PRE-COVID CONTEXT

1. **Botswana's economy was already facing significant structural challenges and declining buffers when the COVID-19 pandemic struck**. Thanks to large natural endowments and a track record of very strong policies and policy frameworks, the country has made impressive strides in economic and social development through the 2000s. Over the last four decades, extreme poverty rate has declined by about 40 percentage points to 16 percent; per capita income has quadrupled; and secondary school enrollment has increased from 20 percent to above 80 percent. That said, persistently lower-than-anticipated diamond revenue (including through declining prices over 2016-20) and SACU transfers in recent years have exposed the country's external and fiscal position to external shocks. Limited fiscal and exchange rate adjustment and hiccups in implementation of structural reforms contributed to eroding reserves by about US$½ billion per year on average since 2014, reduced competitiveness and stymied the much-needed transformation of the economy toward an export- and private-sector led growth model as envisaged in the authorities' National Development Plan 11 (NDP11) and Vision 2036. With growth decelerating, job creation remained anemic relative to the large number of young and more educated entrants into the labor force. In addition, climate change shocks have increased in recent years with severe droughts, affecting primarily the rural population and countering the government efforts to reduce poverty and inequality.

IMPACT OF THE PANDEMIC AND THE POLICY RESPONSE

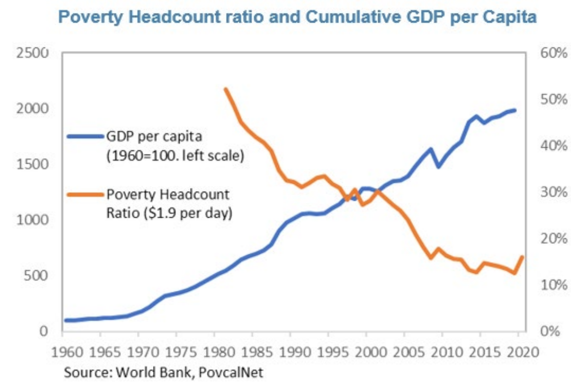
2. **Stringent containment measures imposed at the onset of the COVID-19 crisis have helped limit the spread of the virus and save lives** (Figure 1). Botswana registered its first cases in late March 2020. Early on, the authorities responded by issuing a State of Emergency and imposing a 6-week nationwide lockdown followed by partial lockdowns, travel restrictions, mandatory mask wearing and social distancing measures, including bans on social events. With these measures coupled with targeted testing and contact tracing, Botswana kept the morbidity and mortality rate under control (3,172 cases, about 0.1 percent of the population, and 16 deaths as of end-September 2020).

3. **However, cases have accelerated since November 2020.** Cases have been rising rapidly totaling about 44,000, while deaths exceeded 670 mid-April 2021. The South African variant, reportedly more contagious, has been detected. After deciding a phased lifting of travel restrictions in November to support the recovery of the tourism sector, Botswana government decided to impose a curfew to curb the spread of the virus. At end-March, the parliament approved the extension of the State of Emergency for another 6 months.

4. **The COVID-19 disrupted activity in most sectors in the second quarter of 2020, with the economy recovering somewhat in the second half of the year** (Table 1, Figure 2). The stringent restrictions on mobility and huge drop in global demand caused an unprecedented collapse in GDP (-11 percent y-o-y in H1 and -24 percent in Q2). The economic structure of the

economy, relying on diamond, tourism and "contact-intensive" services, has largely contributed to this contraction. Yet, the economy is bottoming out in the second half (-4.1 percent in Q4), led by buoyant domestic consumption, supported by the increase in public wages in September, and the relaxation of mobility restrictions. Diamond sales have also rebounded while tourism activity remained very slow. On annual basis, GDP growth stood at -7.9 percent, making Botswana one of the hardest hit countries in Sub-Saharan Africa.

5. **The crisis has worsened social outcomes.** The unemployment rate reached 24.5 percent in 2020Q4 from 22.2 percent in 2019Q4 and could increase further once the State of Emergency is lifted. Youth unemployment rate also rose from 28.8 percent to 32.4 percent. The World Bank estimates the extreme poverty rate (US$1.9/day in 2011 Purchasing Power Parity) to have increased to 16 percent in 2020 from 12.6 percent in 2019. Forecasts suggest the poverty rate would remain above the 2019 figure until 2022. Notwithstanding the government's support, the disproportionate impact on poorer and more vulnerable households could lead to even more inequality.



6. **Inflation remains well below the Bank of Botswana's 3 to 6 percent objective.** Inflation fell to 1.9 percent in 2020, from 2.8 percent in 2019, as lower import prices, especially oil prices, more than offset higher prices for domestically produced goods and services. The rise in domestic prices reflects the effects of increases in food prices, electricity tariffs and domestic wages.

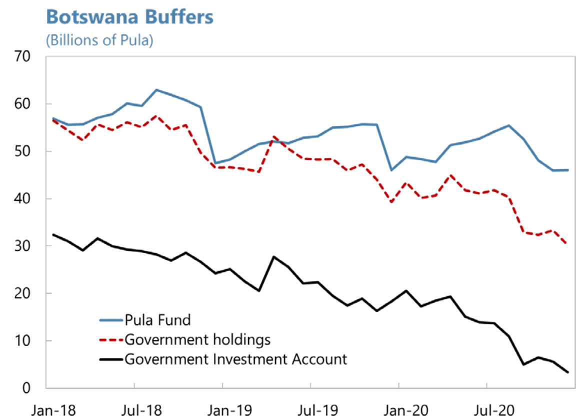
7. **The external position deteriorated further, but foreign reserves remain comfortably above adequacy levels.** The CA deficit stood at 10.1 percent of GDP in 2020. Diamonds net exports declined by 40 percent (in US$), while non-diamond imports declined only by 5 percent. Exports of services also declined by 51 percent led by tourism. Despite positive valuation effects, reserves fell by US$1.2 billion to 7.3 months of imports at end-November.[1] In response to the COVID-19 shock and given the low domestic inflation, the authorities moved the crawl rate from -1.5 to -2.9 percent in May 2020 and the REER depreciated by 3.5 percent y-o-y in December (Table 2, Figure 3).[2]

8. **The government put in place a large fiscal relief package that helped mitigate the economic, social and health effects of the pandemic.** The government initially put in place a P4.7 billion (2.6 percent of GDP) economic COVID-relief package to mitigate the impact of the crisis on households and firms and reduce its scarring effects. In addition, P1 billion was provided as supplementary recurrent budget to the Ministry of Health and Wellness for COVID-related spending, and P1.3 billion as loan facility to benefit firms affected by the COVID-19 crisis (Text Table 1).

[1] ARA metric range is equivalent to 3¾ -5¾ months of imports.

[2] The same crawl rate was continued in 2021.

Reflecting these measures, the cyclical drop in revenue, the salary increases for public servants and the GDP contraction, the fiscal deficit is expected to be about 11 percent of GDP in FY2020. The deficit was financed by domestic borrowing, fiscal buffers, and exceptional revenue from the BoB. Public debt is estimated to increase to about 23.5 percent of GDP in FY2020, still below the 40 percent debt ceiling limit, but with a further erosion of fiscal buffers (Table 3a–3c, Figure 4).[3]



Text Table 1. Fiscal Relief Package

(In million pula)

1. COVID-19 Pandemic Relief Fund: Initial Allocation	**2,000**
Spending as of Nov 11, 2020	*1,946*
Health Supplies	*397*
Wage Subsidy	*924*
Food Relief	*351*
Diaspora Citizen Support	*11*
Education	*67*
Agriculture	*197*
2. Loan Guarantee (*Below the line***)**	**1,000**
3. Foregone Revenue and Accelerated Spending	**1,680**
Tax concessions and acceleration of VAT refunds	1,000
o/w tax deferrals	0
Waiver of training levy	150
Accelerated repayment of invoices	530
4. Additional Injection to COVID-19 Pandemic Relief Fund: October 2020	**1,300**
Industry Support Facility (ISF Loan facility)	1,300
Allocation from ISF as of January, 2021	*450*
5. Supplementary budget October 2020	**1,000**
Ministry of health supplementary budget	1,000
Total Fiscal Package	**6,980**

Source: MFED and IMF staff calculations

9. **Monetary policy has been eased.** Since April 2020, BoB reduced the policy rate (by 100 basis points to 3.75 percent) and the reserve requirement ratio, and expanded the maturity of repo operations to 92 days and the eligible collateral to access its facility. These measures reduced interest payments on existing debt and supported credit growth (+5.3 percent in December). As a result, the share of credit to households in banks' balance sheets increased (to 65.4 percent in

[3] To finance the deficit, the parliament approved a doubling of domestic borrowing limit from 15 to 30 billion. The Government Investment Account balance stood at P5.6 billion in November 2020 down from P15,7 billion a year earlier.

November 2020 from 63.7 in December 2019). About 70 percent of this credit is non-collateralized and carries higher interest rates (Table 4, Figure 5).

10. The financial sector has proven resilient this far, but some risks may be looming.

- Commercial banks remain adequately capitalized and liquid.[4] NPLs have declined and provisioning has improved. However, some COVID-19 relief measures, notably the 6-month loan repayment moratorium, loans restructuring, and guaranteed loans to affected sectors, may have delayed the deterioration in asset quality. Thus, banks' financial stability indicators may not fully reflect the impact of the COVID-19 shock (Table 5).[5]

- To mitigate the negative economic effects of COVID-19 on households, while also ensuring sustainability, NBFIs introduced temporary measures, including restructuring and rescheduling of loan installments, life premium and retirement contributions for at least three months; discount on insurance products; reduction of interest rates on non-bank lending; and provision of quick turnaround time for processing insurance and medical aid claims. Such measures may have negatively impacted profitability of the sector in the short term. Yet, given their strong balance sheets at the onset of the crisis, NBFIs' solvency risks remain low.

OUTLOOK AND RISKS

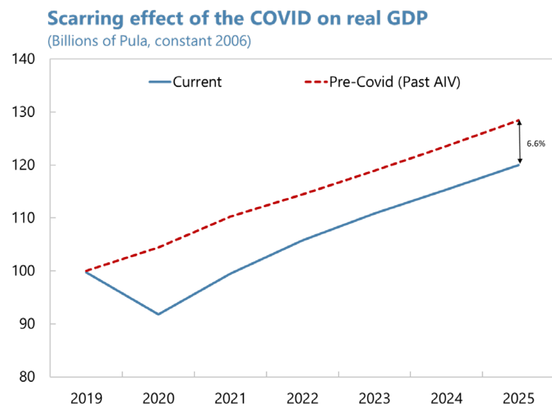
11. Botswana plans to vaccinate 75 percent of the adult population by end-2021. The country has made an upfront payment to COVAX, the World Health Organization's (WHO) vaccine arrangement, to acquire 940,800 vaccines under a two-dose regime, enough to cover about 20 percent of the population. In parallel, the authorities have reached agreements with vaccine manufacturers to acquire 1.9 million doses, enough to cover the entire adult population. The vaccination initiative is expected to cost a minimum of 1/3 percent of GDP.

12. Economic growth is projected to rebound in 2021, but the output losses from the crisis are expected to persist. Following an estimated contraction of 7.9 percent in 2020, real GDP is expected to grow by 8.3 percent in 2021. The recovery assumes a normalization of diamond production to pre-crisis levels in line with recent trends, the entry in production of Khoemacau copper mine, some containment measures but no nationwide lockdowns in response to the second

[4] BoB reduced the capital adequacy ratio from 15 percent to 12.5 percent, but most banks remain above the 15 percent threshold.

[5] Since the implementation of the discretionary loan repayment holiday by banks, loans that have benefited from this measure accounted for 11.4 percent of the aggregate commercial banks' loans and advances, which translates into P7.3 billion (74 percent of which was business loans), as at the end of June 2020. Business loans given moratoria were mainly concentrated on those extended to commercial real estate (33 percent), "restaurants and bars" (16 percent) and "Tourism and Hotels" (13 percent), industries. At the same time, banks restructured loans amounting to P5.8 billion (9.1 percent of total credit extended by commercial banks), with private businesses accounting for the largest share (73 percent).

wave, and international tourism resuming in the second half of 2021 as vaccination ramps up. The effect of the projected fiscal consolidation is expected to be moderate in 2021, as consumption will continue to benefit from the lagged effect of the civil servants' salary increase while investment will be supported by the shift in the composition of public spending from non-priority spending to capital spending (with higher fiscal multiplier). The recovery is expected to continue through the medium term, though at a slower pace as the government's fiscal consolidation plan is implemented. Thus, output will remain below its pre-pandemic forecasted levels through the projection period.



13. Inflationary pressures are expected to rise temporarily in 2021. Staff forecasts inflation to pick up to 4.8 percent on average in 2021 (from 1.9 percent in 2020), still within the central bank objective of 3-6 percent. This reflects the rebound in oil prices, the planned increase in the VAT rate, fuel levy, electricity tariffs, sugar tax, rentals, and sustained domestic consumption. These pressures are expected to linger through the first half of 2022 and ease thereafter.

14. In the near term, the fiscal and external positions are expected to improve but with limited room to address large future shocks.

- The current account deficit is expected to narrow to -4.5 percent of GDP and -3.3 percent of GDP in 2021 and 2022, respectively, as the rebound of diamond production and favorable terms of trade are expected to more than offset the projected drop in SACU revenue.[6] Reserves are expected to stabilize in 2021 and improve thereafter.

- Despite the large drop in SACU transfers, the fiscal deficit is expected to narrow as the cyclical downturn in revenue fades; COVID-related spending is gradually phased out; and revenue and expenditure consolidation measures are implemented. Public debt as a share of GDP will continue to increase in the next two years, before declining in the medium term.

15. The outlook is subject to significant uncertainty with risks tilted to the downside (Annex II and Annex V).

- **Near term.** The COVID-19 pandemic could last longer than envisaged, which would affect employment, domestic demand, diamond exports, tourism receipts, SACU transfers and government expenditure. Even if the pandemic wanes as expected in the baseline, the uneven nature of the recovery could delay expected improvements in labor markets, people's livelihoods, and the balance sheets of firms in hospitality-related sectors. At the same time, in an environment of low real interest rates and excess liquidity, increased

[6] The SACU revenue sharing formula adjust for forecast errors with a 2-year lag. A sharp correction is therefore projected in FY 2022 to reflect the effect of the crisis.

lending to households could possibly fuel inflation further with attendant effects on poverty, and increase households' indebtedness. Other risks stem from contingent liabilities (state-owned enterprises (SOEs), guaranteed loans) and a larger-than-expected deterioration in the corporate sector that could increase unemployment once the State of Emergency is lifted, impair banks' balance sheets, and amplify the scars of the crisis. On the upside, a faster rollout of vaccines worldwide could lead to a resumption of tourism activity, higher SACU revenue in FY2022 and higher demand for diamond exports.

- **Medium term.** Weaker-than-expected diamond revenue amid shifts in consumer preferences (see Figure A1.1) and greater competition from synthetic diamonds could weaken current account and fiscal balances, put pressure on external buffers, and increase public debt. On the upside, accelerated implementation of the ERTP could improve potential growth over the medium term.

Authorities' Views

16. The authorities broadly agree with Staff's outlook and risks assessment. They are more sanguine on the diamond outlook and are encouraged by the positive outcome of the first three "sights" (global wholesale event) by De Beers this year. They nonetheless acknowledged the high uncertainty and vowed to continue to monitor developments closely. In addition, BoB continues to see elevated financial stability risks if Botswana does not exit the AML/CFT Grey-listing. Finally, the authorities concurred with the staff that implementation of the planned fiscal consolidation and the ERTP are critical to preserve macroeconomic stability and create sustained, high, job-rich, and diversified growth.

POLICIES TO ENTRENCH THE RECOVERY AND FACILITATE TRANSFORMATION

Discussions focused on the calibration of macroeconomic policies to navigate the uncertain outlook and sustainably support a more even recovery while facilitating structural transformation.

A. Macroeconomic Policy Mix

Fiscal Policy

17. The authorities' MTFF aims to support the recovery and lay the foundation for higher growth potential, while ensuring fiscal sustainability. To create space for transformative investment in infrastructure and human capital, the authorities' budget for FY2021 envisages to enhance revenue mobilization by increasing the VAT rate by 2 percentage points, fuel levy, sugar levy, tax on plastic bags and withholding taxes, estimated to yield about 1 percent of GDP. They also initiated a tax amnesty to increase revenue collection this year by about ½ percent of GDP. On the expenditure side, measures include containment of the wage bill,[7] cuts in non-priority spending and

[7] No inflation adjustment and savings on vacancies.

"efficiency gains" in grants and subventions and transfers to local government. For the remainder of NDP11, the authorities also envisage to expedite fiscal reforms, including better targeting of social spending, restructuring of parastatals, and strengthening of the public investment management framework.[8]

18. Staff welcomes the commitment to fiscal sustainability and recommends that the planned adjustment be implemented without further delay. Under the baseline, the envisaged pace and size of consolidation and the shift in spending composition are appropriate to gradually reduce the deficit and rebuild buffers. The plan will help achieve a balanced primary budget by 2026 and keep the debt below 30 percent of GDP. The fiscal consolidation plan will allow for rebuilding asset positions in the Government Investment Account and the Pula Fund, while the re-orientation of expenditures towards investment and human capital development will raise productivity, create jobs, and help diversify the economy and revenue sources. At the same time, the envisaged incentives for training and financial support to transformative sectors will facilitate the reallocation of factors to new sectors. These measures will benefit future generations and insure against volatility.

19. There is a need to maintain targeted support to firms and households still affected by the pandemic and make the support state-contingent or conditional to reduce moral hazard. The extension of the State of Emergency and the industry support facility will help households and firms cope with the crisis through end-2021. This will help address the uneven nature of the recovery across sectors and mitigate the regressive impact of planned increase in the VAT rate and other taxes and fees on the most vulnerable.[9] Additional support would be required if the pandemic is more protracted than expected and the recovery is uneven. Given the uncertainty on the evolution of the health crisis, and that a shortfall in mineral revenue could entail a significant increase in the debt ratio and force a sharp adjustment, staff is of the view that the recommended targeted support would need to be financed through the following additional measures:

- On the revenue side, measures could include increasing progressive tax measures such as property taxes and reducing VAT exemptions while compensating the most vulnerable. In addition to the planned tax amnesty that could help reduce tax arrears, there is a need to expedite the promulgation of tax bills and continue tax administration reforms, including accelerating e-filing.

- On the expenditure side, extending the wage freeze to FY2022, means-testing of scholarships to tertiary education, and cost recovery in some public services (e.g. electricity and water tariffs) could provide savings and also lead to a better targeting of social spending.

[8] The authorities are extending the coverage of social registry to six more districts for five social programs in cooperation with the World Bank, which will help better target social transfers. The authorities are also reviewing the design of the public work program IPELEGENG and implementing proxy means testing for the Destitute Persons Program.

[9] In order to alleviate the burden on taxpayers, and reflect the impact of inflation on their purchasing power, the threshold at which income earners become liable for income tax will be raised from P36,000 to P48,000 per annum with effect from the 2021/2022 tax year. This measure however will only reach formal workers.

20. Strengthening the fiscal framework is paramount to better anchor fiscal policy and increase credibility. This requires i) revamping the fiscal rule in line with past Article IV recommendations to benefit future generations while allowing for countercyclical policy,[10] ii) implementing medium-term budgeting involving a complete re-orientation of budget engagements to cover the full 3-year time horizon; budget communication must be reformed to align with the objective of multi-year strategic budgeting; establishing differing levels of authority to discuss the budget before it is tabled in Parliament; restructuring the budget on the basis of a unitary definition—fully integrating the recurrent and development budgets; and analyzing fiscal policy and the budget from a risk perspective, including assessing the credibility of the baseline projections and the risks arising from the SOE sector, iii) improving accounting and reporting by accelerating the implementation of the new chart of accounts, migrating to GFSM 2014 and increasing the coverage of fiscal statistics,[11] iv) strengthening the fiscal risks management framework given the uncertain outlook and mounting contingent liability risks.

