SM/10/33
Correction 1

February 25, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of Swaziland—Staff Report for the 2009 Article IV Consultation—Staff Assessment and Recommendations**

The attached correction to SM/10/33 (2/9/10) has been provided by the staff:

Typographical Error

Page 9, Text Table: replaced to reflect correct numbers for Non SACU fiscal balance in the Baseline Scenario.

Questions may be referred to Mr. Toe (ext. 36557) and Mr. Fontaine (ext. 37937) in AFR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

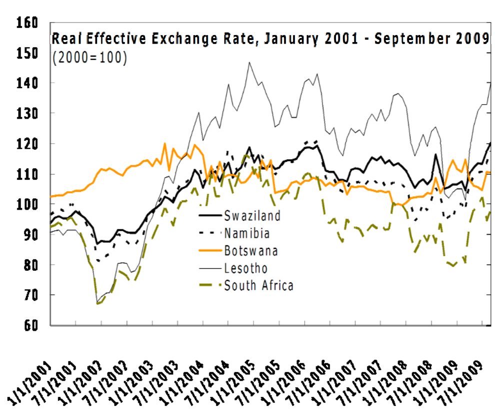
Swaziland: Macroeconomic Indicators in the Baseline and Alternative Scenarios, 2009/10 - 2014/15 1/
(In percent of GDP)

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Baseline Scenario (Authorities' policies)						
Total Revenue and Grants	34.9	22.2	23.2	23.3	26.3	27.1
Total Expenditure	42.9	37.0	35.0	34.6	34.8	34.7
Overall balance (including grants)	-8.0	-14.9	-11.7	-11.3	-8.5	-7.7
Gross official reserves (months of imports)	3.9	3.1	2.3	2.0	1.9	2.0
Gross official reserves (percent of broad money)	89.3	76.9	56.2	48.9	47.5	49.7
Non SACU fiscal balance	-29.5	-28.5	-22.1	-20.6	-20.3	-19.5
Governmnet debt	19.3	31.2	37.1	43.9	48.5	52.0
Current account balance	-6.5	-12.8	-12.3	-9.1	-7.2	-6.2
Alternative Scenario (Staff Recommendations)						
Total Revenue and Grants	34.9	22.3	23.5	23.8	27.0	28.4
Total Expenditure	42.8	36.8	34.0	33.9	34.0	34.0
Overall balance (including grants)	-8.0	-14.5	-10.5	-10.1	-6.9	-5.6
Gross official reserves (months of imports)	3.9	3.4	3.0	2.5	2.9	3.1
Gross official reserves (percent of broad money)	89.3	82.1	65.3	58.9	62.3	65.1
Non SACU fiscal balance	-28.4	-21.7	-19.1	-19.0	-17.7	-16.6
Governmnet debt	17.2	27.3	28.5	31.3	33.5	36.4
Current account balance	-6.4	-12.0	-11.9	-8.2	-6.5	-5.5

Sources: Swazi authorities and Fund staff projections.
1/ The fiscal year runs from April 1 to March 31.

B. Preserving External Stability and Improving Competitiveness

12. **The peg to the South African rand has served the country well**. Staff estimates based on different methodologies point to an overvaluation of the real exchange rate with the degree of overvaluation depending on the extent of fiscal adjustment over the medium



Source: Information Notice System.

Swaziland: Exchange Rate Assessment 1/

	Underlying Current Account Balance	Current Account Norm	Estimated Over (+)/ under (-) valuation
Macroeconomic Balance			
Without adjustment	-18.7	-9.8	26.9
With authorities policies	-6.2	-1.9	12.9
External sustainability 2/	-6.2	-0.9	15.9
Purchasing Power Parity	n.a	n.a	9.7

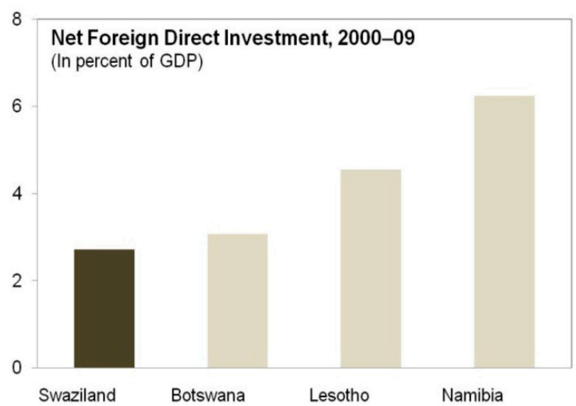
1/ Baseline results based on CGER-like and non-CGER methodologies.
2/To stabilize the net foreign assets-to-GDP ratio at 2008 level.

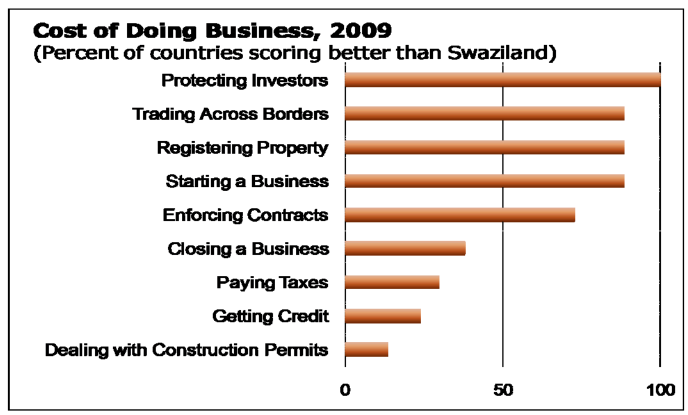
term. Moreover, the projected decline in the reserves both in terms of months of imports and broad money coverage could call into question the viability of the exchange rate peg.[5]

[5] The authorities believe that a reserve level of at least three months of import cover is appropriate in relation to the domestic monetary base (reflecting the free circulation of the rand) and external debt, while preserving confidence in the peg.

Substantial progress toward fiscal consolidation is therefore key to ensure consistency with the peg. Wage moderation and structural reforms to improve competitiveness will be also important.

13. **Swaziland continues to face the daunting challenge of remaining competitive in a rapidly changing global environment.** Linked to this competitiveness challenge is the inability to attract and sustain FDI. Attracting FDI will require among other things focusing on (i) simplifying business licensing requirements and procedures; and (ii) reducing uncertainties surrounding the renewal of work permits. In addition, reducing the high cost of doing business, land and labor productivity, and creating an enabling environment for private sector-led growth are all critical in improving Swaziland's competitiveness. Key elements should include skills training combined with policies to alleviate the productivity-eroding impact of skill mismatches, labor market rigidities, and HIV/AIDS.





C. Ensuring Consistent Monetary Policy and Stepping Up Monitoring of NBFIs

14. **The policy rate differential with the SARB should, at least, be reversed and the domestic asset requirement reconsidered in a regional context**. Given the free movement of capital in the CMA, commercial banks have taken advantage of higher rates in South Africa, giving rise to capital outflows. The CBS therefore needs to raise its policy rate at least to par with the SARB's repo rate to stem the outflow of capital. Also, contrary to expectation, the domestic asset requirement for pension funds and insurance companies has thus far not benefited the local economy as the lack of investment opportunities has resulted in the repatriation back to South Africa. Meeting this requirement is also forcing these institutions to forgo higher yield investments abroad, and some may be venturing into areas where they might not have expertise such as granting loans directly to the private sector, thereby putting at risk their long-term financial viability.