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CREDIT ANALYSIS

Rate this Research

Botswana, Government of

RATINGS

Botswana

	Foreign Currency	Local Currency
Gov. Bond Rating	A2/STA	A2/STA
Country Ceiling	Aa3	Aa3
Bank Deposit Ceiling	A2	Aa3

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Botswana, Government of and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

Overview and Outlook

Botswana's A2 government bond rating with a stable outlook balances the government's relatively strong balance sheet, net external creditor position and low debt burden against its small economy, which remains heavily dependent on the diamond industry.

Key credit strengths include the government's robust balance sheet, as highlighted by its fiscal surplus of around 5.6% of GDP in 2014 (compared with a deficit of 12.3% in 2009) and its low debt levels averaging around 18.6% of GDP in the past five years. These results reflect the government's prudent approach to fiscal policy and the effectiveness of its consolidation measures to date, which should favour surpluses going forward.

Furthermore, Botswana's sovereign wealth fund, the Pula Fund, adds a significant buffer against shocks and shortfalls in government revenue. In contrast to many other resource-rich countries in the developing world, Botswana's government has successfully managed income from its diamond mines with a long-term view to promote economic and social development. As a result, the government has remained a large net creditor for decades.

Botswana's undiversified economy with its heavy reliance on the diamond industry is a key credit weakness over the long term. Despite the government's efforts to diversify the economy, the mining industry's share of gross value added remains high at around 25% in 2013, albeit down from 29% in the 2000s. Moreover, the economy is highly susceptible to shocks given its narrow economic base; this was reflected in the 7.8% contraction in GDP during the global financial crisis in 2009.

Upward pressure on Botswana's A2 rating could develop as a result of the successful implementation of economic diversification strategies over the medium term, coupled with the accumulation of an even larger net financial position. Conversely, a large deterioration in its net asset position over the medium term could exert downward pressure on the rating, given that the country's financial buffer was more than halved during the global financial crisis. Fiscal consolidation and economic diversification will become more crucial to preserving the country's economic strength given that its diamond mine resources are finite, although the life of these mines is estimated to extend to 2050.

This Credit Analysis elaborates on Botswana's credit profile in terms of Economic Strength, Institutional Strength, Fiscal Strength and Susceptibility to Event Risk, which are the four main analytic factors in Moody's Sovereign Bond Rating Methodology.

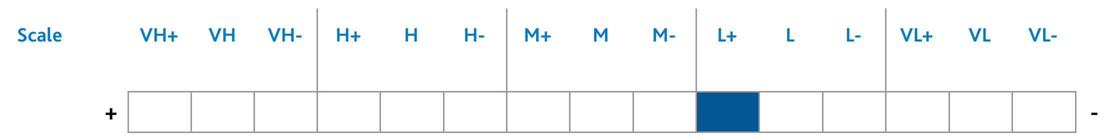
Rating Rationale

Our determination of a sovereign's government bond rating is based on the consideration of four rating factors: Economic Strength, Institutional Strength, Fiscal Strength and Susceptibility to Event Risk. When a direct and imminent threat becomes a constraint, that can only lower the preliminary rating range. For more information please see our [Sovereign Bond Rating Methodology](#).

Economic Strength: Low (+)

A middle income economy still heavily reliant on the diamond sector

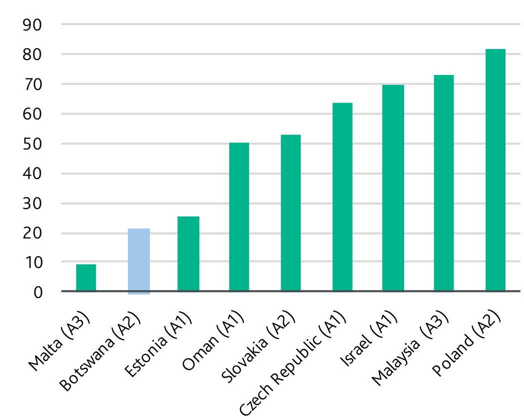
Factor 1



Economic strength evaluates the economic structure, primarily reflected in economic growth, the scale of the economy and wealth, as well as in structural factors that point to a country's long-term economic robustness and shock-absorption capacity. Economic strength is adjusted in case excessive credit growth is present and the risks of a boom-bust cycle are building. This 'Credit Boom' adjustment factor can only lower the overall score of economic strength.

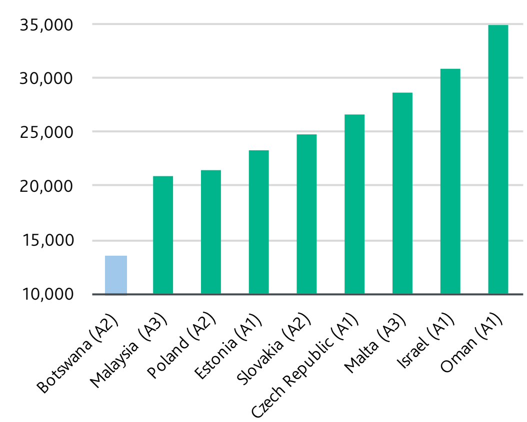
We score Botswana's economic strength as Low (+), a ranking shared by countries including Bulgaria (Baa2 stable), Bahamas (Baa2 stable) and Bermuda (A1 stable). Botswana is an economically relatively small, yet commodity-rich middle-income country, with a slightly larger geographic size than Spain or Thailand, but slightly smaller than France.

EXHIBIT 1
Nominal GDP
US$, Average 2010-13F



Source: Moody's Investors Service

EXHIBIT 2
GDP per capita (purchasing power parity)
US$, Average 2007-12



Source: Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moodys.com](#) for the most updated credit rating action information and rating history.

Botswana has a population of two million inhabitants and a $15 billion economy, which is heavily reliant on the diamond industry. With a GDP per capita on a purchasing power parity (PPP) basis of around $15,241, the country falls into the middle-income category along with rating peers Mexico (A3 stable) and Peru (A3 stable). Despite relatively dynamic growth, averaging 4.5% over the past ten years in real terms, and forecast to expand moderately at around 5% this year and next, we do not expect the country's long-term economic strengths to change significantly in either direction given (1) the levelling-off in diamond output (although there will be some expansion in non-mining sectors); and (2) relatively low population growth.

The diamond industry is Botswana's key economic sector, representing both a risk and an opportunity

Botswana is one of the leading global diamond producers, both in terms of carats produced and value. Although estimates for global production vary, data released through the Kimberley Process Certification Scheme show that total global production of rough diamonds recovered in 2013 to 130 million carats, from the sharp inflection point in 2009 of 120 million carats. As one of the world's largest producers, rough diamonds from Botswana supported this recovery in supply, producing an estimated 22 million carats in 2013, up 30% from 2009. This level of production, however remains lower than prior to the financial crisis, for example in 2007, when Botswana produced over 33 million carats, which were sold at a significantly lower price per carat than today.

While Botswana's position as a leading diamond producer is a source of strength for the country, it also represents a vulnerability for the economy. Diamond exports, both rough and polished, comprised 87% of total exports in 2013 in dollar terms, meaning economic activity, exports growth and foreign exchange generation are highly correlated to the fortunes of the diamond industry. Rough diamonds mined in Botswana alone made up over 50% of that total, at about $3.4 billion. We expect diamond exports to be buoyant this year, as earnings in the first half of 2014 increased about 14% over the same period in the previous year. The Diamond Trading Company (DTC), De Beers' trading arm, estimates that sales of rough diamonds from Botswana will continue to rise steadily over the next few years.

The country's main diamond producer, Debswana, is a 50/50 joint venture between De Beers and the government. Debswana has invested significantly into extending the life of the current diamond mines and, while the discovery of another large and very productive mine such as Botswana's Orapa is unlikely, the company foresees stability in the terms of diamond ore quality and quantity available from Botswana. The company philosophy is now to produce to demand and to build capacity for flexible production. In the medium term, Botswana's annual production is likely to remain between 23-26 million carats.

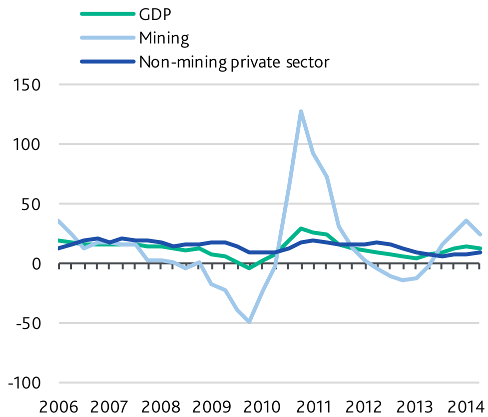
In 2013, the DTC transferred a significant portion of its operations from London to the capital Gaborone, including the sorting, sights and sales operations, bringing with them professionals, equipment and technology. While some DTC activities, specifically financial, marketing and research, are not being transferred to Botswana, the company will also continue to support Botswana's domestic cutting operations by ensuring adequate diamond supplies. This represents a significant opportunity for Botswana to move up the value chain from production to diamond-related value added activities. Currently there are twenty-one diamond cutting factories in Botswana, up from sixteen in 2008, to which close to $800 million worth of rough diamonds were sold in 2013. The DTC estimates that in some of these factories, up to 90% of the staff are comprised of the local population.