21. A special attention should be given to emerging fiscal risks.

- The plan to further rely on public-private partnerships (PPPs) to finance infrastructure projects needs to be accompanied by the adoption of appropriate legal and institutional frameworks to limit risks given that these arrangements often entail sizable contingent liabilities. In addition, existing plans to increase capacity at the PPP unit at the MFED would help safeguard public finance from risks arising from PPPs and cope with a growing PPP portfolio.

- The COVID-19 shock could exacerbate contingent liabilities associated with parastatals (about 5 percent of GDP) and loan guarantees to the private sector (0.5 percent of GDP). Hence, there is a need to expedite the plans to rationalize parastatals, including merging those with overlapping mandates and restructuring/privatizing loss-making SOEs and enhancing their governance. Going forward, there is a need to design effective mechanisms for intragovernmental coordination; define clear ownership and financial oversight functions; compile timely and comprehensive financial data on SOE performance; continue to build capacity to assess SOEs' performance; and regularly publish their financial statements and evaluation reports in a timely manner.

22. Over the medium term, civil service reform will be key to the success of the fiscal consolidation. The 2019 two-year wage increase agreement with civil service unions exceeded productivity gains and inflation and thus exerted significant strains on the government's resources. It may have also widened the already significant gap in compensation between the public sector and the private sector. Such practices should be avoided going forward to prevent further pressures on the budget and help strengthen the attractiveness of the private sector as an employer, without

[10] For more details on the fiscal rule proposed by staff, see Botswana 2019 Article IV (Appendix 1). Technical assistance is already planned to help with the calibration of the new fiscal rule.

[11] Progress has been made on the objective of establishing a platform for implementation of international reporting standards including development of the accrual IPSAS policies, accrual data collection and development of financial reports as well associated revisions for the Public Finance Management Act. It will be important to continue with these activities, pending the availability of the proposed upgraded Government Accounting and Budgeting System.

which it would be difficult for the government to achieve its structural transformation objective. Staff recommends a careful monitoring of salary increases in the parastatal sector[12] and designing a civil service reform that better aligns public sector wages to productivity over the medium term. This will ensure that the wage bill remains under control as planned.

23. As buffers are eroding, the authorities are diversifying their financing sources in line with past staff advice. They have already stepped up domestic issuance to finance the FY2020 deficit and will continue with this strategy in coming years. They are also negotiating a budget support with the World Bank and the AfDB and are exploring different external financing options, including syndicated loans, to finance the deficit in FY2022–23. A more active debt management strategy is needed. The financing strategy should result from a comparison of returns on assets and the cost of issuing debt, including in domestic and foreign markets.

- The regular issuance of medium-and long-term maturities in the domestic market should help build the yield curve and support secondary market development. The success of this strategy will hinge on enhancing the efficiency and liquidity of the domestic bond market (see below) and coordination of issuance plans from various public sector entities.

- When issuing debt in foreign markets, the currency composition of external borrowing should be tailored to the composition of revenue to hedge against exchange rate risk.

Authorities' Views

24. The authorities reiterated their commitment to fiscal sustainability and broadly agreed with staff's assessment and advice. While acknowledging uncertainty and risks, they indicated that their objective in the short term is a deficit below 4 percent of GDP. Should downside risks materialize, they envisage to reprioritize spending and increase some fees. They requested a TA that will help them redesign and calibrate a fiscal rule in the context of the National Development Plan 12. To achieve the planned fiscal consolidation, they see scope for higher revenue mobilization through a broadening of the tax base, introduction of new taxes[13] as well as tax administration reforms. In this context, they stressed that pending tax bills are being finalized with assistance from the Fund and will be presented to parliament in the July session, and that the revenue authority intends to use electronic billing machines to reduce tax evasion. Reforms in the parastatal sector are also one the authorities' top priorities.

Monetary and Exchange Rate Policy

25. Monetary policy should remain accommodative in the near term. Further reductions in interest rates risk tipping inflation outside the BoB objective range and fueling credit to households with attendant risks to financial stability. At the same time, a rapid increase in the policy rate could compromise the fragile recovery, and exacerbate existing vulnerabilities in households balance

[12] For example, government support (subsidies, guarantees) could be conditional on efforts to contain the wage bill. Similarly, enhanced governance and accountability through competent and independent boards, could contribute to better align salary increases to performance.

[13] For example, they are considering the feasibility of introducing a carbon tax.

sheets. Given the large negative output gap and as long as expected inflation remains within BoB's objective range, staff is of the view that BoB should keep the monetary policy rate unchanged. That said, BoB should carefully monitor the second-round effects of supply shocks and administrative price changes on inflation expectations, as well as the development of credit and demand.

26. A more active liquidity management will be essential to smooth interest rate volatility and enhance the monetary policy transmission. The large fiscal deficits may entail significant swings in domestic liquidity, and potentially crowd-out private sector credit. These effects could be larger with a potential removal of Botswana from the AML/CFT Grey-listing, despite its positive effect on integration into the global financial system. Thus, staff recommends setting the reserve requirement as a buffer against the fluctuations of the autonomous factors of liquidity, conducting regular OMO at fixed-rate full-allotment, and complementing these actions with fine-tuning operations to smooth volatility. Staff welcomes the BoB's plan to replace the Bank rate with the BoB certificate rate as the main monetary policy instrument to enhance policy transmission. Staff recommends pursuing the development of the unsecured interbank and REPO markets to strengthened monetary policy transmission.

27. Despite some real depreciation in 2020, the external position remains moderately weaker than suggested by fundamentals and desirable policies. The exchange rate is assessed to be moderately overvalued (8½ percent). Under staff's baseline, the current account balance is expected to improve but remain weaker than the norm in the near term. This would exert further pressures on international reserves. Over the medium term, the anticipated fiscal consolidation together with the recovery in external demand will contribute to narrowing the gap and gradual reserves accumulation. However, this scenario hinges on favorable diamonds projections that reflect the strength of activity in the United States, India, and China.

28. The flexibility within the current exchange rate regime should continue to be used. This would allow to gradually reduce real overvaluation, help the economy adjust to shocks, and facilitate structural transformation, while avoiding de-anchoring inflation expectations. The pass-through of nominal effective exchange rates to inflation is estimated to be lower than 0.4 for the first two quarters, and below 0.5 over a year. The expected pick-up in inflation in 2021–22 hence limits the extent to which a real depreciation could be achieved through changes in the crawl rate in the near term while maintaining inflation within the 3–6 percent objective range and inflation expectations anchored. However, as inflation pressures abate and with progress on fiscal consolidation, there will be a need for a steeper crawl to help address the residual overvaluation harmful to Botswana's structural transformation.

Authorities' Views

29. The authorities broadly agree with staff's recommendations. On monetary policy, BoB indicated it will monitor closely inflation expectations and strengthen its communication to keep them well anchored. The authorities also appreciated the timeliness of the upcoming TA mission on monetary policy implementation and operations that will help with the possible transition to the BoBC rate as the monetary policy rate. On exchange rates, the authorities agreed with staff assessment but noted the important role that the objective of a stable REER has played in anchoring

investors' expectations. They expressed concerns on the impact of greater exchange rate flexibility could have on capital flows and financial deepening, while stressing the importance of structural reforms and fiscal adjustment in maintaining external stability, enhancing competitiveness, and promoting economic transformation.

Policies to Safeguard Financial Stability

30. Major government interventions have mitigated immediate macro-financial risks, but they remain a concern. An uneven recovery could increase corporate vulnerabilities, while the expiration of the debt moratorium could be followed by higher NPLs. These risks could add to structural vulnerabilities in the banking system: households indebtedness–in particular the large share of unsecured loans– could further increase in a context of low interest margins; and concentration on wholesale funding exposes banks to liquidity risks, increases their funding costs and reduces their profitability. At the same time, further reliance on domestic borrowing to finance the fiscal deficit will increase the sovereign-financial nexus. Thus, staff recommends to:

- Continue targeted support to viable firms through liquidity provision and loan restructuring. The measures should be time-bound and designed with sufficient skin in the game (e.g. loans as opposed to guarantees). Relatedly, staff welcomes the recently revised insolvency framework which should facilitate voluntary credit workouts in commercial courts and thus the reallocation of resources toward more productive sectors.

- Maintain the reduced CAR at 12.5 percent and reassess this decision on a regular basis based on a close monitoring of risks to financial stability and evolution of credit. Tighter macroprudential policies should be put in place in the event of excessive credit growth, especially toward households. These could include measures, such as lower debt-to-income and debt-service-to-income ratios or put limits on unsecured loans. Such measures would also encourage a reallocation of credits toward more productive sectors.

- Closely monitor risks, including through enhanced reporting, regular stress-testing and financial oversight. Also, any forbearance in recording NPLs should be avoided, as such practice weakens the quality of supervision.

- Strengthen crisis preparedness and bank resolution framework by expediting the preparation of the banking act and operationalizing the deposit insurance mechanism.

Authorities' Views

31. The authorities have more nuanced view on the risks related to households' indebtedness. They noted that the ratio of credit to households to GDP remains low and that the credit gap does not show signs of overheating. While acknowledging the large share of non-collateralized loans, they highlighted that a large share of credit to households goes to public sector employees, who are less vulnerable to loss of income, in the form of direct payroll deduction lending schemes.

B. Structural Policies

32. The parliament has approved an Economic Recovery and Transformation Plan (ERTP) in October 2020. The ERTP aims at reducing the potential economic scars from the COVID-19 crisis, accelerating structural transformation, and increasing job creation and inclusiveness (citizen empowerment). To achieve this objective, the authorities will continue to focus on traditional sectors (e.g. cattle, tourism, mining), import substitution (local content requirement, protection), and different programs support to MSMEs. At the same time, they plan to i) boost investment in digitalization (including e-government), human capital development and R&D, ii) reduce the government footprint, iii) enhance the business environment, and iv) strengthen accountability and governance to improve implementation. Successfully implementing this strategy requires a continuous appraisal of existing sectoral programs, assessment and adaptation to changes in markets and risks and opportunities (learning externalities, environmental risks), focusing on promising sectors, tackling market and government failures, and addressing key bottlenecks in a cost-efficient manner.

33. Diversification policies should be designed in an incentive-compatible manner. This should be done with a view to enhancing competitiveness, creating jobs, especially for the youth, and fostering productivity gains, including through innovation and technology upgrade. In particular:

- *Reduce reliance on import substitution and protectionist policies*, especially if these are not time bound and deter competition.
- *Enhance competitiveness*. Government support should be conditional on productivity gains and performance, help promote technological and quality upgrade (e.g. through certification), and foster innovation. These efforts should be complemented with a reduction of network costs through greater competition, leveling the playing field between public and private companies, enhancing the efficiency of SOEs, and spatial planning/geographic clustering to minimize costs. More targeted higher education and vocational training and promoting internships and exchanges of skills would help reduce skills mismatches.
- *Reduce information frictions and facilitate access to market* through platforms, language services, visas, open skies agreements, trade fairs, buyer-seller matching, country image, collective reputation, and relationship-building.
- *Promote regional integration and regional value chains*, which could be reciprocal reduction of non-tariff barriers, coordination of industrial policies and promotion of cross-border investment.
- *Attract FDI and knowledge transfer* (including both more advanced technology and management know-how).
- *Strengthen and clarify mandates of export and investment promotion agencies*.

35. Botswana is expected to accelerate its transition to the digital economy. It plans to invest 1½ percent of GDP (about 22 percent of total development expenditure) in this sector during 2021–23. As showcased during the COVID-19 shock in several countries, digital technologies could enhance Botswana's resilience and efficiency, expand access to global markets, improve public service delivery, boost transparency and accountability, improve learning, and foster the creation of new jobs. The latter will be particularly important in the context of regional trade integration, as the AfCFTA framework will likely increase the scope for increased trade in services and e-commerce. Staff also welcomes the authorities' efforts to reduce the digital divide (Annex VI).

36. The parliament approved Botswana climate change policy in April 2021. This includes promoting renewable energy sources (by implementing the Integrated Resource Plan), reducing subsidies to the use of fossil fuels, and increasing fossil fuel fees. Full implementation of the climate agenda in the ERTP will reduce Botswana's dependence on carbon-intensive energy sources, enhance its energy generation capacity, promote exports and private sector activity, enhance its climate resilience, and support its transition to higher income status. Transition to a greener economy will also support the livelihoods of the poor who typically rely on subsistence agriculture, and the tourism and mining sectors.

37. The authorities are implementing a multipronged strategy for financial development and inclusiveness, consistent with past staff recommendations. Despite large domestic savings, Botswana' credit to the private sector remains low compared to other countries at similar levels of development. Domestic credit is concentrated on households and non-tradable sectors. To increase resource mobilization and efficiently allocate them, the authorities' strategy aims at deepening financial markets, revising the regulatory framework and strengthening supervision, and upgrading the infrastructure, while leveraging technology (FINTECH) to increase efficiency and inclusiveness. In this context, in addition to reforms to the National Payment System, the authorities are finalizing several bills related to the credit information and collateral framework. That said, the following additional measures are needed:

- *Clarify the role of development banks.* In particular, there is a need to separate their social role from their development mandate, and enhance their supervision, governance, and accountability.

- *Deepen the domestic bond market.* This will require a coordinated approach from public and private issuers, including the following:

    - Issuance of a longer benchmark maturity for government debt securities, eligibility of government securities as high-quality liquid assets, a formal market making agreement for primary dealers, a pricing mechanism as well as variety of instruments that maximize market demand.

    - On the back on the new benchmark tenor, the private sector and various public sector entities should be encouraged to issue longer maturity securities to reduce maturity mismatches. There would be ground, in particular for banks, to replace volatile time deposit for issuances of longer-term bank bonds.

OTHER SURVEILLANCE ISSUES

38. Data provision is broadly adequate for surveillance (Informational Annex). The authorities have continued to improve statistics, with adequate support from AFRITAC South and IMF. Staff urges the authorities to move to GFSM 2014 and improve the classification of current and capital expenditures and accelerate the collection of financial accounts of extra-budgetary entities, including SOEs.

39. Staff welcomes the recent steps toward compliance with the International Cooperation Review Group recommendations and encourage the authorities to address remaining strategic deficiencies in its AML/CFT framework. Botswana has made good progress in the area of AML/CFT supervision. Yet, efforts should remain in order to further strengthen the overall AML/CFT regime and mitigate any possible risks of pressures on correspondent banking relationships as a result of the grey listing process. In particular, the authorities are encouraged to take additional steps with respect to the analysis and dissemination of financial intelligence, terrorist financing investigations, and implementation of effective targeted financial sanctions regime.

40. Staff welcomes the enactment of the COVID-19 Relief Fund Order, which would improve transparency and governance of the fund. The Order provides an institutional mechanism for the management and auditing of the COVID-19 Relief Fund. However, publication of the COVID-related procurements and contracts are lagging behind. Staff welcomes the authorities' plans to publish the execution report as well the publication of all COVID-related procurement contracts, including beneficial owner information.

STAFF APPRAISAL

41. The authorities' decisive response to the pandemic has helped mitigate its social and economic impact. The authorities' relief package provided timely support to households and businesses, reducing the fallout from the pandemic. The implementation of the relief package through a dedicated Pandemic Relief Fund to enhance transparency and tracking of spending is commendable. In addition, successful implementation of the ERTP will help reduce the potential economic scars from the COVID-19 crisis.

42. Growth is expected to recover, but uncertainty is high. Careful management of mineral resources and track record of very strong policies and policy frameworks have allowed Botswana to enter the crisis with larger fiscal space than most countries. This has helped its economy navigate through the crisis and a relatively strong recovery is underway. But the outlook is subject to significant downside risk and hinges on the evolution of the pandemic, availability and deployment of vaccines, and diamond revenue. At the same time, a steadfast implementation of supply side reforms could promote private sector activity and diversify the sources of growth. In this context, the immediate priority remains securing and ensuring a successful rollout of vaccines to a share of the population large enough to keep the pandemic under control and prevent health systems from being overwhelmed. The next priority is to enhance Botswana's resilience to shocks and lay the foundation for sustained, high, and job-rich growth.

43. **Successful implementation of the planned fiscal consolidation is critical to achieve fiscal sustainability and rebuild an asset base that will benefit future generations and deal with future shocks.** Measures planned in the budget are appropriate. That said, until the pandemic is over, it is necessary to maintain targeted support to households and illiquid but solvent firms and make the support state-contingent or conditional to reduce moral hazard. Going forward, fiscal reforms are needed to lock-in consolidation efforts. These include civil service reform that helps align future wage increases with productivity, acceleration of plans to rationalize the parastatal sector and improve its governance, and a strengthening of the fiscal framework, including revamping the fiscal rule to better anchor fiscal policy and increase credibility and enhancing the fiscal risks framework.

44. **Monetary policy should remain accommodative in the near term, while carefully monitoring second-round effects of supply shocks on inflation expectations, as well as credit developments.** A more active liquidity management and the transition toward the BoBC rate as the policy rate will enhance monetary transmission. Going forward, however, continuing to use the flexibility within the current crawl arrangement would allow to gradually reduce real overvaluation and help the economy adjust to shocks and facilitate structural transformation, while avoiding de-anchoring inflation expectations.

45. **The financial sector is sound but the authorities should remain vigilant to possible latent risks and continue reforms to improve financial deepening and inclusiveness.** In particular, there is a need to maintain a targeted support to solvent but illiquid firms while reducing moral hazard. It is however imperative to avoid any forbearance in recording NPLs, and to closely monitor risks, including through enhanced reporting, regular stress-testing and financial oversight. The macroprudential policy stance should be tightened in case of excessive credit to households. In addition to ongoing reforms to enhance resource allocation, there is a need to clarify the role of development banks and improve their governance and oversight, and deepen the domestic bond market through a coordinated approach from public and private issuers.

46. **The approval of the Economic Recovery and Transformation Plan lays the ground for the country to accelerate its structural transformation.** The focus on promoting non-mineral exports, manufacturing, and transformative sectors (including digital, green and climate adaptation technologies) should help diversify Botswana's economy. But to be successful, the strategy needs to rely less on import substitution and protectionist policies, and more on enhancing competitiveness and strengthening institutions and accountability. A swift implementation of the ERTP is imperative to strengthening Botswana's resilience and ensuring sustained high and job-rich growth.

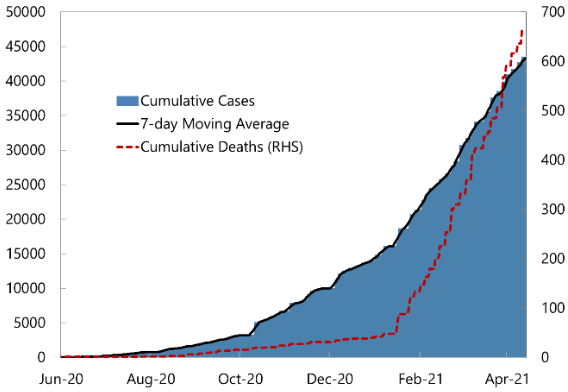
47. **Staff recommends that the next Article IV consultation with Botswana be held on the standard 12-month cycle.**

Figure 1. Botswana: The COVID-19 Pandemic

Cases and deaths have been recently increasing rapidly…

Botswana COVID-19 Cumulative Cases and Deaths

(Number of cases)

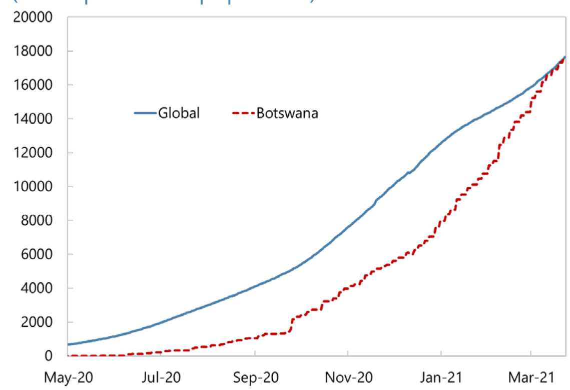


Source: World Health Organization.

