



BOTSWANA

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

August 2017

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 2017 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on May 16, 2017, with the officials of Botswana on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 14, 2017.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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IMF Executive Board Concludes 2017 Article IV Consultation with Botswana

On July 28, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Botswana, and considered and endorsed the staff appraisal without a meeting.²

Following a small contraction in 2015, economic activity recovered in 2016 with real GDP growth of 4.3 percent. Mineral production has remained subdued, but diamond sales rebounded as conditions in the global market begun to improve. Non-mining activities also expanded, supported by accommodative fiscal and monetary policies and reforms in the electricity sector. Year-on-year inflation has remained stable near the lower band of the Bank of Botswana's inflation objective range of 3–6 percent, with the 12-month rate of inflation at 3.5 percent in in May 2017.

The fiscal position has also improved as the deficit narrowed from 4.6 percent of GDP in fiscal year 2015/16 (the fiscal year begins in April) to about 1 percent of GDP in 2016/17. This outcome was supported by a recovery in diamond revenues and constrained recurrent spending. Higher diamond sales also contributed to a large surplus in the external current account and helped sustain a high level of international reserves (45 percent of GDP at end-2016).

Executive Board Assessment

In concluding the 2017 Article IV Consultation with Botswana, Executive Directors endorsed staff's appraisal as follows:

The economy is undergoing a cyclical recovery and the outlook is broadly positive. Supported by a gradual rebound in the global diamond market and public investment, annual real GDP growth is projected to approach 5 percent in the near term while prudent financial policies are expected

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.

² The Executive Board takes a decision under its lapse-of-time procedure when it agrees that a proposal can be considered without convening formal discussions.

to maintain inflation within the 3–6 percent objective range set by the Bank of Botswana. In the medium-term, the outlook is also positive and risks are balanced.

The authorities' macroeconomic policies are appropriate. The fiscal stance articulated in the 2017/18 budget and the Medium-Term Expenditure Framework (MTEF) entail small deficits over the next two fiscal years and a rebalancing of expenditure composition toward development spending. This is consistent with a small output gap and the need to upgrade the water and electricity infrastructure. Starting in 2019/20, the MTEF envisages returning to fiscal surpluses, with a tighter control of the wage bill and of transfers to parastatals. At present, the authorities' neutral monetary policy stance is appropriate as there does not seem to be room to lower interest rates. Botswana's exchange rate regime continues to serve the country well.

Domestic revenue mobilization will provide added funding for development spending and help protect buffers. Given the volatility of diamond and revenues from the Southern African Customs Union and a relatively low domestic tax effort, there is a need to pass into law and implement the new Tax Administration Act as well as to strengthen the large taxpayers' unit. In addition, it would be important to consider streamlining VAT exemptions, simplifying the personal income tax, and accelerating plans to register and re-evaluate properties.

Further financial sector reforms will bolster stability. The authorities should proceed with plans to set up the macroprudential policy function and improve the AML/CFT framework, establish a crisis resolution framework, finalize the implementation of Basel II requirements, and strengthen risk-based supervision of nonbank financial institutions.

Fostering private sector growth will require determination and focus on key reforms. Achieving the long-sought objectives of inclusive growth and diversification will require political commitment, improved capacity and coordination among government agencies, and focus on a few plans with a manageable set of high-impact, time-bound, monitorable reforms. In this context, the authorities need to press ahead with the key measures discussed to strengthen the efficiency of the public sector, build skills in the labor force, and create an enabling environment for the expansion of the private sector.

Public sector reforms could enhance growth prospects. In this regard, the priorities should be to proceed with measures to improve the planning, prioritization, and execution of public investment programs; build capacity in the management of public-private partnerships; improve the financial monitoring and evaluation of SOEs and accelerate the privatization of key loss-making enterprises; make the energy regulator fully operational; review the structure of electricity subsidies to set rates in line with commercial criteria and avoid political interference; and lower water losses.

Similarly, there is a need to proceed with measures to enhance education outcomes and reduce skill mismatches. The authorities need to accelerate the implementation of the strategic plan aimed at enhancing the quality of instruction and training across education levels. Deepening the dialogue and coordination with the private sector is also relevant to improve education outcomes and address skill-mismatches, as is easing the process to grant work permits to foreign workers

with skills that are not present in the country. These actions will ultimately foster private sector development and facilitate the transfer of skills to the domestic labor force.

Selected reforms to lower the costs of doing business and foster financial deepening will also promote private sector development. In this regard, there is a need to accelerate the implementation of the 2015 Roadmap to improve the business environment, especially establishing a one-stop shop to start businesses, introducing risk-based inspections to speed up granting construction permits, broadening the scope of the creditor database to include both positive and negative credit data, allowing lenders to enforce securities out of court through a collateral agreement, establishing a collateral registry for immovable and movable assets, and implementing the Making Access Possible Plan to foster financial inclusion.

Lastly, efforts to diversify the economy can usefully focus on removing distortions and improving competitiveness. Capacity constraints, high transport costs, and the risks associated with industrial policies argue for an approach based on removing distortions and investing wisely in key public infrastructure. If industrial policies are pursued, the authorities should undertake careful cost-benefit analysis and ensure minimal government intervention. Furthermore, fiscal incentives and tax concessions (including in economic zones) should also be carefully evaluated and, if granted, be in the form of accelerated depreciation schemes or investment tax credits.

Botswana: Selected Economic Indicators, 2014–18

	2014	2015	2016	2017	2018
			Prel.	Projections	
(Annual percent change, unless otherwise indicated) ¹					
National income and prices					
Real GDP	4.1	-1.7	4.3	4.5	4.8
Mineral ²	0.5	-19.6	-3.7	-0.3	4.7
Nonmineral	4.9	1.7	5.5	5.1	4.8
Consumer prices (average)	4.4	3.1	2.8	3.7	3.7
Diamond production (millions of carats)	24.7	20.8	20.9	21.5	22.5
External sector					
Exports of goods and services, f.o.b. (US\$)	7.6	-22.4	1.6	6.2	3.9
<i>Of which: diamonds</i>	10.4	-28.4	15.5	-4.2	3.7
Imports of goods and services, f.o.b. (US\$)	-3.6	-10.2	-14.2	27.0	4.8
Terms of trade	8.6	0.1	-0.1	14.4	-1.1
Nominal effective exchange rate	-0.2	0.0	0.2	...	...
Real effective exchange rate	0.4	0.6	-0.3	...	...
Money and banking					
Monetary Base	-8.5	18.6	3.7	5.0	7.2
Broad money (M2)	4.6	19.9	5.4	5.3	7.4
Credit to the private sector	13.7	9.0	9.0	6.3	5.9
(Percent of GDP, unless otherwise indicated)					
Investment and savings					
Gross investment (including change in inventories)	27.9	32.1	23.8	25.1	26.3
Public	8.2	8.8	8.6	9.0	9.2
Private	19.6	23.3	15.3	16.1	17.1
Gross savings	43.2	40.5	42.1	29.5	29.1
Public	19.8	16.1	15.6	16.9	15.9
Private	23.5	24.4	26.5	12.6	13.2
Central government finances³					
Total revenue and grants	38.4	31.3	31.9	32.4	30.3
Total expenditure and net lending	34.7	35.8	33.1	32.5	31.9
Overall balance (deficit –)	3.7	-4.6	-1.1	-0.1	-1.6
Non-mineral primary balance ⁴	-16.1	-18.1	-18.0	-15.4	-17.4
Total central government debt	17.3	16.4	15.5	15.5	15.0
External sector					
Current account balance	15.2	8.3	11.7	4.5	2.8
Balance of payments	3.7	-5.4	-2.3	3.3	2.0
External public debt ⁵	16.7	17.2	14.4	13.2	12.1
o/w public and publicly-guaranteed	4.8	5.3	4.7	4.4	4.2
(Millions of U.S. dollars, unless otherwise indicated)					
Gross official reserves (end of period)	8,323	7,546	7,189	7,742	8,092
Months of imports of goods and services ⁶	12.7	13.4	10.1	10.6	10.8
Months of non-diamond imports ⁶	18.6	18.0	14.6	15.3	15.5
Percent of GDP	54.2	57.7	51.4	54.5	58.1

Sources: Botswana authorities and IMF staff estimates and projections.

¹ Calendar year, unless otherwise indicated.

² Projections are based on diamond production due to lack of information on the breakdown of mining value added by mineral.

³ Year beginning April 1.

⁴ The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.

⁵ Includes central government-guaranteed debt.

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



BOTSWANA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

July 14, 2017

KEY ISSUES

Context. Botswana's economic performance over the past two decades has been impressive, allowing the country to move quickly from low to upper-middle income status. The authorities have pursued prudent economic policies and have been working to upgrade the electricity and water infrastructure. Notwithstanding such progress, reforms in the areas of tax administration, state-owned enterprises, and the labor market have been constrained by limited capacity and, at times, insufficient coordination or political support. Furthermore, economic diversification has been limited and unemployment has been persistently high. The authorities consider that resolving these challenges will require a fundamental shift from a diamond and government-driven growth model to one based on building human capital and fostering a competitive private sector.

Outlook. Following a downturn in 2015, annual GDP growth is expected to gradually increase to near 5 percent by 2018, supported by a recovery in the diamond market and moderate fiscal stimulus. Inflation, while picking up slightly, is projected to remain within the Bank of Botswana's objective range of 3 to 6 percent. Risks are balanced, linked to economic activity in the U.S. and major emerging markets and to progress with domestic structural reforms.

Macroeconomic policies. The fiscal stance envisages small deficits over the next two years and a gradual rebalancing of spending toward public investment, consistent with a remaining output gap and the need to upgrade the public infrastructure. In the medium term, revenue mobilization and expenditure restraint are projected to lead to fiscal surpluses. Monetary policy is likely to remain neutral but could be tightened if needed to dampen inflation expectations. The crawling peg exchange rate regime with preset basket weights continues to serve the country well and no changes are deemed necessary at this stage.

Key reforms. There has been agreement between the authorities and IMF staff on policies and reforms and several recommendations of the 2015 Article IV consultation have been or are being implemented, notably with respect to public financial management and the electricity and water sectors. Looking ahead, despite a rebound in diamond revenues, reforms to raise domestic revenues will be important to fund future expenditure and strengthen fiscal sustainability, while proceeding with plans to enhance financial supervision will reinforce the soundness of the financial system. Over time, the goal of inclusive growth would benefit from a set of concrete, time-bound, monitorable reforms aimed at improving public financial management, enhancing human capital, and lowering barriers to the expansion of the private and the financial sectors through the removal of distortions, wise investments, minimal government intervention, and focus on sectors with clearly defined comparative advantage.

Approved By
**Anne-Marie Gulde-
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 Zeidane (SPR)**

The discussions took place in Gaborone during May 1–16, 2017. The staff team comprised Mr. Gelbard (head), Ms. Marchettini, and Mr. Maino (African Department); Ms. Gonzalez Prieto (Research Department); and Mr. Varsano (Consultant, Fiscal Affairs Department). Mr. Torres (African Department) assisted the mission from headquarters. The mission worked together with a concurrent mission by Mr. Helis (IMF’s Regional Technical Assistance Center for Southern Africa) on public financial management. The staff met with the Governor of the Bank of Botswana, Mr. Moses Dinekere Pelaelo, the Minister of Finance and Economic Development, Honorable O. Kenneth Matambo, other senior officials, and representatives of the donor community, civil society, and the financial sector.

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CONTEXT

Botswana has maintained economic stability and high rates of economic growth over the years. Nevertheless, the country continues to face important structural constraints that are reflected in a low level of human capital and limited economic diversification.

1. **Botswana has made impressive strides in economic development.** The country is frequently mentioned as “An African Success Story”.¹ It is deemed to have the best quality of governance and rule of law in Africa, its economic growth averaged 4.6 percent during the past two decades, and the poverty rate was reduced rapidly from 31 percent in 2003 to 19 percent in 2010. Owing to prudent fiscal and monetary policies, the authorities have accumulated substantial foreign exchange reserves and secured macroeconomic stability with low levels of public debt.²
2. **Despite these achievements, important challenges remain.** Notwithstanding efforts to diversify the economy, large expenditures on public education, and plans to build skills in the labor force, the economy remains heavily dependent on diamonds³, non-mining activities have not expanded enough, and unemployment has remained almost unchanged at about 18 percent in the past decade. Progress appears to have been hampered by various factors, especially weaknesses in implementation capacity and insufficient coordination within the government.
3. **At end-2016, the government adopted a new six-year National Development Plan.** The plan recognizes that outcomes in terms of reducing unemployment and inequality and promoting private sector development have not been satisfactory. The plan is also appropriately ambitious and articulates well a vision to address the challenges of unemployment, poverty, and income inequality. The plan, however, is quite broad in scope so its implementation will need to be more focused and complemented with time-bound measures and close monitoring.
4. **There has been broad agreement between the authorities and IMF staff on policies and reforms in recent years, although some reforms have proceeded slowly.** The authorities have pursued prudent macroeconomic policies and have stepped up efforts to upgrade the electricity and water infrastructure. Reforms in the areas of tax administration, state-owned enterprises (SOEs) and labor market have been gaining momentum, but implementation has been constrained by limited capacity, while reforms to improve the business environment and

¹D. Acemoglu, S. Johnson, and J. A. Robinson (2001) “An African Success Story: Botswana”, *MIT Department of Economics Working Paper No. 01–37* and M. Lewin “Botswana’s Success: Good Governance, Good Policies, and Good Luck”, in P. Chuhan-Pole and M. Angwaf (eds.) (2011) *Yes, Africa Can – Success Stories from a Dynamic Continent*, Chapter 4, pp. 81–90, World Bank.

² The country ranks 35th on the 2016 Transparency International Corruption Perceptions Index, the highest ranking for an African nation, while it ranks second in the continent according to the Ibrahim Index of African Governance. Botswana also has the highest sovereign rating in Africa (A- according to S&P and A2 according to Moody’s).

³ Diamonds account for 37 percent of government revenues and 88 percent of goods’ exports.

review the tax system have been proceeding at a slow pace owing to insufficient coordination among key agencies and hesitant political support (Annex I).

RECENT DEVELOPMENTS

Economic activity is recovering from a downturn in 2015, supported by accommodative fiscal and monetary policies. The economy remains stable, with inflation at about 3 percent, sizable international reserves, low debt, and a profitable banking sector.

5. **Economic activity has been recovering and inflation remains low.** Following a downturn in 2015, real GDP growth recovered rapidly to 4.3 percent in 2016 (Table 1). The recovery was supported by higher diamond exports, accommodative macroeconomic policies, and improvements in electricity generation (while diamond and copper production remained depressed, diamond sales rebounded in 2016). Year-on-year inflation was 3.5 percent in May 2017 and it has remained near the lower band of the Bank of Botswana's (BoB) inflation objective range of 3–6 percent.

6. **The global demand for rough diamonds has been recovering.** In 2015, a decline in the global demand for diamonds cascaded through the supply chain and led Botswana to accumulate inventories of nearly 7 million carats of rough diamonds.⁴ In 2016, the demand for rough diamonds rose as prices were reduced and polishers and cutters began restocking their inventories.⁵ Thus, although the annual production of rough diamonds remained flat, the surge in sales led to a strong upswing in Botswana's mineral exports and fiscal revenues (Tables 2 and 3).

7. **The balance of payments and the trade weighted exchange rate have remained steady.** In 2016, the current account balance stood at almost 12 percent of GDP, while the value of the pula remained broadly stable in effective (trade-weighted) terms vis-à-vis the currencies of Botswana's key trading partners (Figures 1 and 2). In January 2017, in response to rand volatility and evolving inflation differentials, the authorities reduced the rand's weight in the currency basket and the upward rate of the crawl from 50 to 45 percent and from 0.38 to 0.26 percent, respectively.⁶ These changes are minimal and are not expected to have a major impact on the economy. Botswana continues to comply with the obligations of Article VIII of the IMF Articles of Agreement. During 2016, the ratio of international reserves to GDP fell somewhat to about 45

⁴ The reduced demand for rough diamonds originated from squeezed profit margins and increasing debt in the midstream segment of the global market (cutters and polishers), which in turn resulted from lower prices of polished diamonds together with unchanged prices for rough diamonds (the latter are controlled by the major producing companies De Beers and Alrosa). The situation was compounded by an accumulation of inventories owing to unrealized expectations of continued rising demand from China and India.

⁵ De Beers' average rough diamond price declined by 13 percent in 2016.

⁶ Since 2005, Botswana has maintained a crawling peg mechanism where the value of the pula is set against a basket of currencies representing major trading partners (the South African rand and the SDR). The rate of crawl is set annually aiming to compensate for the projected inflation differential between Botswana and its trading partners.

percent, but remained well above the 21 percent upper bound of the optimal range estimated by the Adequacy of Reserves Assessment metric (Table 1 and Annex II).

8. **The fiscal position has been improving.** In 2015/16 (the fiscal year begins in April), the fiscal balance worsened owing to lower mineral revenues and higher spending associated with an economic stimulus program (Table 3). The recovery in diamond revenues and constrained current spending are estimated to have lowered the fiscal deficit from 4.6 percent of GDP in 2015/16 to around 1.1 percent of GDP in 2016/17.

9. **Monetary policy has been accommodative, the banking system has been stable, and the nonbank financial sector has been growing.** In August 2016, the policy rate was reduced from 6 to 5.5 percent, a stance consistent with the prescription of a standard Taylor rule.⁷ Despite low interest rates, banks' credit to the private sector has been decelerating, reflecting restrained growth in personal incomes and relatively high levels of household debt (Table 4).⁸ Banks remain well capitalized and profitable, while liquidity conditions have improved owing to higher government spending. Non-performing loans, while rising, have remained relatively low at 5.5 percent of total loans (Table 5 and Selected Issues, Chapter I).⁹ Other financial activities have grown rapidly in recent years, leading to a large nonbank sector, increased interconnectedness between banks and nonbanks, and challenges regarding supervision of nonbanks.

⁷ The policy rate (the "Bank rate") is the rate at which the BoB lends to commercial banks through its discount window. The appropriateness of the rate was measured against a standard Taylor rule calculation: $i = p + 1/2 \cdot (y - y^*) + 1/2 \cdot (p - p^*) + r^*$, where i is the nominal policy rate, p the rate of inflation, $(y - y^*)$ the percent deviation of real non-mining GDP from trend (non-mining output gap), $(p - p^*)$ the percentage deviation from the inflation target, and r^* the equilibrium real interest rate. Non-mining potential output y^* and the equilibrium real interest rate r^* were computed by applying a backward-looking HP filter. Given the BoB inflation objective range, the Taylor rule implied policy rate range was 5.28–5.52 percent at end-2016.

