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Research Update:

Republic of Botswana 'A-/A-2' Ratings Affirmed; Outlook Still Negative

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Overview

- Government fiscal deficits are narrowing as diamond revenues have temporarily increased owing to higher diamond sales from selling stock.
- We assume Botswana's economic growth performance will remain stable, at least at 3% of GDP over the medium term, supported by a stable diamond sector, strong growth prospects in service sectors, construction, and an improving agriculture sector.
- We are affirming our ratings on Botswana at 'A-/A-2'.
- The continuing negative outlook reflects our view that over the next 12 months economic growth performance and fiscal outcomes could be weaker than we currently expect if the diamond sector were to underperform.

Rating Action

On April 28, 2017, S&P Global Ratings Services affirmed its 'A-/A-2' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Botswana. The outlook remains negative.

Rationale

The negative outlook reflects our view that economic growth performance and fiscal outcomes could be weaker than we currently expect over the next 12 months, barring a structural improvement in international diamond prices to support higher production levels. The ratings are supported by Botswana's relatively strong institutions, strong external balance sheet, well-managed minerals-based economy, long track record of political stability, and relatively sound institutional effectiveness. The ratings are constrained by the country's narrow economic base, which relies heavily on the diamond sector and is vulnerable to external shocks, despite efforts to diversify.

Botswana is one of the world's largest rough diamond producers, and the diamond mining industry remains its main economic locomotive. The diamond sector contributes just under one-third of Botswana's GDP, over one-third of its fiscal receipts, and more than two-thirds of exports. Debswana, a 50-50 joint venture between De Beers and the Botswana government is the main producer of diamonds in Botswana. Nevertheless, the economy remains exposed to a weak performance in the diamond sector, which could hurt economic growth prospects and potential fiscal adjustment.

Under our current assumptions, we expect Botswana's economy may be able to maintain economic growth rate of 3% in real terms in 2017, similar to 2016. In addition to strong growth in the service and construction sectors, strong rains could also bolster the agricultural sector. At the same time, government projects focused on water and increasing electricity capacity will reduce the drag these factors have had on economic growth in the past. We estimate the 10-year weighted real GDP per capita growth at 1.5% over 2010-2020. We also expect that wealth levels, measured by GDP per capita, will remain above US$6,000 over the medium term.

Botswana's estimated fiscal deficit in fiscal year 2016 (ended March 31, 2017) is narrower than our assumptions six months ago. But the deficit has been helped by what we view as one-off higher diamond sales experienced in 2016 (as Debswana sold inventory), rather than by a significant firming of diamond prices and/or production on a longer-term basis. Debswana production levels have declined by at least 10% from close to 23 million carats in 2014 to average 20 million over the past three years. At the same time, Debswana's average diamond prices have declined by 15% from US$178 per carat in 2015 to $152 per carat in 2016.

Along with expenditure consolidation, we expect fiscal deficits to gradually decline to a near balance in 2020. We project that the annual change in gross general government debt will average less than 1% of GDP over our forecast period through 2020. Diamond revenues contribute close to 40% of total revenues, while the Southern African Customs Union (SACU) revenues contribute close to 30%. Both sources are significant, but can be volatile due to changes in international prices or trade patterns with South Africa. On the expenditure side, we assume the government is now unwinding its enhanced expenditures under the economic stimulus program, along with other expenditure consolidation measures, such as containing real public sector wage increases, lowering transfers to loss-making state-owned enterprises, and reducing the government's non-wage operating costs. Thus we expect the government's overall fiscal position to be near balance by 2020.

Botswana has a strong fiscal balance sheet exhibited by a net fiscal asset position over many years. The asset position has served Botswana well in times of countercyclical fiscal policy implementation. We expect Botswana's net fiscal asset position (i.e., fiscal assets less general government debt) will decline from 7% of GDP in 2016 to 2% of GDP by 2020. Of its gross debt estimated at 14% of GDP in 2017, 70% is external, dominated by multilateral and bilateral lenders, while the remaining 30% is domestic debt. Thus interest-servicing measured by interest to revenue ratio is low, at well below 2%.

We also estimate that contingent liabilities from the financial and nonfinancial public sectors are limited. Although at still low levels, we observe a rising trend for financial support to state-owned enterprises through equity injections and loans. We note that BCL, a government-owned copper and nickel mining company, was provisionally liquidated in the second half of 2016, which should ease pressure on government finances, as no further support will be required.