… catching up with the world average…

COVID-19 Cumulative Cases

(Cases per million population)

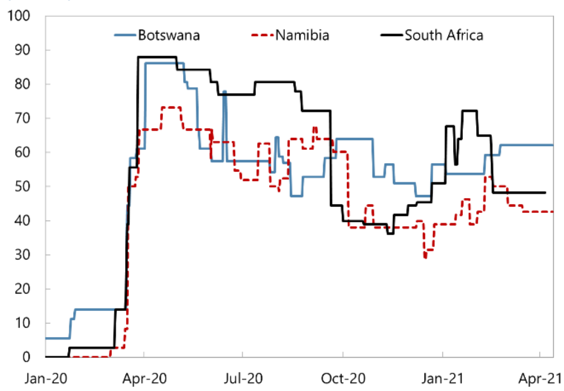


Source: Johns Hopkins University, WEO and IMF staff calculations.

…forcing the country to tighten containment measures.

Stringency and Policy Indices

(Index)

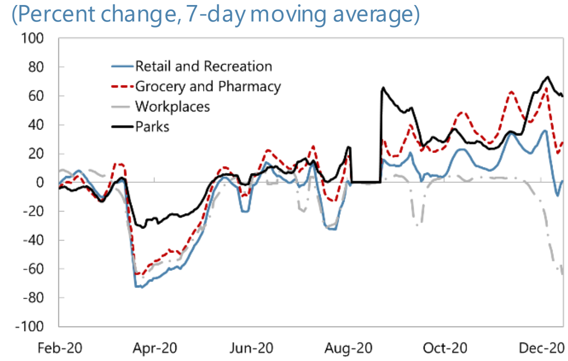


Source: Oxford COVID-19 Government Response Tracker.

While mobility indicators improved from their 2020:Q2 dip…

Google Mobility Report

(Percent change, 7-day moving average)



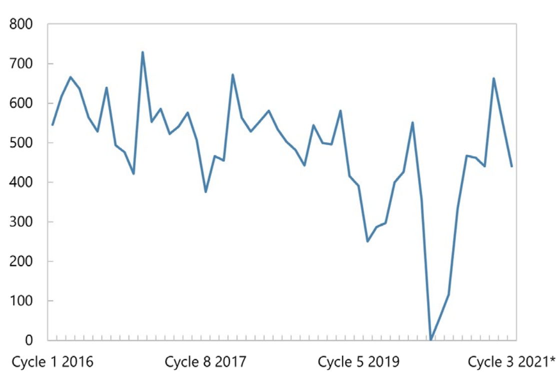
Source: Google COVID-19 Community Mobility Report and IMF staff estimates.

Note: The data shows how visitors to (or time spent in) categorized places change compared to a baseline value for that day of the week recorded as the median value during Jan 3 – Feb 6, 2020. Values are smoothed using a 7-day moving average.

… and diamond sales rebounded….

Rough Diamond Sales Value

(Millions of USD)



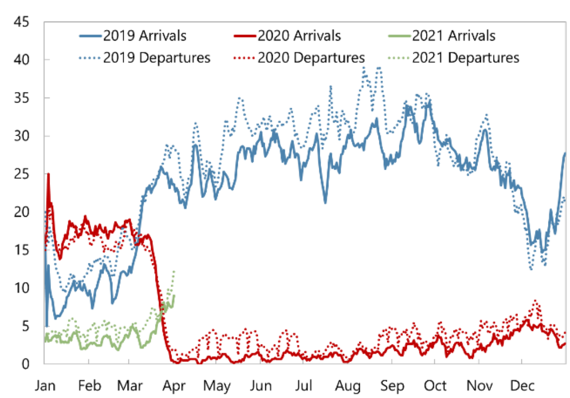
Source: Sales Public Release of De Beers Group

Note: *Provisional sales value represents sales as at a specific date.

… tourism activity remains heavily affected.

International Flights

(The number of flights, 7-day moving average)



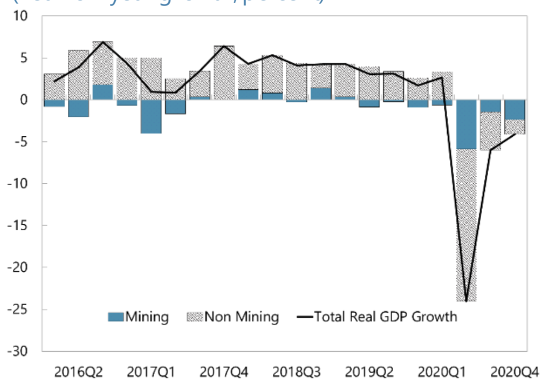
Sources: FlightRadar24 and IMF staff estimates.

Figure 2. Botswana: Real Sector

Following a sharp contraction in Q2, GDP is recovering...

Contribution to Real GDP Growth

(Year-on-year growth, percent)

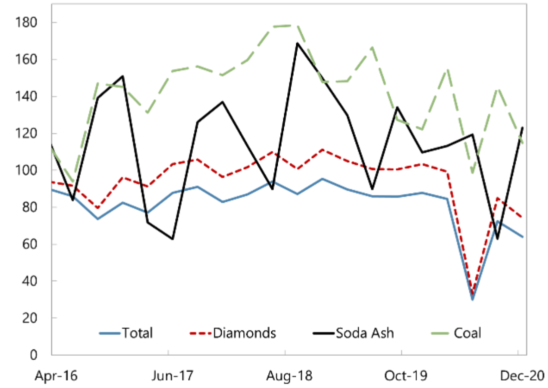


Note: Real GDP is at constant 2006 price.

... driven by higher diamond production...

Mining Production Index

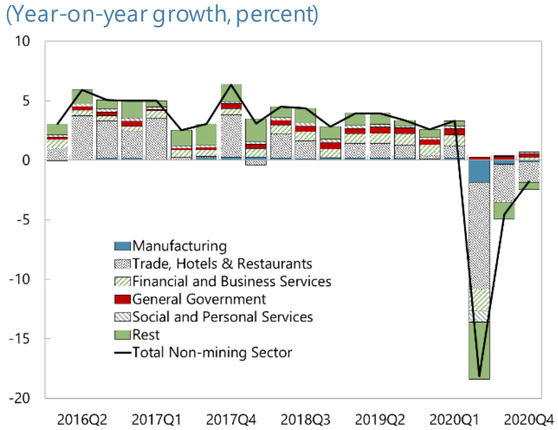
(NSA, 2013=100)



...and improvements in non-mining sectors performance (except tourism)...

Contribution to Real GDP, Non-mining Sectors

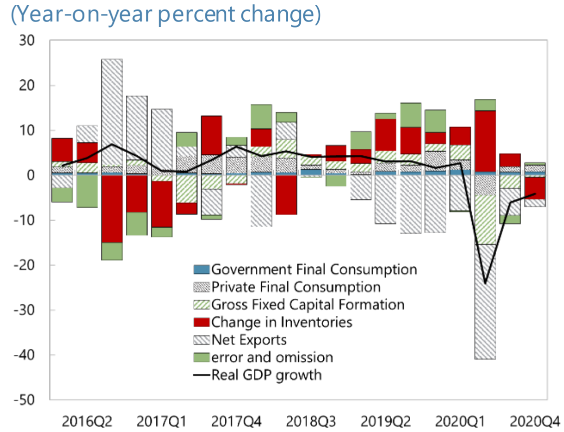
(Year-on-year growth, percent)



... as consumption contributed positively to growth, supported by higher public wages.

Contribution to Real GDP Growth, Demand

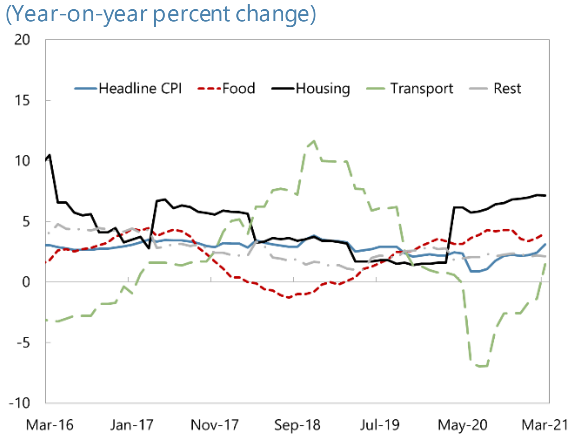
(Year-on-year percent change)



Lower oil prices weighed on inflation...

Consumer Price Inflation by Items

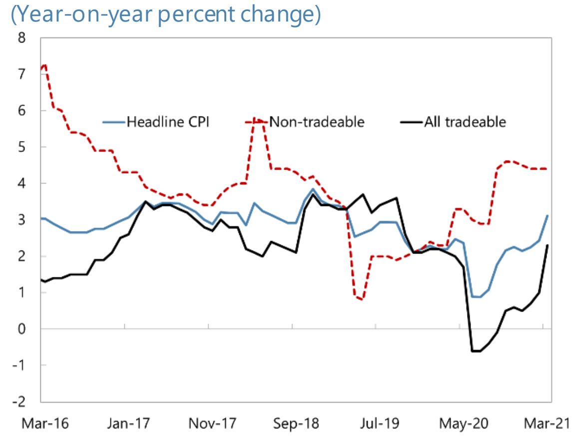
(Year-on-year percent change)



while inflation in non-tradeable products accelerated in mid-2020.

Consumer Price Index, Tradeable vs Non-Tradeable

(Year-on-year percent change)

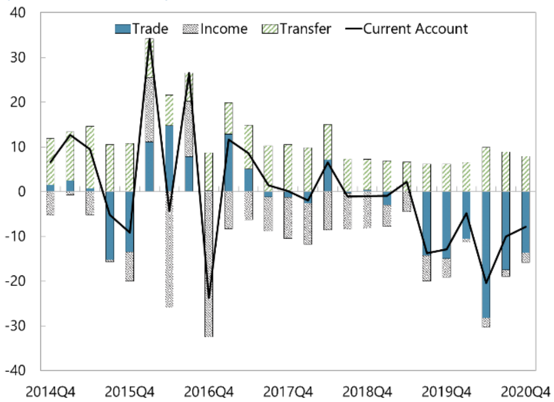


Sources: Bank of Botswana, Statistics Botswana, and IMF staff calculations.

Figure 3. Botswana: External Sector

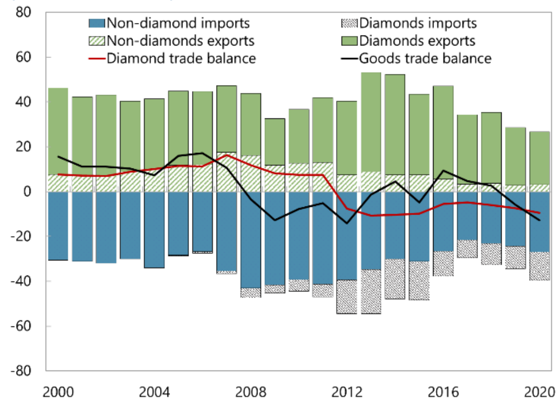
The current account deteriorated significantly, especially in 2020:Q2…

Current Account
(Percent of GDP)



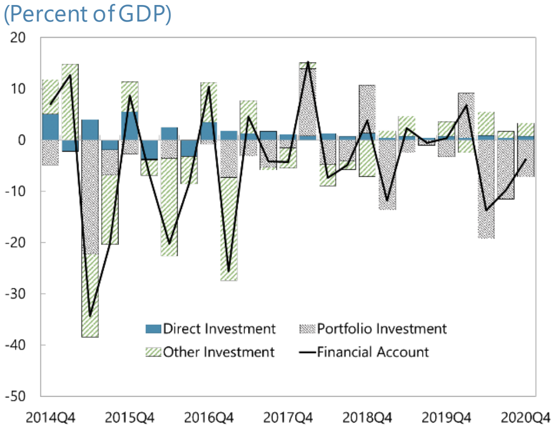
… mainly owing to substantial decline in diamonds net exports, while non-diamond trade balance remained unchanged.

Goods and Diamond Trade
(Percent of GDP)



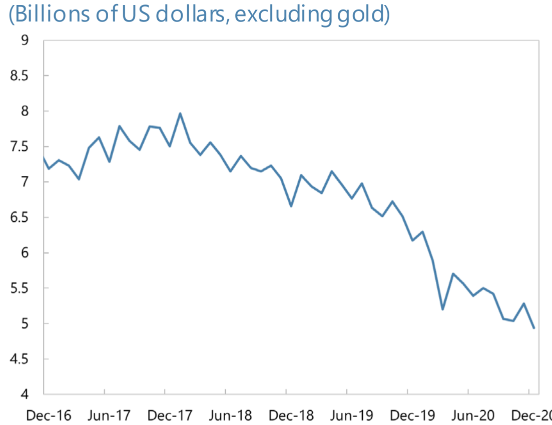
Outward portfolio investment picked up especially in 2020:Q2-Q4…

Financial Account
(Percent of GDP)



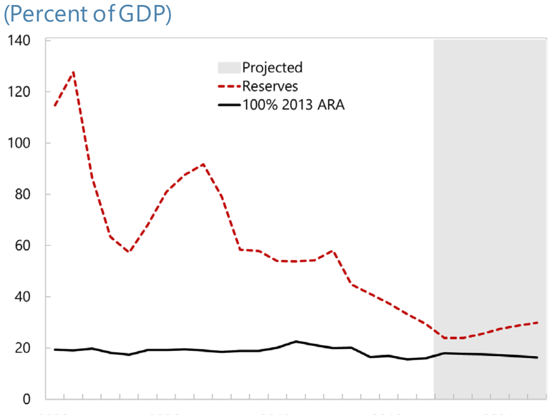
… further exacerbating the decline in Botswana's foreign reserves.

Total Reserves
(Billions of US dollars, excluding gold)



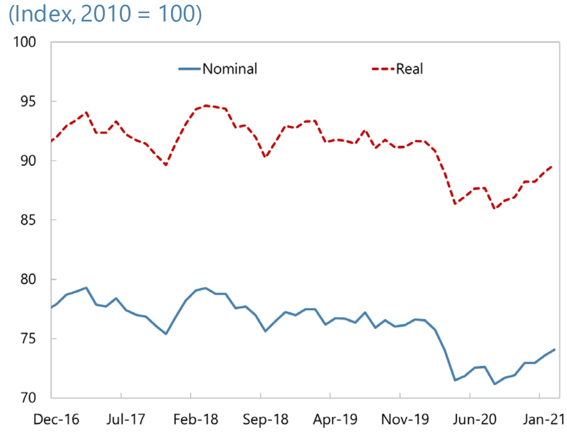
Reserves are trending downwards, above adequate levels, and are expected to improve over the medium term.

Assessing Reserve Adequacy
(Percent of GDP)



Effective exchange rates depreciated moderately as a result of depreciated Pula crawl rate and low inflation rate

Effective Exchange Rate
(Index, 2010 = 100)

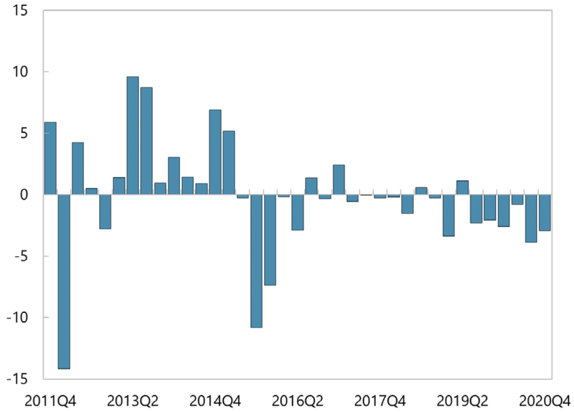


Sources: Bank of Botswana, Statistics Botswana, INS, and IMF staff calculations.

Figure 4. Botswana: Fiscal Sector

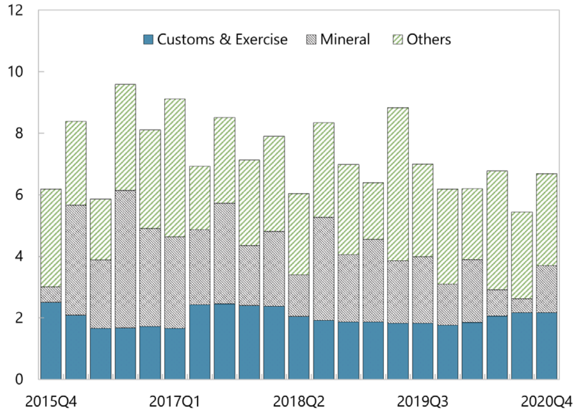
The fiscal deficit has widened, reflecting fiscal measures to tackle the pandemic ...

Fiscal Balance
(Percent of annual GDP)



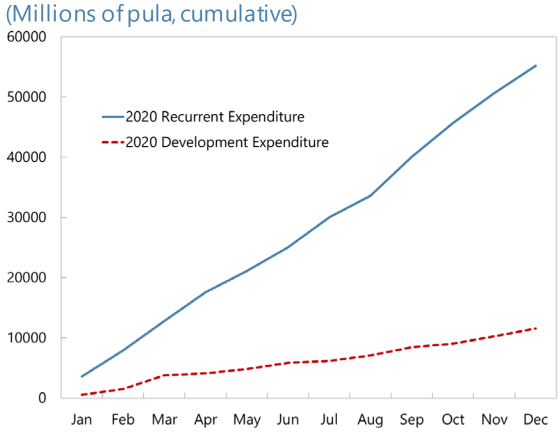
... coupled with lower non-SACU revenues...

Government Revenues
(Percent of annual GDP)



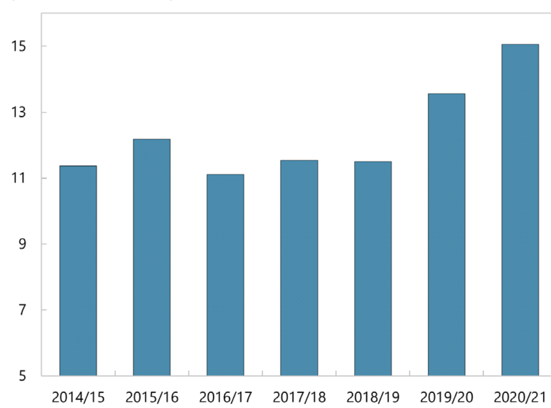
Expenditures are increasingly dominated by current spending...

Monthly Expenditure
(Millions of pula, cumulative)



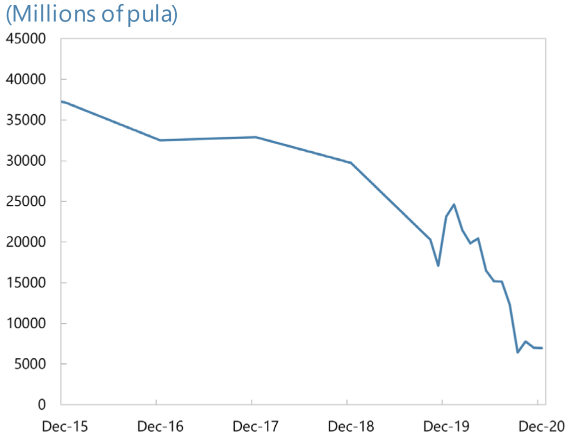
...with a rising share of public wage bill following the recent salary increase.

Public Wage Bill
(Percent of GDP)



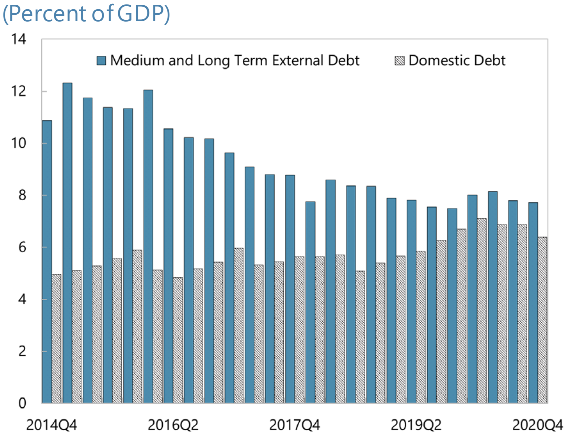
Fiscal buffers have been depleted rapidly...

Government Investment Account
(Millions of pula)



...and debt levels are rising.

