September 16, 2022
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/12-1

10:00 a.m., January 31, 2020

1. Kingdom of Eswatini—2019 Article IV Consultation

Documents: SM/20/25 and Cor 1; and Cor 2; and Sup 1

Staff: Palomba, AFR; Ahuja, SPR

Length: 53 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
	E. Boukpessi (AF), Temporary
	L. Dips (AG), Temporary
	N. Heo (AP)
	P. Fachada (BR)
	X. Cai (CC), Temporary
L. Villar (CE)	
	A. McKiernan (CO)
R. Kaya (EC)	
A. Buisse (FF)	
	K. Merk (GR)
	N. Thiruvenkadam (IN), Temporary
	M. Psalidopoulos (IT)
T. Tanaka (JA)	
	M. El Qorchi (MD)
	P. Al-Riffai (MI), Temporary
	S. Harutyunyan (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	J. Al Saud (SA), Temporary
	S. Chea (ST), Temporary
P. Inderbinen (SZ)	
	D. Ronicle (UK)
	R. Farber (US), Temporary

O. Vongthieres, Acting Secretary
E. Tsounta, Summing Up Officer
L. Briamonte, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
African Department: H. Alsokhebr, G. Ganum, G. Palomba, D. Robinson, J. Thakoor. Legal Department: A. Aly. Monetary and Capital Markets Department: P. Jeasakul. Strategy, Policy, and Review Department: A. Ahuja. World Bank Group: E. Noubissie Ngankam. Alternate Executive Director: K. Chikada (JA), I. Mannathoko (AE), P. Rozan (FF), K. Tan (ST). Senior Advisors to Executive Directors: M. Maidi (AE), L. Marek (EC),

W. Nakunyada (AE), T. Sitima-wina (AE), J.Weil (CO). Advisors to Executive Directors: A. Arevalo Arroyo (CE), M. Bangrim Kibassim (AF), M. Bernatavicius (NO), L. Cerami (IT), J. Corvalan (AG), D. Crane (US), J. Essuvi (AE), J. Garang (AE), T. Iona (AP), M. Ismail (AE), B. Jappah (AE), H. Mori (JA), K. Osei-Yeboah (MD), D. Shestakov (RU), C. Wehrle (SZ), F. Antunes (BR), E. Comolet (FF), J. Stockill (UK).

1. KINGDOM OF ESWATINI—2019 ARTICLE IV CONSULTATION

Mr. Mahlinza and Mr. Ismail submitted the following statement:

INTRODUCTION

Our authorities appreciate the constructive Fund engagement during the recent Article IV Consultation mission to the Kingdom of Eswatini. They broadly concur with the staff's analysis and policy recommendations.

The economy of Eswatini continues to face severe macroeconomic challenges characterized by high fiscal deficits, rising debt, accumulation of domestic arrears, and a decline in foreign exchange reserves. At the same time, volatility in Southern African Custom Union (SACU) revenues, recurring droughts, and a recent terms of trade shock have weighed on economic performance. Recognizing these challenges, the new government, which came into power in October 2018 launched the National Development Plan 2019-2022 (NDP), which aims to restore macroeconomic stability by fostering fiscal discipline, ensuring prudent debt management, adherence to good governance practices, and promoting private sector led growth. In addition, the new government launched a Strategic Roadmap, focused on improving the business climate and boosting private investment.

RECENT ECONOMIC DEVELOPMENTS AND THE OUTLOOK

Real GDP growth declined from 2.4 percent in 2018 to 1.2 percent in 2019 owing to a decline in private sector activity emanating from an escalation of fiscal challenges that culminated in the accumulation of government arrears. Going forward, the authorities anticipate a modest recovery in medium term growth supported by increased private investment in response to the implementation of policies articulated in the recently developed recovery roadmap and relief for the private sector as government clears some of its arrears.

Inflation declined from 4.8 percent in 2018 to 2.6 percent in 2019 due to depressed aggregate demand that accompanied the economic slowdown, and a sustained freeze on water and electricity tariffs. Against the backdrop of subdued inflation and low growth, the Central Bank of Eswatini (CBE) cut the discount rate by 25 basis points in July 2019 to 6.5 percent to support private sector credit and stimulate economic activity.

The current account surplus increased from 2.0 percent of GDP in 2018 to 3.8 percent of GDP in 2019 underpinned by improvements in the trade balance as exports recovered somewhat and imports declined slightly. Over the medium term, the current account is expected to slightly weaken due to slow export growth. Meanwhile the fiscal deficit is expected to narrow from 11.2 percent of GDP in 2018 to 6.3 percent of GDP in 2019 supported by several expenditure and tax measures implemented as part of the 2019/20 budget. Going forward, the deficit is expected to further decrease as the authorities implement consolidation measures.

FISCAL POLICY

The authorities recognize the extent of the fiscal challenges and broadly concur that a fiscal adjustment of about 6 percent of GDP would be needed over the next few years to restore fiscal sustainability and place public debt on a downward trajectory. They, however, note that a more gradual consolidation path would be more appropriate to smoothen the adverse effects of adjustment on growth and vulnerable households.

Since taking office in late 2018, the new government has taken steps to control the rising fiscal deficit, including implementing policies to contain the wage bill and restructure some loss-making public entities. As a result, they estimate the FY 19/20 deficit to be lower than the previous year. Given the magnitude of the adjustment required to restore fiscal sustainability, the authorities intend to use FY20/21 to build consensus towards a comprehensive consolidation plan, while keeping the fiscal deficit low. Starting in FY21/22, the authorities plan to continue a gradual fiscal adjustment spread over four or five years. Importantly, they plan to develop a medium-term fiscal framework to stabilize public debt levels going forward.

As part of an effort to place public finances on a sustainable path, the authorities have implemented a combination of expenditure and revenue measures. Going forward, they plan to continue controlling the wage and non-wage expenditures over the medium term through a sustained freeze on new hiring while accounting for capacity constraints. They also plan to leverage a temporary increase in SACU revenue to finance a wage increase in FY2020/21 to cushion civil servants following three years of a wage freeze. Further, they plan to optimize capital expenditures in line with the new NDP to focus on high impact and high return projects, while strengthening the project selection criteria and tendering process, and improving project implementation and management, in line with the recent PIMA recommendations. While they see limited scope to reduce capital outlays in

FY2020/21 given the respective legal and financial agreements associated with ongoing projects, the authorities will prioritize spending thereafter as part of their medium-term plan.

On the revenue side, measures already introduced by the authorities include increases in excise taxes for alcohol, tobacco and fuel that are expected to be fully effective in FY20/21. The authorities also have plans to improve revenue collection, review tax exemptions, and sell off some government assets to generate additional revenue.

The authorities concur with the need to develop an effective and transparent arrears clearance strategy, going forward. To this end, they recently introduced an invoice tracking system to help identify unpaid bills from ministries and government departments and improve the management of government arrears. To clear part of the existing stock of arrears and provide relief to the private sector, they have issued domestic securities and secured external financing.

To address weaknesses in public financial management, the authorities are planning to accelerate operationalization of the Public Financial Management Act, implement an Integrated Financial Management Information Systems and introduce a Treasury Single Account. They also plan to undertake a comprehensive review of public enterprises to reduce relevant subventions and increase dividends through potential mergers, where appropriate. The authorities also concur with the need to develop a cost-effective and transparent procurement system, including revamping the tender board and would require Fund technical assistance in this area.

MONETARY AND FINANCIAL POLICIES

The authorities reiterate that the exchange rate peg has served the economy well, providing an effective policy anchor and helping to contain inflation. Recognizing deterioration in the level of reserves, the CBE launched a program to purchase FX from banks at market price to support the exchange rate peg. In addition, they intend to secure a large FX swap to further bolster the reserves' position. In parallel, the CBE will continue to employ effective monetary policy instruments to mop up resultant excess liquidity. Further, the authorities plan to maintain the policy rate broadly in line with the South African Reserve Bank's rate, taking into account differential risks and other key economic factors.

Despite the challenging macroeconomic environment, the financial sector has remained broadly stable, well capitalized, and profitable, with ample liquidity buffers. Nonetheless, vulnerabilities in the banking sector have continued to grow with a weakening in bank's asset quality, rising exposure to the sovereign.

To improve financial sector oversight, the authorities are progressively implementing Basel II standards, strengthening risk-based supervision and requiring exposed banks to develop plans to address high NPLs. While an early intervention regime is in place, the authorities have identified gaps and plan to introduce mandatory corrective actions to strengthen the regime. They recognize the importance of introducing a macro-prudential policy framework to address financial stability risks and will continue to monitor risks emanating from high household debt.

The authorities are presently reviewing the Financial Services Regulatory Authority (FSRA) Act and laws regulating specific sectors to strengthen the non-bank financial institutions' oversight framework. At the same time, the FSRA has continued to expand its coverage of non-banks under its purview and continues to build its regulatory and supervisory capacity with Fund TA. Further, the authorities plan to conduct a national risk assessment in 2020, which will inform a review of AML/CFT requirements and risk-based activities of the CBE, FSRA, and the Financial Intelligence Unit. They also intend to expedite enactment of the Financial Institutions Act and the CBE law, to strengthen the oversight of the financial sector and the bank resolution framework.

STRUCTURAL REFORMS

The authorities recognize that implementing structural reforms is critical to facilitate private sector growth, bolster long-term inclusive growth, and reduce poverty. To this end, the Strategic Roadmap identified priority high impact actions to facilitate private investment. In this connection, the authorities recently established special economic zones with investment incentives and launched a National Financial Inclusion Strategy to enhance access to finance, stimulate SME growth, and support small-holder farmers. In addition, they are facilitating the set-up of selected large foreign investment projects.

As part of an effort to improve the business environment, the authorities plan to establish a one-stop shop for business registrations, simplify licensing requirements, and enhance the use of e-government and digital processes. They also plan to reduce the costs and time associated with commercial court cases and resolution of commercial disputes as well as improve the governance and strengthen the anti-corruption framework.

To help increase competition in the ICT sector and reduce communication costs, the authorities intend to accelerate liberalization of the ICT sector by unbundling the Eswatini Posts and Telecommunications Corporation (EPTC) into three separate and independent entities as well as encouraging competition in the fixed and mobile telephone market. They also plan to restructure the electricity sector by supplementing electricity supply with renewable energy sources while adjusting electricity cross-subsidies to ensure cost-effective pricing, in line with the objectives of the NDP.

The authorities continue to allocate substantial budgetary resources towards social spending, including education, health, and cash transfers. They have also decentralized social services to increase access at more affordable costs. Going forward, the authorities plan to strengthen social safety nets, increase the old age grant, and introduce programs to target poor children to further protect the vulnerable segments of the population.

Finally, the authorities are working on improving access to quality, relevant, and inclusive education, reducing the skills gap in the economy, enhancing research and development and innovation, and removing wage rigidities with a view to enhancing social and human capital deployment.

CONCLUSION

The authorities are committed to implementing a comprehensive fiscal consolidation plan and structural reforms needed to restore fiscal stability, stop accumulation of government arrears, stabilize the public debt, and support inclusive growth. They appreciate Fund's advice and technical support and look forward to continued collaboration in implementing their reform agenda.

Mr. Psalidopoulos and Ms. Cerami submitted the following statement:

We thank staff for the comprehensive and insightful report and Mr. Mahlinza and Mr. Ismail for their helpful buff. As the Kingdom of Eswatini has strong economic ties with South Africa, we appreciate that the Board's discussion has been aptly scheduled shortly after the conclusion of the consultation with South Africa. We broadly agree with staff's assessment and policy recommendations, rightly focused on achieving macroeconomic stability and removing structural impediments to private investments. We add the following remarks for emphasis.

To restore macroeconomic stability, the authorities should develop a credible medium-term fiscal adjustment plan and refrain from monetary financing of the budget. Staff's projections of fiscal deficits and public debt are a cause for concern, particularly in the context of subdued economic growth in South Africa, that is driving the decline in Southern African Customs Union revenue. While there are also upside risks from the recently ratified African Free Trade Agreement, which may create an opportunity for expanding regional trade, thereby supporting economic growth and fiscal revenues, we agree with staff that prevailing downside risks require steadfast action to ensure fiscal discipline and debt sustainability. Furthermore, to maintain price stability under the currency peg to the rand, the central bank should restore a positive spread with the policy rate set by the South Africa Reserve Bank and refrain from financing the budget.

