Bank of Botswana

ANNUAL REPORT

2014

Board Members

(as at year-end 2014)

Linah K Mohohlo
Governor
(Chairman)

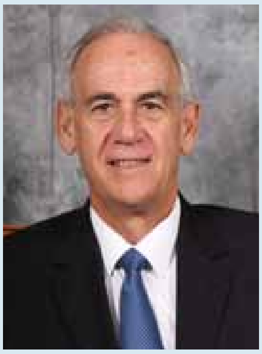
Gordon K Cunliffe

Solomon M Sekwakwa*

Caroline S Botlhole-Mmopi

Dr Joel Sentsho

Sir Paul Collier



Robert N Matthews

Dr Malebogo Bakwena

* Permanent Secretary, Ministry of Finance and Development Planning

Board Members

(as at year-end 2014)

Linah K Mohohlo

Governor

(Chairman)

Gordon K Cunliffe

Solomon M Sekwakwa*

Caroline S Botlhole-Mmopi

Dr Joel Sentsho

Sir Paul Collier

Robert N Matthews

Dr Malebogo Bakwena

* Permanent Secretary, Ministry of Finance and Development Planning

Contents – Part A

Statutory Report on the Operations and Financial Statements of the Bank – 2014

Contents – Part B

Boxes, Charts , Tables and Appendices

Boxes

Charts

Tables

Appendices

Abbreviations Used in the Report

AACB	Association of African Central Banks
AC	Audit Committee
BAB	Bankers Association of Botswana
BATC	Botswana Automated Clearing House
BIS	Bank for International Settlements
BISS	Botswana Interbank Settlement System
BITRI	Botswana Institute for Technology Research and Innovation
BoBCs	Bank of Botswana Certificates
BPC	Botswana Power Corporation
CCBG	Committee of Central Bank Governors
COMESA	Common Market for Eastern and Southern Africa
DTI	Debt-To-Income
ECH	Electronic Clearing House
EFTA	European Free Trade Area
EPA	Economic Partnership Agreement
EU	European Union
FCA	Foreign Currency Account
FDI	Foreign Direct Investment
FSI	Financial Soundness Indicators
FY	Fiscal Year
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
HHI	Hirschman-Herfindahl Index
ICT	Information and Communications Technology
IIP	International Investment Position
IMF	International Monetary Fund
IT	Inflation Targeting
ITU	International Telecommunication Union
LHS	Left Hand Scale
LIC	Low-Income Country
LTV	Loan-To-Value
MDG	Millennium Development Goal
MIC	Middle-Income Country
MoU	Memorandum of Understanding

MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
MTEF	MediumTerm Expenditure Framework
NBFI	Non-Bank Financial Institution
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
NDP	National Development Plan
NEER	Nominal Effective Exchange Rate
NFP	Net Financial Position
NIE	Newly Industrialising Economy
OMAC	Open Market Auction Committee
OMCC	Open Market Coordination Committee
OMO	Open Market Operations
PPP	Public Private Partnership
REER	Real Effective Exchange Rate
REMCO	Remuneration Committee
RHS	Right Hand Scale
SACU	Southern African Customs Union
SADC	Southern African Development Community
SDR	Special Drawing Right
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TFP	Total Factor Productivity
UK	United Kingdom
UMIC	Upper-Middle-Income Country
UNDP	United Nations Development Programme
USA	United States of America
USD	United States Dollar
VAT	Value Added Tax
WEF	World Economic Forum
WTO	World Trade Organisation

Part A

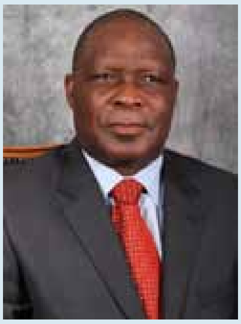
Statutory Report on the Operations and Financial Statements of the Bank for 2014

Bank of Botswana

Senior Management

(as at year-end 2014)

Deputy Governors



Oduetse A Motshidisi

Moses D Pelaelo

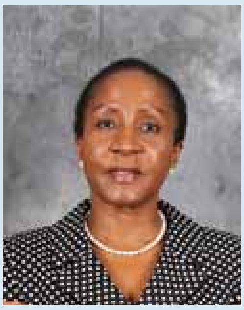
General Manager

Richard H Nlebesi

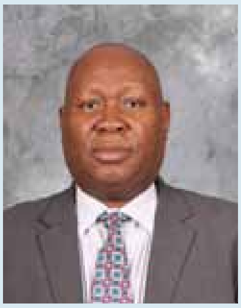
Heads of Department

Andrew M Motsomi
Banking Supervision

Julius Ghanie
Information Technology



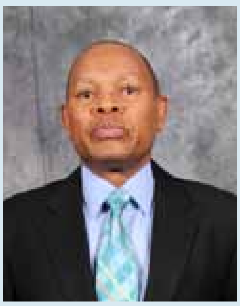
Ewetse T Rakhudu
Payments & Settlement



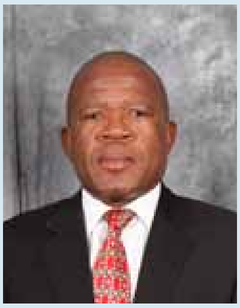
Ralesedi E Somolekae
Human Resources

Dr Kealeboga S Masalila
Monetary & Financial Stability

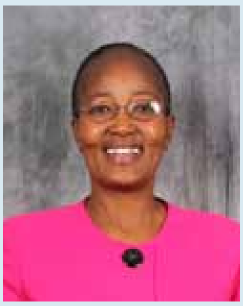
Pelani D Siwawa-Ndai
Secretariat



Daniel N Loeto
Finance



Sholo A Matale
Banking & Currency



Sheila M Sealetsa
Financial Markets (Acting)

GOVERNOR'S FOREWORD

The *Annual Report* for 2014 is published in accordance with Section 68(1) of the Bank of Botswana Act (CAP 55:01). In fulfilling the statutory requirements, the *Report* highlights the Bank's operational and financial performance for the year.

The *Report* also outlines the global and domestic economic and financial developments for 2014 as background to the Bank's formulation and implementation of monetary policy as well as implementation of the exchange rate policy. The Bank's other responsibilities, as indicated in the *Report,* relate to maintaining monetary and financial stability, a sound banking system and efficient payment systems, reserves management as well as economic and financial advisory role to the Government. Hence, the *2014 Annual Report* theme topic, *Preserving Macroeconomic Stability and Fostering Economic Growth,* highlights the challenges and policy choices for maintaining macroeconomic stability.

With respect to the Bank's financial performance, total assets grew by P11.1 billion to P79.7 billion between 2013 and 2014. This was mainly attributable to an increase in the foreign exchange reserves to P79.1 billion in December 2014, and equivalent to 18.5 months of imports of goods and services. The Bank's net income for the year was P4.1 billion compared to P7 billion in 2013. After transferring non-distributable currency gains of P1 billion to the Currency Revaluation Reserve, the net distributable income was P2.4 billion; this compares to P1.6 billion of 2013. The Government Investment Account increased by 40.8 percent in 2014 to P37.3 billion.

In the course of 2014, monetary and other policies were conducted in the context of sluggish economic performance and uncertain prospects for the world economy. Economic growth strengthened in the United States of America and, to a lesser extent, in the United Kingdom, while the Eurozone and Japan continued to face the threat of deflation. Although output growth for emerging market economies was robust overall, it varied between countries. Inflationary pressures remained generally benign as reinforced by a decline in international oil and food prices. The domestic economy recorded moderate growth of the non-mining sector, while expansion of mining boosted overall output.

Low global inflation, particularly in Botswana's trading partner countries, benefitted domestic prices. This was in the absence of major upward adjustments to administered prices and given the impact of monetary policy on demand. Inflation fell from 4.1 percent in December 2013 to 3.8 percent at year-end, thus remaining within the Bank's 3 - 6 percent medium-term objective range throughout the year. As a result, the Bank Rate was maintained at 7.5 percent during the year in light of the positive medium-term outlook. In order to encourage productive deployment of funds and market efficiency, the Bank conducted monetary operations with a view to limiting the amount of outstanding Bank of Botswana Certificates to P5 billion. Temporary liquidity shortfalls experienced by individual banks continued to be addressed through access to the interbank market and recourse to the Bank's overnight credit facilities.

The banking industry was soundly managed and profitable and the sector's balance sheet increased by 12.6 percent to P68 billion. Overall, credit growth slowed from 15.1 percent in 2013 to 13.5 percent in 2014. However, there was a divergence in trends between the business and household sectors, with growth in lending to households declining from 24.2 percent to 10.7 percent, and business credit increasing from 4.6 percent to 17.2 percent. The slower growth of household credit, in an environment of modest increase in personal incomes, augurs well for maintenance of financial stability. Moreover, loan default ratios remain low and the banks made sufficient provisions within a well-capitalised banking system.

The higher level of foreign exchange reserves was due to positive net foreign currency inflows as demand for exports strengthened and import growth slowed. Export competitiveness continued to be supported by the 0.16 depreciation of the nominal effective exchange rate and the resultant marginal 0.4 percent appreciation of the real effective exchange rate during 2014. The Pula was broadly stable against the South African rand; it depreciated against the United States dollar (8.3 percent) and appreciated against the euro (4 percent).

Both international sovereign credit rating agencies, Moody's Investors Service and Standard & Poor's, retained the investment grade ratings for Botswana. The ratings affirmed the on-going strengthening of the Government's financial position, as underpinned by prudent macroeconomic policies and strong external position. The agencies reiterated concern about the slow pace of economic diversification.

The Bank continued to implement measures in support of enhancing the efficiency and security of its operations. A new family of coin was launched in February 2014 in line with international best practice. The efficiency of the national and international payments system was enhanced given the growing importance of electronic payments. Skills development, through appropriate short and long-term training programmes, and staff welfare continued to be the cornerstone of capacity building initiatives during 2014.

In fulfilment of statutory obligations, the Bank's *Annual Report* and *Banking Supervision Annual Report* for 2013 were submitted to the Minister of Finance and Development Planning on March 31 and June 30, 2014, respectively. The monthly *Botswana Financial Statistics,* biannual *Business Expectations Survey* and *Research Bulletin* were also published.

External stakeholder relations were maintained during the year by way of, inter alia, economic briefings, consultations with relevant international bodies and institutions, such as the Association of African Central Banks, Committee of SADC Central Bank Governors, International Monetary Fund, World Bank and Bank for International Settlements.

As always, the Board was instrumental in ensuring that the Bank delivers on its mandate, as stipulated in, among others, the Bank's statutes, bye-laws and work programme(s).

It is anticipated that stakeholders will find the contents of the Bank's *Annual Report* for 2014 informative.

Linah K Mohohlo

GOVERNOR

STATUTORY REPORT ON OPERATIONS AND FINANCIAL STATEMENTS OF THE BANK – 2014

The Bank's Mission and Objectives

As provided in Section 4 (1) of the Bank of Botswana Act (CAP 55:01), the Bank's mission and primary objectives are:

- to promote and maintain monetary stability, which primarily requires the maintenance of a low, predictable and sustainable level of inflation;
- to ensure that the overall financial system is safe and sound;
- to regulate and oversee the payments system and ensure that it is secure and efficient; and
- in so far as it would not be inconsistent with monetary stability, to promote the orderly, balanced and sustainable economic development of the country.

Figure 1 shows the strategies, activities and supportive infrastructure that are utilised to achieve the aforementioned Bank's mission and objectives. Monetary stability is attained through the formulation and implementation of monetary policy. Banks are regulated and supervised to foster operational safety and soundness. Financial sector vulnerability assessment and performance monitoring are carried out to promote financial stability. Currency management entrenches confidence in the payments and settlement system and payments oversight by preventing systemic risks. The Bank also provides banking services to the Government, commercial banks and selected public institutions. As Government's agent, the Bank implements the exchange rate policy. Foreign exchange reserves enable the country to meet international financial obligations, and the Bank provides advice to Government on macroeconomic and financial policy matters. The governance structure coordinates and creates synergies between policy-oriented activities and supportive services, including human resource management and training, adoption of efficiency-enhancing technology, risk management, creating a culture of good conduct, staff discipline and adherence to institutional values.

Governance and Organisational Structure

The Board is at the apex of the governance structure of the Bank and has two Committees, Audit Committee (AC) and Remuneration Committee (REMCO). The Governor is chairman of the Board and Chief Executive Officer of the Bank; she oversees nine Departments and four Divisions, supported by two Deputy Governors and General Manager (Figure 2). The Governor and Deputy Governors are Presidential appointees.

Board Functions, Membership and Appointments

The Board oversees and guides the Bank's general strategic direction and operations in accordance with the Bank of Botswana Act and Bye-Laws. It comprises two ex-officio members, Governor and Permanent Secretary of the Ministry of Finance and Development Planning, as well as seven other members who are appointed by the Minister of Finance and Development Planning in their individual capacity, two of whom may be public officers. Six Board meetings were held during the year (Table 1). At year-end, the Board had two vacancies. The Governor and the two Deputy Governors (who are not Board members) are appointed by the President. The Audit Committee and Remuneration Committee are constituted and chaired by non-executive Board members; they consider issues pertaining to their respective mandates and make recommendations to the Board.

FIGURE 1: MISSION, OBJECTIVES, STRATEGIES AND SUPPORTIVE STRUCTURES

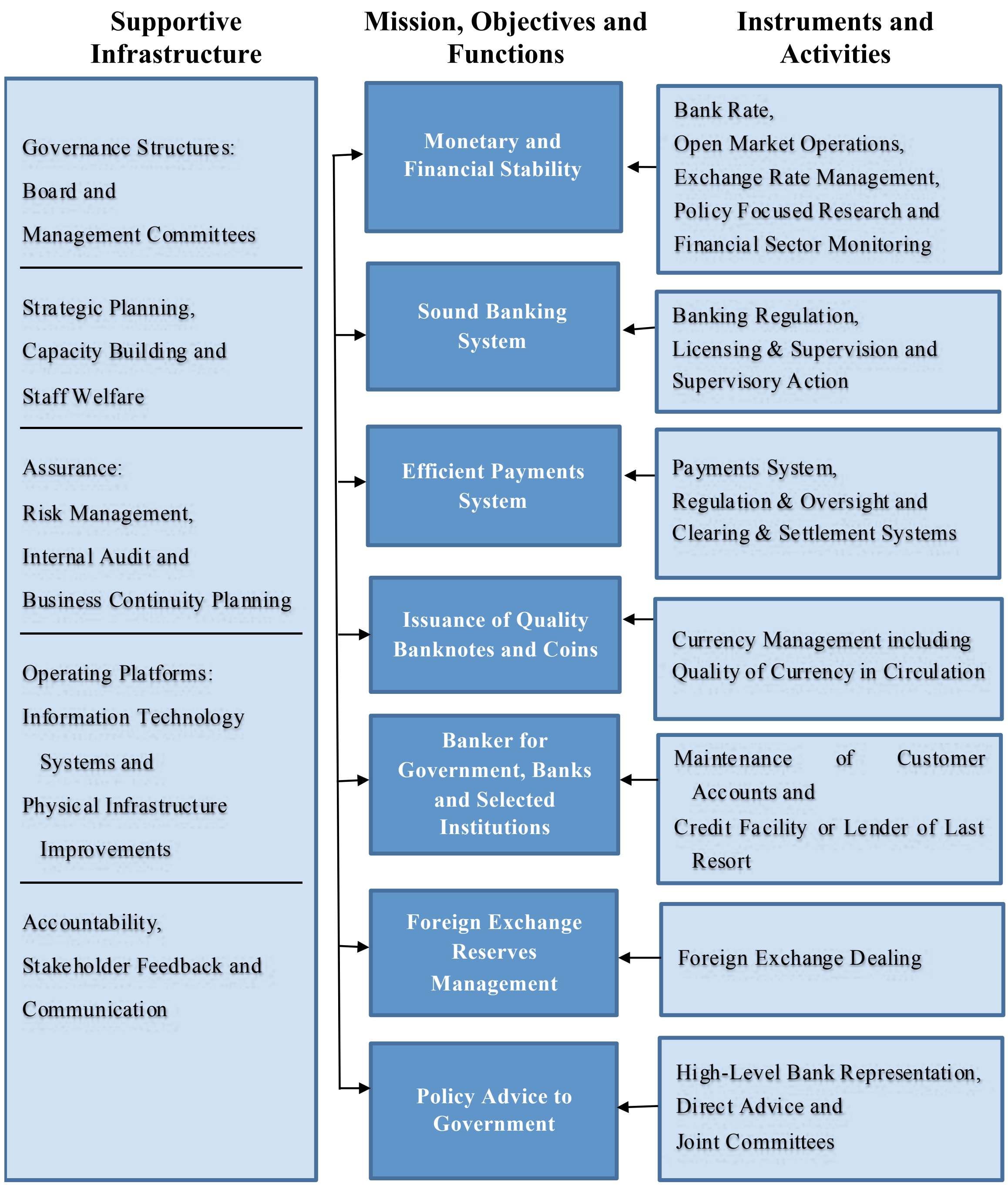
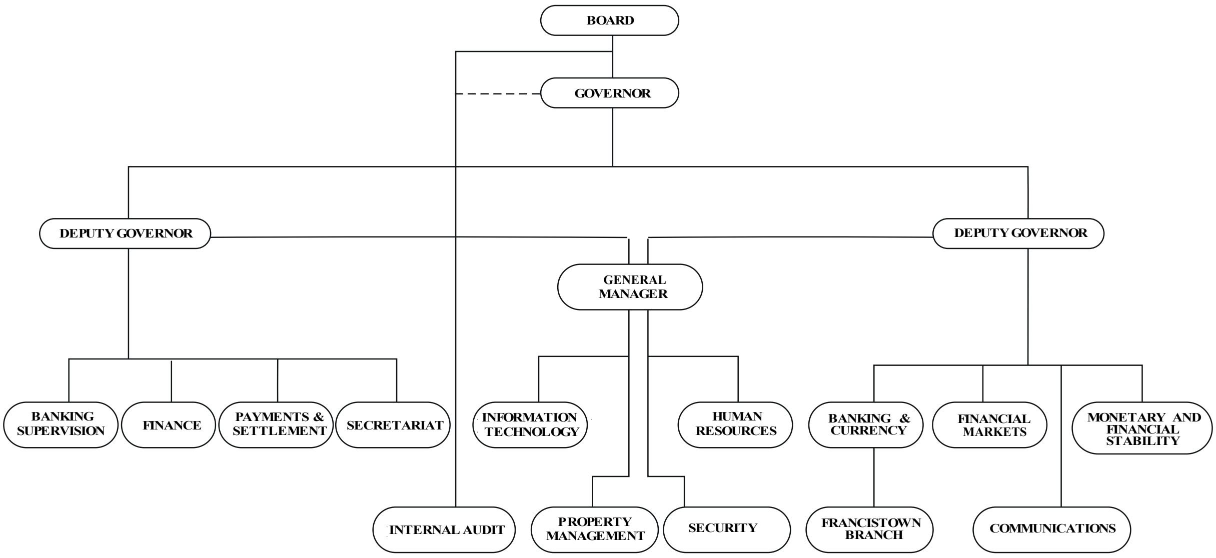


FIGURE 2: GOVERNANCE AND ORGANISATIONAL STRUCTURE AS AT DECEMBER 31, 2014



Source: Bank of Botswana

TABLE 1: BOARD MEETINGS AND ATTENDANCE IN 2014

Meeting	L K Mohohlo (Chairman Board)	S Sekwakwa (Ex-officio)	G K Cunliffe (Chairman AC)	R N Matthews (AC)	C S Botlhole-Mmopi (AC)	J Sentsho (REMCO)	P Collier (REMCO)	H Siphambe (Chairman REMCO)
BB 1/14 (Feb 21)	✓	✓	×	✓	✓	✓	×	✓
BB 2/14 (Mar 27)	✓	✓	✓	✓	✓	✓	×	✓
BB 3/14 (Jun 17)	✓	×	✓	✓	×	✓	×	N
BB 4/14 (Aug 29)	✓	×	✓	×	✓	✓	✓T	N
BB 5/14 (Oct 23)	✓	✓	×	✓	✓	✓	×	N
BB 6/14 (Dec 12)	✓	×	✓	✓	✓	×	✓T	N

Key:
- ✓ Attended
- × Not attended
- T Participation through video and teleconferencing
- BB Board Meeting
- N No longer a Board member

Governor, Deputy Governors and General Manager

The Governor implements Board decisions and, as stipulated in the Bank of Botswana Act, submits the *Annual Report* on the operations and financial performance (including audited financial statements) of the Bank to the Minister of Finance and Development Planning within three months of the end of the financial year. In turn, the Minister presents the *Annual Report* to Parliament within 30 days following receipt of the Report. The *Banking Supervision Annual Report* is submitted to the Minister by the end of June each year. The Governor represents the Bank at relevant local, regional and international meetings, and is the country's representative on the Board of Governors of the International Monetary Fund (IMF).

Executive Committee

The Executive Committee, which is chaired by the Governor, includes Deputy Governors, the General Manager and Heads of Department. Senior advisors may be co-opted as members. The Committee meets once a week to monitor and review the implementation of the Bank's work programme.

Departments and Divisions

Five policy Departments fulfil the Bank's core mandates, while the other four Departments provide auxiliary support and corporate services.

The Monetary and Financial Stability Department undertakes data collection, macroeconomic analysis, monitors the financial sector and evaluates emerging risks and other developments emanating from the macroeconomic environment, conducts macro-prudential assessments, and facilitates coordination with other relevant external entities to ensure macroeconomic and financial stability. The Department undertakes macroeconomic forecasting and policy review in support of the Bank's conduct of monetary policy, implementation of exchange rate policy and advice to the Government. Production and dissemination of the Bank's *Annual Report* and other publications are also the responsibility of the Monetary and Financial Stability Department.

The Banking Supervision Department regulates and supervises banks and other financial institutions that fall under the Bank's purview and publishes the *Banking Supervision Annual Report.* The management of foreign exchange reserves, foreign exchange dealing, open market operations and other money and capital market activities, which include issuance of government bonds, are undertaken by the Financial Markets Department. The oversight and regulation of payments and settlement transactions is carried out by the Payments and Settlement Department.

The Banking and Currency Department is responsible for the custody and issuance of the national currency, and provision of banking services to the Government, commercial banks and selected institutions. The Department is also a repository for the country's financial relations with the (IMF).

The Finance Department is responsible for accounting and reporting on the Bank's financial activities, including production of monthly and annual financial statements of the Bank, in accordance with the Bank of Botswana Act and International Financial Reporting Standards (IFRS). The Department also coordinates strategic planning, formulation and implementation of risk management and business continuity management. The Human Resources Department is responsible for staff recruitment, training, remuneration and welfare; while Information Technology Department ensures that the Bank's information technology systems and infrastructure are robust and effective in meeting the needs of the Bank.

The Bank's Secretariat serves the Board and Executive Committee and discharges related support functions. It is also responsible for the library, records management and protocol services. The other support services are undertaken through the specialised activities of four Divisions; viz., Internal Audit, Security, Communications and Property Management. The Internal Audit Division ensures that the Bank's operations are sound and comply with established internal controls and governance structures, in line with the Bank of Botswana Act and international best practice. The Security Division has the primary responsibility of managing all safety and security-related risks within the Bank and all its facilities. The Communications Division is responsible for the coordination of communications activities, media relations and effective transmission of information on the Bank's mandate, policies and practices to stakeholders in a timely and efficient manner. The Division also coordinates the Bank's Public Education Programme and policies with the aim of promoting financial literacy as well as improving public understanding of the Bank's role in the economic development of the country. The

Property Management Division undertakes procurement, custody and maintenance of immovable and movable assets, including the Bank's real estate and related equipment.

REVIEW OF THE BANK'S MAIN ACTIVITIES IN 2014

Monetary Policy, Money and Capital Market Activities and Exchange Rate Policy

Monetary Policy

The 2014 Monetary Policy Statement and the Mid-Term Review maintained the medium-term inflation objective range of 3 - 6 percent. Inflation fluctuated, but remained within the Bank's medium-term objective range in 2014, peaking at 4.6 percent in February 2014 due to the impact of the upward adjustment of the alcohol levy as well as higher costs of health and education. The subsequent decline in inflation was due to a general moderation of the pace of price increases, which included the reduction in fuel prices and the dissipation, at the end of the year, of the effect of the previous year's increase in the alcohol levy. Thus, inflation decreased from 4.1 percent in December 2013 to 3.8 percent in December 2014. In the circumstances, and given a positive outlook for inflation, the Bank Rate was maintained at 7.5 percent for the year.

Money and Capital Markets

Monetary policy was implemented using Open Market Operations to absorb excess liquidity and interest rates were maintained at levels that were consistent with the policy stance. Due to the decline in excess liquidity, the value of Bank of Botswana Certificates (BoBCs) fell from P5.5 billion at the end of 2013 to P4.2 billion in December 2014. Repurchase Agreements (repos) and reverse repos were used during the year to manage liquidity between auctions; P0.56 billion worth of reverse repos was outstanding at the end of 2014 compared to zero at the end of 2013. There were no repos outstanding at the end of 2014 compared to P0.3 billion at the end of 2013 (Table 2 and Chart 1).

TABLE 2: MONEY MARKET 2013-2014

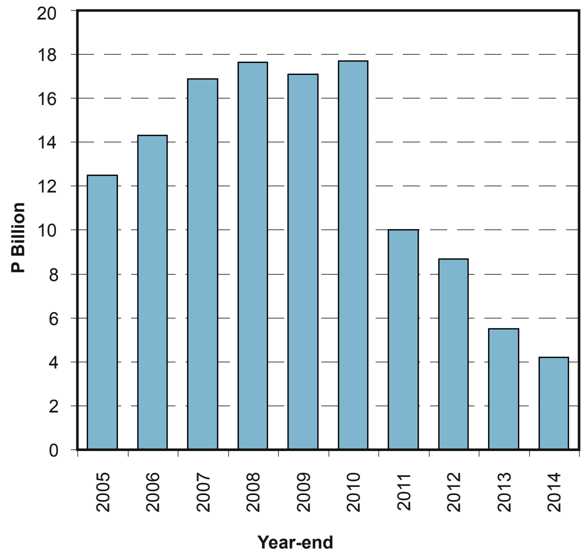
	End-2013			End-2014		
	Outstanding balances[2] (P Billion)	Interest rate (Percent)[1]		Outstanding balances[2] (P Billion)	Interest rate (Percent)[1]	
		Nominal	Real		Nominal	Real
3-month Treasury Bills[3]	0.34	5.38	-1.17	–	–	–
6-month Treasury Bills[1,3]	0.34	3.38	-0.90	0.54	3.25	-0.53
14-day BoBCs[1]	2.27	3.06	-1.00	0.85	3.07	-0.70
3-month BoBCs[1]	3.23	3.58	-0.50	3.36	3.19	-0.59
Reverse repos	0	3.00	-1.06	0.56	3.00	-0.77
Repos	0.30	7.00	2.79	0	7.00	3.08
88-day deposits	4.91	2.58	-1.46	4.40	2.67	-1.09
Prime rate		9.33	5.02		9.00	5.01

1. Stop-out yield is used for Treasury Bills, while weighted average yield is used for 14-day and 91-day BoBC yields.
2. Book value
3. Original date to maturity

Source: Bank of Botswana

The 14-day BoBC weighted average yield increased slightly from 3.06 percent in December 2013 to 3.07 percent in December 2014, while the yield on the 91-day BoBC fell from 3.58 percent to 3.19 percent in the

Chart 1: Bank of Botswana Certificates 2005 – 2014



Source: Bank of Botswana

same period.[1] The prime lending rate for commercial banks was 9 percent throughout 2014. Meanwhile, the nominal 3-months deposit interest rate increased from 2.58 percent at the end of 2013 to 2.67 percent in December 2014. In line with the Bank's commitment to encourage savings, commercial banks continued to offer and advertise the 91-day deposit facility or equivalent deposit product which pays an interest rate that, at a minimum, is the prevailing Bank Rate less 3.5 percentage points,[2] with higher interest rates for longer-dated deposits. Real interest rates on deposits generally rose due to the reduction in inflation in 2014, and were marginally positive for longer dated deposits by year-end.

The P15 billion Government Bond Programme remains in place with the focus on the development of the capital market, while providing an alternative source of government funding. The Government increased borrowing from the domestic market in 2014, with outstanding bonds of various maturities and Treasury Bills rising from P6.7 billion at the end of 2013 to P7.2 billion in December 2014 (Table 3).

Table 3: Government Bonds and Treasury Bills 2013–2014

	End 2013			End 2014		
	Outstanding	Market Yields[3] (Percent)		Outstanding	Market Yields[3] (Percent)	
Bond Code[4]	(P Million)	Yield	Real	(P Million)	Yield	Real
3-month Treasury Bills	340	5.38	-1.17	–	–	–
6-month Treasury Bills	340	3.38	-0.90	540	3.25	-0.53
BW003 (31/10/2015)	1 642	4.21	0.11	1 642	3.97	0.16
BW010 (14/03/2017)	618	4.64	0.52	718	4.52	0.69
BW005 (12/09/2018)	1 233	4.86	0.73	1 233	4.78	0.94
BW008 (08/09/2020)	858	5.46	1.31	933	5.35	1.49
BW007 (10/03/2025)	1 295	5.85	1.68	1 295	5.83	1.96
BW011 (10/09/2031)	399	6.24	2.06	870	6.28	2.39
	6 725			**7 231**		

1. Where outstanding values differ for the same bond code between the two years, it means the bond was reopened for issuing an additional amount after the initial issue.
2. Book value.
3. Market yields are indicative yields.
4. Date of maturity is in brackets.

Source: Bank of Botswana

1 The 91-day BoBCs are only auctioned at the beginning of each month, so the recorded yield for the 91-day BoBC for the end of December 2013 was determined prior to the December MPC meeting, where the Bank Rate was reduced by 50 basis points.

2 Given the Bank Rate of 7.5 percent, the minimum deposit interest rate was 4 percent for the 91-day deposit.

Exchange Rate Policy

Consistent with the crawling band exchange rate policy, the Bank implemented the 0.16 percent downward crawl of the nominal effective exchange rate (NEER) and maintained the Pula basket weights at 55 percent South African rand and 45 percent Special Drawing Rights (SDR) in 2014. However, the rate of depreciation of the NEER was slightly lower than the differential between domestic and trading partner countries' inflation, thus resulting in a marginal 0.4 percent appreciation of the real effective exchange rate (REER) by year end.

Supervision and Regulation of Banks and Bureaux de Change

The banking sector remained safe, sound and stable, with adequate capital levels and profitability indicators. However, there were signs of short-term liquidity stress across the sector in the latter half of the year, as well as a marginal decline in asset quality during the year. Nevertheless, most banks satisfied both prudential and other regulatory requirements (Table 4).

Four licence applications for commercial banking business were received during the year. One applicant was granted conditional approval, two were not successful (i.e., either rejected, or returned on account of inadequate information), while the other application was deferred. Two commercial banks[3] voluntarily surrendered their banking licences during the year, thus reducing the total number of licenced commercial banks to 11 as at December 31, 2014. The Bank licensed two bureaux de change, while two had their licences revoked for failure to comply with the foreign exchange regulations. One bureau de change surrendered its licence after failing to commence operations, subsequent to being granted temporary closure for six months, thus bringing the number of total operating bureaux de change to 56 as at December 31, 2014.

Banks continued to expand their delivery channels/footprints countrywide, albeit at a slower rate. Two branches were opened during the year, compared to eight in 2013. Automated teller machines (ATMs) and other delivery service channels, such as mobile phones and internet-based services, were also used extensively to provide access to finance to the public. Furthermore, banks introduced 24 new products and/or services during the year.

Abandoned funds continued to be administered in accordance with Section 39 of the Banking Act (CAP. 46.04). As at December 31, 2014, abandoned funds balances had decreased to P5.1 million, compared to P8.2 million in December 31, 2013.

TABLE 4: FINANCIAL SOUNDNESS INDICATORS AND RANGE OF PRUDENTIAL STANDARDS FOR LICENSED BANKS (2011 - 2014)

	Prudential Standard[1]	Range of Prudential Standard for Local Banks (Percent)			
		2011	2012	2013	2014
Capital Adequacy	≥1 5	16.0 – 28.5	17.3 – 24.2	16.2 – 24.3	16.1 – 23.1
Liquid Asset Ratio	≥ 10	10.0 – 52.4	12.4 – 51.4	12.0 – 36.0	10.5 – 19.6
Profitability (Return on Assets)	Positive	0.6 – 5.0	0.8 – 4.5	0.7 – 4.0	0.2 – 3.8
Profitability (Return on Equity)	Positive	7.2 – 39.0	9.2 – 39.1	6.0 – 32.0	2.1 – 27.7
Asset quality[1] (Non-performing Loans/Total Loans)	≤ 2.5	0.6 – 6.3	1.7 – 14.4	0.6 – 11.6	0.6 – 11.8
Intermediation (Advances/ Deposits)	≥ 50	49.3 – 86.4	52.5 – 84.4	63.0 – 86.0	68.7 – 94.9

1. For ratios that do not have statutory or prudential limit, use the 5 years average.
2. New banks are excluded to avoid distortion of data.

Source: Bank of Botswana

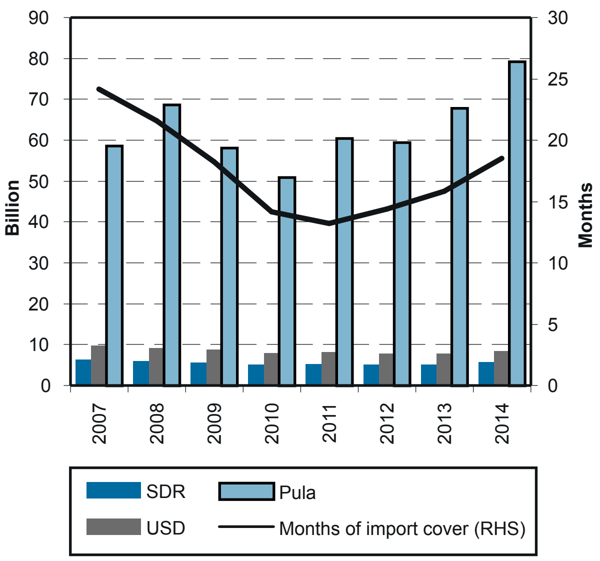
3. These were ABN AMRO Bank (Botswana) Limited and ABN AMRO (Botswana) OBU Limited.

In order to enhance supervisory cooperation and collaboration among regulatory authorities, the Bank finalised and signed Memoranda of Understanding (MoUs) with the Competition Authority and Botswana Accountancy Oversight Authority.

Foreign Exchange Reserves Management

The foreign exchange reserves increased by 16.7 percent from P67.8 billion in December 2013 to P79.1 billion in December 2014. The increase in foreign exchange reserves is due to net foreign exchange inflows and the depreciation of the Pula against major international currencies. In terms of months of import cover, the reserves were equivalent to 18.5 months in December 2014, having increased from 15.8 months of December 2013 (Chart 2).

Chart 2: Foreign Exchange Reserves



Source: Bank of Botswana

Currency Operations and Issues

Following a comprehensive review of the national currency, a new family of coin was introduced and officially launched in February 2014. This was in line with international best practice of reviewing banknotes and coin periodically, taking into account changes in technology, security features, counterfeiting risk, inflation, cost of currency production, as well as social and economic circumstances of the country.

Consequent to the issuance of the new family of coin, the old coin was demonetised with effect from August 28, 2014. The old coin is, however, exchangeable for equivalent value only at the Bank of Botswana in Gaborone and Francistown for a period of five years until August 28, 2019.

The number of banknotes in circulation increased by 0.5 percent in 2014, mainly due to an increase in the net issuance of the P200 banknote denomination, which increased by 17 percent between 2013 and 2014. The net issuance of all coin denominations increased by 31.7 percent in 2014, compared to a decrease of 12.2 percent in 2013. The decrease in 2013 was mainly attributed to the rationing of stock of old coin in anticipation of the introduction of the new family of coin, while the increase in 2014 was a result of the introduction and issuance into circulation of new coin effective February.

Payments and Settlement

The utilisation of electronic means of payment continues to expand, as payments undertaken through cheques consistently registered a decline during 2014, while both Electronic Funds Transfer (EFT) and Botswana Inter-Bank Settlement System (BISS) payments increased, thus indicating that there are more payments made electronically than by cheques. The volume and value of cheque transactions fell by 12 percent and 7.9 percent, respectively, in 2014 (Chart 4). In contrast, EFT transactions through the electronic clearing house (ECH) increased by 13.3 percent in volume and 22.6 percent in value in 2014 (Chart 5). The number of transactions settled in the BISS increased by 6.9 percent in 2014, while the value decreased by 5.3 percent (Chart 3). The Botswana Automated Clearing House (BACH) project was commissioned in February 2015 and encompasses a cheque imaging and truncation process that has enabled a reduction in the cheque clearing cycle to two days.

CHART 3: BOTSWANA INTER-BANK SETTLEMENT SYSTEM (BISS) TRANSACTIONS (2008-2014)

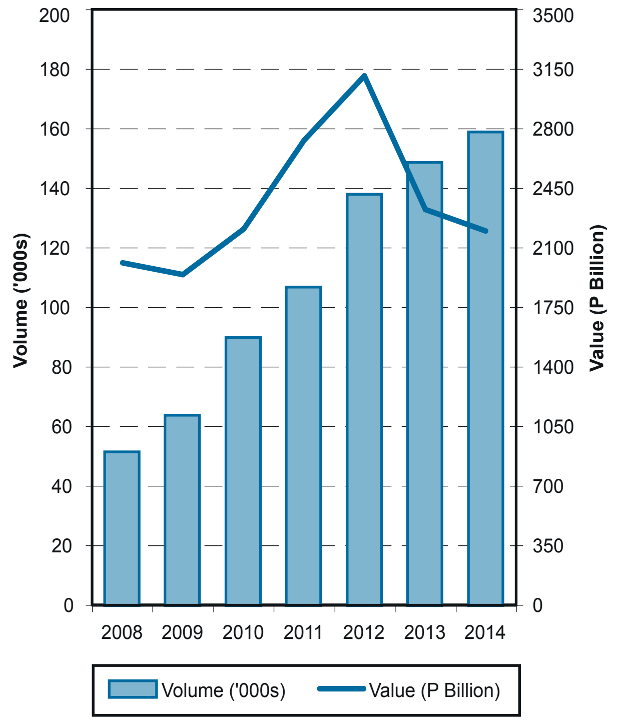
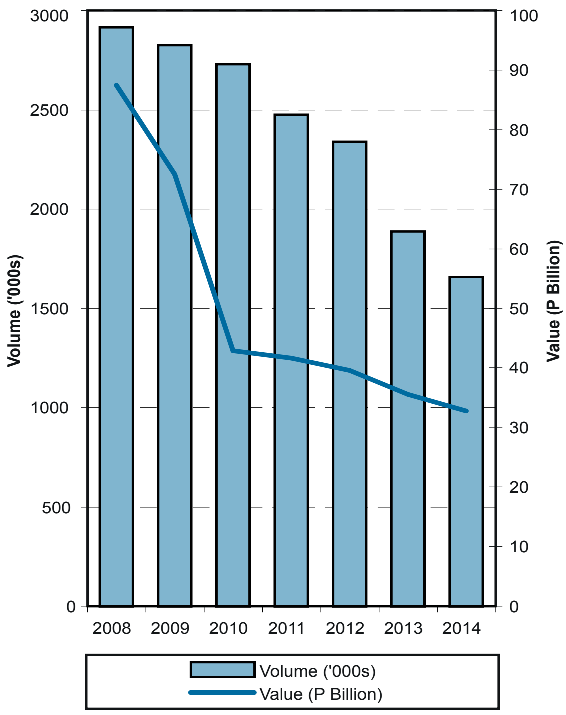


CHART 4: ELECTRONIC CLEARING HOUSE: CHEQUE PROCESSING (2008 - 2014)

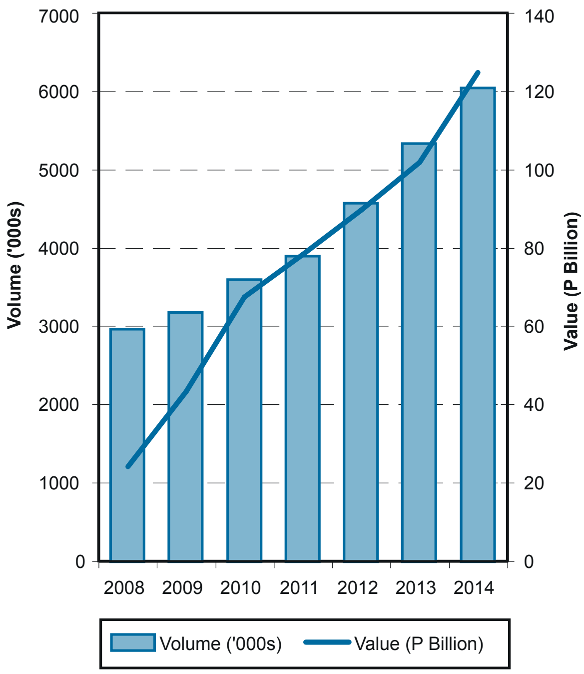


Source: Bank of Botswana

Information Technology

As part of the Botswana Automated Clearing House (BACH) project, data transfer lines between the Bank and the Bankers Association of Botswana (BAB) were configured to facilitate connection and transmission of data between the Bank's Item Processing Centre and the BACH. Mandatory updates to the SWIFT application were effected in November 2014. These were meant to address enhancement requests by the industry, as well as the addition of new features deemed necessary to improve the system functionality.