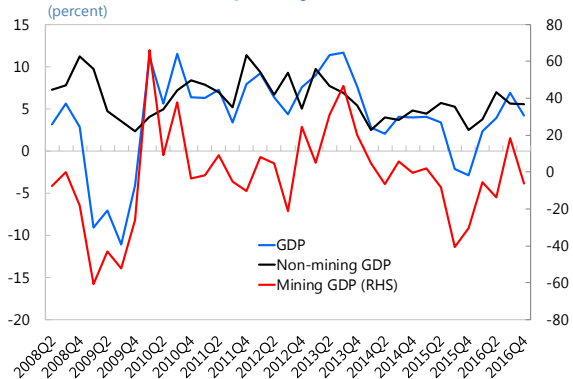
⁸ Household debt is mainly in the form of unsecured consumer credit, which relies on the use of deduction codes. This implies that lenders can deduct instalments directly from borrowers' salaries (mainly civil servants) up to a certain share of income. This limit has been reached for many qualifying borrowers.

⁹ The increase in non-performing loans is mainly associated with defaults by former employees of the state-owned copper mine BCL Limited, which was put under provisional liquidation in 2016. The mine was the second-largest corporate employer in the country (after the diamond producer Debswana) and employed about 5,000 people (1.5 percent of total employment). The economic impact of the closure of the mine was particularly severe in the north-east area of the country, where BCL was located.

Figure 1. Botswana: Recent Developments

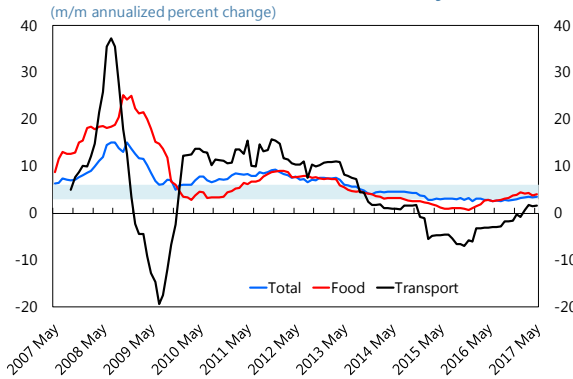
Non-mining GDP growth has been recovering, supported by fiscal and monetary policies.

Real GDP Growth: Quarterly Annualized Rates



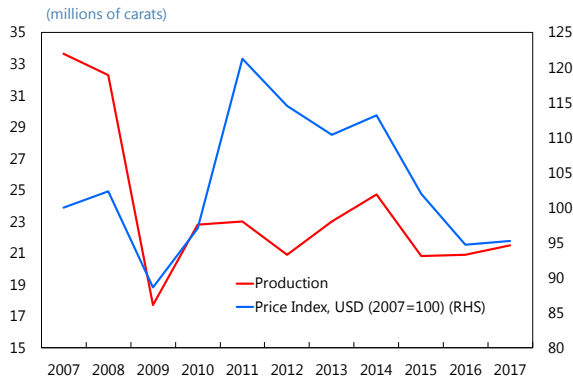
Inflation bottomed in mid-2016 but increased slightly in recent months, driven by higher food and fuel prices.

Consumer Price Inflation, Jan. 2007 - May 2017



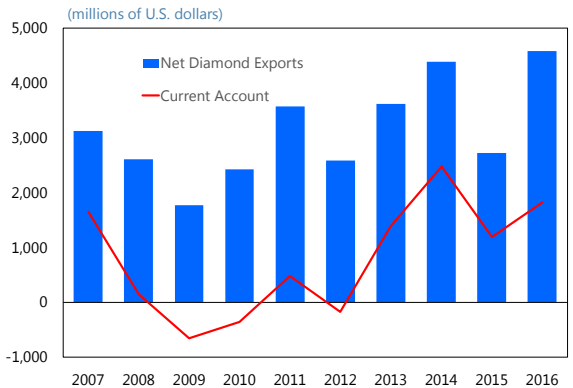
In 2015–16, diamond production and prices declined, but a gradual recovery is under way in 2017.

Diamond Production and Prices



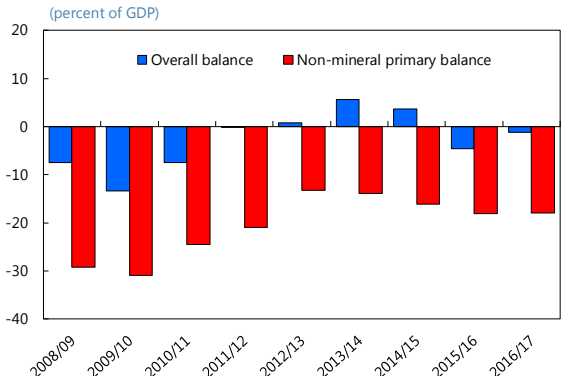
Higher diamond exports in 2016 resulted in an increase in the current account surplus...

Current Account and Diamond Trade



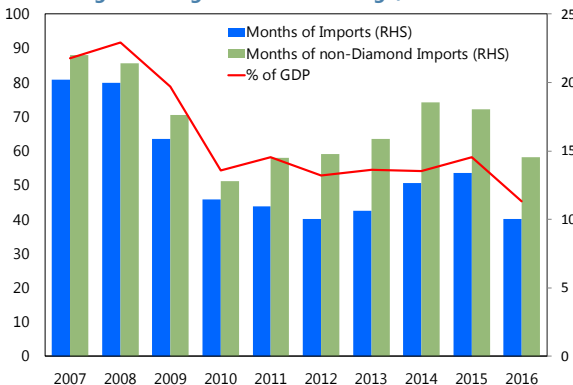
...and contributed to a lower fiscal deficit in 2016/17...

Fiscal Balances, FY08/09 – FY16/17



...while international reserves remained comfortably high.

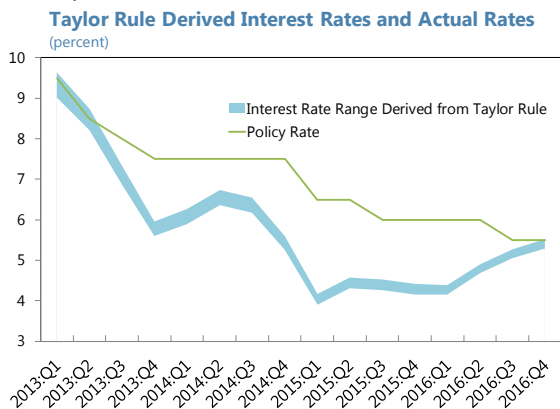
Foreign Exchange Reserves Coverage, 2007–16



Sources: Botswana's Authorities, Bloomberg, IMF Staff estimates.

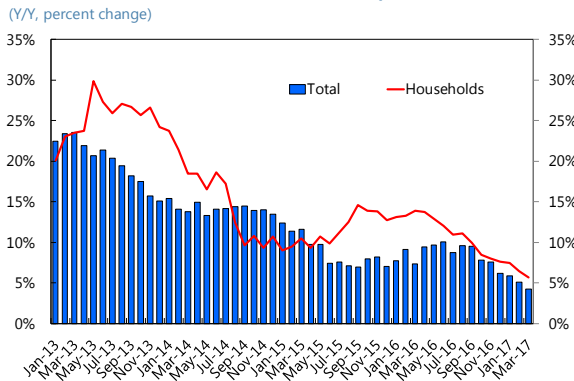
Figure 2. Botswana: Monetary and Exchange Rate Developments

A Taylor rule confirms that the accommodative monetary stance has been consistent with cyclical developments...*

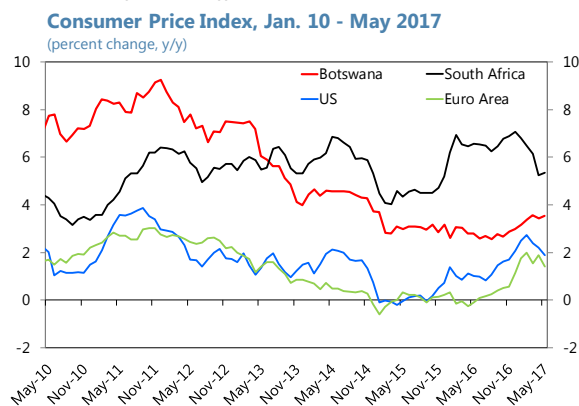


...while growth in banks' lending to the private sector has been declining.

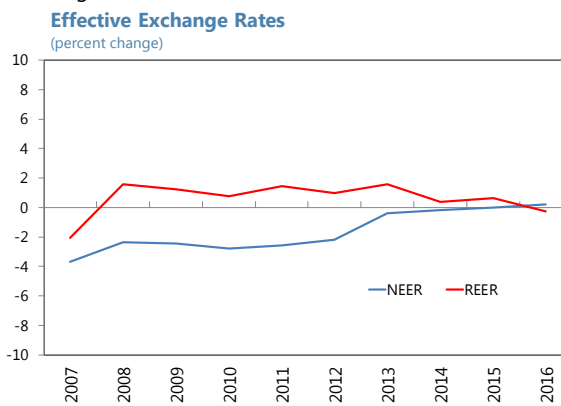
Commercial Banks Loans and Advances, Jan 2013–Mar 2017



In early 2017, the BOB began implementing a slower upward crawl for the pula as the expected foreign-domestic inflation differential narrowed.



The exchange rate regime has continued to work well, leading to broadly stable nominal and real effective exchange rates (NEER and REER).



Sources: Botswana's Authorities and IMF Staff estimates.

* Recurring revisions of output data explain the difference between the policy rate and the Taylor-rule derived range for historical values.

OUTLOOK AND RISKS

Botswana's recovery is expected to strengthen over the medium term, supported by a pickup in diamond demand, public investment, and structural reforms. Risks to the outlook are balanced.

10. The baseline forecast envisions macroeconomic stability and continued growth.

Improved prospects for the diamond sector are expected to lead to a gradual increase in diamond production and international prices in the medium term,¹⁰ while public investment spending is

¹⁰ Despite improvements in the diamond sector, mining GDP growth in 2017 is projected to decline slightly because of the closure of the BCL copper mine.

projected to increase during the next two years. These trends could translate in annual GDP growth rates of nearly 5 percent by 2018. The forecast assumes a gradual pace of reforms to improve the efficiency of the public sector and foster private sector activities. The rate of inflation is expected to inch upwards but remain within BoB's objective range, while modest fiscal deficits in 2017–18 are projected to turn into surpluses in subsequent years (Table 1).

11. **Risks to the outlook are balanced:**

- On the positive side, a benign global scenario could entail the ongoing global recovery strengthening in the near term, backed by fiscal stimulus in the U.S., accommodative policies in Europe, and recovery in emerging markets. Similarly, a faster implementation of key reforms in Botswana could set the basis for stronger and more inclusive growth compared to the baseline.¹¹
- On the negative side, the outlook could be affected by adverse developments on advanced countries' economies (e.g. changes in trade policies) or a significant deterioration of economic conditions in South Africa, including the possibility of lower Southern African Customs Union (SACU) revenues.¹² In addition, delays in implementing the structural reform agenda and a postponement of projects in the electricity and water sectors would lead to a weaker economic outlook (Annex III).

POLICY DISCUSSIONS

As the recovery strengthens, the overarching theme in the authorities' agenda revolves around fostering inclusive growth. Accordingly, while the discussions covered the macroeconomic policy mix and reforms to strengthen the financial sector and mobilize domestic revenue, the focus of the consultation was on measures to enable private sector growth, especially those to improve the efficiency of public investment, reduce costs of doing business, and build skills in the labor force.

¹¹ As noted on the Debt, Investment, Growth, and Natural Resources (DIGNAR) model simulation carried out as part of the 2015 Article IV consultation, different growth paths would emerge in Botswana depending on the ambitiousness of reforms, their speed, and the extent to which the efficiency of public investment is improved in the near term. The results suggested that a more ambitious implementation of reforms and efficiency improvements in the public sector could push annual GDP growth rates towards 5-6 percent in the medium to long-term.

¹² The effects of economic instability in South Africa are mitigated by the fact that more than 95 percent of Botswana's exports go to other countries. For instance, recent political turmoil in South Africa and a downward revision of debt ratings had no impact on Botswana's investment grade ratings. Regarding SACU revenues, a reform of the SACU revenue-sharing formula has been on the agenda for several years but no decision has been made in light of concerns expressed by Botswana, Lesotho, Namibia, and Swaziland. The baseline projections do not assume a change in the formula.

A. Policy Mix and Reforms to Support Economic Stability

12. **The near-term fiscal stance is appropriate.** During 2017/18 and 2018/19, a mildly expansionary stance entailing small fiscal deficits is consistent with a residual non-mining output gap estimated to be about 1 percent (Table 3). Revenues are projected to increase slightly in 2017/18 and decline in 2018/19 because of changes in SACU receipts,¹³ while the composition of spending will appropriately shift towards investment in infrastructure (especially projects in the transport and water sectors).¹⁴

13. **From FY2019/20 onwards, higher fiscal revenues and constrained spending are expected to result in fiscal surpluses.** Domestic revenues are projected to increase in response to tax administration reforms (see below), while modest increases in the wage bill and lower transfers to parastatals are projected to lead to a string of fiscal surpluses. This stance is appropriate given the need to contain the growth of already high levels of public sector wages and to rationalize parastatals. Consequently, the public debt-to-GDP ratio is projected to fall over the projection period and remain within its legislated ceiling of 40 percent (Annex IV).

14. **The scope for further interest rate cuts is limited, while credit growth is likely to remain subdued.** Since the economy is recovering and inflation is slightly higher (albeit low), the authorities' monetary policy stance is neutral. As the negative output gap is estimated to be closed by 2019, the authorities and staff agreed that possible interest rate hikes in the U.S. and elsewhere or domestic inflationary pressures could require a tightening of monetary policy. At the same time, credit to the private sector is expected to grow modestly reflecting gradual growth in personal incomes and household deleveraging.

¹³ SACU revenues depend mainly on South Africa's projected customs and excise revenues and are shared across countries based on a formula (based on countries' imports and GDP levels). The formula includes an adjustment mechanism where any over/underpayment from past forecasting errors is recouped two years later. These revenues tend to be quite volatile because: i) imports are more volatile than GDP; ii) custom receipts are affected by exchange rate developments; and iii) the adjustment mechanism tends to exacerbate the procyclicality of revenues (e.g. during bad times SACU revenues are lower due to reduced customs and excise receipts, and, to make things worse, this is usually accompanied by the repayment of past over-receipts as the downturn was most likely unanticipated and thus past receipts were too elevated). For Botswana, in addition, SACU revenues as a share of GDP have been on a declining path given low growth in South Africa and high GDP growth in Botswana. In FY2017/18, SACU revenues are expected to increase due to an adjustment aimed at compensating the underpayment in FY2015/16. In the following years, SACU receipts are expected to decline in line with projections of subdued GDP growth in South Africa.

¹⁴ The composition of revenue in the baseline differs slightly from the 2017/18 budget. On the one hand, the authorities expected VAT collection to increase rapidly owing to improvements in tax administration. While these gains may be feasible, the baseline projections are somewhat more conservative because of capacity constraints at the Botswana Unified Revenue Service. On the other hand, projections of mineral revenues are more optimistic than in the budget because of recent improvements in the diamond market outlook. The expenditure figures in the baseline are in line with the budget which envisages higher capital expenditures and a temporary increase in the wage bill which is almost entirely related to a training program that required the hiring of temporary teachers. In the medium-term, only some of the new hires are expected to become permanent and, consistent with the authorities' fiscal consolidation goals, the wage bill is projected to grow broadly in line with inflation but fall as a share of GDP.

15. **Botswana's external position is sound.** The external position is broadly consistent with fundamentals and desirable policy settings (Annex II). The external current account balance has been in surplus in most years and is expected to remain positive throughout the projection period, while international reserves and the net international investment position are also expected to improve over time. The real effective exchange rate has only appreciated slightly during the past decade (it is currently 2 percent above its 10-year average) and its volatility has been modest, partly a reflection of the exchange rate framework based on annual reviews to the rate of crawl and basket weights to reflect changes in trade patterns and expected inflation differentials.¹⁵ This policy is based on sound principles and continues to be appropriate.

16. **Risks to the financial system are contained and financial supervision reforms will strengthen the system's soundness.** The team endorsed the authorities' plans to set up the macroprudential policy function to enhance supervisory risk analysis, set up macroprudential measures as needed, and strengthen coordination among supervisors. It encouraged the authorities to proceed with plans to finalize the implementation of Basel II requirements in line with previous Fund advice; address the shortcomings identified by a recent assessment of the AML/CFT framework;¹⁶ build up a legal framework and prepare a contingency plan for crisis resolution; and move toward risk-based supervision of non-bank financial institutions (Selected Issues, Chapter I). The team also suggested setting up a legal department at the Bank of Botswana to advise on legal matters and monitor and update the legal framework.

17. **Despite improved prospects in the global diamond market, revenue mobilization will be important to ensure stability and fund government outlays.** The authorities agreed that there is a significant potential to boost domestic revenues through tax administration and tax policy reforms that could further insulate Botswana from fluctuations in diamond revenues or receipts from the Southern Africa Customs and provide additional funding for future fiscal expenditures.

18. **A number of tax administration reforms are underway, but implementation has been challenging.** Since 2015, the authorities instituted a requirement for electronic filing of taxes and set up a risk management unit at the Botswana Unified Revenue Service, although collection efficiency has been hampered by administrative costs and other constraints.¹⁷ Looking ahead, the authorities need to expedite the passage into law and implement the new Tax Administration Act

¹⁵ The current basket weights are justified by the pattern of trade between Botswana and its main trading partners (most exports go to countries whose currencies are in the SDR basket and most imports are from South Africa).

¹⁶ Botswana's anti-money laundering and combatting of terrorism (AML/CFT) regime is not yet fully developed. The Eastern and Southern Africa Anti-Money Laundering Group carried out an evaluation in May 2017 highlighting several shortcomings and providing recommendations to improve Botswana's compliance with the 2012 Financial Action Task Force standards and strengthen the effectiveness of the AML/CFT system.

¹⁷ For instance, the requirement for universal filing of personal income tax returns has yet to deliver improved compliance but it has raised administrative costs, while the uptake of electronic filing by taxpayers has been constrained by frequent system downtime and requirements to provide supporting documents manually.

(which modernizes tax procedures) and strengthen the audit and risk functions of the Large Taxpayers Unit (which collects the bulk of tax revenue).

19. **Tax policy reforms can also be usefully considered.** First, the authorities could streamline VAT exemptions and replace those used for social purposes (e.g. on food items and transportation services) with targeted social transfers. Second, they could simplify the personal income tax by instituting a single rate final withholding tax on all passive capital income and capital gains¹⁸ and relieving employees with a single source of labor income and no active capital income from filing annual tax returns. Third, they could accelerate plans to register and re-evaluate properties to broaden the tax base and geographic coverage. Lastly, they need to ensure that any corporate income tax concessions (including on economic zones) are granted sparingly and in the form of accelerated depreciation schemes or investment tax credits (Selected Issues, Chapter II).

20. **The authorities generally concurred with the staff assessment and recommendations.** Regarding monetary policy, they appreciated the staff's assessment and reiterated their commitment to stay vigilant if inflation were to approach the upper band of their objective range. They also noted the importance of continued Fund technical assistance on financial supervision and regulation. Regarding taxation, they emphasized that recent reforms in tax administration should lead to higher domestic revenue collection but acknowledged that results may not be immediate. Lastly, they agreed on the need to expedite remaining tax administration reforms and consider tax policy changes, although they indicated that the latter may take some time to be developed and implemented.

