

**BANK
OF
BOTSWANA**

ANNUAL REPORT

2016



BOARD MEMBERS
(as at year-end 2016)



Moses D Pelaelo
Governor
(Chairman)



Gordon K Cunliffe



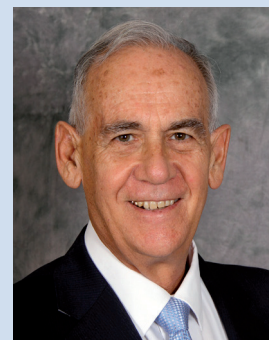
Dr Joel Sentsho



Solomon M Sekwakwa*



Dr Malebogo Bakwena



Robert N Matthews

* Permanent Secretary, Ministry of Finance and Economic Development

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ABBREVIATIONS USED IN THE REPORT

AACB	–	Association of African Central Banks
AC	–	Audit Committee
AIDS	–	Acquired Immune Deficiency Syndrome
AfDB	–	African Development Bank
BACH	–	Botswana Automated Clearing House
BCL	–	Bamangwato Concessions Limited
BDC	–	Botswana Development Corporation
BDF	–	Botswana Defence Force
BECI	–	Botswana Export Credit Insurance
BEMA	–	Botswana Exporters and Manufacturers Association
BFS	–	Botswana Financial Statistics
BIH	–	Botswana Innovation Hub
BITRI	–	Botswana Institute for Technology Research and Innovation
BISS	–	Botswana Inter-bank Settlement System
BITC	–	Botswana Investment and Trade Centre
BMC	–	Botswana Meat Commission
BoBCs	–	Bank of Botswana Certificates
BOC	–	Botswana Oil Company
BOTC	–	Botswana Telecommunications Corporation
BPC	–	Botswana Power Corporation
BQA	–	Botswana Qualification Authority
BSE	–	Botswana Stock Exchange
BURS	–	Botswana Unified Revenue Services
CCBG	–	Committee of Central Bank Governors
CEDA	–	Citizen Entrepreneurial Development Agency
CPI	–	Consumer Price Index
DBGSS	–	De Beers Global Sightholder Services
DBI	–	Doing Business Index
DRC	–	Democratic Republic of Congo
DTCB	–	Diamond Trading Company Botswana
EDD	–	Economic Diversification Drive
EFTA	–	European Free Trade Association
EPZ	–	Export Processing Zones
ESP	–	Economic Stimulus Programme
EU	–	European Union
FCA	–	Foreign Currency Account
FCI	–	Foreign Company Index
FDI	–	Foreign Direct Investment
FTA	–	Free Trade Agreement
GATT	–	General Agreement on Tariffs and Trade
GCI	–	Global Competitiveness Index

GCR	–	Global Competitiveness Report
GDP	–	Gross Domestic Product
GIA	–	Government Investment Account
GSP	–	Generalised System of Preferences
HIV	–	Human Immunodeficiency Virus
HRDC	–	Human Resources Development Council
ICT	–	Information and Communications Technology
IHDI	–	Inequality-Adjusted Human Development Index
IIP	–	International Investment Position
IMF	–	International Monetary Fund
IPR	–	Intellectual Property Rights
IFSC	–	International Financial Services Centre
IFC	–	International Finance Corporation
IFRS	–	International Financial Reporting Standards
KBAL	–	Kingdom Bank Africa Limited
LEA	–	Local Enterprise Authority
LF	–	Labour Force
LFPR	–	Labour Force Participation Rate
LPI	–	Logistics Performance Index
MADFS	–	Ministry of Agricultural Development and Food Security
MERCOSUR	–	Mercado Común del Sur
MFED	–	Ministry of Finance and Economic Development
MIGA	–	Multilateral Investment Guarantee Agency
MITI	–	Ministry of Investment, Trade and Industry
MTS	–	Multilateral Trading Systems
NCTPN	–	National Committee on Trade Policy Negotiations
NDB	–	National Development Bank
NDP	–	National Development Plan
NEDC	–	National Economic Diversification Council
NEER	–	Nominal Effective Exchange Rate
NFTRC	–	National Food Technology Research Centre
NTP	–	National Trade Policy
OECD	–	Organisation for Economic Cooperation and Development
OPEC	–	Organisation of Petroleum Exporting Countries
OMO	–	Open Market Operations
PPADB	–	Public Procurement and Asset Disposal Board
PTA	–	Preferential Trade Area
REER	–	Real Effective Exchange Rate
REI	–	Regional Economic Intergration
REMCO	–	Remuneration Committee
RMCI	–	Real Money Conditions Index
RSA	–	Republic of South Africa

RSF	–	Revenue Sharing Formula
SACU	–	Southern African Customs Union
SADC	–	Southern African Development Community
SDG	–	Sustainable Development Goals
SDR	–	Special Drawing Rights
SEZ	–	Special Economic Zones
SEZA	–	Special Economic Zone Authority
SIPS	–	Systematically Important Payments Systems
SIRESS	–	SADC Integrated Regional Settlement System
SMME	–	Small Micro and Medium-sized Enterprises
TNCM	–	Tati Nickel Mining Company
UK	–	United Kingdom
UNDP	–	United Nations Development Programme
USA	–	United States of America
USAID	–	United States Agency for International Development
USD	–	United States Dollar
VAT	–	Value Added Tax
WB	–	World Bank
WEO	–	World Economic Outlook
WFH	–	Women's Finance House
WIBA	–	Women in Business Association
WUC	–	Water Utilities Corporation
WTO	–	World Trade Organisation

PART A

STATUTORY REPORT ON THE OPERATIONS AND FINANCIAL STATEMENTS OF THE BANK FOR 2016

BANK OF BOTSWANA

SENIOR MANAGEMENT AS AT DECEMBER 31, 2016

DEPUTY GOVERNORS



Dr Kealeboga S Masalila



Andrew M Motsomi

GENERAL MANAGERS



Ewetse T Rakhudu

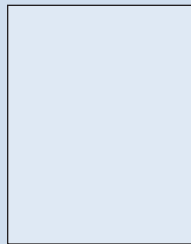


Richard H Nlebesi

HEADS OF DEPARTMENT



Ralesedi E Somolekae
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Vacant
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Julius Ghanie
Information Technology



Dr Lesedi Senatla
Banking Supervision



Daniel N Loeto
Finance



Matthew Wright
Financial Markets

GOVERNOR'S FOREWORD

The Bank publishes the 2016 *Annual Report* in accordance with Section 68(1) of the Bank of Botswana Act (CAP 55:01). The *Report* provides a summary of the operational activities and audited financial statements of the Bank for the period ended December 31, 2016.

The *Report* also covers the key functions and responsibilities, and outlines the accountability framework for the Bank's performance. These functions and responsibilities include conduct of monetary policy; maintaining financial stability, implementation of the exchange rate policy; the design and issuance of currency, management of foreign exchange reserves; regulation and supervision of banks; oversight of the payments systems and provision of banking and settlement services to Government, commercial banks and other financial institutions as well as economic research and policy advice.



The year 2016 was of special significance to the Bank in several ways. First, the commemoration of the Bank's 40th Anniversary on March 31, 2016, marked a major milestone in the history and growth of the Bank as the central bank of the Republic of Botswana. The Bank came into existence on July 1, 1975, with the promulgation of the Bank of Botswana Act, but commenced operations in January 1976. Second, the commemoration of the 40th Anniversary coincided with Botswana's 50th Anniversary of Independence celebrations on September 30, 2016. Third, 2016 also marked the 40th Anniversary of the introduction of the national currency, Pula and Thebe, which replaced the South African rand as legal tender on August 23, 1976, Pula Day.

The Bank experienced significant changes in leadership, notably the retirement of Ms Linah K Mohohlo, the long-serving former Governor of the Bank from October 21, 1999 to October 20, 2016. Subsequent to her retirement, His Excellency the President appointed Mr Moses D Pelaelo, on October 21, 2016, as Governor of the Bank. Earlier, Mr Oduetse A Motshidisi, retired on January 31, 2016, after serving the Bank for over 27 years, 15 of which he was Deputy Governor. His Excellency the President also appointed Mr Andrew M Motsomi and Dr Kealeboga S Masalila as Deputy Governors on February 4, 2016 and December 1, 2016, respectively.

The *Annual Report* contains a theme topic titled *Botswana's Trade Pattern, International Investment and Regional Economic Integration: Opportunities for Industrial Development and Inclusive Growth*. The topic reviews Botswana's external sector, in particular, trade and investment performance, related institutional and policy support, and suggests opportunities that should be exploited through trade and industrial policies to stimulate sustainable economic diversification, inclusive growth and job creation.

The Bank was successful in the implementation of its work programmes and, in general, achieved its policy objectives during 2016. However, as in the previous year, the domestic and external environment was less favourable and uncertain. Global economic activity was weak in 2016 relative to 2015, with varying performance across countries and regions. In advanced economies, growth in output slowed, weighed down by ongoing structural adjustments, policy uncertainty and slower growth in global demand and trade. In the emerging markets, output growth was unchanged in the same period, reflecting the combined outcome of slowdown in economic activity in emerging Asia, moderation in China's economic growth and some improvement in hitherto contracting economies, particularly Brazil and Russia.

For Botswana, non-mining output growth improved, although overall economic expansion was constrained by a contraction in mining production and weak performance of the agricultural sector. Inflationary pressures were generally subdued, reflecting modest domestic demand, which, in turn, and in part, reflected slow growth in personal incomes, and a reduction in fuel prices. Inflation in Botswana has been, since June 2013, either within or slightly below the desired medium-term objective range.

Domestic inflation fluctuated around the lower end of the 3 – 6 percent medium-term objective range in 2016 and was 3 percent in December. This outturn was the combined result of a decrease in fuel prices in the first quarter of 2016; the absence of major upward adjustments to administered prices and government levies; subdued domestic economic growth; and, low global inflation. The consumer price index (CPI) was rebased from September 2006 to September 2016 and the consumer basket composition and weights were adjusted based on the results of the 2009/10 Botswana Core Welfare Indicators Survey.

A positive medium-term outlook for inflation and a stable financial environment provided scope for monetary policy easing to support economic activity. The Bank Rate was, therefore, reduced by 0.5 percentage points to 5.5 percent in August 2016. Moreover, to encourage productive commercial bank lending and market efficiency, as well as alleviate the cost of liquidity absorption, the Bank conducted monetary operations with a view to limiting Bank of Botswana Certificates (BoBCs) issuance and the use of repos, although this was balanced against the need to keep money market interest rates aligned with the monetary policy stance.

Given projected low inflation in Botswana compared to trading partner countries, the nominal effective exchange rate (NEER) of the Pula crawled upwards by 0.38 percent during 2016, while the Pula basket weights were 50 percent each for the South African rand and the Special Drawing Rights (SDR).¹ However, the real effective exchange rate (REER) depreciated by 0.8 percent in 2016, as the upward rate of crawl was smaller than the inflation differential between Botswana and its trading partner countries.

The banking industry remained sound, prudently managed, solvent, liquid and profitable. All licensed banks met the minimum prudential requirements as set out in the Banking Act and Banking Regulations. The industry's profitability was due to the increase in both net interest income and non-interest income. The process of liquidation of the failed Kingdom Bank Africa Limited (an offshore bank) was ongoing as at December 31, 2016.

The banking sector's balance sheet increased by 5.2 percent from P76.7 billion in December 2015 to P80.7 billion in December 2016. The 4.1 percent and 8.7 percent growth in total deposits and capital, respectively, supported the increase in government bonds, treasury bills and gross loans and advances. Even so, annual credit growth slowed from 7.1 percent at the end of 2015 to 6.2 percent at the end of 2016 because of the slower rate of increase in lending to both households and businesses.

National and international payments were carried out efficiently through various platforms, including the Botswana Automated Clearing House (BACH). The Bank continues to embrace improvements in the payments and settlement landscape as driven by developments in information and communications technology, competition and customer requirements. At the same time, the Bank continued to implement related security and risk mitigation measures to avert any possible cyber-attacks, fraud and misuse of payments systems.

Both Moody's Investors Service and Standard & Poor's retained Botswana's investment credit ratings of A2 and A-, respectively. The ratings affirmed the Government's strong financial position as underpinned by prudent macroeconomic policies, net external creditor position and low public debt. The rating agencies also recognised the presence of robust institutional frameworks that facilitate prudent policymaking and continuing political stability. However, both rating agencies reiterated the concerns about the country's heavy reliance on the diamond industry, narrow economic base and the slow pace of economic diversification.