CHART 5: ELECTRONIC CLEARING HOUSE: ELECTRONIC FUNDS TRANSFERS (2008-2014)



Source: Bank of Botswana

Human Resources, Staff Welfare and Staff Pension Fund

Human Resources and Staff Welfare

As at December 31, 2014, the Bank's Staff Establishment was 593. The vacancy level rate fell by 9.1 percent compared to 10.1 percent in 2013. Twenty-three new staff joined the bank, while 30 terminated employment. The Bank continues to place emphasis on staff development and, in this regard, several staff members benefited from both short and long-term training.

Staff Pension Fund

The Bank of Botswana Defined Contribution Staff Pension Fund declared an investment return for the year ended September 30, 2014 of 21 percent and 20.44 percent, compared to the 2013 declared return of 30.69 percent and 30.13 percent for the active and deferred members, respectively.

External Relations and Communication

External Relations

During 2014, the Bank participated in relevant regional and international meetings, as well as hosting consultation, surveillance and technical assistance missions. Internationally, the Bank participated at meetings and conferences of the World Economic Forum, Bank for International Settlements (BIS), World Bank and International Monetary Fund (IMF), while at regional level, it was represented at meetings of Southern African Customs Union (SACU), SADC Committee of Central Bank Governors (CCBG) and the Association of African Central Banks (AACB). In addition, the Bank hosted the international sovereign credit rating agencies, Moody's Investors Service and Standard & Poor's to conduct the annual review of the credit ratings.

Publications, Communications and Public Education

In accordance with statutory requirements, the *2013 Annual Report* on the Bank's operations and financial statements and the *2013 Banking Supervision Annual Report* were submitted to the Minister of Finance and Development Planning by March 31, 2014 and June 30, 2014, respectively. The 2014 Monetary Policy Statement (and Mid-Term Review), monthly *Botswana Financial Statistics* and *Research Bulletin* were also published, while the Bank's website provided timely access to data, publications, press releases and the Bank's policies.

In fulfilment of accountability and transparency principles of governance, and in implementation of the public outreach programme, the Bank conducted economic briefings following the publication of the *2013 Annual Report*. Among the key stakeholders briefed were the Cabinet, heads/representatives of diplomatic missions, heads of public and private sector institutions, senior government officials and the media. Other public relations activities included participation at exhibitions and career fairs.

ANNUAL FINANCIAL STATEMENTS

2014

BANK OF BOTSWANA

CONTENTS

Statement of Responsibility of the Board and Approval of the Annual Financial Statements

The members of the Board are responsible for the preparation and fair presentation of the annual financial statements of the Bank, comprising the Statement of Financial Position at December 31, 2014, Statement of Profit or Loss and Other Comprehensive Income, Statement of Distribution, Statement of Cash Flows and Statement of Changes in Shareholder's Funds for the year then ended, and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes, in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

The members are also responsible for such internal control as the members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and for maintaining adequate accounting records and an effective system of risk management.

The members have made an assessment of the ability of the Bank to continue as a going concern and have no reason to believe that the Bank will not be a going concern in the year ahead.

The auditor is responsible for reporting on whether the annual financial statements are fairly presented in accordance with the applicable financial reporting framework.

Approval of Annual Financial Statements

The annual financial statements of the Bank, as identified in the first paragraph, were approved by the Board on March 27, 2015 and signed on behalf of the Board by:

Linah K Mohohlo

Governor

Gordon K Cunliffe

Board Member

(Audit Committee Chairman)

KPMG

KPMG, Chartered Accountants
Audit
Plot 67977, Off Tlokweng Road,
Fairground Park
PO Box 1519, Gaborone, Botswana

Telephone +267 391 2400
Fax +267 397 5281
Web http://www.kpmg.com/

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE BOARD OF BANK OF BOTSWANA

We have audited the financial statements of the Bank of Botswana, which comprise the Statement of Financial Position at December 31, 2014, Statement of Profit or Loss and Other Comprehensive Income, Statement Of Distribution, Statement of Cash Flows and Statement of Changes in Shareholder's Funds for the year then ended and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes as set out on pages 31 to 63.

Board Members' Responsibility for the Financial Statements
The members of the Board are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01), and for such internal control as the members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements, plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, these financial statements give a true and fair view of the financial position of Bank of Botswana at December 31, 2014 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

KPMG
Certified Auditors
Practising Member: A.G Devlin (19960060.23)

Gaborone
March 27, 2015

KPMG, a partnership domiciled in Botswana and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Partners: AG Devlin* NP Dixon-Warren FJ Roos**
G Motsamai
*British ** South African
VAT Number: P03623901112

STATEMENT OF FINANCIAL POSITION

December 31, 2014

	Notes	2014 P'000	2013 P'000
ASSETS			
Foreign Assets			
Liquidity Portfolio	1.1	22 723 901	16 845 007
Pula Fund	1.2	54 757 524	49 326 918
International Monetary Fund (IMF)			
Reserve Tranche	2.1	430 044	422 311
Holdings of Special Drawing Rights	2.2	1 178 929	1 157 062
General Subsidy Account	2.3	20 907	20 531
Total Foreign Assets		79 111 305	67 771 829
Domestic Assets			
Property and Equipment	3	413 618	412 089
Government of Botswana Bonds	4	24 137	24 942
Repurchase Agreements	9.1	–	302 078
Other Assets	5	140 821	88 389
Total Domestic Assets		578 576	827 498
TOTAL ASSETS		79 689 881	68 599 327
LIABILITIES AND SHAREHOLDER'S FUNDS			
Foreign Liabilities			
Allocation of IMF Special Drawing Rights	6	789 694	778 784
Liabilities to Government (IMF Reserve Tranche)	7	364 435	356 703
Total Foreign Liabilities		1 154 129	1 135 487
Domestic Liabilities			
Notes and Coin in Circulation	8	2 598 609	2 381 516
Bank of Botswana Certificates	9	4 201 384	5 490 723
Reverse Repurchase Agreements	9.1	304 357	-
Deposits	10	6 841 828	6 957 393
Dividend to Government	11	544 689	780 655
Other Liabilities	12	214 974	145 861
Total Domestic Liabilities		14 705 841	15 756 148
Total Liabilities		15 859 970	16 891 635
Shareholder's Funds			
Paid-up Capital	14	25 000	25 000
Government Investment Account			
Pula Fund and Liquidity Portfolio		37 260 622	26 463 736
Currency Revaluation Reserve		19 728 010	18 750 076
Market Revaluation Reserve		5 216 279	4 868 880
General Reserve	15	1 600 000	1 600 000
Total Shareholder's Funds		63 829 911	51 707 692
TOTAL LIABILITIES AND SHAREHOLDER'S FUNDS		79 689 881	68 599 327
FOREIGN ASSETS IN US DOLLARS (000)[1]		8 322 509	7 739 543
FOREIGN ASSETS IN SDR[2] (000)		5 751 392	5 021 893

1 United States dollar/Pula – 0.1052 (2013: 0.1142)
2 SDR/Pula – 0.0727 (2013: 0.0741)

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
Year ended December 31, 2014

	Notes	2014 P'000	2013 P'000
INCOME			
Interest – Foreign exchange reserves	16	1 147 416	1 073 446
Dividends – Foreign exchange reserves	17	472 768	394 783
Interest – Government of Botswana bonds		2 000	2 000
Net gains from fair value changes on disposal of securities	18	1 446 836	1 003 790
Net realised currency gains	19	3 711 730	2 413 870
Net unrealised currency gains	20	–	3 100 846
Profit on foreign exchange deals		31 380	30 535
Other income		13 475	10 981
		6 825 605	8 030 251
EXPENSES			
Interest expense	22	196 168	368 552
Administration costs		507 414	465 611
Depreciation expense	3	25 975	15 498
Net unrealised currency losses	20	2 024 881	-
Net unrealised losses from fair value changes	21	1 398	169 041
		2 755 836	1 018 702
NET INCOME		4 069 769	7 011 549
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified subsequently to profit or loss			
Net unrealised currency gains on non-monetary "available-for-sale" financial instruments		192 732	1 162 362
Net unrealised gains from fair value changes on "available-for-sale" financial instruments		1 749 190	2 886 528
		1 941 922	4 048 890
TOTAL COMPREHENSIVE INCOME		6 011 691	11 060 439

STATEMENT OF DISTRIBUTION
Year ended December 31, 2014

	Note	2014 P'000	2013 P'000
TOTAL COMPREHENSIVE INCOME		6 011 691	11 060 439
Net unrealised currency gains on non-monetary "available-for-sale" financial instruments		(192 732)	(1 162 362)
Net unrealised gains from fair value changes on "available-for-sale" financial instruments		(1 749 190)	(2 886 528)
NET INCOME		4 069 769	7 011 549
TRANSFER TO CURRENCY REVALUATION RESERVE	23	(1 621 302)	(5 425 058)
NET INCOME TO GOVERNMENT		2 448 467	1 586 491
TRANSFER TO GOVERNMENT INVESTMENT ACCOUNT		(1 378 778)	(430 836)
DIVIDEND		(700 000)	(500 000)
RESIDUAL NET INCOME	11	(369 689)	(655 655)

STATEMENT OF CASH FLOWS
Year ended December 31, 2014

	Notes	2014 P'000	2013 P'000
OPERATING ACTIVITIES			
Cash generated from/(used in) operations	26	1 690 789	(2 482 825)
INVESTING ACTIVITIES			
Net (investments)/withdrawals from foreign exchange reserves		(7 756 804)	1 194 160
Interest received from Government of Botswana bonds		2 000	2 000
Proceeds from disposal of property and equipment		847	47
Purchase of property and equipment	3	(28 487)	(35 350)
NET CASH (USED IN)/GENERATED FROM INVESTING ACTIVITIES		(7 782 444)	1 160 857
FINANCING ACTIVITIES			
Dividend to Government	11	(1 305 655)	(2 679 770)
Government Investments		7 180 217	3 895 038
NET CASH GENERATED FROM FINANCING ACTIVITIES		5 874 562	1 215 268
NET INCREASE IN CURRENCY IN CIRCULATION		(217 093)	(106 700)
CURRENCY IN CIRCULATION AT BEGINNING OF THE YEAR		(2 381 516)	(2 274 816)
CURRENCY IN CIRCULATION AT YEAR-END		(2 598 609)	(2 381 516)

STATEMENT OF CHANGES IN SHAREHOLDER'S FUNDS

Year ended December 31, 2014

	Paid-up Capital P'000	Currency Revaluation Reserve P'000	Market Revaluation Reserve P'000	General Reserve P'000
BALANCE AT JANUARY 1, 2013	25 000	14 408 783	3 487 449	1 600 000
Total profit and other comprehensive income	–	1 162 362	2 886 528	–
Net unrealised currency gains on non-monetary "available for sale" financial instruments	–	1 162 362	–	–
Net unrealised gains from fair value changes on "available for sale" financial instruments	–	–	2 886 528	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	(2 246 127)	(1 505 097)	–
Net unrealised gains from fair value changes	–	–	(1 505 097)	–
Net unrealised currency gains	–	(2 246 127)	–	–
Excess of Government's share of net income from Pula Fund over dividend	–	–	–	–
Government Investments	–	–	–	–
Transfer to Currency Revaluation Reserve	–	5 425 058	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2013	25 000	18 750 076	4 868 880	1 600 000
Total profit and other comprehensive income	–	192 732	1 749 190	–
Net unrealised currency gains on non-monetary "available for sale" financial instruments	–	192 732	–	–
Net unrealised gains from fair value changes on "available for sale" financial instruments	–	–	1 749 190	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	(836 100)	(1 401 791)	–
Net unrealised gains from fair value changes	–	–	(1 401 791)	–
Net unrealised currency gains	–	(836 100)	–	–
Excess of Government's share of net income from Pula Fund over dividend	–	–	–	–
Government investments	–	–	–	–
Transfer to Currency Revaluation Reserve	–	1 621 302	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2014	25 000	19 728 010	5 216 279	1 600 000

Government Investment Account P'000	Accumulated Profit P'000	Total P'000	
18 386 638	-	37 907 870	**BALANCE AT JANUARY 1, 2013**
–	7 011 549	11 060 439	Total profit and other comprehensive income
–	–	1 162 362	Net unrealised currency gains on non-monetary "available for sale" financial instruments
–	–	2 886 528	Net unrealised gains from fair value changes on "available for sale" financial instruments
–	7 011 549	7 011 549	Net income
8 077 098	(430 836)	3 895 038	Transfers (to)/from Government Investment Account:
1 505 097	–	–	Net unrealised gains from fair value changes
2 246 127	–	–	Net unrealised currency gains
430 836	(430 836)	–	Excess of Government's share of net income from Pula Fund over dividend
3 895 038	–	3 895 038	Government Investments
–	(5 425 058)	–	Transfer to Currency Revaluation Reserve
–	(500 000)	(500 000)	Dividend to Government
–	(655 655)	(655 655)	Residual net income
26 463 736	–	51 707 692	**BALANCE AT DECEMBER 31, 2013**
–	4 069 769	6 011 691	Total profit and other comprehensive income
–	–	192 732	Net unrealised currency gains on non-monetary "available for sale" financial instruments
–	–	1 749 190	Net unrealised gains from fair value changes on "available for sale" financial instruments
–	4 069 769	4 069 769	Net income
10 796 886	(1 378 778)	7 180 217	Transfers (to)/from Government Investment Account:
1 401 791	–	–	Net unrealised gains from fair value changes
836 100	–	–	Net unrealised currency gains
1 378 778	(1 378 778)	–	Excess of Government's share of net income from Pula Fund over dividend
7 180 217	–	7 180 217	Government investments
–	(1 621 302)	–	Transfer to Currency Revaluation Reserve
–	(700 000))	(700 000)	Dividend to Government
–	(369 689)	(369 689)	Residual net income
37 260 622	–	63 829 911	**BALANCE AT DECEMBER 31, 2014**

SIGNIFICANT ACCOUNTING POLICIES
December 31, 2014

REPORTING ENTITY

The Bank of Botswana (the Bank) is the central bank of Botswana established under the Bank of Botswana Act (CAP 55:01). The address of the Bank's registered office is 17938 Khama Crescent, Gaborone. These financial statements apply to the financial year ended December 31, 2014. The Government is the Bank's sole shareholder.

BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

Statement of Compliance
The principal accounting policies applied in the preparation of the financial statements are stated below. These policies have been consistently applied to all the years presented and comply with International Financial Reporting Standards in all material respects.

The Financial Statements were authorised for issue by the Board on March 27, 2015.

Basis of Measurement
The financial statements are prepared on a historical cost basis, modified by fair value accounting for available-for-sale financial assets, all derivative contracts, financial assets and liabilities that are held at fair value through profit or loss.

Functional and Presentation Currency
The financial statements are presented in Pula, which is the Bank's functional currency. Except as otherwise indicated, financial information presented in Pula has been rounded to the nearest thousand.

ADOPTION OF REVISED STANDARDS AND INTERPRETATIONS

As at the date of finalisation of the financial statements, the following standard was relevant to the Bank's operations and available for adoption.

Standard	Effective for annual periods beginning on or after
IAS 32 – *Financial Instruments: Disclosures* – Amendments enhancing disclosures about the effect of offsetting arrangements. These amendments require entities to disclose information that will enable the users of the financial statements to evaluate the effect or potential effect of netting arrangements of financial assets and liabilities, including rights of set-off associated with the entity's recognised financial assets and liabilities, on the entity's financial position. The amendments had no impact on the Bank's financial statements.	January 1, 2014

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

As at the date of finalisation of the financial statements, the following standards, relevant to the Bank's operations, are in issue and have not yet been adopted in the financial statements.

Standard	Effective for annual periods beginning on or after
Amendment to IAS 16 - Clarification of Acceptable Methods of Depreciation The clarification states that the revenue-based methods of depreciation are not acceptable, as these methods reflect generation of economic benefits by the asset, and not consumption of the asset. The Bank uses the straight line method of depreciation, and not the revenue-based method, hence the amendment will have no impact on the Bank's financial statements.	January 1, 2016
Amendments to IAS 1 - Disclosure Initiative The amendments clarify that information should not be obscured by aggregating or providing immaterial information: materiality considerations must apply to all parts of the financial statements; and that even when a standard requires a specific disclosure, materiality considerations must apply. Adoption of the amendments is not expected to have any impact on the financial statements of the Bank.	January 1, 2016
IFRS 15 – Revenue from Contracts with Customers The standard replaces IAS 18 Revenue and other revenue standards. It contains a single model that applies to contracts with customers and two approaches to recognising revenue at a point in time or over time. The model features a contract-based five step analysis of transactions to determine whether, how much and when revenue is recognised. The Bank is currently in the process of performing a more detailed assessment of the impact of this standard on its financial statements.	January 1, 2017
IFRS 9 - Financial Instruments (Replacement of IAS 39) IFRS 9 published in July 2014 replaces IAS 39 Financial Instruments: Recognition and Measurement. Financial assets and liabilities are to be classified and measured based on the entity's business model on which they are held, and the characteristics of their contractual cash flows. IFRS 9 includes revised guidelines on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets and the new hedge accounting requirements. The Bank is assessing the full potential impact on its financial statements that will result from the adoption of IFRS 9. Early adoption is permitted, but the Bank will adopt it by December 31, 2018.	January 1, 2018

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

FINANCIAL INSTRUMENTS

General
Financial instruments carried on the Statement of Financial Position include all assets and liabilities, including derivative instruments, but exclude property and equipment and other assets (prepayments, VAT receivables, sundry receivables and sundry receipts).

Fair Value Measurement
"Fair value" is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

The Bank measures the fair value of a financial instrument using the quoted price in an active market for that particular instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When quoted prices in an active market are not available, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

Financial Assets
Financial assets are initially measured at fair value plus, in the case of financial assets not at fair value through profit or loss, incremental direct transaction costs and subsequently accounted for depending on their classification as either loans and receivables, held to maturity, fair value through profit and loss or available-for-sale.

Loans and Receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These arise when the Bank provides a service directly to a counterparty. Loans and receivables (as well as prepayments, advances to banks and staff advances) are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method less any identified impairment losses at the end of each reporting period.

Financial Assets at Fair Value through Profit or Loss
Financial assets are classified as fair value through profit or loss when the financial asset is held for trading. The Bank holds short-term investments as held for trading.

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling it in the short-term or if so designated by management. Financial assets at fair value through profit or loss are stated at fair value, with any realised and unrealised gains and losses arising from changes in the fair value of financial assets recognised in profit or loss in the year in which they arise.

Short-term Investments (Liquidity Portfolio)
The Bank has designated the Liquidity Portfolio as a fund in which money market instruments and bonds are invested to facilitate payments for regular transactions.

Securities invested in this portfolio are measured "at fair value through profit or loss" and are classified as held for trading. They are initially recognised at fair value and are subsequently remeasured at fair value based on bid prices. All related realised and unrealised gains and losses are recognised in profit or loss.

All purchases and sales of investment securities in the portfolio are recognised at trade date, which is the date the Bank commits to purchase or sell the investments.

The realised and unrealised gains and losses recognised in profit or loss exclude interest and dividend income. Derivatives are classified as held for trading.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

FINANCIAL INSTRUMENTS (Continued)

Available-For-Sale
Available-for-sale assets are non-derivative financial assets that are designated as available-for-sale or are not classified as another category of financial instruments. Available-for-sale instruments are intended to be held for long periods of time but may be sold in the normal course of business of the Bank.

Long-term Investments (Pula Fund)
This is a long-term fund intended to maximise returns and is invested in foreign financial instruments. These investments, which may be sold in response to needs for liquidity, changes in interest rates, exchange rates, etc., are classified as "available-for-sale", except for derivatives. These securities are initially recognised at fair value (which includes transaction costs) and are subsequently remeasured at fair value, based on bid prices.

All realised currency gains/losses are recognised in profit or loss. Unrealised currency gains/losses on monetary items are also recognised in profit or loss. The unrealised currency gains/losses on non-monetary items are recognised in other comprehensive income. However, in line with the Bank's policy, all currency gains/losses for this fund are not distributable and are, therefore, appropriated to the Currency Revaluation Reserve.

Realised fair value changes are recognised in profit or loss. Unrealised fair value changes are recognised in other comprehensive income. Unrealised gains and losses arising from fair value changes of the instruments classified as "available-for-sale" are non-distributable as per the Bank's policy and are appropriated to the Market Revaluation Reserve. When these instruments are disposed of or impaired, the related accumulated fair value or impairment adjustments are included in profit or loss as gains or losses from investment securities.

All purchases and sales of investment securities in the portfolio are recognised at trade date, which is the date the Bank commits to purchase or sell the investments.

Government of Botswana Bonds
The Bank acquires Government of Botswana bonds for purposes of facilitating orderly trading in the local bond market. The bonds, which may be sold in response to the need to intervene in the market, are classified as "available-for-sale" securities.

The bonds are initially recognised at fair value and are subsequently remeasured at fair value, based on bid prices. All unrealised gains and losses arising from changes in the fair value are recognised in the Market Revaluation Reserve. When these instruments are disposed of or impaired, the related accumulated fair value adjustments are included in profit or loss as gains or losses from Government of Botswana bonds.

All purchases and sales of bonds are recognised at trade date, which is the date that the Bank commits itself to purchase or sell the bonds.

The unrealised currency gains or losses on non-monetary available-for-sale items are recognised in other comprehensive income under the heading "net unrealised currency gains or losses on non-monetary "available-for-sale" financial instruments".

When investments are disposed off or determined to be impaired, the cumulative unrealised currency gains or losses previously accumulated are reclassified to profit or loss.

Derivative Instruments
The Bank uses a variety of derivative instruments to manage its exposure to interest rate and foreign exchange risks, including interest rate futures, foreign exchange forward contracts, cross-currency swaps and options.

Derivative instruments are initially recognised at fair value (including transaction costs) and are subsequently remeasured at fair value, based on bid prices for assets held or liabilities to be issued, and ask/offer prices for assets to be acquired or liabilities held. The resulting gain or loss is recognised in the profit or loss.

Impairment of Financial Assets
Financial assets other than loans and receivables are carried at fair value. "Loans and receivables" are assessed for any evidence of impairment at each Statement of Financial Position date. Financial assets are impaired when there is objective evidence that as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been adversely impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. In respect of "available-for-sale" equity securities, any increase in fair value subsequent to an impairment loss is recognised directly in other comprehensive income.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

FINANCIAL INSTRUMENTS (Continued)

Financial Liabilities
All the Bank's financial liabilities are classified as other financial liabilities at amortised cost. Financial liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method.

Derecognition
The Bank derecognises a financial asset when it loses control over the contractual rights that comprise the asset and transfers substantially all the risks and benefits associated with the asset. This arises when the rights are realised, expire or are surrendered. A financial liability is derecognised when its contractual obligations are discharged, cancelled or expire.

Other Financial Liabilities
Other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on the effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts future cash payments through the expected life of the financial liability, or where appropriate, a shorter period.

Bank of Botswana Certificates
As one of the primary tools for maintaining monetary stability in the economy, the Bank of Botswana issues its own paper, Bank of Botswana Certificates (BoBCs), to absorb excess liquidity in the market and thereby influence short term interest rates. BoBCs are issued at a discount to counterparties. They are classified as "other financial liabilities".

The Bank's liability in respect of BoBCs is stated at offer prices on auction date, adjusted for movements in matured and unmatured discount recognised in profit or loss.

CREDIT FACILITY

Under the Credit Facility, the Bank provides emergency and intermittent funding to solvent banks, intended to bridge intra-day and overnight liquidity shortages. The advances are secured by Government of Botswana bonds and Bank of Botswana Certificates (BoBCs), valued at fair value prices on the date of the transaction. Only high quality, marketable and freely transferable paper with a minimum amount of risk is acceptable as collateral at the discretion of the Bank. Government bonds and Government guaranteed securities of any maturity and other eligible paper with a remaining maturity of 184 days or less are also acceptable as security. The Bank has the right to call for additional collateral, should the value of the security decline during the tenure of the facility. Interest earned on the advances is credited to profit or loss, while advances outstanding as at the Statement of Financial Position date are recorded under "other assets".

SECURITIES LENDING PROGRAMME

The Bank takes part in a Securities Lending Programme. Where securities are lent, the Bank holds collateral in the form of cash or other securities. The securities lent continue to be recorded in the Bank's Statement of Financial Position.

The Bank's global custodian administers the Securities Lending Programme and monitors the securities lent and related collateral against requirements agreed by the Bank.

The Bank records income from lending securities as it accrues.

REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

This facility is one of the mechanisms designed to deal with short-term liquidity fluctuations in the domestic money market. It is available to primary counterparties which are solvent institutions licensed and supervised by the Bank.

The term of a repurchase agreement and reverse repurchase agreement can vary from overnight to 92 days, depending on the liquidity conditions in the domestic market.

Interest earned by the Bank on repurchase agreements and interest paid by the Bank on reverse repurchase agreements is recognised in profit or loss.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

FINANCIAL INSTRUMENTS (Continued)

OFFSETTING FINANCIAL INSTRUMENTS

The Bank offsets financial assets and liabilities and reports the net balance in the Statement of Financial Position where:

(a) There is a legally enforceable right to set off; and
(b) There is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

FOREIGN CURRENCIES

All transactions denominated in foreign currencies are translated to Pula at the mid exchange rate at the transaction date. All assets and liabilities denominated in foreign currencies are translated to Pula using mid rates of exchange at the close of the financial year. Foreign currency differences arising on translation are recognised in profit or loss, except for unrealised exchange differences arising on translation of non-monetary "available-for-sale" financial instruments, which are recognised in other comprehensive income. However, all gains and losses relating to disposals whose proceeds are reinvested in foreign assets, and all the unrealised gains/losses arising on financial instruments are not considered distributable in terms of Bank policy; they are appropriated to the Currency Revaluation Reserve.

NON-FINANCIAL ASSETS, LIABILITIES AND RECOGNITION OF PROVISIONS

Non-financial Assets
Non-financial assets are recognised when the Bank obtains control of a resource as a result of past events, and from which future economic benefits are expected to flow to the Bank.

Contingent Assets
The Bank discloses a contingent asset arising from past events where it is probable that economic benefits will flow from it, but this will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events outside the control of the Bank.

Liabilities and Provisions
The Bank recognises liabilities (including provisions) when:

(a) It has a present legal obligation resulting from past events;
(b) It is probable that an outflow of resources embodying economic benefits will be required to settle this obligation; and
(c) A reliable estimate of the amount of the obligation can be made.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

INCOME AND EXPENSE RECOGNITION

Interest income on all assets is calculated using the effective interest method and is recognised in profit or loss. The 'effective interest rate' is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses. The calculation of the effective interest rate includes transaction costs that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the statement of profit or loss and other comprehensive income include:

(a) interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis; and
(b) interest on available-for-sale investment securities calculated on an effective interest rate basis.

Dividends on available-for-sale equity instruments are recognised in profit or loss when the right to receive payment is established. Usually, this is the ex-dividend date for quoted equities.

GENERAL RESERVE

Under Section 7(1) of the Bank of Botswana Act, (CAP 55:01), the Bank of Botswana is required to establish and maintain a General Reserve sufficient to ensure the sustainability of future operations of the Bank. The Bank may transfer to the General Reserve funds from other reserves, which it maintains, for the purposes of maintaining the required level of the General Reserve.

CURRENCY REVALUATION RESERVE

Any changes in the valuation, in terms of Pula, of the Bank's assets and liabilities in holdings of Special Drawing Rights and foreign currencies as a result of any change in the values of exchange rates of Special Drawing Rights or foreign currencies and in realised currency gains reinvested in foreign assets are transferred to the Currency Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

MARKET REVALUATION RESERVE

Any changes in the value of the Bank's long-term investments as a result of any change in the fair values of such investments are transferred to the Market Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

GOVERNMENT INVESTMENT ACCOUNT

The Government Investment Account, which was established on January 1, 1997, represents the Government's share of foreign exchange reserves in the Pula Fund and Liquidity Portfolio.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less related accumulated depreciation and any accumulated impairment losses.

Land and buildings are carried at cost. These are valued on a fair value basis every two years, and the recoverable (revalued) amounts disclosed by way of a note to the Financial Statements, providing that revalued amounts are in excess of the carrying amounts. Where the carrying amounts are more than the revalued amounts, an impairment loss is recognised in profit or loss.

At each Statement of Financial Position date, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Any impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

If significant parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Depreciation
Depreciation is charged so as to write-off the cost of assets less residual values, other than land and buildings under construction, over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation methods are reviewed at each year end, with the effect of any changes in the estimate accounted for on a prospective basis.

The annual depreciation rates used in the calculation of depreciation are as follows:

	Percent
Buildings	2.5 – 6
Other Assets	
Furniture, fixtures and equipment	5 – 25
Computer hardware	25
Computer software	20
Motor vehicles	5 – 25

A gain or loss arising on disposal or retirement of an item of property and equipment is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Capital works in progress comprise costs directly attributable to the construction of an asset. Assets remain in capital works in progress until they have become available for use or commissioned, whichever is the earlier date. At that time, these assets are transferred to the appropriate class of property and equipment as additions and depreciated.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

RETIREMENT BENEFITS

Pension benefits are provided for employees through the Bank of Botswana Defined Contribution Staff Pension Fund, which is governed in terms of the Pension and Provident Funds Act (CAP 27:03). The contribution per pensionable employee is at the rate of 21.5 percent of pensionable salary, which comprises 16 percent and 1.5 percent payable by the Bank as its contribution to the Fund and for administration costs of the Fund, respectively, and a 4 percent contribution by each pensionable employee. Other than the contributions made, the Bank has no commitments or obligations to this Fund. Obligations for contributions to the pension fund are recognised in profit or loss in the periods during which services are rendered by employees.

SHORT-TERM EMPLOYEE BENEFITS

Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
December 31, 2014

PROPERTY AND EQUIPMENT (Continued)

FINANCE LEASES

Assets held by the Bank under leases that transfer to the Bank substantially all of the risks and rewards of ownership are classified as finance leases. The leased asset is initially measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognised in the Bank's statement of financial position.

RELATED PARTY TRANSACTIONS

The Bank enters into various transactions with other wholly owned or partly owned Government institutions and its key management personnel (related parties). All related party transactions are entered into at arm's length in the ordinary course of business. The transactions with key management personnel are staff benefits provided under the General Conditions of Service of the Bank.

SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Useful Lives of Property and Equipment
Management reviews the estimated useful lives of property and equipment at the end of each annual reporting period. In this financial year, no change was made to the useful lives, hence the depreciation rates provided are similar with the prior year.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
December 31, 2014

		2014 P'000	2013 P'000
1.	**FOREIGN EXCHANGE RESERVES**		
1.1	**Liquidity Portfolio**		
	Bonds: held for trading	9 559 860	9 941 332
	Amounts due from Pula Fund	784 979	576 127
	Short-term deposits	12 379 062	6 327 548
		22 723 901	16 845 007
1.2	**Pula Fund**		
	Equities: available-for-sale	23 817 720	21 409 042
	Bonds: available-for-sale	30 382 537	27 352 573
	Derivative instruments: assets (Note 13)	8 273	18 017
	Amounts due to Liquidity Portfolio	(784 979)	(576 127)
	Derivative instruments: liabilities (Note 13)	(8 512)	(6 117)
	Short-term deposits	1 342 485	1 129 530
		54 757 524	49 326 918
	Statement of Financial Position		
	Capital Employed		
	Government	37 260 596	26 161 289
	Bank of Botswana	17 496 928	23 165 629
		54 757 524	49 326 918
	Employment of Capital		
	Investments	54 757 524	49 326 918
	Investments expressed in US dollars ('000)	5 760 491	5 633 134
	Investments expressed in SDR ('000)	3 980 872	3 655 125
	Statement of Profit or Loss and Other Comprehensive Income		
	Income		
	Interest and dividends	1 198 863	1 104 298
	Realised currency revaluation gains	2 289 736	1 658 801
	Unrealised currency revaluation (losses/gains)	(1 237 900)	1 934 968
	Realised gains from fair value changes	1 526 359	1 021 749
	Sundry income	1 062	198
		3 778 120	5 720 014
	Expenses		
	Administration charges	165 138	141 174
		165 138	141 174
	Net income	3 612 982	5 578 840
	Other Comprehensive Income		
	Items that may be reclassified subsequently to profit or loss		
	Net unrealised currency gains on non-monetary "available-for-sale" financial instruments	192 732	1 162 363
	Net unrealised gains from fair value changes on "available-for-sale" financial instruments	1 749 995	2 885 592
	Other comprehensive income	1 942 727	4 047 955
	Total comprehensive income	5 555 709	9 626 795

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

December 31, 2014

	2014 P'000	2013 P'000

2. INTERNATIONAL MONETARY FUND (IMF)

2.1 Reserve Tranche

This asset represents the difference between Botswana's Quota in the IMF and IMF Holdings of Pula. Botswana's Quota is the membership subscription, of which at least 25 percent was paid for in foreign currencies and the balance in Pula. The holding of Pula by the IMF, which initially was equal to 75 percent of the quota, has changed from time to time as a result of the use of the Pula by the IMF in lending to member countries.

	2014 P'000	2013 P'000
Quota (SDR 87 800 000; 2013: SDR 87 800 000)	1 207 255	1 184 885
Less: IMF Holdings of Pula	(777 211)	(762 574)
Reserve Position in IMF	430 044	422 311

The IMF Holdings of Pula are represented by the Non-Interest Bearing Note of P353 179 294 (2013: P353 179 294) issued by the Government of Botswana in favour of the IMF, maintenance of value currency adjustments and the amount in the current account held at the Bank (included in other deposits in Note 10).

2.2 Holdings of Special Drawing Rights

	2014 P'000	2013 P'000
The balance on the account represents the value of Special Drawing Rights (SDR) allocated and purchased less utilisation to date.	1 178 929	1 157 062

2.3 General Subsidy Account

	2014 P'000	2013 P'000
Face Value (SDR 1 520 000)	20 900	20 524
Interest	7	7
	20 907	20 531

This is an investment with the International Monetary Fund, the purpose of which is to augment the resources of the Poverty Reduction and Growth Trust Fund. The investment is expected to generate SDR 0.2 million over five years. It matures on August 22, 2017.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

3. **PROPERTY AND EQUIPMENT**	**Freehold Land**	**Leasehold Land**	**Buildings**	**Capital Works in Progress**	**Other Assets**	**Total**
	P'000	**P'000**	**P'000**	**P'000**	**P'000**	**P'000**
Cost - December 31, 2014						
Balance at the beginning of the year	2 065	3 083	385 709	3 357	176 042	570 256
Additions	–	–	–	17 051	11 436	28 487
Disposals	–	–	–	–	(3 935)	(3 935)
Transfers from WIP	–	–	14 222	(14 291)	69	–
Balance at year-end	2 065	3 083	399 931	6 117	183 612	594 808
Accumulated Depreciation						
Balance at the beginning of the year	–	–	65 074	–	93 093	158 167
Charge for the year	–	–	10 157	–	15 818	25 975
Disposals	–	–	–	–	(2 952)	(2 952)
Balance at year-end	–	–	75 231	–	105 959	181 190
Net book value at December 31, 2014	2 065	3 083	324 700	6 117	77 653	413 618
Cost - December 31, 2013						
Balance at the beginning of the year	2 065	3 083	161 187	253 532	117 122	536 989
Additions	–	–	–	28 552	6 798	35 350
Disposals	–	–	–	–	(2 083)	(2 083)
Transfers from WIP	–	–	224 522	(278 727)	54 205	–
Balance at year-end	2 065	3 083	385 709	3 357	176 042	570 256
Accumulated Depreciation						
Balance at the beginning of the year	–	–	60 107	–	84 488	144 595
Charge for the year	–	–	4 967	–	10 531	15 498
Disposals	–	–	–	–	(1 926)	(1 926)
Balance at year-end	–	–	65 074	–	93 093	158 167
Net book value at December 31, 2013	2 065	3 083	320 635	3 357	82 949	412 089

Valuation of Properties

Freehold and leasehold land and buildings were valued by an independent professional property valuer in December 2014 at an open market value of P770 940 000 (2012: P353 699 000).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
4. GOVERNMENT OF BOTSWANA BOND		
Government Bond BW005, maturing on September 12, 2018, bearing interest at the rate of 10 percent, receivable semi-annually in arrears:		
Fair value	23 524	24 329
Interest accrued	613	613
	24 137	24 942
5. OTHER ASSETS		
Staff loans and advances	49 663	52 614
Prepayments	2 868	2 633
Other	88 290	33 142
	140 821	88 389
6. ALLOCATION OF IMF SPECIAL DRAWING RIGHTS		
This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Botswana.	789 694	778 784
7. LIABILITIES TO GOVERNMENT (IMF RESERVE TRANCHE)		
This balance represents the Bank's liability to the Government in respect of the Reserve Tranche position in the IMF (Note 2.1).	364 435	356 703
8. NOTES AND COIN IN CIRCULATION		
Notes	2 466 520	2 265 599
Coin	132 089	115 917
	2 598 609	2 381 516

Notes and coin in circulation held by the Bank as cash in hand at the end of the financial year have been netted off against the liability for notes and coin in circulation to reflect the net liability to the public.

	2014 P'000	2013 P'000
9. BANK OF BOTSWANA CERTIFICATES		
Face value	4 208 000	5 498 760
Unmatured discount	(6 616)	(8 037)
Carrying amount	4 201 384	5 490 723

Bank of Botswana Certificates are issued at various short-term maturity dates and discount rates.

