MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Botswana's A2 rating; Outlook stable

27 Apr 2018

London, 27 April 2018 -- Moody's Investors Service ("Moody's") has today affirmed the Government of Botswana's A2 long-term issuer and senior unsecured ratings. The outlook remains stable.

The key factors for affirming the A2 ratings are:

1. Botswana's very high fiscal strength, supported by low and stable government debt (at 15% of GDP in December 2017), the sovereign wealth fund's (Pula Fund) large assets (about 30% of GDP as of December 2017), and Moody's expectation that the country's prudent fiscal policy will continue.

2. The country's strong institutional framework which delivers macroeconomic stability. Adherence to the rule of law and low corruption levels also contribute to strong institutions, notwithstanding some weaknesses in the governance of state-owned enterprises and in delivering high returns on public investment.

3. Rating constraints related to the country's economic model which is highly dependent on the volatile diamond industry and a large public sector. The country's economic strength is further diminished by high unemployment, inequality and HIV infection rates.

The stable outlook reflects balanced risks at the A2 rating level, which comprise our assessment of the government's continued prudent macroeconomic policies on the positive side and structural rigidities in the economy and underperforming state-owned enterprises on the negative side.

Botswana's local currency bond and deposit ceilings remain at Aa3, foreign currency deposit ceiling at A2/P-1, and foreign-currency bond ceiling at Aa3/P-1, all unchanged.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION

PRUDENT FISCAL POLICY WILL PRESERVE HIGH FISCAL STRENGTH, SUPPORTED BY LOW DEBT AND LARGE ASSETS

Moody's decision to affirm Botswana's A2 ratings is underpinned by the government's very high fiscal resilience, supported by large fiscal buffers and prudent fiscal policy.

The economic stimulus programme deployed in the last two years was limited in size relative to plans. While it reduced the large fiscal reserves from about 25% of GDP in December 2015 to 18% in December 2017, it did not raise the government debt burden.

The availability of large sovereign wealth fund assets together with a credible track record of fiscal prudence affords the government space to implement moderately expansionary fiscal policy in the next few years without weakening the fiscal metrics.

While some spending pressures are likely to rise in the run-up to 2019 general elections, Moody's expects that Botswana will maintain its track record of fiscal prudence and that the fiscal balance will gradually turn to surplus over the medium term. Moody's expects the government to reach its objective of reducing government expenditures below 30% of GDP, albeit only over the medium term, following an initial increase to about 36% of GDP projected for the 2018/19 fiscal year from 33% in 2017/18. Fiscal prudence will also manifest itself in changes in the composition of government outlays, with a further gradual shift towards development expenditures.

Moody's expects Botswana's budget deficit to reach 1.9% of GDP this fiscal year and to remain at 2.0% of GDP in 2019/20. The government plans to cover most of these deficits by drawing on its existing assets. With projected annual nominal GDP growth of about 6-7%, Moody's forecasts the government debt-to-GDP ratio to remain stable around 15% of GDP. The Pula Fund is also projected to stay around 30% of GDP over the medium term.

In the event of a negative shock to diamond revenues, Botswana's fiscal buffers would erode as demonstrated during the negative commodity price shock that occurred in 2015. Moody's expects that fiscal policy would effectively halt the erosion and preserve relatively strong fiscal flexibility.

STRONG INSTITUTIONAL FRAMEWORK DELIVERING MACROECONOMIC STABILITY

The government's strong institutional framework maintains macroeconomic stability through commodity price fluctuations, further supporting the A2 ratings.

Moody's expects the Bank of Botswana will continue implementing monetary policy that delivers moderate and stable inflation and the government to maintain fiscal policy that is rule-based, transparent and helps preserve sizeable fiscal and external buffers against potential shocks. The crawling peg exchange rate regime has helped maintain macroeconomic stability.

Botswana's adherence to the rule of law and control of corruption further contribute to strong institutions.

The main institutional challenges include relatively low government effectiveness, demonstrated by a large public sector that delivers social outcomes (health, education) and returns on public investment below those commonly achieved in upper-middle income countries.