With regard to financial performance, the Bank's total assets fell by P7.8 billion to P77.6 billion in December 2016, of which P76.8 billion (P84.9 billion in 2015) was foreign exchange reserves. The reserves were equivalent to 17 months of imports of goods and services. The decrease in foreign exchange reserves, in Pula terms, reflects a drawdown in the Government Investment Account, market and currency valuation losses, the latter being due to the appreciation of the Pula against currencies in which the reserves are held. The Bank's net income for the year was P1.4 billion, compared to P9.1 billion in 2015. After transferring non-distributable

1. The SDR is the IMF's unit of account, comprising of the US dollar, euro, Japanese yen, British pound and the Chinese renminbi.

currency gains of P2.2 billion from the Currency Revaluation Reserve, the net distributable income was P3.6 billion, which was higher than the P2.3 billion given to Government in 2015.

The focus on skills development, through appropriate short- and long-term training programmes, and staff welfare improvement was maintained with a view to sustaining the Bank's operational and leadership capability and productivity.

In addition to the ceremonial activities for the 40th Anniversary, the Bank facilitated a seminar on the *Emerging Role of Central Banks – Policies and Strategies* and hosted the 42nd meeting of the Committee of SADC Central Bank Governors. Earlier in January, the Bank co-hosted, with the International Monetary Fund, a regional conference on “*Small Middle-Income Countries in Sub-Saharan Africa – Raising the Bar*” at which the Deputy Managing Director of the IMF, Mr Min Zhu, delivered a keynote address.

In fulfilment of its statutory obligations, the Bank's *Annual Report* and *Banking Supervision Annual Report* for 2015 were submitted to the Minister of Finance and Economic Development on March 31 and June 30, 2016, respectively. The Bank also continued to publish the monthly *Botswana Financial Statistics*, the biannual *Business Expectations Survey* and the *Research Bulletin*.

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

The management and staff owe a debt of gratitude to the Board for the guidance and support in implementing the 2016 work programme. It is hoped that stakeholders will find the 2016 *Annual Report* informative.



Moses D Pelaelo

GOVERNOR

STATUTORY REPORT ON OPERATIONS AND FINANCIAL STATEMENTS OF THE BANK – 2016

THE BANK'S MISSION AND OBJECTIVES

The mission and primary objectives of the Bank, as stipulated in Section 4 (1) of the Bank of Botswana Act (CAP 55:01), are to: promote and maintain monetary stability, an efficient payments mechanism and the liquidity, solvency and proper functioning of a soundly based monetary, credit and financial system, and, in so far as it would be consistent with the monetary stability objective, to foster monetary, credit and financial conditions conducive to the orderly, balanced and sustainable economic development of the country.

These objectives are pursued through the following:

- (a) monetary policy - monetary stability provides a healthy macroeconomic environment for sustainable economic growth;
- (b) banking regulation and supervision - banks are regulated and supervised to foster operational safety and soundness;
- (c) macro-prudential supervision - financial sector vulnerability assessment and performance monitoring are carried out to help inform policy to maintain financial stability;
- (d) issuance of currency (banknotes and coin) - currency management ensures adequate supply of high quality banknotes and coin to facilitate daily transactions and economic activity;
- (e) central banking, payments and settlement services - the Bank provides banking services to the Government, commercial banks and selected public institutions. Facilitation of payments systems enables the flow of payments and settlement. Moreover, oversight and regulation entrenches confidence in the payments and settlement system and mitigates systemic risks;
- (f) implementation of exchange rate policy - the Bank also implements the Government's exchange rate policy, the objective of which is to promote and maintain competitiveness of domestic firms and contribute to overall macroeconomic stability;
- (g) management of official foreign exchange reserves and make foreign payments on behalf of Government - the Bank manages the country's foreign exchange reserves as an agent of Government. The management of foreign exchange reserves enables the country to meet international financial obligations. The investment guidelines ensure that the reserves are managed prudently to ensure safety, liquidity and return within acceptable risk parameters; and
- (h) economic analysis and policy advice - furthermore, the Bank provides advice to Government on macro-economic and financial policy matters.

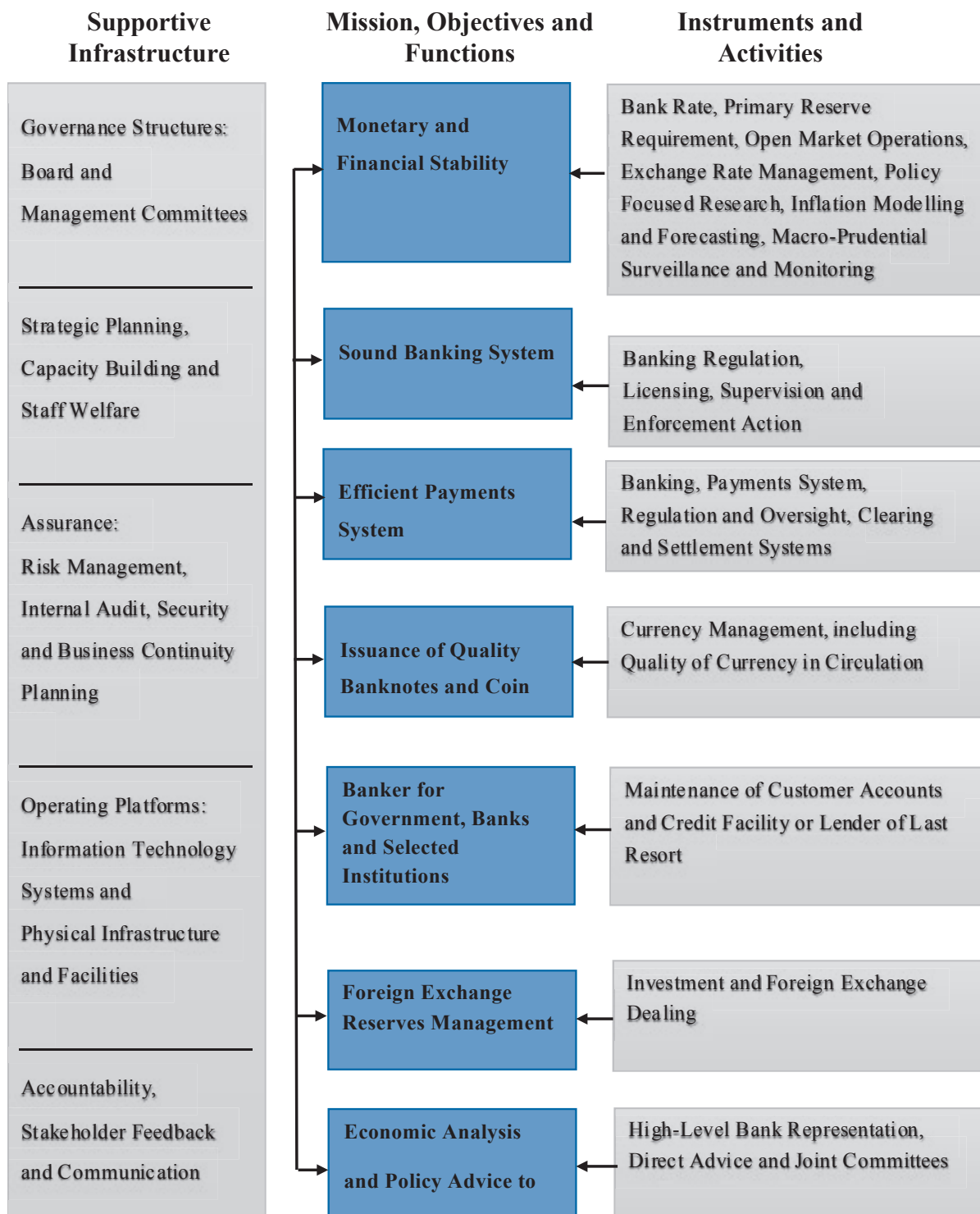
In an endeavour to achieve its mission and objectives, the Bank utilises various strategies, activities and supportive infrastructure as indicated in Figure 1.

GOVERNANCE AND ORGANISATIONAL STRUCTURE

The Bank's functions and key responsibilities, its organisation and how it is held accountable for its performance are as described below.

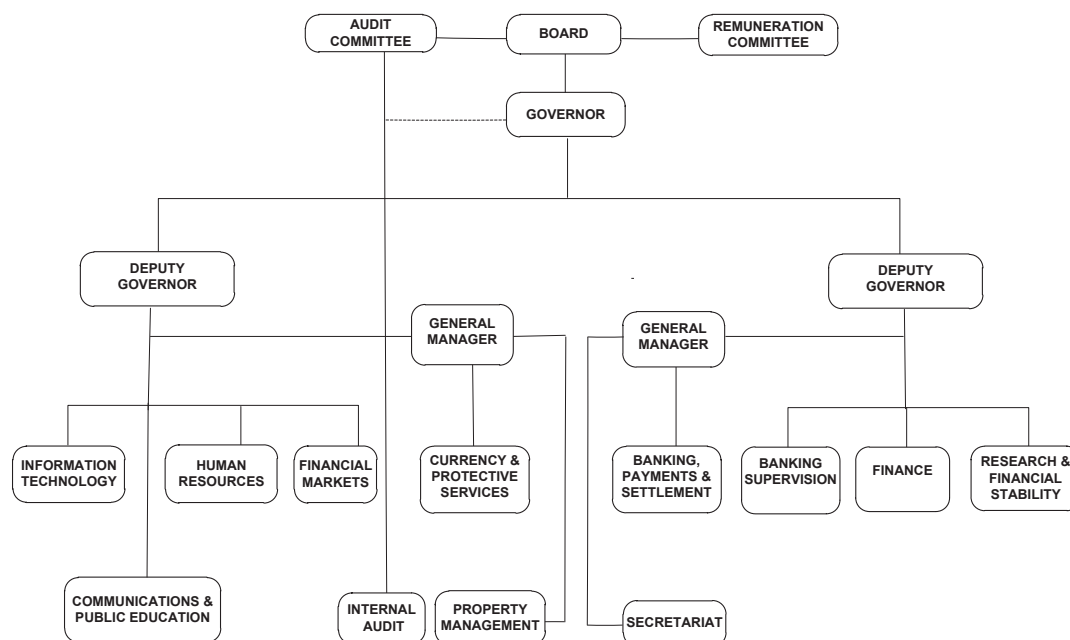
The Board is at the apex of the governance structure of the Bank and it is chaired by the Governor, who is also the Chief Executive Officer of the Bank. The Governor oversees eight departments and four divisions;

FIGURE 1: MISSION, OBJECTIVES, STRATEGIES AND SUPPORTIVE STRUCTURES



supported by two Deputy Governors and two General Managers (Figure 2). The governance structure fosters coordination and synergy between policy-oriented activities and support services, including human resource management and training, adoption of efficiency-enhancing technology, risk, safety and security management, creating a culture of good conduct, staff discipline and adherence to institutional values.

FIGURE 2: ORGANISATION STRUCTURE AS AT DECEMBER 31, 2016



Source: Bank of Botswana

Board Functions, Membership and Appointments

The Board oversees and guides the Bank's general strategic direction, policy formulation and operations in accordance with the Bank of Botswana Act and Bye Laws. It comprises nine members, two of whom are ex-officio members, the Governor and Permanent Secretary of the Ministry of Finance and Economic Development. The other seven members are appointed by the Minister of Finance and Economic Development in their individual capacity, two of whom may be public officers. The Governor and the two Deputy Governors, who are not Board members, are appointed by the President.

The Board has two committees, the Audit Committee (AC) and the Remuneration Committee (REMCO), which are chaired by non-executive board members. The Audit and Remuneration Committees consider issues pertaining to their respective mandates and make recommendations to the Board. The Board is required to meet once a quarter, although in practice it typically meets six times in a year. Indeed, in 2016 there were six Board meetings held (Table 1, oveleaf). The Board approves the Bank's annual budget, monitors the financial and operational performance of the Bank, ensuring that the Bank is well run in accordance with the Bank of Botswana Act and the Bye Laws. At year-end, the Board had seven members and two vacancies.

Governor

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

TABLE 1: BOARD MEETINGS AND ATTENDANCE IN 2016

Meeting	L K Mohohlo (Chairman, Board)	S Sekwakwa (Ex-officio)	G K Cunliffe (Chairman, AC)	R N Matthews (AC)	C S Botlhole- Mmopi (AC)	J Sentsho (REMCO)	P Collier (REMCO)	M Bakwena (Chairman, REMCO)
BB 1/16 (Feb 19)	✓	×	✓	✓	✓	✓	×	✓
BB 2/16 (Mar 24)	✓	✓	✓	✓	✓	×	×	✓
BB 3/16 (Jun 16)	✓	×	✓	✓	✓	✓	×	✓
BB 4/16 (Aug 11)	✓	✓	✓	×	×	✓	✓	✓
BB 5/16 (Sept 23)	✓	×	✓	✓	×	✓	×	✓
BB 6/16 (Dec 8)	NM ¹	✓	✓	✓	×	×	NM	✓

1. The first Board Meeting chaired by the new governor

Key: ✓ Attended
 × Not attended
 BB Board Meeting
 NM No longer a member

Source: Bank of Botswana

Executive Committee

The Executive Committee comprises Deputy Governors, General Managers and Heads of Department and is chaired by the Governor. Senior advisors may be co-opted as members. The Committee has the collective responsibility for advising the Governor on day-to-day administration, including policy formulation, risk and financial management as well as overall governance of the Bank. It meets once a week to monitor and review the implementation of the Bank's work programme.