Government Debt
(Percent of GDP)



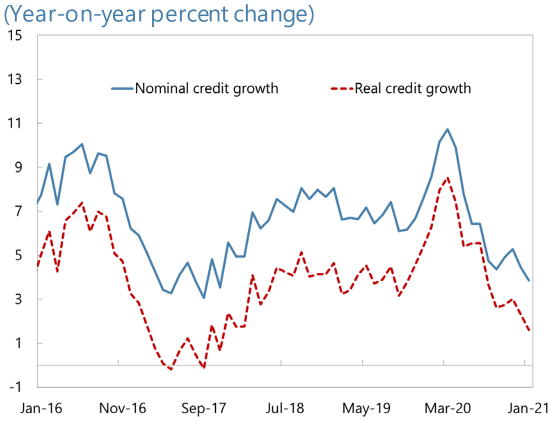
Sources: Bank of Botswana, Haver Analytics, and IMF staff calculations.

Figure 5. Botswana: Macro-Financial Linkages

Following the onset of the pandemic, credit growth dropped sharply, reflecting the slowdown in economic activities and risk aversion of banks.

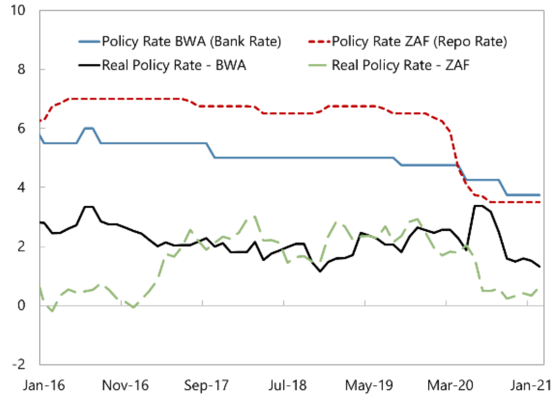
Credit Growth

(Year-on-year percent change)



BoB cut policy rate twice by a cumulative of 100 bps in 2020 to support the economy...

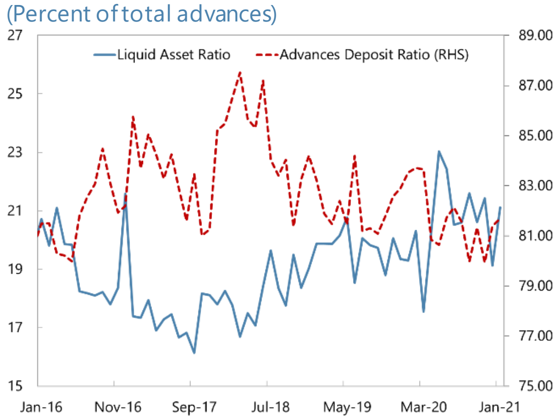
Policy Rates



...while commercial banks have increased liquid assets and decelerated credit growth to cope with uncertainties...

Advances and Liquid Asset Ratio

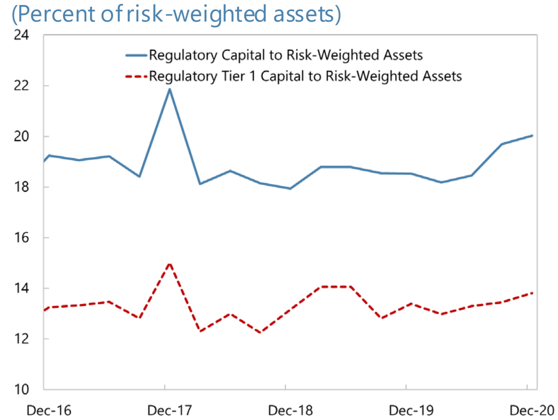
(Percent of total advances)



...but the banking sector remains well capitalized...

Adequacy

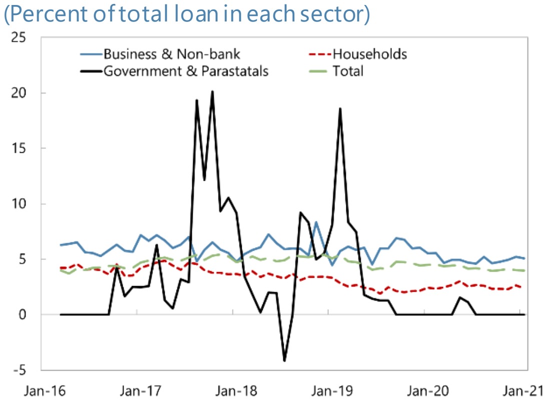
(Percent of risk-weighted assets)



...with low NPL...

Non-performing Loan by Sector

(Percent of total loan in each sector)



Note: Non-performing loan here is defined as arrears over 30 days net of provisions.

...and ample provisions.

Provisions to NPL

(Percent)

Note: Non-performing loan here is defined as arrears over 30 days net of provisions.

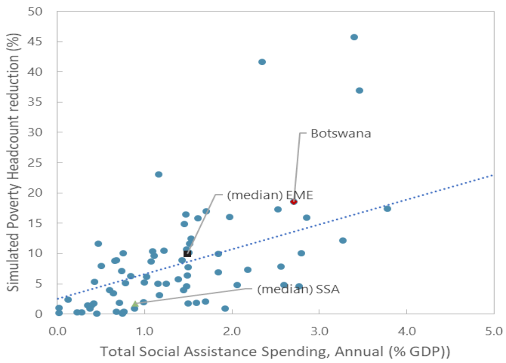
Sources: Bank of Botswana, Haver Analytics, and IMF staff calculations.

Note: Credit and deposits are defiend within commerical banks.

Figure 6. Botswana: Social Protection and Labor Assessment

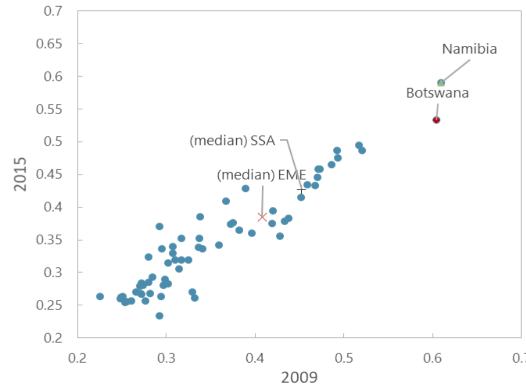
Higher spending on social assistance in Botswana has contributed to poverty reduction…

Poverty Gap Reduction
(Percent)



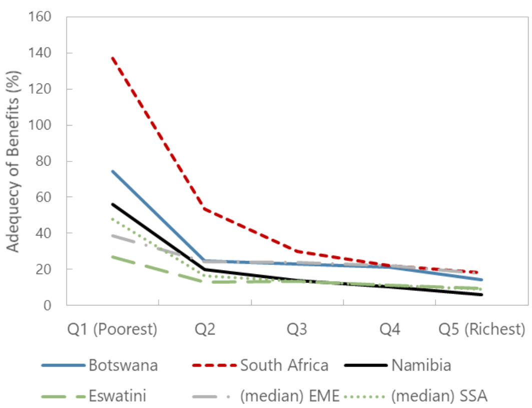
… but has not had sufficient impact on inequality.

Gini Coefficients
(2015 vs. 2009)



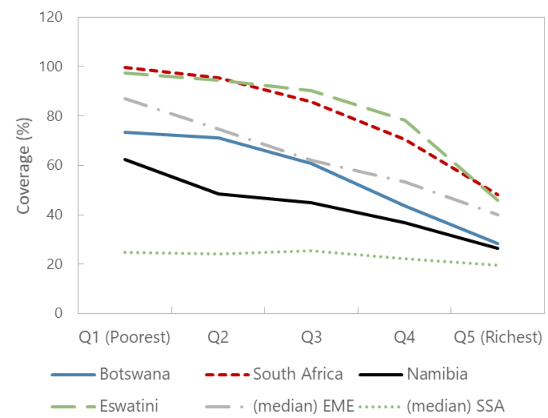
While Botswana' social assistance spending is higher than most comparators…

Adequecy by Quintile
(Percent)



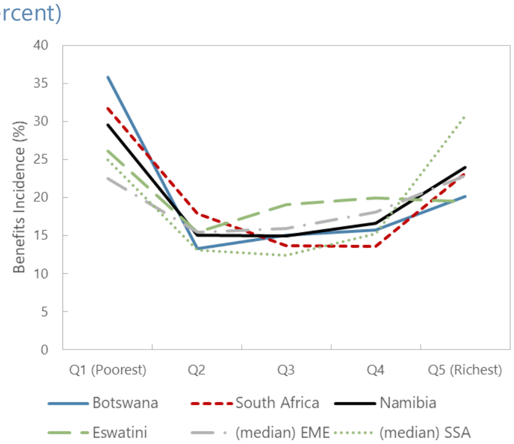
… its coverage is lower across all beneficiaries (except compared to SSA median and Namibia).

Coverage by Quintile
(Percent)



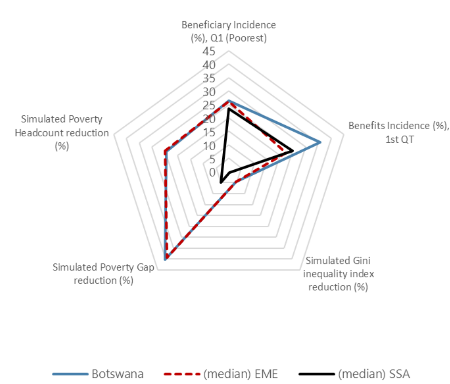
While the poorest receive the highest share of benefits, sizable SPL resources are also allocated to the richest…

Benefits Incidence by Quintile
(Percent)



… sustaining high inequality despite higher SPL spending. Better targeted SPL policies could further increase its distributional impact.

Simulated Impact Variables



Sources: IMF FAD Social Protection & Labor – Assessment Tool (SPL-AT).

Table 1. Botswana: Selected Economic Indicators, 2015–26

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Prel.			Projection			
	(Annual percent change, unless otherwise indicated)[1]											
National income and prices												
Real GDP	-1.7	4.3	2.9	4.5	3.0	-7.9	8.3	6.4	4.8	4.0	4.0	4.0
Mineral[2]	-19.6	-3.5	-11.1	7.6	-4.1	-26.2	52.9	17.2	8.0	1.7	1.3	1.3
Nonmineral	1.7	5.5	4.8	4.1	3.9	-5.9	4.5	5.0	4.4	4.3	4.4	4.4
GDP per capita (US dollars)	6,811	7,249	7,883	8,290	7,989	...	...	...	...	...	...	...
Consumer prices (average)	3.1	2.8	3.3	3.2	2.7	1.9	4.8	5.0	4.4	4.4	4.4	4.4
Diamond production (millions of carats)	20.8	20.9	22.9	24.4	23.7	16.9	23.5	25.9	28.0	27.8	27.8	28.3
Money and banking												
Monetary Base	18.6	3.7	-13.7	17.5	5.4	-7.0	10.4	10.3	8.9	8.9	8.8	8.8
Broad money (M2)	19.9	5.4	2.7	8.3	8.0	5.9	10.4	10.3	8.9	8.9	8.8	8.8
Credit to the private sector	9.0	9.0	5.3	6.6	7.1	5.3	7.8	10.5	9.2	8.9	9.3	9.3
	(Percent of GDP, unless otherwise indicated)											
Investment and savings												
Gross investment (including change in inventories)	32.6	27.0	27.6	29.4	33.3	35.8	34.7	32.4	31.8	31.1	31.2	31.1
Public	8.8	8.5	8.2	8.0	7.1	6.2	6.2	5.9	5.5	5.3	5.1	4.9
Private	23.8	18.5	19.4	21.4	26.1	29.6	28.5	26.5	26.3	25.8	26.1	26.2
Gross savings	39.5	123.1	104.8	108.4	27.2	25.7	31.4	30.5	32.8	33.6	33.8	33.6
Public	16.1	16.2	15.2	12.5	8.8	4.9	8.8	8.1	10.2	11.5	11.6	11.9
Private	23.4	106.9	89.6	95.9	18.4	20.8	22.6	22.4	22.6	22.1	22.1	21.8
Central government finances[3]												
Total revenue and grants	31.2	33.2	30.9	27.8	26.0	24.0	27.5	24.4	27.3	27.5	27.1	26.7
Total expenditure and net lending	35.8	32.5	32.0	32.4	33.9	35.0	32.0	30.2	29.2	28.3	27.6	26.6
Overall balance (deficit –)	-4.6	0.6	-1.1	-4.6	-7.9	-11.0	-4.4	-5.7	-1.9	-0.8	-0.5	0.1
Non-mineral primary balance[4]	-18.1	-17.6	-14.3	-17.1	-17.7	-18.5	-16.5	-18.3	-13.4	-12.3	-11.2	-10.3
Total central government debt	23.2	21.3	18.1	18.6	19.2	23.5	25.7	28.9	28.5	27.3	26.0	23.7
External sector												
Exports of goods and services, f.o.b. (% change)	-24.1	14.4	-16.2	9.2	-17.5	-24.6	58.9	8.1	8.5	8.0	4.5	5.9
o/w diamonds	-28.4	24.6	-17.0	9.8	-19.9	-21.8	64.2	2.8	7.4	7.5	4.4	6.5
Imports of goods and services, f.o.b. (% change)	-10.0	-14.6	-9.8	17.0	5.2	-4.9	11.7	-3.0	5.2	5.8	4.6	4.6
Current account balance	2.1	7.7	5.3	0.6	-6.0	-10.1	-3.3	-1.9	1.0	2.5	2.5	2.5
Overall Balance	-5.4	-2.3	1.8	2.3	-8.4	-14.4	-0.7	1.8	3.3	3.4	3.1	3.1
Nominal effective exchange rate (2010=100)	94.9	95.1	95.4	95.5	...	...	...	...	...	...	...	...
Real effective exchange rate (2010=100)	105.2	104.8	105.0	105.1	...	...	...	...	...	...	...	...
Terms of trade (2005=100)	197.4	175.9	159.2	166.2	143.6	138.7	151.6	159.0	165.4	170.0	170.6	171.4
External public debt[5]	18.4	14.3	11.6	11.7	10.5	11.1	12.4	13.0	12.4	11.1	9.9	8.7
o/w public and publicly guaranteed	5.3	4.7	4.4	4.2	4.1	4.4	3.8	3.4	3.0	2.8	2.6	2.4
	(Millions of U.S. dollars, unless otherwise indicated)											
Gross official reserves (end of period)	7,546	7,189	7,502	6,657	6,172	4,944	4,818	5,178	5,914	6,724	7,504	8,345
Months of imports of goods and services[6]	13.1	13.8	12.3	10.4	10.1	7.3	7.3	7.5	8.0	8.7	9.3	9.9
Months of non-diamond imports[6]	17.5	17.8	16.3	13.7	13.9	10.1	9.6	9.8	10.7	11.5	12.2	12.9
Percent of GDP	58.0	44.9	41.1	37.5	33.2	29.5	26.3	25.6	27.1	28.8	30.1	30.5

Sources: Botswana authorities and IMF staff estimates and projections.

[1] Calendar year, unless otherwise indicated.

[2] The projection is based on current value added and projected growth rates by different types of minerals.

[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

[5] Includes central government-guaranteed debt.

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

Table 2. Botswana: Balance of Payments, 2015–26

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Prel.			Projection			
(millions of U.S. dollars, unless otherwise indicated)												
Current account balance	302	1,203	926	119	-1,100	-1,593	-625	-392	221	588	636	686
Trade balance	-703	1,477	812	490	-1,082	-2,022	-122	549	756	884	884	1,017
Exports, f.o.b.	6,283	7,378	5,956	6,595	5,242	4,211	6,789	7,190	7,734	8,264	8,635	9,159
Diamonds	5,215	6,498	5,396	5,923	4,742	3,710	6,091	6,260	6,726	7,230	7,549	8,037
Other raw materials	466	328	66	94	52	90	247	449	512	522	533	549
Other	602	553	494	578	448	412	450	480	495	512	552	573
Imports, f.o.b	-6,986	-5,901	-5,144	-6,104	-6,324	-6,234	-6,911	-6,641	-6,978	-7,380	-7,751	-8,141
Diamonds	-2,495	-1,736	-1,392	-1,799	-1,862	-1,989	-2,315	-1,878	-2,018	-2,169	-2,232	-2,411
Other	-4,491	-4,166	-3,752	-4,305	-4,462	-4,244	-4,596	-4,762	-4,960	-5,211	-5,519	-5,730
Services	-207	-168	-162	-268	-401	-614	-614	-436	-366	-280	-262	-240
Transportation	-243	-226	-164	-191	-200	-190	-211	-206	-219	-237	-256	-285
Travel	277	265	316	352	414	122	192	343	442	569	615	651
Other services	-241	-207	-314	-429	-615	-546	-595	-573	-588	-611	-621	-650
Income	-455	-1,291	-1,365	-1,584	-876	-249	-1,130	-1,348	-1,455	-1,544	-1,608	-1,706
Current transfers	1,667	1,186	1,641	1,481	1,259	1,292	1,241	844	1,286	1,528	1,622	1,721
SACU receipts	1,561	1,174	1,577	1,525	1,318	1,383	1,278	875	1,320	1,565	1,661	1,763
Capital and financial account	-1,258	-968	-1,247	306	-445	-684	499	751	515	222	144	156
Direct investment	196	-27	261	204	113	97	236	307	331	353	376	406
Portfolio investment	-1,095	-166	-740	628	-927	-983	-269	-171	-168	-247	-268	-309
Other investment	-359	-774	-770	-528	364	203	531	615	352	116	35	59
Assets	-377	-629	-657	-605	444	269	195	188	158	140	105	116
Liabilities	18	-146	-114	76	-80	-67	337	427	194	-24	-70	-58
Net government long-term borrowing	19	-110	-77	-95	-137	-125	267	355	124	-91	-137	-124
Other net private long-term borrowing	-33	71	107	51	74	71	64	66	64	62	62	62
Short-term borrowing	31	28	8	77	-18	-17	6	6	6	5	5	5
Net errors and omissions	179	-593	634	-1,270	1,060	1,049	0	0	0	0	0	0
Overall Balance	-777	-357	313	425	-1,545	-2,277	-126	359	736	810	780	842
(Percent of GDP, unless otherwise indicated)												
Current account	2.1	7.7	5.3	0.6	-6.0	-10.1	-3.3	-1.9	1.0	2.5	2.5	2.5
Trade balance	-4.9	9.4	4.7	2.6	-5.9	-12.8	-0.6	2.7	3.4	3.8	3.5	3.8
Exports of goods	43.5	47.1	34.3	35.3	28.6	26.7	35.9	35.1	35.0	35.1	34.4	33.8
Of which: diamonds	36.1	41.5	31.0	31.7	25.8	23.5	32.2	30.6	30.5	30.7	30.1	29.7
Imports of goods	48.4	37.7	29.6	32.7	34.4	39.5	36.5	32.4	31.6	31.3	30.9	30.0
Of which: diamonds	17.3	11.1	8.0	9.6	10.1	12.6	12.2	9.2	9.1	9.2	8.9	8.9
Services balance	-1.4	-1.1	-0.9	-1.4	-2.2	-3.9	-3.2	-2.1	-1.7	-1.2	-1.0	-0.9
Income and transfers balance	8.4	-0.7	1.6	-0.6	2.1	6.6	0.6	-2.5	-0.8	-0.1	0.1	0.1
Financial account	-8.7	-6.2	-7.2	1.6	-2.4	-4.3	2.6	3.7	2.3	0.9	0.6	0.6
Direct investment	1.4	-0.2	1.5	1.1	0.6	0.6	1.3	1.5	1.5	1.5	1.5	1.5
Portfolio investment	-7.6	-1.1	-4.3	3.4	-5.0	-6.2	-1.4	-0.8	-0.8	-1.0	-1.1	-1.1
Other investment	-2.5	-4.9	-4.4	-2.8	2.0	1.3	2.8	3.0	1.6	0.5	0.1	0.2
Net errors and omissions	1.2	-3.8	3.6	-6.8	5.8	6.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (increase reserves +)	-5.4	-2.3	1.8	2.3	-8.4	-14.4	-0.7	1.8	3.3	3.4	3.1	3.1
(Annual percentage change, unless otherwise indicated)												
Export volumes	-13.8	17.7	-8.9	1.1	-9.5	-15.5	47.0	1.3	3.0	2.3	2.6	4.1
Import volumes	4.2	-10.4	-22.8	11.2	8.0	5.8	2.0	-4.9	4.1	4.4	3.4	1.2
Terms of trade	19.1	-10.9	-9.5	4.4	-13.6	-3.4	9.3	4.9	4.0	2.8	0.4	0.4
End-of-year reserves (US$ millions)	7,546	7,189	7,502	6,657	6,172	4,944	4,818	5,178	5,914	6,724	7,504	8,345
Months of imports of goods and services[1]	13.1	13.8	12.3	10.4	10.1	7.3	7.3	7.5	8.0	8.7	9.3	9.9
Months of non-diamond imports[2]	17.5	17.8	16.3	13.7	13.9	10.1	9.6	9.8	10.7	11.5	12.2	12.9
Nominal GDP (US$ millons)	14,445	15,658	17,383	18,664	18,360	15,783	18,915	20,482	22,071	23,551	25,079	27,097

Source: Bank of Botswana; IMF staff estimates.