We expect Botswana to maintain current account surpluses. We assume diamonds, constituting close to 80% of exports, will continue to dominate and the value-added from the diamond-cutting and polishing industry in Gaborone will increase. The 2016 current account surplus is now estimated higher at 13% of GDP against our previous estimate of 3% of GDP six months ago. This is mainly due to a combination of increased diamond sales as Debswana sold past stock levels on increased demand, and a marginal contraction of imports. We estimate the current account should remain in surplus through 2020, albeit at lower levels than in 2016. This is due to what we consider as a one-off increase in sales when Debswana reduced stockpiles, as international diamond prices and production have not significantly firmed up. Service exports, which constitute around 20% of total exports, are supported by tourism inflows. SACU inflows remain relatively stable although declining. The SACU formula, which is used to distribute customs revenues among the members, is unlikely to be changed in the medium term. We expect the country's gross external financing needs through 2020 will remain above 50% of current account receipts and usable reserves. We anticipate Botswana's net external asset position will average close to 60% of current account receipts over 2017-2020.

Overall, we view Botswana's external position as a ratings strength. Nevertheless, the current account balance is vulnerable to terms-of-trade shocks and shifts in demand for foreign consumer goods.

We view Botswana's society as relatively cohesive, partly stemming from the example set by the well-managed diamond sector, strong governmental institutions, effective policies, and well-targeted welfare transfers. Combined, these features have helped Botswana become a middle-income country. We expect the Botswana Democratic Party (BDP) to maintain its political dominance since winning the October 2014 elections. However, BDP will go through a succession process as President Ian Khama's two terms come to an end ahead of the 2019 elections. At the same time, the opposition is increasingly uniting after the Botswana Congress Party (BCP) joined the broader opposition coalition to pose a united front against the ruling party. The key issues center on labor relations, unemployment, delivery of public services, mining, power, and water. Despite a slowdown in the diamond mining sector, we believe Botswana's relations with its trade unions will remain more constructive than those we observe elsewhere in the region.

Botswana operates a crawling peg for the pula against the South African rand (ZAR) and the International Monetary Fund's special drawing rights (SDR), which is a basket of major currencies. The peg helps the central bank control inflation, which has been at the lower end of the 3%-6% target range over the past three years. The central bank has pursued a largely accommodative monetary stance over the past year. We expect inflation to rise moderately, from low levels, owing to higher international food prices and a likely increase in administered prices. However, in southern Africa, food prices are expected to decline thanks to the promise of a good harvest, following a favorable rainy season. Our forecasts assume that the central bank's stance will largely remain accommodative. The monetary stance will help reduce pressures in the banking system, in our view, given weaker mining sector performance that has resulted in slower credit growth and some asset quality weaknesses. The central bank has broad operational independence. Nevertheless, the currency peg, along with the narrowness of the economy and debt markets, limits the country's monetary policy options. We therefore equalize our local currency and foreign currency ratings on Botswana.

We equalize the ratings on the Bank of Botswana with our ratings on the sovereign using our monetary authority criteria, given that we consider monetary authorities as analytically inseparable.

Outlook

The negative outlook reflects our view that economic growth performance and fiscal outcomes could be weaker over the next 12 months than we currently expect if the diamond sector underperforms.

We could lower the ratings if diamond sector underperformance leads to lower economic growth outcomes, or greater fiscal deterioration than we currently assume.

We could revise the outlook to stable if we observe greater improvement in the diamond sector than we currently assume, for example, through higher international prices, which could support higher levels of production, in addition to broader private-sector development that boosted GDP growth compared with other middle-income countries.