The relocation of DTC's activities to Botswana (from the UK) will lead to Gaborone becoming the centre for sales of all De Beers' production (including its own mines and joint venture mines in Canada, South Africa, Namibia and Botswana). This will lead to additional economic activity, greater tax revenue, more jobs and should also have positive externalities in other sectors. Botswana will be well-positioned to become a global hub for diamonds, with at least an expected $6 billion worth of diamonds flowing through the country annually once fully operational.

Current developments in the non-mining sector are positive

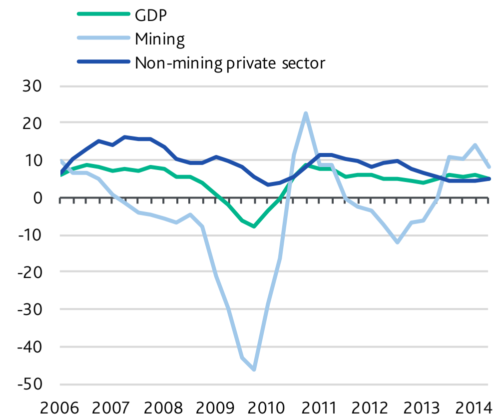
Mining activity comprised about one quarter of total value added in 2013. In addition to diamonds, Botswana is geologically rich in other natural resources, such as copper, nickel, gold, salt, soda ash, silver, uranium, manganese, coal, and iron ore, although most of these minerals are not in widespread production. The mining sector as a proportion of total economic activity has remained roughly stable for the last decade, with the exception of 2009, when the mining sector contracted sharply, leading to an overall 7.8% contraction of the economy in real terms. Notably, growth in the non-mining sectors continued to grow in real terms every year for the past ten years, even during the global financial crisis. This view is supported by 2.2% real growth in the manufacturing sector in the second quarter 2014 y/y, a 3.9% expansion in financial and business services, and 9.3% growth in the tourism and restaurant sector. We expect real GDP growth of around 5% in 2014.

EXHIBIT 3
Annual nominal GDP growth
%change



Source: Statistics Botswana, Moody's

EXHIBIT 4
Annual real GDP growth
%change



Source: Statistics Botswana, Moody's

Despite the relative vigour of the non-mining sectors, mining remains the driver of much of Botswana's growth and the global financial crisis exposed the vulnerability of Botswana's economy to world economic cycles. As a result, the government has prioritized the diversification of the economy throughout National Development Plan 10 (NDP10), a seven year plan (2009-16) articulating the government's medium term development strategy.

The authorities' strategy is to improve the business environment for the private sector with a programs to promote diversification and economic "hubs", as well as increasing the access of small, medium and micro-enterprises (SMMEs) to finance. This should support the authorities' push to further develop Botswana's tourism industry, which is considered a second key asset. On the supply side, an overarching theme in government policy is to improve the quality of public spending, notably on education. Despite government investments to date, there remains a significant skill mismatch in the population as evidenced by a persistently high rate of structural unemployment.

Moreover, Botswana will leverage on its reputation as a mining jurisdiction characterised by transparency and the rule of law to exploit other mineral resources such as copper, coal, nickel, silver, gold and uranium. In this regard, the authorities are developing a strategy to better manage the country's natural resources, which includes finding solutions to the country's infrastructure challenges, such as its land-locked status. In particular, it plans to develop its coal reserves, which are the largest in Africa, and is considering a Trans-Kalahari railroad through Namibia or a route via Mozambique to facilitate their export. Copper and silver could also be potential areas to diversify mining away from diamonds, with prospects at the Boseto copper project.

Institutional Strength: High

A sound institutional framework supported by credible long-term policies, reflected in strong governance indicators

Factor 2

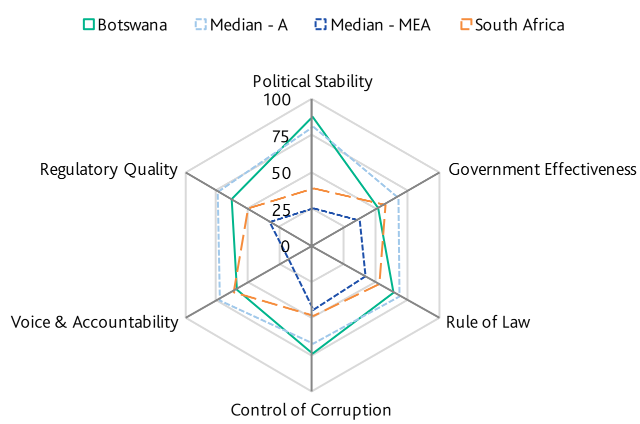
Scale	VH+	VH	VH-	H+	H	H-	M+	M	M-	L+	L	L-	VL+	VL	VL-

Institutional strength evaluates whether the country's institutional features are conducive to supporting a country's ability and willingness to repay its debt. A related aspect of institutional strength is the capacity of the government to conduct sound economic policies that foster economic growth and prosperity. Institutional strength is adjusted for the track record of default. This adjustment can only lower the overall score of institutional strength.

We assess Botswana's institutional strength as High, a ranking shared by countries including Bahrain (Baa2 negative), Malaysia (A3 stable) and Croatia (Ba1 negative). Botswana's score is based on its political stability, policy predictability, strong governance and the successful implementation of forward-looking policies. Its institutional strengths are reflected in its highly ranked government effectiveness on the World Bank's Governance Indicators (see Exhibit 5), its relatively good transparency and the established rule of law.

The relative success of Botswana's government can also be measured by its rapid development since its independence 48 years ago (i.e., from a poverty-stricken, aid-dependent country to an upper middle-income country). The government is now a significant net creditor thanks largely to the careful management of its natural resource-based income. This is also substantiated by expansion of social and physical infrastructure, education, average wealth, institutional capacity within government and increasingly also in the private sector, and significant expansion in transport, communications and utilities networks. For example, at independence in 1966, there were six kilometres of paved roads, whereas there are some 20,000 kilometres today, which provide access to almost all of the country.

EXHIBIT 5
Institutional quality



Source: World Bank Governance Indicators

Botswana continues to improve infrastructure and has ambitious plans to establish road and rail links to the sea through Namibia in order to diversify away from trade routes through South Africa. While the improved level of transport infrastructure provides evidence of the success of Botswana's development strategy, the country has also struggled in the past year in terms of energy generation as the country's only power plant, Morupule B, faced technical difficulties related to the plant's boilers.

Cautious economic policy has supported the accumulation of financial assets

Over the past decade, Botswana's authorities have continued to put in place a set of fiscal rules that have supported healthy budget positions on a nearly uninterrupted basis and the accumulation of substantial government financial assets. These policies reflect the high degree of political consensus regarding policy, which is best illustrated by the absence of political divisions that characterise most other African nations.

As a result, the government has been able to accrue a positive net external financial asset[1] position that was around 84% of GDP at its peak in 2008, and is expected to be around 40% of GDP at the end of 2014. The halving of these financial assets was due in part to the government's response to the global financial crisis, which hit Botswana hard through the diamond sector – general government expenditure was over 50% of GDP in 2009.

Inflation has eased to within the target range, while the crawling peg continues to support monetary stability

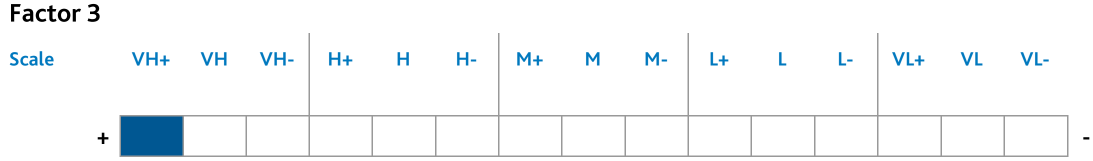
Inflation has eased within the Bank of Botswana's objective range of 3%-6%, averaging 5.9% in 2013, and 4.5% in the first nine months of 2014. This is significantly lower than the 2004-13 average of 8.5%. Reflecting moderate domestic expansion and muted demand side pressure on prices, the Bank of Botswana has held its bank rate at 7.5% in 2014 to date, following cuts in April and August 2013, prior to which the bank rate had stood at 9.5% since 2010. Although inflation pressures remain muted, the Bank of Botswana may tighten monetary policy slightly in coming quarters, which would be in line with the South African Reserve Bank's recent move to defend the rand.

The pula's crawling peg is attached to a basket composed of the South African rand (55%) and Special Drawing Rights (45%). According to the IMF, the crawling peg has served Botswana well in anchoring expectations around the currency, although there may at times be some tension between the Bank of Botswana's mandate to maintain both the inflation target and the currency peg.