B. Fostering Inclusive Growth

21. **Despite high rates of economic growth during the past two decades, unemployment remains high.** Growth has been centered on diamond production and diversification away from diamonds has been rather slow and non-linear.¹⁹ The public sector has become the main source of employment (it now accounts for 52 percent of total employment) but there is no room for further expansion. In sum, the capital-intensive nature of mining activities and the limited expansion of the private sector have then been reflected in persistently high rates of unemployment, including youth unemployment (33.3 percent in 2016), as well as in high income inequality (the Gini index compiled in 2010 is about 60, higher than in most middle-income countries).

22. **Efforts to diversify the economy and create employment have been hampered by several constraints.** The authorities formulated plans to improve the business environment and foster education and skills development and attempted to promote the expansion of several

¹⁸ Dividends are currently subject to final withholding taxation. The proposed reform is to generalize this form of taxation for all passive capital income and capital gains and set a single rate for all.

¹⁹ Although the share of mining in GDP fell from 34 percent in 2000 to 20 percent in 2016, the data masks the direct and indirect impact of diamonds given the expansion of the downstream segment (recorded as non-mining).

sectors.²⁰ These efforts, however, proved too ambitious considering capacity constraints and coordination problems, leading to unsatisfactory results. According to a number of surveys (Doing Business, Global Competitiveness Report, Central Bank's Expectations Survey) the main impediments to private sector development have been weak contract enforcement, lack of access to reliable electricity, an unskilled labor force, concerns about permits for foreign workers, weaknesses in health and education services, and a small domestic market (Figure 3).

23. **A focused and determined approach will be needed to foster inclusive growth.** In the latest National Development Plan (NDP11), the authorities recognize these shortcomings and discuss several strategies, including the development of selected clusters (Box 1). The next step should be to devise and/or implement a few plans with a manageable set of high-impact measures to improve the efficiency of the public sector, build skills in the labor force, and foster the development of a competitive private sector.

C. Improving the Efficiency of the Public Sector

Public Financial Management

24. **Improvements in public financial management will strengthen growth prospects.** Public sector capacity to deliver services and carry out investment projects needs to be improved. In this regard, staff welcomed the adoption of a 2017/2018 work plan to implement the authorities' Public Financial Management Reform Program. The main steps envisaged are to: i) continue with the development of the Medium-Term Expenditure Framework;²¹ ii) implement the 2014 Government Finance Statistics Manual including a more accurate classification of recurrent and development expenditures;²² iii) review and update public investment management practices in line with the recent Public Investment Management Assessment;²³ and iv) amend the Public Procurement and Disposal Act to ensure consistency with the Public-Private Partnership (PPP) Policy and the Implementation Framework of 2009.²⁴ The staff noted that, given the ambitious investment plans

²⁰ Some sectors (e.g. textiles and auto parts) were seen promising, but this proved not to be the case as there was no actual or potential comparative advantage in such activities.

²¹ There has been good progress with the medium term fiscal framework (MTFF), but some reforms need to be accelerated. For instance, the budget needs to be fully unified and have an overview of fiscal risks, especially those coming from parastatals, and the MTFF should contain projections of capital expenditures. In addition, coordination between the current and capital budgets need to be strengthened, particularly between recurrent spending and maintenance of development projects.

²² This will require reclassifying recurrent activities currently funded under the development budget to the recurrent budget (non-capital expenditures in the development budget are estimated to be as high as 40 percent), including operational (recurrent) transfers to SOEs (for instance to finance electricity subsidies) as some of these transfers are classified as development expenditure.

²³ A Public Investment Management Assessment conducted in May 2017 estimated an efficiency gap of 37 percent, higher than the emerging markets' average of 27 percent. The assessment identified deficiencies in project appraisal and implementation (particularly for mega-projects) behind the relatively low efficiency of public investment.

²⁴ Although PPPs were previously procured under the Public Procurement and Disposal Act, the act is not aligned with the PPP policy and the absence of a dedicated PPP framework leads to regulatory uncertainty and (*continued*)

under NDP11, urgent efforts will be needed to upgrade the framework for appraising, prioritizing, and implementing public investment. At the same time, the authorities' intentions to scale up the use of PPPs for infrastructure projects will necessitate an upgrade of capacity at the recently established PPP unit. Lastly, the staff encouraged the authorities to focus also on enhancing the efficiency of education spending to address the issue of skill mismatches in the labor market.

State-Owned Enterprises

25. **Reforms to improve the efficiency and financial viability of government enterprises will safeguard public finances, lower costs, and promote private sector development.** State Owned Enterprises (SOEs) are economically relevant in Botswana but their financial performance, while improving, is generally weak. They operate in key service and network industries, often in monopoly positions, and their assets amount to about 32 percent of GDP. Many SOEs are not financially viable: with a few exceptions, commercial enterprises operate at a loss with high leverage ratios and constitute a burden to public finances in the form of budget transfers and, to a lesser extent, contingent liabilities.²⁵

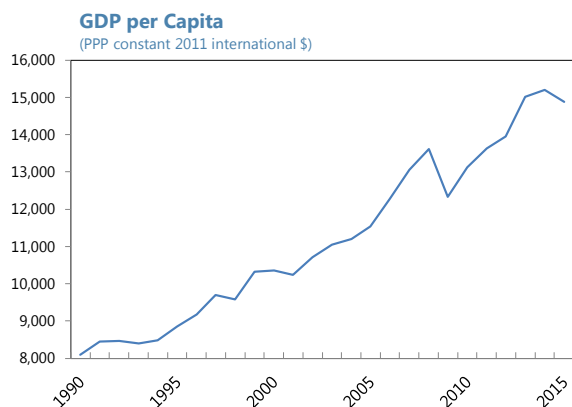
26. **Recognizing the role of SOEs and their problems, the authorities have started spearheading various initiatives.** Since 2015, they approved a privatization master plan and reforms have gained momentum, including with the partial privatization of the Botswana Telecommunications Corporation, the liquidation of the loss-making BCL mine, and advanced negotiations to sell the Morupule B Power Station to a private investor. In addition, the authorities have been working to improve SOEs' financial oversight, and a consolidation of parastatals that are not involved in commercial activities and have overlapping mandates is underway.

may expose the government to excessive risks. To begin promoting PPPs, the authorities created in 2015 a PPP unit within the Ministry of Finance and Economic Development.

²⁵ For instance, budget transfers to the Botswana Power Corporation alone amounted to 1.4 percent of GDP in 2016. While explicit public contingent liabilities (i.e. specified in debt contracts) of SOEs are equivalent to just 4.7 percent of GDP, implicit contingent liabilities could be higher since debt to commercial banks amounted to 18 percent of GDP.

Figure 3. Botswana: Unemployment and Competitiveness

Botswana has experienced high rates of economic growth in the past two decades.



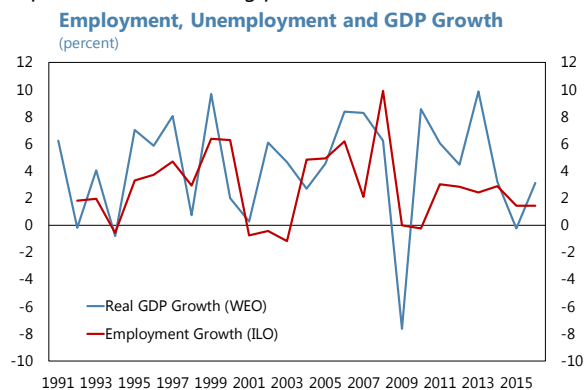
According to the World Bank's Doing Business report, Botswana underperforms its peers with respect to electricity access and enforcement of contracts.



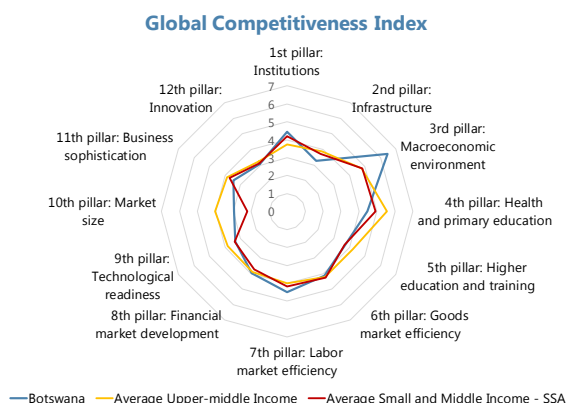
Furthermore, corporates interviewed by the WEF highlight "work ethics" as a concern...



However, unemployment had remained high and does not co-move with GDP growth which is dominated by capital-intensive mining production.

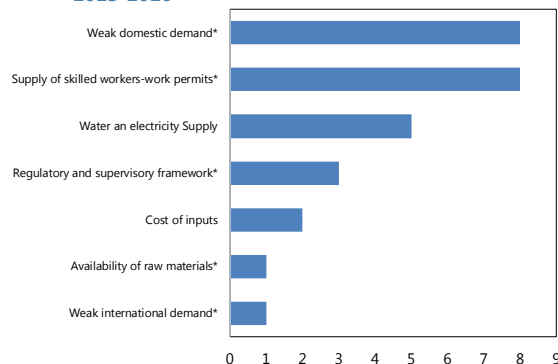


The 2016–17 World Economic Forum (WEF) Index points to education and health, infrastructure, and market size as additional constraints.



...while the central bank expectations survey reveals that the lack of supply of skilled workers and a rigid policy on foreign workers' permits are key obstacles.

Central Bank Expectations Survey- Challenges 2013-2016



Sources: International Labor Organization, World Economic Outlook, World Bank Doing Business database, WEF, and BoB.

Box 1. Botswana's Eleventh National Development Plan, 2017–2023

Botswana's 11th National Development Plan (NDP 11) was launched in April 2017. It is the outcome of a participatory process that involved consultations with various stakeholders, including the private sector and civil society. The Plan aims at addressing three key challenges: unemployment, poverty and income inequality. It envisages an average level of development spending of about 8 percent of GDP per year and an annual rate of real GDP growth of 4.4 percent. The Plan is quite comprehensive and identifies the key challenges. It comprises several strategies to promote growth and create employment, most notably in the following areas:

- **Economic Diversification.** The plan specifies the following clusters: mining beneficiation (especially diamonds, copper, and nickel), tourism, beef, financial services, education, and health services, with the last two being critical to build human capital with economy-wide benefits rather than sectors where comparative advantage can be developed. In addition, it discusses ongoing work to set up a few Special Economic Zones and the need to promote small and middle-sized enterprises.
- **Export-Led Growth.** The authorities plan to promote exports of goods and services based on comparative advantage and analysis.
- **Private Sector Environment.** This entails a stable macroeconomic environment, a highly productive and trained workforce, good quality infrastructure, an efficient regulatory framework, security of investments and contracts, good governance, good work ethics, speedy approvals of work and residence permits, visas, licenses, and allocation of land.
- **Regulatory Framework for Doing Business and Global Competitiveness.** A Cabinet Committee on Doing Business and Global Competitiveness will remain during NDP 11 to coordinate reforms facilitate doing business and improve competitiveness.
- **Infrastructure.** The scaling up of public infrastructure and maintenance of existing infrastructure will be a priority, with the private sector playing a major role in this endeavor (through Public-Private Partnerships).
- **Information and Communication Technology.** Facilitate equitable and affordable access to broadband connectivity and services and universal access to reliable high speed networks.

The Plan also mentions the importance of boosting implementation capacity in the government by improving coordination among relevant agencies, using a dedicated unit to undertake large investment projects; improving and accelerating the tendering and adjudication of projects; ensuring adequate supervision and sanctions for noncompliance of contractors to avoid cost overruns and delays, implementing a privatization policy and a public service outsourcing program, and setting up a monitoring and evaluation system.

While NDP11 has the right goals and strategies, the next step is to formulate plans in selected areas containing specific and time-bound deliverables. In addition to plans already formulated (Doing Business Action Plan, Public Financial Management Reform Program, plan to review and update public investment management practices), it will be important to develop more concrete plans to (i) improve education outcomes and develop skills in the labor force; (ii) ensure appropriate investments based on sound cost-benefit analyses and potential externalities (e.g. information and communication technology); and (iii) support the development of selected sectors with potential comparative advantage (these issues are further discussed in Sections B.1–B.3 of this report).

27. **Staff welcomed the authorities' initiatives and recommended additional reforms.** The main recommendations were: (i) to strengthen coordination among the entities involved in monitoring parastatals (line Ministries, the Ministry of Finance and Economic Development, the Public Enterprises Evaluation and Privatization Agency (PEEPA)) to ensure effective financial oversight; (ii) to avoid the creation of additional parastatals to prevent overlapping mandates, duplication of activities, and waste of resources; (iii) to accelerate the privatization of two enterprises: Air Botswana and the National Development Bank;²⁶ and (iv) for other commercial enterprises slotted for privatization, to enforce any reforms needed to improve their operations and set a timetable for privatization or liquidation to prevent continued losses.

Electricity and Water

28. **Efforts are under way to improve provision of electricity and water.** The availability of electricity and water has recently improved. Following intensive repairs, the Morupule B power station began operating at full capacity in late 2016. Water supply also improved, as dams received large rain inflows following two years of drought. Going forward, the authorities have important plans to boost electricity generation and expand the transmission network within the next 5 years.²⁷ Regarding water supply, a second North-South water carrier is expected to be completed by 2022 and other large projects are also under consideration.²⁸ At the same time, efforts will be needed to reduce water losses, especially by improving the maintenance of the existing infrastructure.

29. **The authorities are also taking steps to improve governance and efficiency in the electricity sector, although financial self-sufficiency is yet to be achieved.** An international expert has been hired as CEO of the Botswana Power Corporation and a plan to improve the financial sustainability of the company has been developed with the goal of reaching financial self-sufficiency by 2022. This entails downsizing the company, shifting the production of electricity to the private sector while maintaining the distribution side, and gradually liberalizing tariffs. While a new regulator (Botswana Energy Regulatory Authority) has been established, tariffs may not be immune to political pressure as the government will have the final say on tariff setting.

²⁶ The National Development Bank (NDB) was established in 1963 to promote the economic development through loan financing to private sector activities, particularly in agriculture. With assets estimated at less than 3 percent of total banking system assets, NDB is small compared to commercial banks. NDB is a statutory bank and is not subject to supervision from Bank of Botswana. On its last two audits in 2014 and 2015, NDB recorded negative profits.

²⁷ The plans include: construction of the Morupule B 5 and 6 power stations (300MW in total), expected to enter in production in 2021, the Morupule 7 and 8 stations (150MW and 300MW, respectively), expected to start production in 2022, and a solar power plant (100MW), expected to be completed in 2019. Except for Morupule B 5 and 6, the other projects are still at a planning stage.

²⁸ These include the Chobe-Zambesi transfer scheme for agricultural irrigation in the Pandamatenga area (eventually it could be linked to the North-South carrier), the Lesotho highlands water transfer (through South Africa), and the Botswana/Namibia/South Africa underground aquifer. In addition, the Government and IBRD recently signed a US\$145 million loan agreement for an emergency water security and efficiency project that will help reduce water supply disruptions.

30. **Looking ahead, the priorities regarding electricity and water services should be to:**

(i) make the energy regulator fully operational to adequately monitor the sector and ensure that prices charged by private power generators are in line with marginal costs; (ii) review the structure of electricity subsidies with a view to set rates in line with commercial criteria and avoid political interference (to protect the poor, consideration could be given to replace the implicit subsidies to consumers with a targeted scheme of direct transfers)²⁹; and (iii) lower non-revenue water losses by improving maintenance of the existing infrastructure.

31. **The authorities broadly agreed with the staff assessment and recommendations.** They noted that their public financial management reform agenda is a result of successful technical cooperation with the IMF's Fiscal Affairs Department and the Southern Africa Technical Assistance Center and other development partners. They acknowledged the importance of strengthening capacity and efficiency in SOEs and concurred on the need to strengthen financial oversight by enhancing coordination among relevant government agencies. Nevertheless, they indicated that building consensus within the government on the need to consolidate SOEs might require some time. On electricity tariffs, they observed that replacing electricity subsidies with targeted cash transfers might prove difficult given the lack of reliable data on the poverty status. In this regard, while efforts to improve data collection proceed, the authorities could limit increases for lower-income households.

D. Building Skills in the Labor Force

32. **Over the past couple of decades, Botswana has made large investments in education with mixed results.** Public investment in education averaged more than eight percent of GDP annually and accounted for almost one quarter of total government spending, contributing to substantial increases in the primary enrolment rate (from 80 in 2000 to 93 percent in 2014) and a reduction of illiteracy among the working age population. Similarly, attempts were made to reduce skills' mismatches by creating the Human Resource Development Council (HRDC).³⁰ However, significant shortcomings remain, particularly regarding weak test scores in secondary and tertiary education and concerns expressed by the private sector about skills mismatches and work ethics.³¹

²⁹ Current electricity tariffs in Botswana are set below the cost of supply, with a tariff/cost gap estimated to be around 40 percent. The corresponding loss in the BPC budget is covered with fiscal transfers from the central government.

³⁰ HRDC was established in 2013 in a supervisory capacity and as advisor to the Government on human resource development. It coordinates efforts by all parties to study Botswana's education and skills development mechanism, assesses its impact on national priorities, and mutually agrees on targeted solutions. One of its responsibilities is the administration of the labor market observatory, a tool intended to reduce information frictions in the labor market. However, the observatory is not yet fully operational and, while the HRDC can provide the needed bridge between the private sector, the education system and the government, this goal remains to be achieved.

³¹ There is a considerable gap in Botswana's student test scores relative to international peers at the secondary level. In addition, tertiary education is seen to be out of line with labor market needs (World Bank, 2015 Systematic Country Report).

33. **There is need to move expeditiously with reforms to address education inefficiencies and skill mismatches.** On one hand, the implementation of the Education & Training Sector Strategic Plan (ETSSP), launched in 2015 and aiming at improving education outcomes (both in quality and quantity) needs to be accelerated given the delays associated with the recent institutional changes and capacity constraints. On the other hand, the Decent Work Country Program (DWCP) that was supposed to have been implemented between 2011 and 2015 has been extended to 2017 in consultation with the International Labor Organization (ILO).³² In this connection, the authorities will need to strengthen capacity and accountability at the HRDC to achieve a constructive dialogue with the private sector on the education system and skills buildup, unify the graduates' registry with the database for internships and make it available to the private sector without restrictions, and use this information to keep an updated registry of scarce skills to assist the immigration system (Selected Issues, Chapter III). Most of the above reforms are supported through cooperation with the European Union.

