EXECUTIVE BOARD MEETING

SM/20/52
Correction 1

March 4, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Botswana—Staff Report for the 2019 Article IV Consultation**

Board Action:	The attached corrections to SM/20/52 (2/24/20) have been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Page 9**
Typographical Errors	**Pages 18 and 24**
Questions:	Mr. N'Diaye, AFR (ext. 39751) Mr. Jardak, AFR (ext. 38304) Mr. Peralta Alva, AFR (ext. 34452)

Authorities Views

16. The BoB considers that the risks related to households' balances sheets are manageable. While acknowledging the high household indebtedness and the high exposure of banks to households, the BoB sees several mitigating factors. These include the fact that banks generally collect payments for unsecured loans directly from borrowers' paychecks; the concentration of unsecured loans is low; and Botswana still has room to deepen credit markets given its macroeconomic fundamentals and when compared with other countries at similar levels of development.

Macroeconomic Policy Mix if Downside Risks Materialize

17. Botswana has room to adjust macroeconomic policies to deal with shocks, but greater flexibility in the exchange rate would permit a more rapid adjustment to persistent shocks. In the event downside risks to growth materialize, the size and pace of fiscal adjustment could be recalibrated as part of a credible medium-term consolidation plan. On the monetary side, the BoB stable REER objective will limit its ability to provide further support to growth and constrain the economy's response to the shock. In fact, the BoB may well need to maintain interest rates higher than they would otherwise, which would further weaken growth (as during the 2015 shock). Thus, the BoB needs to use the flexibility afforded by the current exchange rate framework to allow the Pula REER to respond to persistent shocks.[8]

B. Fostering Economic Transformation

There is an urgent need to advance structural reforms to lift medium-term growth and create the jobs to lower unemployment and absorb the new entrants into the labor market. Doing so will require enhancing macroeconomic policy frameworks and accelerating supply-side reforms.

Enhancing Macroeconomic Policy Frameworks

Fiscal Policy Framework

18. The current framework lacks operational guidance for fiscal policy and did not prevent a large and persistent decline in buffers. Limits are specified on gross debt (40 percent of GDP), and the shares of FX and local currency debt (20 percent of GDP for each). At the same time, the Pula Fund is not governed by strict deposit or withdrawal rules. Instead, deposits are determined by the size of foreign exchange inflows and the fiscal surplus, while withdrawals finance fiscal deficits.[9] This

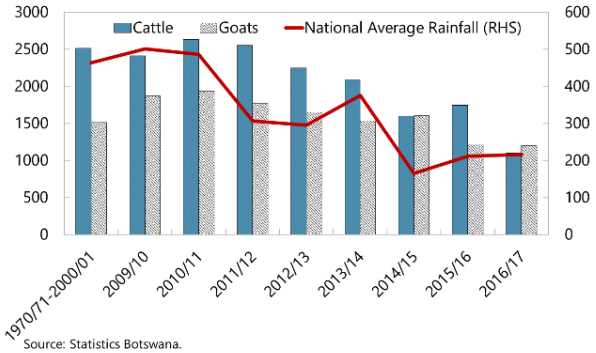
[8] This is possible because the exchange rate pass-through to inflation is incomplete (estimated to 0.46 percent).

[9] Foreign exchange reserves in excess of the amount required for daily foreign transactions kept in the Liquidity Portfolio (currently set at ~~six~~ 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.

Box 1. Climate Change in Botswana

In recent years, more prevalent droughts have challenged economic development. Botswana declared 2018/19 a "severe drought year". The unevenly distributed rains, heat waves, and dry spells have led to lower hectarage planted, crop failure, and falling livestock population. The limited water availability has impacted mining activity and exacerbated tensions between human and wildlife.