Developing an effective and transparent strategy for clearing arrears and rationalizing public entities and enterprises will be key for a successful fiscal consolidation. In addition to reducing current spending, especially the public wage bill, and mobilizing additional tax revenues, the authorities should improve spending efficiency and develop a strategy for clearing existing arrears and preventing the accumulation of new arrears. This will require improving budget formulation and execution and enforcing tight controls and penalties for improper spending across the broad public sector, including public enterprises. Staff recommend a fiscal adjustment of about 6 percent of GDP over three years. However, we agree with the authorities that a more gradual adjustment path could be more successful, by reducing the risk of an economic downturn, which would make it harder meeting the fiscal targets and avoiding cuts to priority social spending. In this regard, we appreciate staff's analysis of poverty and inequality trends in Eswatini and encourage the authorities to step up efforts to improve social outcomes, through strengthening and targeting social programs, increasing the progressivity of the personal income tax, and expanding access to secondary education.

Removing structural impediments to private investments is paramount to reinvigorate growth, export competitiveness and to reduce poverty. Weak governance, high input and trade costs, including labor, and inefficient regulations weigh on business development and export competitiveness. It is encouraging that according to staff's analysis, implementing a comprehensive set of product markets, labor markets, and governance reforms may boost

GDP growth by about 2 percent over five years. We thank staff for providing a broad list of concrete measures in these areas and encourage the authorities to follow up. We take note from staff's report and the buff that the authorities have recently established special economic zones and are facilitating the set-up of selected large foreign investment projects. Can staff provide more details about these initiatives and their fiscal implications? Are the investment incentives expected to be paid off through durable growth and increased tax revenues in the medium term? Finally, we would emphasize the importance of a sound and stable financial sector for supporting investments and call on the authorities to swiftly implement their comprehensive legislative agenda for the sector, to enable the regulatory and supervisory authorities to timely address rising vulnerabilities and AML/CFT risks.

Mr. Bhalla and Mr. Natarajan submitted the following statement:

We thank the staff for the detailed report and Mr. Mahlinza and Mr. Ismail for the informative buff. Eswatini's economy is facing challenges on multiple fronts requiring strong commitment to reforms, urgent measures for macroeconomic stability and medium to long term framework for future growth and stability. In this context, we broadly agree with the thrust of the staff analysis and report.

Macroeconomic outlook is challenging as the growth is expected to be a modest 1.2 percent in 2019 and remain further subdued in the medium term. Combined with fall in revenue from African Customs Union (SACU), this has caused deterioration of fiscal stability and decline in international reserves. Further, expansionary budget policy has widened the fiscal deficit from 7 percent in 2017/18 to 11.2 percent of GDP in 2018/19 and caused a sharp rise in public debt from 17.7 percent in 2015 to 38.1 percent in 2019. Accumulation of domestic arrears to 4 percent of GDP is another cause of concern.

Headline inflation has declined from 6.2 percent 2017 to 4.8 percent in 2018 and further to 3 percent in 2019 reflecting weakening demand and due to freeze in electricity and water tariffs. Pegging currency to Rand has downside risks of accelerating inflation, capital outflows and aggravating external shocks. Credit growth declined from 7.5 percent in 2017 to 3.5 percent in 2018, driven by weak demand from households.

In this emerging scenario, banking sector, currently well capitalized and profitable, may not remain immune as can be seen in rising NPLs and increased government borrowings. We encourage the authorities to strengthen oversight of banking sector and Non-Banking Financial Institution (NBFI) by suitable legislative reforms and administrative mechanism.

In this context, the staff has suggested measures that include continuing freeze on new hiring, containing salary indexation over next 3 years, rationalizing government administrative expenditure, strengthening public financial management, prioritizing capital outlays and reforming public entities (PEs). We take note of the action of the authorities to undertake some measures in excise tax, develop a medium-term fiscal framework and a national development plan for growth. Further, they intend to follow a gradual consolidation strategy which include some wage increases, completing ongoing projects and gradual reform of PEs. Could the staff comment on how much efficacious these measures can be, given the gravity of the problem and what are the expected difference in outcomes between the approach intended by the authorities and suggested by the staff in the short and medium-term?

Business competitiveness has declined due to high labor costs and cost of other production inputs. The national development plan focuses on improving governance, facilitating private investment and enhancing human capital. There is a huge scope for improvement in business conditions by streamlining business regulations, restructuring PEs to reduce electricity and telecommunication costs and contain wage dynamics in the economy.

Mr. De Lannoy and Ms. Harutyunyan submitted the following statement:

We thank staff for the comprehensive report and Mr. Mahlinza and Mr. Ismail for their informative buff statement. Eswatini's economy faces challenging times with high fiscal deficits, rising public debt, weak external position and inadequate international reserves. High unemployment and extreme poverty are persistent on the back of modest growth and decelerating private investments. Looking ahead, the fiscal outlook poses significant challenges to the macroeconomic stability and long-term growth. The risks are skewed to the downside related to potential fiscal slippages, declining SACU revenues and lower exports. In this context, sustained fiscal consolidation alongside structural and governance reforms, is critical to put the economy on a sustainable path. We broadly agree with staff's appraisal and would like to offer the following comments for emphasis.

We stress the importance of a credible medium-term fiscal adjustment plan to put public debt on a declining path while creating a stable macroeconomic environment. We welcome the measures taken by the new government to control the rising fiscal deficits, including restraining the wage bill, restructuring loss-making public entities and increasing some excise taxes. The development of the 2019-2022 National Development Plan and a Strategic Roadmap is well acknowledged. That said, we remain concerned about the public debt outlook, the rising gross financing needs and possible fiscal slippages that may undermine the currency peg. In this context, we urge the authorities to intensify their efforts by taking additional actions to restore the fiscal sustainability, to build adequate international reserve buffers and support inclusive growth. To this end, we emphasize the importance of policies that combine both spending reductions and revenue increases. Enhancing social programs alongside well-targeted budget policies is essential to protect the most vulnerable. We underscore the importance of strengthening the public finance management (PFM) and accelerating fiscal reforms to achieve a successful fiscal consolidation. Also, we encourage the CBE to refrain from further budget financing and maintain the policy rate in line with South African Reserve Bank's (SARB) rate.

On fiscal consolidation, we note that, while staff and the authorities have a common agreement on a cumulative fiscal adjustment of about 6 percent over the next years to restore fiscal sustainability, they differ on the adjustment path. In this regard, could staff elaborate on the implications of a more gradual fiscal adjustment, as suggested by the authorities, on the public debt and fiscal sustainability? Does staff have any quantitative estimates on this?

Strengthening banking supervision and financial oversight is essential to manage financial stability risks. Eswatini's financial sector remains sound, well capitalized and profitable. However, against the background of an unfavorable economic environment and macroeconomic imbalances, vulnerabilities in the sector are expected to rise. To this end, the risks related to the banking sector's concentration, sovereign-financial sector links and household indebtedness need to be carefully monitored and managed. We stress the importance of strengthening the non-bank financial institutions' oversight framework, regulation and supervision. We encourage the authorities to step up their efforts in enacting the Financial Institutions Act and the CBE law. The development of an effective crisis preparedness and management framework is essential. We underline the importance of further strengthening the early intervention regime and setting up a macroprudential policy framework. We encourage the authorities to be cautious about the plans to relax single borrower concentration regulations. And finally, we call for further efforts to enhance the AML/CFT framework. In this context, we welcome the expected assessment of AML/CFT standards in 2020.

With these remarks, we wish the authorities all the success in their future endeavors.

Mr. Sigurgeirsson and Mr. Bernatavicius submitted the following statement:

We thank staff for the detailed report and Mr. Mahlinza and Mr. Ismail for their informative buff statement. We note that Eswatini's economic performance continues to deteriorate and downside risks dominate the outlook. We generally concur with staff's appraisal and would like to provide a few additional points for emphasis.

We note, that since 2015 public debt has more than doubled and is still rising. The FY18/19 fiscal deficit widened to 11.2 percent of GDP and fiscal position remains weak. While the authorities have taken some steps to contain the fiscal deficit, more policy efforts will be needed to restore fiscal sustainability. We strongly encourage the authorities to develop a robust medium-term fiscal consolidation strategy, with the aim to achieve a cumulative adjustment of 6 percent of GDP over the next three years as recommended by staff. Without additional policy measures, under the baseline scenario the fiscal deficit will remain wide and public debt could exceed 60 percent of GDP over the medium term.

Further fiscal and monetary policy slippages could undermine the capacity to support the peg with South Africa's rand. The Central Bank of Eswatini (CBE) should keep the policy rate in line with the South African Reserve Bank's rate and refrain from providing further budget financing. We also encourage the authorities to pursue an effort to re-build international reserves, which have been on a steady declining trend since 2013 and remain below adequate levels based on traditional metrics.

We note with concern, that exports as a percent of GDP have halved during the last two decades. Decisive policy measures will be needed to improve the business climate including strengthening the anti-corruption framework. We also encourage the authorities to increase flexibility in product and labor markets.

Poverty and inequality are widespread and remain high compared to peer countries. We agree with staff that there is room to increase access to secondary education and enhance the redistributionary role of fiscal policy.

The banking sector appears well capitalized, liquid, and profitable. However, due to weak performance of the economy, NPLs have increased to almost 10 percent of GDP and provisioning coverage has declined. Furthermore, over the past few years, sovereign-financial linkages have been rising, exposing the sector to the weak domestic fiscal position. Moreover, cross-border financial linkages need to be monitored closely to control any contagion risks.

Mr. Fachada and Mr. Antunes submitted the following statement:

We thank staff for the insightful report and Mr. Mahlinza and Mr. Ismail for their candid statement. Despite the authorities' recent efforts to reduce fiscal deficits, the Kingdom of Eswatini is still facing sizeable macroeconomic imbalances. Growth is subdued, poverty and unemployment rates are high and domestic arrears are mounting, while declining South African Customs Union (SACU) revenues pose fiscal sustainability concerns and increase the pressure on dwindling international reserves. In face of this challenging scenario, the authorities should redouble their fiscal consolidation efforts and frontload supply-side, productivity-enhancing reforms.

An ambitious fiscal consolidation effort is needed to set the country back on a sustainable development path. We are encouraged by the authorities' full recognition of the prevalent fiscal challenges. Indeed, staff and authorities seem to agree on the size of the required medium-term fiscal adjustment (6 percent of GDP). We take note that staff sees a potential premium in the fast delivering of fiscal adjustment, therefore recommending the frontloading of consolidation efforts. Authorities, on the other hand, seem to favor a slightly more cautious approach, using FY20/21 to build social consensus around a comprehensive fiscal reform plan, to be fully implemented over a longer period. We highlight the importance of incorporating political economy considerations into the decision-making process, in order to avoid backtracking. It is crucial to devise well-targeted mechanisms to shield the most vulnerable from adverse effects of the reforms in the short run. Going forward, it would be important to implement a fiscal framework capable of permanently ensuring fiscal sustainability, thereby increasing macroeconomic predictability and supporting long-term growth.

Inflation remains relatively low under the pegged exchange rate regime. We concur with staff that the Central Bank of Eswatini should keep the policy rate in line with the South African Reserve Bank's (SARB) rate and refrain from providing further budget financing. The CBE should also seize every opportunity to rebuild external buffers in order to be able to support the peg, avoiding any risk of an abrupt exchange rate adjustment.

Boosting productivity through supply-side reforms will be crucial to reignite growth. Considering the necessity of implementing an ambitious fiscal consolidation over the medium-term, private investment will be key to sustain economic growth. To unleash Eswatini's economy potential, supply-side reforms must be frontloaded. The Strategic Roadmap launched by the authorities is a step in the right direction. Going forward, enhancing the business environment, investing in human capital and improving governance practices could have transformative effects for the Kingdom.