34. **Measures to deal with concerns about restrictive practices on immigration and work permits are also important.** On a positive note, the authorities have recently amended the immigration law to empower the Ministry of Nationality, Immigration and Gender Affairs to grant permanent residency status to foreign investors who have resided in Botswana lawfully for a period of less than five years. However, the process of getting work permits remains long and uncertain as requests are sometimes rejected without explanation. In this context, the staff recommended to adopt clear criteria for granting work permits within a short time frame, allow for longer durations as warranted, and report the reasons for rejections. These steps could reduce the appeal rate, help increase private investment, and facilitate the transfer of skills to the domestic labor force.

35. **The authorities broadly concurred with the staff assessment and recommendations.** They indicated that they intend to address the problem of lack of skills by pressing ahead with the recently approved ETSSP. Regarding permits for foreign workers, the authorities highlighted that their legislation already allows hiring foreigners with skills that are not present in the country but recognized that procedures might need streamlining. They also indicated that they want to avoid a bias in favor of foreign workers, as expatriate entrepreneurs frequently prefer workers from their countries even if local workers have the required skills.

E. Enabling Private Sector Development

36. **A range of measures to lower the costs of doing business and improve access to credit have been identified, but implementation needs to be accelerated.** In 2015, the authorities, in cooperation with the World Bank, developed a Roadmap³³ which contains important measures to facilitate the process to start a business, obtain construction permits, register property, enforce contracts, improve access to credit, and facilitate trade. However, only about one-third of the

³² The program is delivered with the support of the ILO and focuses on youth employment, social protection and workplace responses to HIV/AIDS, and labor standards and workers' rights.

³³ Reforming Botswana's Business Environment-Doing Business Reforms Roadmap and Implementation Plan, 2015.

envisaged measures have so far been carried out, highlighting the importance of strengthening capacity, ownership, and accountability in the entities responsible for implementation. These measures would complement the above-mentioned reforms to facilitate visa procedures and permits for foreign entrepreneurs and workers which have been consistently mentioned as a challenge for doing business by the business community.

37. The authorities expressed their intention to move forward with the measures contained in the Roadmap. They plan to submit to Parliament related legislation this year and, going forward, submit to cabinet regular updates on the reforms to strengthen monitoring and accountability. The key measures are to create a one-stop shop for businesses, introduce risk-based inspections to speed up granting construction permits, broaden the scope of the creditor database to include both positive and negative credit data, allow lenders to enforce securities out of court through collateral agreements, establish a collateral registry for immovable and movable assets, and implement the Making Access Possible Plan to foster financial inclusion.³⁴ The latter will be critical to facilitate a much-needed expansion of credit to small and medium enterprises.

38. Efforts to diversify the economy need to focus on removing distortions and improving competitiveness. NDP 11 identifies some key sectors (clusters) such as mining beneficiation, tourism, beef, and financial services and the authorities may pursue industrial policies to promote these sectors. In this context, and considering capacity constraints, high transport costs, the difficulties to increase economic integration with South Africa, and the risks associated with industrial policies, the staff suggested proceeding with an approach based on lowering costs and removing distortions (e.g. securing access to water and electricity, improving information technologies). If the authorities pursue industrial policies, they should first evaluate the potential comparative advantage of any activity and formulate time-bound quantitative targets for the reforms and projects envisaged, ensuring minimal government intervention and defined exit clauses (if results are disappointing).³⁵

39. The authorities should exercise caution with plans to set up special economic zones. Beyond the above-mentioned clusters, NDP 11 envisions eight economic zones.³⁶ However, insufficient vertical integration, expensive inputs, lacking infrastructure, and high transport costs limit the scope to set up profitable production facilities. Given these constraints and the mixed experience with economic zones elsewhere, the authorities' approach not to proceed with all zones at once and

³⁴ In 2015, the authorities finalized a "Making Access Possible Plan" that aims at extending financial services to small and medium enterprises and into underserved areas and includes important measures to improve the payments system and adopt a sound regulatory framework for mobile money.

³⁵ For example, the authorities are developing plans to exploit the country's comparative advantage in tourism (wildlife). So far, the authorities have relied on a conservative high-value and low-volume strategy which implied a limited contribution of the sector to employment and the economy, yet this sector seems to be the one with the largest potential aside from diamonds to generate employment gains and foreign exchange.

³⁶ The eight sites identified for development of these zones are in different parts of the country, namely Gaborone, Fairgrounds, Sir Seretse Khama International Airport, Pandamatenga, Lobatse, Palapye, Tuli Block, Selebi-Phikwe and Francistown. There is also the possible inclusion of Kasane as an additional zone. A pilot zone master plan was completed in 2015 and a Special Economic Zones Authority Board was appointed in 2016.

to monitor results and change course as needed is appropriate. Moreover, the staff recommended to focus on streamlining regulation and concessions rather than on fiscal incentives, and, if fiscal incentives are used, to rely on them sparingly and in the form of accelerated depreciation schemes or investment tax credits rather than tax holidays.

40. **The authorities broadly agreed with the staff recommendations.** They indicated that the cabinet has decided to move ahead with the reforms contained in the roadmap for reforming Botswana's business environment. They also underscored that fostering the development of the private sector in a cost-effective manner is at the core of their development strategy. They expressed concerns, however, that domestic entrepreneurship is weak, which in their view partially explains Botswana's lack of economic diversification despite several initiatives taken in the past. Lastly, the authorities took note of the staff advice to exercise caution with industrial policies, to narrow the focus of any sectoral strategy, and to avoid or minimize government intervention and fiscal incentives. They saw, however, a risk that focusing only on a handful of sectors may entail losing opportunities to develop other sectors.

OTHER ISSUES

41. **The quality of macroeconomic data is adequate for surveillance.** Botswana was the first country to subscribe to the Fund Enhanced General Data Dissemination System (e-GDDS) in January 2016. However, several improvements in the quality of statistics are still needed, most notably to address volatile and large errors and omissions in the balance of payments³⁷ and the incorrect classification of fiscal expenditures items (See Informational Annex).

42. **Lastly, the mission worked with the authorities to harmonize surveillance and policy priorities with technical assistance priorities in the period ahead.** The authorities are highly appreciative of the IMF's technical support from headquarters and from the Regional Technical Assistance Center in Southern Africa. Consistent with the policy priorities discussed during the mission and the areas of Fund expertise, it was agreed that the main areas of technical cooperation with the Fund in the coming year will be revenue mobilization, expenditure management (including oversight of SOEs, the Medium-Term Expenditure Framework, and fiscal reporting), micro- and macroprudential supervision, crisis resolution, monetary operations, and real sector, fiscal, and price statistics.

STAFF APPRAISAL

43. **The economy is undergoing a cyclical recovery and the outlook is broadly positive.** Supported by a gradual rebound in the global diamond market and public investment, annual real GDP growth is projected to approach 5 percent in the near term while prudent financial policies are

³⁷ A recent technical assistance mission from STA concluded that the errors and omissions likely result from unrecorded capital outflows (possibly related to FDI).

expected to maintain inflation within the 3–6 percent objective range set by the BoB. In the medium-term, the outlook is also positive and risks are balanced.

44. **The authorities' macroeconomic policies are appropriate.** The fiscal stance articulated in the 2017/18 budget and the MTEF entail small deficits over the next two fiscal years and a rebalancing of expenditure composition toward development spending. This is consistent with a small output gap and the need to upgrade the water and electricity infrastructure. Starting in 2019/20, the MTEF envisages returning to fiscal surpluses, with a tighter control of the wage bill and of transfers to parastatals. At present, the authorities' neutral monetary policy stance is appropriate as there does not seem to be room to lower interest rates. Botswana's exchange rate regime continues to serve the country well.

45. **Domestic revenue mobilization will provide added funding for development spending and help protect buffers.** Given the volatility of diamond and SACU revenues and a relatively low domestic tax effort, there is a need to pass into law and implement the new Tax Administration Act as well as to strengthen the Large Taxpayers' Unit. In addition, it would be important to consider streamlining VAT exemptions, simplifying the personal income tax, and accelerating plans to register and re-evaluate properties.

46. **Further financial sector reforms will bolster stability.** The authorities should proceed with plans to set up the macroprudential policy function and improve the AML/CFT framework, establish a crisis resolution framework, finalize the implementation of Basel II requirements, and strengthen risk-based supervision of nonbank financial institutions.

47. **Fostering private sector growth will require determination and focus on key reforms.** Achieving the long-sought objectives of inclusive growth and diversification will require political commitment, improved capacity and coordination among government agencies, and focus on a few plans with a manageable set of high-impact, time-bound, monitorable reforms. In this context, the authorities need to press ahead with the key measures discussed to strengthen the efficiency of the public sector, build skills in the labor force, and create an enabling environment for the expansion of the private sector.

48. **Public sector reforms could enhance growth prospects.** In this regard, the priorities should be to proceed with measures to improve the planning, prioritization, and execution of public investment programs; build capacity in the management of public-private partnerships; improve the financial monitoring and evaluation of SOEs and accelerate the privatization of key loss-making enterprises; make the energy regulator fully operational; review the structure of electricity subsidies to set rates in line with commercial criteria and avoid political interference; and lower water losses.

49. **Similarly, there is a need to proceed with measures to enhance education outcomes and reduce skill mismatches.** The authorities need to accelerate the implementation of the strategic plan aimed at enhancing the quality of instruction and training across education levels. Deepening the dialogue and coordination with the private sector is also relevant to improve education outcomes and address skill-mismatches, as is easing the process to grant work permits to

foreign workers with skills that are not present in the country. These actions will ultimately foster private sector development and facilitate the transfer of skills to the domestic labor force.

50. **Selected reforms to lower the costs of doing business and foster financial deepening will also promote private sector development.** In this regard, there is a need to accelerate the implementation of the 2015 Roadmap to improve the business environment, especially establishing a one-stop shop to start businesses, introducing risk-based inspections to speed up granting construction permits, broadening the scope of the creditor database to include both positive and negative credit data, allowing lenders to enforce securities out of court through a collateral agreement, establishing a collateral registry for immovable and movable assets, and implementing the Making Access Possible Plan to foster financial inclusion.

51. **Lastly, efforts to diversify the economy can usefully focus on removing distortions and improving competitiveness.** Capacity constraints, high transport costs, and the risks associated with industrial policies argue for an approach based on removing distortions and investing wisely in key public infrastructure. If industrial policies are pursued, the authorities should undertake careful cost-benefit analysis and ensure minimal government intervention. Furthermore, fiscal incentives and tax concessions (including in economic zones) should also be carefully evaluated and, if granted, be in the form of accelerated depreciation schemes or investment tax credits.

52. The staff recommends that the Article IV consultation with Botswana be held on the standard 12-month cycle.

Table 1. Botswana: Selected Economic and Social Indicators, 2014–2022

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Prel.			Projections			
(Annual percent change, unless otherwise indicated) ¹									
National income and prices									
Real GDP	4.1	-1.7	4.3	4.5	4.8	4.6	4.3	4.3	4.2
Mineral ²	0.5	-19.6	-3.7	-0.3	4.7	3.6	0.9	2.1	2.1
Nonmineral	4.9	1.7	5.5	5.1	4.8	4.7	4.7	4.5	4.4
Consumer prices (average)	4.4	3.1	2.8	3.7	3.7	3.8	3.9	3.9	4.0
Diamond production (millions of carats)	24.7	20.8	20.9	21.5	22.5	23.3	23.5	24.0	24.5
External sector									
Exports of goods and services, f.o.b. (US\$)	7.6	-22.4	1.6	6.2	3.9	5.1	4.7	4.1	3.8
<i>Of which: diamonds</i>	10.4	-28.4	15.5	-4.2	3.7	5.1	4.6	3.7	3.7
Imports of goods and services, f.o.b. (US\$)	-3.6	-10.2	-14.2	27.0	4.8	3.6	3.6	3.1	3.1
Terms of trade	8.6	0.1	-0.1	14.4	-1.1	0.0	-0.2	-0.1	-0.8
Nominal effective exchange rate	-0.2	0.0	0.2	...	...	...	...	...	...
Real effective exchange rate	0.4	0.6	-0.3	...	...	...	...	...	...
Money and banking									
Monetary Base	-8.5	18.6	3.7	5.0	7.2	7.6	8.7	9.7	9.0
Broad money (M2)	4.6	19.9	5.4	5.3	7.4	8.0	9.4	10.0	9.2
Credit to the private sector	13.7	9.0	9.0	6.3	5.9	3.1	4.8	9.2	9.9
(Percent of GDP, unless otherwise indicated)									
Investment and savings									
Gross investment (including change in inventories)	27.9	32.1	23.8	25.1	26.3	26.8	27.3	27.6	27.7
Public	8.2	8.8	8.6	9.0	9.2	8.3	7.7	7.3	7.1
Private	19.6	23.3	15.3	16.1	17.1	18.5	19.6	20.3	20.5
Gross savings	43.2	40.5	42.1	29.5	29.1	29.4	30.5	31.2	31.5
Public	19.8	16.1	15.6	16.9	15.9	15.8	16.0	16.2	16.4
Private	23.5	24.4	26.5	12.6	13.2	13.7	14.5	15.0	15.2
Central government finances³									
Total revenue and grants	38.4	31.3	31.9	32.4	30.3	30.3	30.6	30.6	30.6
Total expenditure and net lending	34.7	35.8	33.1	32.5	31.9	30.1	29.8	29.1	28.9
Overall balance (deficit –)	3.7	-4.6	-1.1	-0.1	-1.6	0.2	0.7	1.5	1.8
Non-mineral primary balance ⁴	-16.1	-18.1	-18.0	-15.4	-17.4	-15.2	-14.4	-13.4	-12.9
Total central government debt	22.3	21.7	20.1	19.8	19.1	17.0	15.4	13.7	12.2
External sector									
Current account balance	15.2	8.3	11.7	4.5	2.8	2.6	3.1	3.6	3.9
Overall Balance	3.7	-5.4	-2.3	3.3	2.0	2.0	3.1	3.6	3.9
External public debt ⁵	17.2	17.2	14.9	14.6	12.7	11.0	10.0	8.7	7.6
o/w public and publicly guaranteed	4.8	5.3	4.7	4.4	4.2	3.9	3.7	3.5	3.3
(Millions of U.S. dollars, unless otherwise indicated)									
Gross official reserves (end of period)	8,323	7,546	7,189	7,742	8,092	8,451	9,046	9,744	10,546
Months of imports of goods and services ⁶	12.7	13.4	10.1	10.6	10.8	10.9	11.4	11.9	13.6
Months of non-diamond imports ⁶	18.6	18.0	14.6	15.3	15.5	15.7	16.4	17.2	19.1
Percent of GDP	54.3	58.1	45.3	46.6	46.6	47.1	48.2	50.5	52.1

Sources: Botswana authorities and IMF staff estimates and projections.

¹ Calendar year, unless otherwise indicated.² Projections are based on diamond production due to lack of information on the breakdown of mining value added by mineral.³ Year beginning April 1.⁴ The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.⁵ Includes central government-guaranteed debt.⁶ Based on imports of goods and services for the following year.

Table 2. Botswana: Balance of Payments, 2014–2022

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Prel.				Projections		
(U.S. dollars millions, unless otherwise indicated)									
Current account balance	2,477	1,192	1,824	746	484	478	593	698	791
Trade balance	522	-900	309	-1,064	-1,086	-987	-910	-869	-876
Exports, f.o.b.	8,519	6,300	6,376	6,758	7,027	7,399	7,762	8,086	8,396
Diamonds	7,282	5,216	6,023	5,773	5,987	6,292	6,582	6,825	7,076
Other raw materials	586	466	387	376	382	386	391	397	404
Other	652	617	665	608	658	721	789	864	915
Imports, f.o.b.	-7,997	-7,200	-6,067	-7,822	-8,112	-8,386	-8,672	-8,955	-9,271
Diamonds	-2,896	-2,496	-1,736	-2,677	-2,751	-2,857	-2,958	-3,041	-3,128
Other	-5,101	-4,704	-4,331	-5,145	-5,361	-5,529	-5,714	-5,914	-6,144
Services	578	691	724	751	684	701	717	764	837
Transportation	-17	17	-11	56	59	63	68	73	75
Travel	701	763	827	811	829	853	875	897	919
Other services	-107	-90	-92	-116	-204	-215	-226	-206	-157
Income	-346	-230	-254	-366	-389	-407	-413	-440	-463
Current transfers	1,724	1,633	1,047	1,426	1,275	1,170	1,199	1,244	1,292
SACU receipts	1,679	1,562	1,173	1,459	1,309	1,206	1,237	1,282	1,333
Capital and financial account	296	-708	-434	-194	-133	-119	2	0	11
Direct investment	404	511	-573	-155	75	145	200	220	255
Portfolio investment	-79	-989	10	-36	-40	-45	-49	-54	-79
Other investment	-29	-231	128	-3	-168	-220	-149	-166	-166
Assets	-113	-190	44	-55	-61	-62	-63	-64	-67
Liabilities	85	-41	84	53	-107	-158	-86	-101	-99
Net government long-term borrowing	30	-30	-122	8	-138	-197	-129	-146	-149
Other net private long-term borrowing	22	-41	-20	-14	-24	-19	-18	-19	-18
Short-term borrowing	33	31	27	29	27	29	30	32	34
Net errors and omissions	-2,176	-1,261	-1,746	0	0	0	0	0	0
Overall Balance	597	-777	-357	553	351	359	595	698	802
(Percent of GDP, unless otherwise indicated)									
Current account	15.2	8.3	11.7	4.5	2.8	2.6	3.1	3.6	3.9
Trade balance	3.2	-6.2	2.0	-6.4	-6.2	-5.4	-4.8	-4.4	-4.3
Exports of goods	52.4	43.6	41.0	40.4	40.1	40.6	41.0	41.2	41.2
Of which: diamonds	44.8	36.1	38.7	34.5	34.1	34.5	34.8	34.8	34.7
Imports of goods	49.2	49.9	39.0	46.8	46.3	46.0	45.8	45.7	45.5
Of which: diamonds	17.8	17.3	11.2	16.0	15.7	15.7	15.6	15.5	15.3
Services balance	3.6	4.8	4.7	4.5	3.9	3.8	3.8	3.9	4.1
Income and transfers balance	8.5	9.7	5.1	6.3	5.1	4.2	4.2	4.1	4.1
Financial account	1.8	-4.9	-2.8	-1.2	-0.8	-0.7	0.0	0.0	0.1
Direct investment	2.5	3.5	-3.7	0.3	0.9	1.1	1.4	1.4	1.8
Portfolio investment	-0.5	-6.8	0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.4
Other investment	-0.2	-1.6	0.8	0.0	-1.0	-1.2	-0.8	-0.8	-0.8
Net errors and omissions	-13.4	-8.7	-11.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (increase reserves +)	3.7	-5.4	-2.3	3.3	2.0	2.0	3.1	3.6	3.9
(Annual percentage change, unless otherwise indicated)									
Export volumes	4.1	-13.8	19.0	-17.0	2.6	3.9	3.4	2.6	2.3
Import volumes	2.3	5.1	-10.5	20.9	2.6	2.1	1.9	1.8	1.3
Terms of trade	8.6	0.1	-0.1	14.4	-1.1	0.0	-0.2	-0.1	-0.8
End-of-year reserves (US\$ millions)	8,323	7,546	7,189	7,742	8,092	8,451	9,046	9,744	10,546
Months of imports of goods and services ¹	12.7	13.4	10.1	10.6	10.8	10.9	11.4	11.9	13.6
Months of non-diamond imports ¹	18.6	18.0	14.6	15.3	15.5	15.7	16.4	17.2	19.1

Source: Bank of Botswana; IMF staff estimates.