Departments and Divisions

The Bank has eight departments, four of which are policy departments that fulfil the Bank's core mandates, while four departments provide auxiliary support and corporate services. The Research and Financial Stability Department undertakes data collection, research, macroeconomic analysis, monitors the financial sector and evaluates emerging risks and other developments emanating from the macroeconomic environment. The Department also conducts macro-prudential assessments, and facilitates coordination with other relevant external entities to ensure macroeconomic and financial stability. Furthermore, the Department undertakes macroeconomic forecasting and policy review in support of the Bank's conduct of monetary policy and implementation of the exchange rate policy. Production and dissemination of the Bank's *Annual Report*, monthly *Botswana Financial Statistics* (BFS) and several other Bank publications are also responsibilities of the Research and Financial Stability Department.

The Banking Supervision Department licenses, regulates and supervises banks and other financial institutions that fall under the Bank's regulatory and supervisory purview; and prepares the *Banking Supervision Annual Report*. The Department is also responsible for investigating unauthorised/illegal deposit-taking activities, improper use of banking names as well as market conduct, including fair treatment of customers. The Financial Markets Department is responsible for the management of foreign exchange reserves, foreign exchange dealing, open market operations and other money and capital market activities, which include issuance of government bonds and treasury bills. The provision of banking services to the Government, commercial banks and selected

institutions as well as oversight and regulation of payments and settlement transactions, is carried out by the Banking, Payments and Settlement Department. The Department is also a repository for the country's financial relations with the IMF, World Bank and African Development Bank.

The Finance Department is responsible for accounting and reporting on the Bank's financial activities, including production of monthly and annual financial statements of the Bank, in accordance with the Bank of Botswana Act (CAP 55: 01) and International Financial Reporting Standards (IFRS). The Department also coordinates strategic planning, formulation and implementation of risk management and business continuity management. The Human Resources Department is responsible for staff recruitment, training, remuneration and welfare, while the Information Technology Department ensures that the Bank's information technology systems and infrastructure are robust and effective in meeting the needs of the Bank. The Currency and Protective Services Department is responsible for procurement, management, custody and issuance of the national currency, as well as ensuring the safety of Bank staff, information and property.

The Secretariat serves the Board and Executive Committee and discharges related support functions. It is also responsible for the library, registry, records management and protocol services. Other support services are undertaken through the specialised activities of three divisions: Internal Audit, Communications and Public Education, and Property Management. The Internal Audit Division ensures that the Bank's operations are sound and comply with established financial and operational controls as well as governance structures in line with the Bank of Botswana Act, Audit Committee Charter and international best practice. The Communications and Public Education Division coordinates communications activities in relation to media and effective transmission of information on the Bank's mandate, policies and practices to stakeholders in a timely, efficient and effective manner. The Division also coordinates the Bank's Public Education Programme and policies with the aim of promoting financial and economic literacy and improving public understanding of the Bank's role in economic development of the country. The Property Management Division undertakes procurement, custody and maintenance of immovable and movable assets, including the Bank's related equipment.

REVIEW OF THE BANK'S MAIN ACTIVITIES IN 2016

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

Monetary Policy

The Bank conducts monetary policy primarily through setting of the policy rate (Bank Rate), open market operations and primary reserve requirements. While the Bank may use prudential regulations and moral suasion, the primary instrument to manage liquidity and influence short-term deposit interest rates is Bank of Botswana Certificates (BoBCs).

In 2016, monetary policy was conducted in the context of a positive medium-term inflation outlook. Inflation was either at the lower end of, or below the Bank's 3 – 6 percent objective range throughout the year due to modest domestic demand, downward adjustment in fuel prices as well as benign foreign price developments. In view of the positive inflation outlook and in order to support economic growth, the Bank Rate was reduced by 0.5 percentage points from 6 percent to 5.5 percent during the year. The conduct of monetary policy also took into consideration the need to maintain financial stability. Among others, the relevant considerations relate to liquidity developments, credit dynamics (expansion and loan default rates) relative to economic activity (including property market developments) and growth in incomes as well as financial sector performance.

Money and Capital Markets

Monetary policy was implemented using open market operations (OMO) to absorb excess liquidity to ensure

TABLE 2: MONEY MARKET 2015-2016

	End-2015			End-2016		
	Interest rate (Percent) ¹			Interest rate (Percent) ¹		
	Outstanding balances ² (P Billion)	Nominal	Real	Outstanding balances ² (P Billion)	Nominal	Real
6-month Treasury Bills ^{1,3}	0.84	1.61	-1.45	1.0	1.00	-1.94
14-day BoBCs ¹	4.2	0.97	-2.07	3.9	0.84	-2.10
91-day BoBCs ¹	4.0	1.17	-1.87	4.0	1.01	-1.93
Reverse repos	1.7	1.50	-1.55	1.3	1.0	-1.94
Repos	0	5.50	2.33	0	5.0	1.94
88-day deposits for commercial banks	9.5	2.50	-0.58	2.1	2.03	-0.94
Prime rate		7.50	4.27		7.0	3.88

1. The stop-out yield is used for Treasury Bills, while the weighted average yield is used for both the 14-day and 91-day BoBC yields.

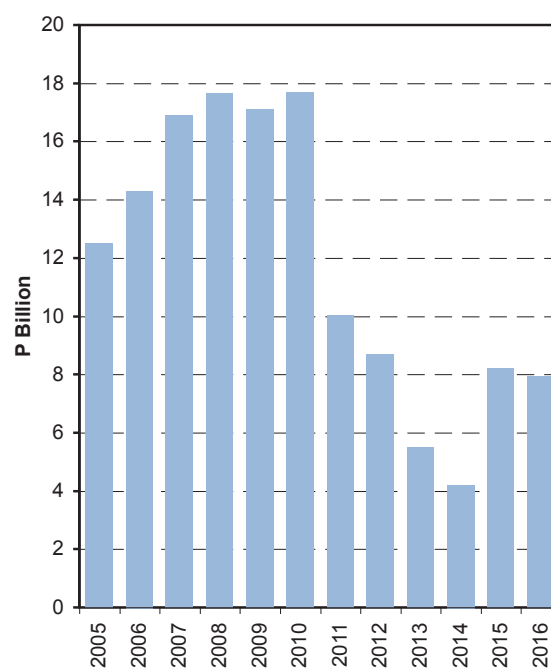
2. Book value

3. Original date to maturity

Source: Bank of Botswana

levels of interest rates that were consistent with the policy stance. The outstanding value of Bank of Botswana Certificates (BoBCs) decreased from P8.2 billion at the end of 2015 to P7.9 billion in December 2016. Repurchase Agreements (repos) and reverse repos were used during the year to manage liquidity in between BoBCs auctions, resulting in outstanding reverse repos of P1.3 billion at the end of 2016 compared to P1.7 billion in December 2015. As in 2015, there were no outstanding repos at the end of 2016 (Table 2 and Chart 1).

The 14-day BoBC weighted average yield decreased from 0.97 percent in December 2015 to 0.84 percent in December 2016, while the yield on the 91-day BoBC decreased from 1.17 percent to 1.01 percent in the same period. The prime lending rate of the commercial banks decreased from 7.5 percent in 2015 to 7 percent in 2016 in line with the Bank's decision to reduce the Bank Rate by 0.5 percentage points during the year. Meanwhile, the nominal 3-month (88-day) deposit interest rate decreased from 2.5 percent in December 2015 to 2.03 percent at the end of 2016. In line with the Bank's commitment to encourage savings, commercial banks continued to offer and advertise the 91-day deposit facility or equivalent deposit product which pays an interest rate that, at a minimum, is the prevailing Bank Rate less 3.5 percentage points,¹ with higher interest rates for longer-dated deposits.

CHART 1: BANK OF BOTSWANA CERTIFICATES 2005 – 2016


Source: Bank of Botswana

¹ Given the Bank Rate of 5.5 percent, the minimum deposit interest rate was 2 percent for the 91-day and equivalent deposit facilities.

The P15 billion Government Bond Programme remains in place, with a focus on the development of the capital market, as well as providing an alternative source of government funding. The Government continued borrowing from the domestic market in 2016. Outstanding bonds of various maturities and Treasury Bills increased from P7.196 billion at the end of 2015 to P9.258 billion in December 2016 (Table 3). Primary dealers (commercial banks) and their customers held P3.05 billion (32.93 percent) and P6.19 billion (66.85 percent), respectively, of the government securities outstanding at the end of 2016. Meanwhile, the Bank held P20 million (0.28 percent) of the total outstanding securities for possible repo transactions.

TABLE 3: GOVERNMENT BONDS AND TREASURY BILLS 2015 – 2016

Bond Code ⁴	End 2015			End 2016		
	Outstanding (P Million) ^{1,2}	Market Yields ³ (Percent)		Outstanding (P Million) ^{1,2}	Market Yields ³ (Percent)	
		Yield	Real		Yield	Real
6-month Treasury Bills	840	1.60	-1.25	1 000	1.00	-1.94
BW010 (14/03/2017)	718	3.54	0.62	718	2.40	-0.58
BW005 (12/09/2018)	1 338	3.83	0.90	1 808	3.02	0.02
BW008 (08/09/2020)	1 083	4.59	1.64	1 564	4.05	1.02
BW007 (10/03/2025)	1 410	4.96	2.00	1 629	4.59	1.54
BW011 (10/09/2031)	1 370	5.52	2.55	1 653	5.19	2.13
BW012 (13/06/2040)	437	5.86	2.59	886	5.44	2.37
	7 196			9 258		

1. Where outstanding values differ for the same bond code between the two years, it means the bond was reopened for issuing an additional amount.
2. Book value.
3. Indicative yields.
4. Maturity dates are in parentheses.

Source: Bank of Botswana

Exchange Rate Policy

The Bank acts as the Government's agent in implementing the exchange rate policy. In accordance with the Bank of Botswana Act, the framework for the determination of the external value of the Pula is set by His Excellency, the President, on recommendation by the Minister of Finance and Economic Development, after consultation with the Bank. The Bank implemented a 0.38 percent upward rate of crawl of the nominal effective exchange rate (NEER) during 2016, as projected inflation was close to the lower end of the medium-term objective range and lower than the expected average inflation for trading partner countries. The Pula basket weights were maintained at 50 percent each for the South African rand and Special Drawing Rights (SDR). In October 2016, the Chinese renminbi was included in the SDR basket, automatically becoming part of the Pula basket. In the twelve months to December 2016, the trade-weighted NEER of the Pula appreciated by 0.38 percent, consistent with the rate of crawl of the Pula exchange rate. However, the real effective exchange rate (REER) depreciated by 0.8 percent in 2016, as the difference between inflation in Botswana and that of trading partner countries more than offset the rate of crawl. Lower inflation in Botswana than in trade partner countries contributes to an improvement in international competitiveness of domestic industry and, thereby, is supportive of national objectives of economic diversification and employment creation.

For 2017, the Pula basket weights have been adjusted to 45 percent for the South African rand and 55 percent for the SDR, with a slower upward rate of crawl of 0.26 percent. The enhanced transparency engendered by the disclosure of Pula exchange rate parameters helps to reduce uncertainty surrounding exchange rate policy

and enriches information used in making financial and investment decisions by economic agents.

Supervision and Regulation of Banks and Bureaux de Change

During 2016, the Bank continued to monitor the performance of banks through a system of monthly and quarterly returns, risk-based supervision, on-site examinations and regular consultative meetings with each bank. The banking sector was adequately capitalised, profitable and liquid as at December 31, 2016. The industry's compliance with the regulatory and prudential requirements was satisfactory, as shown in Table 4. Most banks reported higher levels of profit compared to the previous year, with the exception of Standard Chartered Bank, First National Bank, Bank of India and Bank SBI. The banking sector's balance sheet increased by 5.2 percent from P76.7 billion (December 2015) to P80.7 billion as at December 31, 2016. The industry's total deposits increased by 4.1 percent from P60 billion in 2015 to P62.4 billion in 2016, compared to an increase of 6.2 percent in loans and advances from P48.3 billion in 2015 to P51.3 billion in 2016. As a result, the financial intermediation ratio² increased marginally from 0.81 in 2015 to 0.82 in 2016.

