

**Statement by Ms. Mannathoko and Ms. Basutli on Botswana
May 27, 2021**

While Botswana has enjoyed prolonged periods of robust growth supported by prudent macroeconomic management, strong institutions and good governance, efforts to sustain stronger growth performance and advance diversification have been repeatedly interrupted by external shocks. To reduce dependence on capital intensive mineral exports, economic diversification with sustainable export-led private sector expansion and structural transformation, is an imperative. It will also help to productively employ the dominant youth population. Youth unemployment, including among university graduates, now exceeds 30 percent. The authorities would value any insights Directors may have on how best to advance diversification, as they work to optimize the effective implementation and impact of an Economic Recovery and Transformation Plan (ERTP), approved by parliament in October 2020, which provides a blueprint for the country's emergence from the pandemic and economic recovery beyond.

Introduction

1. We thank staff for an insightful, helpful, and well-written report. The Botswana authorities appreciate the constructive, candid dialogue with staff during the Article IV mission and broadly concur with the policy recommendations.
2. Botswana's long-standing track record of sound macroeconomic policies and good governance enabled the country to build strong buffers that helped weather the severe impact of the pandemic and moderate its effects. Nevertheless, the economy remains vulnerable to external shocks, including those related to dependence on mineral exports, and climate change stresses. At the onset of the pandemic, a series of negative shocks and structural challenges had already generated pressures; however, larger than average fiscal space helped authorities navigate the economy through the current global crisis, with a relatively strong 2021 recovery envisaged.

3. The authorities hope to hasten the recovery with the effective implementation of the E RTP, a plan aimed at accelerating structural reforms for economic transformation and helping to achieve key objectives, including export diversification and stronger growth, and higher productive employment. The reforms aim to strengthen human capital, government efficiency and productive infrastructure, crowding in the private sector and enhancing the role of the financial sector in financing development. The Plan also seeks to increase the country's integration into global and regional value chains. In the short term, the E RTP aims to restore economic activity and incomes and mitigate effects of prolonged or recurring pandemic containment measures. Its longer-term objective is to strengthen the basis for renewed, sustainable growth and to help shape the transition towards a high income, digital and knowledge economy, in line with the country's Vision 2036.

Recent Economic Developments and Outlook

4. The COVID-19 pandemic and its containment measures had a severe impact on economic activity in Botswana. Real GDP contracted by 7.9 percent in 2020, an 11-percentage point drop in the growth rate, and one of the largest declines in sub-Saharan Africa. The contraction reflected the impact of reduced global demand, especially for rough diamonds, as well as of travel restrictions and containment measures, on output in key production and export sectors. The mining and tourism sectors were hard hit, and activity in manufacturing sectors was also subdued due to lockdowns and travel restrictions. Going forward, GDP is forecast to rebound to 8.3 percent in 2021, underpinned by a strong recovery in the diamond sector and the opening of a new copper mine in May 2021. Output growth, however, is expected to moderate to 6.4 percent in 2022 as fiscal consolidation is implemented. Scarring remains significant and output losses high. Output will remain below its pre-pandemic forecast levels over the next four years, with the gap narrowing only slightly to about 6.6 percentage points by 2025. While foreign reserves remain adequate at over 10 months of non-diamond import cover, given the frequency of shocks, the authorities intend to rebuild this important buffer.
5. Inflation remains contained within the target range, although headline inflation rose significantly to 5.6 percent in April 2021, from 2.5 percent a year earlier, this mainly reflected the impact of increases in value added tax, electricity tariffs, rentals, and other fees. Core inflation excluding administered prices is expected to remain within target, while the tax and tariff measures have a temporary effect on headline inflation that will fall away in the first quarter of next year.

The Authorities' Response to the Pandemic

6. At the start of the pandemic last year, the authorities adopted a swift and multi-pronged strategy to mitigate its impact, with fiscal support measures aimed at supporting vulnerable firms and households, and financial sector measures enabling continued credit extension and providing liquidity support.
7. Alongside lockdowns and movement restrictions, fiscal measures included wage subsidies and loan facilities and guarantees to vulnerable firms and households, as well as increased spending on health and education. The implementation of the relief package

through a dedicated Pandemic Relief Fund supported transparency and tracking of spending. In the financial sector, authorities used existing regulatory flexibility to relax bank balance sheet constraints and support lending. Measures included decreasing the prudential capital adequacy ratio from 15 percent to 12.5 percent; along with a reduction in the cost of accessing overnight funding by licensed commercial banks from Bank of Botswana (BoB)'s Credit Facility, to the prevailing Bank Rate. BoB also cut the reserve requirement ratio, while commercial banks instituted loan repayment moratoria and forbearance, among other measures. In the non-bank financial sector, restructuring and rescheduling of loan installments and premiums, discounts on insurance products and interest rate cuts on non-bank lending, helped ease the burden of the crisis on households and firms.