Fiscal Strength: Very High (+)

Strong government balance sheet supported by a very low debt burden and a net external creditor position that will likely further strengthen over the medium term

Factor 3



Fiscal strength captures the overall health of government finances, incorporating the assessment of relative debt burdens and debt affordability as well as the structure of government debt. Some governments have a greater ability to carry a higher debt burden at affordable rates than others. Fiscal strength is adjusted for the debt trend, the share of foreign currency debt in government debt, other public sector debt and for cases in which public sector financial assets or sovereign wealth funds are present. Depending on the adjustment factor the overall score of fiscal strength can be lowered or increased.

[1] Calculated as gross government financial assets minus direct financial liabilities of the government.

We score Botswana's government fiscal strength as Very High (+), a ranking shared by countries including Azerbaijan (Baa3 stable), Estonia (A1 stable), China (Aa3 stable), Chile (Aa3 stable) and Saudi Arabia (Aa3 stable). The government's fiscal strength is derived from a combination of debt affordability and ample resource access, and represents the most important driver supporting Botswana's A2 ratings.

A track record of prudent fiscal policies support government fiscal strength

The anchoring of the budget process in the successive NDP is positive, given that each multi-year plan comprehensively defines key economic policies and objectives. This framework also defines fiscal rules to be followed over the applicable period, which include rules on the total size of spending relative to GDP, the ratio of recurrent and development spending, and the use of mining revenues solely for investment (including recurrent expenditure on education, training and health).

Botswana has built up a track record of fiscal discipline and compliance with NDPs, as illustrated by Exhibit 6 which shows the deficit scenarios in the NDP9 and NDP10 and the realised budget balances. In both cases, Botswana's fiscal surplus was higher than expected, even under the optimistic scenario, mainly driven by better revenue collection, significant under-spending and a continued focus on high-priority projects and expenditure restraints.

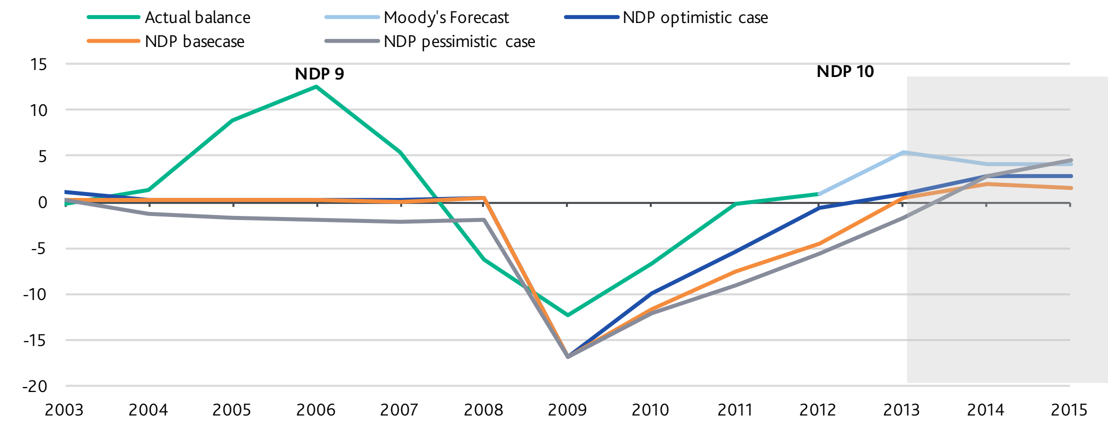
Looking forward, we expect that mining revenues will continue to support the government fiscal balance, although surpluses are not likely to hit the double digit range as they did prior to the global financial crisis.

Recent finalized results from fiscal year (FY) 2013-14 (April 2013 to March 2014) show a fiscal surplus of around 5.6% of GDP, significantly above the previously estimated surplus 1% of GDP. There are two drivers behind this surplus, namely (1) higher than expected mineral revenues; and (2) an under-execution of development expenditure.

Total revenues increased by 17% over the previous year, up from the 8% increase in FY2012-13. Mineral revenue performance was due to buoyant diamond prices, the sale of a number of high value stones that had previously been stockpiled, as well asexchange rate movements which were more favourable than expected in budget forecasts . Customs and excise revenue (which includes the SACU revenues explained in the box on page 9), were lower than the previous year, but remain close to twice the 2007-12 average. However, non-mineral income tax underperformed by about 20% compared with preliminary figures, reflecting profitability challenges faced by the non-mineral sector, despite non-mineral real GDP growth of 5% in calendar year 2013.

On the expenditure side, spending increased at a modest 2% over the previous fiscal year. Current expenditures - including subsidies, transfers, and government wages - increased, but more slowly than in previous years at 2% year-on-year, from 11% in FY 2012-13. Development expenditure rose slowly as well, by 8%, despite a 50% increase having been budgeted. Over 12 billion pula had been budgeted on development expenses, however only 8.9 billion pula was spent in FY2013-14. These projects have been folded into development spending in the current fiscal year.

EXHIBIT 6
Budget balance - NDP forecasts vs. actual
% of GDP



*Fiscal years end March 31st. As such, e.g., 2003 refers to fiscal year 2003/04 in Botswana's NDP Plan.
Source: Botswana Ministry of Finance, NDP9/NDP10

The authorities are currently following the guidelines set out in its NDP10 (running from FY 2009-10 to FY 2015-16), which was adopted in 2009 and aims to address the economy's over-dependence on the diamond sector and bring about a reduction in its then unsustainable structural fiscal deficit that appeared in 2009. This plan included a reduction in government spending to 30% of GDP at the end of the period, down from a 2009 peak of 51.3% of GDP. This ratio is expected to reach around 33% at the end of the current fiscal year (FY 2014-15). Its final goal is a ratio of 25% of GDP by the end of NDP11, which is in line with expected trends in government revenue.

EXHIBIT 7
Botswana government revenue & grants
BWP millions

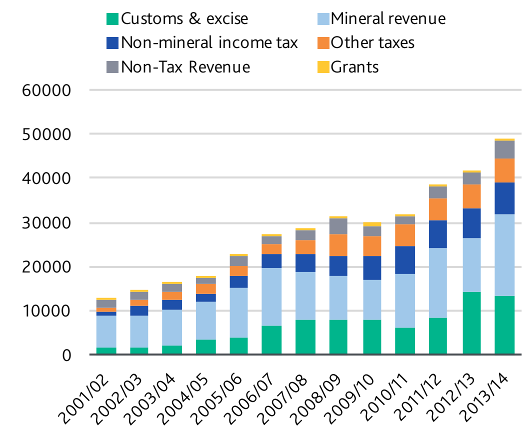
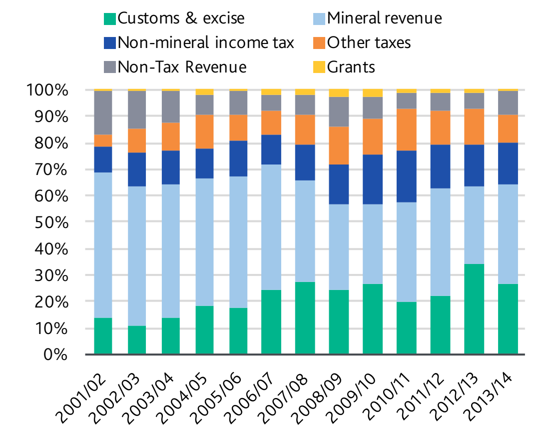


EXHIBIT 8
Botswana government revenue & grants
% of Total Revenue & Grants



Source: Ministry of Finance, Moody's Investors Service

Box 1: SACU Revenue-Sharing Arrangement

The Southern African Custom Union (SACU) is made up of Lesotho, Namibia (Baa3 stable), South Africa (Baa2 stable), Swaziland and Botswana, all of which bar Botswana are also members of the Common Monetary Area (CMA). The economic structure of the custom union links the member states through a single tariff and eliminates custom duties between them. There is a common external tariff that applies to non-SACU members.

All proceeds from customs duties and duties on excisable goods produced within SACU are pooled into a Common Revenue Pool (CRP), which is currently managed by South Africa and then shared among the countries according to a Revenue Sharing Formula (RSF). South Africa generates around 80%-90% of the revenue of the SACU pool and the existing rule makes the other members' receipts heavily dependent on both intra-SACU trade and global trade with the region.

In addition, like other SACU members, Botswana faces the risk of a gradual decline in SACU revenue over the medium term, notwithstanding any potential further slowdown in global economic activity, which would affect the SACU revenue pool. This is based on two structural features affecting the members: (1) a reduction in the common external tariff rates as a result of trade liberalisation; and (2) the creation of the Southern African Development Community (SADC) customs union.