Mr. Palei and Mr. Shestakov submitted the following statement:

We thank staff for the informative report and Mr. Mahlinza and Mr. Ismail for their well-written buff statement. The outlook for Eswatini's economy remains challenging due to fiscal imbalances and structural bottlenecks that constrain economic activity and job creation. The economy is also vulnerable to adverse climate events like droughts, which lead to high food prices, lower electricity production, and higher unemployment. Strong ownership of the reform agenda is critical to address rising vulnerabilities, ensure macroeconomic stability, and reignite robust and broad-based economic growth.

Eswatini's authorities have continued to pursue expansionary budget policies in FY18/19 against the background of declining Southern African Customs Union (SACU) revenues, which resulted in public debt doubling over 2015-2017. According to staff estimates, without additional political actions public debt will almost double again over 2019-2024, exceeding 60 percent of GDP. Furthermore, despite the past IMF warnings, the Central Bank of Eswatini continued to provide advances to the government for budget financing. Against this background, we welcome the measures to contain budget overruns proposed by the authorities, including the newly introduced excises on alcohol, tobacco, and fuel. Reducing fiscal deficit through a credible medium-term adjustment plan is crucial for bringing the economy back to a sustainable path. We notice the authorities' plans to sell off some of the government assets. How large of a difference could these plans make for the overall debt sustainability?

The 2019 National Development Plan proposed by the authorities properly prioritizes improving governance, facilitating investment, and enhancing human capital. Eswatini's ease of doing business rank is below the regional average for Sub-Saharan Africa, which signals scope for improvement of the business climate to boost investment. The need for better governance is highlighted by staff's estimates of negligible contribution of capital accumulation to economic growth, while the total factor productivity's contribution is also turning negative. The authorities noted that an assessment of AML/CFT standards will be conducted in 2020, which is crucial given that governance and regulatory frameworks are assessed by staff as weaker compared to those in neighboring SACU countries. Do staff possess a tentative timeline for further implementation of AML/CFT regulations, and what are the main impediments to progress in this area?

Both the headcount poverty ratio and Gini income inequality index are much higher in Eswatini than the LMIC average. According to staff, the impact of expansionary fiscal policy on the poverty reduction was limited, and we concur with staff's calls to design better-targeted public programs, such as the increased old age grants and conditional cash transfers towards households with children. Cash transfers to children might help ameliorate the issue of childhood poverty and increase education access, which in turn will reduce skill mismatches. We commend the authorities for the adoption of the National Financial Inclusion Strategy, that aims to enhance access to finance and support small-holder farmers.

With these remarks, we wish the authorities success in facing challenges ahead.

Mr. Kaya and Mr. Marek submitted the following statement:

We thank staff for the informative set of reports and Mr. Mahlinza and Mr. Ismail for their helpful buff statement. Eswatini has been facing significant economic and social challenges, including widely spread poverty, high unemployment and inequality as well as rising fiscal risks. While the financial sector is in general profitable and well capitalized, a deterioration in the macro financial conditions could weigh on its stability. We share the thrust of the staff's appraisal and encourage the authorities to address the economic and governance weaknesses to develop a more inclusive growth model.

Fiscal policies should focus on bringing debt on a sustainable path in the long run through well designed fiscal consolidation. We are concerned by the staff's baseline fiscal projection indicating that public debt could exceed 60 percent of GDP by fiscal year 2024/25. An adjustment in public expenditure needs to be implemented swiftly through a series of measures, including by wage moderation in the public sector, streamlining the government's administrative expenditures and improving the efficiency of the healthcare and education systems. There is also scope for strengthening public revenues, through broadening both the VAT base and corporate income tax base. We note that fiscal consolidation should be complemented by well targeted benefits for the most vulnerable to mitigate the adverse social impacts of consolidation.

Long-term fiscal consolidation needs to be supported by strengthened public financial management (PFM). We note that sound fiscal policies need to be anchored in a credible institutional framework. It is critical to step up the implementation of the Public Procurement Act regulations as well as of the new PFM law to streamline the budget formulation and execution. In addition, we encourage the authorities to adopt a strategy to clear existing arrears through the introduction of controls to prevent their further accumulation and execute an audit of the existing ones, aiming for their repayment or liquidation. Thorough reforms are also needed in the public enterprises sector, whose weak financial performance weigh on the government's budget. Refinement of their governance structure, including a review of their mandates and functions, in addition to their immediate financial restructuring, is of utmost importance. Regular spending reviews in the healthcare and education system are also instrumental for maintaining public expenditures in check.

Emerging risks in the financial sector warrant supervisory and regulatory diligence. While we note that the financial sector is in general well capitalized and profitable, it has been exposed to elevated external and domestic risks. Considering the large exposure of banks to the public sector and the buoyant corporate credit growth amid persisting government arrears, it is critical to develop an explicit macroprudential framework to prevent a potential increase in the non-performing loans (NPLs). We are also concerned by the rising indebtedness of households, which could have further adverse impacts on banks' balance sheets, in case of a drop in real income growth. We note that non-bank financial institutions, including institutional investors, should be brought within the scope of financial regulation and supervision given their significant financial interconnectedness with the banking sector to prevent potential contagion in case of financial shocks. Could staff indicate the size of the non-bank financial sector relative to the banking sector?

The private sector would benefit from thorough supply side reforms supported by an enhanced governance framework. We note that Eswatini has been facing bottlenecks to economic growth, in particular weak private investment. We are encouraged by the authorities' plan to establish a one-stop shop for business registrations, simplify licensing requirements, and enhance the use of e-government. In the same vein, the authorities' commitment to unbundling the Eswatini Posts and Telecommunications Corporation (EPTC) into three separate and independent entities is a step in the right direction. The authorities should adopt further measures aiming to liberalize the network industries, including the electricity sector, which would lower production costs and have a positive cost-saving effect on private enterprises. In addition, we urge the authorities to ensure higher labor force participation through improving access to secondary and tertiary education and address the vulnerabilities to state capture and corruption.

Mr. Tanaka, Mr. Chikada, Mr. Heo, Mr. Tan, Mr. Chea, Mr. Iona and Ms. Mori submitted the following joint statement:

We thank staff for the report and Mr. Mahinza and Mr. Ismail for the insightful buff statement. Eswatini is in a very difficult economic situation due to various structural weaknesses and years of unsustainable fiscal expansionary policies. As projected in the 2017 Article IV report, public debt has accumulated rapidly, the current account surplus has narrowed, and international reserves have deteriorated. Private investment has sharply declined along with external competitiveness, owing to inefficient government bureaucracy and limited control of corruption. Macroeconomic stability and growth are expected to deteriorate further in the absence of immediate policy actions as downside risks weigh on the economy's fragile outlook and risk further entrenching widespread poverty, high income inequality and elevated unemployment. That being said, we acknowledge that the authorities recognize the challenges and launched a National Development Plan to tackle problems and encourage them to implement reform efforts without delay. We agree with the broad thrust of staff's analysis and wish to highlight a couple of points for emphasis.

We note the staff's assessment that the Eswatini economy is on an unsustainable path, with subdued growth and deep development challenges. Given Eswatini's close economic links to South Africa, could staff comment on the latter's current economic trends and offer appropriate advice on how the authorities could mitigate risks from this source of external shocks?

The authorities' recent efforts to control rising fiscal deficits are undermined by inadequate follow-through with the needed adjustments. With reference to the comprehensive and in-depth analyses in the latest report, as well as in previous Article IV reports, we find that staff has offered practical policy advice to the authorities. In this regard, we take good note that the authorities are generally in agreement with most of staff's recommendations and are committed to their steadfast implementation. Strong political will be the defining factor in the success of the authorities' efforts, and we see the

Fund playing a critical role beyond the current provision of TAs. Can staff elaborate whether they foresee any balance of payments problems for Eswatini in the immediate future and is there any dialogue with the authorities on the value add of a possible Fund arrangement such as the SMP or PCI that may help address the many pressing challenges?

We agree that further consideration is warranted on the immediate actions needed to reduce next year's fiscal deficit and put in place a credible medium-term fiscal consolidation strategy. Staff has underscored the lack of fiscal space to smooth the adjustment over time despite the temporary adverse effects on growth. Given the authorities' preference for a more gradual consolidation strategy, could staff comment more specifically on what could be done to mitigate their concerns with capacity constraints to deliver reforms quickly and the adverse effects on growth in the near term? On the expenditure side, further containment of the wage bill is necessary, so as to rationalize government administrative expenditures, while ensuring the poor is protected through better targeted budget policies. These efforts will be reinforced by the strict implementation of the new PFM law and the 2011 Public Procurement Act regulations. We agree that the efficiency and governance of public enterprises must be improved to mitigate fiscal risks to the government and lessen the burden on the budget. The consolidation strategy should also constitute measures to mobilize domestic revenue, including reforms to broaden the corporate income tax base and the VAT base, and to simplify the tax system for small taxpayers in order to promote compliance and reduce administration burden.

We commend the authorities for adopting an ambitious 2019 National Development Plan that focuses on reigniting growth through improved governance, scaled up public investment, and enhanced private sector and human capital. Notwithstanding the authorities' acute awareness of the structural impediments to business and private investment, we are cognizant of the limited traction of past policy advice in this space. In this regard, can staff elaborate on the main causes of inaction by the authorities to implement the supply-side and governance reforms? Where possible, could staff prioritize the interventions that would put Eswatini on a private-sector led growth trajectory? Related to human capital, we would also welcome some updates on recent developments in education, employment, gender equality and public health, and how these factors are hindering growth and entrenching poverty.

Managing the rising structural vulnerabilities and risks in the financial sector is important. The deteriorating economic environment has the potential of de-stabilizing the financial sector, with increased NPLs now weighing on banks' profitability and capitalization. We agree with staff that the CBE needs to intensify its supervision and oversight role, including the need to better manage concentration risks and increasing capital regulatory requirements. We welcome the authorities' plan to review the AML/CFT requirements and the risk-based supervision activities of the CBE, the FSRA and the Financial Intelligence Unit, and we urge the authorities to enact the implementing regulations of the 2011 Money Laundering and Financing of Terrorism Prevention Act as soon as possible.

Mr. Farber and Ms. Crane submitted the following statement:

We thank staff for the papers and Mr. Mahlinza and Mr. Ismail for the helpful buff statement. Eswatini's unsustainable fiscal policies and growing debt burden are concerning. We encourage the authorities to take earlier, more decisive action on fiscal consolidation and structural reforms to improve the environment for private sector investment and growth. Enhancing governance, including through greater accountability around public spending across all elements and levels of the government, needs to be a top priority. We agree with the thrust of the staff appraisal and would like to highlight several points.

Fiscal sustainability. We encourage the authorities to consider a more front-loaded approach to fiscal consolidation, combining revenue and spending measures, as recommended in staff's adjustment scenario. We note in the buff statement that the authorities plan to use the upcoming year to build consensus around a comprehensive consolidation plan. But with domestic arrears clearance likely to give a boost to growth in the coming year, this could be a good time to make a down-payment on fiscal consolidation while muting the immediate growth effects. Particularly considering the authorities intention to spread fiscal measures over a somewhat longer timeframe than recommended by staff, an earlier start would seem prudent.

While Eswatini benefits from relatively developed domestic financial markets and a debt composition tilted to the domestic side, the required fiscal consolidation of some 6 percent of GDP is quite substantial. The downward trend in SACU revenues adds to the challenge. We encourage the authorities to focus on executing a transparent arrears clearance plan and resolving issues with public enterprises as expeditiously as possible, to cut off negative feedback loops and avoid a more disruptive adjustment in the future.

Governance and Business Climate. A stronger focus on governance, public spending efficiency and accountability, along with structural reforms to improve the business environment would serve Eswatini well. The decline in private investment is a particularly troubling indicator. We note the authorities' focus on special economic zones and a one-stop-shop for businesses to encourage greater investment. We encourage them to also focus on procurement reform, stronger governance of public investment, streamlining regulatory requirements, and reducing high costs of electricity and telecommunications. Can staff comment on whether Eswatini is working with the MDBs to support the quality and efficiency of education and health spending, which would support improvements in human capital?