	2014 P'000	2013 P'000
9.1 REVERSE REPURCHASE/(REPURCHASE) AGREEMENTS		
Fair value	304 357	(302 078)

The reverse repurchase agreements matured on January 5, 2015 (2013: January 3, 2014).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
10. DEPOSITS		
Government	781 246	954 930
Bankers – current accounts	38 340	177 535
– statutory reserve accounts	4 420 809	4 186 721
Other	1 601 433	1 638 207
	6 841 828	6 957 393

These deposits are various current accounts of Government, commercial banks, parastatal bodies and others, which are repayable on demand and are interest free, except for the statutory reserve requirement, which is also interest free, but not repayable on demand.

	2014 P'000	2013 P'000
11. DIVIDEND TO GOVERNMENT		
Balance due at the beginning of the year	780 655	2 304 770
Dividend to Government from Pula Fund	700 000	500 000
Paid during the year	(1 305 655)	(2 679 770)
Residual net income	369 689	655 655
Balance due at the end of the year	544 689	780 655

The final instalment of the pre-set dividend of P175 000 000 and the residual net income of P369 689 000 unpaid as at December 31, 2014 was provided for in accordance with Section 6 of the Bank of Botswana Act (CAP 55:01); which requires that all profits of the Bank be distributed to the shareholder, the Government.

	2014 P'000	2013 P'000
12. OTHER LIABILITIES		
Accounts payable	9 326	47 113
Other payables and accruals	205 648	98 748
	214 974	145 861

	2014 P'000	2013 P'000
13. CATEGORIES OF FINANCIAL INSTRUMENTS		
13.1 Financial Assets		
Held for trading		
Bonds	9 559 860	9 941 332
Derivative instruments (Note 1.2)	8 273	18 017
Available-for-sale		
Bonds	30 382 537	27 352 573
Equities	23 817 720	21 409 042
Government bonds	24 137	24 942
Loans and Receivables		
IMF Reserves	1 629 880	1 599 904
Repurchase Agreements	–	302 078
Staff loans and advances	49 663	52 614
Short-term deposits	13 721 547	7 457 078
Total Financial Assets	79 193 617	68 157 580

The above is disclosed in the Statement of Financial Position as follows:

	2014 P'000	2013 P'000
Total Foreign Assets	79 111 305	67 771 829
Add: Derivative instruments (liabilities)	8 512	6 117
Government of Botswana bonds	24 137	24 942
Repurchase Agreements	–	302 078
Other Assets - staff loans and advances (Note 5)	49 663	52 614
	79 193 617	68 157 580

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
13. CATEGORIES OF FINANCIAL INSTRUMENTS (Cont'd)		
13.2 Financial Liabilities		
Held for trading		
Derivative instruments (Note 1.2)	8 512	6 117
Other Financial Liabilities - at amortised cost		
Bank of Botswana Certificates	4 201 384	5 490 723
Reverse Repurchase Agreements	304 357	-
Allocation of SDR (IMF)	789 694	778 784
Liabilities to Government (IMF)	364 435	356 703
Deposits	6 841 828	6 957 393
Dividend to Government	544 689	780 655
Other liabilities	214 974	145 861
	13 269 873	14 516 236

13.3 Derivative Instruments

The Bank's investment guidelines authorise the use of derivative instruments. The derivatives are held for managing risk.

The Table below shows the market values and the total notional exposures of derivative instruments as at year end.

		Assets 2014 (P'000)	Liabilities 2014 (P'000)	Notional Amount 2014 (P'000)	Assets 2013 (P'000)	Liabilities 2013 (P'000)	Notional Amount 2013 (P'000)
Fixed Income Futures	-Buy	8 365	–	426 293	14 162	–	1 288 393
	-Sell	–	(8 512)	(420 121)	–	(2 563)	(363 096)
Currency Futures	-Buy	(92)	–	119	1 887	–	257 328
Other Options	-Buy	–	–	–	1 267	–	(1 546)
	-Sell	–	–	–	–	(316)	(2 649)
Swaps	-Buy	–	–	–	701	–	3 929
	-Sell	–	–	–	–	(3 238)	–
		8 273	(8 512)	6 291	18 017	(6 117)	1 182 359

The above derivatives are classified by type of asset and derivative instruments. The assets and liabilities reflect the net position between the market values and the notional amounts.

Futures
A futures contract is an agreement executed on the floor of an exchange to buy or sell a specific amount of a security or cash at a specified price and time. A fixed income futures contract would be an agreement to either buy or sell a specified amount of a fixed income security at a specified price and date, while a currency futures contract will be an agreement to either buy or sell a specified amount of currency at a specified exchange rate and date. Futures contracts are collateralised by cash or marketable securities and changes in the futures contract value are settled daily.

Options
An option is an exclusive right, usually obtained for a fee, but not the obligation to buy or sell a specific financial instrument within a specified time. A fixed income option is the exclusive right to either buy or sell specified units of a fixed income security by a specific date. A currency option is an option to either buy or sell a specified currency by a specific date.

Swaps
A swap is an agreement between two or more parties to exchange sets of cash flows over a period in the future, typically either in the form of interest rate swaps or currency swaps. The cash flows that the counterparties make are linked to the value of the underlying debt financial instrument or the foreign currency, as the case may be.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
14. PAID-UP CAPITAL		
Authorised and Paid-up Capital	25 000	25 000

The capital is the amount subscribed by the Government in accordance with Section 5 of the Bank of Botswana Act (CAP 55:01). The Bank is not subject to any externally imposed capital requirements. Therefore, capital is not actively managed. Management considers the Paid-up Capital and the General Reserve to be capital.

	2014 P'000	2013 P'000
15. GENERAL RESERVE		
In the opinion of the Board, the General Reserve, taken together with other reserves which the Bank maintains, is sufficient to ensure the sustainability of future operations of the Bank.	1 600 000	1 600 000
16. INTEREST – FOREIGN EXCHANGE RESERVES		
Liquidity Portfolio		
Short-term deposits: loans and receivables	219 799	165 091
Bonds: held for trading	199 780	198 196
IMF Reserves: loans and receivables	679	446
Pula Fund		
Short-term deposits: loans and receivables	17 390	17 966
Bonds: available-for-sale	709 768	691 747
	1 147 416	1 073 446
17. DIVIDENDS – FOREIGN EXCHANGE RESERVES		
Pula Fund		
Equities: available-for-sale	472 768	394 783
18. NET GAINS FROM FAIR VALUE CHANGES ON DISPOSAL OF SECURITIES		
Liquidity Portfolio		
Bond: held for trading	(79 523)	(17 958)
Pula Fund		
Derivative instrument: held for trading	38 752	(5 667)
Bonds: available-for-sale	509 613	117 514
Equities: available-for-sale	977 994	909 901
	1 446 836	1 003 790

Included above are net fair value gains of P1 487 607 000 (2013: P1 027 415 000), which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.

	2014 P'000	2013 P'000
19. NET REALISED CURRENCY GAINS		
Liquidity Portfolio		
Short-term deposits: loans and receivables	585 143	493 211
Bonds: held for trading	836 851	261 858
Pula Fund		
Derivative instruments: held for trading	(16 565)	15 747
Short-term deposits: loans and receivables	16 005	22 930
Bonds: available-for-sale	1 925 864	1 230 098
Equities: available-for-sale	364 432	390 026
	3 711 730	2 413 870

Included above are net currency gains of P2 290 296 000 (2013: P1 620 124 000) which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
20. NET UNREALISED CURRENCY (LOSSES)/GAINS		
Liquidity Portfolio		
Short-term deposits: loans and receivables	(139 026)	182 905
Bonds: held for trading	(658 608)	933 858
IMF reserves: loans and receivables	10 654	49 115
Pula Fund		
Short-term deposits: loans and receivables	20 129	3 929
Bonds: available-for-sale	(1 259 726)	1 925 505
Derivative instruments: held for trading	1 696	5 534
	(2 024 881)	3 100 846
21. NET UNREALISED LOSSES FROM FAIR VALUE CHANGES		
Liquidity Portfolio		
Bonds: held for trading	537	(164 494)
Pula Fund		
Derivative instruments: held for trading	(1 935)	(4 547)
	(1 398)	(169 041)
22. INTEREST EXPENSE		
Bank of Botswana Certificates (BoBCs)	173 621	341 003
Reverse Repurchase Agreements	22 547	27 549
	196 168	368 552
23. NET CURRENCY REVALUATION GAINS/(LOSSES) RETAINED IN PROFIT OR LOSS		
Total net realised gains (Note 19)	3 711 730	2 413 870
Total net unrealised (losses)/gains (Note 20)	(2 024 881)	3 100 846
Total net currency revaluation gains	1 686 849	5 514 716
Appropriated to Currency Revaluation Reserve:		
Net realised currency gains and reinvested in foreign assets	(3 646 183)	(2 324 212)
Net unrealised currency losses/(gains) (Note 20)	2 024 881	(3 100 846)
Transfer to Currency Revaluation Reserve	(1 621 302)	(5 425 058)
Net currency revaluation gains retained in profit or loss	65 547	89 658

24. **CONTRIBUTION TO THE BANK OF BOTSWANA DEFINED CONTRIBUTION STAFF PENSION FUND**

The Bank's contribution to the Bank of Botswana Defined Contribution Staff Pension Fund for the year ended December 31, 2014 is P24 121 000 (2013: P21 838 000).

25. **STATEMENT OF CASH FLOWS**

The definition of cash in IAS 7 is not wholly appropriate to the Bank. Due to its role in the creation and withdrawal of currency in circulation, the Bank has no cash balances on its Statement of Financial Position (see Note 8). However, the Bank has the ability to create cash when needed.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

	2014 P'000	2013 P'000
26. CASH GENERATED BY OPERATIONS		
Net income for the year adjusted for:	4 069 769	7 011 549
Net realised and unrealised exchange gains	(1 621 302)	(5 425 058)
Depreciation expense	25 975	15 498
Loss on disposal of Property and Equipment	135	109
Interest: Government of Botswana bonds	(2 000)	(2 000)
	2 472 577	1 600 098
Increase in Deposits: banks and other	58 120	722 125
Decrease in Deposits: Government	(173 684)	(386 551)
Decrease in Bank of Botswana Certificates	(1 289 340)	(3 172 817)
Increase/(Decrease) in Reverse Repurchase Agreements	304 357	(999 020)
Decrease/(Increase) in Repurchase Agreements	302 078	(302 078)
(Increase)/Decrease in other assets	(52 432)	17 691
Increase in other liabilities	69 113	37 727
Cash generated from/(used in) operations	1 690 789	(2 482 825)

27. CAPITAL COMMITMENTS

	2014	2013
Approved and contracted for	68 970	50 356
Approved, but not contracted for	12 165	17 352
	81 135	67 708

These capital commitments will be funded from internal resources.

28. COLLATERAL

(a) Credit Facility

There were no open positions as at December 31, 2014 (2013: Nil) under the Credit Facility accounted for as "Advances to banks".

(b) **Securities Lending Programme**

Under the Bank's Securities Lending Programme, the Bank has lent securities with a fair value of P7.1 billion (2013: P8.5 billion). The Bank has accepted securities with a fair value of P7.4 billion (2013: P8.7 billion) as collateral for the securities lent under this programme.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

29. **GOVERNMENT OF BOTSWANA BONDS AND TREASURY BILLS**

In accordance with Sections 56 and 57 of the Bank of Botswana Act (CAP 55:01), the Bank acts as agent of the Government for the issuance and management of the Government Bonds and Treasury Bills. An analysis of the bonds and treasury bills issued during the financial year ended December 31, 2014 is provided below:

Government of Botswana Bonds and Treasury Bills issued during the year 2014

Bond/ Treasury Bill Detail	BW008	BW010	BW11	BW100914	BW101214	BW110315	BW100615	Total
Date of Issue	Jun/Dec 10, 2014	June 11, 2014	March/June Sept/Dec 10, 2014	March 12, 2014	June 11, 2014	Sept 10, 2014	Dec 10, 2014	
Date of Maturity	Sept 8, 2020	Mar 14, 2017	Sept 10, 2031	Sept 10, 2014	Dec 10, 2014	March 11, 2015	June 10, 2015	
Interest Rate Percent (per annum)	7.75	7.75	7.75	–	–	–	–	
	P’000	P’000	P’000	P’000	P’000	P’000	P’000	P’000
Nominal Value	75 000	100 000	471 000	340 000	340 000	340 000	199 000	1 865 000
Net (Discount)/ Premium	10 449	10 071	78 673	(5 423)	(5 341)	(5 341)	(3 144)	79 944
Net Proceeds	85 449	110 071	549 673	334 577	334 659	334 659	195 856	1 944 944
Interest Paid to date	969	3 875	9 378	5 423	5 341	–	–	24 986
Interest Accrued	1 847	2 334	11 394	–	–	3 526	416	19 517

(a) Net proceeds realised from the issue of the bonds of P1 944 944 000 (2013: P2 958 472 000) were invested in the Government Investment Account. The nominal value of holdings of total outstanding Government bonds and treasury bills as at December 31, 2014, was P7 230 000 000 (2013: P6 725 000 000).

(b) Interest is payable on all bonds on a semi-annual basis in arrears. During the year to December 31, 2014, total interest payments of P577 715 950 were made (2013: P523 440 370) and were funded from the Government’s current account maintained with the Bank.

(c) Government bonds and treasury bills are liabilities of Government; and they are, therefore, not accounted for in the Statement of Financial Position of the Bank.

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS**

Risk is inherent in the Bank’s management of financial instruments which comprised primarily foreign assets, which are held in various financial instruments. This risk is managed through a process of ongoing identification, measurement and monitoring that is subject to an extensive framework of risk limits and other controls. The process of risk management is critical to the Bank’s ongoing operations, with the day to day management of the financial instruments being conducted by the Financial Markets Department. A key element in the risk management of the foreign exchange reserves is safety, defined as the preservation of purchasing power of the foreign exchange reserves. To this end, the Bank has continued to pursue a conservative and diversified investment strategy, with an SDR weighted currency allocation as the benchmark. The Bank’s objectives, policies and procedures for managing the risk exposures and the method used to measure the risks have remained consistent with the prior year. The risk management framework remains sound and effective.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

Risk Management Governance Structure
The Bank's risk management governance structure is broadly as follows:

(a) <u>Board</u>

The Board is responsible for the Bank's overall risk management and for approving investment policies and guidelines. The Bank's management reviews the risk management policies from time to time.

(b) <u>Investment Committee</u>

The Investment Committee, which is chaired by the Governor and comprises representatives from relevant areas of the Bank, meets regularly to review developments in the international financial and capital markets. Where necessary, the Investment Committee makes decisions on Bank managed portfolios. The Investment Committee also monitors the performance of the external fund managers.

(c) <u>Financial Markets Department</u>

The Financial Markets Department is responsible for the management of the foreign exchange reserves and has a specialised Risk Management Unit focusing on the risks associated with all the investment portfolios and ensures compliance with Investment Guidelines.

(d) <u>Segregation of Duties</u>

At an operational level, the main feature of risk control is the segregation of duties relating to dealing, settlement, risk monitoring and recording. These responsibilities are split among three Departments: Financial Markets, Payments and Settlement and Finance.

Tranching of Foreign Exchange Reserves – Liquidity Portfolio and Pula Fund
The Bank of Botswana Act (CAP 55:01) requires the Bank to maintain a primary international reserve, that is, the Liquidity Portfolio, while Section 35 provides for the establishment and maintenance of a long-term investment fund, the Pula Fund. In compliance with the statutory requirements, a major feature of the foreign exchange reserves management strategy is, therefore, to allocate a certain level of reserves to the Liquidity Portfolio, with the remaining amount invested in the Pula Fund.

Pula Fund
Investments of the Pula Fund comprise long-term assets, such as long-dated bonds and equities actively traded in liquid markets, with the expectation of earning a higher return than could be achieved on conventionally managed investments. The asset allocation between bonds and equities is determined using a combination of historical data and assumptions. Exercises are also conducted in respect of the Pula Fund risk/return sensitivity analysis, using different portfolio options, where risk is measured by a standard deviation on the rate of return.

Liquidity Portfolio
In terms of the investment guidelines, the Liquidity Portfolio gives priority to liquidity over return, given the constant need to provide foreign exchange to finance international transaction payments. While the eligible investment currencies are similar to those of the Pula Fund, the Liquidity Portfolio is largely invested in the Bank's international transaction currencies.

There are no equities in the Liquidity Portfolio and investment instruments include government bonds of eligible grade currencies issued by AAA–rated supranational and AAA–rated US agencies in eligible currencies; other liquid money market instruments are also eligible.

Types of Risk Exposure
The Bank's investment guidelines cover basic types of risk exposures, namely, market risk (currency risk, interest rate risk and equity price risk), credit risk, liquidity and instrument risk. These types of risk apply to the foreign assets and liabilities.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

(a) Currency Risk

The foreign exchange reserves are invested in currencies that are freely convertible, less susceptible to frequent and sharp exchange rate fluctuations and are used in well developed financial markets. The Bank's policy is to invest only in currencies with high ratings assigned by Moody's Investors Service and Standard and Poor's. Through a diversified currency allocation relative to an SDR weighted benchmark, the Bank ensures that the purchasing power of the foreign exchange reserves is preserved. In terms of the investment guidelines, a maximum deviation from the neutral level (using the SDR weights as a benchmark) for USD and EUR of 10 percentage points is permitted, while a deviation of up to 5 percentage points on all other currencies is permitted. At the end of 2014, the Bank's total exposure to SDR and related currencies was P73.8 billion (2013: P64.7 billion). The Bank is also exposed to SDR currency risk on net IMF balances amounting to P475 751 000 (2013: P464 417 000).

(b) Interest Rate Risk

Interest rate risk is the possible loss in the value of a fixed income asset resulting from an unexpected and adverse movement in interest rates and a consequent change in price. Interest rate risk is measured by modified duration, which measures the sensitivity of the price of a bond to changes in interest rates expressed in years. The Bank benchmarks the interest rate risk for the Pula Fund (fixed income assets) to reflect the long-term nature of the portfolio, with emphasis on higher return. The higher interest rate risk is generally compensated by higher returns expected from longer maturity bonds. The modified duration benchmark will vary over time, as changing market conditions and index weights impact the global modified duration of the index. At the end of 2014, the average modified duration of the fixed income portion of the Pula Fund was 7 years (2013: 6.1 years). As the Liquidity Portfolio gives priority to liquidity over return, given the constant need to provide foreign exchange to finance international transaction payments, from the Bank's perspective, this portfolio is exposed to minimum interest rate risk. At the end of 2014, the Liquidity Portfolio's average modified duration was 1.7 years (2013: 1.5 years).

(c) Equity Price Risk

Equity price risk is the risk that the value of equities decrease as a result of changes in the level of equity indices and diminution of value of individual stocks. The geographic allocation of equity exposure follows generally the market capitalisation among the major markets. The investment guidelines stipulate the holding levels of equities. Holdings of more than 5 percent in one company are not permitted. A reasonable spread among the industry sectors is maintained in the portfolio. There are no investments in private placements or unquoted stocks. At the end of 2014, the equity portion of the Pula Fund was P23.8 billion (2013: P21.4 billion).

Market Risk Sensitivity Analysis
The set of assumptions used for each of the risk factors hereunder are not forecasts, but merely "what if" scenarios and the likely impact on the current portfolio, based on selected changes in risk variables over a one year horizon.

The Table below gives an indication of the risk sensitivities of the portfolio to various risk parameters. Assuming that the probability of the beneficial change in the risk variables are as likely to happen as an adverse change, both potential increase and decrease are shown for the indicated scenarios.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

December 31, 2014

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(1 164 484)	Decrease in yields by 50 basis points	1 164 484
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(754 262)	Weakening of the Pula by 1 percent	754 262
	South African rand	Strengthening of the Pula by 1 percent	(36 851)	Weakening of the Pula by 1 Percent	36 851
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 190 886)	Increase in global equity prices by 5 percent	1 190 886

December 31, 2013

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(937 764)	Decrease in yields by 50 basis points	937 764
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(662 522)	Weakening of the Pula by 1 percent	662 522
	South African rand	Strengthening of the Pula by 1 percent	(15 196)	Weakening of the Pula by 1 percent	15 196
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 070 452)	Increase in global equity prices by 5 percent	1 070 452

The market risk estimates as presented in the Tables above are based on sensitivities to the individual risk factors. The correlation between the risk variables is not reflected in the effect on the Statement of Profit or Loss and Other Comprehensive Income.

(d) Credit risk

This is the risk that would arise if an entity that the Bank conducts business with is unable to meet its financial obligations or in the event of an adverse credit event or default. This may be a commercial bank accepting a deposit, a sovereign, supranational or corporate entity issuing a bond or a counterparty with whom the market participant has contracted to buy or sell foreign exchange or money or capital market instruments. In the Bank's endeavour to control credit risk, it deals with only the best quality institutions or counterparties, as determined by international rating agencies.

Consistent with the investment guidelines, the Bank withdraws the invested funds if there has been a downgrade of any institution. In cases where the new lower rating necessitates a lower exposure, funds are withdrawn to ensure that the new limit is not exceeded.

3. The effects are expected to have the same impact on shareholder's funds.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

The Bank mitigates credit risk by addressing the following underlying issues:

- Defining eligible investment instruments;
- Pre-qualifying counterparties (financial institutions, brokers/dealers, and intermediaries) doing business with the Bank; and
- Diversifying investment portfolios so as to minimise potential losses from securities or individual issuers.

The Bank has not impaired any of its assets in the current and previous period.

Exposure to Credit Risk
The Table below shows the maximum exposure to credit risk for the components of the Statement of Financial Position, including derivatives. The maximum exposure is shown gross, before the effect of the above mitigation factors.

	Notes	2014 P'000	2013 P'000
Financial Assets			
Liquidity Portfolio			
Bonds: held for trading	1.1	9 559 860	9 941 332
Short-term deposits: loans and receivables		13 164 041	6 903 675
Pula Fund			
Bonds: available-for-sale	1.2	30 382 537	27 352 573
Derivative instruments: held for trading		8 273	18 017
Short-term deposits: loans and receivables		557 506	553 403
International Monetary Fund – loans and receivables			
Reserve tranche	2.1	430 044	422 311
Holdings of Special Drawing Rights	2.2	1 178 929	1 157 062
General Subsidy Account	2.3	20 907	20 531
Government of Botswana bonds: available-for-sale	4	24 137	24 942
Repurchase Agreements	9.1	–	302 078
Other Assets- staff loans and advances: loans and receivables	5	49 663	52 614
Total		55 375 897	46 748 538
Analysis of Credit Exposure by class:			
Measured at fair value			
Bonds		39 942 397	37 293 905
Derivatives		8 273	18 017
Government of Botswana bonds		24 137	24 942
Repurchase Agreements		–	302 078
Measured at amortised cost			
IMF Reserves		1 629 880	1 599 904
Staff advances		49 663	52 614
Short-term deposits: loans and receivables		13 721 547	7 457 078
Total		55 375 897	46 748 538

While some financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure, but not the maximum risk exposure that could arise in future as a result of changes in values. The Tables below reflect the credit exposure based on the fair value of the assets with counterparties as at December 31, 2014.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

Credit Exposure on Bonds

Moodys/S&P Rating	Government (P'000)	Corporate (P'000)	2014 Total (P'000)	2013 Total (P'000)
AAA	33 302 898	335 573	33 638 471	13 602 737
AA+	1 963 856	82 999	2 046 855	16 402 540
AA	1 279 817	57 792	1 337 609	3 723 800
AA–	1 813 207	–	1 813 207	1 179 383
A+	–	–	–	22 949
A	195 142	7 983	203 125	456 645
A–	–	–	–	350 671
A1	–	–	–	27 170
Other[4]	903 130	-	903 130	1 528 010
	39 458 050	484 347	39 942 397	37 293 905

Credit Exposure to Banks (Short-term deposits)

Fitch Rating	2014 (P'000)	2013 (P'000)
AAA[5]	2 298 545	2 812 020
AA+[5]	207 265	–
A+[5]	15 637	–
A1	–	659 223
aa1	–	1 362 066
a+1	150 593	–
aa5	–	114 788
a1	806 870	849 504
a5	402 877	–
aa-1	4 216 276	–
aa-5	1 095 798	–
a-2	998 671	–
a-1	338 517	–
BBB[5]	2 117 242	1 657 814
bbb1/bbb2/bbb3	1 073 256	1 663
	13 721 547	7 457 078

Credit Exposure on Securities Lending Programme

The Bank's global custodian manages a securities lending programme as agent of the Bank. Due to the short term nature of the securities lending transactions, the collateral received under this programme changes on a short term basis. The securities lending is regulated by a securities lending agreement with the global custodian and follows the general criteria for the Bank's credit exposure. The global custodian monitors the market value of the collateral and, where necessary, obtains additional collateral in line with the underlying agreement.

(e) Instrument Risk

Sovereign Bonds

In accordance with the investment guidelines, the Bank invests in eligible instruments that are direct obligations or obligations explicitly guaranteed by governments or local governments of 13 selected sovereign countries that are highly rated by Standard and Poor's and Moody's Investors Service. Exposure limits are assigned to the specific sovereign countries in accordance with the ratings assigned by the credit rating agencies.

4. Other includes investments rated below A-, but still rated investment grade as per the investment guidelines.
5. Included in AAA, AA+, A+ and BBB are deposits held with central banks, while the deposits held by the custodian are rated aa-5.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

Corporate Bonds

The Bank invests in a small proportion of corporate bonds rated A1 or higher, with the issuer being incorporated and tax resident in a country whose sovereign debt is eligible for investment by the Bank. A reasonable geographical spread of issuers is maintained.

(f) Liquidity Risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due, hence liquidity is an integral part of the Bank's foreign exchange reserves policy. To limit this risk, the Management manages the assets with liquidity in mind and monitors future cash flows and liquidity on a daily basis. The Bank is exposed to daily Pula liquidity requirements on the deposits it holds on behalf of the shareholder, Government of Botswana, the banking system and other clients holding deposits with the Bank (mainly parastatals). For the purpose of managing foreign exchange reserves, the Bank keeps some of its assets in short-term deposits and other liquid money market instruments to enable the availability of liquidity to meet outflows without incurring undue capital loss and to provide flexibility to respond effectively to changing market requirements.

Financial Liabilities at Undiscounted Cash Flows

The table below summarises the maturity profile of the Bank's financial liabilities as at December 31, 2014, based on contractual undiscounted repayment obligations.

December 31, 2014	Less than 3 months (P000	3-12 months (P'000)	1-5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificates	4 208 000	–	–	–	4 208 000
Reverse Repurchase Agreements	304 357	–	–	–	304 357
Deposits	6 841 828	–	–	–	6 841 828
Allocation of SDR – IMF	–	–	–	789 694	789 694
Liabilities to Government – IMF	–	–	–	364 435	364 435
Dividend to Government	544 689	–	–	–	544 689
Other Liabilities	214 974	–	–	–	214 974
	12 113 848	–	–	1 154 129	13 267 977

December 31, 2013	Less than 3 months (P000)	3-12 months (P'000)	1-5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificate	5 498 760	–	–	–	5 498 760
Deposits	6 957 393	–	–	–	6 957 393
Allocation of SDR – IMF	–	–	–	778 784	778 784
Liabilities to Government – IMF	–	–	–	356 703	356 703
Dividend to Government	780 655	–	–	–	780 655
Other Liabilities	145 861	–	–	–	145 861
	13 382 669	–	–	1 135 487	14 518 156

(g) External Fund Managers and Custody

External fund managers are engaged to complement the Bank's reserve management activity. The Bank uses the services of a custodian which provides custodial services for the Bank's assets.

(h) Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. The Bank has a Risk Management and Planning Division within the Finance Department which focuses primarily on operational risk and coordination of the business continuity management.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

31. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value of financial instruments carried at amortised cost
The Board considers that the carrying amounts of financial assets and liabilities recognised in the financial statements at amortised cost approximate their fair values.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risk affecting the specific instrument.

Valuation models and techniques
The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).

The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models and valuation techniques. The fair values are based on net present value, discounted cash flow models and comparison with prices from observable current market transactions and dealer quotes for similar instruments.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank uses widely recognised valuation models for determining the fair value of financial instruments, such as interest rates yields, that use only observable market data and require little management judgement and estimation.

The fair value of Government bonds is derived from market quotations. These are prices dealers will be willing to pay for similar instruments.

The Bank uses discounted cash flow analysis to value Bank of Botswana Certificates (BoBCs). The valuation is based on observable market prices, with the yield curve providing the discount factors needed.

The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Fair values are categorised into different levels in a fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

31. **FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)**

If the inputs used to measure the fair value of an asset or a liability are categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

Fair Value Measurements recognised in the Statement of Financial Position
The following Table provides an analysis of financial instruments that are measured at fair value, including their levels in the fair value hierarchy.

December 31, 2014	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds	13.1	9 559 860	–	9 559 860
Derivative instruments	13.1	–	8 273	8 273
Available-for-sale				
Bonds	13.1	30 382 537	–	30 382 537
Equities	13.1	23 817 720	–	23 817 720
Government Bonds	13.1	–	24 137	24 137
Loans and Receivables	13.1	–	15 401 090	15 401 090
		63 760 117	15 433 500	79 193 617
Financial Liabilities				
Held for trading				
Derivative instruments	13.2	–	8 512	8 512
Other financial liabilities				
Bank of Botswana Certificates	13.2	–	4 201 384	4 201 384
Other liabilities	13.2	–	9 059 977	9 059 977
		–	13 269 873	13 269 873

December 31, 2013	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds	13.1	9 941 332	–	9 941 332
Derivative instruments	13.1	–	18 017	18 017
Available-for-sale				
Bonds	13.1	27 352 573	–	27 352 573
Equities	13.1	21 409 042	–	21 409 042
Government Bonds	13.1	–	24 942	24 942
Loans and Receivables	13.1	–	9 411 674	9 411 674
		58 702 947	**9 454 633**	**68 157 580**
Financial Liabilities				
Held for trading				
Derivative instruments	13.2	–	6 117	6 117
Other financial liabilities				
Bank of Botswana Certificates	13.2	–	5 490 723	5 490 723
Other liabilities	13.2	–	9 019 396	9 019 396
		–	**14 516 236**	**14 516 236**

There were no transfers between levels during the year.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2014

32. RELATED PARTY BALANCES AND TRANSACTIONS

Balances and Transactions with the Government
The Bank provides several services to its shareholder, the Government. The main services during the year to December 31, 2014, were:

(a) provision of banking services, including holding of the principal accounts of the Government;

(b) management of the Notes and Coin in issue, including printing and minting of notes and coin; and

(c) being the Government agent for government bonds and treasury bills.

The aggregate balances in Government accounts are disclosed in Note 10.

No charge is made to the Government for provision of these services.

The Bank earned interest on its holding of the Government of Botswana bonds (as described in Note 4) of P2 000 000 (2013: P2 000 000).

Other Related Party Balances and Transactions
(a) Amounts due to related parties.

Included in the balance of outstanding "Deposits – Other" in Note 10 are the following balances with Government-owned institutions.

	2014 P'000	2013 P'000
Botswana Savings Bank	1 781	2 983
Botswana Unified Revenue Service	535 074	652 071
Total	536 855	655 054

The amounts outstanding are unsecured and have no fixed repayment terms.

(b) Remuneration of Key Management Personnel

Key management personnel comprise the Governor, Board Members, Deputy Governors, General Manager and Heads of Department.

Gross emoluments of the key management personnel are:

	2014 P'000	2013 P'000
Non-Executive Board members	59	74
Executive Management		
Salaries, allowances and other short term benefits	10 988	10 402
Post-employment benefits	2 004	1 854
	13 051	12 330

Of the Staff Loans and Advances per Note 5, P1 377 000 (2013 : P1 244 000) are attributable to Executive Management.

33. EVENTS AFTER THE REPORTING DATE

At the date of finalisation of the annual financial statements, there were no material events that occurred subsequent to the statement of financial position date that require adjustment to or disclosure in the financial statements.

Part B

The Botswana Economy in 2014 and Theme Chapter

Bank of Botswana

Chapter 1

The Botswana Economy in 2014

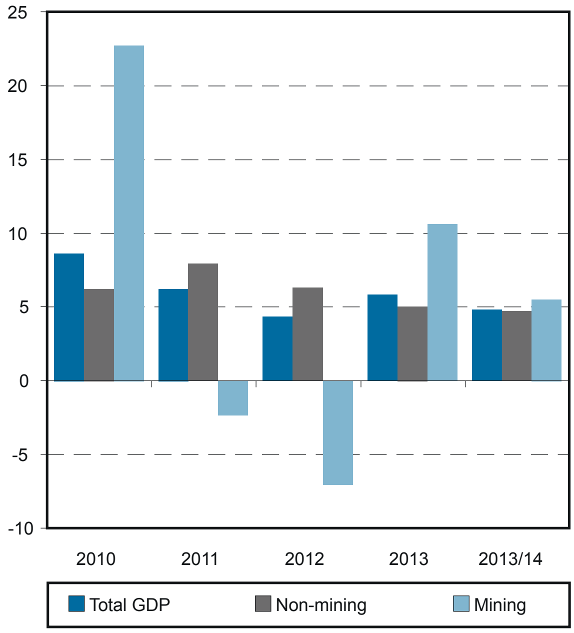
1. Output, Employment And Prices

(a) National Income Accounts

Overview

1.1 In the twelve-months to September 2014, GDP growth is estimated at 4.8 percent, compared to 5.8 percent in 2013.[1] Growth was led by the mining sector which expanded by 5.5 percent (Chart 1.1), albeit lower than an increase of 10.6 percent the previous year. Non-mining GDP grew by 4.7 percent, with strong performance of the *trade, hotels and restaurants* sector (8.2 percent) and *transport and communications* sector (5.2 percent). *Mining* remains the largest sector in the economy and accounts for 22.8 percent of total output at current market prices, compared to 22.4 percent in 2013.

Chart 1.1: Real GDP Growth 2010 – 2014 (Percent)



1. Data for 2013/14 are for the 12-month period to September 2014.

Source: Statistics Botswana

Sectoral Performance

1.2 Expansion in the *mining* sector in 2014 was mainly due to improved performance of the mines operated by Debswana, where output increased by 7 percent, against the background of generally robust international diamond markets. However, concerns about over-supply and lack of liquidity in the industry[2] caused demand to soften towards the end of 2014. Among other diamond producers, the Karowe mine also performed well, boosted by sales of exceptional (i.e., large, high value) stones recovered during the year, while Gem Diamonds Ghaghoo underground mine was officially opened in September 2014, with the first diamonds recovered to be sold in early 2015. In contrast, output at two small diamond mines, Lerala and BK11, remained suspended during the year.[3] The increase in diamond output was partially offset by declining production for other minerals. Production at the BCL copper/nickel mine was disrupted by temporary closure of the mine's smelter, while activity at the other copper mines was adversely affected by the fall in prices. Output of coal (which depends heavily on demand from the Morupule B power station) and soda ash contracted by 11.5 percent and 3 percent, respectively. However, this was offset by growth in "other mining" of 5.7 percent, while prospecting activity expanded by 13.6 percent.

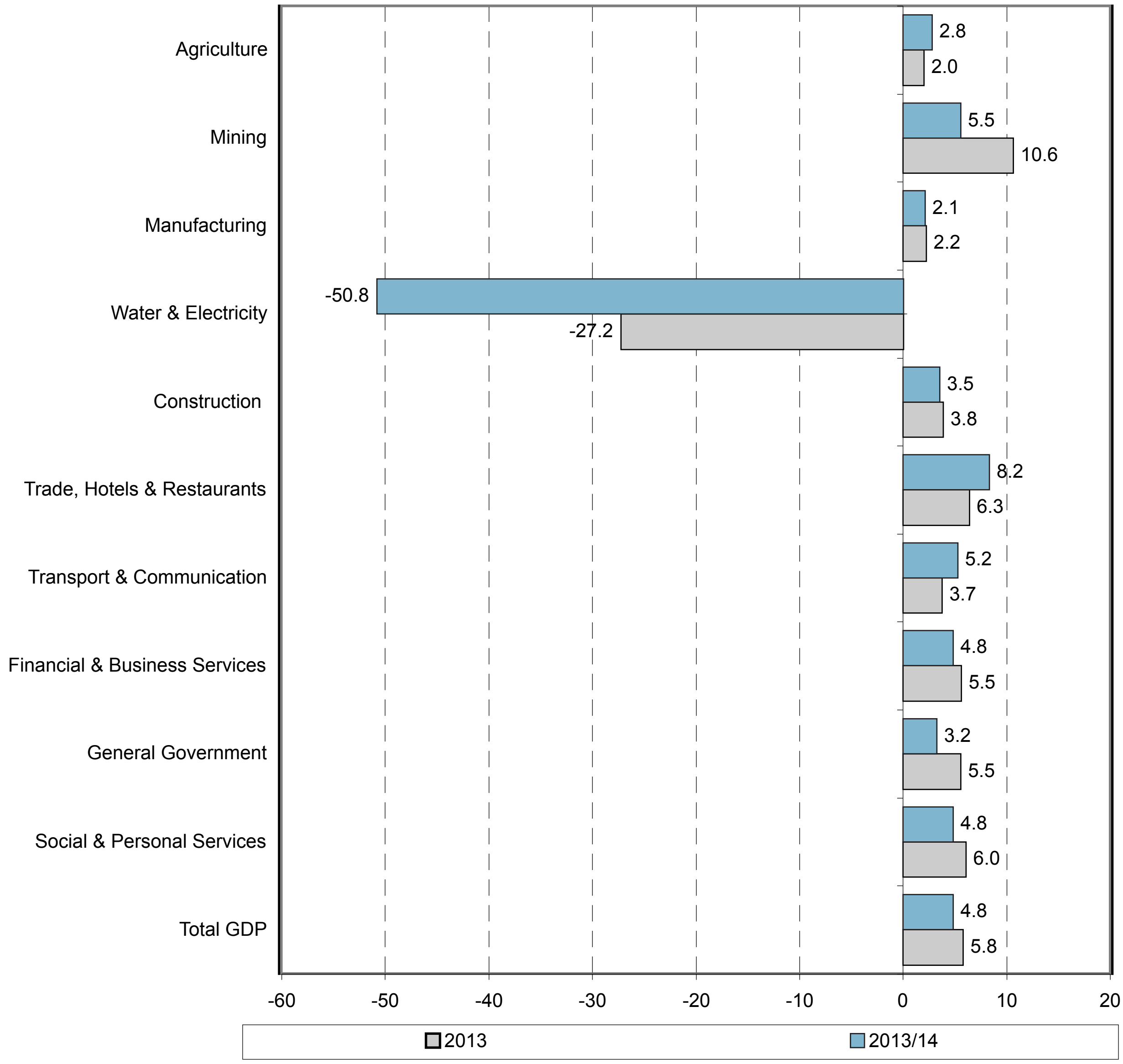
1.3 *Agriculture* experienced modest growth of 2.8 percent compared to 2 percent in 2013, as it

1 Estimates for the final quarter of 2014 are yet to be published. Comparison between the twelve months to September 2014 with the calendar year 2013 includes an overlap of one quarter.

2 Liquidity shortage is due to a variety of factors, including currency depreciation in the key Indian market, more rigorous lending criteria applied by banks and the closure, in late 2014, of the Antwerp Diamond Bank.

3 The Lerala mine is only due to reopen in late 2015, subject to adequate new capital being raised by the owners, Kimberly Diamonds; while Firestone Diamonds is seeking a buyer for the BK11 mine, which has been on care and maintenance since February 2012.

