feasible to attain inflation in the range of the forecast for the trading partner countries, in which case the objective would be different. In 2006, for example, it was considered that while the forecast inflation for the trading partner countries was in the range of 3 percent to 4.5 percent, the impact of the May 2005 devaluation and increase in administered prices was such that inflation would be much higher. Consequently, the inflation objective was set at a higher range of 4 - 7 percent. In the circumstances a downward crawl of the nominal effective exchange rate would contribute to achieving real effective exchange rate stability. As both Botswana's objective and the forecast trading partner inflation are ranges, the determination of the exact rate of crawl within these bounds is discretionary and is dependent on an assessment of other relevant economic factors.

It is considered that the objective of low inflation to support export competitiveness is not incompatible with the crawling band exchange rate mechanism as it is possible to achieve the price stability objective by influencing domestic demand and inflation expectations. Even if domestic consumption has large import content and there is a significant component of administered prices, domestic demand and second-round price increases would be influenced by the interest rate impact on the demand for credit. Moreover, inflation control through monetary policy would minimise or eliminate the need for a downward crawl of the exchange rate which could be inflationary depending on the size of the rate of the crawl. For Botswana, the rate of crawl is moderate with very low inflationary pressures.

It is important to note that the rise in inflation from mid-2005 to April 2006 was largely due to supply shocks, including the devaluation of the Pula, that were transitory. As the effects of these shocks dissipated, inflation maintained a downward trend with a corresponding increase in real interest rates. As the authorities had forecast an eventual fall in inflation, it was considered that following the February 2006 increase in the Bank Rate, monetary policy was sufficiently restrictive to restrain demand pressures and reign in on expectations, hence sustain the downward inflation trend. It is notable that inflation subsequently decreased from a peak of 14.2 percent in April 2006 to 8.5 percent in December 2006 (and 7.2 percent in February 2007).

Over the years, empirical studies on determinants of inflation in Botswana have shown a variety of inconsistent results. The inconsistency in the results is possibly due to data and statistical limitations and the significant structural and policy shifts in the country. The results of the selected issues paper '*A Note on Inflation*' prepared by staff should, therefore, be used cautiously, particularly with respect to policy advice.