The current proposal by the SACU secretariat for a new revenue-sharing formula could potentially lead to a cut in its share of the funding pool. However, we note that the South African government remains committed to the SACU arrangement, given that the development of neighbouring countries is in its interest. Moreover, a transition to a new revenue-sharing framework is expected to be consensual and gradual and should help to reduce the current pro-cyclicality the current revenue-sharing formula leads to. In addition, Botswana's very strong revenue growth over the last few years following the development of trade may help to limit the financial impact of a nominal decrease in its share of pooled revenue.

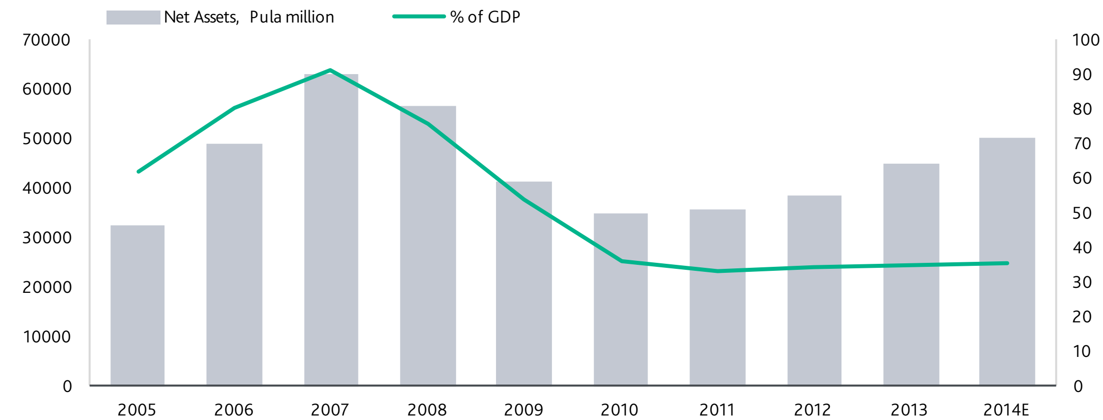
The gradual change in public-sector weight will preserve a positive net financial position

The government's financial assets include (1) the Pula Fund holding, which is a sovereign wealth fund invested abroad in foreign currency; and (2) a liquidity portfolio that is replenished/drawn down with transfers to/from the Pula Fund in order to keep liquidity equivalent to at least three months' worth of imports, with the target to maintain six months of import cover. In addition, government deposits at the central bank that are counterpart to some government foreign assets amounted to BWP34.2 billion (USD3.6 billion), or about 24% of estimated 2014 GDP at the end of September. Foreign-currency reserves amounted to BWP75.5 billion (USD8.1 billion), or 54% of GDP.

As a result of Botswana's quicker-than-anticipated fiscal consolidation, general government debt is expected to reach 17.4% of GDP in 2014, trending downwards from a peak of 20.1% in 2011. The government's cost of debt is likely to remain very low for the foreseeable future, given that the bulk of its debt consists of an African Development Bank (AfDB, Aaa stable) loan made in 2009 on concessional terms (Libor +20 bps for 20 years with five years' grace). Debt affordability is quite strong; Botswana's government interest payment to revenue, despite having increased slightly in the last five years, remains relatively low at 1.4% in 2013. Government guarantees stood at BWP7.5 billion at the end of March 2014, or 5.4% of GDP.

Botswana's current net financial asset position hovers near 40% of GDP, which offers a sizeable cushion in case of shocks. Given the medium-term fiscal trend and the government's track record, we expect a gradual reconstitution of its fiscal reserves that were effectively drawn upon during the global financial crisis. We note that, in addition to its financial assets, the government could potentially mobilise resources through the privatisation of some "real" assets, particularly Botswana Telecommunication Corporation (BTC), if necessary.

EXHIBIT 9
Net financial assets



Source: Bank of Botswana, IMF, Moody's Investors Service

Barring a global recession similar to that in 2009, the most plausible scenario is a slow replenishment of the Pula Fund, given that fiscal surpluses will likely be smaller than they have been historically, as the economy has expanded more rapidly than diamond proceeds. This scenario also assumes the successful retrenchment of the importance of government in the economy by the end of NDP11, i.e. government expenditure representing less than 25% of GDP.

Susceptibility to Event Risk: Low

Botswana's strong government balance sheet preserves a low susceptibility to event risk

Factor 4

Scale	VL-	VL	VL+	L-	L	L+	M-	M	M+	H-	H	H+	VH-	VH	VH+	
+					■											-

Susceptibility to Event Risk evaluates a country's vulnerability to the risk that sudden events may severely strain public finances, thus increasing the country's probability of default. Such risks include political, government liquidity, banking sector and external vulnerability risks. Susceptibility of Event Risk is a constraint which can only lower the preliminary rating range as given by combining the first three factors.

We assess Botswana's event risk to be Low, a ranking shared by countries including Bermuda (A1 stable), Malaysia (A3 positive), Estonia (A1 stable) and Namibia (Baa3 stable).

Strong support for BDP underpins 'Low' Political Risk assessment

Only one political party – the Botswana Democratic Party (BDP) – has led the government since independence. Under the constitution, the president is elected by the national assembly and is not allowed to serve more than two five-year terms. Although Botswana has a multi-party system, the parliament has always been controlled by the BDP and as such, only BDP leaders have ever been president. Although it enhances political stability, as we have seen in other emerging market countries, a peaceful transition of power to the opposition is a landmark in establishing democracy.

At the end of October 2014, the BDP won again the parliamentary elections albeit at a reduced margin than in 2009. The diminished victory of the BDP, which won 47% of the vote, down from 52% in the previous election, reflects a certain measure of discontent after few years of austerity to restore public finances and cope with the legacy effects of the global financial crisis, as a handful of ministers failed to secure re-election as MPs. However, given the solid institutional underpinnings and the popular support for economic reform, we do not expect this relative political setback – the BDP still commands a two-thirds majority in parliament – to unduly affect the economic reform and development policy.

The BDP will remain the dominant force in the country over the medium term. The appointment of the new administration was finalised one month after the elections without too many changes. Mokgweetsi Masisi was appointed as new Vice-President of the country. In Botswana, historically, the Vice-President selected by the President in his second term is seen as the likely BDP candidate in the next presidential elections. The Finance Minister was reappointed in the new administration which should imply a certain degree of continuity and predictability in the economic and fiscal policies. On external politics, the probability of Botswana's relationship with neighbours, while at times noisy in the local media, leading to a sudden deterioration of creditworthiness is very low.

Access to domestic financing pool leads to Very Low (-) assessment of Government Liquidity Risk

The government's access to a robust domestic market (both banks and pensions funds) leads to our Very Low (-) assessment of liquidity risk. Firstly, the significant excess liquidity in the banking system has allowed the central bank to issue short-term instruments, called Bank of Botswana Certificates or "BoBCs", for many years in order to mop up liquidity. Although on a downward trend, BWP6.3 billion of such instruments was still held by banks at the end of August 2014, which is equivalent to about 4.5% of 2014 GDP. Following the change in the Bank of Botswana's liquidity policy, short-term government bonds benefited from renewed attention, as they represent a perfect substitute to BoBCs, if necessary.

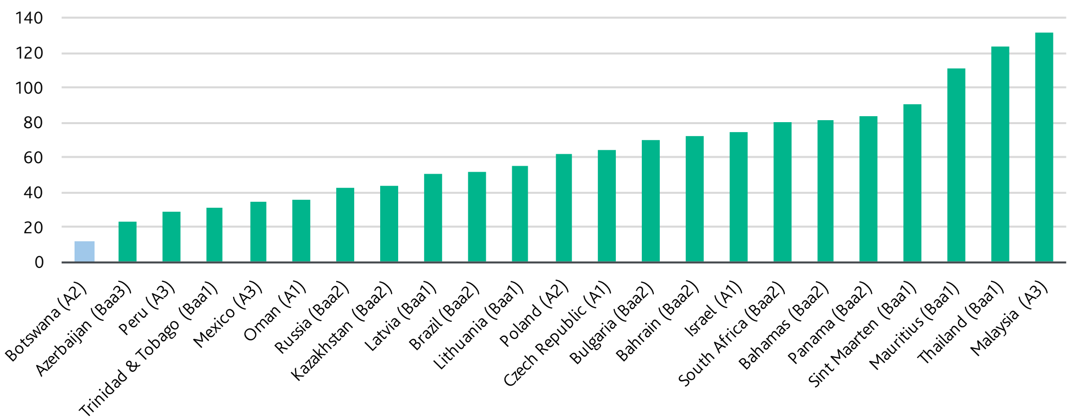
Secondly, private pension funds seek longer-dated government bonds for asset/liability matching. At the end of August 2014, the sector's total assets had reached BWP58.2 billion (USD5.6 billion) or about 41.5% of GDP, with 58% of this invested offshore. By law, private pension funds cannot invest more than 70% of their assets outside of the country. Pension funds already hold some government bonds worth an estimated BWP8 billion at the end of August 2014, which is equivalent to 14% of total assets and this proportion has remained relatively stable for the last five years. In addition to existing assets, pension funds are expected to receive at least BWP2 billion of new employee contributions every year – the equivalent of around 1.7% of GDP annually. Pensions funds are currently fully funded and they receive a positive net contribution every year that could potentially be invested in government bonds.