Chart 1.2: Real GDP Growth by Sector (Percent)



1. Data for 2013/14 are for the 12-month period to September 2014.
Source: Statistics Botswana

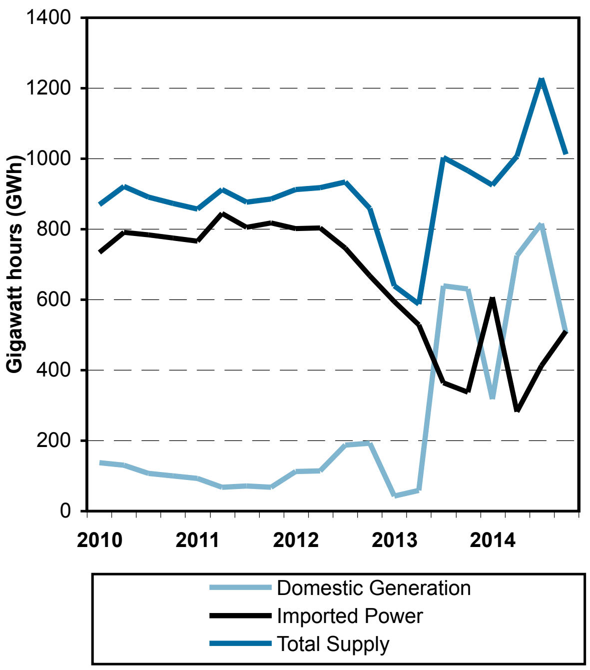
benefited from timely rainfall across much of the country during the 2013/14 ploughing season (Chart 1.2). *Manufacturing* increased at a lower rate of 2.1 percent in the 12 months to September 2014, underpinned by strong growth of 9.4 percent in other manufacturing, while the other main sub-sectors that include *meat and meat products, beverages* and *textiles*[4] *recorded negative growth.*

1.4 *Water and electricity* contracted by a further 50.8 percent in the twelve months to September 2014, following a 27.2 percent decline in the previous year (Chart 1.2). The contraction is largely attributable to the *electricity* sub-sector, which continues to be negatively affected by disruptions to domestic electricity generation. Moreover, growing demand necessitates the use (although on a reduced scale) of imported power and expensive diesel-powered generators. Electricity supply shortages were mostly experienced during the first and third quarters of 2014, due to recurring technical problems at the Morupule B power station (Chart 1.3). Performance of the *water* sub-sector was constrained by water restrictions

4 *Other manufacturing* comprises about 60 percent of sectoral value added and indicates the need for a more detailed breakdown into additional sub-sectors.

arising from insufficient rainfall in the main catchment areas as well as inadequate infrastructure to carry and reticulate water to areas of most use.

Chart 1.3: Electricity Supply 2010 – 2014



Source: Botswana Power Corporation

1.5 Growth in *construction* was marginally down at 3.5 percent from 3.8 percent in 2013. Construction activity was sustained by government spending on major infrastructure projects, as well as continued brisk private sector development of residential, commercial and retail property across the country.

1.6 *Trade, hotels and restaurants* grew by 8.2 percent compared to 6.3 percent in 2013. Increased activity in retail and wholesale trade (8.1 percent and 6.4 percent, respectively) is indicative of increase in consumer spending and local procurement by government. In the *hotels and restaurants* sub-sector (9.3 percent) growth reflects a combination of larger tourist volumes[5] and increased business travel to the country due to its emergence as a diamond trading hub.

1.7 Activity in the *transport and communications* sector increased by 5.2 percent mainly due to expansion of the *communications* sub-sector; boosted by both the number of customers and the introduction of additional services on mobile phones. However, contraction of rail *and* air transport held back overall growth in the sector.

1.8 Growth in the *financial and business services* sector slowed from 5.5 percent in 2013 to 4.8 percent in 2014. Slower growth across all the main sub-sectors, including banking, insurance, pensions and business services, is consistent with the moderate pace of expansion in the domestic economy.

(b) Domestic Economic Outlook

1.9 The slow pace of recovery in the global economy continues to constrain prospects for growth in Botswana. World output growth is projected at 3.5 percent in 2015, which is marginally higher than 3.3 percent in 2014 (Table 1.1). However, projections have been repeatedly revised downwards as stronger economic recovery in the United States of America (USA) and the United Kingdom (UK) is offset by deteriorating prospects for other advanced economies, notably the Euro area and Japan, as well as several of the major emerging markets, including China. The recent decline in global oil prices is expected to provide some stimulus to the global economy. However, subdued commodity prices will

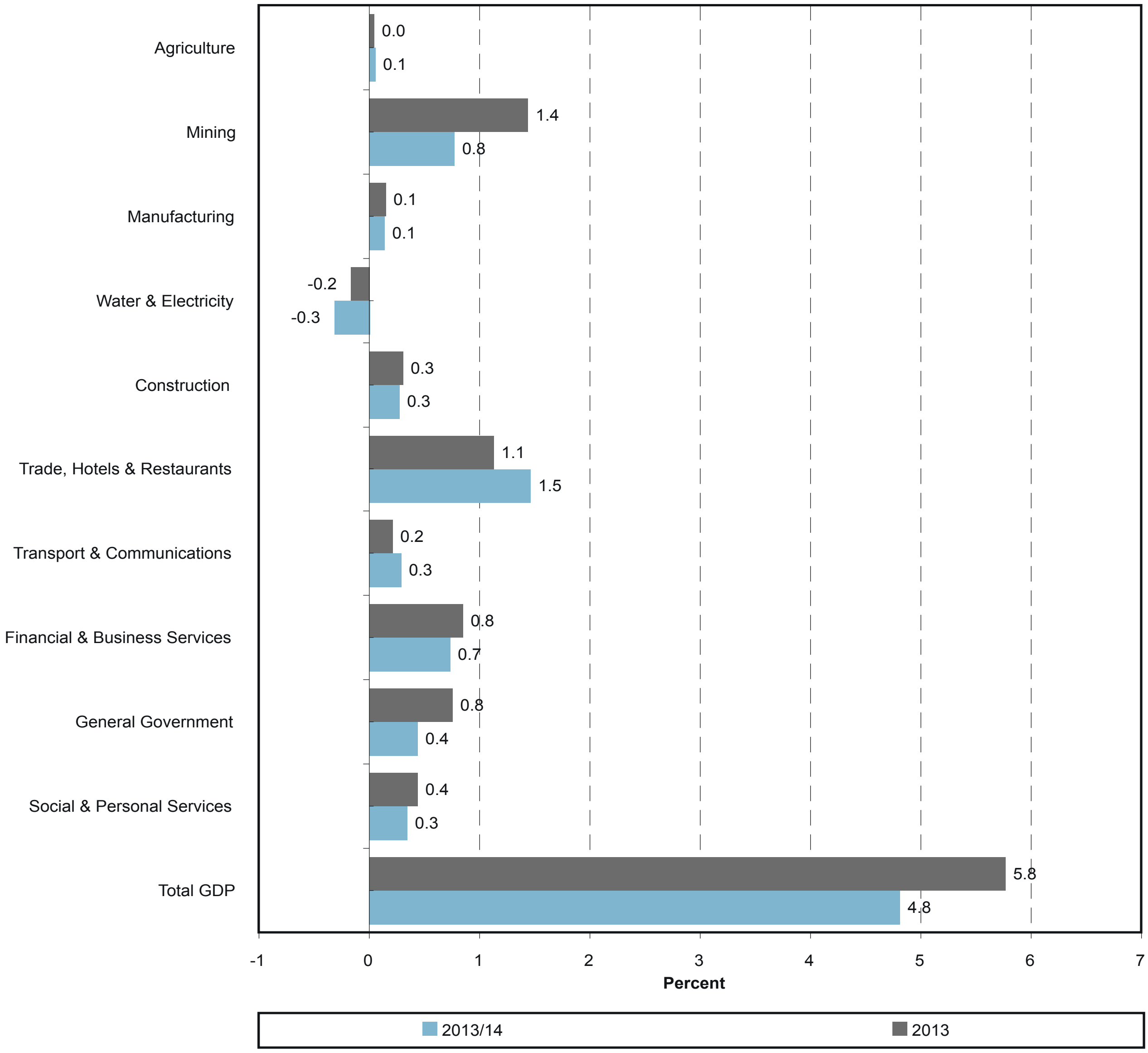
Table 1.1: Global Growth Estimates and Forecasts 2014 – 2016 (Percent)

	2014	2015	2016
Global	3.3	3.5	3.7
Advanced economies, of which,	1.8	2.4	2.4
USA	2.4	3.6	3.3
Euro zone	0.8	1.2	1.4
Japan	0.1	0.6	0.8
United Kingdom	2.6	2.7	2.4
Emerging markets, of which,	4.4	4.3	4.7
Sub-Saharan Africa	4.8	4.9	5.2
China	7.4	6.8	6.3
India	5.8	6.3	6.5

Source: International Monetary Fund, World Economic Outlook, January 2015 update

5 Although the outbreak of Ebola virus in some West African countries is reported to have impacted negatively on tourism across the continent in 2014.

Chart 1.4: Contribution to Real GDP Growth by Sector (Percent)



1. Data for 2013/14 are for the 12-month period to September 2014.
2. The contribution measure weights of sectoral growth rates according to that sector's share of total economic activity, thus showing the contribution to growth in overall GDP from that sector. The sum of the contributions by all sectors, including adjustment items, equals total GDP growth.

Source: Statistics Botswana

constrain activity in Botswana's mining sector and undermine the viability of proposed new investments and downstream manufacturing and service industries. Regionally, continued lacklustre growth in South Africa, where acute power shortages are expected to remain a constraint for some time, will adversely affect performance in neighbouring countries, including Botswana.

1.10 Output expansion for the domestic economy is forecast to be 4.9 percent in 2015 compared to an estimate of 5.2 percent in 2014, with activity restrained by modest growth in non-mining output. Government expenditure will provide some stimulus to the economy, although spending bottlenecks, especially with regard to development spending, may dilute this effect. Consumer spending will provide support to domestic demand, although spending on construction, other than by government, could moderate. Continued water shortages and any further electricity supply disruptions may dampen growth prospects.

(c) Inflation

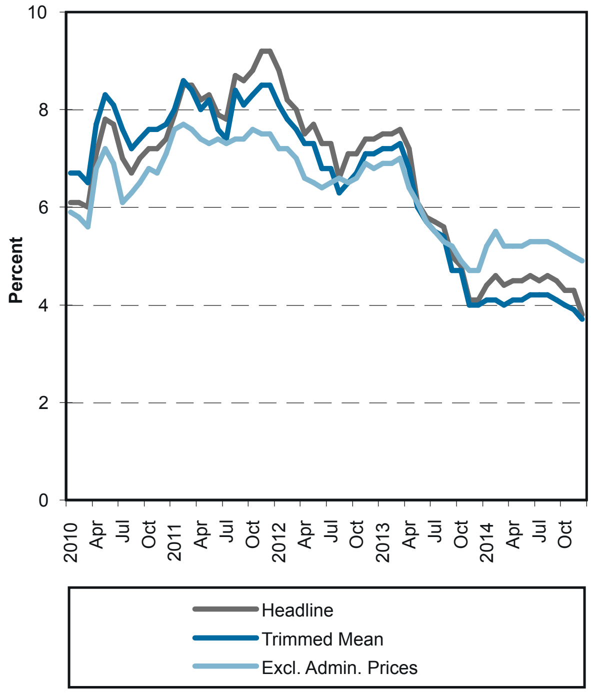
1.11 Global inflationary pressures were low during 2014, mainly reflecting subdued energy prices and persistent excess capacity in major economies. International oil prices, which had been relatively stable since 2012, fell sharply in the second half of 2014, in the context of modest global demand and ample supply. In addition, average world food prices[6] declined since May 2014, and this translated into a minimal easing of global inflation from 3.9 percent in 2013 to 3.8 percent in 2014.

1.12 For Botswana's trading partner countries, trade-weighted average inflation declined from 3.6 percent in December 2013 to 3.1 percent in December 2014. Inflation in SDR countries (USA, UK, Japan and euro area) decelerated from 1.3 percent to 0.5 percent in the same period, while headline inflation in South Africa slowed slightly from 5.4 percent to 5.3 percent,[7] ending the year within the South African Reserve Bank's medium-term target range of 3 – 6 percent (Chart 1.5).

Chart 1.5: Botswana and Trading Partner Countries' Inflation (2010 – 2014)

Source: Statistics Botswana, Bank of Botswana and Bloomberg

Chart 1.6: Botswana Headline and Core Inflation (2010 – 2014)



Source: Statistics Botswana

1.13 Domestic inflation was within the Bank's medium-term objective range of 3 – 6 percent in 2014, having fallen from 4.1 percent in December 2013 to 3.8 percent in December 2014 against the background of modest wage growth and weak demand pressures, as well as the limited impact of increase in administered prices and government levies. External pressures on domestic prices were also benign in the context of low and declining inflation in trading partner countries and a largely stable rand/Pula exchange rate. The decrease in domestic inflation is reflected across most categories of goods and services. In particular, food price inflation eased from 3.9 percent in December 2013 to 2.5 percent in December 2014, while fuel prices fell by 6.1 percent in the same period, thus lowering inflation

6 Food Price Index compiled by the United Nations' Food and Agriculture Organisation (FAO).

7 Inflation was above the country's medium-term target range of 3 – 6 percent from April to August 2014, with a peak of 6.6 percent in May and June. The subsequent decline was due in large part to falling fuel prices.

by 0.51 percentage points. On average, administered prices reduced inflation by approximately 0.39 percentage points in 2014 compared to 0.34 percentage points in 2013. The core measures of inflation, exclusion method of administered prices and 16 percent trimmed mean increased from 4.7 percent in December 2013 to 4.9 percent in December 2014, and fell from 4 percent to 3.7 percent in the same period, respectively.

(d) Inflation Outlook

1.14 Global inflation is forecast to be marginally higher than 2014's 3.8 percent at 3.9 percent in 2015, against the background of weakening commodity prices and persistent spare capacity in advanced economies. In Botswana, although it is anticipated that non-mining output growth will be above trend in the medium term, pressures from domestic demand on inflation are expected to be modest, given restrained growth in personal incomes. Overall, it is projected that domestic inflation will continue to be within the objective range of 3 – 6 percent in the medium term and closer to the lower bound in the short term. Any substantial upward adjustment in administered prices and government levies beyond current projections present upside risks to the inflation outlook. Nevertheless, there are downside risks arising from weak global economic activity and falling commodity prices, as well as technological progress, productivity improvements, structural reforms, and growing trade and competition that could result in lower inflation than currently projected. At the same time, amendments to the Value Added Tax Act that came into effect at the beginning of 2015 extended the range of goods that are zero rated to include, inter alia, additional staple foodstuffs, thus providing some potential for lower prices.[8]

8 These include unprocessed fruit and vegetables, cereals not already covered (rice and samp), milk, bread flour and brown bread, which comprise approximately 5 percent of the CPI basket. In principle, this fall in inflation could amount to as much as 0.6 percentage points. However, the administrative costs of these changes could erode the magnitude and timing of price cuts.

2. Public Finance and The 2015/16 Budget

2.1 The Government budget for 2015/16 was presented against the background of positive growth prospects, low inflation and a stable external position. Thus, the medium-term process of fiscal consolidation continues, with the overall position of a budget surplus being maintained, while utilising a portion of the forecast growth in revenues to accommodate additional expenditure. In seeking to optimise the allocation of resources in line with national priorities, the 2015 Budget Speech emphasised four themes that drive growth and diversification of the economy: growing the economy; promoting inclusive growth; enhancing the business environment; and promoting investment and fostering diversification.

(a) Budget Performance: 2013/14 and 2014/15

2013/14 Budget Outturn

2.2 The budget outturn for the 2013/14 financial year was a surplus of P7.2 billion, which is substantially higher than the revised estimate of P386 million surplus. This was attributable to a combination of higher revenue and underspending of the development budget (Table 1.2).

2.3 Revenue[9] increased by P7.3 billion (17.5 percent) in 2013/14 to P49 billion, mainly because of higher mineral revenue occasioned by unanticipated large volume of diamond sales, and further augmented by exchange rate gains. Total expenditure and net lending increased slightly from P40.7 billion in the previous year to P41.7 billion, but was below the revised estimate of P45 billion due to underperformance of development spending by P3.2 billion compared to the revised estimate; recurrent expenditure exceeded the revised estimate by P243 million.

2014/15 Revised Estimates

2.4 The revised budget estimates for 2014/15

9 Total revenue includes grants.

TABLE 1.2: GOVERNMENT BUDGET 2013/14 – 2015/16 (P MILLION)

	2013/14			2014/15		2015/16
	Budget	**Revised**	**Final**	**Budget**	**Revised**	**Budget**
Revenue	**44 022**	**45 426**	**48 951**	**50 183**	**51 544**	**55 382**
Mineral Revenue	13 254	13 257	18 443	15 241	17 243	20 144
Non-mineral Revenue	30 768	32 169	30 508	34 942	34 301	35 238
Expenditure	**43 242**	**45 039**	**41 730**	**48 857**	**51 263**	**54 153**
Recurrent Expenditure	32 194	32 977	33 220	36 693	37 861	41 296
Personal Emoluments	14 481	15 128	15 338	15 749	16 377	16 057
Grants & Subventions	8 350	8 350	8 331	9 809	9 930	10 864
Public Debt Interest	778	778	687	907	907	1 079
Other Charges	8 586	8 721	8 863	10 228	10 647	13 296
Development Expenditure	11 103	12 118	8 909	12 240	13 478	12 933
Net Lending	-55	-55	-399	-76	-76	-76
Balance	**779**	**386**	**7 222**	**1 326**	**281**	**1 229**

Source: Ministry of Finance and Development Planning

indicate a surplus of P281 million, and considerably lower than the original budget estimate of P1.3 billion, due to upward revision of the expenditure budget. However, the final surplus could be larger as inadequate implementation capacity continues to result in underspending of the development budget.[10]

2.5 The revised estimates show higher revenue of P51.5 billion due to a 13.1 percent upward revision in expected mineral revenue. The estimate for expenditure and net lending has been revised upwards, from P48.9 billion to P51.3 billion. The recurrent spending increased from P36.7 billion to P37.9 billion, while the development budget rose from P12.2 billion to P13.5 billion due, in large part, to the additional financing of the Botswana Power Corporation (BPC).

(b) The 2015/16 Budget Proposals

2.6 Proposals for the 2015/16 budget indicate prioritisation of human capital development, the fight against HIV/AIDS, poverty alleviation, provision of water and power, employment creation, as well as maintenance of existing infrastructure. At the same time, it was emphasised that the overarching objective of fiscal policy is rebuilding of the net financial position of Government through budget surpluses, in order to provide flexibility and a buffer to respond to negative shocks. A surplus of P1.2 billion is, therefore, projected for 2015/16.

Revenue

2.7 Revenue for 2015/16, including grants, is projected to be P55.4 billion, which is 7.4 percent higher than the revised budget for 2014/15 (Table 1.3), and reflects a positive outlook for domestic and global economic performance. It is projected that mineral revenue will increase from P17.2 billion in 2014/15 to P20.1 billion in 2015/16 and will be the largest source of revenue, representing 36.4 percent of the total. SACU receipts are forecast to increase slightly from P16 billion to P16.3 billion,

10 In the 2015 Budget Speech, it was reported that the development budget has been underspent by an average of 17.3 percent for the years 2011/12 to 2013/14, due to delayed project implementation.

Table 1.3: Government Budget 2010/11 – 2015/16

Fiscal Years (FY)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
GDP, current prices, (P Million)	96 660	107 306	112 730	128 502	143 712	155 735
Growth rate (Percent)	25.9	11.0	5.1	14.0	11.8	8.4
Budget					Revised Budget	Budget
Revenue & Grants	31 909	38 486	41 658	48 951	51 544	55 382
Recurrent Expenditure	27 089	28 836	32 106	33 220	37 861	41 296
Development Expenditure	11 372	9 956	8 280	8 909	13 478	12 933
Net Lending	-44	-124	351	-399	-76	-76
Expenditure & Net Lending	38 417	38 667	40 736	41 730	51 263	54 153
Balance	-6 508	-181	922	7 222	281	1 229
Share of GDP (Percent)						
Revenues & Grants	33.0	35.9	37.0	38.1	35.9	35.6
Recurrent Expenditure	28.0	26.9	28.5	25.9	26.3	26.5
Development Expenditure	11.8	9.3	7.3	6.9	9.4	8.3
Expenditure & Net Lending	39.7	36.0	36.1	32.5	35.7	34.8
Balance	-6.7	-0.2	0.8	5.6	0.2	0.8

Source: Ministry of Finance and Development Planning

equivalent to 29.5 percent of total revenue. The dominance of these two revenue sources, which together account for 66.3 percent of the total revenue, highlights the need to diversify the government's revenue base. VAT collections are expected to grow by 9.1 percent to P6.6 billion (11.9 percent of total revenue) in 2015/16. Non-mineral income tax is projected to decline by 4.4 percent to P8.6 billion, thus accounting for 15.5 percent of budgeted revenue, while grants will decline by 14.6 percent to P344 million in 2015/16.

Expenditure

2.8 Total expenditure and net lending for 2015/16 is budgeted to increase by 5.6 percent from P51.3 billion to P54.2 billion. Recurrent expenditure is projected to grow by 9.1 percent, from P37.9 billion to P41.3 billion, and accounting for 76.3 percent of total spending. In contrast, development spending is expected to fall by 4 percent from a revised P13.5 billion in 2014/15 to P12.9 billion in 2015/16.

2.9 Personal emoluments of P16.1 billion, which include wages and salaries, pensions and gratuities, have the largest share of recurrent expenditure at 38.9 percent. The balance is accounted for by "other charges" at P13.3 billion (32.2 percent), grants and subventions at P10.9 billion (26.3 percent) and interest on public debt at P1.1 billion (2.6 percent).[11] By sector, education is allocated the highest share of the recurrent budget at 28.1 percent. Health, local government, defence and transport account for 15.5 percent, 14.2 percent, 13.7 percent and 5.7 percent, respectively, of recurrent expenditure.

2.10 The development budget[12] focuses on completion of on-going major development projects, while it also contains a significant allocation for maintenance of infrastructure and welfare programmes. The largest share at P3.3 billion (25.7 percent of the development budget) is allocated to the Ministry of Minerals, Energy and Water Resources and

11 In previously published estimates, grants and subventions were included as part of "other charges", thus becoming the largest component of the recurrent budget.

12 Increasingly, recurrent expenditure items (e.g., operational subsidies for BPC, Ipelegeng, etc.) are being funded through the development budget, thus blurring the distinction between the two budgets.

includes P2 billion for electricity generation and transmission and tariff subsidies, most of which is for enhancing water supply. The second highest share of 12.5 percent amounting to P1.6 billion was allocated to the Ministry of Transport and Communications and will mostly finance information and communications technology, road and air transport infrastructure. The Ministry of Defence, Justice and Security has the third largest budget of P1.3 billion. Allocation to the Ministry of Local Government and Rural Development is 9.3 percent of the total development budget amounting to P1.2 billion, mainly to fund the *Ipelegeng* unemployment relief programme, village infrastructure and elimination of the primary school infrastructure backlog.

TABLE 1.4: GOVERNMENT DEBT AND GUARANTEES FOR 2013/14 – 2014/15 (P MILLION)

Debt & Liabilities as at March 31, 2014	External	Internal	Total
External Debt	15 484		
External Contingent Liabilities	6 401		
Internal Debt		7 018	
Internal Contingent Liabilities		775	
Total Debt & Contingent liabilities as at March 31, 2014	**21 885**	**7 793**	**29 678**
GDP for FY 2013/14			128 502
Debt as percentage of GDP	17.0	6.1	23.1
Total Debt & Contingent Liabilities anticipated March 31, 2015	**20 680**	**8 528**	**29 208**
GDP forecast for FY 2014/15			143 712
Debt as percentage of GDP	14.4	5.9	20.3

Source: Ministry of Finance and Development Planning

Debt Management

2.11 Government and government-guaranteed debt as at the end of the 2014/15 fiscal year is projected at P29.2 billion.[13] Of this amount, the Government's own debt amounts to P23 billion, while the balance is government guaranteed debt (Table 1.4). External debt amounts to P20.7 billion, while the P8.5 billion internal debt includes P7.7 billion government securities and guarantees. Total debt is equivalent to 20.3 percent of forecast GDP, and, therefore, within the statutory ceiling of 40 percent of GDP.[14]

(c) Fiscal and Other Legislation

2.12 Amendments to the Value Added Tax (VAT) Act that were announced in 2014 to extend the range of staple foods (including unprocessed fruit and vegetables) to be zero rated were implemented at the beginning of 2015. The 2015 Budget Speech indicated that a wide-ranging legislative review would be undertaken with the overall objective of improving the business climate. These include labour laws (such as the Employment Act, Trade Disputes Act, Workers' Compensation Act and Trade Unions and Employers' Organisations Act), and legislation related to the financial sector, including the Insurance Industry Bill, a revised Non-Bank Financial Institutions Regulatory Authority Bill and a new Collective Investment Undertakings Bill.

13 A decrease of 1.6 percent compared to the balance outstanding at the end of the 2013/14 fiscal year.

14 The figures reported for Government debt are taken from Table VII of the *Financial Statements, Tables and Estimates of the Consolidated and Development Funds Revenues*. These may differ in some instances from those included in the *2015 Budget in Brief*.

3. Exchange Rates, Balance of Payments and International Investment Positions

(a) Exchange Rates

3.1 The exchange rate policy aims at supporting competitiveness of domestic industries in the international and domestic markets, thus contributing to the national objectives of economic diversification and employment creation. This is achieved through maintaining a stable real effective exchange rate (REER)[15] of the Pula against a basket of currencies of major trading partner countries. In 2014, the weights of the currencies in the Pula basket were 55 percent South African rand and 45 percent SDR, based on estimated patterns of trade. A modest downward crawl of the Pula exchange rate (0.16 percent) was implemented for the year in line with the policy objective of maintaining a stable REER. As a result, the nominal effective exchange rate (NEER) depreciated by this magnitude in 2014.

3.2 The REER of the Pula appreciated marginally by 0.4 percent in 2014, due to a smaller downward crawl relative to the differential between inflation in Botswana and the average inflation of the trading partner countries. The modest rate of crawl helped mitigate the potential inflationary impact of a more substantial depreciation of the nominal exchange rate. Moreover, it is recognised that REER stability alone is not sufficient to ensure the competitiveness of local producers. The best way of achieving durable improvement in competitiveness of domestic producers is through increased productivity, which also contributes to lower inflation.

3.3 The Pula depreciated by 8.3 percent and 2.9 percent against the United States dollar and British pound, respectively, in 2014, and appreciated by 4.5 percent against the Japanese yen and by 4 percent against the euro. Overall, the Pula depreciated against the SDR by 2.4 percent, and appreciated by 1.7 percent against the South African rand in the same period (Table 1.5).

(b) Overview of the Balance of Payments

3.4 The balance of payments was in overall surplus of P11.4 billion in 2014, compared to a surplus of P1.3 billion in 2013 (Chart 1.7 and Table 1.6). The positive outturn was attributable to a substantial increase in export earnings and a decline in imports.

Table 1.5: Pula Exchange Rates against Selected Currencies

Currency (As at end of)	2013	2014	Change (Percent)
Nominal Exchange Rates (Foreign Currency per Pula)			
SA rand	1.1963	1.2169	1.7
US dollar	0.1147	0.1051	-8.3
British pound	0.0696	0.0675	-2.9
Japanese yen	12.04	12.58	4.5
SDR	0.0744	0.0726	-2.4
Euro	0.0832	0.0865	4.0
NEER (index, Sept. 2006 = 100)	85.5	85.3	-0.16
Real Pula Exchange Rate Indices[1] (Sept. 2006 = 100)			
SA rand	109.4	109.7	0.2
US dollar	109.5	103.3	-5.7
British pound	115.5	115.8	0.2
Japanese yen	111.2	117.8	5.9
Euro	101.1	109.3	8.1
SDR	105.4	106.1	0.7
REER	106.3	106.8	0.4

1. All real indices calculated using headline inflation.

Source: Bank of Botswana

Current Account[16]

3.5 Preliminary estimates for 2014 indicate a current account surplus of P33.6 billion compared to the revised surplus of P13.3 billion in 2013. The larger surplus is due

15 The REER is a trade-weighted exchange rate of the Pula (against a fixed basket of currencies, after allowing for relative inflation). It is used as an indicator of the relative competitiveness of the country's tradeable goods and services.

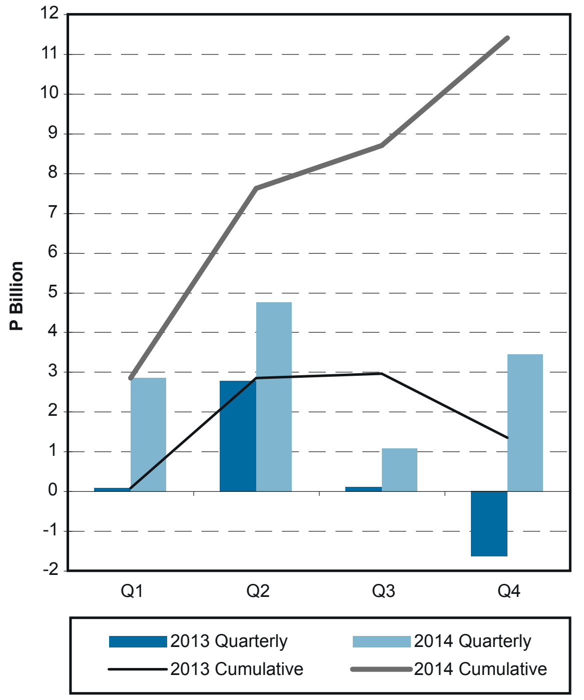
16 The current account comprises trade in goods and services, the income account and the net current transfers.

TABLE 1.6: BALANCE OF PAYMENTS: 2010 – 2014 (P MILLION)

	2010*	2011*	2012*	2013#	2014#
Current Account	-2 268	2 857	-7 037	13 309	33 619
Of which:					
Merchandise trade	-6 825	-5 152	-21 870	- 60	15 516
Services	349	932	1 229	2 365	5 410
Income	-3 733	-768	331	-3 152	-2 694
Net current transfers	7 942	7 846	13 272	14 156	15 387
Financial account	-2 464	7 008	1 523	- 8 046	-985
Capital account	23	3	–	–	–
Net errors and omissions	- 1 802	-6 438	4 652	-3 923	-19 461
Overall balance	-6 511	3 430	-862	1 340	11 404

* Revised
\# Provisional
Source: Bank of Botswana

CHART 1.7: QUARTERLY BALANCE OF PAYMENTS 2013 – 2014



Source: Bank of Botswana

to improvement in the merchandise trade account, predominantly accounted for by diamond exports, together with inflows from SACU and increased tourism receipts.

Merchandise Trade[17]

3.6 Growth in merchandise trade in 2014 was driven by the relocation to Botswana of De Beers' aggregation and sightholder sales functions,[18] a process that was completed in November 2013. This has resulted in a substantial import and re-export trade relating to rough diamonds from other countries where De Beers operates,[19] while downstream diamond cutting and polishing businesses and related service industries also benefited (Table 1.7). In addition, the government-owned Okavango Diamond Company, which was established in 2012 and commenced sales operations in September 2013, provides an alternative marketing channel for a portion of Debswana production. As a result of these developments, the direction of trade for Botswana's imports and exports has also changed, with the importance of the UK (where De Beers aggregation and sales operations

17 Note that the trade data used in preparing the balance of payments does not fully match the monthly trade statistics prepared by Statistics Botswana. For some exports, the trade statistics are supplemented by additional information collected directly from exporters.

18 "Sightholders" are selected long-term clients who participate in regular sales ("sights") at pre-set prices. These account for the bulk of De Beers' sales of rough diamonds; a small portion is sold through auction outside Botswana.

19 Other countries where De Beers has mining operations are Canada, Namibia and South Africa. The aggregation and sales processes add value to the imported rough diamonds, which is reflected in the trade balance. Some aspects of the statistical treatment of diamond trade flows continue to be reviewed and, as such, may be subject to further revision.

Table 1.7: Diamond Trade 2014 (P Million)

Period		Rough: Botswana Exports	Rough: Total Exports	Polished Exports	Total (Rough and Polished)	Imports	Net Re-Exports
2012		**23 237**	**30 398**	**5 340**	**35 738**	**17 200**	**-10 039**
2013		**28 469**	**51 081**	**6 943**	**58 024**	**24 787**	**-2 175**
2014	Q1	10 217	11 342	1 554	12 896	3 085	-1 959
	Q2	8 054	16 815	2 264	19 079	7 830	931
	Q3	8 129	17 025	1 783	18 808	5 847	3 049
	Q4	9 111	17 732	2 490	20 222	5 847	2 774
Total		**35 512**	**62 915**	**8 090**	**71 005**	**22 609**	**4 795**

1. Botswana Exports: Refers to the value of rough diamonds mined in Botswana, and are important for balance of payments purposes, as such sales are accompanied by financial inflows.
2. Total Exports: Represents the value of rough diamonds from Botswana, including re-exports. Subtracting Botswana diamonds from this total approximates the gross value of re-exports. However, this is subject to distortions due to time lags, which means that the two sets of data are not fully comparable, especially over short time periods.
3. Net Re-Exports of Rough Diamonds: This is important for balance of payments purposes and is approximated by subtracting the value of imports from the gross value of re-exports. It is subject to similar limitation as the gross measure.

Source: Bank of Botswana

Table 1.8: Major Export Destinations in 2014 (Percent)

	2013	2014				
	Total	Q1	Q2	Q3	Q4	**Total**
United Kingdom	48.3	0.3	1.1	0.8	0.9	0.8
Belgium	13.2	31.3	28.1	22.9	25.1	26.1
Hong Kong	0.9	2.9	3.7	2.2	2.9	2.9
United Arab Emirates	1.2	5.1	5.7	3.6	4.5	4.6
Israel	6.0	9.3	10.6	7.0	8.5	8.7
India	3.3	13.0	20.5	11.7	15.5	15.1
United States of America	1.3	2.6	3.1	2.0	2.5	2.5
South Africa	10.5	10.7	9.2	13.4	11.6	11.4
Norway	4.4	1.5	2.9	1.1	1.9	1.8
Other	10.9	23.2	15.0	35.4	26.6	26.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Botswana

were previously located) being much reduced (Table 1.8), and a growing prominence of trade with other global diamond centres, such as Belgium, India and Israel.

3.7 The growing complexities of the diamond trade in Botswana contribute to the net errors and omissions in the balance of payments estimates. In particular, physical movements in and out of the country that form the basis for trade estimates may not always be matched by offsetting financial flow transactions, a large portion of which remain external to Botswana. In turn, this will tend to overstate the trade surplus as exports are not all matched by inward receipts, thus resulting in negative net errors and omissions.

3.8 The merchandise trade surplus was P15.5 billion in 2014, which is an improvement from the revised deficit of P59 million in 2013. It is estimated that total exports (Table 1.9) increased by 12.7 percent in 2014, while imports declined by 4.2 percent (Table 1.10). Diamond exports increased by 15.8 percent to

TABLE 1.9: EXPORTS, 2013 – 2014 (P MILLION)

	2013	2014	Percent 2013	Percent 2014	Change (Percent)
Total Exports	67 915	76 511			12.7
of which:					
Diamonds[1]	56 733	65 691	83.5	85.9	15.8
Copper-Nickel	4 709	3 933	6.9	5.1	-16.5
Beef	996	962	1.5	1.3	-3.4
Soda Ash	723	853	1.1	1.1	17.9
Gold	451	362	0.7	0.5	-19.7
Textiles	366	381	0.5	0.5	4.1
Vehicles	659	639	1.0	0.8	-3.0
Other Goods	3 278	3 690	4.8	4.8	12.5

1. See Footnote 20
Source: Bank of Botswana

P65.7 billion,[20] due to a recovery in demand and the depreciation of the Pula against the US dollar. Exports of soda ash and textiles also increased by 17.9 percent and 4.1 percent, respectively. Lower exports were recorded in respect of copper-nickel, gold and vehicles, viz -16.5 percent, -19.7 percent and -3 percent, respectively.

3.9 Imports for 2014 are estimated at P65.2 billion, which is a decrease of 4.2 percent from the revised estimate of P68 billion in 2013 (Table 1.10). A significant reduction in imports was in other goods and metal and metal products, which decreased by 56.7 percent and 10.6 percent, respectively. Imports of food and fuel also fell, with the latter benefitting from reduced electricity imports. However, the overall decrease in imports was diluted by growth in external purchases of vehicles and

TABLE 1.10: IMPORTS, 2013 – 2014 (P MILLION)

	2013	2014	Percent 2013	Percent 2014	Change (Percent)
Total Imports	67 974	65 152			-4.2
of which:					
Diamonds[1]	23 480	23 063	34.5	35.4	-1.8
Fuel	10 860	10 588	16.0	16.3	-2.5
Food	6 392	6 063	9.4	9.3	-5.1
Machinery and Electrical Equipment	7 571	7 742	11.1	11.9	2.3
Chemicals and Rubber Products	5 823	5 610	8.6	8.6	-3.7
Metals and Metal Products	3 025	2 705	4.5	4.2	-10.6
Textiles and Footwear	1 901	1 934	2.8	3.0	1.8
Vehicles and Transport Equipment	5 132	5 804	7.5	8.9	13.1
Other	3 790	1 643.5	5.6	2.5	-56.7

1. See Footnote 20
Source: Bank of Botswana

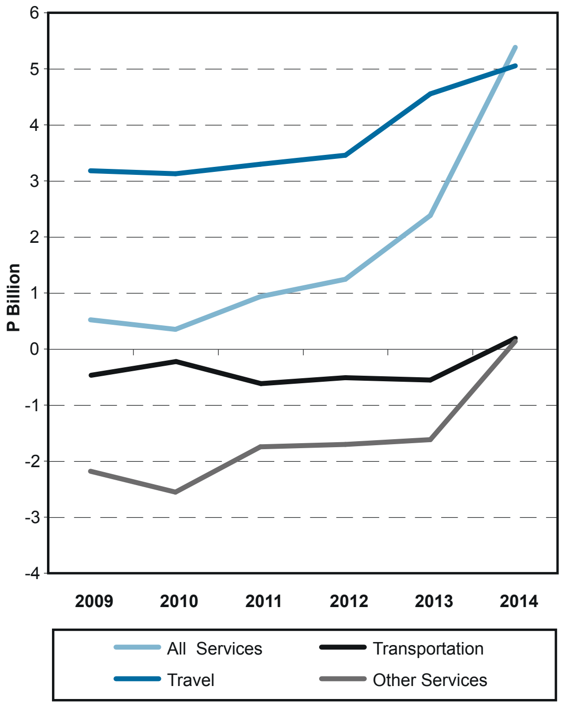
20 Estimates of diamond imports and exports produced by Statistics Botswana are currently undergoing revision. While this process is on-going, the estimates for exports and imports of diamonds used in this report are supplemented by additional information gathered from the industry.

transport equipment (13.1 percent), machinery and electrical equipment (2.3 percent) and textiles and footwear (1.8 percent).

Services[21]

3.10 In 2014, the services account recorded a surplus of P5.4 billion, compared to the revised surplus of P2.4 billion in the previous year (Chart 1.8). Exports of services increased by 10.4 percent to P10.5 billion, mainly due to higher travel receipts, which is dominated by tourism.[22] Imports of services declined by 28.3 percent to P5.1 billion, due to lower imports of 'other services', which includes communications, business and mining services.

Chart 1.8: Balance of Trade in Services (2009 – 2014)



Source: Bank of Botswana

Income Account

3.11 The income account registered a deficit of P2.7 billion in 2014, which is lower than the revised deficit of P3.2 billion in 2013. The credit side of this account comprises mainly earnings from foreign exchange reserves which increased by 12.9 percent to P1.7 billion. The debit component consists of dividends and retained earnings[23] of foreign companies operating in Botswana and interest payments on external debt, which fell from P4.7 billion in 2013 to P4.3 billion in 2014.