¹ Based on imports of goods and services for the following year.

Table 3. Botswana: Central Government Operations, 2014/15–2022/23¹

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
				Prel.		Projections			
	(Billions of pula)								
Total revenue and grants	55.9	47.4	55.0	59.4	59.2	62.9	67.4	71.8	76.4
Total revenue	55.5	47.3	54.9	59.1	58.9	62.6	67.1	71.4	75.9
Tax revenue	37.6	33.9	35.8	41.8	40.4	42.7	45.9	48.9	52.0
Income taxes	15.9	12.2	17.9	18.1	19.6	20.9	22.5	23.9	25.4
Mineral	7.5	3.5	7.2	6.8	7.3	7.8	8.4	8.9	9.5
Nonmineral	8.4	8.7	10.7	11.2	12.3	13.0	14.1	15.0	15.9
Taxes on goods and services ²	5.7	5.5	5.8	6.3	7.0	7.8	8.5	9.2	9.8
Customs Union receipts ³	15.7	15.8	11.8	17.0	13.5	13.6	14.4	15.3	16.3
Other	0.3	0.4	0.3	0.4	0.4	0.4	0.5	0.5	0.5
Nontax revenue	17.9	13.4	19.1	17.3	18.5	19.9	21.2	22.5	23.9
Mineral royalties and dividends	14.0	11.0	15.3	14.6	15.4	16.7	17.9	19.0	20.2
Grants	0.4	0.1	0.1	0.3	0.3	0.3	0.3	0.4	0.4
Total expenditure and net lending	50.6	54.4	57.0	59.5	62.4	62.5	65.8	68.4	72.0
Current expenditure	37.6	40.4	41.3	43.1	44.4	45.9	48.7	51.5	54.2
Wages and salaries	16.6	18.5	19.2	21.5	22.1	22.8	23.6	24.6	25.5
Interest	0.7	0.8	0.9	0.9	1.0	1.2	1.3	1.5	1.6
Other	20.3	21.0	21.2	20.7	21.3	22.0	23.7	25.4	27.1
Of which: grants and subsidies	10.6	11.3	11.8	12.5	12.9	13.3	14.2	15.0	16.0
Capital expenditure	13.1	12.8	15.1	16.5	18.0	16.7	16.9	16.9	17.7
Net lending	-0.1	1.2	0.6	0.0	-0.1	-0.1	0.2	0.0	0.0
Primary balance (deficit -)	3.3	-7.3	-1.9	0.0	-3.2	0.5	1.9	3.8	5.0
Overall balance (A)	5.3	-7.0	-2.0	-0.1	-3.2	0.4	1.7	3.4	4.4
Financing (B)	-9.4	7.8	2.0	0.1	3.2	-0.4	-1.7	-3.4	-4.4
Foreign (net)	-0.6	-1.3	-1.3	0.9	-2.0	-2.0	-1.0	-1.6	-1.5
Drawing	0.2	0.2	0.0	2.5	0.2	0.2	1.0	0.5	0.6
Amortization	-0.8	-1.4	-1.4	-1.5	-2.1	-2.1	-1.9	-2.0	-2.0
IMF transactions (net) ⁴	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic (net)	-8.8	9.1	3.3	-0.8	5.2	1.6	-0.6	-1.8	-2.9
Issuance	2.0	2.1	3.8	2.7	6.0	1.4	1.0	1.0	1.0
Amortization	-0.8	-0.8	0.0	-2.0	-3.2	-1.4	-1.4	-1.4	-1.4
Change in cash balance (- increase)	-9.9	7.8	2.3	-1.4	2.4	1.6	-0.3	-1.4	-2.5
Discrepancy (B-A)	-4.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>									
Non-mineral primary balance ⁵	-18.2	-21.8	-24.4	-21.4	-25.9	-24.0	-24.4	-24.1	-24.6
Excluding SACU revenue	-33.9	-37.6	-36.2	-38.5	-39.4	-37.6	-38.8	-39.4	-40.9

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

¹ Fiscal year begins on April 1.² Refers to sales tax and VAT.³ SACU receipts consist of external trade and excises on imported goods as well as a development component derived from excise taxes.⁴ These transactions reflect Botswana's SDR allocation and contribution to the IMF's General Resource Account (GRA).⁵ The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 3. Botswana: Central Government Operations, 2014/15–2022/23 (continued)¹

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
			Prel.			Projections			
	(Percent of GDP)								
Total revenue and grants	38.3	31.2	31.9	32.4	30.3	30.3	30.5	30.6	30.6
Total revenue	38.1	31.1	31.8	32.2	30.2	30.1	30.4	30.4	30.4
Tax revenue	25.8	22.3	20.8	22.8	20.7	20.5	20.8	20.8	20.8
Income taxes	10.9	8.0	10.4	9.9	10.0	10.0	10.2	10.2	10.2
Mineral	5.1	2.3	4.2	3.7	3.7	3.8	3.8	3.8	3.8
Nonmineral	5.7	5.7	6.2	6.1	6.3	6.3	6.4	6.4	6.4
Taxes on goods and services ²	3.9	3.7	3.4	3.5	3.6	3.7	3.8	3.9	3.9
Customs Union receipts ³	10.8	10.4	6.7	9.3	6.9	6.5	6.7	6.9	7.1
Other	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Nontax revenue	12.3	8.8	11.1	9.4	9.5	9.6	9.6	9.6	9.6
Mineral royalties and dividends	9.6	7.2	8.9	8.0	7.9	8.0	8.1	8.1	8.1
Grants	0.3	0.1	0.1	0.2	0.1	0.1	0.2	0.2	0.2
Total expenditure and net lending	34.7	35.8	33.1	32.5	31.9	30.1	29.8	29.1	28.9
Current expenditure	25.8	26.6	23.9	23.5	22.8	22.1	22.0	21.9	21.7
Wages and salaries	11.4	12.2	11.2	11.7	11.3	10.9	10.7	10.5	10.2
Interest	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.7
Other	13.9	13.9	12.3	11.3	10.9	10.6	10.7	10.8	10.9
Of which: grants and subsidies	7.3	7.4	6.9	6.8	6.6	6.4	6.4	6.4	6.4
Capital expenditure	9.0	8.4	8.8	9.0	9.2	8.0	7.7	7.2	7.1
Net lending	-0.1	0.8	0.3	0.0	0.0	0.0	0.1	0.0	0.0
Primary balance (deficit -)	2.3	-4.8	-1.1	0.0	-1.7	0.2	0.9	1.6	2.0
Overall balance (A)	3.7	-4.6	-1.1	-0.1	-1.6	0.2	0.7	1.5	1.8
Financing (B)	-6.4	5.1	1.1	0.1	1.6	-0.2	-0.7	-1.5	-1.8
Foreign (net)	-0.4	-0.9	-0.8	0.5	-1.0	-0.9	-0.5	-0.7	-0.6
Domestic (net)	-6.0	6.0	1.9	-0.4	2.7	0.8	-0.3	-0.8	-1.1
Discrepancy (B-A)	-2.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum item:</i>									
Non-mineral primary balance ⁴	-12.5	-14.3	-14.2	-11.7	-13.3	-11.6	-11.0	-10.3	-9.9
Excluding SACU revenue	-23.2	-24.8	-20.8	-21.0	-20.2	-18.1	-17.8	-17.2	-17.0
GDP (fiscal year; billions of pula)	145.9	151.9	172.3	183.3	195.3	207.8	220.9	234.7	249.4

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

¹ Fiscal year begins on April 1.

² Refers to sales tax and VAT.

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

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

Table 3. Botswana: Central Government Operations, 2014/15–2022/23¹ (concluded)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
			Prel.			Projections			
	(Percent of non-mineral GDP)								
Total revenue and grants	49.3	39.5	40.5	42.6	39.7	39.8	39.9	40.0	40.0
Total revenue	48.9	39.4	40.4	42.3	39.6	39.6	39.7	39.8	39.8
Tax revenue	33.2	28.2	26.3	30.0	27.1	27.0	27.2	27.3	27.2
Income taxes	14.0	10.1	13.2	12.9	13.1	13.2	13.3	13.3	13.3
Mineral	6.6	2.9	5.3	4.9	4.9	5.0	5.0	5.0	5.0
Nonmineral	7.4	7.2	7.8	8.0	8.2	8.2	8.3	8.3	8.3
Taxes on goods and services ²	5.0	4.6	4.3	4.5	4.7	4.9	5.0	5.1	5.1
Customs Union receipts ³	13.8	13.2	8.5	12.2	9.0	8.6	8.8	9.1	9.3
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	15.8	11.1	14.0	12.4	12.4	12.6	12.6	12.5	12.5
Mineral royalties and dividends	12.4	9.1	11.2	10.5	10.3	10.6	10.6	10.6	10.6
Grants	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Total expenditure and net lending	44.6	45.3	41.9	42.7	41.9	39.5	39.0	38.1	37.7
Current expenditure	33.1	33.6	30.4	30.9	29.8	29.0	28.8	28.7	28.4
Wages and salaries	14.6	15.4	14.1	15.4	14.8	14.4	14.0	13.7	13.4
Interest	0.6	0.7	0.6	0.6	0.7	0.7	0.8	0.8	0.9
Other	17.9	17.5	15.6	14.8	14.3	13.9	14.0	14.2	14.2
Of which: grants and subsidies	9.3	9.4	8.7	9.0	8.6	8.4	8.4	8.4	8.4
Capital expenditure	11.5	10.6	11.1	11.8	12.1	10.5	10.0	9.4	9.3
Net lending	-0.1	1.0	0.4	0.0	-0.1	0.0	0.1	0.0	0.0
Primary balance (deficit -)	2.9	-6.1	-1.4	0.0	-2.2	0.3	1.1	2.1	2.6
Overall balance	4.7	-5.8	-1.5	-0.1	-2.1	0.2	1.0	1.9	2.3
<i>Memorandum items:</i>									
Non-mineral primary balance ⁴	-16.1	-18.1	-18.0	-15.4	-17.4	-15.2	-14.4	-13.4	-12.9
Excluding SACU revenue	-29.9	-31.3	-26.4	-27.6	-26.4	-23.8	-23.2	-22.5	-22.3
Non-mineral GDP (fiscal year; billions of pula)	113.5	120.1	135.9	139.6	148.9	158.1	168.8	179.4	190.9

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

¹ Fiscal year begins on April 1.

² Refers to sales tax and VAT.

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

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

Table 4. Botswana: Monetary Survey, 2014–2022

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Prel.			Projections			
	(Billions of pula, end of period)								
Net foreign assets	83.3	91.0	82.2	90.9	96.4	101.6	109.9	119.7	131.4
Bank of Botswana	77.7	83.4	75.3	83.4	88.2	92.8	100.4	109.3	120.3
Assets	79.1	84.9	76.8	84.9	89.6	94.2	101.8	110.8	121.7
Liabilities	-1.4	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Commercial banks	5.6	7.7	6.9	7.5	8.2	8.8	9.6	10.3	11.1
Assets	7.8	9.9	9.5	10.1	10.8	11.5	12.2	12.9	13.7
Liabilities	-2.2	-2.2	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Net domestic assets	-22.9	-19.3	-5.3	-19.6	-22.1	-21.0	-21.4	-21.7	-24.1
Net domestic credit	7.2	13.1	23.3	26.3	30.5	33.3	36.3	41.5	47.1
Net claims on the government	-37.0	-35.2	-29.3	-29.6	-28.7	-27.7	-27.6	-28.2	-29.6
Bank of Botswana	-38.9	-37.1	-32.5	-32.8	-31.9	-30.8	-30.7	-31.4	-32.8
Commercial banks	2.0	1.9	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Claims on parastatals	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.6
Claims on nongovernment	43.8	48.0	52.2	55.5	58.7	60.5	63.4	69.2	76.1
Claims on the private sector	45.2	49.3	53.7	57.1	60.5	62.4	65.4	71.4	78.4
Other financial institutions	-1.4	-1.3	-1.6	-1.7	-1.8	-1.9	-2.0	-2.1	-2.3
Other items (net)	-30.0	-32.4	-28.6	-45.9	-52.5	-54.3	-57.6	-63.2	-71.2
Monetary Base	11.8	14.0	14.5	15.3	16.3	17.6	19.1	21.0	22.9
Broad money (M2)	55.8	66.9	70.5	74.3	79.7	86.2	94.2	103.7	113.2
Money	13.2	13.7	15.9	17.8	19.1	19.8	21.7	23.8	26.0
Currency	1.7	1.7	1.8	1.9	2.0	2.1	2.3	2.6	2.8
Current deposits	11.5	12.0	14.1	16.0	17.1	17.7	19.3	21.3	23.3
Quasi-money	42.6	53.2	54.7	56.4	60.6	66.3	72.6	79.8	87.2
<i>Memorandum items:</i>									
Nominal GDP (bn pula)	146	146	170	180	192	205	217	231	246
Nominal non-mineral GDP (bn pula)	113	120	136	140	149	158	169	179	191
Velocity (GDP to M2)	2.6	2.2	2.4	2.4	2.4	2.4	2.3	2.2	2.2
Velocity (non-mineral GDP to M2)	2.0	1.8	1.9	1.9	1.9	1.8	1.8	1.7	1.7
Money Multiplier	4.7	4.8	4.9	4.9	4.9	4.9	4.9	4.9	5.0
Base Money (annual % change)	-8.5	18.6	3.7	5.0	7.2	7.6	8.7	9.7	9.0
Broad Money (annual % change)	4.6	19.9	5.4	5.3	7.4	8.0	9.4	10.0	9.2
Credit to the private sector (annual % change)	13.7	9.0	9.0	6.3	5.9	3.1	4.8	9.2	9.9
Private sector credit to GDP	31.0	33.8	31.7	31.7	31.5	30.5	30.1	30.9	31.9
Private sector credit to non-mineral GDP	39.9	41.1	39.6	40.9	40.6	39.5	38.7	39.8	41.1

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

Table 5. Botswana: Financial Soundness Indicators

	2013	2014	2015	2016	Mar-17
	(Percent, unless otherwise indicated)				
Banking indicators					
Capital adequacy					
Capital to assets	8.4	9.1	8.5	8.4	9.0
Regulatory capital to risk-weighted assets	19.6	18.6	20.0	19.2	19.1
Regulatory tier I capital to risk-weighted assets	13.4	13.1	14.1	13.2	13.3
Nonperforming loans net of provisions to capital	9.8	10.6	10.0	12.8	15.9
Asset quality					
Large exposure to capital	147.7	191.8	170.0	147.7	140.4
Nonperforming loans to total gross loans	3.6	3.5	3.7	4.9	5.5
Bank provisions to nonperforming loans	49.8	48.4	54.7	57.1	...
Earnings and profitability					
Trading income to total income	3.5	3.4	...	...	...
Return on assets	3.8	2.8	2.0	2.3	1.7
Return on equity	34.8	25.2	17.5	20.2	14.6
Interest margin to gross income	64.7	59.6	57.5	61.4	63.5
Noninterest expenses to gross income	48.8	55.5	61.1	57.1	59.7
Personnel expenses to noninterest expenses	47.2	43.9	40.6	43.2	42.8
Liquidity					
Liquid assets to total assets	12.4	30.2	15.4	16.3	13.6
Liquid assets to short-term liabilities	15.0	36.2	18.5	20.0	16.7
Customer deposits to total (non-interbank) loans	122.5	113.6	119.8	121.6	117.6
Exposure to foreign exchange risk					
Net open position in foreign exchange to capital	-10.4	-9.7	-59.4	...	...
Foreign currency-denominated loans to total loans	6.3	7.3	6.7	7.5	7.3
Foreign currency-denominated liabilities to total liabilities	13.3	13.1	13.0	14.6	14.3
Sources: Bank of Botswana					

Annex I. Traction of Past IMF Advice

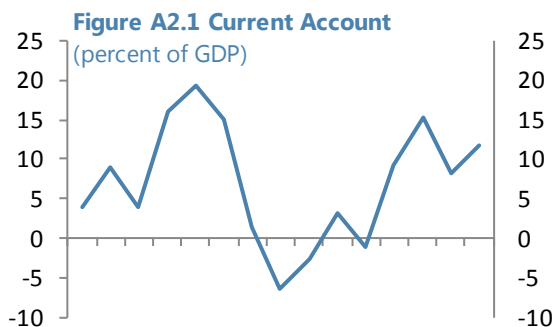
Goals	Objectives	Actions/Measures	Developments
Maintain strong fiscal and external buffers	Rebuild fiscal buffers after downturns	Prudent fiscal management. Consider Introducing a more formal fiscal rule.	The latest Medium-Term Expenditure Framework and the National Development Plan (NDP11) envisage fiscal surpluses from 2019 onwards. NDP11 proposes a fiscal rule* but implementation has been postponed until the time of the next national development plan.
Promote labor market improvements and private sector development	Improve skills of the labor force Reduce private sector constraints Reduce Skill Mismatches	Working with private sector to redesign programs, increase vocational scholarships, and incentivize apprenticeships Implement an action plan in collaboration with the World Bank to ease registration of businesses, improve the legal framework, and facilitate access to credit Reduce restrictions on visas and work permits for businesses and skilled foreign workers	A strategic plan has been approved but integration of graduate/internship registries and enhanced coordination with the private sector is needed. Only one-third of the envisaged reforms have been implemented to date. Introduced an amendment to the immigration law to grant permanent residency to qualifying foreign entrepreneurs
Address water and electricity shortages	Upgrade infrastructure Enhance efficiency in this sector	New north-south water carrier Morupule A and B repair and refurbishment work Construction of two new units at Morupule B Plans for independent regulator to oversee tariffs and service Greater private sector participation	Under construction Morupule B repair work completed, Morupule A is under refurbishment and it is expected to be completed by October 2017 Agreement with private investor signed, units expected to enter on stream in 2019–20. Regulator introduced, tariffs are not expected to rise in the near term Morupule B is being privatized
Improve Public Financial Management	Raise public investment efficiency Increase domestic revenue Rationalize spending	Undertake a Public Investment Management Assessment (PIMA) to identify inefficiencies and bottlenecks Review tax policy, notably VAT exemptions and property taxation. Contain wage bill growth and conduct a spending review of the seven largest ministries Reform SOEs (improve their efficiency and profitability)	PIMA performed in February 2017. The authorities' PFM action plan has included the main PIMA recommendations The authorities are expected to consider such policy changes in the coming year. Little progress to date, but the MTEF envisages declines in the wage bill and subsidies as a share of GDP over the medium term Positive steps have been taken but more remains to be done.
* The proposed rule involves financing the recurrent budget from non-mineral revenues and splitting mineral revenue between investment in physical and human capital (60 percent) and saving for future generations (40 percent). This entails a fiscal anchor based on the non-mining recurrent primary balance and is broadly in line with the earlier staff recommendation to target the non-mining primary balance to ensure that it improves over the medium-term (i.e. not in a single year).			