In recent years, institutional strength has also been tempered by challenges with governance of state-owned enterprises (SOEs), some of which rely on significant and persistent transfers from the government, as well as limited transparency regarding their performance. While the government-guaranteed debt of SOEs remains relatively low at 5 - 6% of GDP, Moody's estimates that in 2017/18 the budgeted subsidies for these enterprises accounted for additional 5 -- 6% of GDP. Without reforms to governance, fiscal risks from SOEs -- currently contained -- will rise. Overall, transparency with fiscal data has been mixed.

ECONOMIC STRENGTH CONSTRAINED BY HIGH DEPENDENCE ON DIAMOND SECTOR AND WEAK RETURNS ON PUBLIC INVESTMENT

Botswana's economic model is reliant on a volatile diamond sector, with increasingly costly to process resources, and a large public sector. This model, combined with low return on public investment and weak social outcomes, constrains creditworthiness.

The mining sector, comprising mostly from diamonds, drives GDP growth (directly and through the spending of incomes generated in the sector), provides for most export proceeds, and almost 40% of government revenue. The production potential of the diamond mining sector has been extended, but at increased costs, eroding profit margins. Beside exposure to sudden shocks to diamond demand and prices, as diamond resources become more expensive to extract, Botswana's main source of revenue will generate fewer benefits for the wider economy. Moreover, the diamond sector generates very few jobs or know-how and infrastructure spill-overs to the broader economy.

While Botswana has built-up financial assets from its resource wealth, the high levels of public investment deployed by the large public sector have not yielded quality outcomes in health, education and infrastructure, hampering the government's objectives of generating inclusive growth and reducing unemployment, poverty and inequality.

Botswana also continues to grapple with persistently high unemployment (18% of the labour force in 2017), skill shortages and mismatches, wide income inequality, poverty, and some of the highest HIV infection rates in the world, which combined constrain the country's productive capacity. These structural weaknesses also hinder prospects of a shift to new, more productive and durable sectors, away from diamond production and the public sector.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's assessment of policymakers' continued commitment to prudent fiscal stance while utilizing some of the significant fiscal policy space resulting from sizeable fiscal reserves and low government debt. These credit strengths are balanced by medium- to long-term challenges to Botswana's economic model, structural rigidities in the labour and product markets and weak governance of state-owned enterprises.

WHAT COULD CHANGE THE RATING UP

The stable outlook indicates that changes to the rating are unlikely in the near term.

Over time, structural reforms that would significantly reduce rigidities in the labour and product markets, increase economic diversification and reduce inequality, boosting Botswana's growth potential would put upward pressure on the rating.

A broadening of the tax base that reduces fiscal vulnerability to sudden declines in Southern African Customs Union revenues and/or mineral revenues would also be credit positive.

WHAT COULD CHANGE THE RATING DOWN

Prospects of a significant and lasting erosion of fiscal reserves, which could be relatively rapid in the event of a negative shock to government revenue, that policy is ineffective at countering, would put downward pressure on the rating. A material and sustained increase in financial support to state-owned enterprises would also erode Botswana's fiscal buffers and put negative pressure on the rating.

Lack of structural reforms that would lead weaken potential growth in the medium term would be also credit negative.

GDP per capita (PPP basis, US$): 17,113 (2016 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 4.3% (2016 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3% (2016 Actual)

Gen. Gov. Financial Balance/GDP: 0.6% (2016 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 11.7% (2016 Actual) (also known as External Balance)

External debt/GDP: 13.4% (2016 Actual)

Level of economic development: Moderate level of economic resilience

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 24 April 2018, a rating committee was called to discuss the rating of the Botswana, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutional strength/ framework has decreased. The issuer's fiscal or financial strength, including its debt profile, has not materially changed.

The principal methodology used in these ratings was Sovereign Bond Ratings published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Zuzana Brixiova
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Marie Diron
MD - Sovereign Risk
Sovereign Risk Group
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454