Current Transfers

3.12 Net current transfers improved from a surplus of P14.2 billion in 2013 to P15.4 billion in 2014. Net Government transfers grew by 8.6 percent to P14.5 billion, mainly because of an increase in SACU receipts, while net private transfers registered a surplus of P923 million, and higher than P842 million in 2013.

Capital and Financial Accounts

3.13 The capital account records transfers of financial assets by migrants and, as in previous years, such transfers were insignificant in 2014.

3.14 The financial account, which is made up of direct investment, portfolio investment and "other" investment,[24] registered a net outflow of P985 million in 2014 compared to the revised net outflow of P8 billion in 2013,[25] in the context of a much smaller increase in offshore assets compared to the previous year.

Foreign Exchange Reserves

3.15 The foreign exchange reserves increased by 16.7 percent from P67.8 billion in December

21 Data on services should be interpreted with caution due to challenges relating to data collection.

22 Estimates for this category have been significantly revised upwards following incorporation of additional information on tourist-related expenditures prepared by the Department of Tourism.

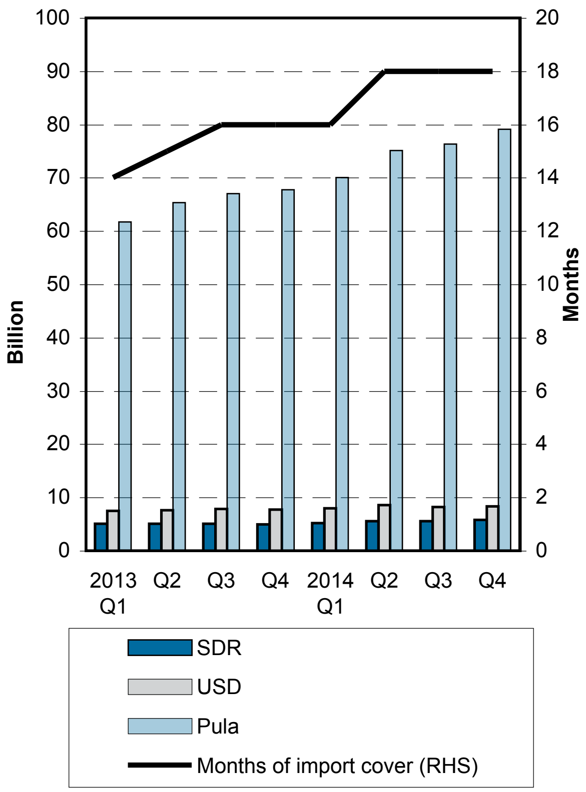
23 Retained earnings by foreign-owned businesses are treated as an imputed outflow on the income account, matched by an offsetting inflow for foreign direct investment.

24 Other investment comprises borrowing from and lending to foreign entities not classified as direct investment.

25 The 2014 position is based on preliminary estimates and is subject to revision following completion of the 2014 Balance of Payments Survey.

2013 to P79.1 billion in 2014 (Chart 1.9). This reflects net inflows, mainly arising from the trade surplus and SACU receipts, together with market and currency valuation gains. The currency valuation gains resulted from the depreciation of the Pula against currencies in which the reserves are held. In foreign currency terms, the level of reserves increased by 7.7 percent to USD8.3 billion and by 14.8 percent to SDR5.8 billion. This was equivalent to 18.5 months of import cover[26] in December 2014, compared to 15.8 months as at December 2013.

CHART 1.9: LEVEL OF FOREIGN EXCHANGE RESERVES – QUARTERLY (2013 – 2014)



Source: Bank of Botswana

(c) Balance of Payments Outlook

3.16 The current account is expected to remain in surplus in the medium term, largely supported by growth in merchandise exports and SACU revenues associated with the global economic recovery. Following a period of rapid expansion due to the relocation of De Beers' sales operations and establishment of the diamond re-export trade in the country, imports of diamonds will grow less strongly. Imports are, therefore, expected to increase mainly as a result of growth elsewhere in the domestic economy, including capital goods required for investment. Inflows on the financial account will, to a large extent, finance private sector investment, especially the mining sector.

(d) International Investment Position (IIP) and Foreign Investment

3.17 Detailed estimates for the IIP, which records the stock of foreign assets and liabilities, are only available up to 2013. For 2014, preliminary estimates are available only for major aggregates.

(i) International Investment Position[27]

3.18 On the basis of preliminary estimates for 2014, Botswana's net international investment stood at P65.8 billion, which was an increase of 17.4 percent from P56 billion in 2013. This was driven by the 12.3 percent increase in foreign assets from P120 billion in 2013 to P135.2 billion; foreign liabilities rose by a smaller 7.8 percent from P64.4 billion to P69.4 billion in the same period. The stock of direct investment and portfolio investment outside Botswana increased by 5.5 percent and 4.6 percent, respectively. More rapid growth was recorded for 'other investment' (mainly comprising offshore/foreign currency liabilities of residents) and reserve assets of 16.4 percent and 16.3 percent, respectively. On the liabilities side, direct investment by foreigners increased by 9.3 percent from P38 billion in 2013 to P41.5 billion in 2014, and 'other investment' rose by 6.4 percent from P23.6 billion to P25.1 billion.

26 The calculation of import cover excludes imports of rough diamonds, as these are mainly for re-export.

27 There have been substantial revisions to the data to align them with balance of payments flows.

(ii) Investment in Botswana by Industry and Country Classification in 2013

3.19 The stock of Botswana's foreign liabilities at the end of 2013 is shown in Tables 1.11 and 1.12, classified by industry and country.[28] The mining and the finance sectors have the largest shares of foreign direct investment at 68.1 percent and 20.5 percent, respectively. Europe remains the principal source of total direct investment, accounting for 71.4 percent, with Luxembourg at 61.2 percent due to the residence status of the major mining investors in Botswana. This is followed by Africa at 24.2 percent, of which investment from South Africa accounts for 60.8 percent.

3.20 In 2013, government external debt classified under "public administration" constituted 48.9 percent of "other" investment by foreigners,

Table 1.11: Level of Foreign Investment in Botswana by Industry 2013 (P Million)

Industry	Direct Investment	Other Investment	Total
Mining	20 584	6 542	27 126
Manufacturing	198	147	345
Finance	6 189	2 029	8 219
Retail and Wholesale	963	620	1 583
Electricity, Gas and Water	293	6 446	6 739
Real Estate and Business Services	733	47	779
Transport, Storage and Communication	105	0	105
Construction	1	0	1
Hospitality	225	39	264
Public Administration	0	15 544	15 544
Other	925	352	1 277
Total	**30 215**	**31 766**	**61 982**

Source: Bank of Botswana

Table 1.12: Levels of Foreign Investment in Botswana by Country 2013 (P Million)

Country	Foreign Direct Investment	Other Investment	Total
North and Central America	411	890	1 301
Of which			
United States	301	888	1 190
Europe	21 570	788	22 358
Of which			
United Kingdom	2 249	257	2 506
Netherlands	19	0	19
Luxembourg	18 488	481	18 969
Other Europe	815	50	864
Asia Pacific	244	6 253	6 497
Africa	7 320	4 187	11 507
Of which			
South Africa	4 453	2 010	6 463
Middle East	79	0	79
Other	591	19 648	20 239
Total	**30 215**	**31 766**	**61 982**

Source: Bank of Botswana

28 These figures are based on the 2013 Balance of Payments Survey conducted by the Bank of Botswana.

thus making it the largest component. This was followed by mining and electricity, gas and water with respective shares of 20.6 and 20.3 percent in "other" investment. The latter was dominated by debt financing, sourced from China, for the Morupule B power plant. By country, the "other" category, which largely comprised public sector debt from multilateral organisations and development partners and was not attributable to countries, constitutes the largest source of "other" investment with 61.9 percent, followed by Asia Pacific (19.7 percent) and Africa (13.2 percent).

4. Money And Capital Markets

(a) Monetary Policy and Liquidity Management

4.1 The primary goal of the Bank's monetary policy is to achieve price stability, defined as stable and sustainable inflation within the medium-term objective range of 3 – 6 percent. Additionally, policy is formulated with a view to safeguarding the soundness and stability of the financial system. A low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers and, thus, contributes towards the broader national objective of sustainable economic diversification and development.

4.2 The monetary policy framework is forecast-based, with a medium-term outlook that primarily guides the Bank's response to forecast movements in inflation, while taking into account prospects for economic growth and developments with respect to financial stability indicators. The main elements of the policy framework are as follows:

(i) generation of a broad-based medium-term inflation forecast, including an assessment of both the "output-gap" [29] and "real monetary conditions" [30] as well as an estimate of the impact of changes in administered prices and government levies;

(ii) assessment of additional information not incorporated in the inflation forecast, including responses to the twice-yearly Business Expectations Survey and other supplementary data sources;

(iii) evaluation of financial and other indicators that can impact on the stability of the financial system, including credit and deposits, liquidity conditions and property market developments, as well as economic growth and employment prospects;

(iv) regular meetings of the Bank's Monetary Policy Committee (MPC) to review recent economic developments, the related inflation outlook and implications for monetary policy, as well as prompt dissemination of decisions to foster policy credibility and help anchor inflation expectations;

(v) use of interest rates and open market operations to affect demand conditions in the economy and, ultimately, the rate of increase in prices.[31] In general, the Bank responds to a sustained deviation of inflation from the objective range, and when the causal factors could be influenced by domestic monetary policy; and

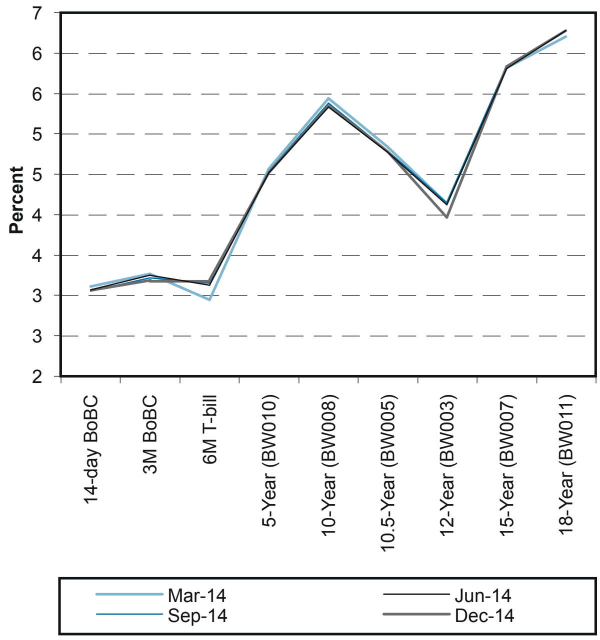
(vi) monitoring of exchange rate developments and implementation of the crawling band exchange rate policy

29 The output gap refers to the difference between actual output and the long-term trend output (as an indicator of productive capacity). A negative output gap means the actual level of output for a given period is below the trend level, in this way indicating that the economy is operating below its estimated potential.

30 The real monetary conditions index (RMCI) measures the relative looseness or tightness of monetary conditions and gauges the likely effect that monetary policy has on the economy through changes in the exchange rate and interest rates. The RMCI combines, through a weighted average, the deviations of the real exchange rate and real interest rate from their respective trend values.

31 For example, a sustained level of economic performance above trend is potentially inflationary and could signal the need to increase interest rates to dampen inflationary pressures, while output below trend could require a reduction of interest rates to stimulate economic activity.

Chart 1.10: Yield to Maturity on Bank of Botswana Certificates and Government Bonds



Source: Bank of Botswana

to support competitiveness of the local producers.

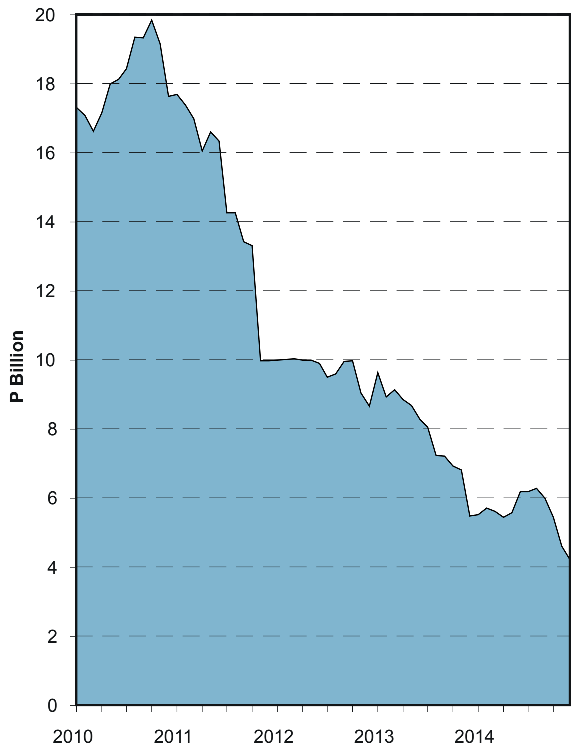
(b) Interest Rates and Bank of Botswana Certificates

4.3 During 2014, monetary policy was conducted in the context of modest expansion of global economic activity, easing financing conditions, benign inflationary pressures and declining commodity prices, particularly the oil price which fell significantly from mid-year. Domestically, below-trend growth in the domestic economy indicated a non-inflationary output gap. Modest domestic demand and benign foreign price developments contributed to the positive inflation outlook in the medium term. Thus, the Bank Rate was maintained at 7.5 percent throughout the year, and, therefore, the commercial banks' prime lending interest rate was unchanged at 9 percent. The yield on 14-day Bank of Botswana Certificates (BoBCs) increased slightly from 3.06 percent in December 2013 to 3.07 percent in December 2014, while the 3-month BoBC yield fell from 3.58 percent to 3.19 percent.[32]

4.4 The real 14-day BoBC rate increased from -1 percent in December 2013 to -0.7 percent in December 2014 in recognition of lower inflation, while the faster decrease in the nominal 3-month BoBC yield resulted in a marginal decline in the real interest rate from -0.5 percent to -0.59 percent in the same period.

4.5 Implementation of monetary policy involved open market operations (OMOs), with excess liquidity absorbed through the sale of BoBCs to achieve interest rates consistent with the policy stance. Given a lower level of excess liquidity, the outstanding value of BoBCs fell from P5.5 billion in 2013 to P4.2 billion in 2014 (Chart 1.11). Repurchase Agreements (repos) and reverse repos were used to manage

Chart 1.11: Outstanding Bank of Botswana Certificates

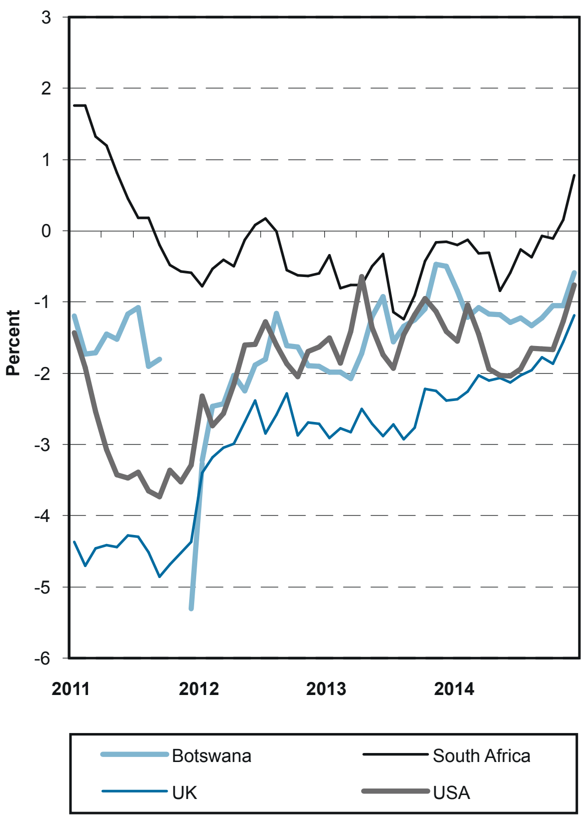


Source: Bank of Botswana

32 The quoted yields for papers of both the 14-day and 3-month maturities are based on the weighted average of the winning bids at auction; as such they reflect the bidding preferences of OMOs counterparties at auctions. The fall in the 3-month BoBC yield in 2014 was due to a delayed response (auctions of the 3-month BoBC take place only once every month) to the interest rate reduction in December 2013.

intra-auction liquidity. In December 2014, absorption of liquidity through reverse repos was P304 million, and in contrast to the P302 million injection of liquidity through repos of December 2013.

Chart 1.12: Real Interest Rates – International Comparisons



1. There were no 3-month BoBCs auctioned in November 2011.

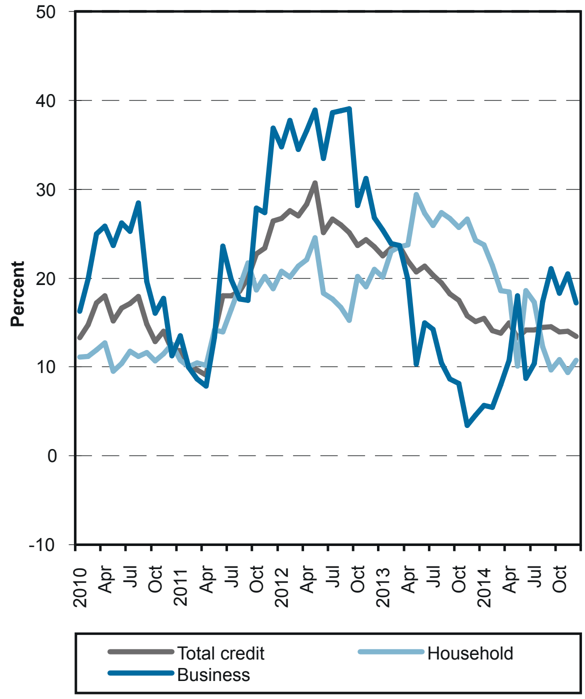
Source: Bank of Botswana

(c) Banking System

Domestic Credit

4.6 The year-on-year increase in commercial bank credit eased from 15.1 percent in December 2013 to 13.5 percent in December 2014, due to a significant slowdown in growth of lending to the household sector, from 24.2 percent to 10.7 percent. In contrast, the annual increase in business credit rose from 4.6 percent in 2013 to 17.2 percent in 2014 (Chart 1.13). As at December 2014, the share of household credit in total private commercial bank credit was 56.4 percent compared to 57.7 percent in December 2013.

Chart 1.13: Year-on-Year Commercial Bank Credit Growth



Source: Bank of Botswana

4.7 The lower growth in household credit was due to a significant slowing in the yearly increase in mortgages from 40.1 percent to 18.4 percent and in personal loans from 19.6 percent to 7.4 percent, in an environment of slow growth in incomes. At the same time, from the supply side, there was weak growth in loanable funds, which further suppressed credit growth through tighter lending conditions.[33] The slowdown in the growth of mortgage lending appeared to be consistent with other indications that the market for residential property was weakening, especially for high-value properties.

4.8 Overall, the deceleration in the rate of growth in household credit represents a normalisation in line with the slower growth in incomes, which augurs well for maintenance of financial stability. Similarly, the softening of mortgage credit against the background of moderation in the property market reduces potential risks in this area. Thus, current indicators, including

33 These credit trends in household and business credit may be exaggerated by banks' reclassification of significant amounts of their loans between the two categories without necessarily correcting data for the earlier periods.

low and stable default ratios for household borrowing, reflected a generally stable financial system. The ratio of non-performing loans to total credit was 2.9 percent at the end of December 2014 in the context of a well-capitalised banking system and sufficient provisioning by banks. Moreover, prospects for sustained positive economic growth suggest accompanying increases in household and business incomes, which is supportive of a sound financial system.

Monetary Aggregates

4.9 Annual growth in broad money supply increased from 4 percent in December 2013 to 4.6 percent in December 2014. The year-on-year growth in money supply in December 2014 reflected the impact of the expansion in credit and the increase in net foreign assets that more than offset the contractionary effect of the rise in government deposits at the Bank of Botswana. With respect to components of the money supply, currency outside depository corporations grew annually by 6.2 percent in December 2014, while transferable (current account) and other deposits expanded by 5.5 percent and 4.3 percent, respectively, in the same period. The Pula value of deposits in foreign currency accounts (FCAs) increased by 25.4 percent in the twelve months to December 2014 and accounted for 15.5 percent of total deposits at commercial banks.

Bank of Botswana

4.10 Total assets and liabilities of the Bank of Botswana grew by 16.1 percent, from P68.6 billion in December 2013 to P79.7 billion in December 2014. The growth of the balance sheet in 2014 reflected the impact of the 16.7 percent increase in the foreign exchange reserves, underpinned by a 23.4 percent increase in shareholder's funds, which mainly comprised the Government's share of the Pula Fund and Liquidity Portfolio, from P51.7 billion to P63.8 billion. Thus, the government investment account grew by 40.8 percent from P26.5 billion in December 2013 to P37.3 billion in December 2014. Commercial bank deposits at the Bank of Botswana (including primary reserve balances) edged up modestly from P4.4 billion to P4.7 billion, while the value of outstanding BoBCs fell by 23.5 percent.

Commercial Banks

4.11 Total banking sector assets reached P68 billion in December 2014, which is an increase of 12.6 percent from P60.4 billion in December 2013. This expansion in assets was driven by growth of 13.6 percent in loans and advances from P38.8 billion in December 2013 to P44.1 billion at the end of 2014, while BoBCs held by banks fell by 22.7 percent in the same period. Deposits by local banks held in foreign banks rose by 14 percent, while "other assets" increased by 3.6 percent. On the liabilities side, public deposits at commercial banks increased by 6.1 percent in the same period. A notable feature of commercial banks' balance sheets is that funding is supported by wholesale business deposits (71.5 percent of total deposits), which sustains the net debtor position of households (accounting for 55.4 percent of total credit). The ratio of commercial bank assets to nominal GDP remained broadly stable at around 50 percent in both 2013 and 2014.

(d) Other Financial Institutions

4.12 Assets and liabilities of the Botswana Building Society rose by 12.4 percent from P3 billion in December 2013 to P3.4 billion in December 2014; this compares with the 9.9 percent increase in 2013. Loans and advances increased by 14.2 percent, while the Society's cash and deposits grew by 4.5 percent. Total assets and liabilities of the National Development Bank expanded by 15.6 percent to P1.9 billion; this is considerably lower than the growth of 33.2 percent in 2013. This reflected slower growth in lending of 16.1 percent against 20.4 percent the previous year, together with a contraction in cash and deposits and other assets. The balance sheet of the Botswana Savings Bank grew by 9.7 percent in 2014 (14.6

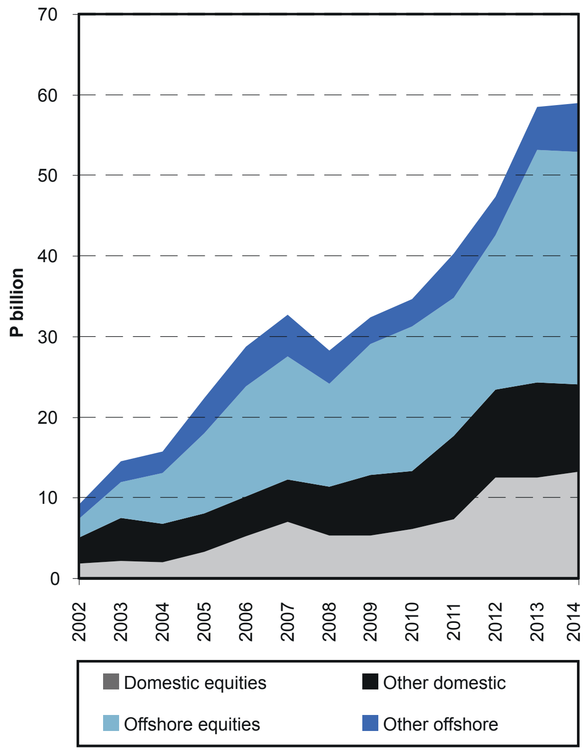
percent in 2013) as lending increased by 20 percent (16.5 percent in 2013). Mobilisation of savings was also sustained, with deposits growing by 10.8 percent in 2014, albeit slower than 15.4 percent in 2013. For the Botswana Development Corporation, assets increased by 5.4 percent to P2.1 billion in the year to December 2014 on the back of growth of 7.2 percent in investments in related companies, which offset the decline in bank deposits and loans, advances and leasing.

4.13 With respect to the Botswana Stock Exchange (BSE), the Domestic Companies Index increased by 5.1 percent in 2014 to 9 501.6 at the end of the year; this is significantly lower than the 20.2 percent increase in 2013. Trading was active, with 602 million shares valued at P2.2 billion traded, while the market capitalisation of domestic companies grew by 6.8 percent to P46.2 billion. There were 24 listed domestic companies in 2014, unchanged from the previous year. The Foreign Companies Index declined by 0.3 percent (thus losing 4.3 points) compared to the fall of 1.1 percent in the previous year as global economic prospects gradually improved. Twelve foreign companies were listed on the BSE at the end of 2014, as was the case in 2013.

4.14 Pension funds' assets grew by 11.9 percent from P58.7 billion in December 2013 to P59.4 billion in December 2014 (Chart 1.14). Holdings of domestic equities increased by 6.2 percent to P13.3 billion, while offshore equities decreased by 6.8 percent to P26.9 billion. The value of domestic bonds held by pension funds fell by 5.9 percent to P7.8 billion, while offshore bonds increased by 41.1 percent to P6 billion. The proportion of assets invested offshore by pension funds increased from 58.3 percent in December 2013 to 58.8 percent in December 2014.

4.15 The Government continued to support capital market development through issuing securities under the P15 billion Bond Note Programme. In 2014, bonds of differing maturities (2.5 years, 6 years and 17 years) were re-opened at auctions and four rollovers of the 6-month Treasury Bill were issued. As at December 2014, the total par value of outstanding bonds and Treasury Bills was P7.2 billion (P6.7 billion in 2013), with 24.7 percent and 75 percent held by primary dealers (banks) and their clients, respectively. The Bank of Botswana held the balance of P20 million (0.3 percent) for potential secondary market activity.

CHART 1.14: BOTSWANA PENSION FUND ASSETS (2002 – 2007)



Source: Ministry of Finance and Development Planning and NBFIRA.

(e) Credit Rating

4.16 Both the international sovereign credit rating agencies, Moody's Investors Service (Moody's) and Standard & Poor's Ratings Services (S & P) maintained the investment grade sovereign credit ratings for Botswana of A2 and A-/A-2 (short/long term), respectively, and the stable outlook. The ratings are supported by the strong external and fiscal balance sheets, net external creditor position and low public debt. Robust institutions sustain a well-managed economy, resulting in continued strengthening of the Government's net financial position, underpinned by prudent fiscal policies and a track record of political stability. The stable outlook reflects expectations of resilient growth and continued fiscal surplus. However, there continues to be a concern about the relatively slow progress in economic diversification, which implies that the economy remains vulnerable to shocks.

Chapter 2
Preserving Macroeconomic Stability and Fostering Economic Growth

1. Introduction

1.1 Macroeconomic stability is characterised by a combination of robust and steady growth together with low and stable inflation, a sound financial system and resilience to adverse economic shocks. In contrast, instability, in the form of large swings in economic activity, high inflation, weak financial institutions, external imbalances and the build-up of debt towards unsustainable levels, can damage long-term growth prospects and result in rising unemployment, poverty and inequality. For Botswana, in the last four decades consistent application of sound policies has resulted in a high degree of macroeconomic stability. Although not sufficient, this is a necessary precondition for sustained development, the creation of productive employment opportunities and a rising standard of living. These are necessary for the country to make a successful transition from middle- to upper-income status, which is a key objective of the national long-term vision.

1.2 Reflecting the importance of macroeconomic stability as a foundation for sustained development, growth of the Botswana economy has averaged 7.5 percent per annum since independence in 1966. More recently, the economy has rebounded after the 2009 economic downturn that followed the 2007-2008 financial and economic crisis, with most sectors of the economy now experiencing positive growth. Inflation is currently low by historical standards, remaining within the Bank of Botswana's medium-term objective range of 3 - 6 percent since mid-2013.[1] while stability of the real effective exchange rate was sustained through the crawling band mechanism. The domestic financial system proved to be resilient to the shocks arising from the global crisis (albeit due to limited external exposure) and remains sound. There has also been effective consolidation of government finances with renewed budget surpluses and a rebuilding of foreign exchange reserves.

1.3 While the overall economic situation is currently relatively healthy, there remain prospective vulnerabilities that could threaten macroeconomic stability in future. The recent period of low inflation should not lead to complacency regarding the primacy of the price stability objective in the central bank's mandate, while the monetary policy framework must continue to evolve taking into account relevant economic, financial and market developments. In this regard, although financial sector development is important, including greater financial inclusion and a wider range of services to both businesses and households, it can be accompanied by risks of instability that can disrupt the economy more widely. Thus, macroeconomic policies also need to address developments in the financial system and their impact on economic performance. Meanwhile, external stability, as indicated by a sustainable path for the balance of payments and exchange rate, must be viewed in the context of unlocking the potential for Botswana to maximise opportunities arising from external linkages, both regionally and internationally, in terms of trade, investment and associated benefits from skills and technology transfer.

1.4 Similarly, the heavy reliance of government finance on minerals as well as customs and excise revenues poses a significant risk. Not only are minerals a non-renewable resource that will ultimately be depleted; revenue from this source is vulnerable to large external shocks. Similarly, the future of receipts from the Southern African Customs Union (SACU) is uncertain while, at the same time, growth of other sources of government revenue is likely to be modest, given the moderate expansion

1 In February 2015, inflation in Botswana fell to 2.8 percent, below the bottom end of the objective range.

that is projected for the economy in the medium term together with the need to keep tax rates relatively low as part of maintaining the business-friendly investment climate. In such circumstances, any significant deterioration in government revenue could limit the stimulus provided by public spending to the economy, including the coverage of social services and safety nets. This could undermine prospects for inclusive growth and its beneficial impact on the population.

1.5 Overall, it is imperative for Botswana to preserve macroeconomic stability in order to foster economic growth that is not only sustained, but benefits the entire population in terms of enhanced employment opportunities, rising living standards and poverty reduction. The recent experience of both the financial crisis and ensuing global recession reinforces the need for Botswana to pursue appropriate stabilisation policies, including during times when relatively favourable conditions prevail. Such policies should be an integral part of the process of preparing for National Development Plan 11 (NDP 11) and the adoption by the Government of medium-term fiscal and expenditure frameworks. In addition, there continues to be a need to evaluate performance and relevance of monetary and exchange rate policies, especially with regard to their contribution to macroeconomic stability. Finally, for growth to be inclusive, it is imperative for the micro-economy to also function effectively, including through policy interventions that impact on resource allocation in terms of productive efficiency and provision of effective and appropriately-targeted social safety nets.

1.6 The theme chapter assesses the effectiveness of Botswana's current macroeconomic policies, and their likely evolution if they are to remain relevant going forward in terms of the maintenance of sustainable economic growth. Section 2 reviews Botswana's experience with respect to achieving macroeconomic stability, while Section 3 analyses potential threats to the maintenance of stability and Botswana's growth prospects. Section 4 examines opportunities for enhancing macroeconomic linkages in support of inclusive growth. The relevance of Botswana's macroeconomic policies going into the future is considered in Section 5, while Section 6 concludes the chapter.

2. Botswana's Experience in Achieving Macroeconomic Stability

(a) Definition and Benefits of Macroeconomic Stability

2.1 Macroeconomic stability is a multi-dimensional concept which encompasses important attributes as follows:

(i) fiscal solvency manifested by medium-term budget balance (low deficits) and relatively low debt levels is consistent with the maintenance of a sustainable government expenditure programme. Solvency also affords discretion in undertaking both revenue and expenditure initiatives, particularly for stabilisation purposes or responding to shocks. Moreover, there is less need for government to undertake measures that can undermine stability in other areas, such as prices (inflation), the exchange rate and financial sector;

(ii) price stability (low, predictable and stable inflation) reduces uncertainty and the risks associated with investment and consumption decisions. It also contributes to price competitiveness of the domestic industry and supports growth in real incomes and maintenance (and increase) of consumption levels/living standards;[2]

(iii) external balance refers to sustainable balance of payments and a stable and competitive real effective exchange rate (REER) and maintenance of adequate foreign exchange reserves.

2 Conversely, high and volatile inflation rates result in quick erosion of the value of the currency and incomes and redistribution of real incomes and wealth to the detriment of those least able to defend their economic interests.

In the circumstances, a stable REER fosters competitiveness of the tradeable goods sector and, therefore, encourages expansion and diversification of production. The maintenance of sufficient foreign exchange reserves (accumulated from positive balance of payments) affords intervention in the foreign exchange markets to sustain the desired exchange rate and maintenance of import levels and spending programmes in the event of temporary shocks to the export market or government revenue;

(iv) financial stability relates to efficient, prudent and uninterrupted supply of funding and facilitation of payments by the financial sector to other sectors of the economy to undertake investment, production, trade and consumption.

2.2 Overall, the aforementioned attributes of macroeconomic stability promote sustainable development, wealth accumulation and rising standards of living. However, macroeconomic stability is not a sufficient condition for growth, which also depends upon the structure of key markets and sectors. Therefore, in order to benefit fully from macroeconomic stability, policies need to include relevant structural elements that can strengthen and improve the functioning of the economy.

2.3 In the last three decades, the main thrust of economic policy in Botswana has been to diversify the economy in order to reduce dependence on the mining sector, particularly diamonds, and to create employment opportunities that, in turn, contribute to improved living standards, including poverty reduction. To achieve this, maintaining macroeconomic stability through the policy frameworks highlighted below has been one of the key components of the overall economic strategy.

(b) Review of Botswana's Current Macroeconomic Policy Framework

Monetary Policy

2.4 Since monetary independence in 1976, Botswana's monetary policy framework has evolved owing to financial and economic, as well as policy and institutional developments (Appendix Table 2.1).[3] Between 1976 and 1991, monetary policy was directed primarily at maintenance of low interest rates to encourage domestic investment. However, the thrust and conduct of monetary policy changed considerably in 1991 as price stability was increasingly emphasised and the authorities embarked on financial liberalisation, adopting the use of indirect policy instruments.[4] From the late 1990s, improvements involved a more transparent framework for the conduct of monetary policy and explicit statement of price stability as an objective of monetary policy.[5] In this respect, a short term (annual) numerical definition of price stability was introduced in 2002 (set at 4 - 6 percent) and used alongside an intermediate target for commercial bank credit growth as the basis of policy making until 2006.[6]

2.5 The monetary policy framework was further enhanced in 2008 with the adoption of a forecast-based and medium-term approach. In this regard, the forecast for inflation is derived from projections of a wide set of inflation determinants and informs the policy decision; a forecast for inflation in the medium term above the objective (currently 3 – 6 percent) will normally require policy tightening, while the reverse would also hold.[7] The medium-

3 The evolution of monetary policy can be traced in detail through various Annual Reports and other publications of the Bank of Botswana.

4 Unlike direct instruments which operate through regulation and administration, indirect instruments operate by influencing market conditions.

5 The principal objective of monetary policy in Botswana has always been to promote and maintain price stability.

6 The target growth for credit was defined as expected growth rate for GDP plus the inflation objective and two percentage points added to accommodate financial deepening.

7 Even then, a distinction is made between the factors that have a transitory impact, such as supply-side shocks, and those with an enduring effect on inflation, especially changes in demand conditions. Policy decisions are undertaken by the Monetary Policy Committee, which meets every two months.

term perspective recognises the horizon over which policy changes are likely to impact on price developments, which conventionally is assessed to be at least four quarters ahead.

2.6 The Bank's main instruments of monetary policy continue to be the Bank Rate and the purchase and sale (including repurchase operations or "Repos") of Bank of Botswana Certificates (BoBCs). Other instruments of monetary policy include the primary reserve requirement, moral suasion and the communication strategy. Broadly, these instruments are intended to regulate the cost and availability of commercial bank credit which has an influence on aggregate demand in the economy. In turn, the extent to which demand matches the supply of goods and services in the economy determines the rate of increase in prices or inflation. The communication strategy embodies transparency and accountability and also helps to promote credibility and understanding of monetary policy with a view to anchoring public expectations of a low, predictable and sustainable level of inflation.[8] Elements of accountability and transparency include annual publication of the Monetary Policy Statement (and mid-term review) and issuance of a public statement following each Monetary Policy Committee meeting.

2.7 In terms of performance, headline inflation had, until recently (2013), generally been outside the desired range. However, the result cannot be attributed to the failure of monetary policy, but rather an indication that inflation was mostly driven by factors outside the scope of monetary policy.[9] Without these factors, inflation would have been much closer to, if not within, the objective range. It is also significant that as inflation has moderated, and in the context of improvements in the monetary policy framework, interest rates have steadily fallen, thus lowering the cost of finance in Botswana, to the benefit of economic activity.

Exchange Rate Policy

2.8 Botswana's exchange rate policy has similarly evolved over time since the introduction of the local currency (Pula) in 1976 (Appendix 2.2). After the initial fixing to a single currency (US dollar), the Pula has been pegged to a basket of currencies of trading partner countries. Variations were occasionally made to the currency composition and weights in the basket to reflect the desire for stability of the Pula exchange rate and to recognise changes in trade patterns. Earlier on, with a limited role and muted impact of monetary policy on domestic price developments, the focus was generally to contain imported inflation and provide a nominal anchor for prices. However, from the 1980s onwards, adjustments to the exchange rate and related parameters tended to be geared towards supporting international competitiveness of Botswana's producers of tradeable goods and services (both exports and import substitutes), through maintenance of a stable REER.

2.9 Prior to May 2005, the response to exchange rate misalignments was generally undertaken after a long time and involved relatively large adjustments of the Pula exchange rate, which were destabilising in several respects. In particular, devaluations led to a significant increase in inflation and undermined predictability of macroeconomic policies. Consequently, in May 2005, a crawling band exchange rate mechanism was introduced to enable maintenance of REER stability through a gradual nominal adjustment of the Pula exchange rate, thus obviating the need for large discrete devaluations.

2.10 The annual rate of crawl is determined on the basis of the differential between the Bank's inflation objective and forecast inflation for trading partner countries, and implemented through proportionate daily adjustments. During 2014, the rate of crawl was minus 0.16 percent and the currency weights were

8 Successive editions of the Bank's annual Monetary Policy Statement provide more details on the monetary policy framework.

9 Some of the factors include the upward adjustment in administered prices and government levies, as well as the impact of the global food and oil price shocks.

55 percent South African rand and 45 percent Special Drawing Rights (SDR).[10] Since the inception of the crawling band exchange rate regime, the REER has generally been stable, reflecting the impact of both the adjustment of the nominal effective exchange rate (NEER) through the crawl and some success in moderating inflation towards the average level for trading partner countries. Notably, the crawling band arrangement is used in the context of active monetary policy that seeks to achieve inflation close to that prevailing in the trading partner countries, which similarly contributes to domestic industry competitiveness and obviates the need for large nominal exchange rate adjustment.

Financial Stability

2.11 In the aftermath of the global financial crisis of 2008, the need for a financial stability framework to proactively address any emerging vulnerabilities as well as the resilience of the financial system is now widely accepted. In particular, it is acknowledged that the regulatory and supervisory focus on individual financial institutions may not sufficiently take into account systemic risk. Among others, it is considered that adding macro-prudential oversight to micro-prudential supervision of financial markets would be helpful in detecting the build-up of vulnerabilities. In this regard, many central banks and regulatory authorities have undertaken institutional and organisational changes to establish appropriate monitoring and response mechanisms, which are also aligned to other relevant functional and policy areas. In addition, several central banks also publish financial stability reports that outline key risks and vulnerabilities of the financial sector, as well as highlight required regulatory interventions and reforms to the benefit of market participants, policymakers and the general public.