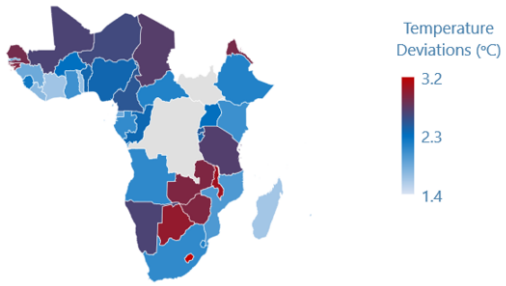
Rainfall and Livestock Population
(Thousands for liverstock and millimiters for rainfall)



Source: Statistics Botswana.
Note: Livestock statistics in 2001, 2014 and 2017 include traditional sector only.

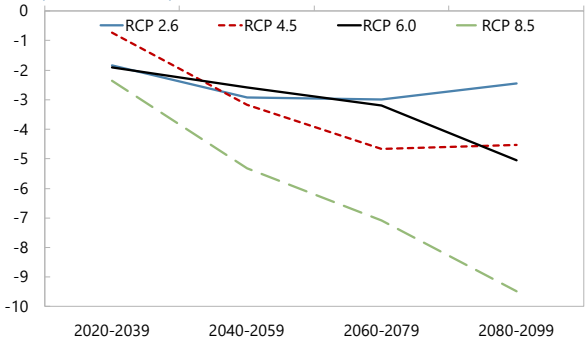
Long-term projections suggest that Botswana will be one of the most exposed sub-Saharan countries to climate change. Botswana ranks in the top-3 countries in sub-Saharan Africa in terms of expected average temperature increase, ranging over 2.9-3.8 degrees Celsius by 2100. In three out of the four IPCC emissions scenarios (RCP 4.5, 6.0 and 8.5), Botswana also ranks in the top 2 countries in sub-Saharan Africa in terms of expected average decrease in annual rainfall (4.7-9.5 millimeters). The extreme climate is expected to reduce domestic water available, with Botswana's Limpopo catchment expected to decline by 26 percent (36 percent) and cause maize yield to decline by over 20 percent (35 percent) by 2100, under stringent GHG emission mitigation scenarios of global warming contained to 1.5 degrees (2.0 degrees) Celsius, according to analysis from the Adaptation at Scale in Semi-Arid Regions (ASSAR) project. While deeply affected by the extreme weather, Botswana produces only 1 percent of the region's emissions that account for 2 percent of global total.

Proj. Average Temperature Change by 2100, RCP 4.5



Source: The World Bank Climate Change Knowledge Portal.

Botswana: Average Annual Precipitation Projections
(Percent deviation)

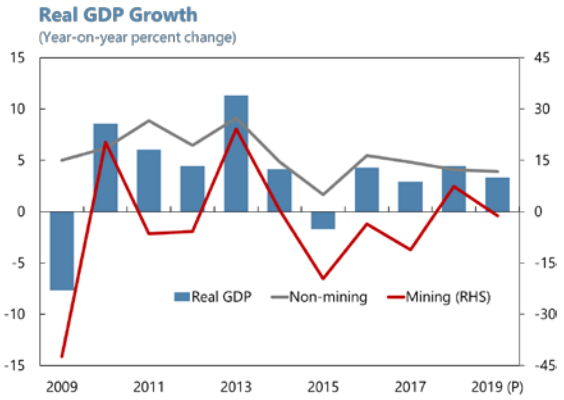


Source: The World Bank Climate Change Knowledge Portal.

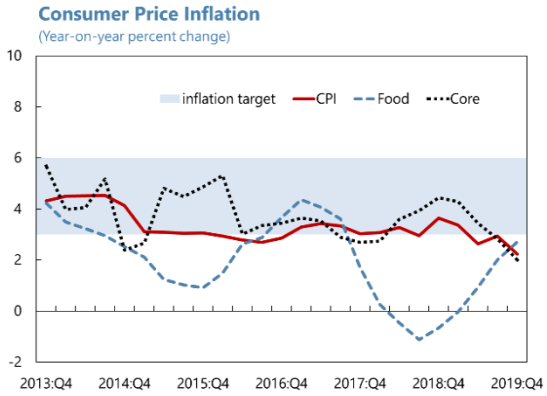
The authorities are adapting to climate change. Botswana has developed an automatic mechanism to support the agriculture sector which delivers subsidized animal feeds, vaccines, and drugs. Additional measures and initiatives by the government include a Climate Change Policy, Climate Change Strategy and Action Plan, Climate Smart Agriculture (CSA) program, and Global Environmental Facility (GEF). Going forward, advancing economic diversification, making infrastructure more resilient to climate shocks, increasing access to financing and cost-effective insurance, and enhancing social safety nets and policy buffers will help reduce Botswana's vulnerability to climate shocks.