Mr. Merk and Mr. Herold submitted the following statement:

We thank staff for their comprehensive and insightful report and broadly concur with the appraisal. We also thank Mr. Mahlinza and Mr. Ismail for their very helpful buff statement. We share staff's assessment that the economy is on an unsustainable path, with subdued growth and deep development challenges and have the following remarks for emphasis:

We support staff's call for a credible medium-term fiscal adjustment plan, starting with measures to reduce the fiscal deficit and to bring the economy on a sustainable path. The measures should combine spending reductions and revenue increases that can deliver sustained adjustment and enhance long-term growth prospects, while well targeted transfers would help protect the poor. Fiscal reforms will be critical to the success of any fiscal consolidation and should include strengthening budget formulation and expenditure controls, revamping the procurement process and reforming public entities and enterprises.

Supply side and governance reforms are essential to facilitate growth, as structural impediments to business and weak governance are hampering competitiveness and private investment. Reforms should aim at improving business climate especially through reducing vulnerabilities to state-capture and corruption.

Mr. Villar and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for its report and Mr. Mahlinza and Mr. Ismail for their useful buff statement. While some actions have been taken to restore macroeconomic stability, the Kingdom of Eswatini faces significant challenges posed by a deteriorating fiscal position, a weaker economic outlook, structural barriers to growth and pervasive poverty. Furthermore, strong dependence on Southern African Customs Union (SACU) revenue and its close trade and financial links to the South African economy further exposes the economy to external shocks. Measures to put the economy on a sustainable path will need to be supported by supply-side and governance reforms to improve the business climate, raise competitiveness, and make growth more inclusive.

A strong and continuous commitment to fiscal consolidation efforts will be required to restore fiscal sustainability. While the required adjustment is ambitious, we are encouraged to see that it is feasible as a larger reduction in the fiscal deficit has been done previously. Excessive dependence on SACU revenues and reducing the high level of current expenditure should be addressed. In this regard, we agree with staff that the adjustment should be underpinned by policies that both deliver a sustainable fiscal consolidation while enhancing growth. We take note that the existing social transfer system in Eswatini is lower than other SACU countries and has limited impact on poverty reduction. Measures that mitigate the impact of the adjustment to the poorest while increasing their effectiveness on poverty rates should be devised and we take note of the authorities' intention to strengthen social safety nets as noted in the buff.

Going forward a medium-term fiscal framework should be established in order to strengthen the budgetary process, promote expenditure efficiency and ease the burden of extrabudgetary public entities. Moreover, we welcome that the authorities are starting to take action on government arrears as stated in the buff and encourage them to develop an effective and transparent arrears clearance strategy. We agree with staff that the CBE should refrain from providing further budget financing.

Efforts to strengthen the capacity to manage vulnerabilities and increase oversight in the financial sector are required. We note that the banking sector remains well capitalized and profitable on average. However, NPLs are increasing and the interconnections of the financial sector could amplify risks in a context of weakening economic environment. In this regard, enhancing the financial stability architecture is crucial and we look forward to the completion of the ongoing legislative changes towards this end.

A structural reform agenda that aims at improving governance, supporting private investment and increasing competition will be crucial for boosting growth potential. Improving the business climate and increasing competition will be important to attract more private investment and support the authorities' reform agenda. Enhancing governance, reducing state-capture and fighting corruption will contribute to these efforts. Moreover, enhancing social and human capital will be crucial to increase productivity and address the shortage of skilled workers.

We encourage the authorities to make improvements in the adequacy and transparency of fiscal and national accounts. We are pleased to see that improving the quality and timeliness of macroeconomic statistics is a strategic priority of the capacity development agenda.

Continuous Fund TA engagement to support key policy challenges is welcome. We thank staff for the annex on the capacity development strategy. We note that Eswatini has been a high-intensity technical assistance recipient and note the implementation risks outlined by staff, particularly regarding capacity implementation. We agree that mitigation of capacity issues could be solved with increased hands-on training, resident advisors and continuous TA engagement.

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

We note the significant challenges ahead for Eswatini. We thank staff for the good set of documents and Mr. Mahlinza and Mr. Ismail for their helpful buff statement. It is concerning that expansionary fiscal policies have left Eswatini with no more fiscal space and many unaddressed structural bottlenecks. Wide-ranging structural reforms aimed at restoring fiscal soundness, strengthening budget controls, improving competitiveness, and strengthening financial sector resilience are called for. We welcome that the authorities broadly agree with staff's assessment, are committed to reforms to stabilize debt, increase private investment, and strengthen financial supervision, as highlighted in the staff report and the buff statement. We nonetheless note the difference in views between staff and the authorities on the speed and types of policies to put in place.

We encourage the authorities to focus on high-quality fiscal consolidation measures. Expenditure measures should go beyond hiring and wage freezes and focus on strengthening processes to ensure greater controls, prioritization, and efficiency. We thus welcome the authorities' commitment to accelerate the operationalization of the Public Financial Management Act and their plan to establish a medium-term fiscal framework. On the revenue side, we agree with staff that the tax base should be broadened, the personal income tax should be made more progressive, and exemptions and loopholes should be avoided. Restructuring public enterprises and improving their governance and accountability frameworks is also urgent, given the significant fiscal burden that SOEs represent.

We support the National Development Plan's focus on improving governance, facilitating private investment, and enhancing human capital. We welcome the plan to enhance the use of e-government and digital processes to limit state capture and enhance the business environment. We nonetheless would welcome more details on the concrete steps planned to improve governance and strengthen the anti-corruption framework. In this regard, we encourage the authorities to implement the regulations of the 2011 Money Laundering and Financing of Terrorism Prevention Act without further delay.

Financial sector oversight should be strengthened. We encourage the authorities to strengthen banking supervision, especially given the rise in NPLs and the decline in provisioning coverage. It would also be important to reconsider the plan to relax single borrower concentration regulation, given the banks' already highly concentrated loan books. Further, an oversight framework for non-bank financial institutions should be developed, given their size and interconnectedness with the banking sector.

Mr. Beblawi, Mr. Mouminah, Ms. Al-Riffai and Ms. Alzamel submitted the following joint statement:

We thank staff for a well-written report and Messrs. Mahlinza and Ismail for their helpful buff statement. We welcome the authorities' commitment to address the existing challenges to macroeconomic stability and growth. We broadly concur with the staff appraisal and would therefore limit our remarks to the following issues.

The authorities are pursuing fiscal consolidation to restore fiscal sustainability, but additional measures are needed. Expansionary budget policies and falling SACU revenue have accelerated the rise in public debt and the accumulation in domestic arrears amidst limited financing. In this context, we positively note the authorities' efforts to reduce the FY19/20 fiscal deficit. However, as the fiscal deficit is projected to remain large and growth to be negative in per capita terms, a medium-term fiscal consolidation plan is needed. The proposals to introduce budget spending ceilings and excise taxes on some goods are promising first steps. Here, we encourage the authorities to consider the additional revenue and expenditure measures proposed by staff. We note with concern the accumulation in domestic arrears and find staff's analysis in Annex VI on designing an effective and transparent arrears clearance strategy to be useful and timely. Strengthening tax administration and broadening the tax base will enhance domestic revenue mobilization and reduce dependence on SACU revenue sources. Furthermore, rationalizing and prioritizing spending, including by reforming the governance of extra-budgetary entities and public enterprises (PEs), will help support fiscal sustainability.

Strengthened public financial management (PFM) and procurement systems will be critical to the success of the fiscal adjustment plans. Here, we commend the authorities for implementing regulations for the new PFM law, supported by Fund TA, and look forward to its swift implementation. We also look forward to the adoption of recommendations of the recently conducted PIMA. It may be worthwhile to review and update the 2011 Public Procurement Act prior to its adoption especially given the underlying time lapse.

Despite the authorities' efforts to prioritize poverty reduction, close to 40 percent of the population lives in extreme poverty. We concur with staff that there is a need to strengthen the impact of fiscal policy on reducing poverty and income inequality. In addition to building and strengthening efficient and well targeted social safety nets, we also see merit in devoting resources towards improving education outcomes especially since higher education is associated with lower poverty results.

While the financial sector is overall stable, rising macroeconomic imbalances and the sovereign-financial sector nexus have increased vulnerabilities. Declining bank asset quality and provisioning coverage, as well as increasing NPLs and liquidity risks are sources of rising vulnerabilities. We concur with staff that having a macroprudential framework in place is necessary to prevent the buildup in systemic risk. We commend the CBE on its efforts to expand and comply with Basel II standards as well as their efforts to enhance risk-based supervision. We are also pleased to note that the authorities are reviewing the Financial Services Regulatory Authority (FSRA) Act to strengthen the non-bank financial institutions' oversight framework. Further strengthening of the AML/CFT framework is essential to help safeguard financial sector stability. In this context, we look forward to the planned assessment of AML/CFT standards in 2020.

Swift implementation of supply-side and governance reforms is warranted to enhance productivity and strengthen competitiveness. We encourage the authorities to advance the efforts to improve business environment and promote private investment together with enhancing the quality of the regulatory environment. In this connection, developing the Recovery Roadmap and the 2019 National Development Plan is a very welcome step. As noted above, we concur with staff on the importance of improving education attainments and access to secondary and higher education to address shortages of well-educated and skilled workers.

With these remarks, we wish the authorities success in their future endeavors.

Mr. El Qorchi and Mr. Osei Yeboah submitted the following statement:

We thank staff for the well-written report and Mr. Mahlinza and Mr. Ismail for their insightful buff statement. The outlook for Eswatini's economy remains challenging and requires additional actions to bring the economy back to a sustainable path. Structural bottlenecks continue to hamper economic activity and limit the government's efforts to create jobs and reduce poverty. We broadly agree with the thrust of staff appraisal and would like to offer the following comments for emphasis.

The close linkage of the Eswatini's economy to South Africa has anchored the policy framework and supported macroeconomic stability, but leaves the country exposed to external shocks. Amidst declining Southern African Customs Union (SACU) revenue, rising public debt, high domestic arrears, falling reserves, and declining private investments, growth has remained weak and vulnerabilities have heightened. Looking forward, the outlook is clouded by significant downside risks, and staying the course of the significant fiscal dominance may undermine the Central Bank of Eswatini's (CBE's) capacity to support the currency peg. We welcome the new government's National Development Plan 2019-2022 (NDP), which is underpinned by commitment to prudent fiscal management and good corporate governance to enhance competitiveness and foster a private sector-led inclusive growth.

An ambitious policy stance is critical to restoring fiscal sustainability and providing buffers for pro-poor investments. To this end, adopting a credible multi-year consolidation plan to reduce the fiscal deficit within a medium-term framework and place public debt on a declining path is warranted. We welcome the authorities' steps to contain rising debt and avoid further accumulation of domestic arrears. To safeguard spending efficiency, we urge the authorities to extend the measures to contain salary and allowance increases to all public entities, rationalize government non-wage expenditures, and prioritize capital outlays to deliver sustained fiscal consolidation and enhance long-term growth prospects. Revenue measures should aim at expanding the tax base, limiting discretionary tax expenditures, and simplifying the tax regime. While restoring fiscal discipline may weigh on growth in the short term, we urge authorities to take the appropriate measures to mitigate the adverse impact of fiscal adjustment on low-income households and support public programs on poverty reductions.

The focus of structural reforms must target strengthening governance in public institutions, enhancing transparency, and rationalizing loss-making state entities. This will reignite private investment inflows, bolster durable inclusive growth, and reduce poverty. We welcome the launch of the National Development Plan that is supported by increased investments in capacity development and the integration of ICT in business processes to boost competition, as noted in the statement of Mr. Mahlinza and Mr. Ismail. Incentivizing the recently established special economic zones will also boost the business climate and maximize the chances of successful implementation of the strategic roadmap to preserve economic stability.