2.12 As in other countries, the financial stability framework in Botswana seeks to promote a sound financial system that supports economic activity on a sustainable basis. The framework, therefore, encompasses effective prudential regulation of individual financial institutions, mechanisms for liquidity support, an efficient payments mechanism, recognition and monitoring of systemic risk, regulatory and supervisory coordination, as well as macroeconomic policy formulation that takes cognisance of financial sector developments and vulnerabilities. In this context, individual banks are regulated by the Bank of Botswana, while the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) supervises and regulates the non-bank financial institutions (NBFIs), such as pension funds, insurance companies, non-bank credit institutions, capital markets, collective investment undertakings and asset managers. A Memorandum of Understanding between the Bank and NBFIRA addresses the commitment to communication and cooperation to facilitate optimal effectiveness and efficiency of the supervisory processes. Furthermore, supervisory regulations and practices have evolved in line with international norms, and are currently being updated to comply with Basel II/III principles.[11]

Fiscal Policy

2.13 Fiscal policy in Botswana has been characterised by prudent management of the government budget, with public expenditure aligned to expected sustainable revenue sources, and where borrowing is contained within structural limits that do not threaten government solvency.[12] Moreover, given the country's dependence on diamond revenue,

10 The SDR is a unit of account of the International Monetary Fund and is constituted by the US dollar, British pound, euro and Japanese yen.

11 Basel II is a framework introduced to make regulatory capital more reflective of the underlying economic risks. It provides incentives to a bank to adopt the best risk management and governance practices by allotting such a bank lower capital requirements for holding higher quality assets and vice versa. Basel III is an enhancement of Basel II and aims to enhance the resilience of the banking sector.

12 Fiscal policy can be a source of macroeconomic instability by aggravating imbalances between aggregate demand and aggregate supply.

fiscal management focuses on ensuring sustainable budgeting and implementing spending programmes that would transform the value of the exhaustible resource into a lasting contribution to the development of the economy. Therefore, over time, the Government has established various fiscal rules (Appendix 2.3).

2.14 The "Principle of Sustainable Budgeting" was introduced in NDP 7 (1991 – 1997) with the purpose of ensuring that all mineral revenues were to be invested productively or saved, and not used to finance consumption. In this regard, the Sustainable Budget Index (SBI), an indicator of fiscal soundness, and calculated as the ratio of non-investment recurrent expenditure to non-mineral revenue should be maintained below one. When it is above one, it would indicate that revenues from non-renewable resources (part of the country's natural wealth endowment) are used to finance current consumption, thereby not contributing to future economic growth and prosperity by replacing the natural wealth depleted. In addition to the SBI, and in order to strengthen commitment to sustainable budgeting, an expenditure target based on the expected revenue yield as a proportion of GDP was introduced in 2006 as part of the Mid-Term Review of NDP 9. Currently, the target requires that total government expenditure should not exceed 40 percent of GDP, although it is envisaged that a reduction to 30 percent of GDP would represent a more sustainable level in the long run.[13] Furthermore, the Stocks, Bonds and Treasury Bills Act 2005 established the limit for the government debt and government guaranteed debt at 40 percent of GDP, split equally between domestic and external borrowing. Overall, the SBI rule has largely been adhered to,[14] and the country has been able to maintain a healthy fiscal balance and manageable level of public debt. This outcome was helped by the fact that the Government of Botswana generally ran budget surpluses due to buoyant and often higher than anticipated revenues from diamond mining, as well as limited absorptive capacity.[15]

2.15 The global financial crisis in 2008 and the subsequent recession placed severe strain on the government budget, primarily through the negative shock to diamond export revenues. As a result, the Government embarked on fiscal consolidation measures and committed to achieving a broadly balanced budget in the medium term. This required delaying implementation of new spending programmes, with priority given to the completion of on-going projects. Furthermore, greater emphasis is now placed on "self-liquidating" or high return projects.[16] In order to restrain expenditure on recurrent spending (the wage bill, in particular), efforts are underway to rationalise state-owned enterprises and hive-off non-core activities to the private sector. The Government has also strengthened the tax collection system and is committed to introducing a Medium-Term Expenditure Framework (MTEF) by 2016 and this will provide a more explicit linkage between NDP priorities and budget allocations.

(c) Key Indicators of Macroeconomic Stability and Cross-Country Comparisons

2.16 To examine macroeconomic performance and stability since the global financial crisis, a comparison is made between Botswana and other upper-middle-income countries (UMICs) with respect to the behaviour of the key variables (Appendix 2.4 and Charts 2.1 – 2.10).

2.17 **Output**: UMICs generally benefited from the recovery in export demand that followed the 2009 downturn and the surge in commodity

13 See the 2015/16 Budget Strategy Paper.

14 There are concerns that some expenditure treated as investment under the SBI rule may not be sufficiently productive to properly be counted as investment.

15 Surpluses were also often a result of weak implementation capacity. Under-spending was consistently significant, sometimes contributing to projected deficits turning into surpluses.

16 The projects should yield enough proceeds to cover the initial cost and finance any associated recurrent outlays.

Chart 2.1: Real GDP Growth for Upper Middle-Income Countries

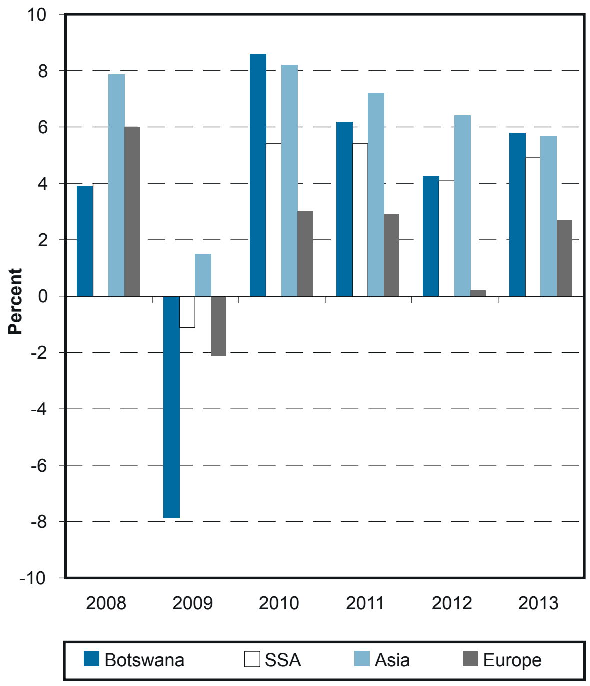
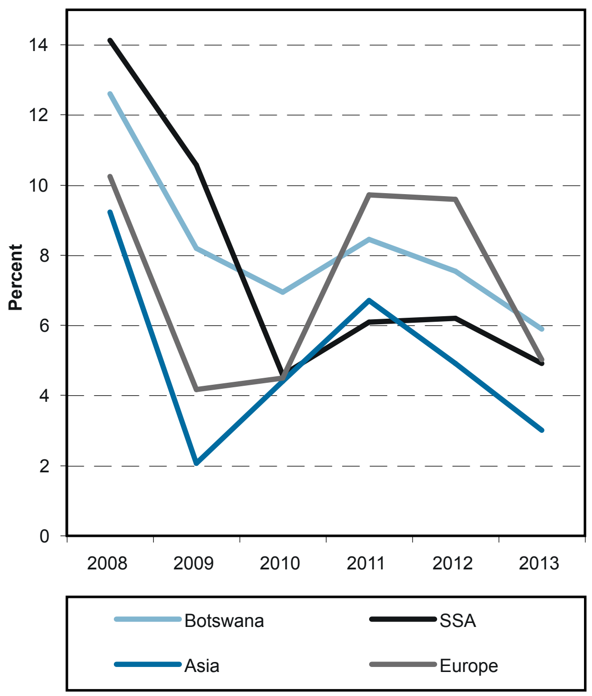


Chart 2.2: Inflation Rates for Upper Middle-Income Countries



Source: Bank of Botswana and World Bank

prices in 2010 and early 2011. As a result, GDP growth rates have remained generally robust for most countries under review. Appendix 2.4 and Chart 2.1 also indicate that, although the Botswana economy was hard-hit by the 2009 world economic downturn, it did not experience prolonged recession and has managed to rebound strongly relative to comparable economies, with the current and projected medium-term growth rate of around 5 percent.

2.18 **Inflation**: Inflation in Botswana was above the 3 – 6 percent medium-term inflation objective range for most of the period both prior to and following the global financial crisis. This suggests that inflation has been a challenge for the country compared to the other UMICs (Chart 2.2). Global fuel and food price shocks which preceded the financial crisis pushed inflation well above the target of many central banks. However, since 2011, inflation has been on a downward trend in most of the countries as the impact of food and fuel price shocks subsided, while moderate demand, rapid pace of innovation and transfer of a large part of global production to low cost centres eased pressures on consumer prices. Similarly, inflation in Botswana trended downward and has been within the medium-term objective range of 3 - 6 percent since June 2013,[17] given the additional benefit of maintenance of an appropriate policy stance, lower rates of increase in administered prices and some moderation in inflation expectations.

2.19 **Financial soundness indicators (FSIs):** these are intended to provide a basis for objective assessment of the strength of financial institutions, including comparison with other countries and standard regulatory requirements. FSIs include measures of capital adequacy, asset quality, liquidity and earnings, together with more broad-based indicators, such as household indebtedness. Botswana generally performs well by these measures, including in the wake of the global financial crisis. Charts 2.3 and 2.4 show this in relation to non-performing loans and profitability. In the case of liquidity (Chart 2.5), there has been a significant decline since 2011, when the Bank of Botswana limited the availability of BoBCs to

17 See Footnote 1.

Chart 2.3: Non-Performing Loans to Total Loans

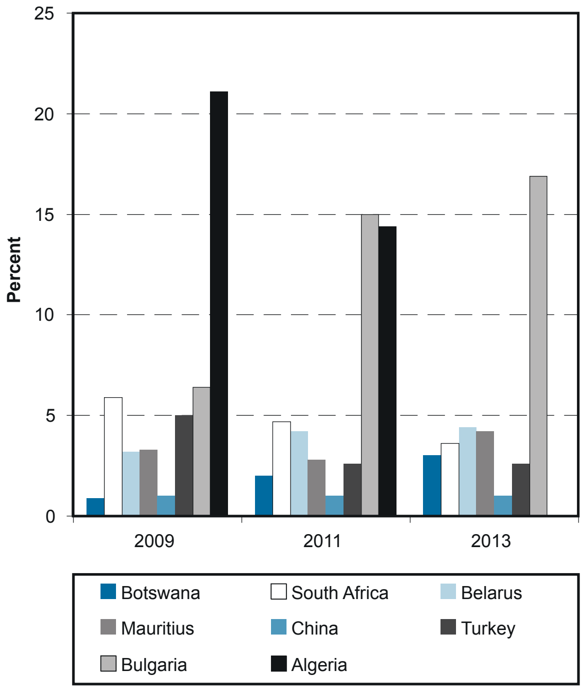
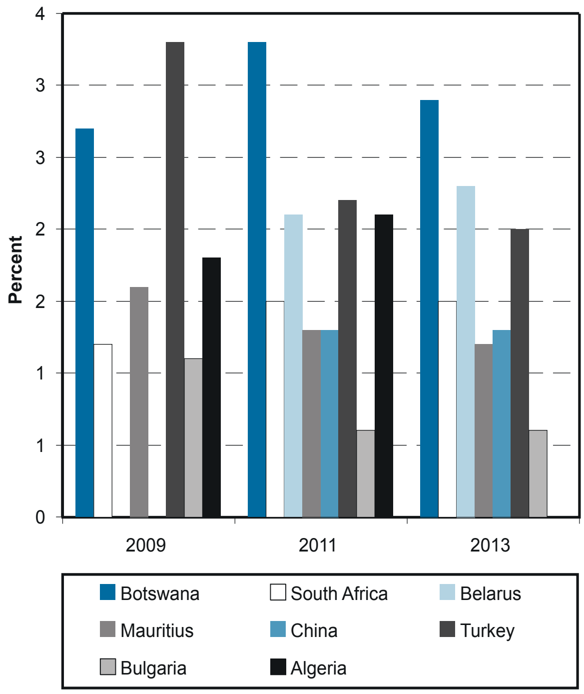


Chart 2.4: Return on Assets

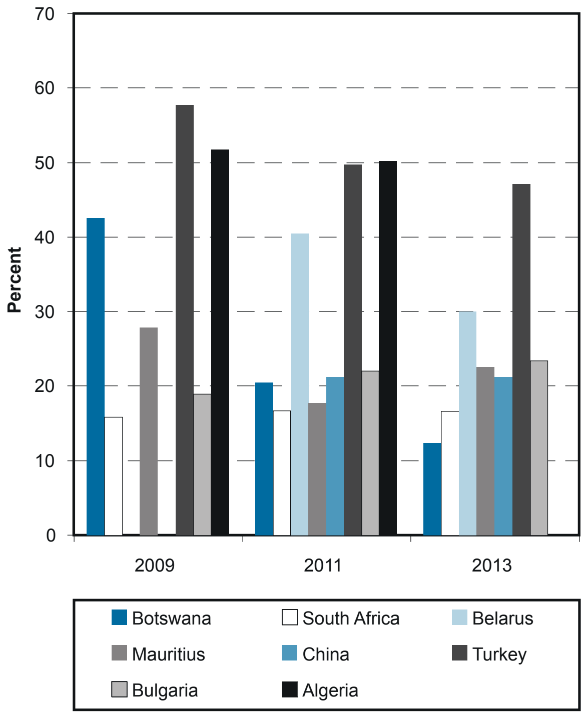


Source: Bank of Botswana

encourage greater bank lending; but this too remains at comfortable levels. Overall, as indicated by these and other measures, financial stability risks are considered low in Botswana.

2.20 **Fiscal Budget**: Although generally narrowing, fiscal deficits prevailed in most countries since the onset of the global financial crisis (Chart 2.6). The prolonged fiscal deficits are mainly a reflection of weaker revenues. This is especially true among natural resource exporters that faced subdued prices and/or lower production levels. In Botswana, the budget deficit for 2009 was estimated at around 12 percent of GDP; this was an unprecedented level for the country. The bulk of the financing gap was closed by borrowing from the multilateral institutions, in particular, the African Development Bank, and drawdown of past savings, while domestic borrowing played a limited role. The Government responded with fiscal consolidation measures in order to achieve a broadly balanced budget within three years. As a result, budget surpluses have been recorded since 2012/13.[18]

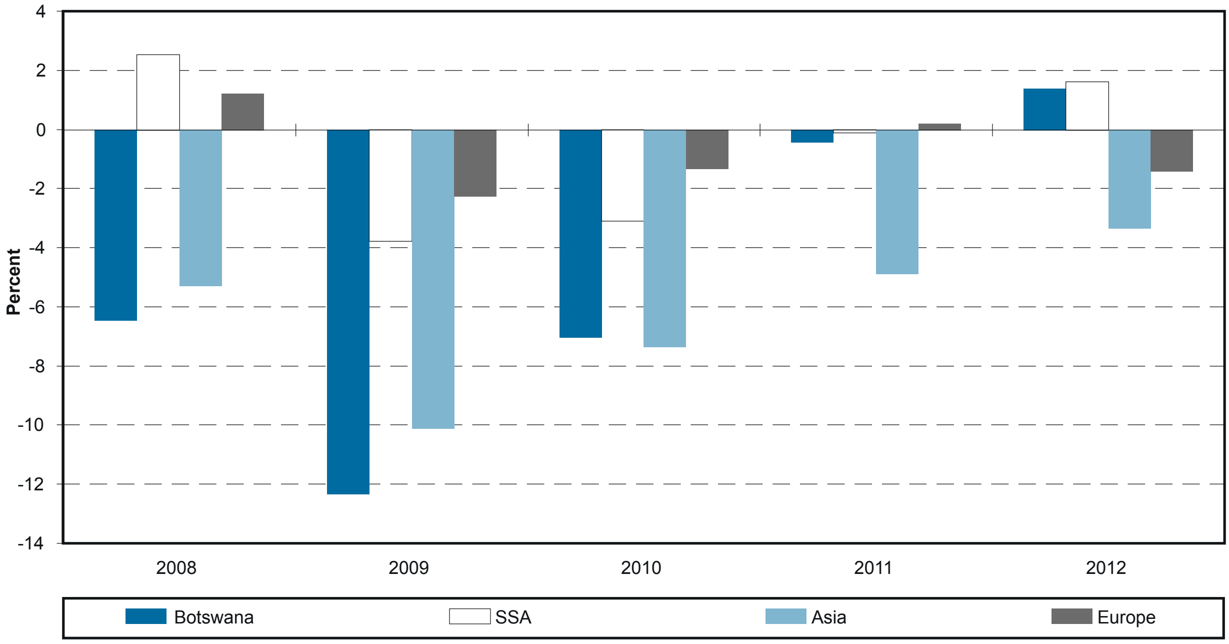
Chart 2.5: Liquid Assets to Total Assets



Source: Bank of Botswana

18 Prior to budget surpluses from 2012/13, government revenues recovered much more strongly than initially anticipat-

CHART 2.6: BUDGET SURPLUS/DEFICIT (PERCENT OF GDP) FOR UPPER-MIDDLE-INCOME COUNTRIES



Source: Bank of Botswana and World Bank

2.21 **Current Account Balance**: The current account deficit is commonly viewed as a leading indicator of future instability, with excessive deficits often predicting impending macroeconomic crises. Traditionally, Botswana has had current account surpluses. However, as shown in Appendix 2.4 and Chart 2.7, since the global financial crisis of 2008, the average current account balance has generally remained negative for most of the selected MICs, including Botswana. In most cases, the trade deficit was the main driver of the current account imbalance, reflecting, in part, sluggish performance of exports.

2.22 **External Debt**: Generally, Botswana has avoided excessive accumulation of debt, which has remained well within the prescribed limit for public debt and debt guarantees of 40 percent of GDP, even in the face of adverse shocks to revenue (Appendix 2.1 and Chart 2.8).[19] In contrast, external debt levels increased significantly in several comparator countries as a result of the fiscal and current account deficits between 2008 and 2012.

2.23 **International Reserves (Months of Import Cover)**: As a further indication of external stability, the adequacy of the level of international reserves as measured by months of import cover is higher for Botswana than for other peer group countries (Chart 2.9). The favourable position is generally attributable to receipts from diamond exports, which are a major source of revenue for the country and were well managed in the context of the fiscal policy and rules. However, being a small, open and somewhat undiversified economy, it is "prudent" that Botswana should have a higher import cover compared to larger, more diversified UMICs.

2.24 **Exchange Rate**: The real effective exchange rate (REER)[20] has tended to be generally stable in all the countries under review (Appendix 2.4 and Chart 2.10). Similarly, for Botswana, despite the volatility of the rand (which constitutes a larger portion of the Pula basket)

ed, allowing the budget deficit to be narrowed while maintaining expenditure above initially budgeted levels.

19 Economic recovery was sufficiently robust to avoid hard choices being made, in particular, domestic debt capacity was left largely untouched.

20 A measure of competitiveness

Chart 2.7: Current Account Balance (Percent of GDP) for Upper-Middle-Income Countries

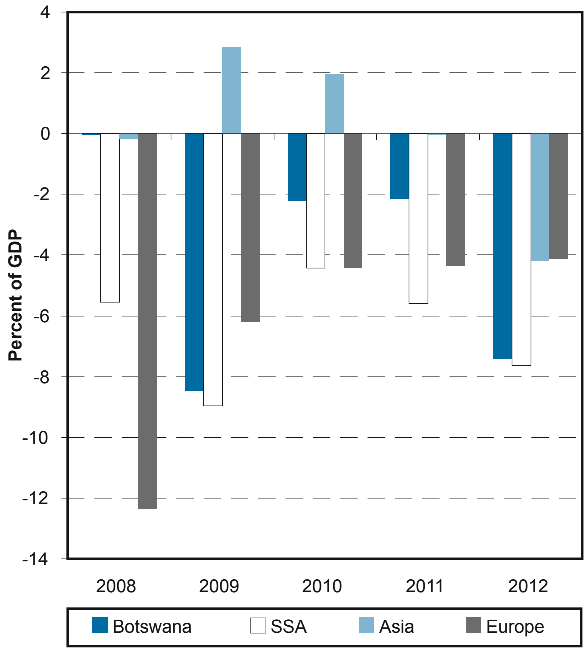
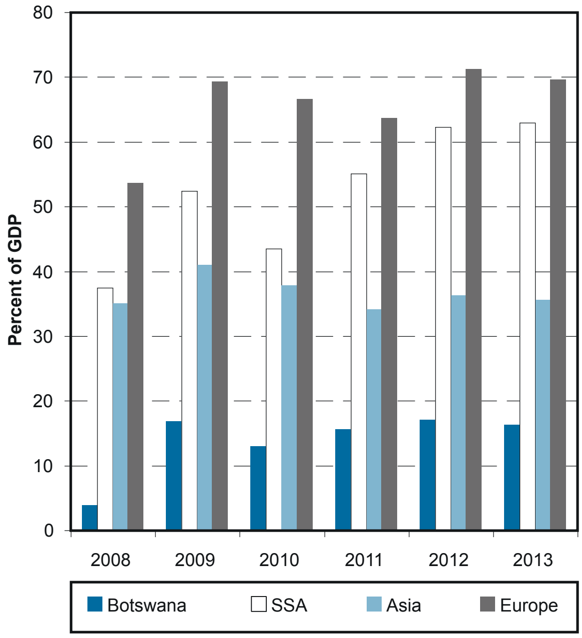


Chart 2.8: External Debt (Percent of GDP) for Upper-Middle-Income Countries



Source: Bank of Botswana and World Bank

Chart 2.9: Months of Import Cover for Upper-Middle-Income Countries

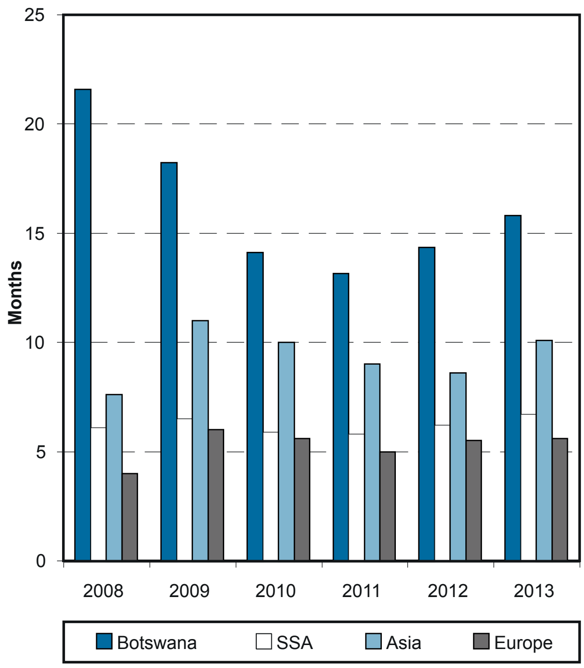
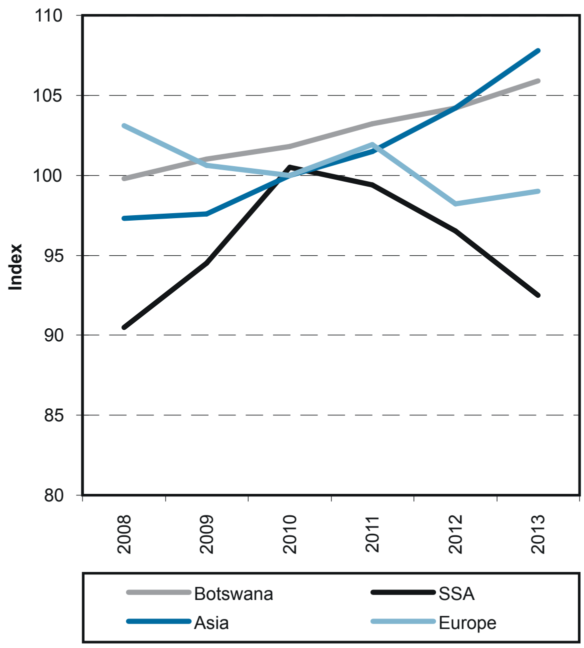


Chart 2.10: REER Indices for Upper-Middle-Income Countries



Source: Bank of Botswana and World Bank

against other major currencies and Botswana having its own domestic shocks, such as the constant increase in administered prices and government levies, the REER has been relatively stable.

3. THREATS TO BOTSWANA'S MACROECONOMIC STABILITY AND GROWTH PROSPECTS

3.1 Botswana will continue to contend with adverse shocks arising from inherent vulnerabilities that can have destabilising consequences. These include external developments, such as deterioration of export markets or sharp price increase for imported food and fuel, as well as domestic shocks in the form of large fluctuations in government expenditure, taxation and credit growth, or natural events such as drought. In recognition of inherent vulnerabilities, the country has institutional and policy frameworks (some of these are highlighted in Section 2) which address economic, financial and natural shocks. Thus, there are mechanisms for identifying (through early warning systems), assessing and monitoring potential risks, and strengthening preparedness.

3.2 However, the nature and severity of the shocks that Botswana faces has changed over time, along with evolution of the structure of the economy and demographic characteristics of the population. In the main, threats to stability and prosperity are in the areas of slow progress towards economic diversification and weak prospects for adequate employment creation, deficiencies in the supply of key inputs, modest productivity, as well as threats to the government's financial position and performance of key macroeconomic variables.

(a) Pace of economic diversification, growth and employment

3.3 Botswana's diversification efforts to date have been less successful than hoped for, especially considering the range of initiatives and resources expended for this purpose (Charts 2.11 and 2.12). This suggests that risks associated with an undiversified economy will continue to exist. In particular, these relate to potential for large fluctuations in rates of economic growth resulting from continued heavy dependence on performance of the mining sector, with respect to both production and export markets. Historically, since 1975, mining GDP fluctuated more widely than non-mining GDP, although overall average growth rates were similar, at 8.2 percent

CHART 2.11: SECTORAL SHARES OF VALUE ADDED, 1975 – 2013

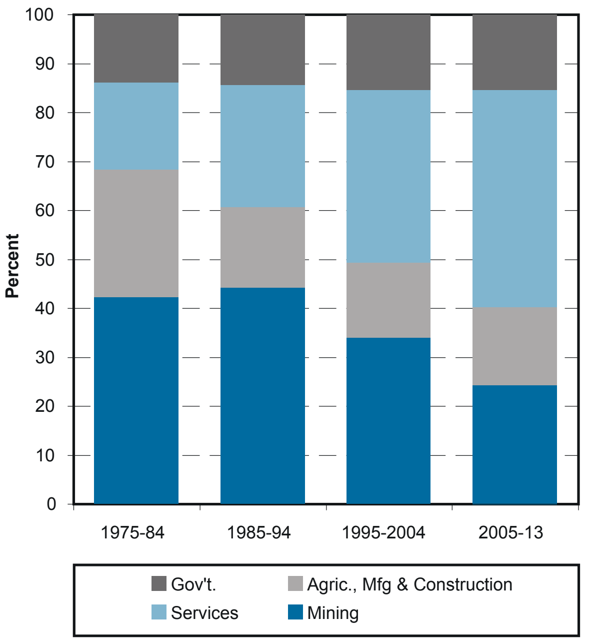
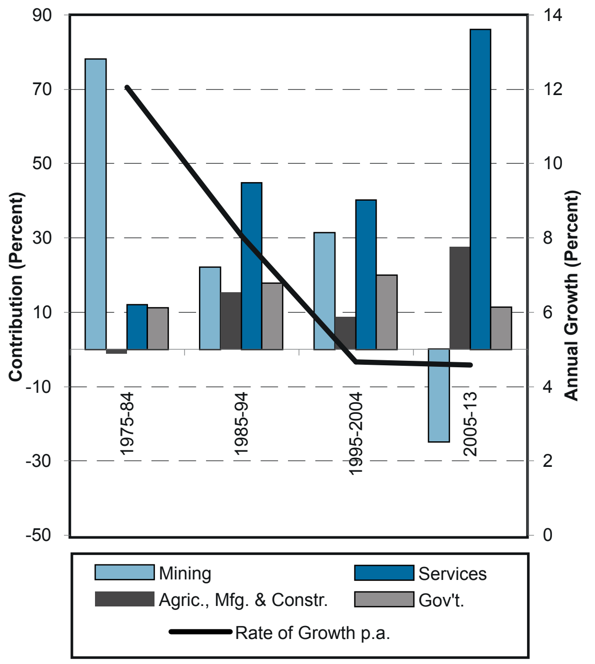


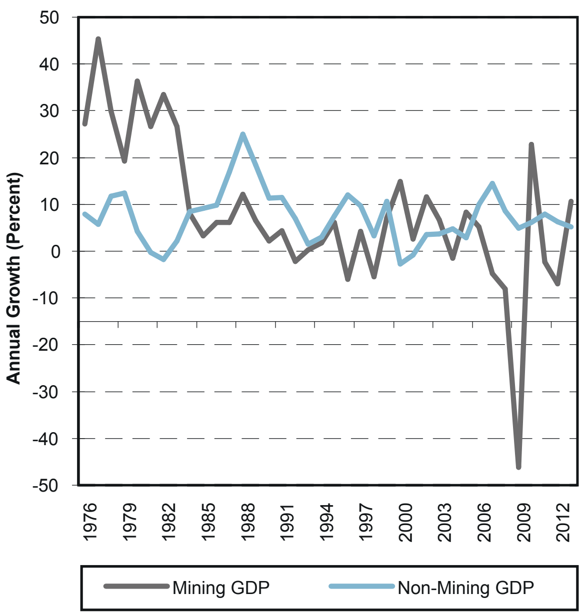
CHART 2.12: CONTRIBUTION TO REAL GROWTH IN VALUE ADDED OVER PERIOD



Source: Bank of Botswana and World Bank

and 7.4 percent per annum, respectively (Chart 2.13).[21] Moreover, there is a risk that unemployment will continue to be intractable as more capital-intensive mining continues to be a major component of GDP and source of growth (even with diversification within the mining sector).[22] In addition, the areas of notable diversification, such as services beyond the trade sector (for example, financial and telecommunications), tend to be high-skill intensive and would likely have a small impact on the problematic segment (those without tertiary education) where the unemployment rate is highest. In contrast, areas of potential high employment uptake such as agriculture and manufacturing continue to show lacklustre performance and deteriorating contribution to growth

Chart 2.13: Real Growth in Mining and Non-Mining GDP 1976 – 2013



Source: Statistics Botswana

and the economy, despite extensive support from the Government. Rationalisation by the Government also implies that it is less likely in future to be a source of employment growth or stimulus to the economy.

(b) Risks to Major Revenue Sources and Fiscal Outturns

3.4 The heavy reliance of government finance on mineral revenues poses risks to budget sustainability. Apart from minerals being a non-renewable resource that will ultimately be depleted, revenue from this source is subject to external shocks. In addition, the status of SACU receipts, which is a major source of revenue through the country's allocation of customs and excise receipts collected within the union, is uncertain and has the potential to diminish substantially in future. Thus, the reliance on these two sources of revenue poses risks and uncertainty regarding the stability and sustainability of government expenditure programmes. On the other hand, the growth of other sources of revenue (income and consumption taxes) are highly dependent on robust economic performance, pace of increase in incomes and levels of employment; so far projections suggest only moderate annual growth rates for the economy going forward. At the same time, large and frequent tax adjustments to compensate for loss of major revenue sources could be destabilising.

3.5 The dominance of mineral and SACU receipts in government revenue (Chart 2.14) can also be captured by measures of concentration, such as the Hirschman-Herfindahl Index (HHI),[23] which has ranged between 0.20 and 0.40 since the latter part of the 1970s, a range that is generally considered to indicate

21 The standard deviation of the mining sector's rate of growth was almost twice as large as the average rate of growth. In contrast, standard deviation of the non-mining sectors' annual rate of growth, at 5.69 percent, was only 76.6 percent as great as the average rate of growth.

22 Employment in mining was 11 840 in 2012, out of total employment (excluding Ipelegeng) of 337 075, thus contributing 3.5 percent to total employment compared to a GDP share of 19.9 percent.

23 The Hirschman-Herfindahl Index (HHI) is a summary measure of the size of components of a variable (e.g., firms in an industry) relative to the total size of the variable (the industry). Expressed as a ratio, the HHI can range between 0 (many firms) and 1 (a monopoly). As a measure of concentration, it is commonly used in industry studies, including for competition policy. It is used in Bank of Botswana reports on banking in Botswana. However, its use can be extended to any area where a measure of concentration is required.

high concentration. While the measure has come down from 0.39 in 2000/01 to 0.25 in 2012/13, it still reflects high concentration, with the two major sources having averaged over 63 percent of government revenues and grants over the past eight years.

CHART 2.14: MINERAL AND SACU REVENUES AND HIRSCHMAN-HERFINDAHL INDEX FOR TOTAL GOVERNMENT REVENUE, 1973/74 – 2014/15

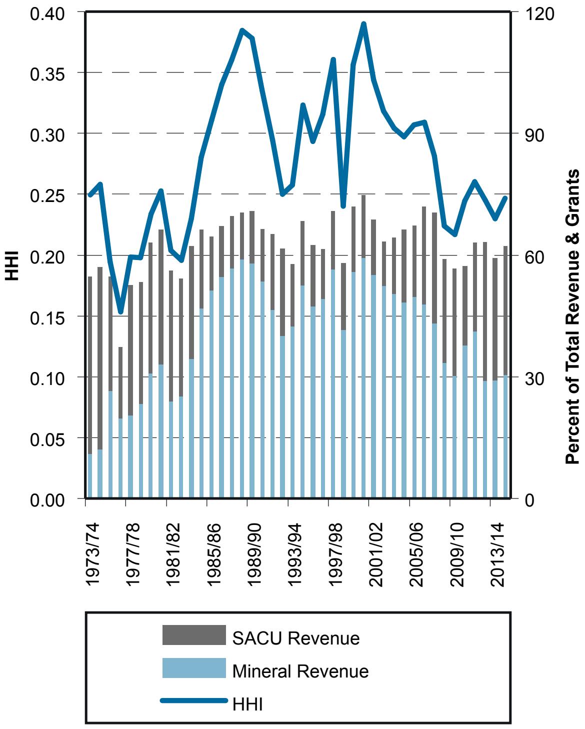
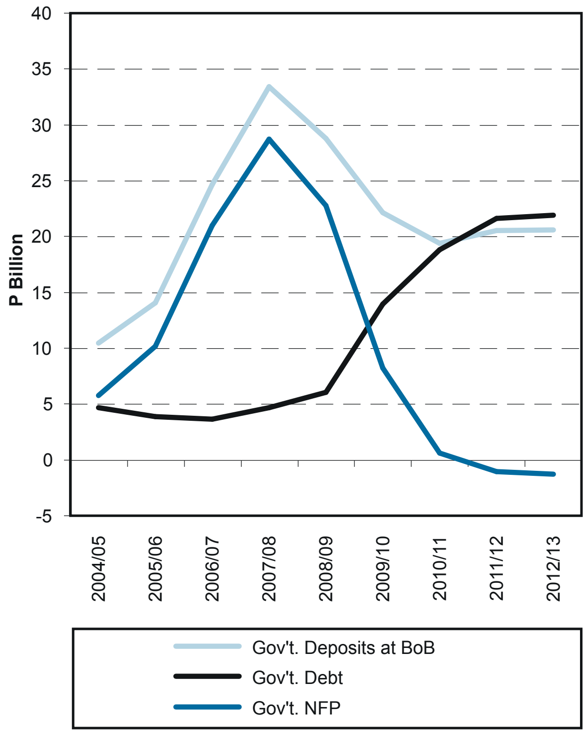


CHART 2.15: GOVERNMENT SAVINGS, DEBT AND NET FINANCIAL POSITION (NFP) 2004/05 – 2012/13



Source: Bank of Botswana and Ministry of Finance and Development Planning

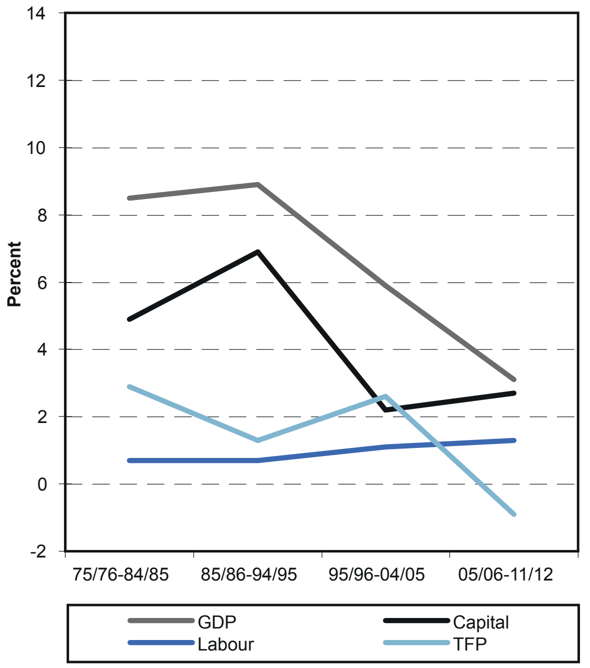
3.6 Apart from the threat emanating from undiversified sources of revenue, Botswana's fiscal cushions and buffers may be quickly drawn down in a global economic downturn. This could be exacerbated if the country's sovereign credit ratings eroded as a result of deterioration in the country's balance sheet (net financial position), which can constrain government borrowing to support counter-cyclical fiscal policy. In order to finance the deficits that arose from 2008/09 to 2010/11, the Government drew down on savings by some P14 billion, while also borrowing domestically (issuing government bonds and treasury bills) and internationally (African Development Bank, World Bank and others). As a result, government debt rose from P3.7 billion in 2007 to P21.9 billion at the end of March 2013, with the effect that the net financial position of Government[24] deteriorated rapidly, turning negative in 2011/12 and 2012/13. In contrast with many other countries, this did not result in a major downgrade in the sovereign credit ratings. There was a risk of a downgrade in the event of continued erosion of the net asset position.

3.7 The net financial position gives some indication of the Government's buffers that could be drawn upon to cushion economic shocks; although it can be noted that government borrowing capacity is far from exhausted. However, if the next macroeconomic shock

24 Measured as government funds at the Bank of Botswana minus debt, but excluding government guaranteed debt. The Ministry of Finance and Development Planning uses a somewhat different measure of net financial position that includes government-guaranteed debt of commercial parastatals as part of debt obligations, but nets out (subtracts from its debt) loans that it has given to local authorities and parastatals, some of which require government subvention in order to be serviced.

comes, as a small open economy, heavily dependent on imports for consumption and as inputs to production, the capacity to borrow domestically would not be of much help in generating the foreign exchange needed to pay for the imports required. If the Government were to have to borrow from the international financial institutions and other external funding agencies, the terms and conditions would likely not be that attractive and/or flexible with respect to the strategies the Government might hope to pursue to try and maintain macroeconomic stability. Thus, in order to cope with future shocks, it is critical for the Government to re-build the net financial position through savings in order to engender discretion and capability to respond to any future shocks.

