Statement by the IMF Staff Representative
December 18, 2002

1. This statement reports on information that has been made available since the staff report (SM/02/351, November 14, 2002) was issued. It does not change the thrust of the staff appraisal.

2. Inflation has continued to increase. CPI inflation rose steadily to 12.9 percent (12-month rate) in October, from 11.8 percent in July, largely reflecting rising inflation in South Africa (14.5 percent in October) and higher food prices.

3. On December 2, 2002, Parliament approved supplementary expenditures worth E 282 million (2¼ percent of GDP) for the current fiscal year (April 2002–March 2003). Three-fifths of the supplementary expenditure represents current spending (nearly half of it on grants and subsidies, education, and housing and urban development) and the remainder spending on capital projects (principally a major road project). The Ministry of Finance anticipates that the impact on the central government deficit will be contained by improved fiscal management and tax collection, reductions in nonessential spending, and, as in the past, underspending on investment projects. It expects the deficit in 2002/03 to be 4–4½ percent of GDP, compared with 3.9 percent reported in the staff report. It is hard to make an assessment of the impact of the supplementary expenditures on fiscal prospects, since details were not released on developments in the other elements of the expenditure plan and in revenues, but the effort to bring the budget deficit down to a sustainable level in the medium term will likely be more difficult. This reinforces the need for fiscal discipline in order to restore macroeconomic stability.

4. A final decision has not yet been taken regarding the government's proposed acquisition of a new airplane for King Mswati III. After parliament voted against the original proposal in October, the government revisited the issue at a parliamentary caucus on November 18. The caucus suspended the acquisition, but asked for more detailed information on the transaction in order to make a final decision. A select committee was appointed and charged with providing the necessary information.

5. Governance issues have come to the forefront recently, particularly in the areas of the law and the independence of the judiciary. The majority of the judges in the High Court resigned on December 1 after the government refused to accept a ruling on the grounds that it undermined the King's ability to rule by decree. The planned airplane acquisition and the circumstances surrounding the judges' resignation have triggered protests by the business community and labor unions, who have called for a general strike and mass protests during December 19–20, 2002.

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700 19th Street, NW
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IMF Concludes 2002 Article IV Consultation with Swaziland

On December 19, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Swaziland.[1]

Background

Swaziland's growth performance has weakened since the early 1990s as the emergence of South Africa from economic isolation has eroded some of the country's advantage as a location for investment. Real GDP growth fell from 7¾ percent annually during the 1980s to 3¾ percent during the 1990s. In 2001, growth declined further to 1.8 percent, reflecting a fall in export demand associated with the economic slowdown in South Africa, foreign disinvestment in some industries, and poor weather. Economic activity appears to have weakened further in 2002, with manufacturing output showing the effects of additional closures by foreign firms and agricultural output being affected by the drought in the region.

Swaziland faces a serious humanitarian situation, with a food shortage and the spread of HIV/AIDS exacerbating the already severe impact of high unemployment (nearly one third of the labor force), income inequality, and poverty. Over a quarter of the population could be in need of emergency food assistance and over a third of the adult population is infected with HIV/AIDS. The authorities are making efforts to alleviate the food shortage, including through budgetary allocations and the formation of a task force on disaster relief to organize foreign food inflows.

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

allocations and the formation of a task force on disaster relief to organize foreign food inflows. They have renewed their commitment to fighting HIV/AIDS, notably through the establishment of a National Emergency Response Committee (NERCHA) in December 2001.

The central government fiscal balance has shifted into deficit since 1999/2000 (April-March), and by 2001/02 the deficit (including grants) had widened to 2¾ percent of GDP. The deterioration in public finances has mainly reflected a decline in Southern African Customs Union (SACU) receipts. In 2002/03, the authorities expect that the deficit could widen to 4–4½ percent of GDP, largely due to an increase in the civil service wage bill and, in early December, supplementary expenditures equivalent to around 2 percent of GDP.

Inflationary pressures have picked up since late 2001, and CPI inflation rose to 12.9 percent (12-month basis) in October 2002. The rise in inflation has blunted the impact on competitiveness of a depreciation in the nominal effective exchange rate of the lilangeni, which fell by 5 percent (end-year basis) in 2001, largely reflecting the depreciation vis-à-vis the U.S. dollar of the South African rand (to which the lilangeni is pegged). The real effective exchange rate, however, appreciated by 1 percent.

The external current account deficit widened to 4 percent of GDP in 2001. A reduction in the trade deficit, due to an import contraction related to weak investment, was offset by lower SACU receipts. Gross international reserves declined slightly to 3 months of imports. Total external debt fell to 22 percent of GDP, and external debt service as a percent of exports fell to 2¼ percent.

Given the peg of the lilangeni to the rand, and Swaziland's membership in the Common Monetary Area (CMA), the scope for an independent monetary policy is limited. The Central Bank of Swaziland raised short-term policy interest rates by 400 basis points during January-September 2002, in step with monetary tightening by the South African Reserve Bank.