A healthy financial sector remains the mainstay of boosting the business environment and creating jobs. It is comforting to note that the banking sector is well-capitalized, liquid, and profitable. However, the rising NPL levels and the heightened risk of macroeconomic imbalances can jeopardize the stability of the sector. Additionally, given that the NBFIs are systemically important and have cross-border linkages, we encourage the Financial Services Regulatory Authority (FSRA) to develop adequate supervisory and regulatory tools for the sector. Against that backdrop, more progress is needed to strengthen the macroprudential, crisis management, and legal framework. We also welcome authorities' plan to conduct assessment of AML/CFT standards this year, which should pave the way for addressing any shortcomings.

Ms. Levonian, Ms. McKiernan, Mr. Ronicle, Mr. Rozan, Mr. Weil, Mr. Comolet and Ms. Stockill submitted the following joint statement:

Thank you to staff for their comprehensive reports, and to Mr. Mahlinza and Mr. Ismail for their buff statement in which they outlined the authorities' plans to steer the economy through severe macroeconomic challenges.

We note with concern staff's assessment that the economy is on an unsustainable path. Whilst growth has picked up in the last 2 years, this was in part driven by a temporary pick up in agricultural production and high public spending. At the same time Eswatini remains highly exposed to climate events and economic performance in South Africa, as well as having an unsustainable fiscal position. So, we concur with the staff assessment that downside risks dominate and urge the authorities to take decisive action now to reduce the risk of severe macroeconomic instability in the future. We note from the helpful annex summarizing implementation of past IMF advice that in many areas implementation has been limited. We would be interested in staff's comments on why Fund advice has had limited traction? And how staff plan to adjust the approach to Technical Assistance in light of the "mixed" implementation of previous TA?

We support the staff appraisal of the fiscal situation but stress the need to find the right balance between a credible medium-term fiscal adjustment and alleviating widespread poverty. On the one hand we agree that near-term measures to further reduce the fiscal deficit and contain worsening debt dynamics are needed. We support staff's focus on rationalizing government spending, tax policy measures to expand the domestic tax base, and rationalizing extra-budgetary spending. We encourage the authorities to draw lessons from the Fiscal Adjustment Roadmap which succeeded in controlling spending post-GFC. If the authorities do choose to consolidate at a slower pace than recommended by staff, we urge them to be ready to accelerate consolidation in the face of negative shocks or deteriorating risks. On the other hand, we are sympathetic to the authorities' concerns about the adverse effects of adjustment on growth and vulnerable households. Despite its Middle-Income Country status, 38.6 percent of the population of Eswatini live in extreme poverty. We note that options to mitigate the impact of adjustment on low-income households (increasing old age grants, considering targeted cash transfers) do not seem as fully developed as the adjustment proposals and may involve a significant lead-time to implement. Immediate work to improve the targeting of social spending, leveraging staff's advice to rebalance the cash transfer system towards households with children, may help bridge the gap between staff and the authorities' perspectives. The situation of Eswatini underscores the importance of the timely completion of a guidance note to assist staff with the implementation of the Strategy for IMF Engagement on Social Spending.

Beyond the immediate fiscal pressures, Eswatini needs to focus on structural reforms to enhance the long-term growth prospects of the economy and move to a more inclusive growth model. We agree with the staff recommendations on supply-side and governance reforms to boost competitiveness and private investment but think it could provide more advice on how best to sequence structural reforms. In particular, we would welcome staff comments on which measures should be prioritized to help address Eswatini's long-standing challenges with inequality. We note that Eswatini has a wide range of trade agreements and preferential market access options, but they are currently underused. A greater diversity of trading partners would reduce export concentration and associated risks. We also underline the importance on reducing vulnerabilities to state-capture and corruption to improve the investment environment.

As discussed in the 2017 Article IV consultation, the Central Bank should refrain from providing further budget financing and keep the policy rate in line with the South Africa Reserve Bank (SARB) rate. A small positive spread is required to reflect differential risks, but the peg with the South African rand has proven an effective anchor for monetary policy. Could staff elaborate on the role monetary and exchange rate policies (and in particular, modification of the peg regime) could play to complement and support the fiscal adjustments recommended in the report?

Financial sector vulnerabilities should be managed closely. Funding and loan concentration put the banking system at risk in the event of a shock. We were struck by the finding that the top 20 bank loans and deposits represent 50 percent of the total value of loans and deposits, which in our view argues against any relaxation of single borrower concentration rules that may be contemplated. We took note of elevated bank sovereign exposures which could accelerate vulnerabilities in each sector in a stress scenario. In such an environment it will be important for the authorities to continue improving the quality of financial supervision. Higher quality supervision should extend to non-bank financial institutions given financial interconnections and associated contagion risks.

Mr. Raghani, Mr. Bangrim Kibassim and Mrs. Boukpessi submitted the following statement:

We thank staff for their well-written report and Mr. Mahlinza and Mr. Ismail for their informative buff statement.

The Eswatini's economy continues to experience daunting challenges with growth at 1.2 percent in 2019, rising public debt and domestic arrears as well as limited external reserves. Looking forward, real GDP growth is expected to gradually fall below 1 percent from 2022 onwards owing to significant fiscal and external pressures as well as financial sector and structural vulnerabilities, including on governance. In addition, this fragile macroeconomic outlook is subject to significant domestic and external risks including further fiscal policy slippages and decelerating global growth. We welcome the authorities' acknowledgement of these challenges as indicated the helpful buff statement as well as the reforms envisaged to address them.

We urge the authorities to steadfastly implement their reform agenda which is geared towards restoring fiscal sustainability and rebuilding buffers, enhancing the policy framework and addressing macro-financial and structural issues to achieve sustained and inclusive growth.

A comprehensive medium-term fiscal consolidation is crucial to ensure macroeconomic stability and debt sustainability. We encourage the authorities to swiftly implement their fiscal consolidation plan. In addition, we urge them to give due consideration to the additional fiscal measures recommended by staff. We concur that the fiscal consolidation measures on both revenue and spending fronts should be growth-friendly to the extent possible. In this regard, further containing the wage bill, streamlining extra-budgetary entities and restructuring public enterprises, and making social spending more efficient particularly in health and education are of paramount importance. Enhancing the corporate income tax, broadening VAT bases and reducing tax incentives and exemptions should help expand the revenue base and improve revenue collection. We also see merit in staff's recommendations to forcefully implement reforms in public financial management (PFM).

On the monetary policy, we welcome the authorities' commitment to maintain the central bank of Eswatini (CBE)'s policy rate broadly in line with the South African Reserve Bank's rate as indicated by Mr. Mahlinza and Mr. Ismail to support the peg. Making further efforts to abstain from financing the budget will be critical.

Vulnerabilities and emerging macro-financial risks in the financial sector call for immediate measures to reinforce the sector stability and resilience. We acknowledge that the financial sector in Eswatini is served by a well-capitalized and profitable banking system and well-performing NBFIs. Nonetheless, the sovereign-financial sector nexus, liquidity risks, elevated non-performing loans (NPLs), and high household indebtedness represent vulnerabilities that should be closely managed to prevent them from spilling over to the rest of the economy. We encourage a swift implementation of the authorities' legislative reforms - including the enactment of the CBE bill, the Financial Services Regulatory Authority Act and the Financial Stability bill - aimed at enhancing macroprudential and crisis preparedness and management frameworks. We also call on the authorities to take the necessary steps to deepen financial inclusion and increase access to financial services. Going forward, the remaining provisions of the AML/CFT legislation should be implemented in a timely manner.

To revitalize growth prospects and support job creation, the authorities should address structural bottlenecks and further deepen their reforms. Low productivity, high cost of production, and labor market mismatches constrain the country's potential growth. Against this backdrop, we take positive note of the efforts envisaged by the authorities as articulated in the 2019 National Development Plan and their Strategic Roadmap through the implementation of policies to improve the ease of doing business, foster competitiveness and reduce the high level of poverty and inequality. In addition, we share the view that reforms in the labor market should consider streamlining wages, building human capital and addressing skill shortages. The authorities should also step up their efforts to strengthen governance and enhance the delivery of public services.

With these remarks, we wish the authorities success in their endeavors.

Mr. Chodos, Mr. Dips and Mr. Morales submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Mahlinza and Mr. Ismail for the helpful buff statement. We recognize the authorities' efforts to control rising fiscal deficits, by containing the wage bill and restructuring some loss-making public entities. To bring the economy back to a sustainable path, we encourage the authorities to take decisive steps towards a medium-term fiscal adjustment plan, combining spending reductions and revenue increases that can deliver sustained adjustment and enhance long-term growth prospects.

Real GDP growth has declined, reaching 1.2 percent in 2019 down from 2.4 percent in 2018. While we appreciate steps taken under the national development plan, and the preparation of a roadmap of priority actions to support private investment, steady growth will not resume without consolidation of macroeconomic stability. The current account surplus of 3.8 percent of GDP in 2019 increased from 2 percent in 2018, as the trade balance improved because of a recovery in exports paired by a slight decline in imports.

We encourage the authorities to reverse their expansionary public spending policy. Although the fiscal deficit declined to 7.9 percent of GDP in 2019, it remains high. The fiscal stance is not sustainable, as debt keeps rising and the accumulation of government arrears continues. This was especially complicated in 2019 as the contraction in SACU revenue triggered a fiscal liquidity crisis.

We agree with staff that fiscal reforms are critical to the success of fiscal consolidation plans. Critical steps to deliver fiscal adjustment include developing a sound fiscal framework, strengthening budget formulation and expenditures controls, reforming extrabudgetary public entities and enterprises, and adopting transparent selection and appraisal systems for capital spending. To complement these efforts, it is also important to revamp public procurement processes and set up a transparent arrear clearance strategy.

Inflation declined from 4.8 percent in 2018 to 2.6 percent in 2019 due to depressed aggregate demand and the economic slowdown. A freeze on water and electricity tariffs also contributed to low inflation.

On structural reforms, we look forward to the advances in framework that will be implemented by the authorities to provide legal certainty and motivate private investment, transparency, regulatory, and other related to financial services, like anti-corruption, anti-money laundering, combating the finance of terrorism. We expect staff to intensify technical assistance with sufficient follow up to strengthen technical and managerial capabilities.

We wish the authorities the greatest success on the difficult road to recover macroeconomic stability that would allow the country to reach higher growth rates and more equal access to economic opportunities for the population in extreme poverty.

The Acting Chair (Mr. Zhang) made the following statement:

The Kingdom of Eswatini is a small landlocked country in Africa with a population of only 1.1 million, and this is the first Article IV consultation for the country under its new name, which changed in 2018 from Swaziland to the current name, Eswatini.

The country is facing a number of macroeconomic challenges as well as social challenges, including widespread poverty, inequality, the prevalence of disease, including HIV/AIDS. The Fund has maintained close engagement with the country in the last couple years, including providing customized technical assistance to the country. Staff also committed to continue its engagement with the authorities after the Article IV consultation.

From your grays, I believe the focus is on the appropriate pace and timeline for the fiscal adjustment strategy and how to sequence the structural reforms, including some political economy considerations. I hope our discussion can lead to consensus on these issues.

Mr. Mahlinza made the following statement:

As indicated in our buff statement, the authorities broadly agree with staff's policy recommendations. I wish to take this opportunity to appraise the Board that the authorities have requested language modifications and that discussions with staff are still ongoing. We have language in paragraph 10 of the report which suggests that the central bank's capacity to support the currency peg is questionable. This also suggests that there are doubts about the sustainability of the peg, which could be a self-fulfilling prophecy. Given the limited research and analysis of key climate developments in the country, the authorities are concerned that such language in an IMF staff report could result in unintended consequences and have therefore requested modification of the language. We hope that this request can be considered favorably by staff.

The staff representative from the African Department (Mr. Palomba), in response to questions and comments from Executive Directors, made the following statement:[1]

Regarding the pace of fiscal adjustment, which has been one of the main issues discussed in the grays, staff and the authorities agree on the size of fiscal adjustment needed to restore fiscal sustainability and ensure macroeconomic stability. However, staff and the authorities differ on the pace of adjustment. Staff advise for some frontloading. The authorities currently have a preference to start the adjustment in 2021 and pace it over four or five years. In the Eswatini context, the choice between frontloading and pace of the adjustment is largely dictated by the government's tight financing constraints. With limited financing options currently available, there is no fiscal space to pace the adjustment for a long period of time without incurring new domestic arrears.