Annex II. External Stability Assessment

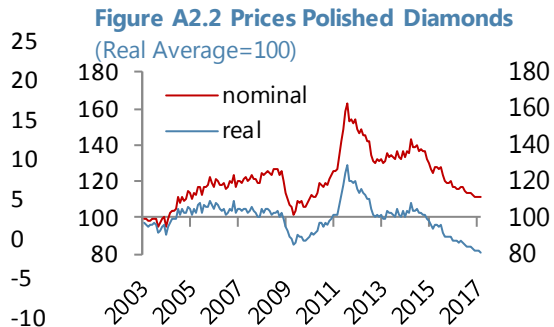
The analysis suggests that Botswana’s external position is stable and broadly consistent with fundamentals. The exchange rate framework, based on annual reviews of the rate of crawl and of basket weights, remains appropriate, and international reserves comfortably exceed their adequate level according to the IMF’s metric. Given the country’s volatile foreign exchange receipts and its dependence on diamond exports, the authorities should continue to maintain sufficient buffers.

A. Introduction

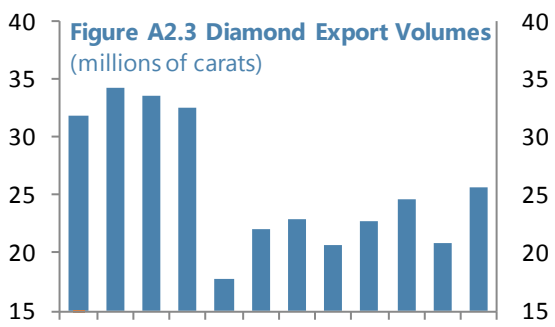
1. Botswana’s external current account has recovered since 2009 despite temporary deteriorations in 2012 and 2015. A sizable surplus of 12 percent of GDP was achieved in 2016, slightly lower than a recent peak in 2014. The baseline is conservative and projects a gradual increase in diamond production and prices but no change in diamond prices in real terms (real diamond prices are projected to remain below their long-term average), although an anemic demand for diamonds in the global market (that could affect prices and production) cannot be ruled out.



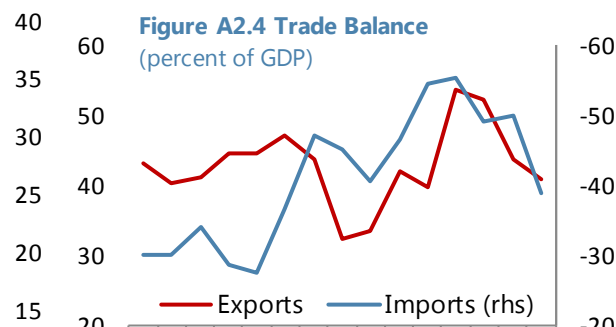
Source: BoB and staff estimates



Source: Bloomberg and staff estimates

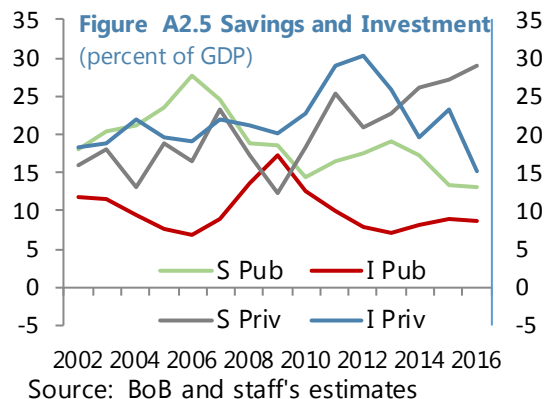


Source: BoB and staff estimates

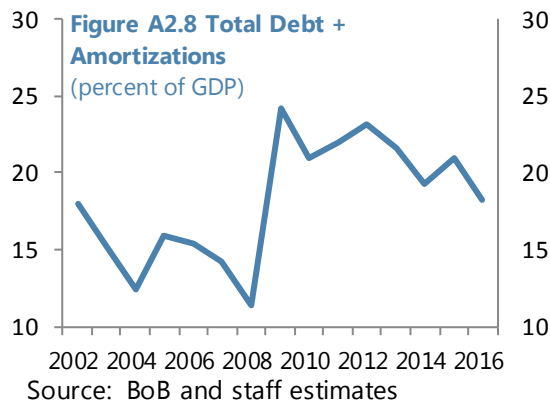
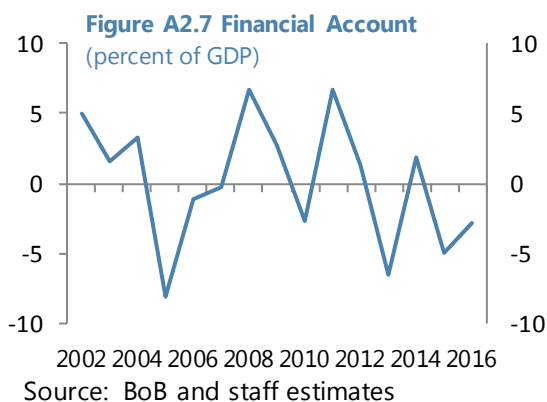
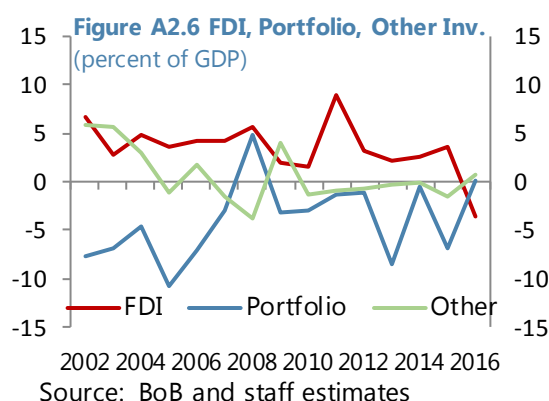


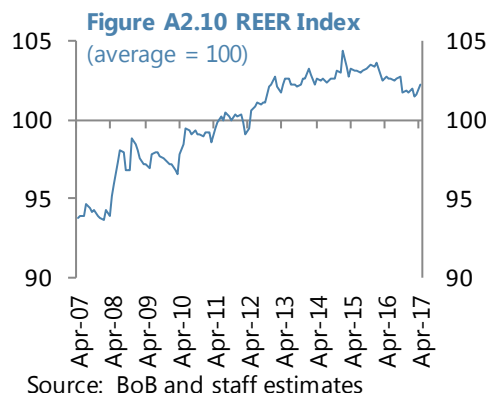
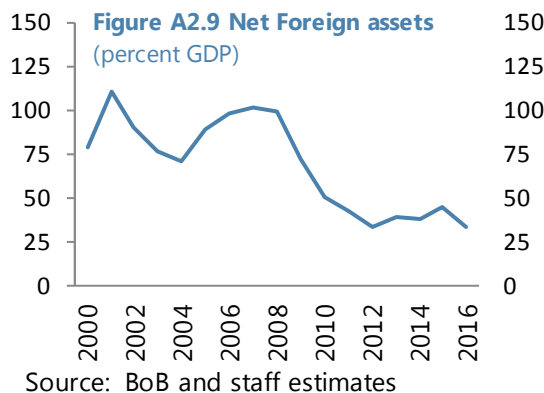
Source: BoB and staff estimates

2. A savings and investment decomposition suggests that public finances have historically been linked to changes in the external current account. In recent years, periods when government investment or public spending rose were matched by a deterioration in the fiscal and the external balances. Both the fiscal and the current account balances are expected to improve in the medium-term, thus supporting a comfortable level of international reserves at more than ten months of imports.



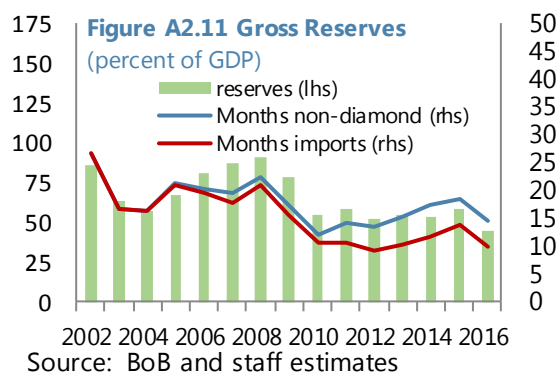
3. Historically, the financial account has been quite volatile resulting from the behavior of portfolio investment, with foreign direct investment (FDI) remaining mostly stable and positive —associated with investments in the mining sector, which accounted for about 80 percent of FDI inflows. Gross external financing requirements have remained broadly stable at about 20 percent of GDP, of which about one-fourth were of a short-term nature. Net foreign assets have stabilized at about 35 percent of GDP and their dynamics depend primarily on the behavior of international reserves. In the medium term, the financial account is expected to improve gradually.





4. Botswana's real effective exchange rate (REER) has appreciated slightly since 2007 (at present, the REER is 2 percent above its 10-year average). In particular, the pula appreciated (in real terms) with respect to the rand but depreciated with respect to the US dollar (these trends have been partially reversed since the beginning of 2016, leading to a 1 percent depreciation in the REER). Despite variations in bilateral rates, changes in the REER have been quite modest, partly a reflection of the BoB's goal to limit fluctuations in the REER by adjusting the nominal value of the pula in line with expected inflation differentials with major trading partners and basket weights (comprising the SDR and the South African rand with a 45 percent weight for the latter).

5. Botswana's level of international reserves remains high. At end 2016, they stood at about US\$7.2 billion, equivalent to 45 percent of GDP or 10 months of imports.^{1 2} Under the baseline projections, the import coverage is expected to increase gradually as the scaling up of public investment fades in the medium-term, the fiscal accounts turn into surplus, and prospects for diamonds remain broadly favorable.



B. Exchange Rate Assessment

6. The assessment of Botswana's REER is based on two IMF's panel regression-based methodologies, the CA and REER External Balance Assessment (EBA)-lite models.³ The estimations

¹ The authorities concurred with the assessment from past Article IVs (in 2012, 2014 and 2015) that reserves exceeded their adequate level.

² The authorities preferred measure of reserve coverage takes the ratio to current year imports of goods and services excluding diamond imports for re-exporting purposes (which would amount to 14 months at end-2016).

³ EBA-lite, an extension of EBA methodologies, uses annual data for 190 countries for the 1995-2015 period and incorporates fundamentals for low and middle-income countries. See further details of the EBA methodology in IMF (2013).

assume that both the CA and REER are endogenous variables simultaneously determined as a function of domestic and external variables including fundamentals, policy variables, cyclical conditions, and the global environment. Thus, these methodologies assess the CA and REER in a multilateral-consistent manner, as each country's variables are measured relative to a weighted-average of other countries' values.⁴

7. The regression-based methodologies suggest that Botswana's REER is consistent with fundamentals. The CA gap is defined as the difference between the observed and fitted values of the CA EBA-lite regression model—which in turn corresponds to deviations of policy variables from their adequate levels and to regression residuals (the unexplained portion of the model). The gap is then converted into a REER misalignment using estimated trade elasticities.

8. For Botswana, the CA gap is estimated to be 11.5 percent of GDP, as the fitted value of the regression is a CA deficit of 0.2 of GDP compared to a current account surplus of 11.7 percent in 2016. The estimated elasticity of the trade balance to changes in the REER is -0.32. Thus, according to the CA-EBA lite approach, the REER would need to appreciate by 36 percent for the CA surplus to be reduced to the fitted value of the regression.⁵ It should be noted, however, that the CA surplus would have only been about 3 percent of GDP (instead of 11.7) if the exports of the accumulated stock of diamonds (from 2015) were not taken into account.⁶ In this case, the REER would only need to appreciate by 8 percent to reduce the surplus to the fitted value of the regression.⁷ Alternatively, the REER EBA-lite approach indicates that the REER would need to depreciate by 0.3 percent to reach the fitted value of the regression.

Model	Observed	Fitted	GAP	Overvaluation
CA	11.7%	0.2%	11.5%	36%
ln(REER)	4.652	4.649	n.a.	0.3%

⁴ Since the CA and ER are measured relative to other countries, they not only reflect a country's own characteristics but also external conditions within a simultaneously determined general equilibrium system. This also implicitly recognizes that developments in a small economy would mostly influence its own CA and REER, unlike those in a large country.

⁵ Since 90 percent of Botswana's exports correspond to the sale of diamonds in the global market (at international prices), the CA EBA-lite methodology probably overstates the misalignment as increases in the international price of diamonds would appreciate the real exchange rate but also increase the CA surplus.

⁶ The inventories were accumulated in 2015 due to the unexpected low demand for diamonds that had already been mined. The strong sales in 2016 are a one-off development as inventories were depleted since production levels were also reduced to adjust to the lower demand. Moreover, early results in 2017 suggest that the very strong sales in 2016 resulted from the restocking of inventories of retailers and thus the sales in 2017 are expected return to their norm (a fall from 2016 but higher than in 2015).

⁷ It should also be acknowledged that the sizable CA surpluses in Botswana are the result of large diamond sales rather than of exchange rate misalignment.

C. Reserve Adequacy

9. Traditional metrics of adequacy –such as months of imports, cover of short-term debt plus debt service, or percent of broad money– though attractive for their simplicity are rather arbitrary as they only focus on one aspect of vulnerability and may provide conflicting signals. Since a balance of payments crisis can arise from various sources, the IMF’s metric for market access countries employs a risk-weighted measure of different sources of risk.⁸

10. The IMF’s metric encompasses four specific vulnerabilities: (i) export earnings to capture potential losses from terms of trade shocks; (ii) short term debt at remaining maturity (short term debt plus debt service) to reflect rollover risk; (iii) portfolio investments plus medium and long-term debt to account for drains from non-residents’ investment; and (iv) broad money as a proxy for residents’ capital flight.⁹ The weights for the risks in the metric are computed as the drains at the tenth percentile of the estimated annual distributions of percentage changes of each of the items discussed above, during periods of exchange market pressures.¹⁰ Separate distributions are estimated for countries with fixed exchange rates or capital controls.¹¹ The weights for countries with a fixed exchange rate (assumed for Botswana) are:¹²

	Short-term Debt	Other Liabilities	Broad Money	Exports
Weights	30%	20%	10%	10%

11. Botswana exhibits a comfortable reserve position. According to the IMF’s metric, reserves of 13 to 20 percent of GDP would be adequate, compared to the current level of 45 percent of GDP (reserves equivalent to 100–150 percent of the metric are considered appropriate). Using a weight of 25 percent for exports (instead of 10 percent) to incorporate the country’s dependence on volatile

⁸ See further details in IMF (2011, 2013 and 2014). A separate methodology is used for non-market access countries but is not relevant for Botswana (being an upper middle income country with substantial capital inflows and outflows). The country has little external debt and maintains investment grade ratings.

⁹ Other risks, such as derivative exposures, are excluded due to data limitations.

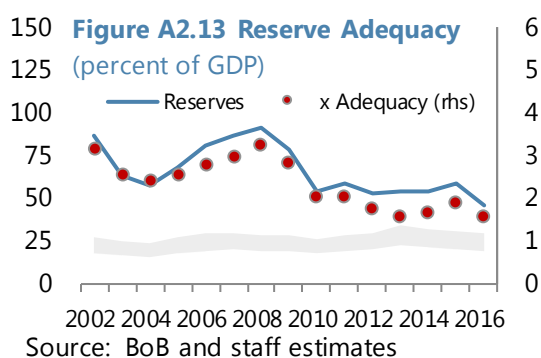
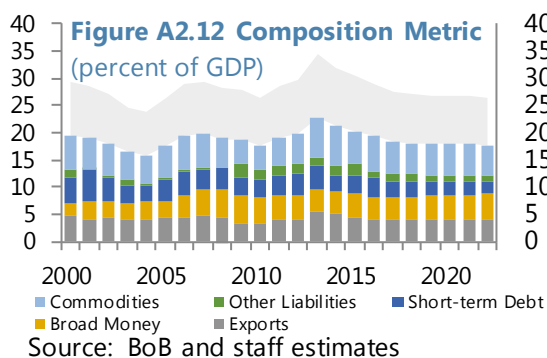
¹⁰ As in Eichengreen et. al. (1997), an exchange market pressure (EMP) index is constructed as the weighted average of reserve losses, exchange rate depreciation, and increases in interest rates. An episode of EMP occurs when the index deviates more than 1.5 times standard deviations from its average.

¹¹ Additional buffers are suggested for countries with commodity exports that exceed 50 percent of total exports. Botswana’s commodity exports account for 80 percent of exports of goods and services (90 percent of goods exports). However, the IMF’s methodology for commodity exporters relies on futures’ prices which are unavailable for diamonds. Nonetheless, considering the decrease in exports due to the drop in diamond prices in 2009 and 2015, a weight of 25 percent for exports could be used to reflect the volatility of diamond prices.

¹² Botswana’s pula is pegged to a basket of currencies that comprises the South Africa’s rand and the SDR (with a 45 percent weight for the former). While not exactly a fixed exchange rate regime, its operational details are closer to it than to a flexible exchange rate regime. In any case, using the weights for flexible exchange rates would, by design, yield a lower level of adequate reserves compared to the weights for fixed exchange regimes.

diamond receipts, the adequacy range would increase to 20 to 30 percent of GDP. Thus, the current level of reserves would exceed by about 67 percent the upper bound of the estimated adequate range.¹³ Moreover, for the past twenty years the level of reserves has far exceeded the upper bound of the adequacy range.

12. Foreign reserves are under the control of the Bank of Botswana (BoB)—with about two-thirds kept in a sovereign wealth fund (the pula Fund) and one-third in a “liquidity” portfolio (used as a short-term liquidity buffer). Within the pula Fund, one-third is owned by the BoB and two-thirds by the government (kept separately in a “government investment account” held at the BoB). The authorities could consider specifying rules for withdrawals from the government’s investment account. This could be useful because, even if in the absence of rules past governments have accumulated sizable savings from non-renewable revenues, nothing precludes a future government from boosting unproductive spending and eroding the country’s reserve buffers.



D. Conclusions

13. Botswana’s external balance has improved since 2009 and is projected to remain in positive territory in the medium-term. The large CA surplus in 2016 was due to the one-off sale of accumulated diamond stocks. Over the projection period, the CA account balance is expected to be about 3.5 percent of GDP. The REER seems broadly consistent with fundamentals.

14. Botswana should continue implementing prudent policies and reforms that allow for the maintenance of an adequate reserve buffer. Given the volatility of diamond revenues and of SACU receipts, the authorities should maintain a comfortable foreign reserves buffer and periodically monitor its adequacy.

¹³ International reserves are composed of the liquidity portfolio, which covers six months of current year non-diamond imports (of which three months are kept in cash in pula), and the pula Fund co-owned by the government and central bank. The liquidity portfolio itself is also adequate according to the IMF’s metric.