The liquidation of the defunct Kingdom Bank Africa Limited (KBAL) and the subsequent litigation instituted

TABLE 4: FINANCIAL SOUNDNESS INDICATORS AND RANGE OF PRUDENTIAL STANDARDS FOR LICENSED BANKS (2013 - 2016)

Prudential and Financial Indicators	Prudential Standard (Percent)	Range of Indicators for Local Banks (Percent)			
		2013	2014	2015	2016 ¹
Capital Adequacy	≥15	16.2 – 24.3	16.1 – 23.1	16.4 – 31.0	16.3 – 35.9
Liquid Asset Ratio	≥10	12 – 36	10.5 – 19.6	2.9 – 28.6	10.3 – 36.5
Profitability (Return on Assets)	Positive	0.7 – 4.0	0.2 – 3.8	(1.0) – 2.7	(1.9) – 2.5
Profitability (Return on Equity)	Positive	6 – 32	2.1 – 27.7	(6.4) – 21.4	(10.5) – 20.4
Asset Quality (Non-Performing Loans/ Total Loans)	≤2.5	0.6 – 11.6	0.6 – 11.8	0.6 – 8.4	0.8 – 8.5
Intermediation (Advances/Deposits)	50 - 80	63 - 86	68.7 - 94.9	51.1 - 104.6	58 - 91.3

1. Figures as at September 30, 2016

Source: Bank of Botswana

by one of its major creditors against the Bank of Botswana for alleged negligence in the performance of statutory duties, were ongoing as at December 31, 2016.

Abandoned funds continued to be administered in accordance with Section 39 of the Banking Act (CAP. 46:04). As at December 31, 2016, the total abandoned funds balance had increased to P6.9 million, from P5.5 million in December 31, 2015. During the year, an amount of P372 291 was claimed, while P547 055 was transferred to the Guardian Fund.³

Following extensive industry consultations, spanning over several years and a one year parallel-run, the Bank adopted the revised International Convergence of Capital Management and Capital Standards (Basel II/III) as a basis for determining the minimum regulatory capital adequacy requirements for banks in Botswana. This is aimed at strengthening and safeguarding the soundness of banks and, in general, the resilience of the banking system.

2 The financial intermediation ratio is calculated as the liabilities of the financial corporations divided by the sum of the liabilities of all the other sectors. It is a measure of the degree of financial intermediation of an economy.

3 The Guardian Fund is administered under the Administration of Estate Act (CAP 31:01). It is under the custody of the Master of the High Court and was created to hold and administer funds whose rightful owners could not be located immediately.

In addition to its prudential supervisory role, the Bank continued to monitor business conduct to ensure that banks treat their customers in a fair, professional and transparent manner. Following the expiry of a two-year moratorium on upward adjustment of banking tariffs (non-interest fees), the Bank allowed commercial banks to adjust fees as necessary, balanced against the need for the bank charges to be commensurate with the quality of service and not be a deterrent to savings mobilisation and cost-effective access to banking services. Overall, the banking sector remained solvent, profitable and prudently managed.

Foreign Exchange Reserves Management

In 2016, global financial markets were affected by two major developments, namely, the decision by the United Kingdom to leave the European Union and the outcome of presidential elections in the United States of America. These events led to significant market volatility and policy uncertainty which adversely impacted global economic growth prospects. At the end of December 2016, foreign exchange reserves amounted to P76.8 billion, a decrease of 9.5 percent from P84.9 billion in December 2015 and represented 17 months of import cover.⁴ In US dollar terms, the level of reserves decreased by 4.7 percent to USD7.2 billion and in SDR terms they decreased by 1.9 percent to SDR5.4 billion over the same period. The decrease in foreign exchange reserves (both in Pula and foreign currency terms) reflects, among others, market revaluation losses, foreign currency translation losses, which resulted from the appreciation of the Pula against currencies in which the reserves are held, and a drawdown of reserves to meet government obligations.

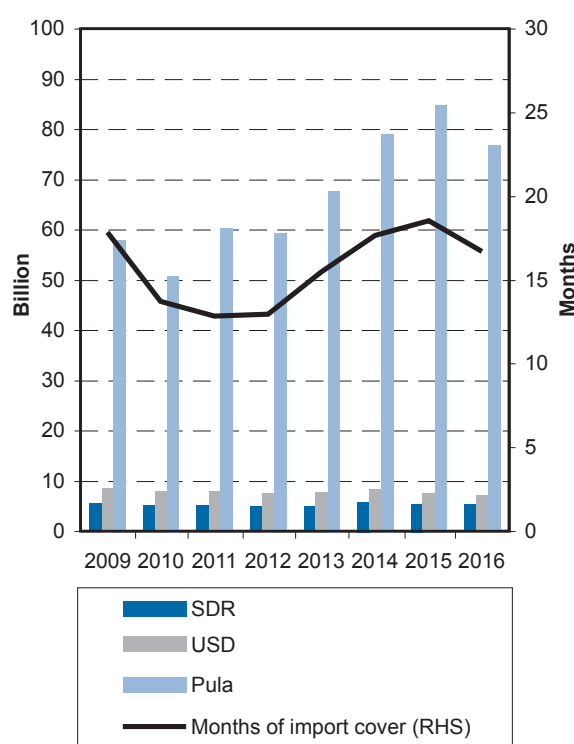
The national (official) foreign exchange reserves are managed by the Bank in accordance with Board approved investment policies and guidelines underpinned by the key objectives of safety, liquidity and return within well-defined risk parameters. The foreign exchange reserves, tranching into two portfolios, the Liquidity Portfolio and the long-term (Pula Fund) portfolio, are managed prudently using a diversified pool of high quality financial instruments traded in deep and liquid international markets. In addition to its staff, the Bank uses selected international fund managers to manage a portion of the foreign exchange reserves and, also, employs the services of a reputable, well-rated global custodian to safeguard the reserve assets.

Currency Operations

The Bank continued to monitor the supply and quantity of banknotes and coin in circulation, withdrawing from circulation and destroying soiled and damaged currency; replacing it with banknotes and coin of high acceptable standard, in accordance with the Bank's Clean Banknote Policy. The Bank continued to develop strategies against banknote counterfeiting activities in collaboration with the Botswana Police Service and other law enforcement agencies.

The annual rate of growth of banknotes in circulation decreased from 8.3 percent in 2015 to 6.2 percent in

CHART 2: FOREIGN EXCHANGE RESERVES



Source: Bank of Botswana

⁴ The calculation of import cover excludes imports of rough diamonds, as these are mainly for re-export.

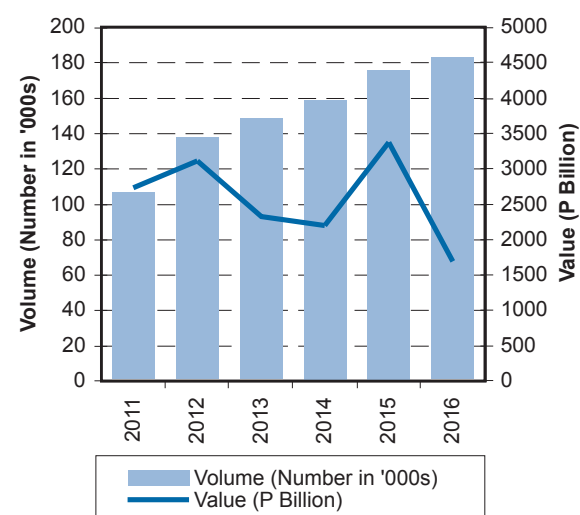
2016. Notably, the rate of increase in net issuance of P20 and P10 banknote denominations decreased from 17.8 percent and 19.4 percent in 2015, to 5.1 percent and 6.5 percent, respectively, in 2016. The P20 denomination continued to have the highest share of total issuance at 29.5 percent in 2016. The net issuance of all coin denominations increased by 6 percent in 2016, less than the increase of 10.4 percent in 2015. The relatively low net issuance in 2016 was attributable to sufficiency of coin issued into the market and the fact that coin is exchanged at commercial banks and not ordinarily returned to the Bank of Botswana.

Banking Operations, Payments and Settlement

The National Payments System landscape continued to evolve, as evidenced by an increase in participants and new payment methods associated with information and communications technology developments. These necessitated a close monitoring of the operations and provision of oversight in respect of Systemically Important Payment Systems (SIPS) licensed by the Bank to provide payments and financial services. Consistent with its oversight responsibilities, the Bank continued to foster and monitor these developments, while promoting measures aimed at mitigating related risks.

Transactions processed through the Botswana Interbank Settlement System (BISS) and the electronic clearing house (electronic funds transfer) increased in volume during 2016, while the volume of cheque transactions continued to decline (Charts 3 - 5). The Bank continually upgrades the relevant systems and other risk mitigation measures in order to maintain a safe and secure operating environment for electronic funds transfer and messaging, while also complying with international regulatory requirements for processing financial transactions. With regard to monitoring of SIPS, internationally prescribed

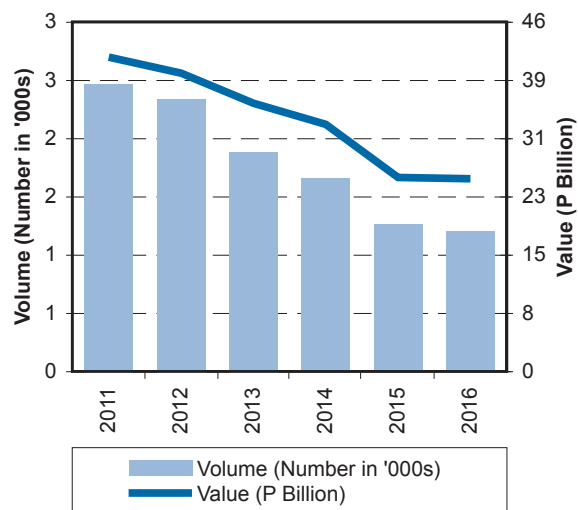
CHART 3: BOTSWANA INTERBANK SETTLEMENT SYSTEM (BISS) TRANSACTIONS (2011 - 2016)



1 Effective June 2016, the BISS values are adjusted to exclude Botswana Automated Clearing House (BACH) Net Settlement Instructions and cancelled payments.

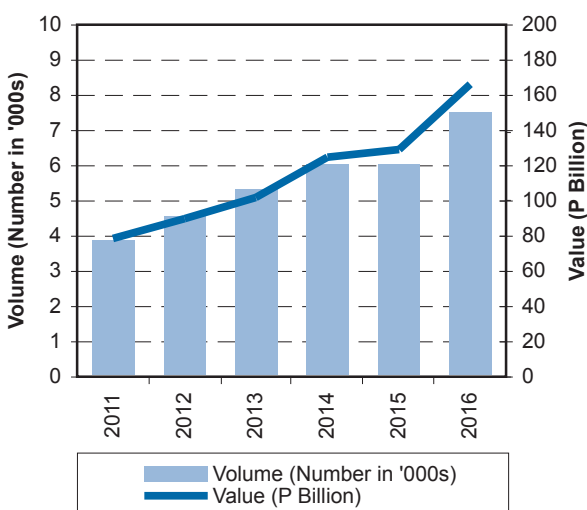
Source: Bank of Botswana

CHART 4: ELECTRONIC CLEARING HOUSE: CHEQUE PROCESSING (2011 - 2016)



Source: Bank of Botswana

CHART 5: ELECTRONIC CLEARING HOUSE: ELECTRONIC FUNDS TRANSFERS (2011 - 2016)



Source: Bank of Botswana

operating standards for financial market infrastructures (FMIs) are applied for effective management and mitigation of risks and to engender resilience.

One commercial bank (First National Bank of Botswana) participates in the Southern African Development Community's Integrated Regional Settlement System (SIRESS). SIRESS was launched in July 2013 to facilitate and lower the costs of regional cross border transactions. It is considered an important milestone towards regional trade facilitation and economic integration.

Information Technology

The Bank's computing and information systems continued to be upgraded in line with innovation and technological advancements and in order to meet evolving functional and strategy requirements, while also allowing for effective internal and external connectivity. Cyber-crime and international regulatory compliance pose major challenges for the global financial industry. The Bank allocated substantial resources to upgrade its banking information technology systems to ensure security and protection of its mission-critical systems as well as to achieve operational efficiency.

The Bank played a leading role in the development of IT Security Guidelines for SADC central banks in line with the ISO 27001/2 international IT Security Standard. These guidelines were presented to the Committee of Central Bank Governors (CCBG) IT Sub-Committee and have been adopted by the SADC central banks for implementation.

Human Resources, Staff Welfare and Staff Pension Fund

Human Resources and Staff Welfare

As at December 31, 2016, the Bank's Staff Establishment was 590, compared to 593 in December 31, 2015. The vacancy rate stood at 8.5 percent, down from 9.4 percent in 2015. Twenty nine (29) staff joined the Bank, while 26 terminated employment. The Bank continued to place emphasis on staff development and, in this regard, several staff members benefited from both short- and long-term training. The Bank has established staff committees and clubs to coordinate staff welfare activities, including health and wellness, and sports.

Staff Pension Fund

The Bank of Botswana Defined Contribution Staff Pension Fund declared an investment return of 7.5 percent and 6.94 percent for the active and deferred members, respectively, for the year ended September 30, 2016. This compares to the 2015 declared return of 11.42 percent and 10.86 percent for the active and deferred members, respectively.