Banking Sector Risk is Low (-)

Botswana's banking system held assets of BWP69.5 billion (USD7.45 billion) or about 49.6% of GDP at the end of August 2014. All banks are foreign-owned, except for three development finance institutions that represent less than a tenth of total assets. The largest four foreign-owned banks are Barclays and Standard Chartered (subsidiaries of UK banks) and First National and Stanbic (subsidiaries of South African banks). They control around 80% of banking system assets, total loans and deposits. Parental support is likely to be forthcoming in times of stress, reducing the government's potential liabilities.

While the financial system has grown significantly over the past decade, intermediation remains low compared with other middle-income countries (see Exhibit 10). Total domestic credit as a percentage of GDP stands at around 13% of GDP, however, this number is net of liabilities that the banks owe to the central government as is the convention when calculating this indicator. If we look solely at credit to the private sector, without netting out the deposits of the central government, overall private sector claims stood at 33.4% of GDP at the end of 2013, slightly higher than the 27% of GDP average of the previous five years.

EXHIBIT 10
Domestic credit
as % of GDP, Average 2009-12



Source: Moody's Investors Service

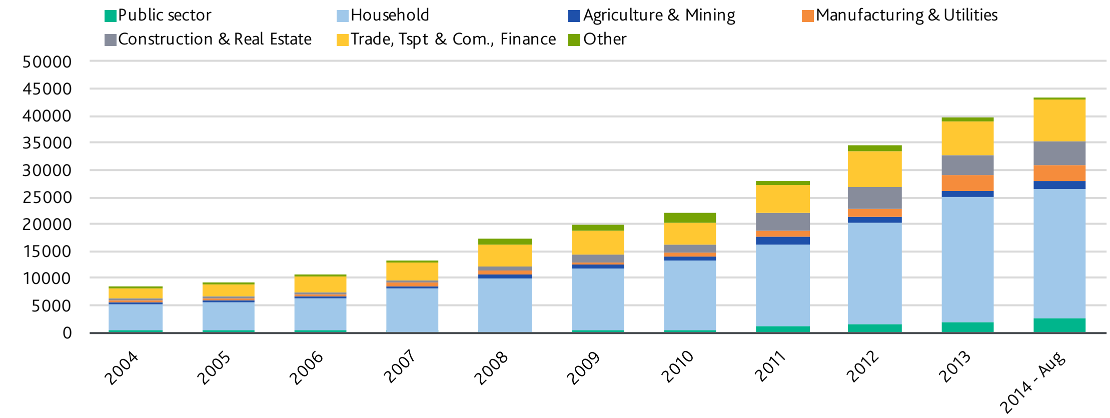
Overall, Botswana's banking system is in good financial health. Its banks have a relatively solid liquidity position, with liquid assets at an average of around 12% of total assets between January and August 2014. The majority of liquid assets are held in Bank of Botswana Certificates. Following a change in its liquidity management policy in order to reduce its sterilisation cost, the Bank of Botswana reduced its issuance of certificates. Consequently, commercial banks have gradually expanded their loan portfolios to the benefit of businesses. Banks are mostly locally funded through deposits: the loan-to-deposits ratio is largely below the 100-mark at around 76% in August 2014.

Despite the predominance of foreign banks, there is a low level of cross-border transactions, limiting potential spill-over effects from parent banks' liquidity provision. The level of non-performing loans (NPLs) as a percentage of gross loans remain relatively low, though rising at about 3% as of August 2014. Capitalisation levels remain comfortably high, with a ratio of regulatory capital-to-risk-weighted assets of above 20%, significantly above the 15% regulatory requirement. Regulatory Tier I (as % of Risk-Weighted Assets) stood at 12.7% in March 2013.

EXHIBIT 11

Loans & advances

BWP million



Source: Bank of Botswana, Moody's Investors Service

The banking system's potential vulnerabilities include its high exposure (57% of lending on average in the first eight months of 2014) to the household sector, representing 17% of GDP at end-August 2014. The level of NPLs in household sector is higher than it is among corporates. The household sector was affected by a reduction in real income in recent years due to the three-year public-sector pay freeze, which affected the ability to service debt. In addition, the non-bank financial institutions (NBFI), which include the micro-lenders, have increased the vulnerabilities affecting the overall financial system, given the recent acceleration of their lending to households and for property market development.[2]

However, the NBFI regulatory authority (NBFIRA) are strengthening the legal and regulatory framework – for instance, micro-finance regulation was adopted in early 2012. As NBFIRA ramps up capacity, the extent of micro-lending are not yet fully understood or regulated in Botswana, although the estimated total size of micro-lending sector is in excess of BWP3 billion.

External Vulnerability is Very Low (-)

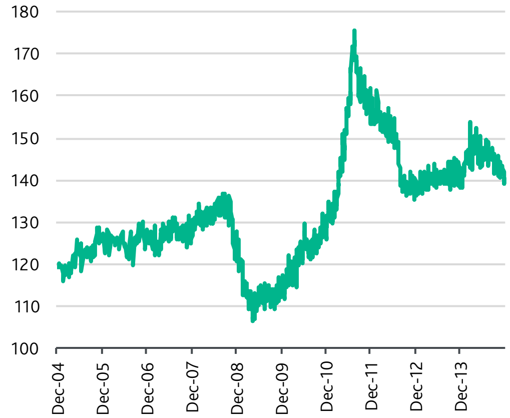
Botswana was severely affected by the 2009 global financial crisis, which had a negative effect on the luxury goods sector, particularly diamonds, of which prices fell by 14% in USD terms between November 2008 and April 2009. High stock levels, liquidity constraints, continued euro area concerns where depressed economic activity constraining European consumer demand for diamond, a weaker rupee in India and softer demand from China have contributed to lower global demand. Still, diamond prices are currently above the pre-crisis levels and according to De Beers, new demand elsewhere, especially in India and China, will likely compensate for any pressures stemming from the risk of a global slowdown, with the US remaining the largest market. Moreover, as most competitors operate mines with tight margins, they are likely to reduce or mothball production if market conditions sour, which will likely make Debswana a more dominant player. As a result, we expect Botswana's revenue to increase alongside its share of global production in value.