Of course, frontloading adjustment has a cost in terms of economic growth. However, there are a number of factors that may ameliorate this effect and in part address some of the political economy considerations associated with frontloading the adjustment.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

First, in this current year, 2020, the government plans to repay about 2.5 percentage points of GDP in domestic arrears. This will boost growth and offer an opportunity to absorb any negative impact of fiscal consolidation in this year. The size the staff propose in terms of frontloading is similar to the amount of arrears that the government plans to pay. Moreover, staff has discussed with the authorities a number of policy design options to limit the adverse effect on growth of some policies, particularly about the wage bill.

Finally, we should expect that as the efficiency of public investment improves, the impact on growth will increase over time because we have proposed a three-year adjustment period. Combined together, these factors we believe will help to cushion the short-term negative effect on growth of frontloading the fiscal adjustment.

Implementing such a sizeable adjustment requires a clear policy priority and adjustment plan, so in this respect, staff encourages the authorities to take advantage of the budget to be announced next month to begin fiscal consolidation and articulate the key policies that will underpin the adjustment plans they are working on. A well-articulated set of policies and a medium-term adjustment plan will lend credibility to the authorities' actions going forward and possibly help relax the currently tight financing constraint that the government is facing while gaining credibility. Staff stand ready to support the authorities in the task ahead.

The representative from the Strategy, Policy, and Review Department (Mr. Ahuja), in response to questions and comments from Executive Directors, made the following statement:

Staff has received the request for modification. We take note of them, and we are in discussion with the country team and the authorities, and we will give them consideration in line with the Transparency Policy.

Mr. Inderbinen made the following statement:

Thank you very much, Mr. Chairman, and thank you also to Mr. Mahlinza and Mr. Ismail for the buff statement and staff for the report and the questions, the answers to the questions they provided.

We issued a gray statement, and we noted the significant challenges that are facing the country at the moment and like others called for wide-ranging structural reforms aimed at restoring fiscal soundness, strengthening budget controls, improving competitiveness, and also strengthening the financial sector and its resilience. We very much welcome the National Development Plan (NDP) and its focus on governance, and we had a question there, and we thank staff for the answer they provided on the details that are in the plan.

We note that work is underway on concrete steps to improve governance and strengthen the anti-corruption framework, including actions envisaged to strengthen public financial management (PFM) regulations, state-owned enterprise (SOE) framework, and governance, anti-money laundering (AML), et cetera.

We also noted the technical assistance (TA) strategy that the staff has provided in the document, which we found very interesting and good, and we note that implementation of TA recommendations has been mixed in some areas, but it has been more effective in other areas.

My question in this regard is, since the SOE sector is an important part and its reform, and the PFM regulation as well, I did not see too much detail in the capacity strategy in the annex of the report, and I was wondering whether the staff could elaborate a little bit further on what is envisaged in that area, also given the commitment of the authorities and the need for support that they have.

Relatedly, the report says and the answer that was provided to one of the questions states that customized TA is important for the country to have better prospects for success. I was wondering how much the regional TA center is supporting the country in this regard. If you could just elaborate a little bit on that, that would be much appreciated.

Mr. Ronicle made the following statement:

The macroeconomic situation in Eswatini is clearly deteriorating in a context of high poverty. I believe it is vital that the authorities act now before things get considerably worse. Given that, I am pleased to see that there is broad agreement between staff and the authorities on the magnitude of the fiscal adjustment needed. As staff highlighted at the beginning of our discussion, it is clear that the crucial question here is the pace of adjustment. I have some sympathy with the authorities' desire to go slowly given the high level of poverty, but I think staff made a good case for frontloading that adjustment earlier, and I might add one more argument to that, which is that in my experience it is easier to slacken the pace of adjustment if you need to than it is to pick it up.

In terms of the question, it is along the same lines as Mr. Inderbinen. We asked a question in our gray about how the TA strategy might change given the track record of lower-than-desirable traction, and you talked about greater use of resident advisors, and I wonder if you could clarify whether there is a resident advisor and what your plans are in that space.

Ms. McKiernan made the following statement:

As you indicated in the report, progress on gender equality has been slow, and in 2019 Eswatini ranked 145 out of 189 countries on the Gender Inequality Index in the Human Development Report (HDR). Given that materiality, we would have appreciated such a finding being incorporated into the staff report itself and perhaps some policy advice, and we would welcome any observations by staff on the drivers of inequality and potential reforms given the scale of the issue.

Mr. Farber made the following statement:

We would like to thank staff for their answers to the technical questions and to Mr. Mahlinza and Mr. Ismail for their candid and direct buff statement, especially regarding the macroeconomic challenges of Eswatini, which actually if you put them on a ledger, there are far more that are heading in a negative direction than in a positive direction. We issued a gray, and we would like to highlight several points along the same lines as Mr. Ronicle and some of the other comments here on the pace of fiscal consolidation, because that clearly is the predominant point.

We welcome that the authorities recognize the need for fiscal consolidation, and they face an important policy question on the pace. In the answer to question 5 in the technical note, staff provided a compelling argument against delay, so we would like to strongly support staff's proposal that fiscal policies are unsustainable and would like them not to be exacerbated. Staff explains the delayed and more protracted adjustment would result in higher debt, about 12 percent of GDP, in additional financing needed, and arrears likely.

Just a general statement regarding debt, because Eswatini is a little bit of a good case study for that, which is if one purpose of debt is to amplify equity returns, then this does not seem to actually be effective for Eswatini. Increased public spending resulted in higher fiscal deficits and increased public debt, and in addition, high levels of individual leverage—so leverage on two sides—seem to have limited if no ability to increase growth, to increase productivity, or to increase inclusiveness in the country where 40 percent of the population is currently living below the poverty level.

Second, along the lines of structural reform, we would like to highlight the need for stronger attention to the quality of spending, which may be related to why increased debt has not resulted in increased improved economic conditions, so we welcome the renewed interest in supply-side and governance reforms of the new administration, reflected in the National Development Plan and strategic roadmap.

There is a quote attributed to Hillel which says, “If not now, when?” And we think that is very applicable in the case of Eswatini. Our hearts certainly go out to the people of Eswatini where one in four adults are afflicted with HIV or AIDS, and we urge the authorities to consider the pace of reforms and investing in human capital to better support private sector-led growth and reductions in poverty.

Mr. El Qorchi made the following statement:

Eswatini is facing a very difficult economic situation in a context of widespread poverty. The staff report highlights that an adjustment of 6 percent of GDP is needed to restore sustainability. It is ambitious; 6 percent is large. But the report also adds that this might have temporary adverse effects on growth. I would like to have an estimate of these measures on growth in the short run because this is only temporary. But the report adds to reduce poverty, stronger growth and more equal access to economic opportunities are critical to address the challenges of poverty and inequality, so a clarification also maybe is warranted.

Staff acknowledged that measures will be needed to mitigate the impact of this adjustment on the poor. At the same time in paragraph 49, it says these measures are needed to protect the poor from the proposed adjustment, but at the same time in paragraph 17, these measures will reduce only the adverse effects of the needed adjustment. Is it protect or reduce?

Mr. Fachada made the following statement:

I just wanted to make a specific comment about the Transparency Policy. We have heard Mr. Mahlinza. I think that his point about modification is very reasonable, but again I wanted to call the attention to the fact that the transparency policy has not been followed in this case again. According to the

Transparency Policy, agreement on modifications of staff reports should be agreed before the Board meeting so that in the Board meeting, the Board is communicated about the modification, or in case of disagreement, the Board can give its opinion about the request. So by delaying the decision about modification and not bringing to the Board the final views of staff and the authorities, the Board is being precluded from its role in giving an opinion about the requests for changes.

The Acting Chair (Mr. Zhang) made the following statement:

Thank you, Mr. Fachada. I think you raised the question again on how to implement the Transparency Policy. I think like last time we agreed at the Board that we will move ahead with the early review of the Transparency Policy, and then we will deal with that issue.

Mr. Palei made the following statement:

I just wanted to echo comments made by Mr. Fachada. I think it is very important to implement the Transparency Policy according to the current rules and, there are a few instances where there is disagreement in the interpretation of the Transparency Policy. So, it is very unfortunate that the transparency policy review has been delayed, and we look forward to an earleir consideration of these issues, and in the meantime, we would ask staff to stick to the rules of the current Transparency Policy. Thank you.

The staff representative from the African Department (Mr. Palomba), in response to further questions and comments from Executive Directors, made the following statement:

There were a number of questions or clarifications about fiscal policies and some apparent idiosyncrasies in some statements. Let me take the first point, which is what appears to be a tradeoff between short-term effects of fiscal policy on growth and the long-term objective to boost growth. When there is fiscal adjustment, there is a compression of domestic demand, so it is unavoidable that there are effects on short-term growth. The important point is that these effects are temporary and do not create long-term effects. The way the point is addressed by staff is that there are a number of opportunities during the fiscal adjustment to modify the fiscal policy, the structural fiscal policy, in order to support long-term growth. To give an example, the economy has clearly high wage. By focusing on the wage policy for the public sector, which is the largest employer in the country, we hope to change the wage dynamic in the entire economy. So there is an obvious short-term cost of fiscal adjustment, but the focus remains on creating the basis for stronger potential growth in the future, which is associated to what is the focus of this Article IV, reducing poverty and inequality.

The second point raised was whether we aim to improve the distributional effect of fiscal policy or just to limit the effect on the fiscal adjustment on the poor? I think the two things are pretty much related. By improving the distributional effect of the fiscal policy, wefocused on the lower part of the income distribution. These are the households which are cash constrained. So, by increasing the distributional power of fiscal policy, we are protecting that part of the population; but that part of the population is also the one that responds better to support because they have de facto very low saving rates. So, by increasing the distributional impact of fiscal policy as a structural objective, at the same time you are also protecting the poor from the impact of the fiscal adjustment. So, these are two things I do not see really much of the tradeoff, which may be just by resulting of some choice of wording.

There was a question about the TA burden on the fiscal side. The Fund has provided extensive TA on the PFM regulation. For us that was a high priority. The regulation will be drafted. Both FAD, AFRITAC, and the LEG Departments have helped in these efforts that give a sense of the resources we have made available. The authorities themselves have hired a consultant to review the governance structure of the SOEs and have advised on restructuring of some SOEs.

As a general strategy, what we have learned, is that hands-on TA is more effective than have just TA reports. Therefore, a large part of our TA now goes through AFRITAC. We had in the last three years, for example, on PFM issues two PFM reports and we have a PFM advisor there. He is going to be there for about another year, so it has already been extended once. We are looking forward to keeping our physical presence in Eswatini because we find it extremely useful, particularly at this juncture.

There was also a point about gender. Currently there was a release of the World Economic Forum (WEF) report last week about gender equality. Eswatini ranked 14 within Sub-Saharan Africa, so it is midway in the region. We do agree that gender inequality is a component of the larger inequality problem which is affecting the country. I think this is an issue that may have some attention for the next Article IV report.

The representative from the Strategy, Policy, and Review Department (Mr. Ahuja), in response to further questions and comments from Executive Directors, made the following statement:

As far as I am aware, the Board is informed of the requests and also of the nature of the corrections before the Board meeting—or at the beginning of the Board meeting. In the case of evident ambiguity, as it is here, staff do need to continue to discuss corrections. I think this way it prevents us from going into a higher bar like the post-Board modification, so we are actually following the current rules.

Mr. Fachada made the following statement:

This is an issue that has been recurrent here in Board meetings, for instance, in the case of Lebanon late last year. We discussed this also this year in the case of the United Arab Emirates, and others. The policy says, and I am quoting from the guidance note: "Requests for corrections are to be submitted before the Board meeting. This ensures that the Board has the correct information for its discussion and decisions." The Board should not only be informed about the request, but about staff's views as well. And my main concern is about the role of the Board in the process of requests for deletions, and I will quote again: "If the authorities disagree with staff, they or the Executive Director can present their concerns to management. In the case of serious disagreement between management and the member, the matter can be referred to the Executive Board by the Executive Director representing the member or by the Managing Director." So, the Board is the final fora to decide about any disagreement on deletions. But the fact that frequently staff says during the Board meeting that the issue is still being under consideration, precludes the Board from its responsibility to give an opinion in cases of disagreement.