Key Statistics

Table 1

Republic of Botswana Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. BWP)	105	110	125	146	146	153	161	171	183	196
Nominal GDP (bil. US$)	15	16	15	16	14	14	15	15	16	17
GDP per capita (US$000s)	7.3	7.5	6.8	7.3	6.4	6.1	6.3	6.4	6.5	6.6
Real GDP growth	6.0	4.5	11.3	4.1	(1.7)	3.0	3.0	3.3	3.5	4.0
Real GDP per capita growth	3.9	2.3	9.1	2.1	(3.5)	1.0	1.0	1.3	1.5	2.0
Real investment growth	12.2	13.6	2.0	1.5	8.8	4.3	5.6	5.5	5.5	5.3
Investment/GDP	38.8	40.9	29.4	26.2	28.6	15.4	17.4	16.8	16.8	16.5
Savings/GDP	41.9	41.1	38.2	41.6	37.0	28.8	26.0	24.6	24.1	23.3
Exports/GDP	50.0	49.3	61.5	60.8	52.2	58.5	53.9	52.7	51.4	50.4
Real exports growth	27.5	17.8	36.3	7.8	(17.1)	13.0	(5.0)	2.0	2.0	3.0
Unemployment rate	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	3.1	0.2	8.9	15.4	8.4	13.4	8.5	7.8	7.3	6.8
Current account balance/CARs	5.1	0.4	11.8	20.9	12.7	19.6	13.3	12.5	12.0	11.3
CARs/GDP	60.9	64.2	75.4	73.5	66.0	68.4	63.9	62.5	61.2	59.9
Trade balance/GDP	(4.6)	(13.8)	(2.3)	3.3	(6.1)	2.6	(1.4)	(1.8)	(2.2)	(2.2)
Net FDI/GDP	9.0	3.3	2.1	2.5	3.5	(4.1)	2.0	2.0	1.0	1.0
Net portfolio equity inflow/GDP	0.6	(1.9)	(7.9)	1.3	(6.9)	0.3	(2.0)	(1.5)	(1.5)	(1.5)
Gross external financing needs/CARs plus usable reserves	64.4	70.5	64.4	61.0	64.8	59.9	66.0	62.7	60.6	61.4
Narrow net external debt/CARs	(62.4)	(51.2)	(49.0)	(51.7)	(61.0)	(52.9)	(59.0)	(64.4)	(64.4)	(66.3)
Net external liabilities/CARs	(63.6)	(45.9)	(48.5)	(48.7)	(62.9)	(60.1)	(66.6)	(70.8)	(72.1)	(75.3)

Table 1

Republic of Botswana Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Short-term external debt by remaining maturity/CARs	9.2	6.0	6.3	5.8	7.5	6.8	9.4	10.2	10.1	10.8
Usable reserves/CAPs (months)	7.8	6.0	6.4	6.0	6.4	6.8	6.3	7.7	8.4	8.4
Usable reserves (mil. US$)	5,140	5,263	4,692	4,407	4,386	4,329	5,334	5,989	6,119	6,328
FISCAL INDICATORS (%, General government)										
Balance/GDP	(0.2)	0.8	5.8	3.7	(4.8)	(1.5)	(1.8)	(1.0)	(1.0)	(0.5)
Change in debt/GDP	2.8	0.1	0.7	1.8	(0.2)	(1.3)	(0.1)	(0.8)	1.0	0.5
Primary balance/GDP	0.4	1.5	6.3	4.1	(4.2)	(0.9)	(1.3)	(0.5)	(0.6)	(0.1)
Revenues/GDP	36.7	37.9	39.1	38.3	32.5	32.5	30.0	30.5	30.7	31.0
Expenditures/GDP	36.8	37.1	33.3	34.7	37.3	34.0	31.8	31.5	31.7	31.5
Interest/revenues	1.5	1.6	1.4	1.2	1.7	1.8	1.7	1.5	1.2	1.2
Debt/GDP	20.7	19.9	18.2	17.4	17.2	15.1	14.3	12.7	12.9	12.6
Debt/Revenue	56.6	52.6	46.6	45.5	53.1	46.6	47.7	41.7	42.1	40.5
Net debt/GDP	(2.4)	(0.5)	(4.7)	(9.4)	(8.4)	(6.5)	(4.4)	(3.1)	(2.0)	(1.3)
Liquid assets/GDP	23.2	20.4	23.0	26.8	25.7	21.7	18.7	15.9	14.9	13.9
MONETARY INDICATORS (%)										
CPI growth	8.5	7.5	5.9	4.4	3.0	2.8	3.5	4.0	5.0	5.0
GDP deflator growth	14.0	0.2	2.3	11.9	1.8	1.8	2.2	3.0	3.0	3.0
Exchange rate, year-end (BWP/US$)	7.5	7.8	8.7	9.5	11.2	10.6	11.0	11.4	11.7	12.0
Banks' claims on resident non-gov't sector growth	29.6	20.9	14.8	14.4	9.0	5.9	8.0	8.0	8.0	8.0
Banks' claims on resident non-gov't sector/GDP	29.5	34.1	34.4	33.7	36.7	37.1	38.1	38.7	39.2	39.5
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	15.5	14.4	13.1	15.5	15.5	16.9	15.0	15.0	15.0	15.0
Real effective exchange rate growth	1.0	1.2	2.0	0.6	2.3	2.2	N/A	N/A	N/A	N/A

Fiscal year ends March 31. Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. BWP--Botswana pula. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. N/A--Not applicable. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Republic of Botswana Ratings Score Snapshot

Key rating factors	
Institutional assessment	Neutral
Economic assessment	Weakness
External assessment	Strength
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Strength
Monetary assessment	Neutral

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- Criteria - Governments - Sovereigns: Monetary Authorities Rating Methodology - September 11, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