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Annex III. Risk Assessment Matrix¹

Nature/source of main risks	Likelihood of realization in the next three years	Expected impact on economy if risk is realized	Possible Policy Response
Policy uncertainty and divergence. ² Two-sided risks to U.S. growth. In Europe, uncertainty associated with post-Brexit arrangements.	High	High Negative impact on diamond demand Possible impact on trade and financial links with the EU (the EU accounts for 17.6 percent of total exports).	Structural reforms to diversify growth, including: i) reduce skill mismatch; ii) ensure reliable provision of water and energy; iii) improve the business environment, and iv) focus on the needs of key sectors with competitive advantage (e.g. tourism, meat)
Tighter and more volatile global financial conditions: ² Rising interest rates and strengthening of the U.S. dollar.	High	Medium (tighter liquidity conditions) Negative impact on liquidity; Low (dollar strengthening) Positive impact on diamond receipts	Continued efforts to enhance financial sector surveillance and manage financial sector volatility, and provide liquidity as needed.
Weaker-than-expected global growth: ¹ Significant China slowdown; Slowdown in other emerging markets Weak growth in key advanced economies and emerging markets	Low (short term)/ Medium (thereafter) Medium High (in AE)/ Medium (in EM)	Medium Possible negative impact on diamond exports, growth, and external and fiscal positions.	Short-term: countercyclical fiscal and monetary policies Medium-term: Step up structural reforms to enhance domestic revenue mobilization and promote diversification
Delayed Fiscal Adjustment in Botswana	Medium Spending pressures may mount ahead of the 2019 national elections, leading to a more protracted period of fiscal deficits.	Low Increase in public debt and guarantees and/or erosion of reserve buffers could raise concerns about long-term fiscal sustainability	As envisaged in the 2017/18 Budget and the MTEF, the authorities expect to contain the growth of current spending, calibrate public investment to capacity constraints, and improve the efficiency of public spending.
Permanent decline in SACU revenues.	High This could result from persistent low growth in South Africa and/or a revision in the SACU revenue sharing formula, leading to permanent lower transfers.	Medium The impact on the fiscal and external balances would be important, although not as pronounced as in other SACU members.	Enhance domestic revenue mobilization and improve the efficiency of public spending.
Continued disruptions in electricity and water provision.	Low Performance of these sectors has improved thanks to recent reforms and investments.	Medium Private sector growth and diversification would be adversely affected.	The authorities need to proceed quickly with envisaged measures and investments to increase efficiency in these sectors and lower the cost-tariff gap, including through involvement of the private sector.

¹ Based on the latest G-RAM (January 2017).

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views at the time of the PCM.

Annex IV. Debt Sustainability Analysis

Botswana's public debt ratios remain low and are projected to decline over the medium-term. A temporary fiscal deficit in the next couple of years will be financed with government savings at the Bank of Botswana and a modest amount of domestic and external borrowing, while fiscal surpluses are expected in the medium to long-term. Based on a favorable outlook and standard stress tests, Botswana's risk of debt distress remains low.

A. Public Debt Sustainability

1. Botswana's gross public debt (including external guarantees) fell slightly from 21.7 percent of GDP in FY15/16 to 20.1 percent of GDP in FY2016/17 (Table IV.1).¹ The nominal stock of debt increased slightly because issuance of domestic bonds to finance the fiscal deficit, while the stock of external debt remained broadly constant. Thus, the share of domestic debt in total debt increased from 24 percent to 27 percent in the same period.
2. The baseline scenario, underlying the medium-term macroeconomic framework, envisages a steady decline in the debt-to-GDP ratio, while the average primary fiscal surplus over the 2017–2022 period is projected to be about 1 percent of GDP.
3. By FY2022/23, the gross public debt is projected to be at about 12.5 percent of GDP, significantly lower than the legal ceiling at 40 percent. Domestic government debt will account for about one third of the total, also remaining within the notional threshold of 15 billion pula (or 9 percent of 2016 GDP) prescribed in the authorities' Bond Issuance Programme.
4. Figure IV.1 shows three alternative scenarios:
 - i. Historical values. The first scenario shows the behavior of public debt if the main macro variables are simulated to remain at their historical 10-year averages. In this case, the debt-to-GDP ratio would initially remain flat and then increase in the medium-term. Nevertheless, public debt would remain below the legal debt ceiling of 40 percent and, based on both the debt level and gross financing needs, Botswana would continue to be classified as a lower scrutiny country. The main drivers of these dynamics are the negative primary balances that arose because of the countercyclical fiscal policy response to the 2008–09 financial crisis and the 2015 downturn in the global diamond market.
 - ii. Constant primary balance. The second scenario simulates no change in policies by holding the primary fiscal balance constant at its 2016/17 level throughout the projection period. In this case, public debt would have a decreasing trajectory until 2020 and remain basically unchanged after that.

¹ Public debt is defined as central government debt only. Botswana doesn't produce consolidated debt data for the overall public sector (including local governments, extra-budgetary funds, and parastatals).

- iii. Contingent liabilities. Finally, the third scenario simulates the materialization of contingent liabilities associated with SOEs' debt with commercial banks. The scenario assumes that SOEs would default on 50 percent of their total debt with banks (i.e. 9 percent of GDP) in 2018. As many studies have shown that contingent liability shocks are associated with a significant output loss, the stress test includes a one standard-deviation shock to growth and the resulting deterioration of the primary balance (as in the standard contingent liability shock scenario in the MC DSA template). In this scenario, the debt-to-GDP ratio would rise abruptly in 2018 but remain below the legal debt ceiling of 40 percent and decline thereafter. Gross financing needs would reach 14 percent of GDP in 2018 but still be manageable given the large reserve buffers (45 percent of GDP at end 2016).

B. External Debt Sustainability

5. Botswana's gross public external debt (including guarantees) remained small at US\$2.4 billion (15.6 percent of GDP) at end-2016. The external debt-to-exports ratio declined from 33.3 percent of exports of goods and services at end-2015 to 31.2 percent at end-2016 (Table IV.2). Botswana's public sector borrowing is mainly from multilateral organizations, including the International Bank for Reconstruction and Development and the African Development Bank. In the medium-term, fiscal consolidation and improvements in the terms of trade are expected to support bring the external debt-to-exports ratio further down to about 17 percent.

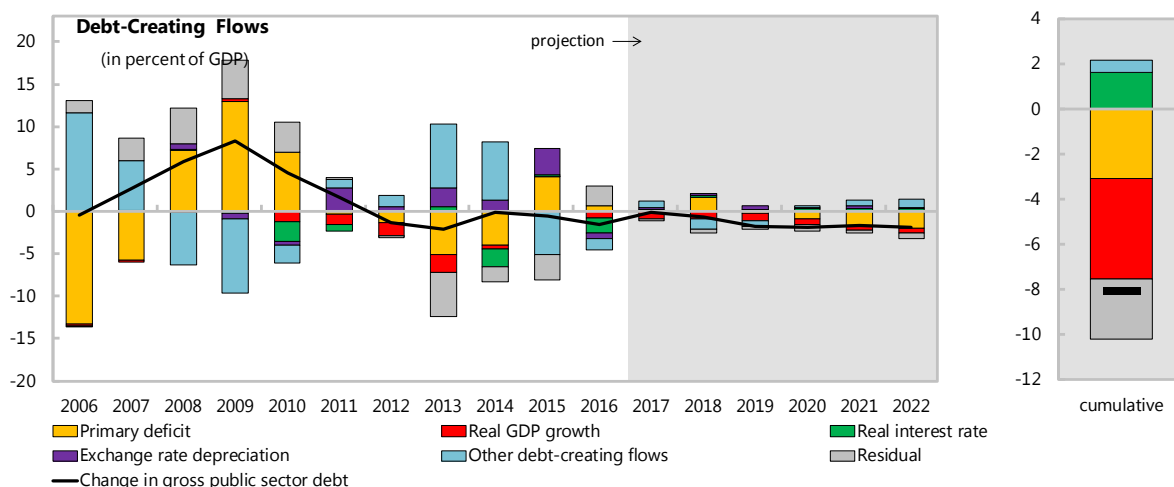
6. An alternative scenario, with key debt-creating variables at their historical levels, suggests that Botswana would be a net creditor vis-à-vis the rest of the world over the medium-term. Other scenarios (e.g. exchange rate shock, interest rate shock, growth shock) also suggest that Botswana's external debt-to-GDP ratio would remain sustainable (Figure IV.2). For instance, a real depreciation, while it would initially increase the debt-to-GDP ratio, would have no impact on debt ratios in the medium-term. Only under a scenario of a non-interest current account shock the debt ratio would increase to about 27 percent of GDP, but this figure would still be below the 35 percent threshold associated with increased likelihood of a debt correction.

Table A4.1. Botswana: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario
(in percent of GDP unless otherwise indicated)

	Actual			Projections						As of June 15, 2017		
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	17.6	21.7	20.1	20.0	19.3	17.5	15.6	14.0	12.1	Spread (bp) 2/		300
Public gross financing needs	1.0	6.2	2.8	2.0	4.4	1.5	0.8	0.1	-0.4	CDS (bp)		NA
Real GDP growth (in percent)	5.2	-0.2	4.3	4.6	4.8	4.5	4.3	4.2	4.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	6.8	1.8	11.5	1.7	1.7	1.8	1.9	1.9	2.0	Moody's	A2	A2
Nominal GDP growth (in percent)	12.0	4.1	13.5	6.4	6.6	6.4	6.3	6.2	6.3	S&Ps	A-	A-
Effective interest rate (in percent) ^{3/}	5.9	2.5	2.7	2.7	2.8	3.3	3.8	4.4	4.7	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{8/}
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	2.1	-0.60	-1.54	-0.1	-0.7	-1.8	-1.9	-1.6	-1.9	-8.0	
Identified debt-creating flows	1.1	2.33	-3.96	0.3	0.0	-1.2	-1.0	-1.0	-1.1	-3.9	
Primary deficit	-0.3	4.1	0.6	0.0	1.7	-0.2	-0.9	-1.6	-2.0	-3.1	0.9
Primary (noninterest) revenue and grants	38.1	31.2	31.9	32.0	29.8	29.8	30.1	30.2	30.2	181.9	
Primary (noninterest) expenditure	37.8	35.3	32.5	32.0	31.4	29.5	29.2	28.5	28.2	178.8	
Automatic debt dynamics ^{4/}	-0.5	3.4	-3.2	-0.5	-0.4	-0.2	-0.2	0.1	-0.1	-1.3	
Interest rate/growth differential ^{5/}	-1.2	0.2	-2.5	-0.7	-0.7	-0.6	-0.4	-0.3	-0.2	-2.8	
Of which: real interest rate	-0.5	0.2	-1.7	0.2	0.2	0.2	0.3	0.4	0.3	1.6	
Of which: real GDP growth	-0.7	0.0	-0.8	-0.9	-0.9	-0.8	-0.7	-0.6	-0.5	-4.5	
Exchange rate depreciation ^{6/}	0.7	3.1	-0.7	...	...	...	...	...	...	...
Other identified debt-creating flows	1.9	-5.1	-1.3	0.8	-1.2	-0.8	0.1	0.6	1.0	0.5	
Privatization receipts (negative)	1.9	-5.1	-1.3	0.8	-1.2	-0.8	0.1	0.6	1.0	0.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{7/}	1.0	-2.9	2.4	-0.2	-0.4	-0.3	-0.7	-0.3	-0.7	-2.6	



1/ Public sector is defined as central government and figures are reported in fiscal year terms.

2/ Bond Spread over U.S. Bonds.

3/ Defined as interest payments divided by debt stock at the end of previous year.

4/ 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 increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the denominator in footnote 4 as $r - p(1+g)$ and the real growth contribution as $-g$.

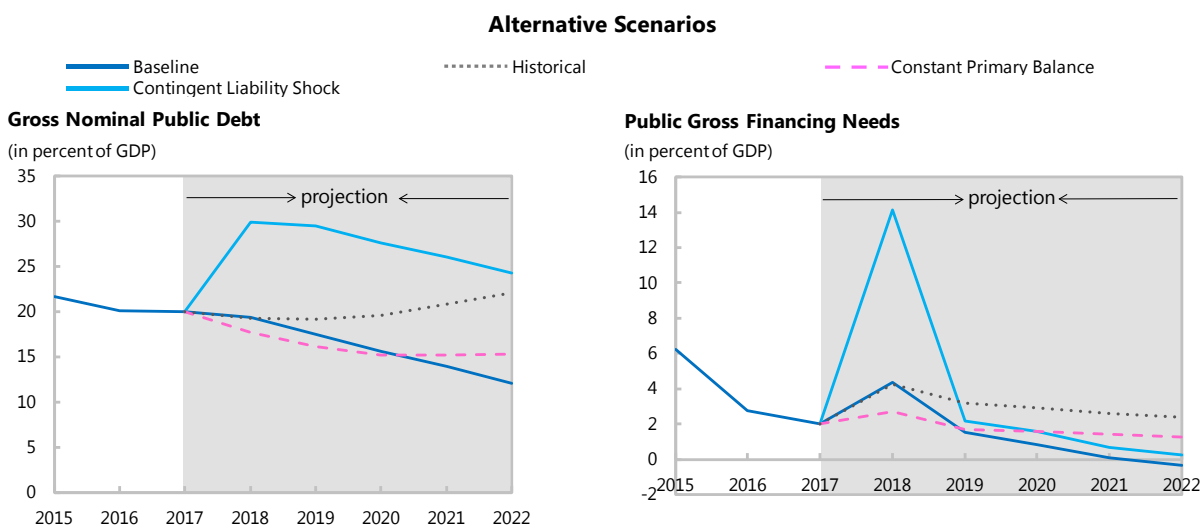
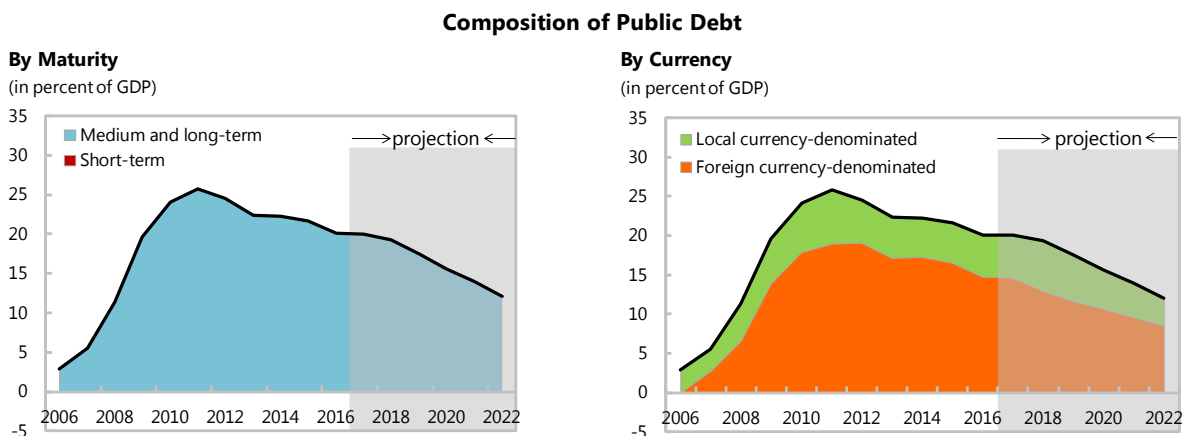
6/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

7/ For projections, this line includes exchange rate changes during the projection period.

8/ 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.

Source: International Monetary Fund, Country desk data, and staff estimates.

Figure A4.1. Botswana: Public DSA – Composition of Public Debt and Alternative Scenarios



Underlying Assumptions (in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022	Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.6	4.8	4.5	4.3	4.2	4.2	Real GDP growth	4.6	4.2	4.2	4.2	4.2	4.2
Inflation	1.7	1.7	1.8	1.9	1.9	2.0	Inflation	1.7	1.7	1.8	1.9	1.9	2.0
Primary Balance	0.0	-1.7	0.2	0.9	1.6	2.0	Primary Balance	0.0	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	2.7	2.8	3.3	3.8	4.4	4.7	Effective interest rate	2.7	2.8	2.7	2.9	3.1	2.9
Constant Primary Balance Scenario							Contingent Liability Shock						
Real GDP growth	4.6	4.8	4.5	4.3	4.2	4.2	Real GDP growth	4.6	0.7	0.4	4.3	4.2	4.2
Inflation	1.7	1.7	1.8	1.9	1.9	2.0	Inflation	1.7	0.7	0.8	1.9	1.9	2.0
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0	Primary Balance	0.0	-11.2	0.2	0.9	1.6	2.0
Effective interest rate	2.7	2.8	3.2	3.8	4.5	4.8	Effective interest rate	2.7	3.5	4.5	4.9	5.3	5.5

Source: International Monetary Fund, Country desk data, and staff estimates.

