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May 25, 2021

**Statement by Mr. Just and Mr. Pucnik on Botswana
(Preliminary)
Executive Board Meeting
May 27, 2021**

We thank staff for the report and Ms. Mannathoko and Ms. Basutli for their helpful Buff statement. In the past decade, Botswana has seen strong growth and a sharp reduction in poverty. The significant policy space has helped the authorities to combat the socio-economic impact of the COVID-19 pandemic but necessitates that the authorities embark on an set of ambitious supply side reforms that will strengthen the overall resilience of the economy and sets the right signals for its diversification. **We share the thrust of staff's appraisal and would like to add the following points.**

The COVID-19 crisis has underscored the long-standing need for transformation to a more diversified economy as Botswana's heavy reliance on commodity exports increases the vulnerability of the economy to shocks. We therefore welcome the Economic Recovery and Transformation Plan which lays the ground to accelerate the much needed structural transformation, which in turn will support job creation in labor-intensive sectors and over time in an upskilling of the workforce.

Fiscal consolidation is imperative to address deteriorating internal and external imbalances. We note that the fiscal deficit widened significantly as the government countered the economic impact of the COVID-19 crisis. The authorities financed the deficit mainly by exploitation of fiscal buffers, while increasingly issuing domestic debt, which however increased only moderately and remains well below Botswana's debt ceiling of 40 percent of GDP. The current account position has worsened, driven by the deterioration of the trade balance. Going forward, increased revenue mobilization and continued expenditure prioritization will be critical. In this regard, we encourage the authorities to stimulate revenue diversification, enhance the efficiency of SOEs, continue to broaden the tax base by streamlining tax exemptions, and improve tax collection by strengthening revenue administration. On the expenditure side, we support fiscal reforms aimed at containing the wage bill, cuts in non-priority spending and efficiency gains in grants and subventions and

transfers to local government. We see merit in staff's recommendation to focus on the non-mineral primary balance when formulating fiscal policy.

Accommodative monetary policy limits the economic and financial consequences of the COVID-19 pandemic. Accommodative monetary policy should be oriented toward maintaining growth in nominal GDP, with a commitment to make up for near-term nominal-growth shortfalls. We agree with the authorities' goal of active liquidity management to smooth interest rate volatility and enhance the monetary policy transmission. As a result of lower oil prices, inflation fell to 1.9 percent in 2020, which is close to the target of 2 percent. Despite a possible temporary increase in inflation due to a rebound in oil prices and administrated prices, the Bank of Botswana should strive to keep inflation expectations close to 2 percent to reduce real overvaluation. *Can staff elaborate on the Bank of Botswana's reasons to raise the target to a rather high 3-6 percent range?*

Enhanced supervision and implementation of macroprudential instruments are key to safeguard financial stability. The recent dynamic growth in lending to households raises concerns about increased households' indebtedness and risks to financial stability. NPLs could further increase with the evolution of the pandemic and sound macroprudential supervision for monitoring these risks is needed. We encourage the authorities to introduce a macroprudential policy strategy and corresponding instruments such as debt-service-to-income and loan-to-value to mitigate identified risks.

Addressing remaining strategic deficiencies of the AML/CFT framework is critical as will be its effective implementation. Botswana has made progress in addressing some, but not all, technical compliance deficiencies. Until full implementation of the AML/CFT framework, elevated financial stability risks can severely curtail foreign investment and trade flows. We encourage the authorities to achieve full compliance with the ICRG recommendations in order to be removed from the grey list.

The effects of climate change are becoming increasingly evident in Botswana. Botswana is affected by water scarcity, erratic rainfall, and recurrent droughts. Despite relatively low overall economic reliance on agriculture, it still provides a livelihood for about 70 percent of the rural population. Volatile climate has also significant influence on tourism, an increasingly important industry in Botswana. In this regard, we commend the authorities for approving Botswana climate change policy in April 2021 with the aim to promote renewable energy sources, reduce subsidies to the use of fossil fuels, and increase fossil fuel fees. Possible further efforts in this regard should be considered in a combination of different policy areas with a common focus on sustainable and green growth.