



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

BOTSWANA

Domestic Bond Market Development

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Prepared By

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Monetary and Capital Markets

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: At the request of the authorities, an IMF team undertook a technical assistance mission to Botswana, from August 17–26, 2022, to support efforts to develop the local currency government bond market. The mission assessed the current stage of the sovereign debt market and formulated policy recommendations for each of the six building blocks included in the [Guidance Note for Developing Local Currency Bond Markets](#).¹

JEL Classification Numbers G11, G18, H63 (consult <https://www.aeaweb.org/econlit/jelCodes.php>)

Keywords: sovereign debt; debt management; local currency bond market development; financial market development

¹ The six building blocks consist of: (i) Money Market; (ii) Primary Market; (iii) Secondary Market; (iv) Investor Base; (v) Financial Market Infrastructure; and (vi) Legal and Regulatory Framework.

Background

As requested by the Ministry of Finance, an IMF team undertook a technical assistance mission to Botswana, from August 17–26, 2022, to support efforts to develop the local currency government bond market.² The mission assessed the current stage of Botswana’s domestic sovereign debt market and formulated policy recommendations for each of the six building blocks included in the [Guidance Note for Developing Local Currency Bond Markets](#).³ In addition, the mission delivered technical presentations on topics requested by the authorities (e.g., investor relations, issuance strategies, and inflation-linked bonds). The team drafted an aide memoire that should facilitate the development of a country-led comprehensive reform strategy to deepen and development local capital markets; it will also serve as a critical input to the forthcoming FSAP for Botswana.

Summary of Findings

The implementation of a new monetary policy framework to support the Bank of Botswana’s (BoB) inflation targeting regime is a welcome development for domestic debt market development. While the introduction of the new monetary policy framework is recent, early indications are encouraging that it will materially improve the BoB’s ability to conduct monetary policy and achieve low and stable inflation—a key ingredient to domestic market development.

There is significant scope to make progress on the authorities’ goal to shift funding from non-concessional external borrowing to the domestic bond market. This shift in the composition of borrowing would also facilitate the building of a robust yield curve and increased depth in benchmark bond issuance.

Further improvements in the domestic debt market and in demand for benchmark securities will require implementing primary market reforms, and once these reforms are completed, a commitment by the authorities to allow rates to be determined competitively in auctions. Improved auction rules, including how to deal with outlier bids, and an overhaul of the primary dealer agreement, would alleviate critical bottlenecks to market development. Moreover, measures to enhance communication with market participants will be invaluable to increase transparency and investor appetite, especially non-bank financial institutions as well non-resident demand for domestic government securities.

Coordination between debt management and liquidity management should be enhanced to facilitate the expansion of the domestic debt market. An efficient money market plays an important role in developing the broader market for public bonds and improved coordination can facilitate meeting the twin objectives of mopping up excess liquidity and stimulating demand for domestic government securities. Improved information sharing, especially regarding strengthening liquidity and cash forecasting, is a critical first step.

² The mission team comprised Trevor Lessard (Mission Chief), Laszlo Buzas, and Bill Northfield (IMF external experts).

³ The six building blocks consist of: (i) Money Market; (ii) Primary Market; (iii) Secondary Market; (iv) Investor Base; (v) Financial Market Infrastructure; and (vi) Legal and Regulatory Framework.

Material improvements in the secondary market will take more time to bear fruit, and efforts in this area should be sequenced after more foundational building blocks (e.g., money markets, primary markets) are operating more efficiently. There is also an opportunity to tap into Botswana’s relatively large non-bank investor base: in particular the pension system that holds sizeable assets and due to recent legal changes will need to hold a higher share of domestic assets in their portfolio.

Measures to develop the domestic debt market are likely to result temporarily in higher funding costs, but this is a necessary investment in the process and will likely be counterbalanced by lower financing costs in the medium-to-long term. A regular and comprehensive medium-term debt strategy (MTDS) should allow for a candid assessment of the costs and benefits associated with different financing strategies and domestic market development. The MoF’s current efforts to update the MTDS represents an opportunity to secure high-level support for LCBM development.

Summary of Recommendations

The mission assessed the stage of development of the six building blocks of market development.

The financial market infrastructure as well as legal and regulatory framework building blocks were both assessed at the “emerging” stage, representing the most developed building blocks of the market, and highlighting the progress the authorities have made in recent years to bolster the policies in these areas. The investor base, money market, and primary market building blocks were assessed as “developing”, but the overall score underplays significant heterogeneity in the scoring of the building block sub-components, especially in the primary market. In contrast, the assessment of the secondary market (“nascent”) represents the lowest scored building block for Botswana, highlighting the reality that secondary market success requires several preconditions, including a well-functioning primary market, as well as structural factors in the financial system.

The recommendations in the report should be implemented in phases. The initial phase tackles the most critical bottlenecks, which are key impediments to market development, as well as ‘quick wins’—reforms to catalyze support for market development. These recommendations are concentrated on the primary market. Progress in other areas, such as the secondary market, or attracting non-resident investors, should be tackled only subsequently. A challenge in developing the local market in Botswana remains that several high priority reforms require coordination across various stakeholders. There is merit in considering assigning an LCBM project lead who has the authority, capacity, and support to push the process forward and encourage the various ministries and agencies to fulfill their parts of the reform plan.