2 Especially in the commercial segment of the real estate market in Gaborone.

EXHIBIT 12

Volatile global diamond prices

$

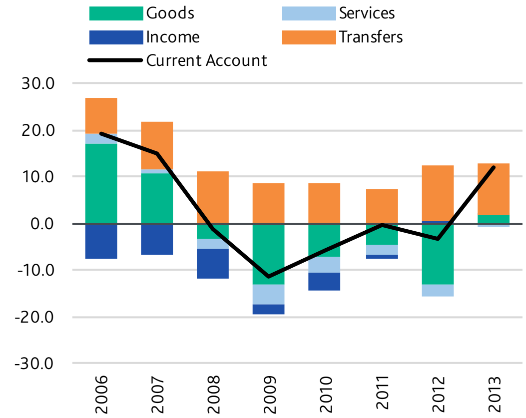


Source: Bloomberg

EXHIBIT 13

Botswana's current account is recovering

% of GDP



Source: Haver, Statistics Botswana, Moody's Investors Service

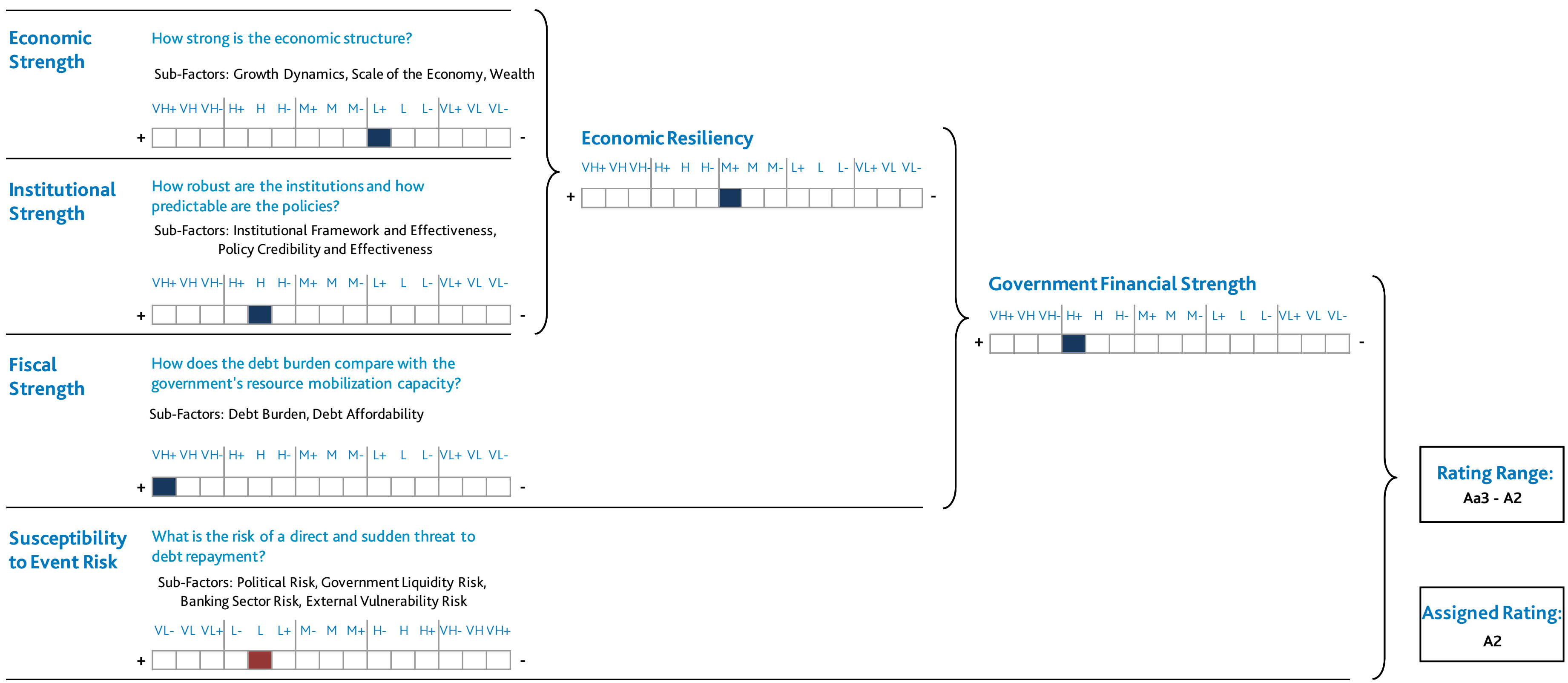
Due to the price movements noted above and illustrated in Exhibit 12, Botswana's current account experienced a deficit of 7% of GDP in 2009, in contrast with large surpluses that averaged 13% in 2005-08. With the recovery of the diamond industry in the following years, Botswana's current account returned to surpluses, albeit at lower levels than previously experienced. Due to the gradual decline in diamond prices since late 2011, the current account was again in deficit in 2012. It was back into surplus in 2013.

While we expect the current account to be in surplus in 2014 and 2015, the large projects that the country is completing, and the complications faced by the Morupule power station, will likely fuel imports of costly capital goods and electricity. In addition, diamond imports are growing as the diversification initiative in cutting and polishing stones is developing. All in all, as Botswana's economy is growing relative to diamond production and its diversification strategy is taking hold, we believe that future current account surpluses will likely be lower than in the past. Meanwhile, the Pula Fund, which stood at around 38% of GDP in August 2014, has acted as a buffer and will likely strengthen again in the future because of expected government surpluses.

Rating Range

Combining the scores for individual factors provides an indicative rating range. While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Sovereign Bond Rating Methodology.

Sovereign Rating Metrics: Botswana



Comparatives

This section compares credit relevant information regarding Botswana with other sovereigns rated by Moody's Investors Service. It focuses on a comparison with sovereigns within the same rating range and shows the relevant credit metrics and factor scores.

Botswana's Low (+) assessment for economic strength is in line with the peer group as is its assessment for institutional strength, at High. Botswana compares favourable to the peer group in terms of its fiscal strength (at Very High (+)) as well as its Susceptibility to Event Risk, at Low.

EXHIBIT 14
Botswana Key Peers

	Year	Botswana	Estonia	Oman	Slovakia	Malta	Poland	A2 Median	Sub-Saharan Africa Median
Rating/Outlook		A2/STA	A1/STA	A1/STA	A2/STA	A3/STA	A2/STA	A2	B1
Rating Range		Aa3 - A2	Aa3 - A2	A1 - A3	A1 - A3	A1 - A3	A1 - A3	A1 - A3	Ba3 - B2
Factor 1		**L+**	**M-**	**H+**	**M**	**M+**	**VH-**	**M**	**L+**
Nominal GDP (US$ Bn)	2013	14.8	24.9	79.7	97.7	10.0	525.9	97.7	29.5
GDP per Capita (PPP, US$)	2013	15,241	26,052	43,304	26,616	30,567	23,273	23,273	3,977
Avg. Real GDP (% change)	2009-2018	4.2	1.4	4.4	2.0	2.3	3.1	3.1	5.7
Volatility in Real GDP growth (ppts)	2004-2013	4.8	7.8	1.9	4.4	1.9	1.8	4.4	2.5
Global Competitiveness Index, percentile [1]	2014	35.3	73.4	59.2	34.5	58.4	61.9	35.3	10.2
Factor 2		**H**	**VH-**	**H-**	**H+**	**VH**	**VH-**	**H+**	**L-**
Government Effectiveness, percentile [1]	2013	51.9	69.2	50.3	63.7	81.8	62.9	62.9	18.9
Rule of Law, percentile [1]	2013	63.7	81.8	62.2	59.0	82.6	69.2	63.7	28.3
Control of Corruption, percentile [1]	2013	72.4	74.8	53.5	52.7	74.0	65.3	65.3	22.0
Avg. Inflation (% change)	2009-2018	6.1	2.4	3.0	1.9	1.9	2.6	2.6	6.8
Volatility in Inflation (ppts)	2004-2013	2.2	2.7	3.4	2.0	0.9	1.2	2.0	3.4
Factor 3		**VH+**	**VH+**	**VH**	**H+**	**H-**	**H-**	**H+**	**M+**
Gen. Gov. Debt/GDP	2013	18.4	10.1	7.3	54.6	69.8	55.7	54.6	33.9
Gen. Gov. Debt/Revenues	2013	48.2	26.2	14.2	142.2	175.2	145.9	142.2	152.1
Gen. Gov. Interest Payments/Revenue	2013	1.4	0.4	0.3	4.9	7.4	6.8	4.9	6.9
Gen. Gov. Interest Payments/GDP	2013	0.5	0.1	0.2	1.9	2.9	2.6	1.9	1.5
Gen. Gov. Financial Balance/GDP	2013	5.6	-0.5	7.9	-2.6	-2.7	-4.0	-2.6	-2.5
Factor 4		**L**	**L**	**M**	**L+**	**L+**	**M**	**L+**	**M**
Current Account Balance/GDP	2013	10.4	-1.4	6.4	2.1	3.2	-1.3	2.1	-6.2
Gen. Gov. External Debt/Gen. Gov. Debt	2013	70.3	78.0	32.1	61.0	--	50.9	61.0	47.3
External Vulnerability Indicator	2015F	8.1	--	44.9	--	--	113.7	60.9	29.0
Net International Investment Position/GDP	2013	52.7	-46.8	--	-63.8	21.8	-71.3	-63.8	4.2

Notes:

[1] Moody's calculations. Percentiles based on our rated universe.

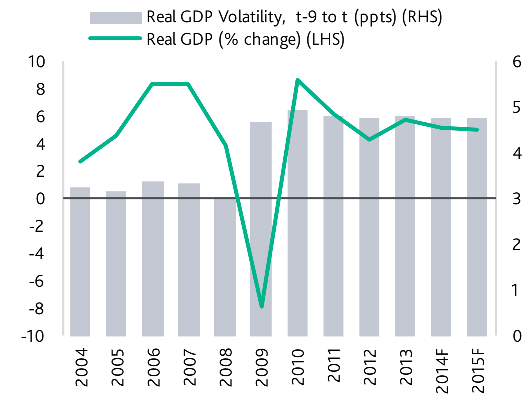
Source: Moody's Investors Service

Appendices

Chart Pack

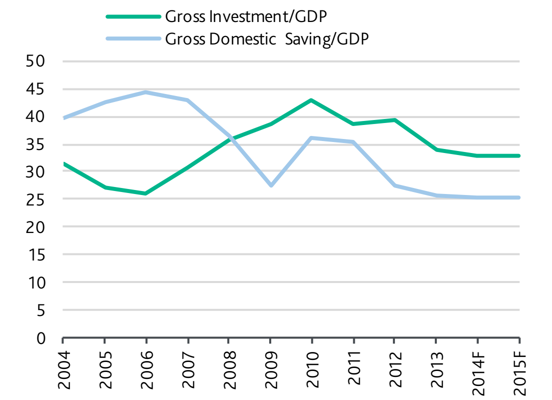
Botswana

EXHIBIT 15
Economic Growth



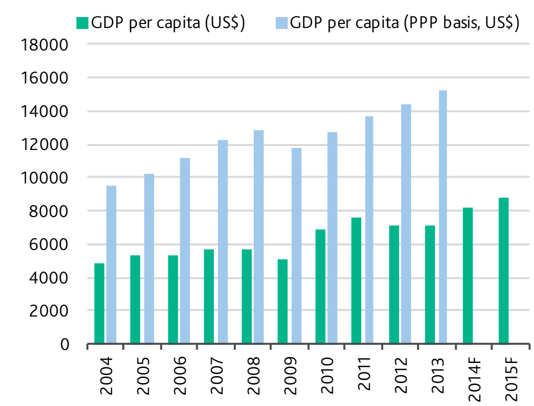
Sources: Moody's, Haver, Botswana Statistics