8. In 2021, the immediate priority for economic recovery remains acquisition and successful rollout of vaccines. To that end, the Government crafted a comprehensive National Deployment and Vaccination Plan for COVID-19, aimed at vaccinating 75 percent of the adult population by the end of 2021. It has secured vaccines under various arrangements, including the COVAX facility. The vaccine rollout commenced in April 2021 with the initial batch of vaccines. Vaccination is ongoing, and while it remains dependent on timely receipt of supplies that have been purchased, the authorities still hope to meet their target.
9. In the meantime, given ongoing uncertainty around the pandemic, the authorities agree with staff that targeted emergency support to affected households and viable firms should be maintained for now. The ongoing revamping of the social welfare and transfers system will help to ensure that support is extended only to the vulnerable. However, authorities will continue to monitor developments and proceed with the planned removal of COVID-19 support measures as soon as this is advisable.

Fiscal Policy

10. Notwithstanding the response to the pandemic, the authorities remain committed to ensuring fiscal and debt sustainability and have incorporated significant fiscal consolidation measures in their budget for FY2021. They have also requested technical assistance to help redesign and calibrate a new fiscal rule as they formulate the next national development plan. In the short term, the authorities plan to shrink the fiscal deficit from 11 percent of GDP in 2020 to 4.4 percent in 2021. This is being done via expenditure controls and robust revenue mobilization measures. These include broadening the tax base, increasing VAT to bring it in line with the rest of the region, fuel and sugar levies, a tax on plastic bags and withholding tax adjustments, all estimated to yield about 1 percent of GDP. They also initiated a tax amnesty to help reduce tax arrears, which should increase revenue collection this year by about 0.5 percent of GDP. Relatedly, several pending tax bills are being finalized with assistance from the IMF, to be presented to Parliament in July 2021. The revenue authority's plan to introduce electronic billing machines will also reduce tax evasion and boost revenue generation.
11. On government spending, the authorities will implement measures to contain the public wage bill, including civil service reform and savings on vacancies and zero inflation adjustments. They will also prioritize spending, including public investments over

recurrent expenditure; and expedite reforms such as the restructuring of parastatals, and strengthening of the public investment management framework, while enhancing efficiency in service delivery and public procurement.

12. The authorities are taking steps to diversify their financing sources in line with staff advice, while maintaining a strong debt management strategy. To that end, parliament approved an increase in the domestic bond-issuance program from P15 billion to P30 billion, in 2020 and domestic issuance was stepped up to help finance the FY2020 deficit and will continue in coming years. The authorities also negotiated budget support with the World Bank and the AfDB and are exploring different external financing options, to finance the deficit in FY2022–23. As they update the medium-term debt management strategy, they will consider a range of financing options including the relative cost/benefits of capitalizing on Botswana’s investment grade credit rating in international bond markets.

Monetary and Exchange Rate Policies

13. With the recovery not yet entrenched, the authorities have maintained an accommodative monetary policy stance. Nevertheless, they reiterate their commitment to responding appropriately to preserve price stability, but without undermining economic recovery. They continue to monitor the second-round effects of supply shocks and administered price increases.
14. To improve the transmission of monetary policy, the authorities are pursuing reforms to monetary operations. In 2019, Bank of Botswana (BoB) introduced Primary Reserve Requirement Averaging (PRRA), which has proved to be a very effective liquidity management tool for most commercial banks, while freeing up additional resources for productive lending. Effective October 30, 2020, BoB also reintroduced the 3-month Treasury Bill in place of the 91-day Bank of Botswana Certificate to support the Government treasury bill market. The authorities also plan to implement additional reforms to the monetary operations framework including changes to the policy rate anchor and interest rate structure.
15. In the wake of the balance of payments shock induced by the pandemic, recognizing the importance of increased exchange rate flexibility, the authorities adopted a significantly larger downward rate of crawl in 2020 and 2021. They are broadly in agreement with staff’s assessment. Given the challenges around multiple shocks and capital flows, the authorities also look forward to being informed by the completion of ongoing IPF analysis which shows the importance of supporting instruments alongside the exchange rate, in imperfect developing country markets. The IPF shows that in the face of shocks, other instruments such as capital flow and macroprudential measures can play an important role, alongside exchange rate flexibility and fiscal measures.