In my interpretation, the policy is not being followed, but I am glad that you, Mr. Chair, has mentioned that we are going to have a review of the transparency policy soon. An early review of the policy is fundamental, and I think that this kind of situation needs to be discussed so that Directors can have more clarity.

Ms. Al Riffai made the following statement:

I have one small technical question to follow-up on Mr. Palomba's recent remark on the wage bill and how the public sector is the predominant employer in the Kingdom of Eswatini. Just to bring back the discussion to what you said, that by reducing the wage bill, we may be able to reduce the gap or change the dynamic of the average wage rate in the economy of

Eswatini to maybe towards encouraging more private sector employment, but in that case, typically the educational profile or background of civil servants and especially of the private sector may be different from the educational background and profile of those working in the private sector, at least for Eswatini, especially since you mentioned that some of the private sector employment is household employment. So how do you see that mismatch in educational backgrounds and profiles being impacted by that wage dynamic that you recently mentioned? And also it may be that especially since employment is, as you say, a determinant or has a positive correlation with reduced poverty prevalence in Eswatini, as in other countries, of course, and so if you can just expand and clarify on that dynamic and how you expect that reducing the wage bill and in turn the national wage would help employment in the private sector, if there do exist those educational background discrepancies.

The representative from the Strategy, Policy, and Review Department (Mr. Ahuja), in response to further questions and comments from Executive Directors, made the following additional statement:

I am not an expert on Transparency Policy, but my understanding from reading the guidance note of the Transparency Policy is that the request for correction has to go to the Board, before the Board meeting. I am not aware at all that the so-called verdict has to come to the Board before the Board meeting; and, in fact, sometimes these are complicated issues that cannot really be adjudicated, or discussion and engagement with the authorities may take more than two days, more than the amount of time required for the request to be submitted to the Board. In the end, as far as I am aware, management has the authority to override SPR on this or area departments on this.

The Acting Chair (Mr. Zhang) made the following statement:

In terms of guidelines, the procedure is quite clear, but the practice needs some clarification about whether or not is effective. The staff is trying to anticipate the Transparency Policy review, earlier than the scheduled date of October next year. Once we have a precise date, then we will let you know.

The staff representative from the African Department (Mr. Palomba), in response to further questions and comments from Executive Directors, made the following additional statement:

I think there are two issues to have in mind. There is the issue of a skills mismatch in the labor market, which is really a labor market issue, and it is a medium-term issue. What we observed is that the wages are much higher in relative terms to other countries for the high level of education. The level of unemployment is low for tertiary education. Why is there a different problem for the lower education? This is a labor market issue that will take time to address. It comes through the short-term policies like facilitating the permit for high-skilled workers through a more long-term policy towards the education system.

When I referred previously to the wage dynamics, I had in mind more about the role of the government in determining the level of wage growth, so if we take the period before the government recently introduced a freeze on wage, public wage increased in real terms about on average of 7 percent over 3 years before they start basically from 2014-2016, in real terms 7 percent; so that way is much stronger than the level of productivity. It actually goes in the other direction. So this gap between the wage and productivity has an effect on the competition of the country. By focusing on some elements of the fiscal policy, we expect this to translate in the dynamics of the wage in the private sector too.

There are two factors to which this may happen. One is that the lower level of public wage acts as the minimum level which people may accept a salary in the private sector, so it is a reservation wage. This is one element. The second is that setting high standards in terms of growth rate. At this point I would like to note also that about 60 percent of public employees belong to the first, to the size of the income distribution, so this is another element to keep in mind. What we see in the rest of the population is a totally different distribution of people across the size, so that policy has both in labor market impact, salary impact, and also some inequality component.

Mr. Mahlinza made the following concluding statement:

On behalf of my Eswatini authorities, I wish to thank Executive Directors for the constructive comments and support towards completion of the Article IV consultation for the Kingdom of Eswatini. Your invaluable advice will be conveyed to my authorities, and also maybe thank SPR for their response to the question on modifications to language and that they will look at that and also maybe at the same time indicate that we also look forward to the discussion at the Board on the review of the Transparency Policy.

I would like to start maybe with the interesting comment by Mr. Farber on the debt dynamics, and that is the case of Eswatini provides a good case study as debt in this case is not leading to growth and maybe just provide a different perspective to this. I want to provide the perspective that we also want to understand the rising debt within the context of a response to multiple shocks that have affected the economy in terms of droughts, in terms of terms of trade shocks, in terms of a decline in Southern African Custom Union (SACU) revenues. I think sometimes the debt dynamics that we are seeing here are likely a response to that where you have got already a high expenditure level, and you are trying to actually accommodate that, so it is not exactly going to lead to growth as expected.

Then I would like to also thank Directors for underscoring in their grays the importance of strong fiscal adjustment alongside structural and governance reforms to bring the economy to a sustainable development path. My authorities broadly concur with this advice and recognize that a fiscal adjustment of about 6 percent of GDP will be needed over the next few years to restore fiscal sustainability. However, they believe that a more gradual consolidation path will be more appropriate to mitigate the adverse spillover effects from the adjustment on growth and the vulnerable segments of the population. After slightly more than a year in office, the new government appreciates the enormity of the challenges facing the economy. They recognize that a comprehensive consolidation plan will require broad political support and have taken any steps along this path. The plan entails a combination of spending and revenue measures supported by public financial management and fiscal governance reforms.

On the expenditure side, the authorities will continue to control the wage bill and manage expenditures by containing new hiring while leveraging a temporary increase in SACU receipts to adjust public wages over a three-year freeze.

The authorities will also strengthen project selection criteria, tendering processes and management to optimize capital expenditure in line with the recent Public Investment Management Assessment (PIMA) recommendations. On the revenue side, the authorities will build on the revenue measures implemented in the context of the 2019-20 budget to mobilize additional revenues, including through excise tax increases, improving revenue collections, containing tax exemptions, and selling off government assets. In addition, the authorities plan to undertake PFM reforms to address fiscal sustainability risks, including putting in place a Treasury Single Account (TSA) and an integrated financial management information system. They will accelerate the operationalization of the Public Financial Management Act; and on public enterprise reform, the authorities have launched a comprehensive review of public enterprises and extra-budgetary entities, focusing on their mandates, governance, and operations to optimize the expenditures and enhance dividends. In addition, the authorities plan to accelerate improvements to the procurement system and develop an effective arrears clearance strategy to support consolidation.

On the monetary sector, the authorities wish to reiterate that the exchange rate peg has served the economy well, providing an effective policy anchor to contain inflation. They remain committed to strengthening the resilience of the financial sector through expediting the enactment of the Financial Institutions Act and the central bank law to strengthen oversight of the financial sector, bank resolution, and central bank independence. In addition, they are reviewing the Financial Service Regulatory Act and related loans to strengthen the nonbank financial institutions' framework. They will vigilantly monitor and manage vulnerabilities in the financial sector and develop a macroprudential framework.

My authorities acknowledge the need to step up social reforms to support inclusive growth and improve social outcomes. In this context, they reiterate their commitment to improving the regulatory and business environment, including liberalizing the economy to support private sector-led growth. They will continue to strengthen the anti-corruption framework following the passing into law of the Prevention of Organized Crimes Act in 2018 and the establishment of an asset forfeiture unit. They also plan to strengthen social safety nets to protect the poor while improving access to education to support human capital development and address poverty.

In closing, I wish to thank the mission chief, Mr. Geremia Palomba, and his team for the open and candid discussions with our authorities. I also wish to thank them for their comprehensive responses to questions raised by Executive Directors in their grays and oral interventions this morning. My authorities look forward to continued Fund advice and engagement in the design and implementation of their consolidation plan.

The Acting Chair (Mr. Zhang) noted that the Kingdom of Eswatini is an Article VIII member and no decision is proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They noted that Eswatini is at a critical juncture, with subdued growth, rising public debt, and depleting international reserves. Moreover, falling private investment and declining competitiveness are hindering growth prospects. Directors welcomed the recent fiscal measures to stabilize the economy and support growth and encouraged more decisive policy action to bring the economy back on a sustainable path. An ambitious structural reform agenda is key to promoting private-sector led growth and addressing poverty and inequality.

Directors recommended a credible medium-term fiscal adjustment plan to achieve debt sustainability and macroeconomic stability. Building on initial steps to rationalize expenditures, Directors emphasized the need for additional high-quality adjustment measures, while supporting long term growth and protecting the most vulnerable through better targeted social programs. Specifically, they encouraged the authorities to contain public wage spending and administrative expenses, rationalize transfers to state owned entities, prioritize capital projects, and broaden the tax base.

Directors underscored the importance of fiscal reforms to support consolidation efforts. They called for further steps to strengthen budget formulation and public financial management to restore fiscal discipline and contain the buildup in arrears. They also encouraged reforms to revamp the public procurement process, improve the efficiency and governance of public enterprises, and adopt a transparent arrears clearance strategy.

Directors concurred that, given the exchange rate peg to the South African rand, the central bank should maintain the policy rate broadly in line with the South African Reserve Bank's rate and refrain from providing further budget financing. They noted that stable monetary conditions and fiscal consolidation would help strengthen the country's external position and support the rebuilding of reserve buffers.

Directors noted that, while the financial sector is overall stable, vulnerabilities are rising. They highlighted the need to strengthen financial sector oversight and accelerate efforts to improve the regulatory and supervisory frameworks for the large non-bank financial sector, including through legislative changes. They also underlined the importance of establishing a macroprudential structure and developing crisis preparedness and management capacity, as well as addressing non-performing loans and the high concentration risks in the banking sector. Directors also supported enhancing the AML/CFT framework and looked forward to this year's planned assessment.

Directors welcomed the authorities' efforts to promote growth, job creation, and good governance, as articulated in the National Development Plan 2019 22 and the Strategic Roadmap. They stressed the importance of complementary supply side and governance reforms to support private investment and strengthen competitiveness. Directors agreed that structural reforms should aim to improve business conditions, address weaknesses in product and labor markets, and invest in human capital. Reform of the electricity and telecommunications industries is also key. Determined efforts are needed to reduce vulnerabilities to state capture and other forms of corruption.

It is expected that the next Article IV consultation with the Kingdom of Eswatini will be held on the standard 12-month cycle.

APPROVAL: September 23, 2022

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook, Risks, and Fund Engagement

1. *Given Eswatini's close economic links to South Africa, could staff comment on the latter's current economic trends and offer appropriate advice on how the authorities could mitigate risks from this source of external shocks?*

- The slowdown in South Africa is affecting Eswatini through various channels, albeit to varying degrees. As the largest economy in the region, South Africa has significant spillovers through SACU transfers, trade linkages, the financial sector, and monetary policy. SACU transfers and trade channels have generally been the most prominent spillover channels for Eswatini, affecting fiscal revenue and the current account balance, usually with some delay. South African banks in Eswatini are largely funded locally, thus financial linkages mainly operate through returns on Eswatini institutional investors' assets held in South Africa. In the context of the peg, changes in the SARB's monetary policy translate in changes in the CBE's monetary stance. More recently, the disruptions to Eskom's power generation capacity could contribute to power outages in Eswatini, which imports the bulk of its electricity from South Africa.
- Eswatini can enhance its overall resilience to external shocks through short- and medium-term policies. As stressed in the staff report, amongst others, it is important to rebuild external buffers through fiscal consolidation; reduce budget reliance on SACU revenue through better domestic revenue mobilization and a well-designed fiscal framework that deals with SACU revenue volatility. Over time, enacting structural and governance reforms to support private investment and improve competitiveness would also help to mitigate external risks.

2. *Can staff elaborate whether they foresee any balance of payments problems for Eswatini in the immediate future and is there any dialogue with the authorities on the value add of a possible Fund arrangement such as the SMP or PCI that may help address the many pressing challenges?*

- The outlook is fragile and subject to risks, but temporary factors provide some buffer against short-term balance of payments problems. Specifically, the temporary increase in the FY20/21 SACU revenue and the external loan recently contracted to repay domestic arrears provide temporary buffers against short-term balance of payments needs. In addition, external debt remains relatively low, and gross external financing needs are largely related to the amortization of medium and long-term capital project loans.