Figure 2. Botswana: Macroeconomic Developments

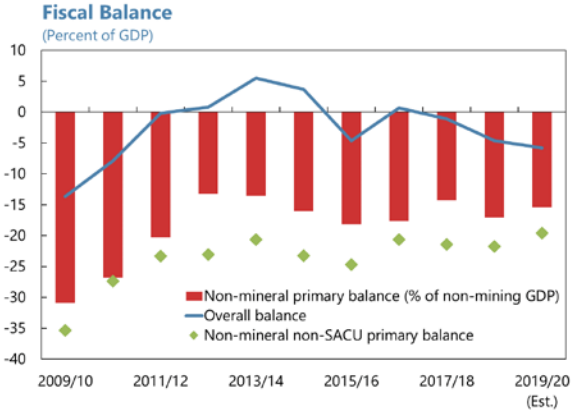
GDP growth decelerated mostly ~~driven~~ due to lower mining activity.



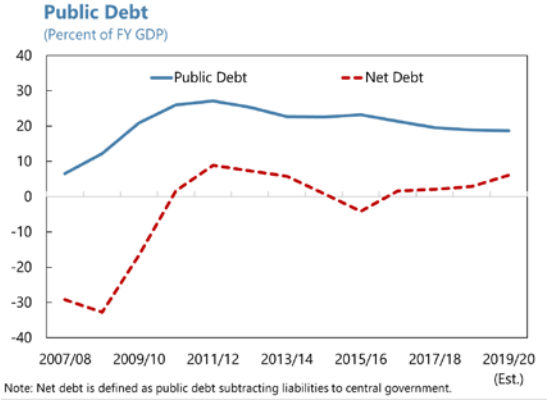
Headline and core inflation remain subdued.



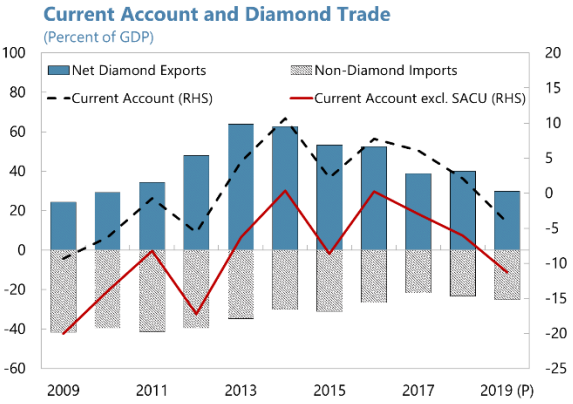
The fiscal deficit deterioration in the run up to the election ...



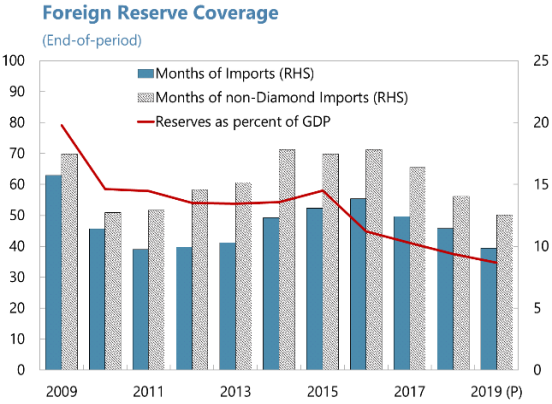
... did not increase public debt as the was financed through a drawdown of buffers...



... but together with lower diamond exports and SACU transfers, weakened the current account balance...



And contributed to continued erosion of reserves.



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