EXHIBIT 16
Investment and Saving



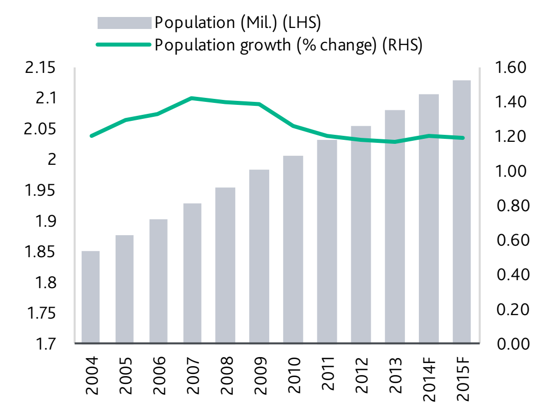
Sources: Moody's, Haver, Botswana Statisticss

EXHIBIT 17
National Income



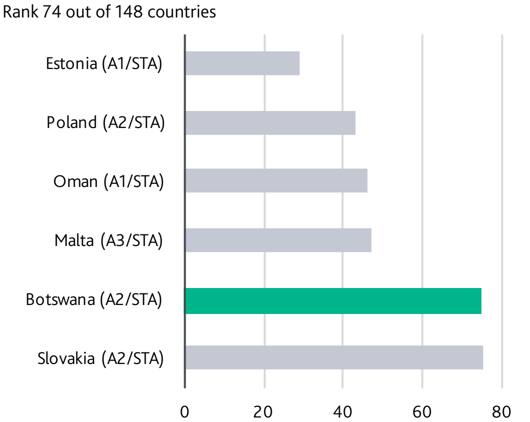
Sources: Moody's, Haver, Botswana Statistics

EXHIBIT 18
Population



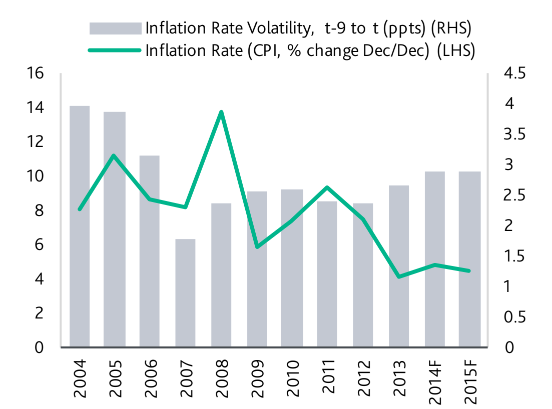
Sources: Moody's, IMF

EXHIBIT 19
Global Competitiveness Index
Rank 74 out of 148 countries



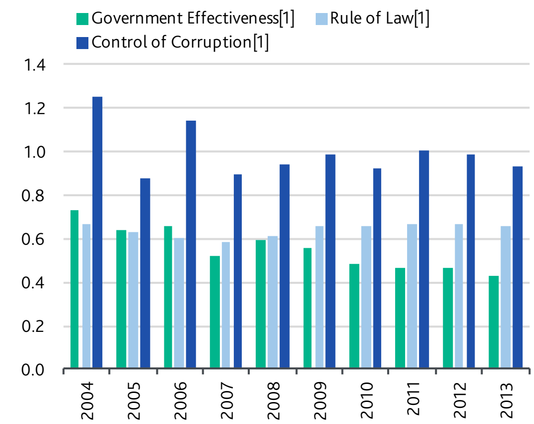
Source: World Economic Forum

EXHIBIT 20
Inflation and Inflation Volatility



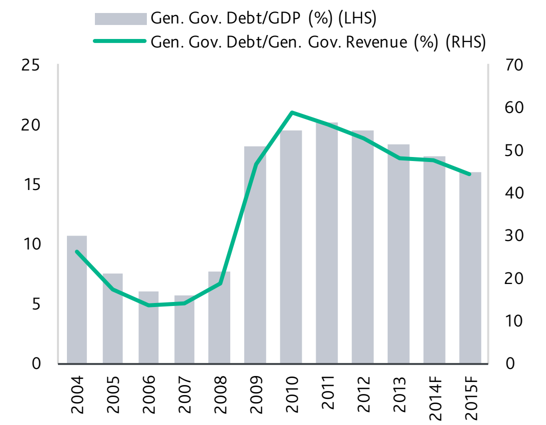
Sources: Moody's, Haver, Bank of Botswana

EXHIBIT 21
Institutional Framework and Effectiveness



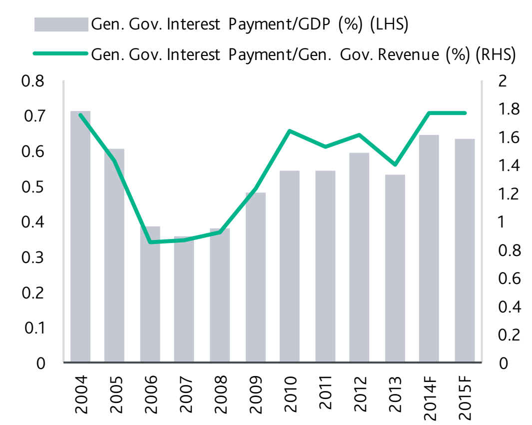
Notes: [1] Composite index with values from about -2.50 to 2.50: higher values correspond to better governance.
Sources: World Bank Governance Indicators

EXHIBIT 22
Debt Burden



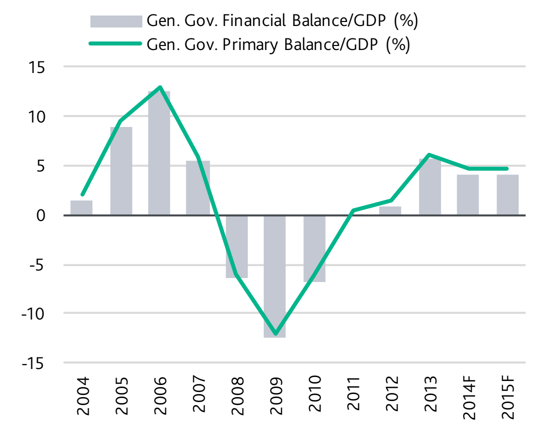
Sources: Moody's, Haver, Botswana Ministry of Finances

EXHIBIT 23
Debt Affordability



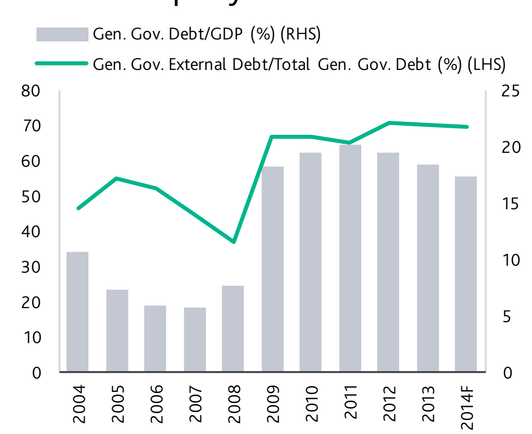
Sources: Moody's, Haver, Botswana Ministry of Finance

EXHIBIT 24
Financial Balance



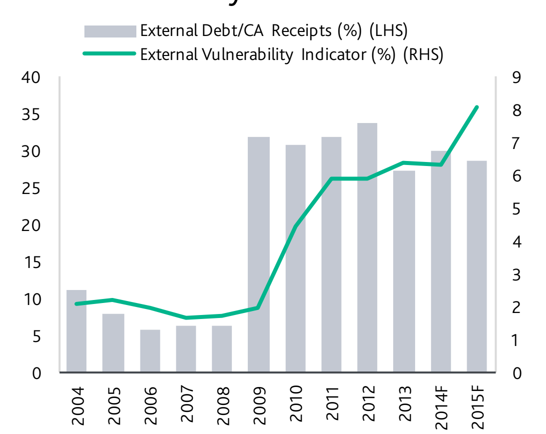
Sources: Moody's, Haver, Botswana Ministry of Finance