Executive Board Assessment

Directors expressed concern about the serious economic situation in Swaziland, with the food shortage and continued spread of HIV/AIDS exacerbating the already severe impact of persistent high unemployment, income inequality, and poverty. They saw the main economic policy challenges as addressing the humanitarian crisis, regaining macroeconomic stability, and raising the economy's sustainable longer-term growth rate, while ensuring that the benefits were spread widely. Meeting these challenges would require a return to fiscal discipline, while reorienting spending toward critical social sectors and humanitarian priorities; implementation of structural reforms to increase economic efficiency, including through restructuring public enterprises and further strengthening the financial sector; and an urgent and well-coordinated response to the HIV/AIDS pandemic; as well as strengthening of governance.

Directors considered the most immediate issue would be to find an adequate response to the humanitarian crisis. They welcomed the authorities' efforts to alleviate the food shortage, including through budgetary allocations and the work of the task force on disaster relief. Equally, Directors welcomed the authorities' renewed commitment to fight HIV/AIDS, notably through the establishment of the NERCHA. Directors stressed that an effective response to the growing humanitarian crisis would urgently require greater foreign inflows and concessional assistance. In this regard, a reorientation of policies, with a clear, determined focus on the humanitarian situation, would be beneficial both through its direct impact and confidence-building effects among the donor community. Directors noted that, over time, it would be critical for the authorities to address the underlying factors behind the successive run of poor harvests and the continued spread of HIV/AIDS.

Against the background of a fragile medium-term outlook, Directors considered that the central longer-term challenge was to address the factors that were holding down Swaziland's growth prospects and preventing improvements in the standard of living. They felt that greater fiscal discipline was needed to restore macroeconomic stability, address social priorities, prepare the budget to withstand prospective medium-term pressures, and regain longer-term growth prospects. Directors also recommended the early adoption of a medium-term framework for the formulation of fiscal policy as a means of strengthening budgetary planning.

Directors welcomed the measures initiated in 2001/02 to broaden the tax base, which would help compensate for an envisaged decline in SACU receipts, and they urged further measures in this direction. Directors also saw a need to strengthen tax administration, particularly audit and enforcement, and to enforce prompt collection of sizable outstanding tax arrears.

On the expenditure side, Directors emphasized the need to reorient spending toward critical social sectors, such as health and education, while restraining overall expenditure. In particular, they considered it important to contain the public wage bill and transfers to public enterprises. Directors expressed concern about the substantial additional expenditures announced by the authorities in early December, which they felt were likely to further weaken the fiscal situation. Directors strongly urged reconsideration of the government's proposed acquisition of a new airplane for the King. This expenditure could crowd out social needs and deter donor support while depleting foreign exchange reserves. They suggested that the authorities' concerns about an appropriate form of transport for the King be met through less costly alternatives that did not require significant additional budgetary and foreign-exchange resources. Directors supported the authorities' intention to devolve the majority of the Millennium Projects to the private sector, and urged them to ensure the economic viability of the few projects in which government participation might be warranted. More generally, they stressed the need to address governance concerns and encouraged further strengthening of the rule of law, including through the current constitutional review process, with a view to improving the environment for private investment.

Directors noted that membership in the Common Monetary Area, which involved pegging the exchange rate of the lilangeni to the South African rand, continued to serve Swaziland well, given the monetary discipline that it entailed and the close economic integration between Swaziland and South Africa. They emphasized that a strengthening of public finances, a prudent monetary policy stance that secured an adequate level of international reserves, and continued structural reforms would be important for ensuring the credibility of the peg.

Directors noted that Swaziland has a well-developed banking system. Banks' capitalization, risk management, and provisioning appeared to be sound and their nonperforming loans were relatively low. However, Directors observed that the future commercial viability of the Swaziland Development and Savings Bank remained a source of concern. They recommended that continued budgetary support to the bank be dependent upon the prevention of a build-up in bad loans, and urged early action to restructure or privatize the institution.

Directors commended the authorities for the passage of anti-money-laundering legislation in August 2002, and encouraged them to move ahead with plans to implement the legislation and develop institutional capacity to combat both money laundering and the financing of terrorism.

Directors cautioned that the Swaziland Public Service Pensions Fund could pose a significant future liability to the government if its financial difficulties were not adequately addressed, and they encouraged the authorities to initiate measures to put the fund on a sustainable path.

Directors felt that reform of the land tenure system would be helpful in raising agricultural productivity and alleviating poverty. They welcomed the cabinet's approval of the Land Policy Act, which would institute long-term leases for agricultural and peri-urban land, and recommended its early enactment into law.

Directors considered that the effectiveness of policymaking in Swaziland would be greatly enhanced by improvements in the economic data. They encouraged the authorities to address the shortcomings in the economic statistics, particularly with respect to the national income, balance of payments, and government accounts. They also encouraged the authorities to improve the timeliness of data reporting to the Fund. In this context, they welcomed the authorities' decision to participate in the General Data Dissemination System (GDDS) Project for Anglophone African Countries, and considered that the initial GDDS assessment should form a sound basis for future technical assistance.