Chart 2.16: Average Annual GDP, Factor and Total Factor Produtivity Growth (1975/76 – 2011/12)



Source: Sediakgotla and Mokoti (2014)

(c) Competitiveness and Industrial Development

3.8 Sustainable growth in living standards is underpinned by progressive increase in productivity. Thus, any impediments to productivity gains are inimical to the objective of maintaining competitiveness and raising living standards on a sustainable basis. In the context of Botswana, using total factor productivity (TFP) as an indicator, there is some evidence that the country is faced with the challenge of a deterioration in productivity over a protracted period.[25] Chart 2.16 shows the trend in the contribution of TFP to growth in Botswana since 1974/75, together with accompanying growth in overall output and basic factor inputs. The slowdown in TFP growth in the period from 2005/06 is particularly apparent, possibly exacerbated by a build-up in idle productive capacity since 2009 in the wake of the global economic slowdown.

3.9 A similar picture emerges from alternative approaches to measuring competitiveness. Table 2.1 shows trends in Botswana's performance in the influential Global Competitiveness Index (GCI), prepared by the World Economic Forum (WEF).[26] The GCI is useful in showing the relative performance of countries in relation to others.[27] Botswana was first included in the index in 2006/07, achieving a relatively high ranking of 56 (out of 134 countries) the following year. Subsequently, there has been a significant decline, with the ranking for 2014/15 at 74 (out of 144 countries). Some of this may be explained by the construction of the index, including the volatility of indicators relating

25 This is the conclusion, for example, in Sediakgotla and Mokoti (2014), "Sources of Economic Growth in Botswana: A Production Function Approach", and may also apply to other countries with similar characteristics (Leigh and Mansoor, forthcoming).

26 Global Competitiveness Report, WEF. A similar picture also emerges in another influential measure, the Doing Business report produced by the World Bank. In the report for 2015, Botswana was ranked 74th out of 189 countries compared to 66th the previous year, with red tape associated with establishing a business (149) and ease of trading across borders (157) being identified as major impediments.

27 Merely maintaining existing levels of competitiveness will not be sufficient if other countries are taking measures to improve theirs. In other words, standing still is not an option. Continued improvement is necessary in order to maintain one's position; an improved position requires re-doubled efforts.

to macroeconomic management.[28] However, it is worrisome that there are steep trend declines in indicators related to health, education (at all levels), infrastructure provision and sophistication of local businesses, including capacity for innovation. The latter is a major challenge for recently-established bodies such as the Botswana Innovation Hub and the Botswana Institute for Technology Research and Innovation (BITRI).

3.10 According to survey work that contributes to the GCI, the single most problematic factor for doing business in Botswana has consistently been identified as poor work ethics in the national labour force. Other problematic factors that are typically highlighted include an inadequately trained workforce, inefficient government bureaucracy and lack of infrastructure.

3.11 A major negative consequence of low productivity is often high and chronic levels of unemployment, especially among young people. Demographic trends in many developing countries, including in Africa (and Botswana), with rapidly growing numbers of young people (often well-educated) joining the labour force, mean that the problem of youth unemployment is increasing. Not only does this waste resources, it also poses a risk to macroeconomic stability through the potential for social unrest. This has been evident from recent experience in some European countries in the wake of the global financial crisis and as a contributing factor to the protests commencing in 2010 across several Middle

TABLE 2.1: GLOBAL COMPETITIVENESS INDEX (GCI) – BOTSWANA

	Rank					Change		
	2006/7	**2008/9**	**2011/12**	**2013/14**	**2014/15**	**1 yr**	**3 yrs**	**6 yrs**
Countries	122	134	142	148	144			
Overall rank	**57**	**56**	**80**	**74**	**74**	**0**	**6**	**-18**
GCI rank (percent of total)	47	42	56	50	51			
A. Basic Requirements		**53**	**81**	**66**	**72**	**-6**	**9**	**-19**
1. Institutions		36	32	34	39	-5	-7	-3
2. Infrastructure		52	92	94	101	-7	-9	-49
3. Macro environment		22	82	24	13	11	69	9
4. Health & primary education		112	120	115	127	-12	-7	-15
B. Efficiency		**82**	**86**	**93**	**84**	**9**	**2**	**-2**
5. Higher education & training		87	93	99	101	-2	-8	-14
6. Goods market		93	68	92	97	-5	-29	-4
7. Labour market		52	52	47	36	11	16	16
8. Financial market		40	44	53	57	-4	-13	-17
9. Technological readiness		89	101	104	76	28	25	13
10. Market size		101	99	101	97	4	2	4
C. Innovation & Sophistication		**98**	**94**	**106**	**110**	**-4**	**-16**	**-12**
11. Sophistication		106	101	102	116	-14	-15	-10
12. Innovation		83	79	102	102	0	-23	-19

Source: World Economic Forum

28 This is measured in relation to key macroeconomic variables on an annual basis. Thus, for 2011/12 when the global economic crisis resulted in the budget moving into deficit and a build-up of government debt, while inflation remained outside the objective range, there was a notable slippage in the GCI ranking. However, if the index used averages calculated over the economic cycle (which would recognise the stabilisation role of fiscal policy), the movements would not be so pronounced.

East and North African Countries (known as the "Arab Spring"). Thus, it is for economic as well as social reasons that reducing unemployment is a key component of the "inclusive growth" agenda (Section 4).

3.12 With respect to infrastructure, economic activity in the country in recent years has been increasingly constrained by deficient provision of basic utilities, in particular major disruptions to supply of water and electricity. Beyond this, major public investment in a range of other infrastructure projects, including those related to health, education, transport and communications (where deficient internet access remains a common complaint), have yet to yield major returns. Inadequate maintenance of infrastructure is a further threat to productivity. At the same time, little progress has been made in involving the private sector, as this could add to quantity and possibly quality of public infrastructure.

d) Price and Financial Instability

3.13 Price shocks leading to potentially destabilising inflationary pressures can arise from both international and domestic sources. Unfavourable international conditions, such as a sharp increase in the cost of fuel and/or food, not only add to the cost of those products, but also threaten to spill over into other domestic prices; this can lead to an inflationary cost-price spiral and accompanying macroeconomic instability. Price instability can also be generated by domestic conditions, including an overheating financial sector, government fiscal measures including large adjustments to administered prices, regulatory interventions and adverse labour market developments. The role of the central bank, in consultation and coordination with government, in managing such threats is crucial.

3.14 Similarly, the recent financial crisis seems to have unearthed that policy formulation by major central banks did not adequately take account of risks in the financial sector. As a result, the narrow focus of many central banks on inflation targeting meant that they were unprepared to help offset these broader threats to the stability of the macroeconomy. While the immediate relevance of this was limited for countries such as Botswana, the lessons should not be ignored. Hence, discussion of the future challenges for monetary policy, together with possible deployment of enhanced macro-prudential measures in support of financial stability, are considered in more detail in Section 5.

(e) Global Economic and Policy Developments

3.15 Given the small size of the Botswana economy (both the productive base and the domestic consumer market), any assessment of threats to macroeconomic stability and growth prospects must be considered in the international context. In essence, the country's ambitious development goals are not readily achievable in the absence of a prospering global economy. Prospects for Botswana's prosperity are also linked to performance and stability of the regional economy, notably South Africa. Thus, there is a need to develop effective and robust external linkages. These include the role of the exchange rate policy in mitigating the impact of international currency adjustments (Section 5). In addition, the external linkages are inherently intertwined with national industrial and trade policy (explored in detail in the next section).

4. Enhancing Macroeconomic Linkages in Support of Inclusive Growth

(a) The Importance of Inclusive Growth

4.1 Standard summary indicators of a country's economic development typically focus on aggregate measures of national income, expressed on a per capita basis to allow for population differences. Thus, the broad levels of development according to which the World Bank classifies countries and which, in turn, determine their eligibility for donor assistance are according to per capita gross national income (GNI). Similarly, the pace of development is judged by reference to the increase in income or output (economic growth).[29]

4.2 The use of such measures has the advantage of measuring countries' performance within a standardised framework that minimises value judgments about the desirability of particular patterns of development. However, using per capita income as a proxy for welfare makes the very important underlying assumption that such income is equitably distributed throughout the population. Previously, such an assumption has been justified on the basis that the benefits of growth would "trickle down" through the population, even if the immediate beneficiaries were more limited.

4.3 However, this justification has been weakened as evidence shows that significant numbers are substantially excluded from sharing the benefits of economic growth. This is not to say that "trickle down" mechanisms do not have a useful role to play. As Collier (2007) argues, the vast majority of the world's population has benefitted from the wealth generated through predominantly free enterprise economies operating in an increasingly interconnected global economy.[30] Similarly, in Botswana a large part of the cumulative success in poverty reduction since the mid-1980s (see Box 4.1 below) can be attributed to the benefits of participation in a well-functioning market-oriented economy, rather than the more limited impact of social welfare programmes.[31] However, in both the international and domestic cases, the excluded portion of the population is still significant.

4.4 Measures that are more encompassing than per capita income include the Human Development Index (HDI) prepared by the United Nations Development Programme (UNDP), which also incorporates indicators related to health and education. An alternative approach has been to focus on a wider range of developmental objectives (and associated indicators) such as the Millennium Development Goals (MDGs) or, in the case of Botswana, the objectives set out in successive NDPs and *Vision 2016*.

4.5 More recently, the term "inclusive growth" has entered mainstream discussions of the development agenda, including by institutions such as the International Monetary Fund (IMF), which previously tended to focus on macroeconomic factors rather than broad-based developmental indicators. In part, this reflects a growing realisation that achieving growth from which significant groups are not excluded is a challenge for all economies, thus countering the view that problems of poverty and social exclusion are the preserve of malfunctioning or "failed" states. Notably, the recent global economic and financial crises exposed not only the fragility of modern, market-driven economies in the absence of significant state-led support, but also the extent to which the costs are borne by the most vulnerable groups. Hence, concerns about "jobless recoveries", even after growth has resumed.

4.6 A concern for inclusion arises not just for reasons of equity or social justice; it is also a matter of economic efficiency. If there is large-scale exclusion from meaningful participation, then resources are wasted, thereby constraining wealth and income generation. At the same time, social stability (and hence economic efficiency) can be undermined if groups are excluded from the benefits of growth (employment and provision of services). Finally, exclusion can upset macroeconomic balance, in particular by distorting and suppressing aggregate demand if

---

29 National income, output and expenditure are all, by definition, equivalent, with discrepancies in practice attributable to data measurement problems and reconciled through use of residuals.

30 "The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It". The reference to the "bottom billion" is an approximate estimate of the numbers who have not benefitted significantly from global growth. If accurate, this would amount to approximately 15 percent of the world population at the time.

31 An indication of this are much lower rates of poverty prevailing in the major urban centres, reflecting the more dynamic and developed urban economy and accompanying income generating opportunities.

resources are concentrated among higher income groups who have a greater propensity to save.

Monitoring Inclusion

4.7 Effective monitoring of inclusion is a formidable challenge. Broad agreement that per capita income is not sufficient as a development indicator is not matched by consensus on better measures. The quality of data in terms of timeliness, coverage and reliability is also a challenge, especially for developing countries with limited resources.[32] For this review, inclusive growth is considered in terms of meaningful inclusion and participation. Key indicators are generally taken to include poverty, inequality and unemployment. [33] The current status regarding these three main indicators in Botswana is discussed in Box 2.1. Substantial progress has been made with respect to poverty reduction, high levels of income inequality notwithstanding, as the benefits of sustained growth have been spread widely across the population. However, unemployment remains stubbornly high, at about 20 percent, while further progress in tackling poverty and inequality are needed for growth to be fully inclusive. A study on social conditions in Botswana in mid-2014 broadly confirms this situation; it has highlighted that unemployment is widely viewed as the most pressing problem facing the country.[34]

Combining stability with pro-growth policies: trade-offs and complementarities

4.8 From the perspective of economic policy, a focus on inclusiveness emphasises the need to ensure that the microeconomy (i.e., interaction between economic agents) functions effectively, in terms of resource allocation within the overall macroeconomic framework. The advantage of an explicit alignment of micro- and macro-elements is that a commitment to macroeconomic stability can make clear the trade-offs involved in a proposed development strategy in terms of competing uses for limited resources and coherence of overall policy objectives. Such trade-offs are inevitable, but there may also be opportunities for complementarity; for example, well-designed policies to tackle inequality may also be conducive to promoting growth.

4.9 In general, a well-functioning microeconomy supports macroeconomic stability, while badly-designed microeconomic interventions (for example, in the areas of trade, industrial or labour market policies) could be a source of instability at the macro level. At the same time, with the resulting income and employment opportunities, a growth oriented macroeconomic policy can allow for more straightforward introduction of necessary micro-reforms. However, it is important that the pursuit of growth and sectoral objectives should not be allowed to undermine discipline and coherence of the overall macro-framework.[35]

Confronting the "middle-income trap"

4.10 Within the broad agenda of pro-growth policies, particular challenges face the group of countries aspiring to reach development levels of high-income economies.[36] The so-called "middle-income trap" refers to only

32 The work of the International Monetary Fund in encouraging countries (including through technical assistance) to comply with its international data standards should be understood from this perspective. Hence, the advice that allocating sufficient resources to the professional and impartial collection and dissemination of statistics represents a good investment.

33 Additional measures may also be considered useful, depending on national circumstance. For example, beyond these, issues of ownership may also be seen as important. Also, meta-indicators relating to the quality of institutions and governance look at conditions necessary for inclusive growth to flourish on a sustainable basis.

34 Afrobarometer, October 2014.

35 These issues have been central to recent discussions between policymakers in major Eurozone economies, where countries in the process of introducing far-reaching microeconomic reforms have argued that some relaxation in current programmes of economic austerity is necessary for these to be politically and socially acceptable.

36 The term was first coined in Kharas et al., "What is the middle-income trap, why do countries fall into it, and how can it be avoided?" Global Journal of Emerging Market Economies 3.3 (2011): 281-289.

BOX 2.1: TRENDS TOWARDS INCLUSION – POVERTY, UNEMPLOYMENT AND INEQUALITY IN BOTSWANA

Poverty: In terms orfincome, poverty can be calculated in relation to some benchmark poverty line. The international standard in this regard is the USD1.25/day measure used by the World Bank to calculate extreme poverty. As of 2011, it has been estimated that approximately 1 billion people (14 percent of the global population) fell into this category, compared to 1.2 billion (19 percent) in 2008. But, where available, this is usefully supplanted by more specific national measures. In Botswana, this comprises a series of sample consumption baskets for a range of typical households according to size and composition, collectively referred to as the Poverty Datum Line (PDL). This has been used to calculate poverty in Botswana using data from four household surveys, undertaken between 1985/86 and 2009/10, providing an extended time series of comparable data with which to analyse underlying trends. Using this, the extent to which overall growth in the economy has contributed to the steady reduction in poverty is clear and impressive: in less than three decades the national household poverty rate had fallen from 45 percent to 20 percent. So it is difficult to argue that growth in Botswana has not been inclusive to some degree. Nonetheless, it is also the case that poverty levels remain too high, especially for a country aspiring for high-income status. Also, the poverty that remains is concentrated mainly in pockets of rural poverty that are particularly challenging. Other major causes of poverty are large household size (large number of dependents) and unemployment.

Unemployment: Compared to poverty, the track record regarding unemployment is less positive. Aggregate unemployment has been broadly constant in the range of 17 – 23 percent since the 1990s. The most recent estimate is for 2013 at 20 percent. This suggests that there has been job creation sufficient to no more than match growth in the labour force. There is particular concern about growth in unemployment among graduates, although this is less evident from the data, which indicate that the lowest rates of unemployment are among those with tertiary education; and that youth unemployment is largely a temporary problem, with lower rates of unemployment for older age groups. However, these estimates understate unemployment to the extent that they do not include "discouraged workers" (i.e., those who are unemployed but not looking for work) and no allowance is made for *under*employment.

Internationally, chronic unemployment, especially among young people, is a major concern across a wide range of developing and developed economies.

Inequality: While poverty and unemployment are clearly undesirable, interpreting measures of inequality is less straightforward. Apart from measurement issues, some degree of inequality is inevitable in the context of a rapidly growing, dynamic economy where productive activity is effectively rewarded. Using the standard Gini coefficient, the principal stylised facts regarding income distribution in Botswana are:

(a) Levels of inequality remained broadly *constant* at a national level between 1985/86 and 2002/03

(b) This inequality is among the highest in the world. For this reason the country's ranking in the UNDP's *Inequality Adjusted Human Development Index* for 2014 falls 21 places compared to the standard HDI. This decline is exceeded by 3 other countries (the USA, Iran and Namibia)

(c) The trend since 2002/03 is unclear as the published measures give conflicting signals according to income (increase in inequality) and consumption (fall in inequality)

Internationally, global income distribution has over time been becoming *more* equal, reflecting the fast growth in developing economies (notably China). On a national basis, however, trends have often been in the opposite direction, i.e., towards greater inequality. In the United States, for example, between 2010 and 2013, mean (overall average) family income rose 4 percent in real terms, but median income fell 5 percent. A similar trend across countries is presented in a major economic study of the subject published in the book *Capital In the Twenty-First Century,* by Thomas Piketty in 2013.

"Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances", Federal Reserve Bulletin 100, no. 4; September 2014.

Table 2.2: Countries Graduating from Middle-Income Status Since 1960

Pre 1976	1976 – 1995	Since 1995
Japan (1966)	Malta (1980)	Slovak Republic (2003)
Greece (1970)	Taiwan (1987)	Czech Republic (2003)
Spain (1974)	Cyprus (1987)	Estonia (2009)
Hong Kong (1975)	Portugal (1989)	Latvia (2011)
Singapore (1975)	South Korea (1994)	
	Slovenia (1995)	

Source: Leigh and Mansoor, eds., forthcoming

a limited number of economies having successively graduated from middle- to high-income status. In 1960, there were 69 low-income and 81 middle-income countries (LICs and MICs). Subsequently, between 1960 and 2012, 35 countries (51 percent) graduated from LIC to MIC, while only 16 (20 percent) moved from middle- to high-income status (Leigh and Mansoor eds., forthcoming). Moreover, those countries that managed the transition successfully were concentrated in East Asia (Japan and the original group of newly industrialising economies (NIEs[37])) and in Europe.

4.11 The reasons for this success, including the lessons for others aspiring to make the same transition, centre on lifting productivity to levels consistent with higher incomes.[38] Tackling the constraints to transition from MIC status encompasses recognising that established institutions and procedures, however successful in the past, may not be sufficient to maintain the momentum to the next level. At the same time, an agenda focussed on economic development should promote inclusive growth; the pursuit of inclusive growth fosters greater social cohesion, which enhances effective marshalling of available resources.[39] For this to be achieved however, it is crucial that measures to bring about inclusiveness are closely aligned with considerations of economic efficiency as well as coherence and consistent application of policies. Notably perhaps, the successful earlier transition from LIC to MIC could have resulted in a diverse mix of competing interests in an economy, with potential to undermine the unity of national purpose required for the next stage of development, and resulting in diffuse and sometimes contradictory policy objectives.

(b) Internal Linkages

Financial inclusion

4.12 Promoting financial inclusion in Botswana has been covered in recent *Bank of Botswana Annual Reports*.[40] Suffice it to say, effective access (availability of financial services at affordable cost) is increasingly recognised as a key element of inclusive growth. Financial

37 Commonly referred to as the Asian Tigers.

38 The MICs in Europe had the major advantage of proximity (and aspirations to join) the European Union, that provided not only role models, but also major incentives for success. Moreover, the sub-group of ex-communist European countries that dominated the latest wave of graduation had a clear sense of national purpose in moving away from their recent past.

39 In this regard, it is notable that countries that have successfully graduated from middle to high-income status have generally been characterised by relatively low levels of inequality and effective policies.

40 Where the theme topics for the reports were: Determinants and Trends in Household Financial Savings in Botswana (2009); Broadening Access to Financial Services (2011) and Household Participation in the Financial Sector, Debt Sustainability and Impact on Financial Stability (2013).

Table 2.3: Mobile Money in Botswana 2010 – 2013[1]

	2010	2011	2012	2013
Number of registered mobile money accounts	3 812	192 536	384 249	635 567
Number of active mobile money accounts	2 806	160 874	308 977	510 604
Number of registered agent outlets	…	…	…	…
Number of active agent outlets	…	…	…	…
Value of mobile money transactions (P million)	1.6	174.9	449.8	917.2
Number of mobile money transactions	4 915	517 457	1 236 693	3 195 959

1. Mobile money is the combination of services provided by the three cellular providers and "e-wallet" services provided by one of the commercial banks.

Source: BOCRA

inclusion provides avenues for improved welfare at the individual/household level and improves mobilisation and access to resources for low income households and small businesses, providing further impetus to inclusive growth. It is for this reason that financial inclusion need not necessarily be at odds with financial stability. This is particularly the case if the primary focus of inclusion is initially on promoting savings and effective payment mechanisms among low-income households, rather than facilitating borrowing (Leigh and Mansoor eds, forthcoming).

4.13 In Botswana, 33 percent of households had no access to any form of financial services in 2009, while 41 percent accessed the formal banking system. Relative to other countries in the sample, this performance is respectable, but not adequate for a country with ambitious development objectives. In high income economies, levels of financial exclusion are typically less than 10 percent. High costs and limited access to financial services also hold back the country in the financial sector development category of international competitiveness rankings.

4.14 Recent advances in information and communications technology (ICT) provide opportunities for improving financial access. The success of *Mpesa* in Kenya is by now well-established,[41] and this raises questions as to why its success has not been repeated to a similar extent elsewhere. A differing approach, including more cautious attitudes from central banks in interacting with telecommunication regulators, may be part of the answer. Nonetheless, this does not suggest that there has been no meaningful progress. In Botswana, the number and value of mobile money transactions has increased exponentially since services were first introduced in 2010 (Table 2.3). However, the total amount remains relatively small at only 1.4 percent of total consumer expenditure (1 percent of non-mining GDP) in 2013. Given the high levels of mobile teledensity in Botswana, which is among the highest in the world, the scope for further development in this area is apparent.[42] Alongside the focus on promoting financial inclusion through the use of relevant technologies, the importance of developing financial literacy and proper usage of ICT should be an essential

41 Mpesa ("mobile money" in Swahili) uses mobile phones to provide banking services, including deposits, withdrawals, transfers, and payment of bills. Launched in 2007 it has grown rapidly (subscribers to Mpesa make up more than 40 percent of the Kenyan population with total transactions, amounting to approximately 20 percent of GDP) and has since expanded to other countries, including India, South Africa and to Eastern Europe.

42 1.6 cellular connections per capita, ranked 11 out of 144 countries surveyed by the World Economic Forum (source: International Telecommunication Union, ITU World Telecommunication/ICT Indicators Database 2014 (June 2014 edition)). By comparison, this is more than twice the teledensity reported for Kenya.

component of effective access to financial services.

Industrial Policy

4.15 The Government clearly recognises the challenges of addressing productivity issues, including through alignment of education and training with skills requirements and improvements to the business climate.[43] However, transforming this into an effective industrial policy necessitates consideration of key priorities alongside potential constraints. Major issues to consider include:

(i) *Appropriate development model*: "borrowing" industrial development models from other countries can be problematic. Even groups of countries that are classified together, such as the NIEs, had widely-differing development patterns and policy environments. In the case of Botswana, beyond the downstream processing of minerals,[44] opportunities for industrialisation based on manufacturing may be limited, while the viability of extensive arable agriculture in the country has still to be demonstrated.

(ii) *Administrative capacity*: an effective industrial policy should not only be relevant to national circumstances, it should also be implementable. A weak and/or over-burdened civil service can impede rather than aid business development; it is also more vulnerable to pressures, or "regulatory capture", including lobbying for additional support from sectoral interest groups. Strategies that rely on government and related agencies to "pick winners" can be problematic. Given this, the impact of policy interventions may be greater when their implementation does not require extensive additional administrative layers. From this perspective, recent moves by the Botswana Government to streamline the number of sectoral support and regulatory bodies are encouraging. However, there remains a concern that these bodies could be overextended, especially given limited supply of skilled labour.

(iii) *The role of the public sector*: historically, the public sector, including both government and parastatals, has played a major role in the Botswana economy, justified initially by a lack of private sector capacity to provide essential services. However, the expansion of the public sector has continued in recent years; for instance, between 2005 and 2012, formal employment by parastatals, including newly-established bodies (some of them previously government departments) increased by 36 percent, compared to 15 percent for the private sector. This has resulted in a private sector that remains heavily dependent on public sector patronage, with the inherent limitation that businesses which rely on preferential access to public sector procurement may not be viable in the absence of such support.

(iv) Broadly speaking, government control and/or ownership should be limited to the agency function of implementing public policy. Progress in this direction is being made in the local economy through outsourcing of non-core government activities, while initial steps have now been taken in privatisation (albeit partial) of

43 These issues are covered prominently in the 2015/16 Budget Strategy Paper and the Keynote Policy Paper for NDP 11.

44 Even then, some of these initiatives may not be viable. The extent to which "beneficiation" (i.e., local processing) of natural resources found in the country can support viable economic developments should not be taken for granted. Creation of genuine value added within the domestic economy requires access to inputs for further production that may not be available on a cost-effective basis. Increasing gross value within the country is not the same as value addition. For example, downstream processing of minerals may require scale economies that are not realisable at current levels of output.

major state-owned enterprises. In carrying this process forward, it is important to ensure that, whatever the specific format chosen for privatisation, these bodies are fully infused with commercial discipline and capacity for innovation, even in cases where profit maximisation is not the primary objective.[45] This includes pricing for publicly-provided services which, even if some degree of regulation is deemed necessary, should reflect the cost of production with consumer welfare issues tackled through other means.

(v) *Conflicting policy objectives*: inclusive growth and overcoming the middle-income trap require an agenda focussed on accelerating growth and programmes for supporting marginalised groups, notably the poor and unemployed. A particular challenge is to ensure congruence between other "empowerment" objectives and the primary goal of promoting inclusive and accelerated growth. Concentrating on the issue of asset ownership, for example, may tend to promote the interests of less-marginalised groups, while not necessarily being beneficial in terms of job creation.

4.16 As a jurisdiction for investment in mining, Botswana has been ranked as one of the most competitive in the world in terms of strong institutions, taxation and risk mitigation, although infrastructure and quality of labour are prominent concerns.[46] This successful alignment between commercial imperatives in the mining sector and national development objectives (which is now gradually being extended into developing related downstream industries) can be instructive for the design and implementation of effective industrial policy in other sectors.

Labour Market Interventions

4.17 The functioning of the labour market, where social and economic issues interact, is key to the effective promotion of competitiveness and productivity. Indeed, the Government can have a profound influence on employment prospects set in motion through, among others, promulgating relevant laws and regulations, where flexibility required for efficiency should be balanced against workers' broader social needs. The setting of minimum wages demonstrates the trade-off between allowing employers to align remuneration of low-paid workers with their actual productivity and providing the workers with security regarding adequate remuneration. At the same time, de-regulation of labour markets should not necessarily be viewed as "anti-worker" or any regulations to protect workers as "anti-business". Both employers and employees should find common ground in recognising that, on the one hand, ultimately job security rests on business efficiency and, on the other hand, employee welfare is a key factor for promoting productivity. In many instances, streamlining of cumbersome labour market regulations can be in the interest of both fairness and efficiency. To the extent that support programmes are required, an approach based on the principle of "protect the worker, not the job" (through well-structured unemployment benefits, for example) would seem to be a practical approach to ensuring the necessary flexibility.

4.18 For inclusive growth, labour market policies should reach beyond trade unions, which primarily represent those who are already employed, typically in the public sector and larger industrial enterprises. Policies should also take account of the interests of marginalised and unrepresented groups, including the unemployed and those working in the informal sector and/or small businesses,

45 The case for privatisation rests firmly on the need for the efficient provision of goods and services that will, in turn, stimulate further growth and job creation. From this perspective, considerations of ownership and/or the number of jobs that might be affected directly are not of primary importance.

46 Botswana is ranked 17 out of 96 mining jurisdictions in the 2012/13 Fraser Institute "Survey of Mining Companies", and ninth in terms of countries (many of those ranked more highly are provinces/states of Canada and United States). This includes a number 1 position for Botswana in several categories; however, the ranking for "supply of labour/skill" is only 76, with infrastructure at 46.

for which excessive labour market regulations can be detrimental. For example, measures to protect those already employed by restricting employers' freedom to reduce staffing can limit the creation of new job opportunities and, thus, opportunities for the unemployed and young people entering the labour market. Equally, the negative consequences for unemployment from a macroeconomic shock can be lessened by labour market flexibility.[47] Recent research has underlined the extent to which youth unemployment is particularly susceptible to the impact (either positive or negative) of labour market interventions (Banerji *et al.,* 2015).[48]

4.19 On labour market efficiency, Botswana is ranked 36 out of 144 countries. The country benefits from not having a historical legacy of confrontation with militant trade unions,[49] with the result that industrial relations disputes typically tend to be settled through a process of negotiation and/or arbitration. In addition, the regular review of minimum wages has not involved adjustments that are likely to jeopardise job creation. However, this generally favourable position should not be a cause for complacency as the strained industrial relations between government and public sector workers in recent years indicate. Moreover, problems related to work ethics and productivity could themselves be symptomatic of there being further room for improvement in this area.

47 As evident from the European labour markets, where there are tough regulations to "protect" workers, overall unemployment rates tend to be high, especially among the youth, while new jobs often take the form of part-time or temporary employment as employers seek to avoid such regulations. Small businesses are also likely to be penalised. Conversely, flexibility in the labour markets in Germany and the United Kingdom limited the impact of the recent global slowdown to stagnant wages rather than job losses.

48 Banerji, A., Lin, H. and Saksonovs, S., Youth Unemployment in Advanced Europe: Okun's Law and Beyond, IMF Working Paper 15/5, January 2015.

49 The public service strike of 2011 is consistent with this view. Although long-lasting, it was only partially supported by government workers and did not feature militancy and violence that occur elsewhere where radical trade unionism is more firmly entrenched.

4.20 Wage policy for the public sector also plays an important role, especially for a country such as Botswana where the government and parastatals account for a large proportion of formal employment. It is understandable that a policy of wage restraint has been implemented in recent years as part of the programme of fiscal consolidation. The need to base public sector pay adjustments on productivity is also paramount in improving efficiency in government service provision and serves as a platform for wage bargaining more generally. However, the need for discipline is not inconsistent with amicable industrial relations in the context of effective collective bargaining with workers' representatives.

The Use of Fiscal Incentives

4.21 Another key issue for governments is the use of fiscal incentives (taxes and subsidies) as a means of supporting businesses. In Botswana, there has been use of development approval orders, which allow for a flexible application of tax-based incentives, while a lower rate of company income tax was introduced for qualifying manufacturers in 1995. This was subsequently extended to cover entities operating as part of the International Financial Services Centre and, more recently, to some of the economic "hubs" that were established in 2009. Looking ahead, similar concessions are expected to apply to special economic zones, envisaged under the current industrial policy.

4.22 Although their use to attract investors has become standard practice in many countries, extensive deployment of such fiscal incentives can have negative effects. Preferential treatment of particular classes of business can raise the burden for other taxpayers which have to make up for revenue shortfalls arising from such "tax expenditures". At the same time, the benefits of preferential tax treatment can be eroded by the costs (both for tax payers and tax collectors) of their administration.[50] This can

50 In Botswana, for example, it is understood that only limited use is made of tax incentives for businesses to invest in training, due to the cumbersome administrative process.

be a particular problem for small businesses, where such costs are less readily absorbed. Meanwhile, businesses may be diverted from effective long-term planning by expending resources on lobbying for maintenance or extension of tax concessions, while reliance on tax concessions can delay governments from dealing with other problems that affect businesses, including provision of quality infrastructure and public services.

4.23 Such concessions are often defended on the basis that they are offered by other countries. However, there is also evidence that "genuine" investors (i.e., those not seeking mainly to exploit concessions) prefer straightforward "low tax" fiscal regimes where the focus is on providing a business environment where their operations are viable without recourse to fiscal incentives. The experience in Botswana of "footloose" investors that cease operations or relocate on the expiry of temporary fiscal benefits, as happened on several occasions under the erstwhile Financial Assistance Policy, is relevant in this regard. More recently, programmes of "temporary" support for the domestic textile industry have not been successful. Businesses are also aware that sufficient taxes need to be paid to fund the provision of public infrastructure and services, and should, therefore, not be considered to be anti-taxation. A desirable way forward may be to promote cooperation between jurisdictions to avoid a "race to the bottom" of competing incentives.

Social Policies

4.24 A key element of inclusive growth is the provision of safety nets to those who do not benefit adequately from direct participation in economic activity (i.e., generating sufficient income from employment and/or asset ownership). Broadly, these include the young, elderly, unemployed and infirm members of society. In Botswana, the range of interventions to support this group has been steadily expanding in recent years in line with ambitious socio-development goals, which include the poverty eradication programme.

4.25 In order to be sustainable, safety nets should not be a drag on growth and wealth generation, with their design taking account of at least four important considerations. First, support should not be at levels that would encourage dependency on such benefits. For example, unemployment benefits that are close to the remuneration for paid labour will reduce the incentive to seek employment. Raising the minimum wage will also not be helpful, especially in cases where widespread informal employment means that actual levels of remuneration could be less than the legal minimum wage. Second, support should be targeted at those genuinely in need of help to avoid waste, which may require some form of means testing.[51] Third, where dependency should only be temporary, as in the case of unemployment, there should be measures to encourage greater self-reliance (for example, through skills acquisition). Fourth, the impact of the social support system should be considered as a whole, rather than on a piecemeal (i.e., benefit-by-benefit) basis, and in the context of conditions in the broader economy. Otherwise, there is a risk of inconsistency between various interventions, including the creation of "poverty traps" and encouraging a culture of dependency.

4.26 Tax concessions, notably for households, are also a common means of social support. Limits on the coverage of consumption taxes such as value added tax (VAT) are typically justified on this basis. However, there are dangers in this approach. In particular, it is difficult to target these concessions effectively; poor households do not pay income tax,[52] while consumption taxes can only be applied on a universal basis; thus benefiting the well-off as well. Moreover, an additional layer of tax

51 Any means testing must be cost effective in that it is neither inordinately costly nor a deterrent to the target group of recipients from utilising social safety nets.

52 In principle, this problem could be addressed through some form of negative income tax for those on low incomes. However, implementation of this approach will require a highly-efficient tax administration.

concessions for welfare purposes can increase costs of collection and compliance, while eroding the revenue base.

4.27 A further element of social support is public service provision, notably for health and education where the critical issues for Botswana are:

(i) the extent of private sector involvement in provision of publicly-funded services. This already occurs to a significant degree with respect to tertiary education, but less so for the health sector; and

(ii) charging of user fees is already in place for both health and secondary education, although with some exemptions for the needy. However, the application of the exemptions is discretionary, while the fees are not closely-related to the costs of service provision and may even be lower than the collection expenses.[53] While such a situation clearly undermines sustainability, the alternative to user fees of public health insurance has yet to be seriously considered in Botswana.

4.28 Quality of service delivery is also paramount for sectors such as health and education where the cost of programmes risks becoming open-ended and vulnerable to escalation. In Botswana, relative poor performance against the relevant international benchmarks, such as the MDGs, indicates that the return on significant investments made by the Government in recent years in areas such as health and education has still to be fully realised. From this perspective, and with respect to health, gaps in quality between public and private healthcare provision suggests that gains can be achieved through combining the strengths of both service providers as borne out by experience in China and India. Similarly, financing schemes based on up-front payments and/or tax revenue (including levies on alcohol and tobacco) can help support affordable and sustainable funding models.[54]

(c) External Linkages

Free Trade and Integration

4.29 The major advantages of free trade accrue when countries specialise in products (goods and services) for which they are most suited in terms of available inputs to production. Therefore, liberalisation is not a "zero-sum game" where the benefits accruing to one party are offset by losses to others. Rather, the development of strong external linkages is a necessary pre-condition for the effective exploitation of mutually-beneficial economic opportunities. Beyond facilitating trade flows, an important aspect of integration is promotion of investment, technology and skills transfer (including supplementing the domestic labour pool with relevant skills) and efficient pricing of goods and services, which benefits the domestic economy.

4.30 However, there are cogent reasons for taking a cautious approach to trade liberalisation. Some degree of protection (limited in extent and duration) for local businesses may be justified where there is need to mitigate adjustment costs and help develop capacity in sectors where competitive advantage can be achieved over time. A lack of competitive international markets for specific products (for example, monopolies or cartels, or where there is extensive government intervention and/or ownership) may also motivate intervention. National interest, including security of supply (for example, energy provision), could also warrant deciding against liberalisation for some sectors or markets.

4.31 In general, protectionist policies in the form of tariffs, quotas and other forms of restrictions on imports, impose a significant, but often hidden, cost in terms of higher prices and distortions to productive efficiency. The

53 Ministry of Health, "National Health Policy: Towards a Healthier Botswana", December 2011 and "Botswana National Health Accounts for Financial Years 2007/08, 2008/09 and 2009/10".

54 "Health: Emerging Markets", Financial Times Special Report, October 2014.

administrative expenses of maintaining a restrictive trade regime may also be significant. Such costs tend to fall heavily on excluded groups, such as the poor and unemployed who, at the same time, reap few, if any, of the benefits of protection. Risks that supposedly emanate from free trade may also be exaggerated. For example, access to a wide range of diverse markets is more effective in ensuring secure supply of the various goods and services needed for consumption and as inputs to production. Thus, self-sufficiency in production should not be equated with security in situations where local production is more costly and/or unreliable.

4.32 The key to maximising the extent to which countries reap the potential benefits of free trade and economic integration is to ensure that the basic supporting infrastructure is in place. Therefore, a reduction in the cost of transport and communications has been among the main drivers of globalisation that has multiplied opportunities and potential benefits arising from international trade and investment. In this context, countries that have inadequate trade logistics (infrastructure and administration, etc.) can be seriously disadvantaged.

4.33 In this regard, the performance of Botswana in the *Logistics Performance Index (LPI)* that is prepared biannually by the World Bank is a relevant indicator. Table 2.4 shows the country's rankings in the surveys published in 2010 and 2014. Overall, there has been some improvement, albeit from a low base; the country ranked 120 out of 160 countries, and scored 17th in sub-Saharan Africa. Areas of particular concern include infrastructure (125), quality of international shipments (129) and tracking and tracing (127).[55]

55 That Botswana is a land-locked country cannot so easily be used to explain these results. Other land-locked countries in Africa rank considerably higher (Burundi, Ethiopia, Rwanda and Malawi, for example), as do both Namibia and South Africa, which provide the major access for Botswana shipments to the coast.

The Uses and Limitations of Trade Policy

4.34 The design, implementation and impact of trade policies are also inextricably intertwined with national industrial policies. This close connection can give rise to policy conflicts. In particular, more open trading arrangements may be resisted on the grounds that they limit the scope for independent industrial policy. However, a positive response to such concerns is that trade agreements and trade cooperation should be in the context of the potential for inter-country trade and investment to support, rather than hinder, a pursuit of national industrial development objectives.