Financial Sector Policies

16. The banking system remains sound, adequately capitalized, liquid, and resilient to shocks. Nevertheless, the authorities remain attentive to the possible emergence of financial sector vulnerabilities. Even though government interventions contained

immediate macro-financial risks, corporate vulnerabilities could increase with a slower recovery. Furthermore, once the debt moratorium ends, banks could face higher NPLs. The authorities are also monitoring household indebtedness, and any risks that might emanate from high household debt, particularly unsecured bank and non-bank credit. BoB continues to collect information on household indebtedness to fill data gaps on non-bank credit sources, including micro-lenders and hire-purchase arrangements. While a range of household indebtedness indicators suggest that household debt remains manageable, should debt risks exceed acceptable thresholds, BoB stands ready to apply the appropriate macroprudential instruments as needed, guided by the framework adopted by the Financial Stability Council in 2020. Reforms in the parastatal sector are also one of the authorities' top priorities. They will give close consideration to staffs' proposals on clarifying the role of development banks.

17. The authorities also note the value of deeper financial markets. They are committed to working with the market to effect improvements necessary to enhance the effectiveness of the government securities issuance program. While government already issues securities with a wide range of maturities including as high-quality liquid assets, the authorities agree with staff on the importance of enhancing the efficiency and liquidity of the domestic bond market and reducing maturity mismatches. Close consideration will be given to the measures recommended by staff to deepen the bond market. This includes changes that will support increased issuance of government debt, as well as debt issuance by state-owned enterprises and the private sector, including banks. Attention will be focused on ensuring that there is a wide range of bond maturities to meet the needs of different institutions, a suitable benchmark maturity with adequate liquidity, and an increased variety of instruments. While there is already a formal market making agreement for primary dealers, and a pricing mechanism, reforms to the operation of the primary dealer system and other technical aspects of the bond market can also be considered.
18. The authorities have made significant progress in the AML/CFT framework, towards compliance with the International Cooperation Review Group recommendations. This includes progress in assessing the risks associated with legal persons, legal arrangements, and non-profit organizations, operationalizing online business registration and amending a range of legislations. They are working actively to address remaining strategic deficiencies mostly reflecting the country's peaceful history and lack of experience with terrorism and its financing. This includes work to meet requirements on the analysis and dissemination of financial intelligence, terrorist financing investigations, and implementation of an effective targeted financial sanctions regime. The Financial Intelligence Act is also being revised as needed to support the AML/CFT framework.

Structural Reforms

19. The authorities are committed to fast-tracking structural reforms to foster diversified and inclusive export-led growth. In this context, the effective implementation of the E RTP, aimed at reducing economic scarring, and accelerating transformation and job creation, is key. Four main sectors are earmarked for support. These are agriculture, tourism, the creative industry, and manufacturing. Given the importance of tourism and the impact it suffered due to the pandemic, the authorities intend to allocate approximately 7 percent of

total E RTP expenditure to the sector. In addition, the plan focuses on accelerating investment in digitalization and “productive” infrastructure while reducing the government footprint in the economy and enhancing the business environment.

20. In addition to efforts to date to reduce the digital divide, Botswana plans to accelerate its transition to a digital economy, investing 1½ percent of GDP in this sector during 2021–23. In the context of the E RTP, this includes addressing digital infrastructure gaps, automating land registration, expanding biometric identification (Botswana issues e-passports, and now adds embedded biometrics) and further and effective rollout of e-government services, and promoting digital payment infrastructure. E-government will also support the investment climate. In this regard, the authorities have now fully digitalized company registration and will advance other digitalization reforms. The goal is to improve the competitiveness of the business climate, integrate in global value chains, upgrade product sophistication, and find more ways to work around limitations such as the country’s landlocked status and small market size. Staff’s advice on enabling competition and expansion in the network sector is also noted. The authorities will work to improve efficiency in both the public and private sectors and further develop domestic research and innovation capacity.
21. The climate agenda in the E RTP will reduce Botswana’s dependence on carbon-intensive energy sources while enhancing its energy generation capacity. In addition, it should strengthen climate resilience, while promoting exports and private sector activity. Resilience building will also benefit the poor who tend to rely on subsistence agriculture, and tourism, both of which are susceptible to climate change impacts. Work on the agenda is underway. In April this year, Parliament approved the Botswana climate change policy which promotes renewable energy sources (through the Integrated Resource Plan), reduces subsidies to the use of fossil fuels, and increases fossil fuel fees.

Conclusion

22. As the Botswana authorities work to exit the pandemic as quickly and effectively as possible, they continue to safeguard macroeconomic stability while positioning the economy for recovery. Beyond this, they are reinvigorating efforts to transform the economy into a diversified, high-growth, private-sector led, knowledge-based economy, and look forward to Directors’ advice and continued Fund engagement and technical assistance, that will help advance the transformation agenda.