- The authorities have not made a request for a Fund arrangement and they are confident that implementing their current policies and future plans will restore macroeconomic stability. Should the outlook deteriorate, they could consider a Fund arrangement, and they have been informed of the Fund facilities available to Eswatini and the modalities surrounding any arrangement.

Fiscal Policy

3. ***The authorities have recently established special economic zones and are facilitating the set-up of selected large foreign investment projects. Can staff provide more details about these initiatives and their fiscal implications? Are the investment incentives expected to be paid off through durable growth and increased tax revenues in the medium term?***

- Leveraging the 2018 SEZs legislation, the authorities have recently authorized the creation of the two SEZs. The objective of the SEZs is to promote investments in the agriculture, mining and forestry sectors, with a view to support domestic beneficiation, and encourage FDI, job creation, and exports. The SEZs intend to achieve these objectives by facilitating access to infrastructure (roads, electricity, water, telecommunications) and financing, as well as by providing tax incentives (e.g., 20-year corporate tax exemption, partial relief from customs duties and VAT). The authorities are also facilitating the setting-up of some foreign investment projects, including in the agro-processing business.
- No fiscal cost-benefit analysis is available yet. The authorities believe that the SEZs can improve tax buoyancy by kick-starting the economy, and fostering job creation and export promotion. The budget costs of the SEZ will likely reflect a combination of costs of providing infrastructure, tax losses arising from tax incentives, and possible increase in personal income tax revenue if the SEZs generate truly greenfield investment with significant impact on job creation.

4. ***They [authorities] intend to follow a gradual consolidation strategy which includes some wage increases, completing ongoing projects and gradual reform of PEs. Could the staff comment on how much efficacious these measures can be, given the gravity of the problem and what are the expected difference in outcomes between the approach intended by the authorities and suggested by the staff in the short and medium-term?***

- See below.

5. ***Could staff elaborate on the implications of a more gradual fiscal adjustment, as suggested by the authorities, on the public debt and fiscal sustainability? Does staff have any quantitative estimates on this?***

- The pace of fiscal adjustment proposed by staff (6 percent of GDP over three years) is largely dictated by the government's tight budget financing constraints and the need to stabilize public debt dynamics and rebuild external buffers. Staff's front-loaded adjustment scenario allows for annual budgets to be fully financed, without further accumulation of domestic arrears. Furthermore, public debt would peak at around 42 percent of GDP before starting to decline in FY23/24, and the government's gross financing needs would gradually decline below the DSA risk threshold.
- A delayed and more protracted fiscal consolidation would result in further arrears accumulation, higher public debt, and smaller external buffers than under staff's adjustment scenario. For instance, if fiscal consolidation is postponed to FY21/22 and is phased-in equally over four years, the fiscal deficit would decline slowly and additional bridge financing of about 12 percent of GDP would be needed, which will likely translate in additional domestic arrears. Debt would peak at around 48 percent before starting to decline in FY24/25. A backloaded adjustment will carry larger interest costs, a slower buildup of international reserves, thus leaving the economy exposed to shocks. Moreover, further arrears build-up would negatively affect economic activity, as well as raise questions about the government's credibility and ability to adjust. Pushing the adjustment in the outer years would also pose the risk of policy reversal, with elections due in 2023.

6. ***We notice the authorities' plans to sell off some of the government assets. How large of a difference could these plans make for the overall debt sustainability?***

- The authorities are in the process of finalizing their asset sale plans and are targeting sales for around 0.6 percent of GDP. If the sale proceeds fully materialize as planned, they would contribute to cover government's financing needs but, given their magnitude, they would not meaningfully improve debt sustainability.

7. ***Given the authorities' preference for a more gradual consolidation strategy, could staff comment more specifically on what could be done to mitigate their concerns with capacity constraints to deliver reforms quickly and the adverse effects on growth in the near term?***

- To mitigate capacity constraints, extensive technical assistance has been provided in recent years, and additional hand-on TA would further help. Over the past three years, Eswatini has received FAD TA in the areas of expenditure rationalization, public investment management, public financial management, particularly cash management and budget formulation and execution, and customs administration. This TA has been complemented with a resident expert assisting with the implementation of cash budget procedures, commitment controls, and the IFMIS. Moreover, LEG has provided TA on the new PFM regulations. All these elements provide a strong backbone to develop and implement a fiscal consolidation strategy, and more hand-on TA may help to support specific government's policy efforts.

- Fiscal consolidation will, to some extent, negatively affect short-term growth and a number of factors can mitigate such effect. A credible medium-term fiscal consolidation plan, supported by a strategy to repay arrears, would improve confidence and likely mitigate the adverse effects of consolidation on growth. The repayment of some domestic arrears in FY2021 would temporarily boost growth and absorb part of the negative growth effect of front-loaded consolidation. Adverse effects can be further reduced by appropriately designing key measures to limit the impact on cash-constrained households, thus lowering fiscal multipliers. During the adjustment period, growth could be further supported by improvements in the efficiency of public investment, and broader supply-side and governance reforms to support private investment. It is worth noting that limited fiscal consolidation would equally weigh on growth through arrears accumulation and higher risks of macroeconomic instability.

Monetary and Exchange Rate Policies

8. ***Could staff elaborate on the role monetary and exchange rate policies (and in particular, modification of the peg regime) could play to complement and support the fiscal adjustments recommended in the report?***

- The peg has so far served Eswatini well given the links to South Africa and the benefits of low and stable inflation. Should staff's proposed fiscal adjustment and structural reforms package proceed as recommended, the peg would continue to contribute to macroeconomic stability. Under the peg, monetary policy is largely dictated by the SARB. Moving to a different exchange rate regime, if the authorities chose to do so, could be helpful if accompanied by a set of consistent policies. While a more flexible exchange rate would meaningfully absorb external shocks, monetary and fiscal policies would continue to be mindful of economic stability. Staff is of the view that under the current exchange rate regime, appropriate economic and structural policies would sustain growth and macroeconomic stability.

Financial sector

9. ***Could staff indicate the size of the non-bank financial sector relative to the banking sector?***

- The non-bank financial sector is large compared to the banking sector. In 2018, NBFI's gross assets amounted to about 105 percent of GDP (about 75 percent of GDP if assets managed by investment advisers are excluded), while assets of deposit-taking institutions (i.e., banks, building societies, saving and credit cooperative) amounted to about 40 percent of GDP.

10. ***Do staff possess a tentative timeline for further implementation of AML/CFT regulations, and what are the main impediments to progress in this area?***

- The authorities are conducting a national risk assessment that will be completed during 2020. The assessment is a high priority as will provide an informed view on gaps on the country's AML/CFT regime and inform risk-based supervision activities. Once the assessment is completed, an action plan can be developed. In the meantime, the CBE has embarked on strengthening its risk-based supervision framework, and has conducted a sectorial risk assessment for banks and forex bureaus. Additional work is needed in a number of areas as outlined in the staff report, and no timeline has been developed yet.

Structural and Governance Reforms

11. ***Can staff elaborate on the main causes of inaction by the authorities to implement the supply-side and governance reforms? Where possible, could staff prioritize the interventions that would put Eswatini on a private-sector led growth trajectory? Related to human capital, we would also welcome some updates on recent developments in education, employment, gender equality and public health, and how these factors are hindering growth and entrenching poverty.***

- After years of inaction, since taking office in November 2018, the new administration has swiftly developed supply-side and governance reform plans. The authorities have developed a National Development Plan and a Strategic Roadmap identifying high-priority actions. They have also set up an implementation monitoring unit to track progress under the strategic plan.
- Improving the quality of the regulatory and business environment would have the largest impact on growth and policies in these areas should be prioritized. High-impact actions in the short-term include: improving business conditions (e.g., expediting the setting up of business and contract enforcement, streamlining business regulations), revamping the public procurement process (e.g., strengthen the tender board, adopting procurement regulations, reviewing preferential treatment in procurement), and facilitating work permits for foreign skilled workers.
- Regarding human capital, Eswatini has approached near universal primary school enrollment and have brought the HIV/AIDS epidemic under control. However, net enrollment in secondary education remains below peer countries. Unemployment rate is high (23 percent in 2016) and concentrated among people with lower education. HIV prevalence remains elevated and affects disproportionally women. Progress in gender equality has been slow and in 2019 the country ranked 145 out of 189 countries on the gender inequality index in the Human Development Report.
- Staff's analysis shows that human capital indicators hinder growth and perpetuate poverty. Low secondary education attainments are strongly associated with higher poverty, and lower enrollment amongst children from poor households is likely to entrench poverty

across generations. Similarly, skills mismatches indicators are strongly associated with lower investment and growth.

12. *Can staff comment on whether Eswatini is working with the MDBs to support the quality and efficiency of education and health spending, which would support improvements in human capital?*

- In recent years, Eswatini has been working with MDBs and other donors to improve human capital. The World Bank has been focused on water and sanitation access, and has recently conducted an education sector spending review. The AFDB has provided project support in the agriculture, water supply and sanitation, and transport sectors. The USAID has also provided assistance focusing on the multi-sector HIV response funded through the United States' President's Emergency Plan for HIV/AIDS Relief (PEPFAR).

13. *We nonetheless would welcome more details on the concrete steps planned to improve governance and strengthen the anti-corruption framework.*

- The new government has made "to end of corruption and introduce a culture of excellence" one of the pillars of its development strategy. Some initial steps have been undertaken to contain cost overruns in procurement (strengthening the role of the Eswatini Public Procurement and Regulatory Agency), and a performance management system for ministers and permanent secretaries has been recently launched. The authorities are also working on streamlining regulations with a view to improving business conditions and reducing opportunities for corruption. Going forward, amongst others, the authorities plan to enhance centralized procurement processes, enacting new PFM regulations, review the governance framework of SOEs, bolster the AML/CFT framework, and strengthen the role and functions of the anti-corruption commission.

14. *We agree with the staff recommendations on supply-side and governance reforms to boost competitiveness and private investment, but think it could provide more advice on how best to sequence structural reforms. In particular, we would welcome staff comments on which measures should be prioritized to help address Eswatini's long-standing challenges with inequality.*

- While stronger and more inclusive growth is critical to address poverty and inequality over time, fiscal policy has an immediate and important role to play. There is room to enhance the redistributive and poverty-alleviating role of budget policies, including by scaling up the existing old age grant (in January 2020, the authorities increased this grant by 25 percent), introduce cash transfers towards households with children and, as the administrative capacity improves, targeting cash transfers. Moreover, increasing the progressivity of the personal income tax would help ameliorate inequality issues and provide additional resources to finance poverty-related programs.

- Over the medium term, a number of structural and governance reforms to support private investment could benefit the poor. The government's emphasis on developing the labor-intensive sectors such as agriculture and forestry, and on products market reforms that may reduce consumer prices (e.g., retail, telecommunication, electricity) would benefit the poor disproportionately more. Moreover, evidence suggests that improving access to higher education is strongly correlated with better job and income opportunities for the poor.

Others

15. ***We would be interested in staff's comments on why Fund advice has had limited traction? And how staff plan to adjust the approach to Technical Assistance in light of the "mixed" implementation of previous TA?***

- Implementation of Fund advice in recent years has been mixed, and one of the main factors delaying implementation has been political inertia in the 1-2 years preceding the 2018 elections. This has affected both Staff and TA's advice. Eswatini is a high intensity TA recipient with positive record of implementation of TA advice in some areas (e.g., wage bill containment, revenue administration) and more mixed outcome in other areas (e.g., budget formulation). The new government shares staff's economic analysis and is supportive of TA recommendations, thus accelerated implementation of Fund and TA advice is expected going forward.
- Eswatini receives adequate TA and better traction can be achieved by focusing on more hands-on assistance (e.g., recent PFM regulations, revenue administration progress, financial sector legislation) and the presence of permanent resident advisors.