TABLE 2.4: LOGISTICS PERFORMANCE INDEX 2010 AND 2014 (RANKING[1])

Countries	2010	2014
Botswana	134	120
of which		
Customs	126	112
Infrastructure	119	125
International shipments	152	129
Logistics	119	99
Tracking & tracing	99	127
Timeliness	123	103
Selected others in Africa		
Burundi	n/a	107
Ethiopia	123	104
Malawi	n/a	73
Mozambique	136	147
Namibia	152	93
Rwanda	151	80
South Africa	28	34
Zambia	138	123
Zimbabwe	n/a	137

1. The 2010 and 2014 surveys comprised 155 and 160 countries, respectively.

Source: World Bank

4.35 There is a further risk that national trade policies do not give adequate recognition to the essential symmetries that define trade relations between countries. This is to the extent that every country's exports (and outward investments) are another's imports (and inward investment); so it cannot, ultimately, be consistent to champion policies that simultaneously promote exports and restrict imports.[56] In the short term, there is some scope for flexibility, particularly for small economies (which have little impact on international trade aggregates) and developing countries reasonably ask for favourable treatment to boost capacity for domestic production. Overall, however, a trade policy that focuses principally on export promotion rather than import substitution is more aligned with underlying microeconomic realities. This has been borne out by experience where the main growth "miracles" derive from building capacity for production of competitive exports. This conclusion applies in particular to small economies where production for the small local market (as import substitution requires) is unlikely to be viable in the absence of extensive support. In addition, innovation and improvements in quality of products and services is likely to be slow in the absence of competition inherent in export markets and where imports are restricted. Therefore, taken together with the industrial development policy, it is important to guard against the risk, at the level of individual policy interventions, of support for import substitution that is unlikely, ultimately, to lead to the establishment of viable local businesses.

4.36 In respect of international investment, the core purpose of attracting Foreign Direct Investment (FDI) to Botswana is to establish a meaningful long-term presence in support of the effective deployment of capital, technology and skilled labour. Therefore, it should be recognised that the resulting foreign presence in the economy will need to be assured and the related need to minimise uncertainty on the part of the investors and skilled workers guaranteed. Areas of uncertainty could relate to taxation, capital movements, including profit repatriation, and regulations relating to work permits and immigration.[57] In this context, investment treaties and favourable laws and regulations on the use of external resources can provide a useful means of reassurance.

Current Regional Initiatives and Future Prospects

4.37 Broadly, Botswana's trade policy is founded on the principles of free trade, aiming to achieve diverse and reliable markets for the country's exports, while giving producers and consumers access to a wide choice of international goods and services. It further recognises the practical reality that Botswana's small domestic market is an impediment to productive efficiency, thus preventing businesses from achieving economies of scale that can make them internationally competitive.

4.38 In line with this, Botswana is a member of the World Trade Organisation (WTO) and has established a number of multilateral and bilateral trade agreements with other countries,[58] most recently agreeing to an Economic Partnership Agreement (EPA) between the European Union and a sub-group of members of the Southern African Development Community (SADC). Historically, Botswana's international trade

56 Again, the same point applies to flows of capital and labour. It also helps to remember the macroeconomic implications of external imbalances. A deficit on the current account of the balance of payments mean that a country is currently investing more than it is saving which is not, in itself, necessarily particularly disadvantageous.

57 Regarding immigration, in making the economic case for a liberal approach, it is also recognised that there may be other concerns, including security and social integration, that also require due consideration. The important point is to recognise the trade-offs that need to be considered.

58 Regionally, Botswana is a member of both SACU and SADC. Under the former, trade agreements have been reached with the USA and the European Free Trade Area (EFTA), while negotiations with India and MERCOSUR (regional trading bloc made up of several Latin American economies) are on-going. Through SACU, prior to the recently-agreed EPA, trade with the EU was largely guided by a bilateral trade agreement between the EU and South Africa. Also on-going are moves to establish freer trade within SADC and between SADC, the Common Market for Eastern and Southern Africa (COMESA) and the East African Community. Botswana currently has bilateral trade agreements with Malawi and Zimbabwe.

policies have been heavily influenced by membership of SACU which offered an enlarged market. However, SACU has not evolved from its pre-independence origins to a body that is relevant to the development objectives of all the member states. In particular, the smaller member states risk being preoccupied by the importance of SACU revenues in their national budgets, while the dominance of South Africa is a key issue in terms of developing a balanced approach to agreeing industrial development priorities for the region.

4.39 The benefits of pan-regional development should also apply to SADC, for which an ambitious blueprint for integration among the 15 members has been agreed in principle. However, persistent delays in making progress are indicative of the formidable obstacles to overcoming adjustment costs arising from trade liberalisation. In this regard, intra-regional transfers are often used to compensate countries that are negatively affected by liberalisation or integration.

4.40 Given the small size of Botswana's domestic market, a more open regional economy is an imperative. Moreover, in terms of location Botswana would be central to a broader southern African economy, as exemplified by the promise of the Kazungula Bridge project or the coastal rail links to Namibia and, possibly, Mozambique. To take full advantage of such a development, complementary measures beyond more-liberal trade agreements are needed, including steps to rectify the shortcomings in the trade logistics noted earlier, some of which require regional cooperation.

4.41 However, it has to be recognised that the effort required to maintain multiple and, in some cases, overlapping commitments in line with various international agreements is substantial. Over and above the lack of progress with SADC integration, there were serious delays in concluding the EPA with the EU, while the ongoing renegotiations of the SACU revenue sharing agreement were due to be finalised in 2013. This gives rise to concerns over the usefulness, in practice, of using such fora to develop effective region-wide policies for sustainable industrial development. Nonetheless, persevering and, where possible, streamlining unnecessary bureaucracy and other impediments to regional trade remains preferable to the alternative of uncoordinated unilateralism that, for small, open economies in particular, can be detrimental.

5. FUTURE RELEVANCE OF BOTSWANA'S MACROECONOMIC POLICIES

(a) Monetary Policy

5.1 Price stability will continue to be central to monetary policy formulation and to be a key attribute of macroeconomic stability, as well as contribute to sustainable economic growth and improvement in living standards. Inevitably, in terms of practical implementation, monetary policy will evolve taking into account relevant economic, financial and market developments. In the context of the development needs for Botswana and lessons from the recent financial and economic crises, monetary policy formulation will also need to take into consideration the potential impact on inclusive growth, financial inclusion and financial stability; which are broad-based approaches that are already provided for in the Bank's objectives.

5.2 In addition, there is evident structural change (fall) in the banking system liquidity emanating from policy initiatives and slower growth in deposits (due to sluggish incomes and rationalisation of funding for parastatals and local authorities) alongside a faster increase in credit. As such, liquidity developments and the need to address financial stability issues (in various banking business areas and facets of the market) could require adjustments to the day-to-day monetary operations and use of macro-prudential tools.

Monetary Policy Framework – Issues in Transition to Inflation Targeting (IT)

5.3 Prior to the major review of macroeconomic policy frameworks brought about by the financial and economic crises, gravitation towards an inflation targeting monetary policy framework appeared natural as a longer-term objective. This was due to the extended period of low inflation and sustained growth that had been widely enjoyed by countries that had already adopted such a framework which, among others, would entail the following main elements:

(i) an explicit central bank mandate to pursue price stability as the primary objective of monetary policy and no overt targeting of other indicators, such as the level of employment, wages or the exchange rate;

(ii) operational autonomy of the central bank with respect to choice of instruments used in pursuit of the inflation target;

(iii) numeric definition of an inflation target to be achieved within a specified time period against which the central bank is publicly accountable;

(iv) institutional set up for transparent policy making and implementation; and

(v) a forward-looking policy approach based on assessment of prospective inflationary pressures and to guide public expectations with respect to future (medium term) inflation and policy stance.

5.4 These elements are deemed to be central to attainment of lasting price stability, which underpins durable growth and favourable performance with respect to other indicators of macroeconomic stability and socioeconomic upliftment. Most importantly, it is suggested that central banks cannot directly and consistently pursue and achieve multiple goals; rather price stability supports the attainment of other goals. In this context, an IT framework, with emphasis on transparency, reinforces the transmission of monetary policy to the macroeconomy, as it affords a role for expectations in the determination of inflation, as well as likely future policy stance and monetary conditions (cost and availability of funding).

5.5 Overall, the consensus is that such an approach to policy formulation is not invalidated by the recent financial crisis. Thus, the key features of inflation targeting remain relevant in charting the agenda for the future direction of monetary policy. Nevertheless, while inflation targeting has proven to be a credible policy framework, recent experience necessitates a reassessment of the relationships between monetary policy and other macroeconomic policies and inputs to policy formulation, in particular consideration of financial stability issues. In addition, the crisis has demonstrated the practical constraints in successfully marshalling fiscal policy in support of macroeconomic stabilisation (where fiscal policy is fully deployed or risks being unsustainable), with a more active monetary policy being called on to fill this role in the advanced economies. Moreover, this needed to be reinforced by "forward guidance", which meant that there had to be a commitment to a particular monetary policy stance until specified performance outcome with respect to key real variables, such as the unemployment rate, is attained.

5.6 For Botswana, it is considered that the current monetary policy framework, as augmented by consideration of financial stability issues and the possible use of macro-prudential tools (discussed below), remains appropriate. However, a more explicit statement of the price stability objective as part of the Bank's statutory mandate might be considered as a means to entrench congruence across macroeconomic policies.

Options for Exchange Rate Policy

5.7 A managed, albeit transparent, exchange rate policy will continue to be a critical element of the macroeconomic policy framework that supports national development objectives. For Botswana, the management of the exchange rate helps to avoid macroeconomic instability (including response to shocks). In this regard, a flexible, market determined exchange rate arrangement is not necessarily appropriate, given the country's undiversified economy that is characteristied by skewed and lumpy foreign exchange receipts that might result in extreme volatility of the exchange rate. At the same time, the large value of exports of one commodity (diamonds) might tend to result in the appreciation of the Pula exchange rate to a point where the tradeable goods sector would become uncompetitive.

5.8 Therefore, a managed exchange rate regime, where the Government targets a stable real effective exchange rate that serves to ensure that domestic producers of tradeable goods and services are competitive, should remain the optimal policy into the foreseeable future. However, it is important to note that discretionary adjustment of the exchange rate can only play a short-term limited role in supporting domestic industrial production; indeed, the need to adjust the exchange rate reflects deficient performance (productivity). Therefore, there is a need to focus on policies that boost productivity as the foundation of sustainable and inclusive growth that leads to an increase in living standards, rather than rely on an adjustment of the exchange rate to maintain competitiveness.

5.9 In the long-term, increased financial integration between Botswana and the global markets will further complicate monetary and exchange rate policy management. The Botswana economy is highly open with a liberal policy environment and in the context of no capital controls. Thus, with expansion of opportunities for inward investments and local economic agents also engaging in foreign commercial and financial activity, currency movements and developments relating to international liquidity and interest rates will increase. In turn, these would have a bearing on domestic policy formulation. In the circumstances, the so-called "impossible trinity" (trilemma) could become binding.[59]

5.10 Consequently, in a liberalised financial system and more diversified economy,[60] it is conceivable that the crawling band/managed exchange rate regime could give way to a more market-based and flexible exchange rate policy framework; although this could still be expected to accommodate considerable intervention in support of stability. In particular, intervention may be necessary when the exchange rate becomes too volatile or is at risk of overshooting (appreciation or depreciation) the level considered to be consistent with stability. However, such a scenario entails further complexity in that there are implications for the management of foreign exchange reserves. In that regard, a developed interbank foreign exchange market would be necessary to support the increased flexibility of the exchange rate (including proper valuation). In terms of the relationship with macroeconomic policies, increased exchange rate flexibility and associated market activity potentially enhances the effectiveness of monetary policy instruments and transmission. Moreover, a flexible exchange rate reinforces price stability as the primary objective of monetary policy.[61]

The Role of Macro-Prudential Tools

5.11 After the 2007-2008 global financial crisis, there is a growing consensus that the goals of macroeconomic stability are inextricably linked to financial stability, and that there is potential for macro-prudential policies to complement monetary policy. To this end, the Bank now has a dedicated financial stability function that monitors risks to

59 "Impossible trinity" relates to the challenge that in a fully liberalised system, including full convertibility on the current and capital accounts (unrestricted financial flows and free mobility of capital), the central bank cannot guarantee maintaining both an inflation and exchange rate target (Bank of Botswana Annual Report 2008).

60 Through increased exports, broadening the sources of foreign exchange earnings and developed foreign exchange markets.

61 Currently, the crawling band exchange rate regime and the 3-6 percent medium term inflation objective suggests multiple objectives and, therefore, uncertainty as to which of the two is the nominal anchor for price stability.

financial stability (including the likely impact of monetary policy) and also potentially guides the determination of macro-prudential policies.

5.12 The current concerns about financial stability in Botswana relate to the risks stemming from rapid growth in unsecured household credit and, more recently, to the growth in residential property loans where there is evidence of significant refinancing and, therefore, the need to ensure credibility of valuations. On the other hand, there is a case for continuing to promote business credit growth to support economic activity. Therefore, the evaluation of prospective macroeconomic developments to inform the monetary policy stance is being extended to cover consideration of more granular data on credit developments, property market, other asset prices and the interaction of non-bank financial institutions with banks and the broader economy. The latter includes an assessment based on a range of internationally standardised financial soundness indicators.

5.13 Thus, policy guidance given by the divergence of the inflation forecast from the objective/target has to be tempered with consideration of the potential impact of adjustment of policy on financial stability and inclusion. A good example is the potential impact of a policy adjustment on credit markets (overall or market segments), patronage of the banking system and the relationship between banks and non-banks, including prospects for disintermediation. In essence, there is a case for considering and testing the effectiveness of macro-prudential policies in supporting the pursuit of price stability. Therefore, macro-prudential instruments, which can be used to mitigate systemic risks generated by strong credit growth and credit-driven asset price inflation, would become relevant. In this regard, it is noted that macro-prudential instruments are more direct (less blunt) than monetary policy tools, and are more flexible (with shorter implementation lags) than most fiscal tools.

5.14 In addition, instruments such as prescriptions relating to the loan-to-value (LTV) and debt-to-income (DTI) ratios, foreign currency lending and capital risk weights can be tailored to risks of specific sectors or loan portfolios without causing a generalised impact on economic activity, thus limiting the economic cost of policy intervention. Nevertheless, costs[62] of using macro-prudential instruments (as is the case with regulation more generally) need to be weighed against the benefits. Generally, macro-prudential instruments and prescriptions should be consistent with other public policy objectives, i.e., fiscal, monetary and micro-prudential policies.

5.15 The use of macro-prudential policies also requires an understanding of macro-financial interactions; key features of these interactions need to be integrated into the analytical and forecasting framework of monetary policy. For example, it will be important to understand how macro-prudential tools and changes in regulation will affect financial market behaviour. Overall, it is important to enhance financial regulation and supervision to bring it in line with global best practice. It is also important that coordination and information sharing between the Bank and other financial sector regulators is strengthened in the interest of effective monitoring of developments and implementation of regulations. Finally, it is paramount that data gaps relating to, among others, profile of borrowers, property market, and non-bank financial institutions, are addressed effectively.

Liquidity Developments and Monetary Operations

5.16 Liquidity in the banking system has decreased in the previous 2-3 years in the context of slow growth in deposits together with relatively faster growth in credit expansion. Nevertheless, there continues to be system-wide excess liquidity, absorbed

62 Macro-prudential tools may push risky activities out of the regulated sector, and may require significant lead time if multiple agencies are involved and could require more intensive monitoring.

through BoBCs, which has so far proven to be an effective instrument of monetary policy. However, the need to absorb excess liquidity through BoBCs should continue to be considered alongside assessment of the potential for effective deployment of financial resources for productive purposes and to meet the industrialisation and development needs of the country. Thus, the reduction (and prospective drying up) of excess liquidity is positive to the extent it signals a realignment towards better use of resources.

5.17 However, the changes in liquidity conditions have implications for monetary operations and the efficiency/effectiveness of the money market, and hence the transmission of monetary policy. At this stage, with system-wide excess liquidity, shortages for individual banks should stimulate an increase in interbank market activity, which is positive, as it potentially engenders efficiency and more effective policy transmission. Efficiency and innovation in the money market should be further enhanced as banks develop and generate interest in alternative instruments that would qualify to meet the liquid asset requirement.

5.18 Beyond the current situation, the substantial decrease in liquidity could portend a transition to an environment in which banks require funding by the central bank. This is the case in most jurisdictions where markets are characterised by overall liquidity shortage; and open market operations predominantly involve liquidity injection by the central bank. Accordingly, given its role, the Bank will, as the need arises, adjust open market operations and invoke relevant instruments to accommodate system-wide liquidity shortage, while maintaining consistency with the monetary policy stance. At the same time, appropriate instruments and operational arrangements are available to foster effectiveness of the interbank market in support of monetary operations. Overall, the Bank addresses liquidity developments and related management issues in individual institutions on an ongoing basis in order to sustain soundness of banks and overall financial sector stability.

(b) Fiscal Policy

5.19 Central to budgetary discipline in Botswana has been the medium-term fiscal framework founded on the NDPs, including the mid-term reviews. The value and durability of this framework has been rightly recognised. Nonetheless, as emphasised in Section 4, institutional renewal is a key element of meeting the challenge of overcoming the middle-income trap. Thus, it is important to consider the possible requirements for the fiscal framework looking ahead, taking into account not only the lessons from the crises, but also the longer-term structural trends affecting the Botswana economy, particularly relating to generation of government revenue.

Revenue Diversification

5.20 Mining revenues, from diamonds in particular, will continue to be the mainstay of government funding for the foreseeable future.[63] At the same time, diversification of the domestic revenue base is essential for mitigation of risks and to adapt to the eventual slowdown in mineral revenues, as well as to ensure a reasonable pace of overall growth to meet future government expenditure and development needs. This point is reinforced further once the uncertainty surrounding the future stream of receipts from SACU is also taken into account.

5.21 Thus, the objectives of diversification of the economy and fiscal stability can be mutually supportive. However, for such a beneficial relationship to be sustained, fiscal policy should be business friendly while eschewing dependence on tax concessions (or even subsidies) to favoured classes of business. The promotion of diversification that is overly dependent on "special treatment",

63 According to current projections, even in the absence of major further discoveries, diamond mining in Botswana can be expected to continue at significant levels until at least 2050.

results in less revenue generation. In this regard, it is also important that beneficiation initiatives should be based on genuinely viable projects. Otherwise, the revenue base will be further eroded through lost tax revenues and/or subsidies arising from both tax concessions and weak business performance. In particular, tax concessions could require matching the decrease (or low pace of growth) in revenue with a reduction of government expenditure, and would thus need to be considered carefully in terms of the likely impact on domestic wealth creation. Overall, diversified and stable revenues are founded on generally low and uniform rates of taxation across all sectors, thus adding to clarity and transparency, while holding down the costs of compliance. A greater reliance on domestically-generated revenues could have the further benefit of more closely aligning the interests of policymakers with those of domestic businesses and consumers.

Expenditure Control

5.22 Effective expenditure control is also critical. The Government has already made welcome advances through a series of coordinated initiatives and reforms, including revisions to relevant legislation and regulations, and the introduction of rolling medium-term fiscal and expenditure frameworks to support more integrated programme-based budgeting. The programme of reforms is expected to be in place by 2018. A key consideration is to ensure that budgeted funds are used as intended (with both over- and under-spending to be avoided), and that the whole budgeting process provides value for money in two respects. First, the linkages between various expenditure components (e.g., the implications of capital spending for future recurrent expenditure) being adequately recognised. Second, the framework involves sufficient flexibility to take into account evolving needs while maintaining overall fiscal discipline.

5.23 The Government is in the process of introducing a refined fiscal rule that is expected to be the cornerstone of fiscal policy in NDP 11 (Budget Strategy Paper, 2015/16). This would reserve a minimum of 40 percent from annual mineral revenues for a fund for future generations, with the balance available to be used for investment spending. Another aspect of the fiscal framework would further limit total government expenditure to a maximum of 30 percent of GDP. Such a framework should help provide a foundation for the necessary accumulation of savings that can help cushion the adjustments required when the major deposits of diamonds are depleted. Constraining the overall spending ceiling within such a limit will also help rebalance the economy in favour of the private sector.

5.24 However, the efficacy of this new fiscal measure depends crucially on the manner in which it is implemented. Setting aside 40 percent of mineral revenues for long-term saving implies a much tighter spending constraint, as compared to the previous sustainable budgeting rule where, at least in principle, all such revenues could be utilised immediately to cover investments. However, it should not be inferred from this that cuts to development spending of such magnitude will necessarily result from introducing this rule given that the downward adjustment to overall spending to 30 percent of GDP would, in any case, require substantial streamlining of the development budget. This is especially given the need to rebalance the budget to adequately cover infrastructure maintenance. In addition, the programme of reforms to improve the management of public finances should reduce the degree of underspending of the development budget, allowing for more efficient allocation of resources, while alternative sources of financing could be considered for priority public infrastructure projects, including making greater use of public-private partnerships (PPPs).

5.25 Nonetheless, the new fiscal rule will put a premium on ensuring that funds reserved for capital projects are not inadvertently assigned to less productive spending. More specifically, the previous sustainable budgeting rule that allowed all spending from the Development Fund, together with a portion of recurrent spending related to health and education, to be covered from mineral revenues should be critically reviewed in light of such considerations.[64] This is appropriate, given that the opportunities for productive new public infrastructure investment by the Government are diminishing compared to earlier stages of the country's development.

5.26 In addition, to provide a useful yardstick for limiting government expenditure, it is important that estimates of GDP are rebased on a sufficiently frequent basis to ensure that recent developments in the size and structure of the domestic economy are adequately recorded. Effective expenditure management could also be strengthened through limiting the extent to which the budget is fragmented through spending supported by special funds separate from the main Consolidated and Development Funds.

Debt Management

5.27 Closely linked to the fiscal rule is the need for an appropriate debt management strategy, which remains relevant in the context of an overall fiscal strategy that aims for recurring budget surpluses. As the recent crisis clearly showed, cyclical fluctuations might necessitate government borrowing so as not to disrupt service delivery and help stabilise the domestic economy. More fundamentally, the fiscal rule might usefully be complemented by some capacity to use debt finance (either directly through government borrowing, or through PPPs) to fund investments with a high yield (and that will also have a realisable benefit on future government revenues), but would otherwise exceed funding available from current mineral revenues. For such options to be utilised optimally, a debt management strategy needs to be firmly in place, supported by appropriate institutional arrangements to ensure effective coordination and consultation among all interested parties rather than leaving this to ad hoc mechanisms.

6. CONCLUSION

6.1 Macroeconomic stability underpins economic development as it provides an enabling environment for economic decisions that foster growth. The institutions, frameworks and operational rules that promote stability also enable timely and effective adjustments to address emerging developments that could be destabilising or undermine growth and development prospects. However, macroeconomic stability has to be viewed in the context of appropriate structural elements and national policies. Among others, the theme topic highlights the significance of a stable and supportive financial sector, an enabling government bureaucracy and administrative processes, productivity as embodied in quality of infrastructure, appropriate skills and responsive labour markets, as well as relevant strategies for regional/global integration. The importance of both the macroeconomic and structural elements was demonstrated by the financial crisis of 2008 and persisting aftershocks. In this respect, countries with sounder macroeconomic policy frameworks and better structural fundamentals generally fared better and emerged quicker from the crisis.

6.2 Botswana continues to stand out as an example of an economy where the consistent application of basic principles of prudent economic management have provided a solid foundation for growth and development that has lifted living standards across the population. Moreover, despite the short-term negative impact on international diamond markets resulting from the financial crisis, the past accumulation of foreign exchange reserves by the Government provided adequate buffers to avoid a hard landing for the domestic economy. In particular, sound policy frameworks in

64 Spending that is related to social support programmes, some of which is currently covered by the development budget, should consistently be treated as part of current consumption spending.

the key areas of monetary, fiscal and exchange rate policies have evolved to meet the requirements of changing economic circumstances.

6.3 Even then, one of the lessons of the financial crisis has been the recognition that there is need for greater attention to financial stability as an aspect of macro fundamentals beyond the established focus of monetary policy on price stability. Similarly, the Government is developing a new framework for fiscal policy management which places greater emphasis on ensuring that benefits from the mining of diamonds extend across generations through the explicit transfer of a proportion of diamond revenues to build a fund for the future; the balance will continue to be invested in expanding productive capacity (infrastructure, education and health).

6.4 The penultimate section of the chapter examined some options for the future direction of macroeconomic policy. Increased focus on financial stability, to accompany the continuing relevance and importance of price stability, could require the introduction of appropriate macro-prudential policies to augment the monetary policy framework. The crawling band exchange rate policy framework remains appropriate and effectively complements the monetary policy framework in sustaining competitiveness of the domestic industry. In this respect, appropriate monitoring needs to be maintained and adjustment of basket weights and the rate of crawl made in response to any significant changes in trade patterns and inflation differentials between Botswana and the trading partner countries. However, it should be recognised that enhanced capital and financial flows could alter the existing relationship between the monetary and exchange rate policies; ultimately, the policy choices could be either explicit exchange rate targeting or more exchange rate flexibility to enable inflation targeting.

6.5 Fiscal policy reforms should continue to be directed at fostering the stability and sustainability of the government budget through revenue diversification and expenditure discipline. This would entail the implementation of new medium-term fiscal and expenditure frameworks to complement the National Development Plan and Long-Term Vision. There is also a need to ensure that the Government gets value for money for projects as well as the public goods and services it provides; this could increasingly involve the use of favourable public-private partnerships.

6.6 Ultimately, sustained growth is the key component of macroeconomic stability. However, to be meaningful, growth has to be inclusive and encompass enhanced employment (or income generating) opportunities, reduced inequality and minimal poverty incidence. Where necessary, there would be need to sustain respectable standards of living and access to services through appropriate (means-tested) social safety nets. Recent instances of social unrest in several countries in response to persistently high-levels of unemployment demonstrate the potential negative consequences of non-inclusive growth. In this context, the increased focus on inclusive growth has been a necessary response from policymakers across the world. For Botswana, it is important to appreciate that growth has to a significant degree been inclusive, as indicated by the positive strides in terms of service provision and poverty reduction. Nonetheless, the persistence of unemployment at nearly 20 percent of the labour force and continuing levels of inequality that are among the highest globally, indicate the formidable challenges that remain in delivering the benefits of growth on an inclusive basis.

6.7 The phenomenon of the "middle-income trap" points to the particular difficulty associated with successful transition from middle to high-income status. Significantly, no country in Sub-Saharan Africa has yet achieved this step. This is in contrast to experience in South East Asia and Europe, where successful role models inspired and spurred the necessary development in neighbouring countries. Sub-Saharan Africa also suffers from the absence of robust regional structures that can reliably support such a transition.

6.8 For Botswana to overcome the "middle-income trap" a programme of economic reforms to remove bottlenecks and other constraints in the economy has to be pursued. However, to be successful, such a programme need not comprise solely major new government interventions. Indeed, modest adjustments, including more efficient implementation of existing policies, could generate the desired results. Moreover, in initiating and implementing reforms, there should be recognition that government capacity is limited and that bureaucratic inefficiency can be the major obstacle to development. In this respect, allowing a greater role for the private sector in the next stage of the development process requires a major change in outlook, given that government leadership was instrumental in the successful earlier transition from low to middle-income status.

6.9 Shortages of skilled labour in the country buttress the case against the establishment of yet more government structures or quasi-government bodies to coordinate sectoral interventions. The current preponderance of such support institutions could also suggest existence of numerous and sometimes conflicting objectives that are not easily coordinated, which potentially contribute to ineffective policy implementation. Equally, complex systems of incentives for industrial development in the form of reduced taxes and subsidies, normally aligned to special economic zones, could be costly to the economy in terms of foregone revenues, without the benefit of an increase in economic activity and productivity.

6.10 In pursuing economic reforms to spur further development, the pressing need is to ease those constraints that are considered most binding on the economy. For Botswana, the issue of low productivity clearly falls into this category. Realigning education policies, curricula and incentives to ensure resources devoted to human capital development are deployed more effectively is critical to improving productivity, value addition to the economy and inclusiveness. However, it should be acknowledged that the issue of productivity goes beyond the lack of relevant skills and poor work ethic of the labour force.

6.11 As outlined in the review, the focus on total factor productivity rather than solely on the labour component serves as a reminder that the challenge relates to the overall work environment. Thus, productivity is determined by working conditions at the enterprise level, including the mindset of the workforce, management and leadership as well as constructive industrial relations. Costly and obstructive regulation and inefficient service provision by public enterprises and government agencies also have a negative impact on productivity. Regarding the provision of utilities and services, a businesslike approach to operations in relevant institutions is urgently required in order to be effective in facilitating productive economic activity. For the monetary authorities, the effective promotion of financial inclusion (including financial education) is crucial to realising the productive potential of low income households and small/informal businesses.

6.12 A key issue, and one where government can expect to continue to play a leading role, is the provision of relevant infrastructure and related support services. Botswana's lowly ranking in the World Bank's transport logistics index, even when compared to other land-locked countries, is a clear indication that much remains to be done in this regard. It is particularly important for Botswana to address this if it is to realise the potential as a transport and communications hub at the centre of the SADC region.

6.13 The report has highlighted the value of free trade in contributing to mutually beneficial development among countries. Economic history shows that a liberal approach to trade and outward looking strategies are more appropriate for small economies. This approach helps to expand opportunities and access to inputs, which are otherwise constrained by a small domestic market and paucity of local resources. In the same vein, Botswana should embrace the opportunities derived from FDI, including capital, technology and augmentation of skills.

Appendix 2.1: Evolution of the Monetary Policy Framework

Period	Primary Objective	Operational Methods/Instruments
Pre-1991	To resolve anomalies in the banking system caused by rising excess liquidity, including commercial banks' unwillingness to take deposits from certain large depositors and a shift out of longer-term interest bearing deposits into shorter-term deposits (current and call deposits).	• Direct tools of monetary control. • Major policy instrument: regulated interest rates for deposits and lending. • Other policy instruments (primary reserve requirements and Bank Rate) also existed, but were not effective due to excess liquidity. • Bank of Botswana Call Account was used to absorb excess liquidity from commercial banks and certain large depositors.
1991-1998	The principal objective was to maintain real interest rates in line with those prevailing in major international markets in order to stabilise capital flows, while price stability was increasingly emphasised.	• Commencement of financial liberalisation. • Indirect monetary policy tools: BoBCs introduced in 1991 to absorb excess liquidity. • The call account facility at the Bank of Botswana was discontinued. • Major policy instrument: Bank Rate became relevant as a signalling device. • Determination of auction amounts and pricing of BoBCs and the Bank Rate through monthly meetings of the Open Market Coordination Committee (OMCC).[1]
1998-2001	Promoting and maintaining monetary stability (as reflected in low and stable rate of inflation) and maintaining positive real interest rates as measured by short-term effective yield on three-month BoBCs.	• The annual Monetary Policy Statement (MPS) was introduced in 1998, and became an important pillar of monetary policy.[2] However, the MPS did not initially specify price stability in terms of a numerical objective. • Repos and reverse repos were introduced in 1998 to supplement use of Bank of Botswana Certificates (BoBCs) in money market operations. • The delineation of responsibilities was clarified with the Monetary Policy Committee (MPC)[3] setting the Bank Rate and giving guidance on the pricing of BoBCs to the Open Market Auction Committee (OMAC), which also determines auction amounts.
2002-2007	To achieve a sustainable, low and predictable level of inflation	• An annual objective for inflation was introduced in 2002, initially at 4 – 6 percent. • A rolling medium-term (3-year) inflation objective of 3 – 6 percent as introduced in 2006, initially running concurrently with the annual objective. • Growth in commercial bank credit used as an intermediate target, consistent with economic growth, the inflation objective and taking into account financial deepening. • The increase in government spending was also monitored for consistency with expected output growth and the inflation objective.
2008-to date	To achieve a sustainable, low and predictable level of inflation	• Annual inflation objective and credit growth target dropped. • Medium-term inflation objective maintained, with an enhanced role for the medium-term inflation forecast in guiding policy decisions. The inflation forecast effectively becomes the intermediate target, although other factors are also considered.

Source: Bank of Botswana

1 The OMCC included representation from the Ministry of Finance and Development Planning.

2 See, for example, the 2000 MPS, which explains the role of the Statement in establishing the framework and objectives for domestic monetary policy.

3 The MPC comprises selected senior management and advisers from the Bank of Botswana.

Appendix 2.2: Chronology of Exchange Rate Events

Date	Action	Comments
Pre-1976	Part of the Rand Monetary Area (RMA)	Exchange rate and monetary policies not independent – Botswana was dependent upon South Africa's policy frameworks
August 1976	Introduction of the Pula pegged to US dollar at P1 = USD 1.15 (Pula also at par with the rand)	Pula pegged to the US dollar at the same rate as rand/ US dollar peg
April 1977	5 percent Pula revaluation	Anti-inflationary measure
September 1979	Rand taken off US dollar peg and SA introduced managed float	Rapid appreciation of the rand against the US dollar as gold prices rose
June 1980	Pula taken off US dollar peg and Pula basket consisting of the SDR and rand introduced	To reduce volatility of rand/Pula exchange rate
November 1980	5 percent Pula revaluation	Anti–inflation measure to curb imported inflation following Pula depreciation against rand and accelerated inflation in South Africa
January 1981	Steep drop in world gold price (from USD 850 in January 1980 to USD 494 per ounce in January 1981)	South African export earnings decline sharply and rand depreciates rapidly against major currencies. Therefore, Pula depreciates against major currencies and appreciates against the rand
May 1982	10 percent Pula devaluation	Part of stabilisation measures in response to 1981/82 balance of payments crisis
February 1984	RSA freezes debt payments and run on the rand	Rapid depreciation of the Pula against the US dollar as rand depreciated against the US dollar; Pula appreciates against the rand
July 1984	5 percent Pula devaluation	To improve competitiveness as Pula appreciated against rand following rand collapse
August 1984	Rand weight in Pula basket adjusted	To reduce drift of Pula from rand as rand depreciated against US dollar (and SDR), the rand was given the dominant weight in the Pula basket
January 1985	15 percent Pula devaluation	Further competitiveness measures in response to rapid Pula appreciation against the rand
January 1986	New Pula basket introduced with the rand weight increased	In response to the rapid rand appreciation against the US dollar following the re-introduction of the financial rand
June 1989	5 percent Pula revaluation	Anti-inflation measure to curb imported inflation
August 1990	5 percent Pula devaluation	Competitiveness measure
August 1991	5 percent Pula devaluation	Competitiveness measure
September 1991	Zimbabwean dollar introduced to the Pula basket	To capture the increase of trade with Zimbabwe (both imports and exports)
June 1994	Technical adjustment and the removal of the Zimbabwean dollar from the basket	Changes made to Pula basket to reflect changes in trade patterns and aimed at maintaining competitiveness and real exchange rate stability
February 2004	7.5 percent devaluation of the Pula	Competitiveness measure
May 2005	12 percent devaluation of the Pula	Competitiveness measure
May 2005	Adoption of the crawling band mechanism	To avoid the need for large discrete adjustments to the exchange rate
February 2013	Announcement of Pula basket weights (55 percent rand: 45 percent SDR) and rate of crawl (-0.16 percent per annum)	To foster transparency in the operation of the exchange rate mechanism

Source: Bank of Botswana

Appendix 2.3: Evolution of the Fiscal Policy Framework

Period	Primary Objective of Fiscal Policy	Operational Methods/Instruments of Fiscal Policy
Pre-NDP 5	Financial independence.	• To eliminate in the shortest possible time reliance on grant-in-aid funds from UK Government to fund the recurrent budget
NDP 5: 1979-1985	Creation of recurrent and manpower ceilings, and development budget guidelines for the new development projects that would be coming on stream. To limit government expenditure to match the resources available for development.	• Raising revenue. • Encouraging certain types of economic activities. • To reduce income inequality
NDP 6: 1985-1991	To build up government expenditures gradually to the levels that the Jwaneng expanded revenue base could sustain.	• Foreign exchange reserves and government balances must build up in early years of the Plan before being drawn down thereafter • To have a bias towards self-liquidating projects • To reduce income inequality
NDP 7: 1991-1997	The principal objective was to achieve lower sustainable growth of government expenditure.	• Spending should leave 9-11 months of foreign exchange to finance imports • Recurrent expenditure growth should be capable of covering the recurrent budget implications of the development expenditure programme. • Recurrent expenditure to be financed out of recurrent revenues
NDP 8: (1997/98-2002/03) and NDP 9: (2003/04-2008/09)	Fiscal sustainability (sustainable budget index) and restraining the growth of government expenditure (Government spending should be limited to 40 percent of GDP).	• For fiscal sustainability, the ratio of non-investment recurrent expenditure to non-mineral revenue should be less than one. A higher value indicates that mineral revenue is financing current consumption, which is not sustainable and, therefore, limiting future growth and prosperity of the economy. • Broadening of sales tax, switch to VAT and gradual shift from direct to indirect taxation • Privatisation • Cost recovery • Prioritise recurrent budget to maintain and operate existing infrastructure before spending on additional infrastructure
NDP 10: 2009-2016	Fiscal sustainability (sustainable budget index) and balanced budget over medium term. Limitation of national debt through the Stocks, Bonds and Treasury Bills Act.	• To progressively decrease government spending as a share of GDP to be in line with long-term expected revenues • Spending plans should reflect that current development spending has a bearing on future recurrent spending • Adoption of broad-based tax system that is supportive of private sector growth • Strengthening of tax collection systems • Outstanding public debt is limited by law to not more than 40 percent of GDP, with limit allocated equally (20 percent each) between external and domestic debt

Source: Bank of Botswana and MFDP

Appendix 2.4: Main Macroeconomic Stability Indicators in Botswana and Comparison with Selected Upper-Middle-Income Countries (Period Averages)

	2008	2009	2010	2011	2012	2013
Real GDP Growth (percent)						
Botswana	3.9	-7.8	8.6	6.2	4.3	5.8
Mauritius	5.5	3.0	4.1	3.9	3.2	3.2
Namibia	2.6	0.3	6.0	5.1	5.2	5.1
Chile	3.3	-1.0	5.8	5.8	5.4	4.1
Malaysia	4.8	-1.5	7.4	5.2	5.6	4.7
Inflation (percent)						
Botswana	12.6	8.2	6.9	8.5	7.5	5.9
Mauritius	9.7	2.5	2.9	6.5	3.9	2.5
Namibia	10.4	8.8	4.5	5.0	1.5	5.5
Chile	-	-	1.4	3.3	3.0	1.8
Malaysia	5.4	0.6	1.7	3.2	1.7	2.1
Budget Surplus/Deficit (percent of GDP)						
Botswana	-6.4	-12.3	-7.0	-0.4	1.4	
Mauritius	-	0.6	-2.4	-1.1	-0.6	
Namibia	5.6	1.4	-7.3	-11.9		
Chile	4.5	-4.2	-0.4	1.3	0.5	
Malaysia	-4.4	-6.1	-5.2	-4.8	-4.5	
External Debt (percent of GDP)						
Botswana	4.0	16.9	13.1	15.6	17.1	16.4
Mauritius	7.0	25.6	28.1	85.1	89.3	91.5
Namibia						
Chile						
Malaysia	46.3	59.1	54.9	50.7	63.9	68.1
Real Effective Exchange Rate (index)						
Botswana	99.8	101.0	101.8	103.2	104.2	105.9
Mauritius						
Namibia	79.4	86.6	100.0	97.9	92.6	82.8
Chile	96.5	94.4	100.0	100.9	104.6	103.5
Malaysia	97.5	94.8	100.0	100.4	100.1	100.3
Current Account Balance (percent of GDP)						
Botswana	0.0	-8.4	-2.2	-2.1	-7.4	
Mauritius	-10.1	-7.4	-10.3	-13.4	-10.5	
Namibia	3.0	-1.4	0.9	-1.2		
Chile	-1.8	2.0	1.5	-1.3	-3.6	
Malaysia	16.8	15.7	10.9	11.6	6.1	
Months of Import Cover						
Botswana	21.6	18.2	14.1	13.2	14.3	15.8
Mauritius	3.4	5.4	5.1	4.5	4.8	5.3
Namibia	2.7	3.8	3.0	3.0	2.7	2.3
Chile	3.9	6.0	4.8	5.7	5.5	5.4
Malaysia	4.8	7.1	7.7	6.8	5.5	4.8

Source: Bank of Botswana and World Bank