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

[2] BOP data have been revised starting in 2012. A change in the information sytem may explain the large drop in import prices in 2017.

Table 3a. Botswana: Central Government Operations, 2015/16–26/27[1]

(Billions of pula)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
					Prel.			Projection				
	(Billions of pula, unless otherwise indicated)											
Total revenue and grants	47.4	57.4	56.4	53.5	50.2	45.2	60.0	59.8	73.5	80.2	85.3	91.6
Total revenue	47.3	57.2	56.0	53.4	50.2	45.2	59.8	59.6	73.3	80.1	85.1	91.4
Tax revenue	34.9	35.6	39.9	37.8	38.0	37.6	43.3	41.1	52.9	57.5	61.8	66.3
Income taxes	13.1	16.8	13.8	15.1	15.3	13.3	18.5	19.6	21.5	23.5	25.1	27.1
Mineral	4.5	7.2	5.6	5.2	4.5	3.3	5.9	6.7	7.4	8.1	8.3	8.8
Nonmineral	8.7	9.6	8.2	9.9	10.8	10.1	12.6	13.0	14.1	15.4	16.7	18.2
Taxes on goods and services [2]	5.5	6.6	7.8	7.4	8.1	7.3	10.6	11.7	12.8	13.9	15.1	16.5
Customs Union receipts [3]	15.8	11.8	17.9	14.8	14.0	16.5	13.5	9.1	17.9	19.4	20.8	21.9
Other	0.4	0.4	0.5	0.5	0.6	0.4	0.5	0.6	0.6	0.7	0.8	0.7
Nontax revenue	12.4	21.7	16.2	15.6	12.2	7.6	16.6	18.5	20.5	22.6	23.3	25.1
Mineral royalties and dividends	10.0	15.3	13.1	13.3	10.0	6.0	14.0	15.8	17.4	19.3	19.7	21.2
Grants	0.1	0.2	0.4	0.1	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Total expenditure and net lending	54.4	56.3	58.4	62.4	65.4	65.9	69.7	73.8	78.5	82.7	86.9	91.3
Current expenditure	40.4	41.2	43.6	47.3	51.8	55.6	55.8	59.9	64.0	67.5	71.1	74.7
Wages and salaries	18.5	19.2	21.1	22.1	26.3	28.4	28.7	30.6	32.4	34.3	36.3	38.4
Interest	0.8	0.9	1.0	1.1	1.2	1.2	1.4	1.8	2.5	2.7	2.9	3.1
Other	21.0	21.1	21.5	24.1	24.4	25.9	25.7	27.5	29.1	30.5	31.9	33.3
Of which: grants and subsidies	11.3	11.3	12.2	13.3	13.8	17.0	15.0	16.2	17.4	18.2	19.1	19.9
Capital expenditure	12.8	15.2	14.7	15.5	13.6	10.4	14.0	14.0	14.6	15.3	15.9	16.6
Net lending	1.2	-0.1	0.1	-0.4	0.0	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Primary balance (deficit -)	-7.3	-1.4	-2.6	-8.7	-15.0	-20.3	-9.3	-13.2	-3.7	-0.9	0.0	1.9
Overall balance (A)	-7.0	1.1	-2.0	-8.9	-15.2	-20.7	-9.7	-14.1	-5.0	-2.4	-1.7	0.3
Financing (B)	7.0	-1.1	2.0	8.9	15.2	20.7	9.7	14.1	5.0	2.4	1.7	-0.3
Foreign (net)	-1.3	-1.2	-0.7	-1.1	-1.6	-1.4	4.7	4.2	0.8	-1.5	-1.5	-1.3
Drawing	0.1	0.2	0.5	0.4	0.1	0.4	6.5	6.1	2.5	0.3	0.3	0.3
Amortization	-1.4	-1.4	-1.3	-1.4	-1.5	-1.6	-1.7	-1.7	-1.6	-1.7	-1.7	-1.5
IMF transactions (net)[4]	0.0	0.0	0.1	0.0	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic (net)	8.3	0.0	2.7	10.0	16.9	22.1	5.0	9.8	4.2	3.9	3.2	1.0
Issuance	2.1	3.8	4.0	4.0	4.4	12.1	11.1	12.9	10.6	11.3	10.5	8.8
Amortization	-3.0	-3.7	-2.3	-4.1	-1.5	-5.2	-5.5	-3.0	-6.4	-7.3	-7.3	-7.6
Change in cash balance (- increase)	9.7	3.5	0.9	14.1	10.8	11.9	-0.6	-0.1	0.0	-0.1	-0.1	-0.1
Other domestic financing	-0.5	-3.6	0.1	-4.1	3.1	3.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Non-mineral primary balance [5]	-21.8	-23.9	-21.3	-27.1	-29.6	-29.6	-29.1	-35.7	-28.5	-28.3	-28.1	-28.2
Excluding SACU revenue	-37.6	-35.6	-39.2	-41.9	-43.6	-46.1	-42.7	-44.8	-46.4	-47.7	-49.0	-50.1
GDP (fiscal year; billions of pula)	152.2	172.9	182.7	192.1	193.3	188.3	218.0	244.9	268.8	291.8	315.0	342.9

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 3b. Botswana: Central Government Operations, 2015/16–2026/27[1]

(Percent of GDP)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
					Prel.				Projection			
	(Percent of GDP, unless otherwise indicated)											
Total revenue and grants	31.2	33.2	30.9	27.8	26.0	24.0	27.5	24.4	27.3	27.5	27.1	26.7
Total revenue	31.1	33.1	30.7	27.8	25.9	24.0	27.5	24.4	27.3	27.4	27.0	26.7
Tax revenue	22.9	20.6	21.8	19.7	19.6	19.9	19.8	16.8	19.7	19.7	19.6	19.3
Income taxes	8.6	9.7	7.5	7.8	7.9	7.1	8.5	8.0	8.0	8.1	8.0	7.9
Mineral	2.9	4.2	3.1	2.7	2.4	1.7	2.7	2.7	2.7	2.8	2.6	2.6
Nonmineral	5.7	5.5	4.5	5.2	5.6	5.4	5.8	5.3	5.3	5.3	5.3	5.3
Taxes on goods and services [2]	3.6	3.8	4.3	3.8	4.2	3.9	4.9	4.8	4.8	4.8	4.8	4.8
Customs Union receipts [3]	10.4	6.8	9.8	7.7	7.2	8.7	6.2	3.7	6.7	6.6	6.6	6.4
Other	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Nontax revenue	8.1	12.5	8.8	8.1	6.3	4.0	7.6	7.6	7.6	7.7	7.4	7.3
Mineral royalties and dividends	6.6	8.8	7.2	6.9	5.2	3.2	6.4	6.5	6.5	6.6	6.3	6.2
Grants	0.1	0.1	0.2	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0
Total expenditure and net lending	35.8	32.5	32.0	32.4	33.9	35.0	32.0	30.2	29.2	28.3	27.6	26.6
Current expenditure	26.6	23.8	23.8	24.6	26.8	29.5	25.6	24.5	23.8	23.1	22.6	21.8
Wages and salaries	12.2	11.1	11.5	11.5	13.6	15.1	13.2	12.5	12.0	11.7	11.5	11.2
Interest	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.9	0.9	0.9	0.9
Other	13.8	12.2	11.8	12.5	12.6	13.8	11.8	11.2	10.8	10.4	10.1	9.7
Of which: grants and subsidies	7.4	6.5	6.7	6.9	7.2	9.0	6.9	6.6	6.5	6.2	6.1	5.8
Capital expenditure	8.4	8.8	8.1	8.0	7.1	5.5	6.4	5.7	5.4	5.2	5.1	4.8
Net lending	0.8	0.0	0.0	-0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Primary balance (deficit -)	-4.8	-0.8	-1.4	-4.5	-7.8	-10.8	-4.3	-5.4	-1.4	-0.3	0.0	0.6
Overall balance (A)	-4.6	0.6	-1.1	-4.6	-7.9	-11.0	-4.4	-5.7	-1.9	-0.8	-0.5	0.1
Financing (B)	4.6	-0.6	1.1	4.6	7.9	11.0	4.4	5.7	1.9	0.8	0.5	-0.1
Foreign (net)	-0.9	-0.7	-0.4	-0.6	-0.8	-0.7	2.2	1.7	0.3	-0.5	-0.5	-0.4
Domestic (net)	5.5	0.0	1.5	5.2	8.7	11.7	2.3	4.0	1.6	1.3	1.0	0.3
Memorandum item:												
Non-mineral primary balance [4]	-14.3	-13.8	-11.7	-14.1	-15.3	-15.7	-13.4	-14.6	-10.6	-9.7	-8.9	-8.2
Excluding SACU revenue	-24.7	-20.6	-21.4	-21.8	-22.5	-24.5	-19.6	-18.3	-17.3	-16.3	-15.5	-14.6
GDP (fiscal year; billions of pula)	152.2	172.9	182.7	192.1	193.3	188.3	218.0	244.9	268.8	291.8	315.0	342.9

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] The 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 3c. Botswana: Central Government Operations: 2015/16–2026/27[1]

(Percent of non-mineral GDP)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
					Prel.				Projection			
	(Percent of non-mineral GDP, unless otherwise indicated)											
Total revenue and grants	39.5	42.3	37.9	33.6	30.0	28.3	34.0	30.7	34.6	34.7	33.9	33.5
Total revenue	39.4	42.2	37.7	33.6	29.9	28.2	33.9	30.6	34.6	34.7	33.9	33.4
Tax revenue	29.0	26.2	26.8	23.8	22.7	23.5	24.5	21.1	24.9	24.9	24.6	24.2
Income taxes	10.9	12.4	9.3	9.5	9.2	8.3	10.5	10.1	10.1	10.2	10.0	9.9
Mineral	3.7	5.3	3.7	3.3	2.7	2.0	3.3	3.4	3.5	3.5	3.3	3.2
Nonmineral	7.2	7.1	5.5	6.2	6.4	6.3	7.2	6.7	6.7	6.7	6.7	6.7
Taxes on goods and services [2]	4.6	4.9	5.2	4.6	4.8	4.6	6.0	6.0	6.0	6.0	6.0	6.0
Customs Union receipts [3]	13.2	8.7	12.0	9.3	8.3	10.3	7.7	4.7	8.5	8.4	8.3	8.0
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	10.3	16.0	10.9	9.8	7.3	4.8	9.4	9.5	9.6	9.8	9.3	9.2
Mineral royalties and dividends	8.3	11.3	8.8	8.4	6.0	3.8	7.9	8.1	8.2	8.3	7.8	7.8
Grants	0.1	0.1	0.2	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure and net lending	45.3	41.5	39.2	39.2	39.1	41.2	39.4	37.9	37.0	35.8	34.6	33.4
Current expenditure	33.6	30.3	29.3	29.7	30.9	34.7	31.6	30.7	30.1	29.2	28.3	27.3
Wages and salaries	15.4	14.2	14.2	13.9	15.7	17.8	16.3	15.7	15.3	14.8	14.4	14.0
Interest	0.7	0.6	0.7	0.7	0.7	0.8	0.8	0.9	1.2	1.2	1.2	1.1
Other	17.5	15.5	14.4	15.2	14.5	16.2	14.6	14.1	13.7	13.2	12.7	12.2
Of which: grants and subsidies	9.4	8.3	8.2	8.4	8.2	10.6	8.5	8.3	8.2	7.9	7.6	7.3
Capital expenditure	10.6	11.2	9.9	9.7	8.1	6.5	7.9	7.2	6.9	6.6	6.3	6.1
Net lending	1.0	0.0	0.1	-0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Primary balance (deficit -)	-6.1	-1.0	-1.8	-5.4	-9.0	-12.7	-5.2	-6.8	-1.7	-0.4	0.0	0.7
Overall balance	-5.8	0.8	-1.3	-5.6	-9.1	-12.9	-5.5	-7.2	-2.4	-1.1	-0.7	0.1
Memorandum items:												
Non-mineral primary balance [4]	-18.1	-17.6	-14.3	-17.1	-17.7	-18.5	-16.5	-18.3	-13.4	-12.3	-11.2	-10.3
Excluding SACU revenue	-31.3	-26.3	-26.3	-26.4	-26.0	-28.8	-24.2	-23.0	-21.9	-20.6	-19.5	-18.3
Non-mineral GDP (fiscal year; billions of pula)	120.1	135.7	148.8	159.0	167.6	160.0	176.6	194.8	212.2	231.0	251.4	273.6

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, 2015–26

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
							Projection					
	(Billions of pula, end of period, unless otherwise indicated)											
Net foreign assets	91.0	82.2	80.9	80.1	73.7	63.0	63.8	70.2	80.8	92.5	103.9	116.1
Bank of Botswana	83.4	75.3	72.2	70.0	63.8	51.9	50.5	54.7	63.5	73.3	82.9	93.3
Assets	84.9	76.8	73.6	71.4	65.2	53.3	51.9	56.1	64.9	74.7	84.3	94.7
Liabilities	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Commercial banks	7.7	6.9	8.8	10.2	9.9	11.0	13.3	15.4	17.3	19.1	20.9	22.8
Assets	9.9	9.5	11.5	13.3	13.1	14.3	16.5	18.7	20.6	22.4	24.2	26.1
Liabilities	-2.2	-2.6	-2.7	-3.1	-3.2	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Net domestic assets	-28.3	-15.4	-12.3	-6.3	5.9	21.2	29.6	33.1	32.0	30.7	30.5	30.5
Net domestic credit	13.9	23.6	26.9	32.9	45.1	66.6	80.9	97.0	109.8	121.5	133.6	144.8
Net claims on the government	-35.2	-29.3	-28.6	-26.3	-18.6	-0.5	8.7	17.3	22.9	26.9	30.3	31.9
Bank of Botswana	-37.1	-32.5	-32.9	-29.7	-23.1	-7.0	-4.5	-4.7	-4.7	-4.8	-4.9	-5.0
Commercial banks	1.9	3.2	4.3	3.4	4.6	6.4	13.2	22.0	27.6	31.7	35.2	36.8
Claims on parastatals	1.3	0.8	0.7	0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Claims on nongovernment	47.9	52.1	54.9	58.5	62.7	66.2	71.3	78.7	86.0	93.6	102.4	111.9
Claims on the private sector	49.3	53.7	56.5	60.2	64.5	67.9	73.2	80.9	88.4	96.2	105.2	115.0
Other financial institutions	-1.3	-1.6	-1.7	-1.8	-1.8	-1.7	-2.0	-2.2	-2.4	-2.6	-2.9	-3.1
Other items (net)	-42.2	-39.1	-39.2	-39.2	-39.2	-45.5	-51.4	-63.9	-77.8	-90.8	-103.1	-114.3
Monetary Base	14.0	14.5	12.5	14.7	15.5	14.4	15.9	17.6	19.1	20.8	22.7	24.6
Broad money (M2)	66.9	70.5	72.5	78.5	84.8	89.8	99.1	109.3	119.0	129.6	141.0	153.4
Money	13.7	15.9	17.3	17.3	20.0	23.5	26.0	28.6	31.2	34.0	36.9	40.2
Currency	1.7	1.8	1.9	1.8	1.9	2.4	2.8	3.3	3.8	4.2	4.5	4.9
Current deposits	12.0	14.1	15.4	15.5	18.1	21.1	23.1	25.3	27.4	29.8	32.4	35.3
Quasi-money	53.2	54.7	55.1	61.2	64.7	66.2	73.1	80.6	87.9	95.7	104.1	113.2
Memorandum items:												
Nominal GDP (bn pula)	146	171	180	190	198	181	211	239	263	286	309	333
Nominal non-mineral GDP (bn pula)	120	136	149	159	168	160	177	195	212	231	251	274
Velocity (GDP to M2)	2.2	2.4	2.5	2.4	2.3	2.0	2.1	2.2	2.2	2.2	2.2	2.2
Velocity (non-mineral GDP to M2)	1.8	1.9	2.1	2.0	2.0	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Money Multiplier	4.8	4.9	5.8	5.3	5.5	6.2	6.2	6.2	6.2	6.2	6.2	6.2
Base Money (annual % change)	18.6	3.7	-13.7	17.5	5.4	-7.0	10.4	10.3	8.9	8.9	8.8	8.8
Broad Money (annual % change)	19.9	5.4	2.7	8.3	8.0	5.9	10.4	10.3	8.9	8.9	8.8	8.8
Credit to the private sector (annual % change)	9.0	9.0	5.3	6.6	7.1	5.3	7.8	10.5	9.2	8.9	9.3	9.3
Private sector credit to GDP	33.7	31.5	31.4	31.6	32.7	37.6	34.7	33.9	33.6	33.6	34.0	34.6
Private sector credit to non-mineral GDP	41.0	39.6	38.0	37.9	38.5	42.4	41.4	41.5	41.6	41.6	41.8	42.0

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

Table 5. Botswana: Financial Soundness Indicators, 2014–20

	2014	2015	2016	2017	2018	2019	Mar-20	Jun-20	Sep-20	Dec-20
	(Percent, unless otherwise indicated)									
Banking indicators										
Capital adequacy										
Capital to assets	9.1	8.5	8.4	8.8	9.4	11.9	8.7	11.5	14.4	11.8
Regulatory capital to risk-weighted assets	18.6	20.0	19.2	21.9	17.9	18.5	18.2	18.5	19.7	20.0
Regulatory tier I capital to risk-weighted assets	13.1	14.1	13.2	15.0	13.2	13.4	12.4	13.3	13.4	13.8
Nonperforming loans net of provisions to capital	10.6	10.0	12.8	13.4	16.2	10.4	9.7	10.1	8.5	9.2
Asset quality										
Large exposure to capital	191.8	170.0	147.7	90.2	112.8	83.4	83.8	91.9	83.8	64.0
Nonperforming loans to total gross loans	3.5	3.7	4.9	5.3	5.4	4.8	4.2	4.6	4.2	4.3
Bank provisions to nonperforming loans	48.4	54.7	57.1	…	…	…	…	…	…	…
Earnings and profitability										
Trading income to total income	3.4	4.7	2.6	3.1	3.6	4.3	5.2	5.4	5.3	5.3
Return on assets	2.8	2.0	2.3	1.9	2.8	2.3	2.5	1.7	1.8	1.9
Return on equity	25.2	17.5	20.2	16.3	23.3	19.5	21.7	14.3	16.0	15.9
Interest margin to gross income	59.6	57.5	61.4	61.6	57.2	56.2	56.2	57.6	57.1	55.7
Noninterest expenses to gross income	55.5	61.1	57.1	59.9	58.5	58.1	59.2	69.3	65.7	64.9
Personnel expenses to noninterest expenses	43.9	40.6	43.2	44.5	44.4	45.4	84.3	41.1	74.1	42.9
Liquidity										
Liquid assets to total assets	30.2	15.4	16.3	13.4	6.1	5.8	3.6	5.4	4.8	5.3
Liquid assets to short-term liabilities	36.2	18.5	20.0	16.4	7.2	7.0	4.4	6.6	5.9	6.5
Customer deposits to total (non-interbank) loans	113.6	119.8	121.6	117.3	118.8	120.6	119.5	123.5	123.6	122.3
Exposure to foreign exchange risk										
Net open position in foreign exchange to capital	-55.7	-59.4	0.0	-66.0	-63.5	0.0	4.0	5.0	7.2	3.8
Foreign currency-denominated loans to total loans	7.3	6.7	7.5	7.0	7.8	6.2	7.2	6.2	5.3	4.9
Foreign currency-denominated liabilities to total liabilities	13.1	13.0	14.6	13.9	14.3	12.7	14.4	10.0	14.6	14.9

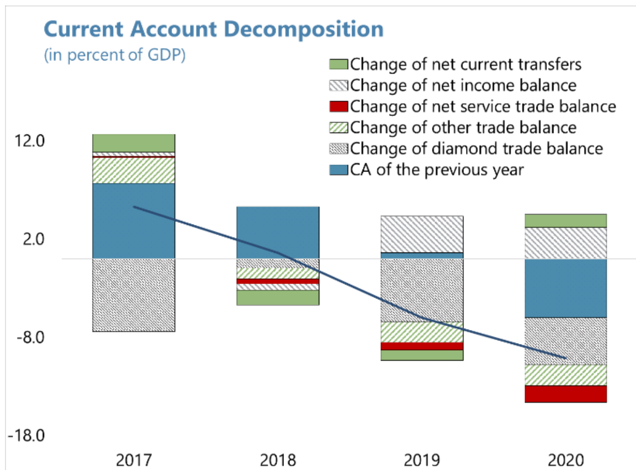
Sources: Bank of Botswana and IMF staff calculations.