EXHIBIT 25
Government Liquidity Risk



Sources: Moody's, Haver, Botswana Ministry of Finance

EXHIBIT 26
External Vulnerability Risk



Sources: Moody's, Haver, Bank of Botswanas

Rating History

Botswana

	Government Bonds			Foreign Currency Ceilings				
	Foreign Currency	Local Currency	Outlook	Bonds & Notes		Bank Deposit		Date
				Long-term	Short-term	Long-term	Short-term	
Outlook Changed	A2	A2	Stable	--	--	--	--	November-11
Outlook Changed	A2	A2	Negative	--	--	--	--	February-10
Rating Lowered	--	A2	Stable	--	--	--	--	March-09
Outlook Changed	A2	--	Stable	--	--	--	--	March-09
Outlook Changed	A2	--	Positive	--	--	--	--	August-07
Rating Raised	--	--	--	Aa3	--	--	--	May-06
Rating Assigned	A2	A1	Stable	A2	P-1	A2	P-1	March-01

Annual Statistics

Botswana

	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Economic Structure and Performance										
Nominal GDP (US$ Bil.)	10.1	10.9	11.1	10.1	13.7	15.4	14.5	14.8	17.3	18.7
Population (Mil.)	1.9	1.9	2.0	2.0	2.0	2.0	2.1	2.1	2.1	2.1
GDP per capita (US$)	5,327.2	5,673.8	5,684.4	5,099.3	6,849.4	7,565.4	7,074.2	7,108.4	8,223.0	8,767.3
GDP per capita (PPP basis, US$)	11,177.7	12,299.1	12,847.8	11,769.3	12,773.3	13,680.9	14,349.2	15,241.1	--	--
Nominal GDP (% change, local currency)	16.5	13.6	13.0	-4.7	29.1	12.5	5.4	12.1	12.9	9.6
Real GDP (% change)	8.4	8.3	3.9	-7.8	8.6	6.2	4.3	5.8	5.2	5.0
Inflation Rate (CPI, % change Dec/Dec)	8.6	8.2	13.7	5.9	7.3	9.3	7.4	4.1	4.8	4.4
Gross Investment/GDP	25.9	30.8	35.6	38.4	42.8	38.5	39.4	33.9	33.0	33.0
Gross Domestic Saving/GDP	44.2	42.8	36.6	27.4	35.9	35.2	27.3	25.6	25.3	25.2
Nominal Exports of Goods and Services (% change, US$ basis)	0.7	12.7	-16.2	-28.5	37.5	41.7	-9.2	28.9	5.5	7.2
Nominal Imports of Goods and Services (% change, US$ basis)	-2.3	28.6	25.8	-4.6	19.3	26.7	7.3	2.5	12.1	7.6
Openness of the Economy (%) [1]	86.3	95.1	95.3	88.1	82.0	97.7	102.9	115.1	107.1	106.6
Government Effectiveness [2]	0.5	0.6	0.6	0.5	0.5	0.5	0.4	0.3	--	--
Government Finance										
Gen. Gov. Revenue/GDP [3]	45.0	41.4	40.9	39.1	33.0	35.9	37.0	38.1	37.0	36.0
Gen. Gov. Expenditures/GDP [3]	32.4	35.9	47.2	51.5	39.7	36.0	36.1	32.5	33.0	32.0
Gen. Gov. Financial Balance/GDP [3]	12.6	5.5	-6.3	-12.4	-6.7	-0.2	0.8	5.6	4.0	4.0
Gen. Gov. Primary Balance/GDP [3]	13.0	5.9	-5.9	-11.9	-6.2	0.4	1.4	6.2	4.6	4.6
Gen. Gov. Direct Debt, $ billion [3]	0.6	0.7	0.8	2.1	2.92	2.87	2.82	2.71	2.99	3.00
Gen. Gov. Debt/GDP [3]	6.0	5.7	7.6	18.2	19.4	20.1	19.4	18.4	17.4	16.0
Gen. Gov. Debt/Gen. Gov. Revenues [3]	13.3	13.9	18.7	46.4	58.9	56.1	52.6	48.2	47.0	44.5
Gen. Gov. Interest Payments/Gen. Gov. Revenues [3]	0.9	0.9	0.9	1.2	1.6	1.5	1.6	1.4	1.7	1.8
Gen. Gov. FC and FC-indexed Debt/Total Gen. Gov. Debt [3]	52.1	44.6	36.8	66.6	66.9	65.4	71.0	70.25	69.39	69.70
External Payments and Debt										
Nominal Exchange Rate (local currency per US$, Dec)	6.0	6.0	7.5	6.7	6.4	7.5	7.8	8.7	8.2	8.3
Current Account Balance (US$ Bil.) [15]	2.0	1.7	0.0	-1.1	-0.8	-0.1	-0.6	1.5	1.3	1.2
Current Account Balance/GDP [15]	19.3	15.1	0.0	-11.3	-6.0	-0.6	-3.9	10.4	7.5	6.5
External Debt (US$ Bil.)	0.4	0.4	0.4	1.7	1.8	2.4	2.5	2.8	3.2	3.2
Public Sector External Debt/Total External Debt [4]	92.2	93.1	88.7	81.3	75.2	79.2	81.0	80.7	76.1	80.5
Short-term External Debt/Total External Debt	--	--	--	--	--	--	--	--	--	--
External Debt/GDP	3.9	4.7	3.9	15.2	14.5	17.7	19.6	18.8	18.6	17.3
External Debt/CA Receipts [5] [15]	5.9	6.5	6.3	32.0	30.8	31.9	33.8	27.4	30.0	28.6
Interest Paid on External Debt (US$ Bil.)	0.012	0.011	0.009	0.011	0.020	0.023	0.025	0.022	0.022	0.025
Amortization Paid on External Debt (US$ Bil.)	0.007	0.006	0.008	0.005	0.009	0.007	0.004	0.004	0.004	0.018
Net Foreign Direct Investment/GDP	4.3	4.1	5.5	1.2	1.0	7.2	1.0	1.3	2.0	2.3
Net International Investment Position/GDP	99.4	99.7	99.2	85.7	52.9	49.9	42.5	52.7	--	--

Botswana

	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Official Foreign Exchange Reserves (US$ Bil.)	7.9	9.7	9.0	8.5	7.7	7.9	7.5	7.8	8.0	9.0
Net Foreign Assets of Domestic Banks (US$ Bil.)	0.2	0.4	0.6	0.4	0.5	0.6	0.7	0.6	--	--
Monetary, Vulnerability and Liquidity Indicators										
M2 (% change, Dec/Dec)	67.4	31.5	21.5	-1.3	10.7	4.4	9.0	4.0	--	--
Short-Term Nominal Interest Rate (% per annum. Dec. 31)	15.0	14.5	15.0	10.0	9.5	9.5	9.5	7.5	--	--
Domestic Credit (% change) [6]	217.5	40.4	-17.4	-92.0	-1,254.0	-11.2	95.8	2.7	--	--
Domestic Credit/GDP [6]	-14.9	-18.4	-13.5	-1.1	10.1	8.0	14.8	13.6	--	--
M2/Official Forex Reserves (X)	0.5	0.6	0.6	0.7	0.9	0.8	0.8	0.7	--	--
Total External Debt/Foreign Exchange Reserves	4.9	5.4	4.3	19.3	27.2	31.3	37.4	34.3	39.6	35.7
Debt Service Ratio [7]	0.8	0.6	1.0	1.0	1.2	0.9	0.6	0.6	0.6	1.6
External Vulnerability Indicator [8]	2.0	1.7	1.8	2.0	4.5	5.9	5.9	6.4	6.3	8.1
Liquidity Ratio [9]	1.6	1.2	5.9	14.2	24.4	26.8	20.6	27.2	--	--
Total Liabilities due BIS Banks/Total Assets Held in BIS Banks	12.3	8.1	7.9	12.9	23.7	35.7	36.5	42.5	--	--
"Dollarization" Ratio [6] [10]	20.2	29.2	27.4	13.0	14.8	15.5	14.4	13.1	--	--
"Dollarization" Vulnerability Indicator [6] [11]	9.7	15.2	15.0	8.6	12.0	11.3	11.7	9.3	--	--

Notes:

[1] Sum of Exports and Imports of Goods and Services/GDP (%)

[2] Composite Index with Values from -2.50 to 2.50, higher absolute Numbers suggest better Level of Maturity and responsiveness of Government Institutions

[3] Fiscal years beginning April 1

[4] General government

[5] Current Account Receipts

[6] Excludes Central Government

[7] (Interest + Current-Year Repayment of Principal)/Current Account Receipts (%)

[8] (Short-term External Debt + Currently Maturing long-term Debt + Total Nonresident Deposits over one Year)/Official Foreign Exchange Reserves

[9] Liabilities to BIS Banks Falling Due within one Year/Total Assets Held in BIS Banks (%)

[10] FX deposits in the domestic banking system/Total deposits in the domestic banking system

[11] FX depositis in the domestic banking system/(Official FX Reserves + Foreign assets of domestic banking institutions)

Source: Moody's Investors Service

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