Related Research

- 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions - April 18, 2017
- Sovereign Ratings History - April 11, 2017
- Sovereign Risk Indicators - April 10, 2017. An interactive version is also available at http://www.spratings.com/sri.
- 2016 Annual Sovereign Default Study And Rating Transitions - April 03, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion - February 23, 2017
- Sub-Saharan Africa Sovereign Rating Trends 2017 - January 10, 2017
- Global Sovereign Rating Trends 2017 - January 10, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision. After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

	Rating	
	To	From
Botswana (Republic of)		
Sovereign Credit Rating		
Foreign and Local Currency	A-/Negative/A-2	A-/Negative/A-2
Transfer & Convertibility Assessment	A+	A+
Bank of Botswana		
Sovereign Credit Rating		
Foreign and Local Currency	A-/Negative/A-2	A-/Negative/A-2
Short-Term Debt		
Local Currency	A-2	A-2

Regulatory Disclosures

- Primary credit analyst: Gardner Rusike, Associate Director
- Rating committee chairperson: Christian Esters, CFA
- Date initial rating assigned: April 2, 2001
- Date of previous review: October 28, 2016

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity participated in the credit rating process. S&P Global Ratings had access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Glossary

- Banks' claims: Claims from resident depository corporations (excluding those of the central bank) on the resident nongovernment sector.
- Consumer price index: Index of prices of a representative set of consumer goods regularly bought by a typical household.
- Contingent liabilities: Obligations that have the potential to become government debt, or affect a government’s credit standing if they materialize.
- Current account balance: Exports of goods and services minus imports of the same plus net factor income plus official and private net transfers.
- Current account receipts (CARs): Proceeds from exports of goods and services plus factor income earned by residents from nonresidents plus official and private transfers to residents from nonresidents.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Debt burden assessment: Reflects a sovereign's prospective debt level, as indicated by the general government debt relative to GDP (including assessment of contingent liabilities), the interest cost of the debt relative to general government revenue, and debt structure and funding access.
- Economic assessment: Based on the analysis of economic structure and growth prospects. Reflects income levels (GDP per capita), economic growth prospects, and economic diversity and volatility.
- External assessment: Based on the analysis of external liquidity and international investment position as well as the status of a sovereign's currency in international transactions. Reflects a country's ability to obtain funds from abroad necessary to meet its public- and private-sector obligations to nonresidents.
- Fiscal performance and flexibility assessment: Reflects the sustainability of sovereign's fiscal deficits. Based on the prospective change in general government debt, calculated as a percentage of GDP, taking into account long-term trends and a government's fiscal flexibility and vulnerabilities.
- Foreign direct investment (FDI): Direct investment by nonresidents.
- GDP per capita: GDP divided by population.
- General government: Aggregate of the national, regional, and local government

sectors, including social security and other defined benefit public-sector pension systems, and excluding intergovernmental transactions.

- General government debt: Debt incurred by national, regional, and local governments and central bank debt.
- General government interest: Interest payments on general government debt.
- General government liquid assets: General government deposits in financial institutions (unless the deposits are a source of support to the recipient institution), widely traded securities, plus minority arms-length holdings of incorporated enterprises that are widely traded plus balances of defined-benefit government-run pension plans or social security funds (or stabilization or other freely available funds) that are held in bank deposits, widely traded securities, or other liquid forms.
- Gross domestic product (GDP): Total market value of goods and services produced by resident factors of production.
- Gross external financing needs: Current account payments plus short-term external debt at the end of the prior year, including nonresident deposits at the end of the prior year plus long-term external debt maturing within the year.
- Institutional assessment: An analysis of how a government's institutions and policymaking affect a sovereign's credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks. Reflects the effectiveness, stability, and predictability of the sovereign's policymaking and political institutions; transparency and accountability of institutions, data, and processes; the sovereign's debt payment culture; and security risks.
- Monetary assessment: The extent to which a sovereign's monetary authority can fulfil its mandate while supporting sustainable economic growth and attenuating major economic or financial shocks. Based on the analysis of the sovereign's ability to coordinate monetary policy with fiscal and other economic policies to support sustainable economic growth; the credibility of monetary policy, and the effectiveness of market-oriented monetary mechanisms.
- Narrow net external debt: Stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities.
- Net general government debt: General government debt minus general government liquid financial assets.
- Net external liabilities: Total public- and private-sector liabilities to nonresidents minus total external assets.
- Official reserves: Monetary authority liquid claims in foreign currency (including gold) on nonresidents.
- Real GDP per capita: Constant-price per capita GDP.
- Terms of trade: Price of goods exports relative to price of goods imports.
- Usable reserves: Official reserves minus items not readily available for foreign exchange operations and repayment of external debt.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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