Annex I. External Stability Assessment

Botswana's external position in 2020 is moderately weaker than implied by medium-term fundamentals and desired policies. Implementing the planned fiscal consolidation, advancing structural reforms to strengthen competitiveness and promote diversification, and using the flexibility in the current crawling arrangement to allow the real exchange rate basket to respond more to changes in fundamentals will help narrow the current account gap and stabilize reserves in the medium term.

Introduction

1. **Botswana's current account balance deteriorated further in 2020, largely driven by decline in diamond exports related to the COVID-19 pandemic.** After a steady decline from a sizable surplus in 2016 to -6 percent in 2019, mostly due to lower demand for diamonds and fiscal expansion, the current account reached a new low at -10 percent of GDP in 2020. The COVID-19 crisis swiftly impacted goods and services trade flow, particularly in the second quarter of 2020. Goods exports in percentage of GDP dropped significantly mostly because of a sharp contraction in diamond production, while goods imports continue to rise especially in rough diamonds, fuel, and food imports. Services trade balance decreased moderately as reduced tourism exports more than offset lower services imports. Net investment payments and net current transfers in percent of GDP improved owing to lower dividends distributed to nonresidents and higher SACU revenue receipts. The current account balance is expected to improve in 2021 to -3.3 percent of GDP before improving to 2.5 percent of GDP over the medium term as diamond production recovers and fiscal consolidation advances.

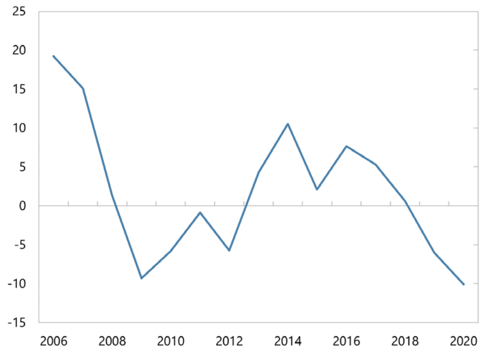


2. **The financial account deficit increased by 2 percent of GDP in 2020, mostly owing to increased net portfolio investment abroad.** Outward investment by pension funds increased by almost 1 percent of GDP. Net foreign assets (NFA) have continuously deteriorated and stood at 31.6 percent of GDP, less than half their 2009 level, reflecting the drawdown of buffers to finance the fiscal expansion. NFA are expected to further deteriorate over the medium term as the current account remains in deficit until 2023 and the pension fund repatriates foreign assets to finance fiscal deficit.

Figure A1.1. Botswana: Key External Sector Indicators

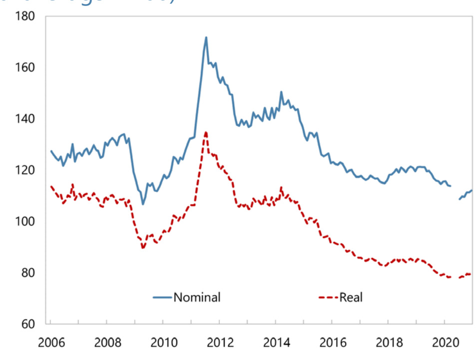
Current Account

(Percent of GDP)



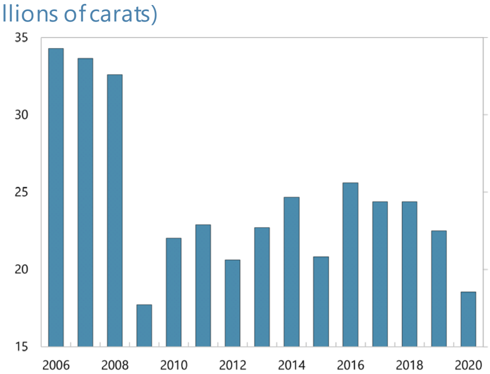
Diamond Price: Polished

(Real average = 100)



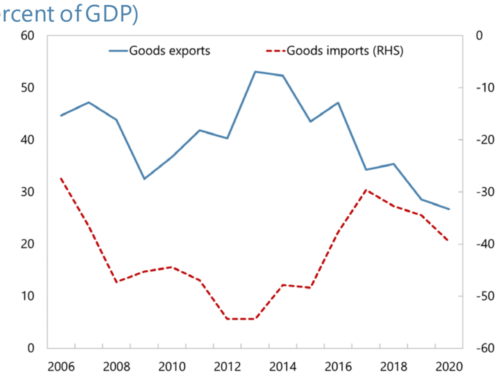
Diamond Export Volumes

(Millions of carats)



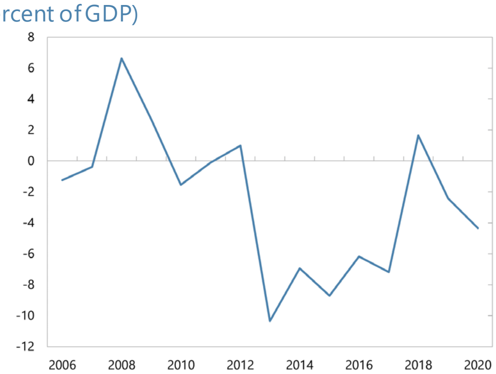
Trade Balance: Goods

(Percent of GDP)



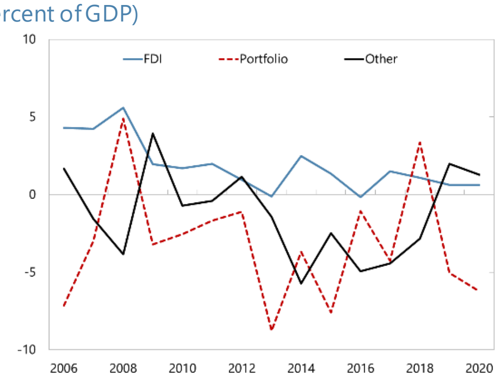
Capital and Financial Account

(Percent of GDP)



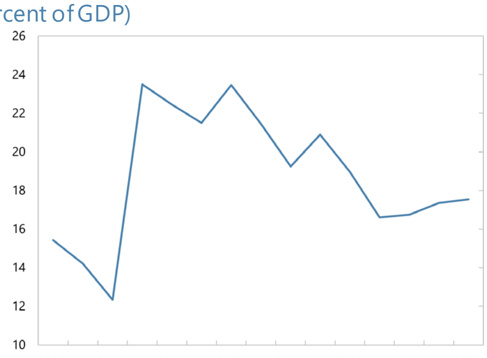
FDI, Portfolio, and Other Investment

(Percent of GDP)



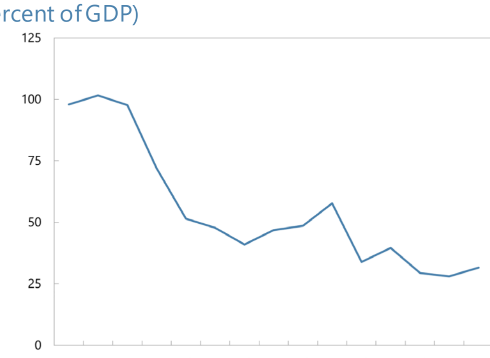
Total Debt and Amortizations

(Percent of GDP)



Net Foreign assets

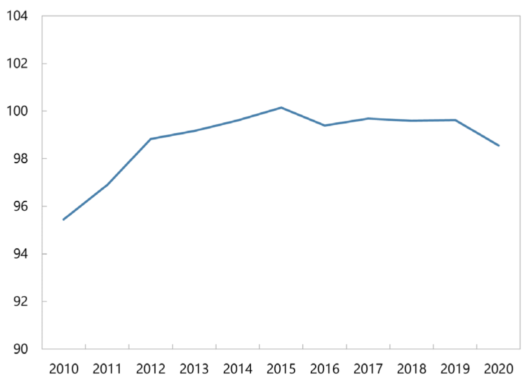
(Percent of GDP)



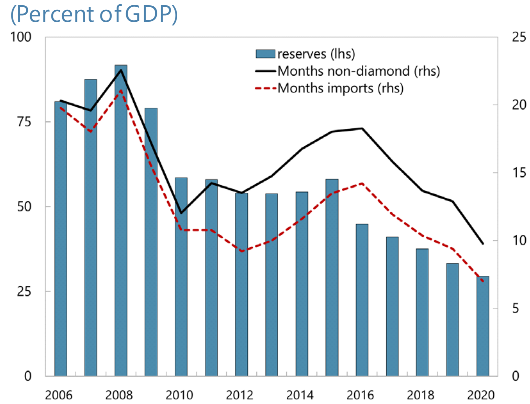
Sources: Bank of Botswana, Ministry of Finance, INS, Haver Analytics, and IMF staff calculations.

3. Botswana's real effective exchange rate (REER) has depreciated only marginally despite substantial decline in diamond prices. The relative stability of the REER can be attributed to the relatively low capital mobility combined with the BoB's policy of adjusting the nominal value of the pula in line with expected inflation differentials with major trading partners and basket weights (the basket comprises the SDR and the South African rand, with a 45 percent weigh for the latter). In response to the COVID-19 crisis, BoB increased the crawling rate from -1.5 to -2.9 percent in May 2020, resulting in the REER depreciation of about 3.5 percent y-o-y in December 2020.

Real Effective Exchange Rate
(Index, 2018 December=100)



Gross Reserves
(Percent of GDP)



Sources: Bank of Botswana, and IMF staff calculations.

4. Botswana's international reserves continued to decline in 2020 but are expected to improve over the medium term. Reserves stood at about US$4.9 billion (US$1.2 billion lower than the previous year), equivalent to 30 percent of GDP or 7.3 months of imports.[1,2] The impact of the current account deterioration on reserves was partially contained by stock market buoyancy and the consequent high returns on reserves investments. Under the baseline projections, the import coverage is expected to increase moderately in the medium term, as diamond production increases and the government improves its fiscal balances.

Current Account and Exchange Rate Assessment

5. The assessment of Botswana's external position employs the External Balance Assessment (EBA)-lite models for the CA and REER.[3] The former approach assesses the current account relative to the position required to generate enough future returns for intergenerational equity purposes. The estimations assume that both the CA and REER are endogenous variables simultaneously determined as a function of domestic and external variables including fundamentals, policy variables, and cyclical conditions (these methodologies assess the CA and REER in

[1] The authorities concurred with the assessment 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 11 months at end-2020).

[3] EBA-lite is an extension of EBA methodologies, uses annual data for 190 countries for the 1995–2016 period and incorporates fundamentals for low and middle-income countries. See further details of the EBA methodology in IMF (2019).

a multilateral-consistent manner, as each country's variables are measured relative to a weighted-average of other countries' values).[4]

6. The EBA-lite suggests a moderate overvaluation of the Pula (see table below). The CA-EBA lite approach estimates the CA gap to be equivalent to -2.6 percent of GDP, with a CA norm of -0.2 percent of GDP in 2020.[5] Since the estimated elasticity of the trade balance to changes in the REER is -0.31, this methodology suggests that the REER would need to depreciate by 8.5 percent for the CA deficit to be reduced to the norm (see table below). From the perspective of the EBA-lite REER approach, the REER would need to depreciate by almost 15.2 percent to reach the CA norm.[6] Staff gives more weight to the CA-EBA lite approach as the one-offs driving some of the imbalances in 2020 can be more directly assessed than in the REER approach (which explains the larger overvaluation suggested by the latter approach).

Results from CA EBA-Lite Estimation, 2020

(In percent of GDP)

	CA model
CA-Actual	**-10.1**
Cyclical contributions (from model) (-)	-1.0
COVID-19 adjustor (+) 1/	6.2
Natural disasters and conflicts (-)	-0.1
Adjusted CA	**-2.8**
CA Norm (from model) 2/	**-0.2**
Adjustments to the norm (+)	0.0
Adjusted CA Norm	**-0.2**
CA Gap	**-2.6**
o/w Relative policy gap	1.5
Elasticity	-0.31
REER Gap (in percent)	**8.5**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on diamond trade balance (4.3 percent of GDP), oil trade balance (1.2 percent of GDP) and tourism (0.7 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

[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] Staff made an adjustment to the cyclically adjusted CA of +6.2 percent (adjustment to the diamond trade balance of 4.3 percent, to the oil trade balance of 1.2 percent and to the tourism balance of 0.7 percent). This is calculated based on (i) an estimated shock to the diamond trade balance of about 9 percent and an estimated elasticity of current account balance to diamond balance of 0.47, (ii) an estimated shock to the oil trade balance of about 1.5 percent and an elasticity of 0.8, and (iii) an estimated temporary tourism shock of 1.3 percent with an elasticity of 0.5. More specifically, the size of the shock to diamond and oil balance is measured as the decrease in the 2020 diamond or oil balance from the pre-COVID projection (Feb 2020 projection. The tourism shock is measured as 73 percent of the 2019 tourism balance.

[6] About 90 percent of Botswana's exports correspond to diamond sold at international prices. Although the exchange rate could affect the level of non-diamond imports, it has no bearing on Botswana's output or sales of diamonds which are demand determined and sensitive to economic developments in the US, China and India. Thus, the current account surplus is weakly dependent on the exchange rate. Moreover, the non-diamond current account deficit would be about 21 percent of GDP, suggesting that the Pula could be overvalued.

Reserve Adequacy

7. The IMF methodology to estimate reserves adequacy provides a rigorous way to assess the appropriate level of reserves. 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 diverse sources of risk (see table below).[7]

8. 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. The weights for the risks in the metric are computed as the financial outflows 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.[8] Separate distributions are estimated for countries with fixed exchange rates or capital controls.[9] The weights for countries with a fixed exchange rate (assumed for Botswana) are:[10]

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

[7] 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 which is an upper middle-income country with little external debt and an investment grade rating.

[8] 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.

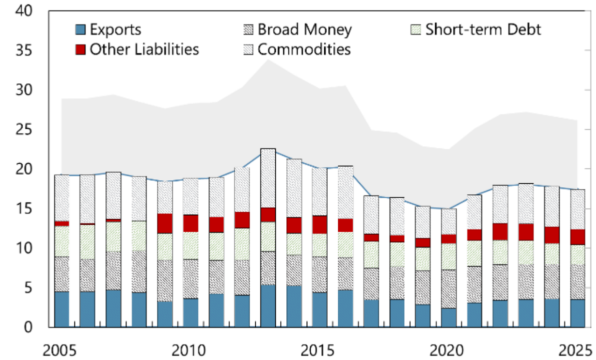
[9] Additional buffers are suggested for countries with commodity exports that exceed 50 percent of total exports. Botswana's commodity exports account for 80 percent of exports of goods and services (90 percent of goods exports). However, the IMF's methodology for commodity exporters relies on futures' prices which are unavailable for diamonds. Nonetheless, considering the decrease in diamond exports and the market weakness and depressed diamond price, staff considers that a weight of 25 percent for exports could be appropriately used to reflect volatility in diamond prices.

[10] 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. 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.

9. Botswana has a comfortable reserve position, which stands at 184 percent of the ARA metric. According to the IMF's metric, reserves of 14 to 16 percent of GDP, amounting to 100–150 percent of the ARA metric, would be adequate, compared to the estimated level for 2020 of 29.5 percent of GDP. However, this assessment doesn't fully consider Botswana's high dependence on commodity exports. Indeed, using a weight of 25 percent for exports (instead of 10 percent) to reflect the country's dependence on volatile diamond receipts, the adequacy range would increase to 18–25 percent of GDP. Moreover, for the past twenty years the level of reserves has far exceeded the upper bound of the adequacy range.

Composition Metric

(Percent of GDP)



Sources: BoB and IMF staff estimates.

10. Foreign reserves are under the control of the Bank of Botswana —with 85 percent kept in a sovereign wealth fund (the Pula Fund) and 15 percent in a Liquidity Portfolio (used as a short-term liquidity buffer). Within the Pula Fund, about one-third is owned by the government and two-thirds by the BoB as at end-2019. Foreign exchange reserves in excess of the amount required for daily foreign transactions kept in the Liquidity Portfolio (currently set at nine months of imports) are transferred to the BoB's portion of the Pula Fund. If the Liquidity Portfolio declines below three months of imports, it receives a transfer from the Pula Fund.

References

International Monetary Fund. 2013. "The External Balance Approach." IMF policy paper.

________________. 2011. "Assessing Reserve Adequacy." IMF policy paper.

________________. 2013. "Assessing Reserve Adequacy–Further Considerations." IMF policy paper.

________________. 2014. "Assessing Reserve Adequacy–Specific Proposals." IMF policy paper.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Expected Impact if Realized	Possible Policy Response
Global Risks			
Weaker-than-expected global growth caused by prolonged need for containment measures or persistent behavioral changes that render many activities unviable and exacerbate stretched asset valuations. Policy support is insufficient.	Medium	High Global growth would affect demand for diamonds, tourism, and other commodities (e.g. copper). This could be compounded by lower or higher SACU revenue, affecting external and fiscal balances, foreign reserves and pressure on the Pula.	Use fiscal space to counter the effects of the slowdown and protect the vulnerable firms and households. Accelerate structural agenda enhancing competitiveness and diversify the economy to build resilience against external shocks. Enhance regional integration. Consider more flexibility in exchange rate response to external shocks.
Oversupply and volatility in the oil market. Higher supply and lower demand lead to renewed weakness in energy prices. (Geo)political tensions in certain regions cause disruption, and uncertainty about production, higher volatility in commodity prices.	Medium	Medium As an oil importer, lower fuel prices would narrow trade deficit, reduce inflationary pressure, and lower inequality.	Use additional fiscal space to advance fiscal consolidation.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions and accelerate emigration from these economies (medium probability).	Medium /Low	Medium More frequent/severe droughts in Southern Africa could disrupt water provision and reduce crop production, tourism activity, weaken strategic sectors (e.g. mining), and have debilitating effects on the poor. This would also lead to higher fiscal deficits, lower growth, and higher unemployment.	Accelerate relief measures in the ST and implement climate change mitigation/adaptation measures in the MT/LT. Adapt spatial development strategies to long-term climate challenges and constraints. Enhance regional coordination to mitigate climate change shocks.
Domestic Risks			
Contingent liabilities (SOEs, guaranteed loans) materialize and delays in implementing fiscal consolidation and key structural reforms due to political economy constraints, capacity limitations or lack of effort on medium-term outcomes.	Low	High Protracted low competitiveness, high fiscal and external deficits. Increase in public debt and/or erosion of buffers would jeopardize fiscal sustainability and threaten macroeconomic and external stability as well as social stability.	Strengthen fiscal framework including by defining a long-term anchor and operational guidance for fiscal policy. Implementing a growth friendly fiscal consolidation, that improves the efficiency of spending and preserves productive capital and social spending. These measures should be accompanied by a greater use of the flexibility afforded by the current exchange rate regime and structural reforms to advance diversification and raise productivity.
Prolonged pandemic--due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them--requires costly containment efforts and further policy support.	Medium	High Growth falls even further, causing unexpected private sector distress, banks' balance sheets deterioration and scarring of the economy. Fiscal deficit and public financing needs increase. The pace of recovery slows down and result in persistently high unemployment.	Fiscal policy could continue to be supportive in the near term, but there should be a credible medium-term consolidation plan. Easy fiscal policy could be supported by looser monetary conditions if greater exchange rate flexibility is allowed. At the same time, reforms to boost productivity and unleash private sector development with a view of reducing the dependence on mining.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood 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 between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Debt Sustainability Analysis

While Botswana's public debt ratio is projected to increase following the COVID-19 pandemic, its public sector debt is assessed to be sustainable over the medium term. The large financing needs in FY2020 is expected to be financed mostly through a drawdown of buffers and exceptional capital gains from the central bank, limiting the effect on public debt. Under current policies, public debt is projected to remain well below Botswana's debt ceiling of 40 percent of GDP over the medium-term as the economy recovers from the COVID-19 shock and fiscal consolidation continues. Implementation of the fiscal plan is key to reducing debt levels. However, debt levels could increase if risks materialize, particularly if the recovery is slower than anticipated and mineral revenues are lower than expected.