External Relations, Special Events and Communication

External Relations

The Bank participated in relevant regional and international meetings, as well as hosting conferences, consultation, surveillance and technical assistance missions. The Bank also took part in meetings and conferences organised by the World Economic Forum, Bank for International Settlements, World Bank and International Monetary Fund. At a regional level, the Bank participated in meetings organised by Southern African Customs Union (SACU), SADC CCBG, Association of African Central Banks (AACB) and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI). In addition, the Bank hosted Moody's Investors Service (Moody's) and Standard & Poor's (S&P) sovereign credit rating agencies. Moody's reviewed and reaffirmed, for 2016, Botswana's credit rating of A2 for foreign and domestic bonds (stable outlook), while S&P reaffirmed the ratings of "A-" for long-term bonds and "A-2" for short-term bonds in domestic and foreign currency denominated borrowing and maintained the negative outlook.

Special Events

The Bank successfully hosted the 42nd ordinary meeting of the SADC CCBG which was attended by SADC central banks. Furthermore, the Bank hosted the IMF Deputy Managing Director, Mr Min Zhu, as well as co-hosting, with the IMF, a regional conference on Small Middle-Income Countries in Sub-Saharan Africa – Raising the Bar. The Bank commemorated its 40th anniversary on March 31, 2016 under the theme of “History of Growth and Adaptation”. His Excellency, the President delivered a keynote address and launched the commemorative activities, which included a symposium on “The Emerging Roles of Central Banks – Policies and Strategies”.

Publications, Communications and Public Education

The Bank submitted the *2015 Annual Report* on the Bank’s operations and financial statements and the *2015 Banking Supervision Annual Report* in accordance with statutory requirements to the Minister of Finance and Economic Development on March 31, 2016 and June 30, 2016, respectively. The 2016 Monetary Policy Statement (and Mid-Term Review), monthly *Botswana Financial Statistics* and *Research Bulletin* were also published, while the Bank’s website provided timely access to data, publications, press releases and the Bank’s policies.

In fulfilment of accountability and transparency principles of governance and in the implementation of the public outreach programme, the Bank conducted economic briefings following the publication of the *2015 Annual Report*. Among key stakeholders briefed were the Cabinet, heads/representatives of diplomatic missions, heads of public and private sector institutions, senior government officials and the media.



ANNUAL FINANCIAL STATEMENTS

2016

BANK OF BOTSWANA

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STATEMENT OF RESPONSIBILITY OF THE BOARD AND APPROVAL OF THE ANNUAL FINANCIAL STATEMENTS

The members of the Board are responsible for the preparation and fair presentation of the annual financial statements of the Bank, comprising the Statement of Financial Position at December 31, 2016, Statement of Profit or Loss and Other Comprehensive Income, Statement of Distribution, Statement of Cash Flows and Statement of Changes in Shareholder's Funds for the year then ended, and the notes to the financial statements.

These financial statements include a summary of significant accounting policies and other explanatory notes, in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

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

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

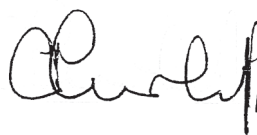
The independent external auditor is responsible for reporting on whether the annual financial statements are fairly presented in accordance with the applicable financial reporting framework.

Approval of Annual Financial Statements

The annual financial statements of the Bank, as identified in the first paragraph, were approved by the Board on March 28, 2017 and signed on behalf of the Board by:



Moses D Pelaelo
Governor



Gordon K Cunliffe
Board Member
(Audit Committee Chairman)



KPMG, Chartered Accountants
 Audit
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 Telephone +267 391 2400
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 Web <http://www.kpmg.com/>

**Independent Auditor's Report
 To the Members of the Board of the Bank of Botswana**

Opinion

We have audited the financial statements of the Bank of Botswana ("the Bank"), which comprise the statement of financial position as at December 31, 2016, the statements of profit or loss and other comprehensive income, distribution, cash flows and changes in shareholder's funds for the year then ended and notes, which include a summary of significant accounting policies, as set out on pages 37 to 69.

In our opinion, the financial statements give a true and fair view of the financial position of Bank of Botswana as at December 31, 2016 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountant's Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Members of the Board are responsible for the other information. The other information obtained at the date of this auditors' report is the "Statement of Responsibility of the Board and Approval of the Annual Financial Statements". The other information does not include the financial statements and our auditor's report thereon.



Other Information (Continued)

Our opinion on the financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, members of the Board are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the members of the Board either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the members of the Board.
- Conclude on the appropriateness of the members of the Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the members of the Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the members of the Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

A handwritten signature in black ink, appearing to read 'AG Devlin', written in a cursive style.

KPMG

Certified Auditors

Practicing member: AG Devlin (19960060:23)

March 28, 2017

Gaborone

STATEMENT OF FINANCIAL POSITION

For the year ended December 31, 2016

	Notes	2016 P'000	2015 P'000
ASSETS			
Foreign Assets			
Liquidity Portfolio	1.1	21 211 469	21 914 420
Pula Fund	1.2	54 145 500	61 183 450
International Monetary Fund (IMF)			
Reserve Tranche	2.1	585 663	424 539
Holdings of Special Drawing Rights	2.2	839 790	1 334 931
General Subsidy Account	2.3	21 845	23 666
Total Foreign Assets		76 804 267	84 881 006
Domestic Assets			
Property and Equipment	3	395 771	403 770
Government of Botswana Bond	4	22 901	23 733
Other Assets	5	370 395	122 604
Total Domestic Assets		789 067	550 107
TOTAL ASSETS		77 593 334	85 431 113
LIABILITIES AND SHAREHOLDER'S FUNDS			
Foreign Liabilities			
Allocation of IMF Special Drawing Rights	6	825 107	893 912
Liabilities to Government (IMF Reserve Tranche)	7	86 615	358 931
Total Foreign Liabilities		911 722	1 252 843
Domestic Liabilities			
Notes and Coin in Circulation	8	2 858 135	2 707 835
Bank of Botswana Certificates	9	7 918 371	8 189 922
Reverse Repurchase Agreements	9.1	1 302 879	1 672 849
Deposits	10	6 307 357	5 067 372
Dividend to Government	11	2 205 952	401 782
Other Liabilities	12	352 439	129 509
Total Domestic Liabilities		20 945 133	18 169 269
Total Liabilities		21 856 855	19 422 112
Shareholder's Funds			
Paid-up Capital	14	25 000	25 000
Government Investment Account			
Pula Fund and Liquidity Portfolio		29 109 428	35 504 942
Currency Revaluation Reserve		20 455 967	23 911 754
Market Revaluation Reserve		4 546 084	4 967 305
General Reserve	15	1 600 000	1 600 000
Total Shareholder's Funds		55 736 479	66 009 001
TOTAL LIABILITIES AND SHAREHOLDER'S FUNDS		77 593 334	85 431 113
FOREIGN ASSETS IN US DOLLARS (000) ¹		7 188 879	7 545 921
FOREIGN ASSETS IN SDR ² (000)		5 345 577	5 449 361

¹ United States dollar/Pula – 0.0936 (2015: 0.0889)

² SDR/Pula – 0.0696 (2015: 0.0642)

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
For the year ended December 31, 2016

	Notes	2016 P'000	2015 P'000
INCOME			
Interest – Foreign exchange reserves	16	1 190 868	1 271 312
Dividends – Foreign exchange reserves	17	520 137	562 428
Interest – Government of Botswana bond		2 003	1 997
Net realised fair value gains on disposal of securities	18	2 505 803	991 575
Net realised currency gains	19	3 617 572	3 099 736
Net unrealised currency gains	20	–	3 868 432
Net unrealised fair value gains	21	50 586	–
Profit on foreign exchange deals		37 830	38 109
Other income		11 978	73 428
		<u>7 936 777</u>	<u>9 907 017</u>
EXPENSES			
Interest expense	22	92 536	182 601
Administration costs		497 815	442 301
Depreciation expense	3	26 231	26 694
Net unrealised currency losses	20	5 916 948	–
Net unrealised fair value losses	21	–	120 037
		<u>6 533 530</u>	<u>771 633</u>
NET INCOME		1 403 247	9 135 384
OTHER COMPREHENSIVE (LOSS)/INCOME			
Items that may be reclassified subsequently to profit or loss			
Net unrealised currency (losses)/gains on non-monetary “available-for-sale” financial instruments		(3 401 924)	2 249 189
Net unrealised fair value losses on “available-for-sale” financial instruments		(1 514 801)	(325 205)
		<u>(4 916 725)</u>	<u>1 923 984</u>
TOTAL COMPREHENSIVE (LOSS)/INCOME		<u>(3 513 478)</u>	<u>11 059 368</u>

STATEMENT OF DISTRIBUTION
For the year ended December 31, 2016

	Notes	2016 P'000	2015 P'000
TOTAL COMPREHENSIVE INCOME		(3 513 478)	11 059 368
Net unrealised currency losses/(gains) on non-monetary "available-for-sale" financial instruments		3 401 924	(2 249 189)
Net unrealised fair value losses on "available-for-sale" financial instruments		1 514 801	325 205
NET INCOME		1 403 247	9 135 384
TRANSFER FROM/(TO) CURRENCY REVALUATION RESERVE	23	2 240 738	(6 869 975)
NET INCOME TO GOVERNMENT		3 643 985	2 265 409
TRANSFER TO GOVERNMENT INVESTMENT ACCOUNT		(802 033)	(1 132 377)
DIVIDEND		(848 000)	(975 000)
RESIDUAL NET INCOME	11	(1 993 952)	(158 032)

STATEMENT OF CASH FLOWS
For the year ended December 31, 2016

	Notes	2015 P'000	2014 P'000
OPERATING ACTIVITIES			
Cash generated from operations	26	4 242 428	5 805 846
INVESTING ACTIVITIES			
Net withdrawals from foreign exchange reserves		578 992	3 123 371
Interest received from Government of Botswana bond		2 003	1 997
Proceeds from disposal of property and equipment		1 030	1 234
Purchase of property and equipment	3	(19 879)	(18 489)
NET CASH GENERATED FROM INVESTING ACTIVITIES		562 146	3 108 113
FINANCING ACTIVITIES			
Dividend to Government	11	(1 037 782)	(1 275 939)
Government withdrawals		(3 917 092)	(7 747 246)
NET CASH USED IN FINANCING ACTIVITIES		(4 954 874)	(9 023 185)
NET INCREASE IN CURRENCY IN CIRCULATION		(150 300)	(109 226)
CURRENCY IN CIRCULATION AT BEGINNING OF THE YEAR		(2 707 835)	(2 598 609)
CURRENCY IN CIRCULATION AT YEAR END		(2 858 135)	(2 707 835)

STATEMENT OF CHANGES IN SHAREHOLDER'S FUNDS
For the year ended December 31, 2016

	Paid-up Capital P'000	Currency Revaluation Reserve P'000	Market Revaluation Reserve P'000	General Reserve P'000
BALANCE AT JANUARY 1, 2015	25 000	19 728 010	5 216 279	1 600 000
Total profit and other comprehensive income	–	2 249 189	(325 205)	–
Net unrealised currency gains on non-monetary “available for sale” financial instruments	–	2 249 189	–	–
Net unrealised fair value losses on “available for sale” financial instruments	–	–	(325 205)	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	(4 935 420)	76 231	–
Net unrealised fair value losses	–	–	76 231	–
Net unrealised currency gains	–	(4 935 420)	–	–
Excess of Government’s share of net income from Pula Fund over dividend	–	–	–	–
Government withdrawals	–	–	–	–
Transfer to Currency Revaluation Reserve	–	6 869 975	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2015	25 000	23 911 754	4 967 305	1 600 000
Total profit and other comprehensive income	–	(3 401 924)	(1 514 801)	–
Net unrealised currency losses on non-monetary “available for sale” financial instruments	–	(3 401 924)	–	–
Net unrealised fair value losses on “available for sale” financial instruments	–	–	(1 514 801)	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	2 186 875	1 093 580	–
Net unrealised fair value losses	–	–	1 093 580	–
Net unrealised currency gains	–	2 186 875	–	–
Excess of Government’s share of net income from Pula Fund over dividend	–	–	–	–
Government withdrawals	–	–	–	–
Transfer to Currency Revaluation Reserve	–	(2 240 738)	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2016	25 000	20 455 967	4 546 084	1 600 000

Government Investment Account P'000	Accumulated Profit P'000	Total P'000	
37 260 622	–	63 829 911	BALANCE AT JANUARY 1, 2015
–	9 135 384	11 059 368	Total profit and other comprehensive income
–	–	2 249 189	Net unrealised currency gains on non-monetary “available for sale” financial instruments
–	–	(325 205)	Net unrealised fair value losses on “available for sale” financial instruments
–	9 135 384	9 135 384	Net income
(1 755 680)	(1 132 377)	(7 747 246)	Transfers (to)/from Government Investment Account:
(76 231)	–	–	Net unrealised fair value losses
4 935 420	–	–	Net unrealised currency gains
1 132 377	(1 132 377)	–	Excess of Government’s share of net income from Pula Fund over dividend
(7 747 246)	–	(7 747 246)	Government withdrawals
–	(6 869 975)	–	Transfer to Currency Revaluation Reserve
–	(975 000)	(975 000)	Dividend to Government
–	(158 032)	(158 032)	Residual net income
35 504 942	–	66 009 001	BALANCE AT DECEMBER 31, 2015
–	1 403 247	(3 513 478)	Total profit and other comprehensive income
–	–	(3 401 924)	Net unrealised currency losses on non-monetary “available for sale” financial instruments
–	–	(1 514 801)	Net unrealised fair value losses on “available for sale” financial instruments
–	1 403 247	1 403 247	Net income
(6 395 514)	(802 033)	(3 917 092)	Transfers (to)/from Government Investment Account:
(1 093 580)	–	–	Net unrealised fair value losses
(2 186 875)	–	–	Net unrealised currency gains
802 033	(802 033)	–	Excess of Government’s share of net income from Pula Fund over dividend
(3 917 092)	–	(3 917 092)	Government withdrawals
–	2 240 738	–	Transfer to Currency Revaluation Reserve
–	(848 000)	(848 000)	Dividend to Government
–	(1 993 952)	(1 993 952)	Residual net income
29 109 428	–	55 736 479	BALANCE AT DECEMBER 31, 2016

SIGNIFICANT ACCOUNTING POLICIES

For the year ended December 31, 2016

REPORTING ENTITY

The Bank of Botswana (“the Bank”) is the central bank of Botswana established under the Bank of Botswana Act (CAP 55:01). The address of the Bank’s registered office is 17938 Khama Crescent, Gaborone. These financial statements apply to the financial year ended December 31, 2016. The Government of Botswana is the Bank’s sole shareholder.

BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

Statement of Compliance

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

The Financial Statements were authorised for issue by the Board on March 28, 2017.

Basis of Measurement

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

Functional and Presentation Currency

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

ADOPTION OF REVISED STANDARDS AND INTERPRETATIONS

As at the date of finalisation of the financial statements, the following standards were relevant to the Bank’s operations and available for adoption.

Standard	Effective for annual periods beginning on or after
<p>Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation</p> <p>The clarification states that the revenue-based methods of depreciation are not acceptable, as these methods reflect generation of economic benefits by the asset, and not consumption of the asset.</p> <p>The amendments to IAS 38; Intangible Assets introduces rebuttable presumption that the use of revenue-based amortisation methods for intangible assets is inappropriate. The presumption can be overcome only when revenue and the consumption of the economic benefits of the intangible assets are “highly correlated” or when the intangible asset is expressed as a measure of revenue.</p> <p>The Bank uses the straight line method of depreciation, and not the revenue-based method, hence the amendments have had no impact on the Bank’s financial statements.</p>	January 1, 2016
<p>Amendments to IAS 1 – Disclosure Initiative</p> <p>The amendments clarify that information should not be obscured by aggregating or providing immaterial information: materiality considerations must apply to all parts of the financial statements; and that even when a standard requires a specific disclosure, materiality considerations must apply.</p> <p>Adoption of the amendments has not had any impact on the financial statements of the Bank.</p>	January 1, 2016

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2016

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

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

Standard	Effective for annual periods beginning on or after
<p>Disclosure Initiative (Amendments to IAS 7)</p> <p>The amendments provide for disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. This includes providing a reconciliation between the opening and closing balances for liabilities arising from financing activities.</p> <p>The amendments will result in the Bank providing additional disclosures relating to the changes in liabilities arising from financing activities in the financial statements.</p>	January 1, 2017
<p>IFRS 9 - Financial Instruments (Replacement of IAS 39)</p> <p>IFRS 9, published in July 2014, replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 sets out the requirements for recognising and measuring financial assets, financial liabilities, and some contracts to buy and sell non-financial assets. Financial assets and liabilities are to be classified and measured based on the entity's business model on which they are held, and the characteristics of their contractual cash flows. IFRS 9 includes revised guidelines on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets and the new hedge accounting requirements.</p> <p>The standard will result in a reclassification of financial instruments into different categories. The impact on the Bank's results and financial position will continue to be monitored.</p>	January 1, 2018
<p>IFRS 15 – Revenue from Contracts with Customers</p> <p>The standard, issued in May 2014, replaces IAS 18 Revenue and other revenue standards. It contains a single model that applies to contracts with customers and two approaches to recognising revenue at a point in time or over time. The model features a contract-based five step analysis of transactions to determine whether, how much and when revenue is recognised.</p> <p>The standard is not expected to have a significant impact on the Bank's financial statements due to the nature of revenue transactions.</p>	January 1, 2018
<p>IFRS 16 - Leases (Replacement of IAS 17)</p> <p>IFRS 16 supersedes IAS 17 Leases, and it sets out principles for recognition, measurement, presentation and disclosure of leases. It provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases unless the lease term is twelve months or less; or the underlying asset has a low value. Lessors will continue to classify leases as operating or finance leases.</p> <p>The Bank is assessing the impact on the financial statements resulting from the application of IFRS 16.</p>	January 1, 2019

SIGNIFICANT ACCOUNTING POLICIES (Continued)**For the year ended December 31, 2016****FINANCIAL INSTRUMENTS****General**

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

Fair Value Measurement

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

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

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

Financial Assets

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

Loans and Receivables

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

Financial Assets at Fair Value through Profit or Loss

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

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

Short-term Investments (Liquidity Portfolio)

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

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

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

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

Available-For-Sale

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

Long-term Investments (Pula Fund)

This is a long-term fund intended to generate returns and maintain the purchasing power of reserves, and is invested in foreign financial instruments. These investments, which may be sold in response to needs for liquidity, changes in interest rates, exchange

SIGNIFICANT ACCOUNTING POLICIES (Continued)**For the year ended December 31, 2016****FINANCIAL INSTRUMENTS (Continued)**

rates, etc., are classified as “available-for-sale”, except for derivatives. These securities are initially recognised at fair value (which includes transaction costs) and are subsequently remeasured at fair value, based on bid prices.

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

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

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

Government of Botswana Bonds

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

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

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

Derivative Instruments

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

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

Impairment of Financial Assets

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

Financial Liabilities

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

Derecognition

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

Other Financial Liabilities

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

For the year ended December 31, 2016

FINANCIAL INSTRUMENTS (Continued)

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

Bank of Botswana Certificates

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

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

CREDIT FACILITY

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

SECURITIES LENDING PROGRAMME

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

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

The Bank records income from lending securities as it accrues.

REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

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

The term of a repurchase agreement and reverse repurchase agreement can vary from overnight to 91 days, depending on the liquidity conditions in the domestic market.

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

OFFSETTING FINANCIAL INSTRUMENTS

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

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

FOREIGN CURRENCIES

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2016

NON-FINANCIAL ASSETS, LIABILITIES AND RECOGNITION OF PROVISIONS

Non-financial Assets

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

Contingent Assets

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

Liabilities and Provisions

The Bank recognises liabilities (including provisions) when:

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

INCOME AND EXPENSE RECOGNITION

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

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

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

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

GENERAL RESERVE

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

CURRENCY REVALUATION RESERVE

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

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

MARKET REVALUATION RESERVE

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

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

GOVERNMENT INVESTMENT ACCOUNT

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

For the year ended December 31, 2016

PROPERTY AND EQUIPMENT

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

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

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

Any impairment loss is recognised immediately in profit or loss.

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

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

Depreciation

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

The annual depreciation rates used are as follows:

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

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

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

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

RETIREMENT BENEFITS

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

SHORT-TERM EMPLOYEE BENEFITS

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2016

FINANCE LEASES

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

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

RELATED PARTY TRANSACTIONS

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

SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Useful Lives of Property and Equipment

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
For the year ended December 31, 2016

	2016 P'000	2015 P'000
1. FOREIGN EXCHANGE RESERVES		
1.1 Liquidity Portfolio		
Bonds: held for trading	8 520 683	12 904 792
Amounts due from Pula Fund	931 761	1 071 669
Short-term deposits	11 759 025	7 937 959
	21 211 469	21 914 420
1.2 Pula Fund		
Equities: available-for-sale	20 576 760	28 253 210
Bonds: available-for-sale	32 424 379	33 418 814
Derivative instruments: assets (Note 13)	–	30 233
Amounts due to Liquidity Portfolio	(931 761)	(1 071 669)
Derivative instruments: liabilities (Note 13)	–	(21 770)
Short-term deposits	2 076 122	574 632
	54 145 500	61 183 450
(a) Statement of Financial Position		
<i>Capital Employed</i>		
Government	28 692 442	35 004 942
Bank of Botswana	25 453 058	26 178 508
	54 145 500	61 183 450
<i>Employment of Capital</i>		
Investments	54 145 500	61 183 450
Investments expressed in US dollars ('000) ³	5 068 019	5 439 208
Investments expressed in SDR ('000) ⁴	3 768 527	3 927 978
(b) Statement of Profit or Loss and Other Comprehensive Income		
<i>Income</i>		
Interest and dividends	1 255 091	1 279 454
Realised currency revaluation gains	2 877 949	1 610 182
Unrealised currency revaluation losses/gains	(3 856 189)	2 822 091
Realised fair value losses/gains	2 616 808	1 045 107
Sundry income	174	1 440
	2 893 833	6 758 274
<i>Expenses</i>		
Administration charges	(157 957)	(166 539)
	(157 957)	(166 539)
Net income	2 735 876	6 591 735
<i>Other Comprehensive (Loss)/Income</i>		
<i>Items that may be reclassified subsequently to profit or loss</i>		
Net unrealised currency (losses)/gains on non-monetary “available-for-sale” financial instruments	(3 401 924)	2 249 189
Net unrealised from fair value losses on “available-for-sale” financial instruments	(1 513 966)	(324 805)
Other comprehensive (loss)/income	(4 915 890)	1 924 384
Total comprehensive (loss)/income	(2 180 014)	8 516 119

3 United States dollar/Pula – 0.0936 (2015: 0.0889)

4 SDR/Pula – 0.0696 (2015: 0.0642)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

	2016 P'000	2015 P'000
2. INTERNATIONAL MONETARY FUND (IMF)		
2.1 Reserve Tranche		
<p>This asset represents the difference between Botswana's Quota in the IMF and IMF Holdings of Pula. Botswana's Quota is the membership subscription, of which at least 25 percent was paid for in foreign currencies and the balance in Pula. The holding of Pula by the IMF, which initially was equal to 75 percent of the quota, has changed from time to time as a result of the use of the Pula by the IMF in lending to member countries.</p>		
Quota (SDR 197 200 000; 2015: SDR 87 800 000)	2 833 333	1 366 579
Less: IMF Holdings of Pula	(2 247 670)	(942 040)
Reserve Position in IMF	585 663	424 539
<p>The IMF Holdings of Pula are represented by the Non-Interest Bearing Note of P1 477 900 684 (2015: P353 179 294) issued by the Government of Botswana in favour of the IMF, maintenance of value currency adjustments and the amount in the current account held at the Bank (included in other deposits in Note 10).</p>		
2.2 Holdings of Special Drawing Rights		
<p>The balance on the account represents the value of Special Drawing Rights (SDR) allocated and purchased less utilisation to date.</p>		
	839 790	1 334 931
2.3 General Subsidy Account		
Face Value (SDR 1 520 000)	21 8398	23 658
Interest	6	8
	21 845	23 666
<p>This is an investment with the International Monetary Fund, the purpose of which is to augment the resources of the Poverty Reduction and Growth Trust Fund. It matures on August 22, 2017.</p>		

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016

3. PROPERTY AND EQUIPMENT	Free- hold Land	Leasehold Land	Buildings	Capital Works in Progress	Other Assets	Total
	P'000	P'000	P'000	P'000	P'000	P'000
Cost – December 31, 2016						
Balance at the beginning of the year	2 065	3 083	400 428	11 062	192 924	609 562
Additions	–	–	–	9 310	10 569	19 879
Disposals	–	–	–	–	(11 710)	(11 710)
Transfers from WIP	–	1 849	2 963	(20 178)	15 366	–
Balance at year-end	2 065	4 932	403 391	194	207 149	617 731
Accumulated Depreciation						
Balance at the beginning of the year	–	–	85 818	–	119 974	205 792
Charge for the year	–	–	10 646	–	15 585	26 231
Disposals	–	–	–	–	(10 063)	(10 063)
Balance at year-end	–	–	96 464	–	125 496	221 960
Net book value at December 31, 2016	2 065	4 932	306 927	194	81 653	395 771
Cost – December 31, 2015						
Balance at the beginning of the year	2 065	3 083	399 931	6 117	183 612	594 808
Additions	–	–	–	6 357	12 132	18 489
Disposals	–	–	–	–	(3 735)	(3 735)
Transfers from WIP	–	–	497	(1 412)	915	–
Balance at year-end	2 065	3 083	400 428	11 062	192 924	609 562
Accumulated Depreciation						
Balance at the beginning of the year	–	–	75 231	–	105 959	181 190
Charge for the year	–	–	10 587	–	16 107	26 694
Disposals	–	–	–	–	(2 092)	(2 092)
Balance at year-end	–	–	85 818	–	119 974	205 792
Net book value at December 31, 2015	2 065	3 083	314 610	11 062	72 950	403 770