Table A4.2. Botswana: External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/	
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022		
Baseline: External debt	20.6	18.5	17.6	17.7	15.6	15.3	13.4	11.8	10.7	9.5	8.4	-1.4	
Change in external debt	2.1	-2.1	-0.9	0.0	-2.1	▼	-0.3	-1.8	-1.6	-1.0	-1.2	-1.1	
Identified external debt-creating flows (4+8+9)	-3.4	-12.9	-13.2	-7.7	-13.2	▼	-4.4	-4.1	-4.2	-4.9	-5.3	-5.7	
Current account deficit, excluding interest payments	0.6	-9.8	-15.7	-8.8	-12.2	▼	-4.9	-3.2	-3.1	-3.7	-4.1	-4.5	
Deficit in balance of goods and services	13.3	-0.5	-6.8	1.5	-6.6	▼	1.9	2.3	1.6	1.1	0.6	0.2	
Exports	47.0	61.9	60.7	53.1	50.0	▼	49.3	48.9	49.5	50.0	50.2	50.1	
Imports	60.3	61.4	54.0	54.5	43.4	▼	51.3	51.3	51.1	51.0	50.8	50.4	
Net non-debt creating capital inflows (negative)	-2.7	-3.5	3.3	0.8	-0.7	▼	0.7	-0.6	-1.0	-1.3	-1.3	-1.5	
Automatic debt dynamics 1/	-1.2	0.4	-0.9	0.3	-0.3	▼	-0.3	-0.2	-0.1	0.1	0.1	0.2	
Contribution from nominal interest rate	0.4	0.5	0.4	0.4	0.5	▼	0.4	0.5	0.5	0.5	0.6	0.6	
Contribution from real GDP growth	-0.7	-2.3	-0.7	0.3	-0.7	▼	-0.7	-0.7	-0.6	-0.5	-0.4	-0.4	
Contribution from price and exchange rate changes 2/	-0.9	2.2	-0.6	-0.5	0.0	▼	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	5.5	10.8	12.3	7.7	11.1	▼	4.1	2.2	2.6	3.9	4.1	4.7	
External debt-to-exports ratio (in percent)	43.9	29.9	29.1	33.3	31.2		31.0	27.5	23.8	21.5	19.0	16.8	
Gross external financing need (in billions of US dollars) 4/	▼ 434.3	-1275.8	-2325.5	-984.5	-1625.7		-522.4	-198.5	-193.0	-322.3	-410.8	-501.1	
in percent of GDP	3.0	-8.6	-14.3	-6.8	-10.4	10-Year	10-Year	-3.2	-1.2	-1.1	-1.8	-2.2	-2.5
Scenario with key variables at their historical averages 5/							15.3	8.8	2.7	-2.0	-6.4	-10.3	-2.5
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Nominal GDP (US dollars)	14700.5	14814.0	16259.3	14435.1	15567.7		▼ 16216.2	16904.4	17578.3	18283.2	19060.1	19855.1	
Real GDP growth (in percent)	4.5	11.3	4.1	-1.7	4.3	4.4	5.2	▼ 4.9	4.7	4.6	4.3	4.2	4.2
GDP deflator in US dollars (change in percent)	5.4	-9.7	3.4	2.7	0.0	0.7	9.3	▼ -0.7	-0.5	-0.5	-0.3	0.0	0.0
Nominal external interest rate (in percent)	2.7	2.4	2.6	2.5	2.8	3.0	1.2	▼ 3.1	3.2	3.9	4.7	5.4	6.4
Growth of exports (US dollar terms, in percent)	-10.1	32.8	7.6	-22.4	1.6	6.1	21.6	▼ 6.2	3.9	5.1	4.7	4.1	3.8
Growth of imports (US dollar terms, in percent)	7.4	2.7	-3.6	-10.2	-14.2	10.2	17.8	▼ 27.2	4.8	3.6	3.6	3.1	3.1
Current account balance, excluding interest payments	-0.6	9.8	15.7	8.8	12.2	5.7	7.3	▼ 4.9	3.2	3.1	3.7	4.1	4.5
Net non-debt creating capital inflows	2.7	3.5	-3.3	-0.8	0.7	2.7	3.2	▼ -0.7	0.6	1.0	1.3	1.3	1.5

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; g = 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 $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

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

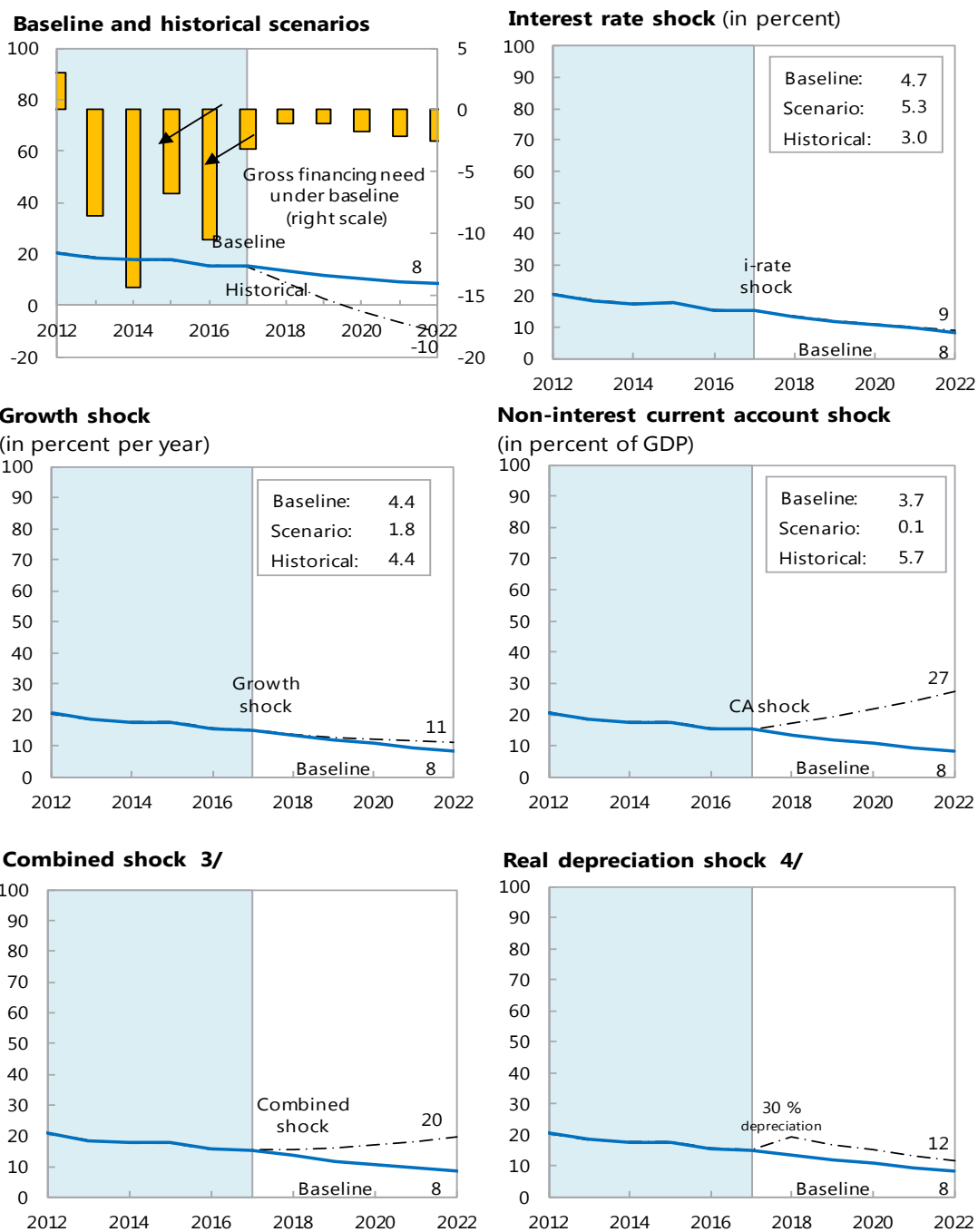
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Source: International Monetary Fund, Country desk data, and staff estimates.

Figure A4.2. Botswana: External Debt Sustainability: Bound Tests ^{1/2/}



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



BOTSWANA

July 14, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

Prepared By

African Department in Consultation with the Statistics
Department and World Bank Staff

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RELATIONS WITH THE FUND

As of June 30, 2017

Membership Status:

Joined July 24, 1968; Article VIII

General resources account	<u>SDR</u> <u>(million)</u>	<u>Percent of</u> <u>Quota</u>
Quota	197.20	100.0
Fund holdings of currency	163.44	82.9
Reserve position in Fund	33.77	17.1
SDR Department	<u>SDR</u> <u>(million)</u>	<u>Percent of</u> <u>Quota</u>
Net cumulative allocation	57.43	100.0
Holdings	58.49	101.9
Outstanding Purchases and Loans		None
Financial Arrangements		None
Project Obligations to Fund		None
Implementation of HIPC Initiative		Not Applicable
Implementation of Multilateral Debt Relief Initiative		Not Applicable
Implementation of Catastrophe Containment and Relief		Not Applicable

Exchange Rate Arrangement

The exchange rate of the Botswana Pula is a crawling peg arrangement against a basket of currencies comprising the SRD and the South African Rand. As of June 30, 2017, the exchange rate of the U.S. dollar to the Pula was US\$1= P10.25, and that of the South African rand to the Pula was R1=P0.79.

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

Article IV consultation

Botswana is on a standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on March 16, 2016.

Technical assistance

Department	Dates	Purpose	
Fiscal Affairs Department	Apr-May 2016	Revenue administration diagnostic mission	
	Apr-May 2016	AFRITAC South: Diagnostic Report - Updated reform strategy	
	Jul 2016	AFRITAC South: Support expenditure reviews/ MTEF/ program structures consistent with the NDP	
	Jul 2016	AFRITAC South: Operational level compliance risk management framework	
	Aug 2016	AFRITAC South: Support for strengthening of fiscal forecasting and investment	
	Aug 2016	AFRITAC South: Support the implementation of budget classification, chart of accounts, and progressive introdu	
	Aug 2016	AFRITAC South: Strategic Budget Techniques and Public Investment Management	
	Sep 2016	AFRITAC South: Assess the status of implementation of the action plan emanating from FY16 risk management missi	
	Nov-Dec 2016	AFRITAC South: PIMA mission	
	Jan 2017	AFRITAC South: PIMA scoping mission	
	Jan-Feb 2017	PIMA	
	May 2017	AFRITAC South: Regional Harmonisation	
	May 2017	Article IV Mission with AFR [WFHI]	
	May-Jun 2017	AFRITAC South: Establishment of industry based segments & capacity LTU	
	May 2017	AFRITAC South: the Development of State-Owned Enterprise Performance Monitoring System	
	May-Jun 2017	AFRITAC South : Prepare a fiscal risks statements as part of the Budget Options Paper that incorporates macro	
	Jun 2017	AFRITAC South: Develop a risk management framework and provide guidance on its implementation	
	Jul 2017	AFRITAC South: Strengthening the Risk Management Program	
	Legal Department	May-Jun 2016	TA in Financial Markets Law: Payments Regulations
		Aug 2016	TA in Fiscal Tax Law - VAT & Income Taxation
Jan-Feb 2017		TA in Fiscal Law: Follow-up Mission--Income Tax, VAT and Tax Procedures (with AFRITAC South)	
Apr 2017		TA in Financial Markets Law: Payments Regulations (Work at Home)	
Apr-May 2016		Multi-Topic TA Mission	
Monetary and Capital Markets Department	Jul 2016	AFRITAC South: Risk Based Supervision- Stress Testing	
	Aug-Sep 2016	AFRITAC South: Modeling and Forecasting	
	Oct 2016	AFRITAC South: Vision and Strategy for NPS	
	Oct 2016	Money and Foreign Exchange Markets and Instruments	
	Nov-Dec 2016	Insurance Supervision	
	Jan 2017	AFRITAC South: Tools and procedures for communication and information	
	Feb 2017	Banking Supervision	
	Feb-Mar 2017	AFRITAC South: Developing Monetary Policy Communications- OFFSITE	
	Mar 2017	Multiple Topic Bank Resolution / Crisis management	
	Mar 2017	Insurance Supervision (follow up)	
	Mar-Apr 2017	AFRITAC South: Strengthening the forecasting and policy formulation processes	
	May 2017	Macroprudential Policy	
	Jun 2017	Effective Macroprudential Framework set-up	
	Jun 2017	AFRITAC South: National Payment System Development	
	Jun 2017	Macroprudential Policy and Financial Stability STAFF	
Jul 2017	AFRITAC South: Liquidity Management		
Jul-Aug 2017	Insurance Supervision		
Aug 2017	Systemic Risk and Financial Stability STAFF		
Statistics Department	Nov-Dec 2016	AFRITAC South: Consumer Price Index	
	Nov-Dec 2016	Balance of Payments and External Sector Statistics	

WORLD BANK AND IMF WORK PROGRAMS

As of June 30, 2017

Title	Products	IBRD \$ Million	Provisional Timing of Missions
A. Mutual Information on Relevant Work Programs			
World Bank indicative work program in the next 12 months	Current Lending <ul style="list-style-type: none"> • Water Security & Efficiency • Integrated Transport Project 	145.5	Twice a year until May 31, 2021
	Proposed Lending <ul style="list-style-type: none"> • Social Protection Modernization • Transforming Senior Secondary Education • Health Systems Support 	30 50 40	FY18 FY19 FY19
	Analytical and Advisory Assistance (ongoing) <ul style="list-style-type: none"> • Strengthening the social protection system • Economic Diversification and competitiveness RAS • Strengthening public sector performance RAS • Regular macroeconomic monitoring • Poverty updates 		FY17-18 FY16-19 FY16-19 FY18 FY17-18
	Article IV Consultation		FY19
IMF work program in the next 12 months	Technical Assistance <ul style="list-style-type: none"> • Domestic revenue mobilization (organizational arrangements, tax and customs procedures, audit and verification) • Strengthening oversight of SOEs • Medium-term Expenditure Framework • Appraisal, selection, and implementation of public investment projects • Government Finance Statistics • Nonbank lenders' risk-based supervision • Development of securities market • Macro-financial forecasting • Macroprudential supervision • Payments' system 		FY18

Title	Products	IBRD \$ Million	Provisional Timing of Missions
	<ul style="list-style-type: none"> • Banking crisis resolution • Stress-testing • Insurance supervision • Basel II and III • Risk-based supervision and AML/CFT • Monetary operations (liquidity forecasting, interest rate corridor, operational instruments, analysis and forecasting, decision making process, communications, Business Expectations Survey) • Monetary statistics (data reported in SRF) • National accounts and price statistics 		

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
<p>General. Data provision is adequate for surveillance, albeit some shortcomings in national accounts, fiscal, monetary, and external sector statistics.</p>
<p>National Accounts: In October 2012, Statistics Botswana (SB) updated the base year of GDP to 2006 and, in 2015, revised the national accounts to include new mines. Areas for further improvements include the coverage of national accounts surveys and the estimation of GDP deflators. TA is provided by the African Development Bank.</p>
<p>Price Statistics. The monthly consumer price index (CPI) is available on a timely manner on the SB's website. The index is comprehensive and provides breakdowns between urban and rural price data and between prices of tradable and non-tradable goods and services. A re-based CPI was first published in October 2016 with an index reference period of September 2016. The weights are derived from the 2009/10 Botswana Core Welfare Indicator Survey. A Multi-Topic Household Survey was conducted during 2015-16. The Survey will support the next re-basing of the CPI expected in early 2018. Compilation challenges include the eventual inclusion of owner-occupied housing costs in the CPI. The development of producer prices is being assisted by AFRITAC South but progress has been slow.</p>
<p>Government Finance Statistics (GFS). The Ministry of Finance and Economic Development compiles cash-based quarterly and annual budgetary central government data following the <i>Government Finance Statistics Manual 2014</i>. No balance sheet data and no expenditure by classification of functions of government (COFOG) are currently reported. No data are compiled for extrabudgetary institutions, consolidated central government, or consolidated general government. Data quality improvements require a breakdown between grants, subsidies, and transfers; and between current and capital outlays in the development budget. The authorities are working on improving data quality and coverage with the development of a revised chart of accounts; they are also expected to broaden the scope of GFS to include local governments and extrabudgetary units.</p>
<p>Monetary and Financial Statistics (MFS). The Bank of Botswana (BoB) compiles MFS data using standardized report forms (SRFs) consistent with the Fund's <i>Monetary and Financial Statistics Manual</i>. The data currently cover the accounts of the BoB and other depository corporations. The BoB is seeking to expand the coverage of MFS to include the operations of nonbank financial intermediaries such as pension funds, insurance companies, and other financial corporations (e.g. unit trusts, finance companies, and financial auxiliaries). The BoB compiles quarterly financial soundness indicators for deposit-takers and real estate markets.</p>
<p>External Sector Statistics. Since 2017, the balance of payments and international investment position (IIP) are compiled following the sixth edition of the <i>Balance of Payments Statistics Manual</i> (BPM6). Quarterly balance of payments and annual IIP data (with the BPM6 framework) are available for 2010-2016. Source data are broadly adequate; the main data source—the International Transaction Reporting System (ITRS) data—has been recently enhanced and work is underway for adjusting it to BPM6 requirements. The methods used for estimating f.o.b. /c.i.f. adjustment factors to import values, flows from stock data, and stocks from flows need to be</p>

revised. Discrepancies exist in trade statistics data concerning: (i) the valuation of diamond exports and imports, and (ii) imports, exports, and payments related to settlements within the Southern African Customs Union (SACU). Following the relocation of De Beers' London operations, the compilation challenges associated with the appropriate treatment of diamond related re-export trade emerged both in the national accounts and balance of payments. These difficulties are likely behind the large errors and omissions recorded in recent years.

II. Data Standards and Quality

Botswana is a participant in the Fund's GDDS (now e-GDDS) since October 24, 2002. Its metadata and improvement plan were last updated on August 6, 2015. Its data ROSC was published on March 27, 2007. Botswana has implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS). Botswana disseminates thirteen of the fifteen data categories defined in Table 1 on its National Summary Data Page (NSDP). This puts Botswana in Baseline 2 of the e-GDDS monitoring framework. Periodicity and timeliness of data dissemination on the NSDP are largely in accordance with Botswana's metadata—albeit with some shortcomings, especially for the timeliness of central government gross debt. Botswana should continue building capacity to disseminate data on general government operations and external debt, and progress towards higher tiers of data standards. Areas for improvement include timeliness and periodicity of central government gross debt and BOP data.

III. Reporting to the IMF's Statistics Department

The BoB reports monetary data for publication in *International Financial Statistics* using *Standardized Report Forms* and quarterly FSIs for deposit-takers and real estate markets. Annual balance of payments and IIP data are reported to STA. The Ministry of Finance reports cash-based budgetary central government data on an annual basis to the IMF's *Government Finance Statistics Yearbook*.

Table 1. Botswana: Common Indicators Required for Surveillance
(As of June 30, 2017)

	Date of Latest Observation		Frequency of Data ¹	Frequency of Reporting ¹	Frequency of Publication ¹	Memo Items	
	Date Received	Date				Data Quality—Methodological Soundness ²	Data Quality—Accuracy and Reliability ³
Exchange rates	Jun/2017	7/1/2017	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities ⁴	Jun/2017	7/12/2017	M	M	M		LNO, O, LO,
Reserve/base money	Jun/2017	7/12/2017	M	M	M	O, O, LO, O	LO, LO
Broad money	Apr/2017	6/12/2017	M	M	M		
Central bank balance sheet	Apr/2017	6/12/2017	M	M	M		
Consolidated balance sheet of the banking system	May/2017	7/12/2017	M	M	M		
Interest rates ⁵	May/2017	6/13/2017	M	M	M		LO, LO, LO,
Consumer price index	May/2017	6/14/2017	M	M	M	O, LO, O, O	LO, O
Revenue, expenditure, balance, and composition of financing ⁶ —general government ⁷	NA	NA				LO, LNO, LNO, LO	LO, O, LO, LO, LNO
Revenue, expenditure, balance, and composition of financing ⁶ —central government	Feb 2017	May 2017	A/Q/M	Q	Q		
Stocks of central government and central government-guaranteed debt ⁸	2016Q4	May 2017	Q	Q	Q		LO, LO,
External current account balance	2016	6/15/2017	A/Q	A	A	O, O, O, LO	LNO, O, LO
Exports and imports of goods	Dec/2016	Jun 2017	M	M	M		
GDP/GNP	2017Q1	June 2017	A/Q	A/Q	A/Q	LO, LO, LNO, LO	LO, LO, LNO, LO, LO
Gross external debt	2016Q4	June 2017	A/Q	A	A		

¹ Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).
² Reflects the assessment provided in the data ROSC published on April 6, 2007 and based on the findings of the mission that took place in October–November 2006 for the data set corresponding to the variable in each row. The assessment indicates whether international standards concerning 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 source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
⁴ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
⁵ Both market-based and officially determined, including discount, money market, treasury bill, notes, and bond rates.
⁶ Foreign, domestic bank, and domestic nonbank financing.
⁷ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
⁸ Including currency and maturity composition.