1. **The COVID-19 shock is expected to cause a sharp increase in gross financing needs with significant increase in public debt levels.** Gross financing needs are projected to increase to 14.6 percent of GDP in FY2020, compared to 9.4 percent in FY2019 (Table A3.1)[1], mainly driven by a significant drop in mineral revenue and rise in COVID-19 related spending. The large increase in the gross financing needs is not reflected on public debt as it was mainly financed through a drawdown of buffers (the Government Investment Account) as well as exceptional gains from the Bank of Botswana. Public debt is projected to increase to 23.5 percent of GDP in FY2020 from 19.2 percent of GDP in FY2019 while the Government Investment Account declined from 18.4 percent of GDP at end-2019 to 3.7 percent of GDP by end-2020.

2. **The medium-term baseline macroeconomic scenario envisages unwinding of one-off COVID-19 related spending and recovery in mining and non-mining revenues.** The economy is projected to expand by 8.3 percent in 2021. The fiscal deficit, which widened to 11 percent of GDP in FY2020 as a result of a pandemic-related fall in revenues and increase in spending, is expected to narrow to 4.4 percent in FY2021 as the one-off spending is unwound and revenues bounce back following the economic recovery. Under the current policies, the deficit is expected to be 4 percent of GDP over 2021–23, on average, and decline to about 0.5 percent of GDP over the medium term. As a result, the gross financing needs are projected to decline from 14.6 percent of GDP in FY2020 to 7.7 percent of GDP in FY2021, and to an average of about 5 percent of GDP over the medium term. The gross financing needs are expected to be filled by drawdown of deposits, medium and long-term domestic debt, and external debt including from multilateral institutions and capital market. Public debt is projected to peak at 29 percent of GDP in FY2022 before it declines to 26.4 percent in FY2025.

3. **Standard shocks and stress test scenarios indicate robust public debt dynamics.**

- ***Growth shock.*** This scenario considers lower real GDP growth because of slower than anticipated recovery, reducing the real GDP growth by one standard deviation (about 4 percent) for two consecutive years. Under this scenario, although debt levels would

[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).

peak at 35.2 percent of GDP in FY2022, well below Botswana's debt ceiling of 40 percent of GDP and the 50 percent of GDP EM threshold.

- ***Primary balance shock.*** This shock considers a scenario where about half of the planned adjustment is not realized, leading to higher primary deficit through 2025. This scenario corresponds to, for instance, a lower than anticipated mineral prices, depressing government revenue. Under this scenario, debt level could be elevated but remain below the debt ceiling through 2025.

- ***Combined macro-fiscal shock.*** This shock considers the most severe scenario of lower growth, higher primary deficit, and the associated higher interest rate. Under this scenario, public debt would surpass Botswana's debt ceiling of 40 percent of GDP but remain below the EM threshold of 50 percent, stabilizing at about 40.4 percent of GDP in 2025. Gross financing need would also be below the 10 percent of GDP threshold by 2022.

- ***Contingent liabilities shock.*** This shock considers that a large share of contingent liabilities related to SOEs' debt is called. The scenario assumes a one standard-deviation shock to growth, with associated deterioration of the primary balance (as in the standard contingent liability shock scenario in the MAC DSA template), and a slight increase in interest rates. Under this scenario, debt would rise to about 29 percent of GDP in 2025 (vs baseline of 26.4 percent of GDP).

4. Realism of Baseline Assumptions:

- Past projections of real GDP growth and primary balance show optimistic bias partly reflecting volatility in the diamond sector and SACU receipts. The forecast errors in the primary balance also reflect the need for improving implementation of the authorities' fiscal plans.

- Under the baseline scenario, the projected 3-year adjustment in the cyclically adjusted primary balance (CAPB) is relatively strong, reflecting the unwinding of the one-off COVID-spending and output recovery. However, the CAPB level is relatively small with a percentile rank of 73 percent compared to the historical experience for high-debt market access countries.

5. Although the financing needs are elevated in 2020 following the pandemic, several factors help mitigate this risk. First, with the projected decline in gross financing need as the economy recovers and one-off spending unwind, both the gross financing needs and external financial requirements would not pose significant risk to Botswana. Second, Botswana has a large investment base (NBFIs assets) and has a good sovereign rating that could facilitate access to foreign markets at favorable conditions. Third, in terms of the high share of public debt held by non-residents, the associated vulnerabilities are mitigated as most of the external borrowing is from multilaterals with long maturities and about 60 percent of fiscal revenue are in foreign currency, offering a natural hedge against currency depreciation.

Table A3.1. Botswana: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

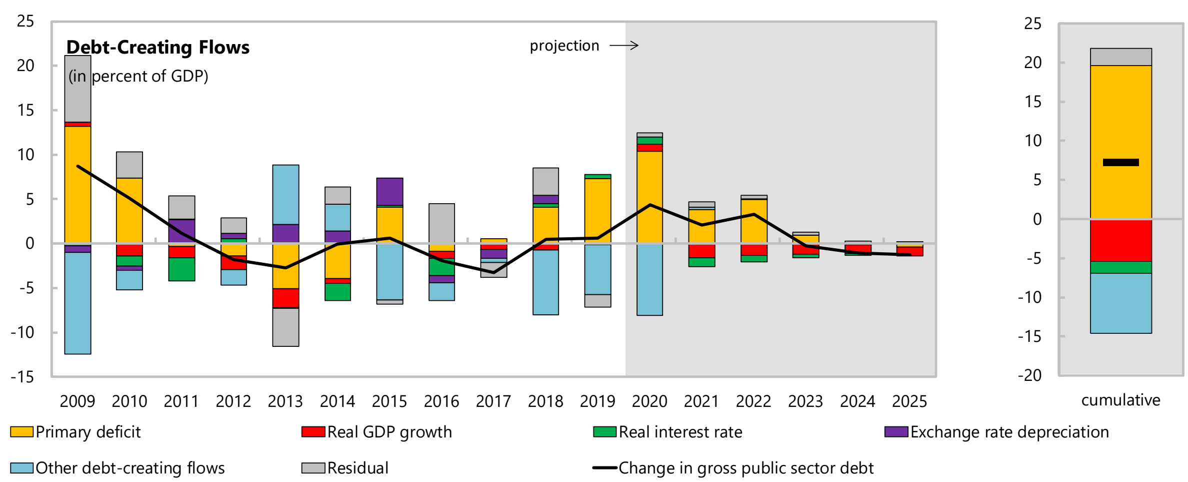
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of April 26, 2021		
	2009-2017 [2]	2018	2019	2020	2021	2022	2023	2024	2025	Sovereign Spreads		
Nominal gross public debt	23.0	18.6	19.2	23.5	25.7	29.0	28.7	27.7	26.4	EMBIG (bp) 3/		462
Public gross financing needs	4.4	7.5	9.4	14.6	7.7	7.7	5.0	4.1	3.7	5Y CDS (bp)		N/A
Net public debt												
Real GDP growth (in percent)	3.9	4.1	0.2	-4.1	7.8	6.0	4.6	4.0	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	6.7	1.2	0.7	-0.6	7.7	6.4	5.1	4.6	3.9	Moody's	A3	A3
Nominal GDP growth (in percent)	10.6	5.2	0.6	-2.6	15.7	12.3	9.8	8.6	7.9	S&Ps	BBB+	BBB+
Effective interest rate (in percent) [4]	2.7	3.3	3.4	3.3	3.2	3.6	3.9	4.1	4.1	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	0.6	0.5	0.6	4.4	2.1	3.3	-0.3	-1.1	-1.2	7.2	
Identified debt-creating flows	-1.0	-2.6	2.0	3.9	1.5	2.9	-0.6	-1.3	-1.4	5.0	
Primary deficit	1.5	4.1	7.3	10.4	3.8	5.0	1.0	-0.1	-0.4	19.6	-1.0
Primary (noninterest) revenue and grants	34.9	27.8	25.9	24.0	27.5	24.4	27.3	27.5	27.1	157.8	
Primary (noninterest) expenditure	36.4	31.9	33.2	34.3	31.3	29.4	28.3	27.4	26.7	177.4	
Automatic debt dynamics [5]	-0.9	0.6	0.3	1.6	-2.6	-2.1	-1.6	-1.2	-1.0	-6.9	
Interest rate/growth differential [6]	-1.7	-0.3	0.4	1.6	-2.6	-2.1	-1.6	-1.2	-1.0	-6.9	
Of which: real interest rate	-0.8	0.4	0.5	0.8	-1.0	-0.7	-0.4	-0.2	0.0	-1.5	
Of which: real GDP growth	-0.9	-0.7	0.0	0.8	-1.6	-1.4	-1.2	-1.1	-1.0	-5.4	
Exchange rate depreciation [7]	0.8	1.0	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.6	-7.3	-5.6	-8.1	0.3	0.0	0.0	0.0	0.0	-7.7	
Privatization/Drawdown of Deposits (negative)	-1.6	-7.3	-5.6	-6.3	0.3	0.0	0.0	0.0	0.0	-6.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	-1.7	0.0	0.0	0.0	0.0	0.0	-1.7	
Residual, including asset changes [8]	1.7	3.1	-1.4	0.5	0.7	0.4	0.3	0.3	0.1	2.2	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

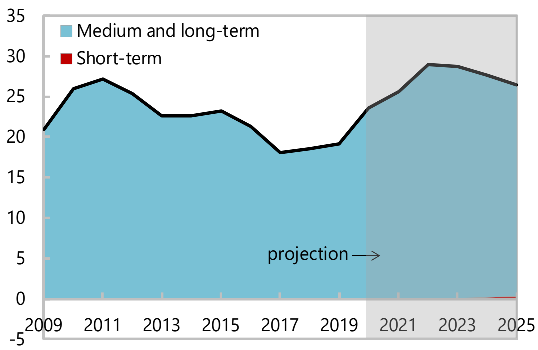
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

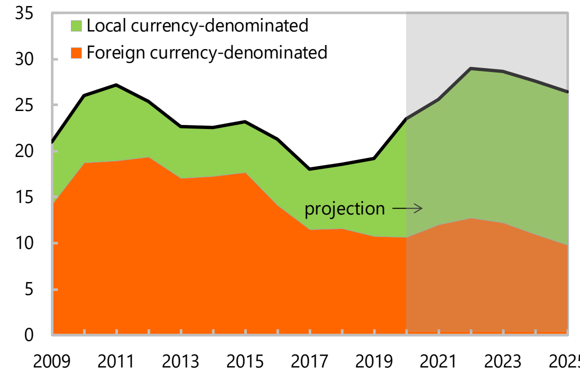
Figure A3.1. Botswana: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



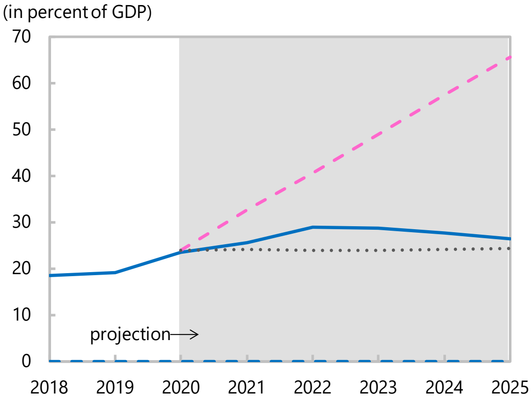
By Currency
(in percent of GDP)



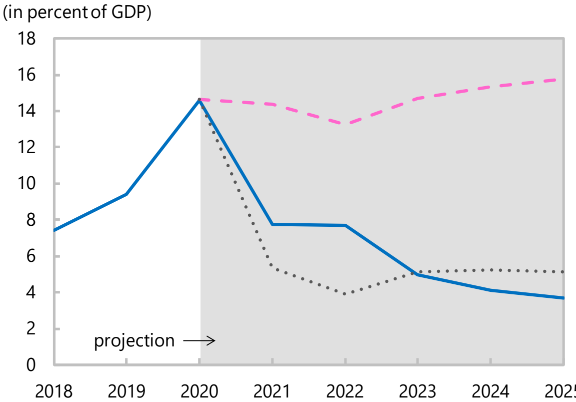
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

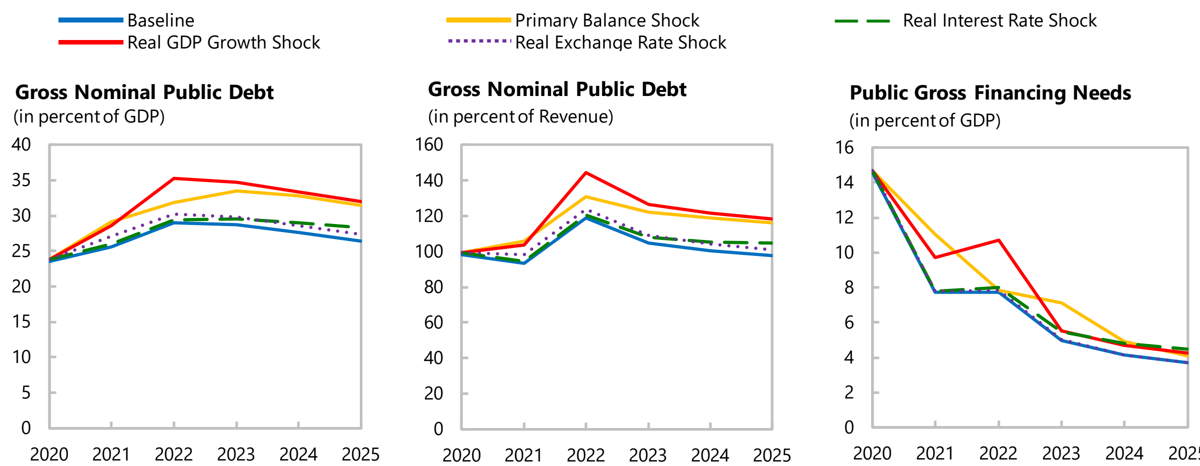
Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-4.1	7.8	6.0	4.6	4.0	4.0
Inflation	-0.6	7.7	6.4	5.1	4.6	3.9
Primary Balance	-10.4	-3.8	-5.0	-1.0	0.1	0.4
Effective interest rate	3.3	3.2	3.6	3.9	4.1	4.1
Constant Primary Balance Scenario						
Real GDP growth	-4.1	7.8	6.0	4.6	4.0	4.0
Inflation	-0.6	7.7	6.4	5.1	4.6	3.9
Primary Balance	-10.4	-10.4	-10.4	-10.4	-10.4	-10.4
Effective interest rate	3.3	3.2	3.4	3.6	3.6	3.5

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-4.1	4.3	4.3	4.3	4.3	4.3
Inflation	-0.6	7.7	6.4	5.1	4.6	3.9
Primary Balance	-10.4	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	3.3	3.2	3.3	3.6	3.4	3.1

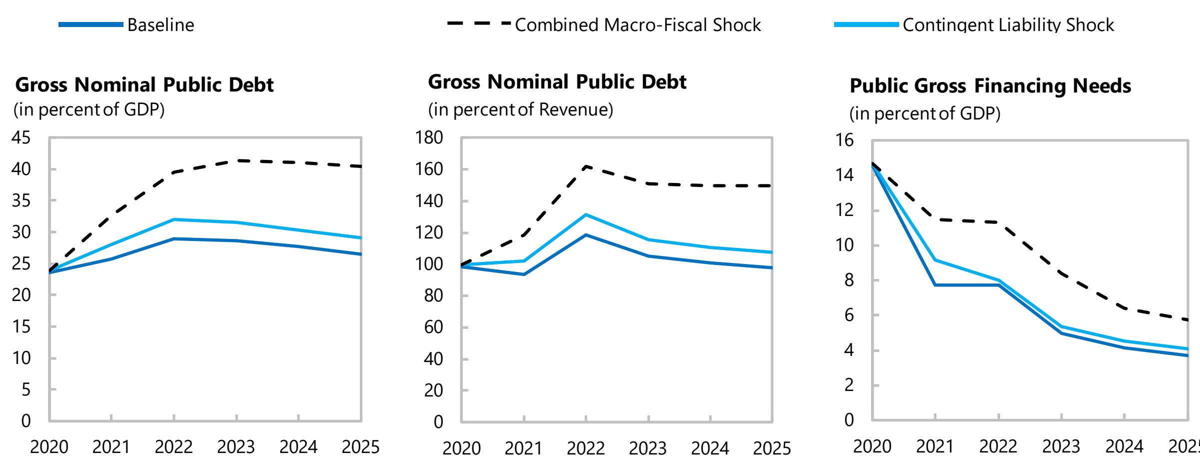
Source: International Monetary Fund, country desk data, and staff estimates.