Valuation of Properties

Freehold and leasehold land and buildings were valued by an independent professional property valuer in December 2016 at an open market value of P852 005 000 (2014: P770 940 000).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

	2016 P'000	2015 P'000
4. GOVERNMENT OF BOTSWANA BOND		
Government Bond BW005, maturing on September 12, 2018, bearing interest at the rate of 10 percent, receivable semi-annually in arrears:		
Fair value	22 288	23 123
Interest accrued	613	610
	22 901	23 733
5. OTHER ASSETS		
Staff loans and advances	59 334	52 579
Prepayments	3 363	3 677
Donor funds – Government projects	303 095	61 971
Other	4 603	4 377
	370 395	122 604
6. ALLOCATION OF IMF SPECIAL DRAWING RIGHTS		
This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Botswana.	825 107	893 912
7. LIABILITIES TO GOVERNMENT (IMF RESERVE TRANCHE)		
This balance represents the Bank's liability to the Government in respect of the Reserve Tranche position in the IMF (Note 2.1).	86 615	358 931
8. NOTES AND COIN IN CIRCULATION		
Notes	2 709 457	2 564 979
Coin	148 678	142 856
	2 858 135	2 707 835
Notes and coin in circulation held by the Bank as cash in hand at the end of the financial year have been netted off against the liability for notes and coin in circulation to reflect the net liability to the public.		
9. BANK OF BOTSWANA CERTIFICATES		
Face value	7 919 900	8 192 650
Unmatured discount	(1 529)	(2 728)
Carrying amount	7 918 371	8 189 922
Bank of Botswana Certificates are issued at various short-term maturity dates and discount rates.		
9.1 REVERSE REPURCHASE AGREEMENTS		
Fair value	1 302 879	1 672 849
The reverse repurchase agreements matured on January 4, 2017 (2015: January 4, 2016).		

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

	2016 P'000	2015 P'000
10. DEPOSITS		
Government	1 084 419	888 240
Bankers – current accounts	1 064 061	429 700
– statutory reserve accounts	2 556 716	2 588 660
Other	1 602 161	1 160 772
	<u>6 307 357</u>	<u>5 067 372</u>
<p>These deposits are various current accounts of Government, commercial banks, parastatal bodies and others, which are repayable on demand and are interest free, except for the statutory reserve requirement, which is also interest free, but not repayable on demand.</p>		
11. DIVIDEND TO GOVERNMENT		
Balance due at the beginning of the year	401 782	544 689
Dividend to Government from Pula Fund	848 000	975 000
Paid during the year	(1 037 782)	(1 275 939)
Residual net income	1 993 952	158 032
Balance due at the end of the year	<u>2 205 952</u>	<u>401 782</u>
<p>The final instalment of the pre-set dividend of P212 000 000 and the residual net income of P1 993 952 000 unpaid as at December 31, 2016 has been provided for in accordance with Section 6 of the Bank of Botswana Act (CAP 55:01); which requires that all profits of the Bank be distributed to the shareholder, the Government.</p>		
12. OTHER LIABILITIES		
Accounts payable	8 844	10 713
Donor funds – Government projects	303 095	61 971
Other payables and accruals	40 500	56 825
	<u>352 439</u>	<u>129 509</u>
13. CATEGORIES OF FINANCIAL INSTRUMENTS		
13.1 Financial Assets		
Held for trading		
Bonds	8 520 683	12 904 792
Derivative instruments (Note 1.2)	–	30 233
	<u>8 520 683</u>	<u>12 935 025</u>
Available-for-sale		
Bonds	32 424 379	33 418 814
Equities	20 576 760	28 253 210
Government bonds	22 901	23 733
	<u>53 024 040</u>	<u>61 695 757</u>
Loans and Receivables		
IMF Reserves	1 447 298	1 783 136
Staff loans and advances	59 334	52 579
Short-term deposits	13 835 147	8 512 591
Total Financial Assets	<u>76 886 502</u>	<u>84 979 088</u>
<p>The above is disclosed in the Statement of Financial Position as follows:</p>		
Total Foreign Assets	76 804 267	84 881 006
Add: Derivative instruments (liabilities) (Note 1.2)	–	21 770
Government of Botswana bonds	22 901	23 733
Other Assets – staff loans and advances (Note 5)	59 334	52 579
	<u>76 886 502</u>	<u>84 979 088</u>

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016

	2016 P'000	2015 P'000
13. CATEGORIES OF FINANCIAL INSTRUMENTS (Cont'd)		
13.2 Financial Liabilities		
Held for trading		
Derivative instruments (Note 1.2)	–	21 770
Other Financial Liabilities - at amortised cost		
Bank of Botswana Certificates	7 918 371	8 189 922
Reverse Repurchase Agreements	1 302 879	1 672 849
Allocation of SDR (IMF)	825 107	893 912
Liabilities to Government (IMF)	86 615	358 931
Deposits	6 307 357	5 067 372
Dividend to Government	2 205 952	401 782
Other liabilities	352 439	129 509
	18 998 720	16 736 047

13.3 Derivative Instruments

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

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

	Asset	Liabilities	Notional Amount	Assets	Liabilities	Notional Amount
	2016	2016	2016	2015	2015	2015
	(P'000)	(P'000)	(P'000)	(P'000)	(P'000)	(P'000)
Fixed Income Futures –Buy	–	–	–	30 233	–	651 841
–Sell	–	–	–	–	(21 770)	(662 833)
Currency Futures –Buy	–	–	–	–	–	–
	–	–	–	30 233	(21 770)	(10 992)

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

Futures

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

Options

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

Swaps

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

	2016 P'000	2015 P'000
14. PAID-UP CAPITAL		
Authorised and Paid-up Capital	25 000	25 000
The capital is the amount subscribed by the Government in accordance with Section 5 of the Bank of Botswana Act (CAP 55:01). The Bank is not subject to any externally imposed capital requirements. Therefore, capital is not actively managed. Management considers the Paid-up Capital and the General Reserve to be capital.		
15. GENERAL RESERVE		
In the opinion of the Board, the General Reserve, taken together with other reserves which the Bank maintains, is sufficient to ensure the sustainability of future operations of the Bank.		
	1 600 000	1 600 000
16. INTEREST – FOREIGN EXCHANGE RESERVES		
Liquidity Portfolio		
Short-term deposits: loans and receivables	258 978	321 815
Bonds: held for trading	196 215	230 647
IMF Reserves: loans and receivables	548	383
Pula Fund		
Short-term deposits: loans and receivables	20 402	20 235
Bonds: available-for-sale	714 725	698 232
	1 190 868	1 271 312
17. DIVIDENDS – FOREIGN EXCHANGE RESERVES		
Pula Fund		
Equities: available-for-sale	520 137	562 428
18. NET REALISED FAIR VALUE GAINS ON DISPOSAL OF SECURITIES		
Liquidity Portfolio		
Bond: held for trading	(111 006)	(53 532)
Pula Fund		
Derivative instrument: held for trading	–	7 373
Bonds: available-for-sale	370 634	273 788
Equities: available-for-sale	2 246 175	763 946
	2 505 803	991 575
Included above are net fair value gains of P2 616 809 000 (2015: P1 037 734 000), which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.		
19. NET REALISED CURRENCY GAINS		
Liquidity Portfolio		
Short-term deposits: loans and receivables	(235 670)	965 028
Bonds: held for trading	975 293	524 526
Pula Fund		
Derivative instruments: held for trading	–	8 276
Short-term deposits: loans and receivables	(29 106)	68 621
Bonds: available-for-sale	1 116 741	930 847
Equities: available-for-sale	1 790 314	602 438
	3 617 572	3 099 736
Included above are net currency gains of P2 907 055 000 (2015: P1 533 285 000), which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.		

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

	2016 P'000	2015 P'000
20. NET UNREALISED CURRENCY (LOSSES)/GAINS		
Liquidity Portfolio		
Short-term deposits: loans and receivables	(269 305)	101 284
Bonds: held for trading	(1 796 189)	890 898
IMF reserves: loans and receivables	4 734	54 159
Pula Fund		
Short-term deposit: loans and receivables	(25 398)	(9 070)
Bonds: available-for-sale	(3 830 790)	2 820 668
Derivative instruments: held for trading	–	10 493
	<u>(5 916 948)</u>	<u>3 868 432</u>
21. NET UNREALISED FAIR VALUE GAINS/(LOSSES)		
Liquidity Portfolio		
Bonds: held for trading	50 586	(118 007)
Pula Fund		
Derivative instruments: held for trading	–	(2 030)
	<u>50 586</u>	<u>(120 037)</u>
22. INTEREST EXPENSE		
Bank of Botswana Certificates (BoBCs)	75 057	113 334
Reverse Repurchase Agreements	17 479	69 267
	<u>92 536</u>	<u>182 601</u>
23. NET CURRENCY REVALUATION (LOSSES)/GAINS RETAINED IN PROFIT OR LOSS		
Total net realised gains (Note 19)	3 617 572	3 099 736
Total net unrealised (losses)/gains (Note 20)	(5 916 948)	3 868 432
Total net currency revaluation (losses)/gains	<u>(2 299 376)</u>	<u>6 968 168</u>
Appropriated to Currency Revaluation Reserve:		
Net realised currency gains reinvested in foreign assets	(3 676 210)	(3 001 543)
Net unrealised currency (losses)/gains (Note 20)	5 916 948	(3 868 432)
Transfer from/(to) Currency Revaluation Reserve	2 240 738	(6 869 975)
Net currency revaluation (losses)/gains retained in profit or loss	<u>(58 638)</u>	<u>98 193</u>
24. CONTRIBUTION TO THE BANK OF BOTSWANA DEFINED CONTRIBUTION STAFF PENSION FUND		
The Bank's contribution to the Bank of Botswana Defined Contribution Staff Pension Fund for the year ended December 31, 2016 is P27 388 000 (2015: P26 234 000)		
25. STATEMENT OF CASH FLOWS		

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016

	2016 P'000	2015 P'000
26. CASH GENERATED FROM OPERATIONS		
Net income for the year adjusted for:	1 403 247	9 135 384
Net realised and unrealised exchange gains/(losses)	2 240 738	(6 869 975)
Depreciation expense	26 231	26 694
Loss on disposal of Property and Equipment	612	414
Interest: Government of Botswana bond	(2 003)	(1 997)
	3 668 825	2 290 520
Adjustments for movements in:		
Deposits: banks and other	1 043 807	(1 881 451)
Deposits: Government	196 178	106 994
Bank of Botswana Certificates	(271 551)	3 988 538
Reverse Repurchase Agreements	(369 970)	1 368 492
Other assets	(247 791)	18 218
Other liabilities	222 930	(85 465)
Cash generated from operations	4 242 428	5 805 846
27. CAPITAL COMMITMENTS		
Approved and contracted for	4 937	3 174
Approved, but not contracted for	58 235	57 898
	63 172	61 072

These capital commitments will be funded from internal resources.

28. COLLATERAL**(a) Credit Facility**

There were no open positions as at December 31, 2016 (2015: Nil) under the Credit Facility accounted for as "Advances to banks".