Figure A3.2. Botswana: Public Sector Debt Sustainability Analysis (DSA) – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

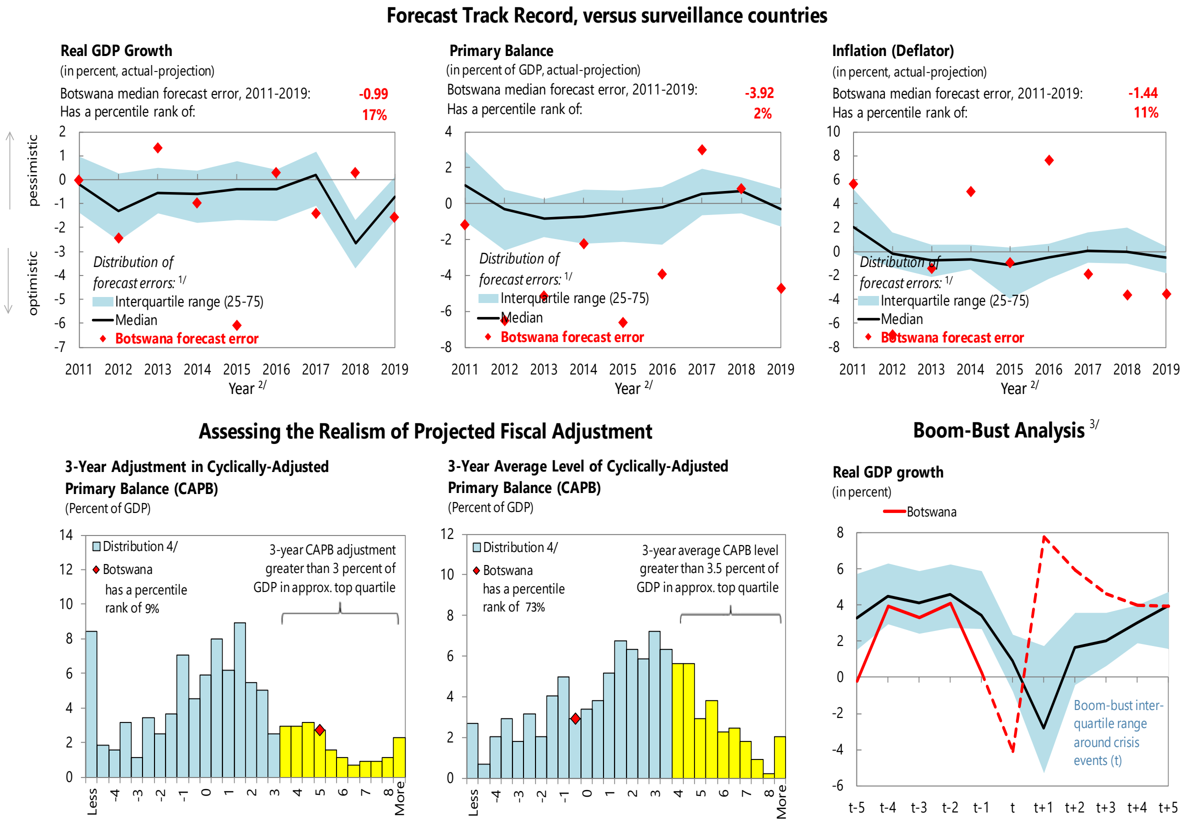
(in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-4.1	8.7	6.8	4.6	4.0	4.0
Inflation	-0.6	7.7	6.4	5.1	4.6	3.9
Primary balance	-10.4	-7.1	-5.0	-3.0	-0.4	0.2
Effective interest rate	3.3	3.2	3.8	4.1	4.2	4.3
Real Interest Rate Shock						
Real GDP growth	-4.1	7.8	6.0	4.6	4.0	4.0
Inflation	-0.6	7.7	6.4	5.1	4.6	3.9
Primary balance	-10.4	-3.8	-5.0	-1.0	0.1	0.4
Effective interest rate	3.3	3.2	4.6	5.7	6.3	6.8
Combined Shock						
Real GDP growth	-4.1	4.7	2.9	4.6	4.0	4.0
Inflation	-0.6	7.0	5.6	5.1	4.6	3.9
Primary balance	-10.4	-7.1	-7.7	-3.0	-0.4	0.2
Effective interest rate	3.3	3.4	4.6	5.7	6.2	6.6

	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-4.1	4.7	2.9	4.6	4.0	4.0
Inflation	-0.6	7.0	5.6	5.1	4.6	3.9
Primary balance	-10.4	-5.5	-7.7	-1.0	0.1	0.4
Effective interest rate	3.3	3.2	3.7	4.2	4.3	4.3
Real Exchange Rate Shock						
Real GDP growth	-4.1	7.8	6.0	4.6	4.0	4.0
Inflation	-0.6	13.8	6.4	5.1	4.6	3.9
Primary balance	-10.4	-3.8	-5.0	-1.0	0.1	0.4
Effective interest rate	3.3	3.4	3.5	3.9	4.0	4.1
Contingent Liability Shock						
Real GDP growth	-4.1	4.7	2.9	4.6	4.0	4.0
Inflation	-0.6	7.0	5.6	5.1	4.6	3.9
Primary balance	-10.4	-5.0	-5.0	-1.0	0.1	0.4
Effective interest rate	3.3	3.5	3.7	4.0	4.1	4.2

Source: IMF staff.

Figure A3.3. Botswana: Public Sector Debt Sustainability Analysis (DSA) – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Botswana has had a positive output gap for 3 consecutive years, 2017-2019. For Botswana, t corresponds to 2020; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex IV. Summary of Capacity Development Strategy (FY2021–23)

Background

1. **The COVID-19 crisis has severely impacted Botswana's diamond- and tourism-dependent economy**. In recent years, structural challenges, persistent and negative external shocks, and delays in adjustment have eroded Botswana's external buffers and weakened its fiscal position. The crisis has exacerbated its economic imbalances. A recovery is underway but its strength and sustainability hinges on implementation of fiscal and transformational supply-side reforms toward a non-mineral export led model. This increases the urgency of fiscal reforms to enhance spending efficiency and revenue mobilization, structural reforms to foster diversification and promote private sector activity, as well as the development of the domestic bond markets to support the government's financing strategy going forward.

Capacity Development Assessment

2. **Cooperation between the Fund and Botswana on technical assistance (TA) and training has been strong, spanning a wide range of areas**. These include monetary policy and operations, financial supervision and regulation, central bank operations, public financial management, domestic revenue mobilization, expenditure management, debt management, legal frameworks (financial and fiscal law reform), AML/CFT financial sector supervision, and macroeconomic statistics. The authorities attach significant value to Fund TA, have showed ownership of the reform process in many areas, and have followed up on TA recommendations, albeit with delays. Implementation of recommendations has been relatively good on financial sector, liquidity management and BOP statistics. Progress in the areas of public financial management, national accounts and fiscal statistics has been more mixed, with a slow pace owing to limited resources (staffing shortages and limited absorption capacity), insufficient coordination among key agencies, and more recently the focus on the COVID-19 response.

Capacity Development Priorities

3. **The TA priorities listed below are consistent with the country's macroeconomic priorities.** The Fund has already delivered some assistance on the items below and further assistance is expected to be forthcoming. The authorities have made additional TA requests in FY2020 in the areas such as taxation of the digital economy, double taxation avoidance agreements, FSAP, stress-testing of NBFIs, fintech strategy monitoring and regulation, crisis preparedness simulation, and macroprudential framework. The Article IV discussions identified other areas where TA is needed, in particular development of the government bond markets and the interbank market. At the same time, there is a need for strong involvement and prioritization of human and financial resources by the authorities in the areas of TA provisioning.

Surveillance Priorities	CD Objectives
Revenue mobilization and administration	- Strengthen international tax policy provisions (e.g. tax treaty policy, transfer pricing rules and taxation of remote digital service). - Improve customs administration core functions - Strengthen revenue administration management and governance arrangements. - Assist with introduction of electronic billing machines (EBMs). - Advance the design and drafting of the Fiscal Tax Laws. - Strengthen tax administration in the financial sector.
Public financial management	- Improve coverage and quality of fiscal reporting - Strengthen identification, monitoring, and management of fiscal risks - Improve laws and effective PFM institutions - Strengthen fiscal risks management framework
Fiscal framework	- Assist the authorities in designing and calibrating a new set of fiscal rules. - Update the debt management framework - Improve debt sustainability analysis (DSA) - Develop a legal framework for dealing with contingent liabilities arising from Public-Private Partnership
Central bank operations	- Strengthen efficient implementation of monetary policy under the existing regime
Financial supervision and regulation	- Recalibrate the existing stress testing model to accommodate macro-financial stress-testing. - Assist stress-testing NBFIs. - Assist in developing a liquidity risk regulatory and supervisory framework, incorporating the Basel III liquidity coverage ratio and the net stable funding ratio). - Implement a Financial Sector Assessment Program (FSAP).
Monetary and macroprudential policy implementation and operations	- Strengthen the operational framework including the liquidity forecasting. - Review the reserve requirement framework. - Provide training on the unsecured and secured interbank market development. - Provide training on the local-currency bond market development. - Improve central bank international and external communication.
Improve the quality of statistics	- Complete the migration to GFSM 2014 and extend the coverage to general government. - Development of the PPI and owner occupier housing component of the CPI - Assist in the compilation of rebased estimates of national accounts. - Extend the coverage of monetary and financial statistics to include other financial corporations' sector (e.g. insurance corporations, and the investment fund shares).

Annex V. Estimating the Impact of Risks using the DIGNAR-19 Framework[1]

This annex presents upside and downside scenarios around Botswana's growth outlook using a dynamic general equilibrium model, DIGNAR-19 (Melina and Zanna, 2020). The model is calibrated to the Botswana economy with the following features: financially constrained households; three sectors of production (diamond, non-diamond traded goods, nontraded goods); and a government with access to various fiscal instruments and borrowing.

1. **The downside scenario envisages a prolonged COVID-19 pandemic and assumes the following simultaneous shocks:** (1) a health shock, affecting employment, domestic demand and government expenditures; (2) a trade shock captured by a fall in non-diamond exports and Southern African Customs Union (SACU) transfers; and (3) a negative shock to diamond price and diamond export volumes.[2] These shocks would take a heavy toll on Botswana's economy. Mainly driven by subdued employment, economic activity and external demand, GDP growth would be 5¼ percentage points lower than the baseline in 2021 and 1¼ percentage points lower in 2022. Absent fiscal consolidation measures, public debt would reach 35 percent of GDP by 2025, primarily due to higher public health expenditures and lower mineral and SACU revenues.

2. **The upside scenario envisages a quicker global vaccine rollout and a faster reform implementation.** This scenario is illustrated through the following assumptions: (1) a positive non-diamond export shock capturing faster rollout of vaccines worldwide, removal of containment measures, and a resumption of tourism activity; (2) a positive shock to diamond export volumes reflecting stronger external demand for diamonds; and (3) a rapid and effective product market reform implementation coupled with an improvement in public investment efficiency.[3]
The combined effects of these positive shocks would be beneficial for Botswana. Largely driven by higher external demand, GDP growth would be 0.6 percentage points higher than the baseline in 2021 and 1 percentage points higher in 2022. In the medium term, successful implementation of reforms would lift potential GDP and, overall, growth would be 1.6 percent points above baseline

[1] This annex was prepared by Zamid Aligishiev (RES) and Giovanni Melina (RES).

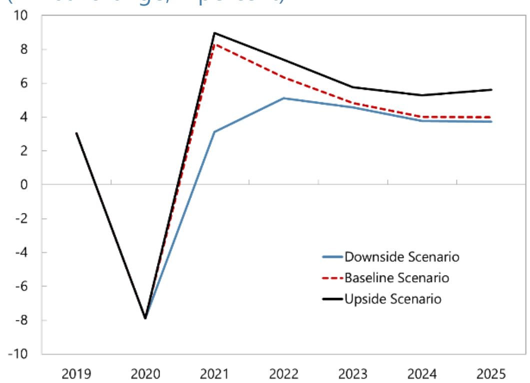
[2] In the downside scenario, simulations assume a decrease in employment (2 and 1 percent drop in 2021 and 2022, respectively) and growth in domestic demand (fall of 1.7 and 0.4 percentage points in 2021 and 2022, respectively). In response, the government would increase health-related expenditures by 0.5 percentage points of GDP in 2021 and 2022. The trade shock is captured by a decline in non-diamond exports (1.5 and 0.5 percentage points of GDP lower in 2021 and 2022, respectively), and SACU transfers (assumed to be 2 percentage points of GDP lower in 2023) relative to the baseline. Finally, diamond prices would experience a more muted recovery, reaching 1,662 Pula per carat by 2025, and the growth rate of diamond exports is assumed to be 13.9 percentage points lower than in the baseline in 2021.

[3] In the upside scenario, simulations assume an increase of non-diamond exports to 8.5 percent of GDP in 2021 and additional SACU transfers relative to the baseline (1 and 1.5 percentage point of GDP higher in 2022 and 2023, respectively). In addition, the growth rate of diamond exports is assumed to be 3 and 3.5 percentage points higher in 2021 and 2022, respectively. Finally, public investment efficiency is assumed to gradually increase to the regional average of 74 percent by 2025, while faster product market reform implementation is presumed to gradually increase annual TFP growth by 1 percentage points by 2025.

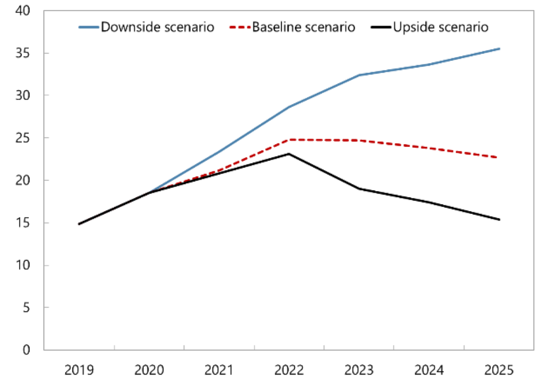
projections by 2025. Also, government debt would decline below the pre-pandemic level by 2025, facilitated primarily by higher external demand, mineral, and SACU revenues.

Figure A5.1. Botswana: Impact of Risks using the DIGNAR-19 Framework

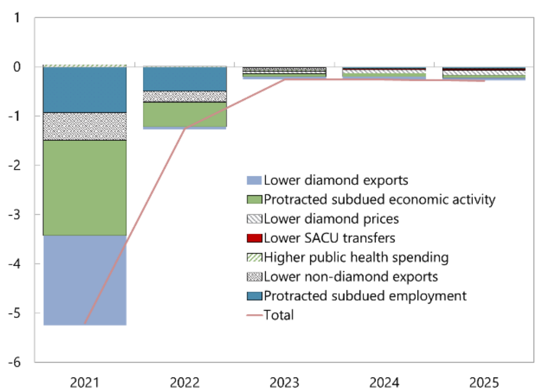
Real GDP
(Annual change, in percent)



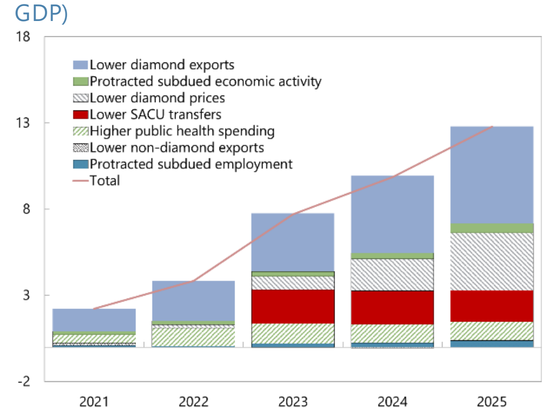
Government Debt
(Percent of GDP)



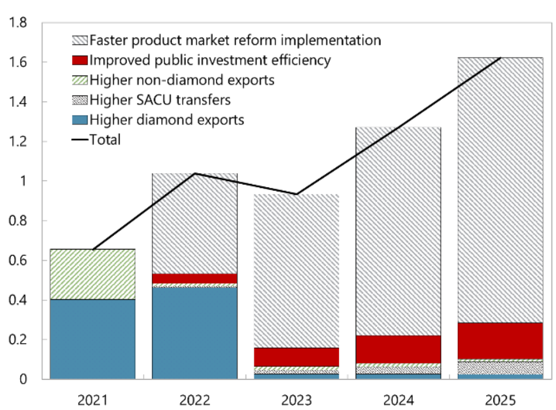
Downside Scenario - Real GDP
(Contributions of shocks to the difference in real GDP growth from the baseline scenario, in percentage points)



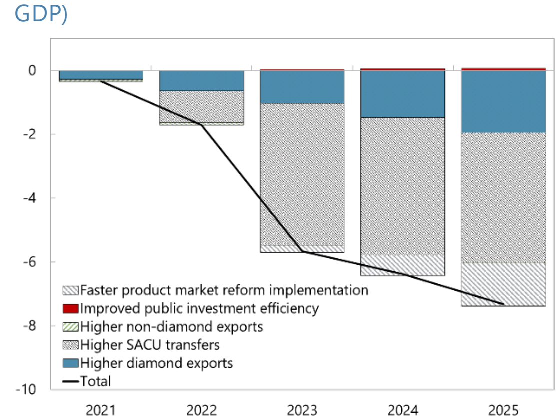
Downside Scenario - Government Debt
(Contributions of shocks to the difference in Government Debt from the baseline scenario, in percentage points of GDP)



Upside Scenario - Real GDP
(Contributions of shocks to the difference in real GDP growth from the baseline scenario, in percentage points)



Upside Scenario - Government Debt
(Contributions of shocks to the difference in Government Debt from the baseline scenario, in percentage points of GDP)



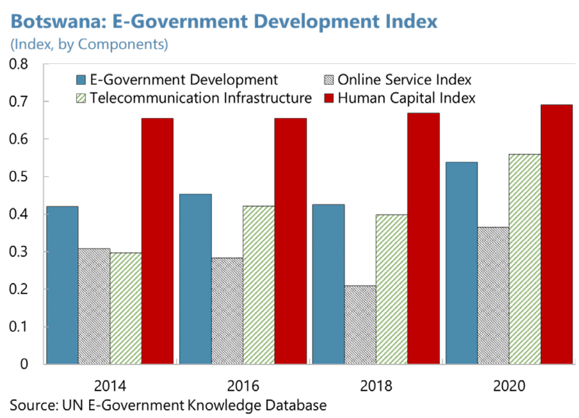
Note: In the downside scenario, diamond prices are assumed to remain constant in real terms.

Annex VI. Digitalization and Structural Transformation

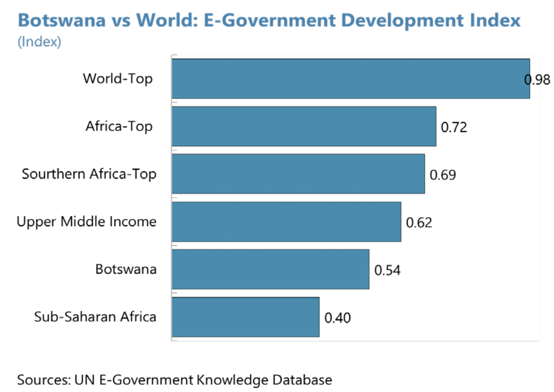
1. **Botswana has significantly improved its digital platform in recent years but lags behind other upper-middle-income countries.** Botswana's e-Government Development Index[1] increased by 26.6 percent in 2020 compared to its level in 2018, mainly driven by improvements in online services and telecommunication infrastructure. The government has adopted the Smart Botswana Strategy to digitalize public service delivery. Most notably, the Companies and Intellectual Property Authority (CPIA) has fully digitalized its company records to facilitate business registration process; and about 52 percent of localities are connected to broadband open access network infrastructure. However, Botswana remains below the upper-middle income average level of e-Government Development Index.

Botswana E-Government Index

Significant improvement in recent years…



…yet lower than its comparators.



2. **Botswana needs to leverage its digitalization drive to accelerate structural transformation and facilitate integration into the global value chain.** Digitalization helps structural transformation by facilitating shifts towards activities (both within and across sectors) that are more knowledge intensive and generate higher value added.[2] Empirical evidence based on panel data for 61 countries shows strong link between digitalization and export sophistication.[3] At a micro level, case studies of manufacturing firms in Kenya also reveal the role of digitalization in product upgrading.[4] Digitalization also helps integrating into the global value chains (GVCs) as digital manufacturing technologies are becoming increasingly important in GVCs. Evidence from Indian

[1] The E-Government Development Index, developed by the UN, is a composite measure of the provision of online services, telecommunication connectivity, and human capacity.

[2] UNCTAD, 2019. Structural transformation, Industry 4.0 and inequality: Science, technology and innovation policy challenges, Geneva.

[3] Atasoy, B. S (2020). The determinants of export sophistication: Does digitalization matter? International Journal of Finance and Economics: 1-25.

[4] Banga, K., and D.W. te Velde. 2018. How to Grow Manufacturing and Create Jobs in a Digital Economy: 10 Policy Priorities in Kenya. Report. London: Overseas Development Institute.

GVC firms indicates that digital leader firms produce 4 to 5 percent more sophisticated goods than digital laggards.[5]

3. Botswana's envisages embracing the Fourth Industrial Revolution through digitalization. The Economic Recovery and Transformation Plan (ERTP) targets fast-tracking digitalization by addressing digital infrastructure gaps, digitalization of land registration, expediting the rollout of the e-Government services and biometric identification, and promoting digital payment infrastructure. These initiatives are critical to improve Botswana's competitiveness, integrate in GVCs, upgrade product sophistication, and circumvent the inherent limitations, including landlocked and small market size.

4. Calibrating digital strategies is required to benefit from digitalization. Both hard and soft digital infrastructure need to be built to create an ecosystem that supports structural transformation through product upgrading. Appropriate business and regulatory environment for digitally enabled businesses and new entrants and investing in human capital are important to benefit from digitalization.[6] Human capital investment should go beyond the emphasis on investing in digital skills—investing in early childhood education is key to develop skills required by the digital economy, including high-order cognitive and socio-behavioral skills, and foundational skills that are the basis for lifelong learning.[7]

[5] Banga, K., 2021. Digital Technologies and Product Upgrading in Global Value Chains: Empirical Evidence from Indian Manufacturing Firms. European Journal of Development Research.

[6] IMF, 2020. Regional Economic Outlook for Sub-Saharan Africa. April 2020.

[7] World Bank (2019). World Development Report 2019, The Changing Nature of Work, Washington, D.C.