(b) Securities Lending Programme

Under the Bank's Securities Lending Programme, the Bank has lent securities with a fair value of P9.3 billion (2015: P9 billion). The Bank has accepted securities with a fair value of P9.7 billion (2015: P9.4 billion) as collateral for the securities lent under this programme.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016

29. GOVERNMENT OF BOTSWANA BONDS AND TREASURY BILLS

In accordance with Sections 56 and 57 of the Bank of Botswana Act (CAP 55:01), the Bank acts as agent of the Government for the issuance and management of the Government Bonds and Treasury Bills. An analysis of the bonds and treasury bills issued during the financial year ended December 31, 2016 is provided below:

Government of Botswana Bonds and Treasury Bills issued during the year 2016

Bond/ Treasury Bill Detail	BW005	BW007	BW008	BW011	BW012	BW070916	BW071216	BW080317	BW670617	Total
Date of Issue	Mar 9, Jun 8, Sep/ Dec 7, 2016	Mar 9, Jun 8, Sep 7, 2016	Mar 9, Jun 8, Sep/Dec 2016	Mar 9, Sep/ Dec 7, 2016	Mar 9, Jun 8, Sep/ Dec 7, 2016	Mar 9, 2016	Jun 8, 2016	Sep 7, 2016	Dec 7, 2016	
Date of Maturity	Sep 12, 2018	Mar 10, 2025	Sep 8, 2020	Sep 10, 2031	Jun 13, 2040	Sept 7, 2016	Dec 7, 2016	Mar 8, 2017	Jun 7, 2017	
Interest Rate Percent (per annum)	10	8	7.75	7.75	6	–	–	–	–	
	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000
Nominal Value Net	470 000	219 000	481 000	283 000	449 000	500 000	500 000	500 000	500 000	3 902 000
(Discount)/ Premium Net	68 133	51 066	67 145	68 651	20 783	(3 775)	(2 975)	(2 725)	(2 480)	263 823
Proceeds Interest Paid	538 133	270 066	548 145	351 651	469 783	496 225	497 025	497 275	497 520	4 165 823
Interest Accrued	7 500	7 440	8 060	5 813	11 970	3 775	2 975	–	–	47 533
	14 412	5 469	11 842	6 846	1 406	–	–	1 737	341	42 053

- (a) Net proceeds realised from the issue of the bonds of P4 165 823 000 (2015: P2 970 655 000) were invested in the Government Investment Account. The nominal value of holdings of total outstanding Government bonds and treasury bills as at December 31, 2016, was P9 258 000 000 (2015: P7 196 000 000).
- (b) Interest is payable on all interest earning bonds on a semi-annual basis in arrears. During the year to December 31, 2016, total interest payments of P573 119 400 were made (2015: P628 738 550) and were funded from the Government's current account maintained with the Bank.
- (c) Government bonds and treasury bills are liabilities of Government; and are, therefore, not accounted for in the Statement of Financial Position of the Bank.

30. RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

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

Risk Management Governance Structure

The Bank's risk management governance structure is broadly as follows:

(a) Board

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

(b) Investment Committee

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

(c) Financial Markets Department

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

(d) External Fund Managers and Custody

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

(e) Segregation of Duties

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

Tranching of Foreign Exchange Reserves – Liquidity Portfolio and Pula Fund

The Bank of Botswana Act (CAP 55:01) requires the Bank to maintain a primary international reserve, that is, the Liquidity Portfolio, while Section 34 provides for the establishment and maintenance of a long-term investment fund, the Pula Fund. In compliance with the statutory requirements, a major feature of the foreign exchange reserves management strategy is, therefore, to allocate a certain level of reserves to the Liquidity Portfolio, with the remaining amount invested in the Pula Fund.

Pula Fund

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

Liquidity Portfolio

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

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

Types of Risk Exposure

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

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

(a) Currency Risk

The foreign exchange reserves are invested in currencies that are freely convertible, less susceptible to frequent and sharp exchange rate fluctuations and are used in well developed financial markets. The Bank's policy is to invest only in currencies with high ratings assigned by Moody's Investors Service and Standard and Poor's. Through a diversified currency allocation relative to an SDR weighted benchmark, the Bank ensures that the purchasing power of the foreign exchange reserves is preserved. In terms of the investment guidelines, a maximum deviation from the neutral level (using the SDR weights as a benchmark) for USD and EUR of 10 percentage points is permitted, while a deviation of up to 5 percentage points on all other currencies is permitted. At the end of 2016, the Bank's total exposure to SDR and related currencies was P72.1 billion (2015: P81.2 billion). The Bank is also exposed to SDR currency risk on net IMF balances amounting to P535 575 000 (2015: P530 293 000).

(b) Interest Rate Risk

Interest rate risk is the possible loss in the value of a fixed income asset resulting from an unexpected and adverse movement in interest rates and a consequent change in price. Interest rate risk is measured by modified duration, which measures the sensitivity of the price of a bond to changes in interest rates expressed in years. The Bank benchmarks the interest rate risk for the Pula Fund (fixed income assets) to reflect the long-term nature of the portfolio, with emphasis on higher return. The higher interest rate risk is generally compensated by higher returns expected from longer maturity bonds. The modified duration benchmark will vary over time, as changing market conditions and index weights impact the global modified duration of the index. At the end of 2016, the average modified duration of the fixed income portion of the Pula Fund was 7.6 years (2015: 7.4 years). As the Liquidity Portfolio gives priority to liquidity over return, given the constant need to provide foreign exchange to finance international transaction payments, from the Bank's perspective, this portfolio is exposed to minimum interest rate risk. At the end of 2016, the Liquidity Portfolio's average modified duration was 2.3 years (2015: 1.9 years).

(c) Equity Price Risk

Equity price risk is the risk that the value of equities decrease as a result of changes in the level of equity indices and diminution of value of individual stocks. The geographic allocation of equity exposure follows generally the market capitalisation among the major markets. The investment guidelines stipulate the holding levels of equities. Holdings of more than 5 percent in one company are not permitted. A reasonable spread among the industry sectors is maintained in the portfolio. There are no investments in private placements or unquoted stocks. At the end of 2016, the equity portion of the Pula Fund was P20.6 billion (2015: P28.3 billion).

Market Risk Sensitivity Analysis

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

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

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

December 31, 2016

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income ⁵ (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income ⁵ (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(1 354 941)	Decrease in yields by 50 basis points	1 354 941
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(735 712)	Weakening of the Pula by 1 percent	735 712
	South African rand	Strengthening of the Pula by 1 percent	(32 331)	Weakening of the Pula by 1 percent	32 331
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 028 838)	Increase in global equity prices by 5 percent	1 028 838

December 31, 2015

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income ⁵ (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income ⁵ (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(1 384 841)	Decrease in yields by 50 basis points	1 384 841
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(830 182)	Weakening of the Pula by 1 percent	830 182
	South African rand	Strengthening of the Pula by 1 percent	(18 628)	Weakening of the Pula by 1 percent	18 628
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 412 661)	Increase in global equity prices by 5 percent	1 412 661

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

(d) Credit risk

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

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

⁵ The effects are expected to have the same impact on shareholder's funds.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

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

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

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

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

Exposure to Credit Risk

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

	Notes	2016 P'000	2015 P'000
Financial Assets			
Liquidity Portfolio			
Bonds: held for trading	1.1	8 520 683	12 904 792
Short-term deposits: loans and receivables		12 690 786	9 009 628
Pula Fund			
Bonds: available-for-sale	1.2	32 424 379	33 418 814
Derivative instruments: held for trading		-	30 233
Short-term deposits: loans and receivables/(payables)		1 144 361	(497 037)
International Monetary Fund- loans and receivables			
Reserve tranche	2.1	585 663	424 539
Holdings of Special Drawing Rights	2.2	839 790	1 334 931
General Subsidy Account	2.3	21 845	23 666
Government of Botswana bond: available-for-sale	4	22 901	23 733
Other Assets- staff loans and advances: loans and receivables	5	59 334	52 579
Total		56 309 742	56 725 878
Analysis of Credit Exposure by class:			
Measured at fair value			
Bonds		40 945 062	46 323 606
Derivatives		-	30 233
Government of Botswana bond		22 901	23 733
Measured at amortised cost			
IMF Reserves		1 447 298	1 783 136
Staff advances		59 334	52 579
Short-term deposits: loans and receivables		13 835 147	8 512 591
Total		56 309 742	56 725 878

While some financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure, but not the maximum risk exposure that could arise in future as a result of changes in values. The Tables below reflect the credit exposure based on the fair value of the assets with counterparties as at December 31, 2016.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

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

Credit Exposure on Bonds

Moody's/S&P Rating			2016	2015
	Government (P'000)	Corporate (P'000)	Total (P'000)	Total (P'000)
AAA	26 823 767	68 170	26 891 937	38 549 529
AA+	3 674 208	105 973	3 780 181	409 931
AA	5 089 133	16 867	5 106 000	3 350 511
A+	3 540 810	–	3 540 810	2 195 542
A	–	–	–	30 370
Other ⁶	1 626 134	–	1 626 134	1 787 723
	<u>40 754 052</u>	<u>191 010</u>	<u>40 945 062</u>	<u>46 323 606</u>

Credit Exposure to Banks (Short-term deposits)

Fitch Rating	2016 (P'000)	2015 (P'000)
AAA ⁷	4 455 047	2 975 442
AA+ ⁷	–	528 122
AA ⁷	52 744	–
A	45 962	–
a+5	636 691	222 222
a1	581 460	562 492
a5	494 797	1 101 506
aa2	157 074	–
aa-1	605 866	–
aa-2	2 083 912	–
aa-5	1 332 500	668 032
a-5	983 511	691 733
BBB- ⁷	1 740 863	1 278 130
bbb+1/bbb+5/bbb-3	664 720	484 912
	<u>13 835 147</u>	<u>8 512 591</u>

Credit Exposure on Securities Lending Programme

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

(e) Instrument RiskSovereign Bonds

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

Corporate Bonds

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

⁶ 'Other' includes investments rated below A-, but still remain within the acceptable investment grades as per the investment guidelines.

⁷ Included in AAA, AA+, AA, A and BBB- are deposits held with central banks.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016

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

(f) Liquidity risk

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

Financial Liabilities at Undiscounted Cash Flows

The table below summarises the maturity profile of the Bank's financial liabilities as at December 31, 2016, based on contractual undiscounted repayment obligations.

December 31, 2016	Less than 3 months (P'000)	3–12 months (P'000)	1–5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificates	7 919 900	–	–	–	7 919 900
Reverse Repurchase Agreements	1 302 879	–	–	–	1 302 879
Deposits	6 307 357	–	–	–	6 307 357
Allocation of SDR – IMF	–	–	–	825 107	825 107
Liabilities to Government – IMF	–	–	–	86 615	86 615
Dividend to Government	2 205 952	–	–	–	2 205 952
Other Liabilities	352 439	–	–	–	352 439
	18 088 527	–	–	911 722	19 000 249

December 31, 2015	Less than 3 months (P'000)	3–12 months (P'000)	1–5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificates	8 192 650	–	–	–	8 192 650
Reverse Repurchase Agreements	1 672 849	–	–	–	1 672 849
Deposits	5 067 372	–	–	–	5 067 372
Allocation of SDR – IMF	–	–	–	893 912	893 912
Liabilities to Government – IMF	–	–	–	358 931	358 931
Dividend to Government	401 782	–	–	–	401 782
Other Liabilities	129 509	–	–	–	129 509
	15 464 162	–	–	1 252 843	16 717 005

(g) Operational Risk

Operational risk is the risk of financial or reputational loss arising from systems failure, human error, fraud or external events. To mitigate this risk, the Bank has in place, a policy and operational risk framework approved by the Board. The risk management and planning function within the Finance Department focuses primarily on coordinating management of operational risks and it ensures that there is a bank-wide system of identifying, assessing, evaluating and monitoring operational risks including business continuity management. Management and the Board maintain an oversight role for the management of operational risks through the Risk Management Committee and Audit Committee of the Board, respectively.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

31. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value of financial instruments carried at amortised cost

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

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

Valuation models and techniques

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

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

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

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

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

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

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

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

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

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

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

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

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

31. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Measurements recognised in the Statement of Financial Position

The following Table provides an analysis of financial instruments that are measured at fair value, including their levels in the fair value hierarchy.

December 31, 2016	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds		8 520 683	–	8 520 683
Available-for-sale				
Bonds		32 424 379	–	32 424 379
Equities		20 576 760	–	20 576 760
Government Bond		–	22 901	22 901
Loans and Receivables				
		–	15 341 779	15 341 779
		61 521 822	15 364 680	76 886 502
Financial Liabilities				
Held for trading				
Other financial liabilities				
Bank of Botswana Certificates		–	7 918 371	7 918 371
Other liabilities				
		–	11 080 349	11 080 349
		–	18 998 720	18 998 720
<hr/>				
December 31, 2015	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds		12 904 792	–	12 904 792
Derivative instruments		–	30 233	30 233
Available-for-sale				
Bonds		33 418 814	–	33 418 814
Equities		28 253 210	–	28 253 210
Government Bond		–	23 733	23 733
Loans and Receivables				
		–	10 348 306	10 348 306
		74 576 816	10 402 272	84 979 088
Financial Liabilities				
Derivative instruments		–	21 770	21 770
Other financial liabilities				
Bank of Botswana Certificates		–	8 189 922	8 189 922
Other liabilities				
		–	8 525 934	8 525 934
		–	16 737 626	16 737 626

There were no transfers between levels during the year.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
For the year ended December 31, 2016

32. RELATED PARTY BALANCES AND TRANSACTIONS

Balances and Transactions with the Government

The Bank provides several services to its shareholder, the Government. The main services during the year to December 31, 2016, were:

- (a) provision of banking services, including holding of the principal accounts of the Government;
- (b) management of the Notes and Coin in issue, including printing and minting of notes and coin; and
- (c) being the Government agent for government bonds and treasury bills.

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

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

The Bank earned interest on its holding of the Government of Botswana bonds (as described in Note 4) of P2 003 000 (2015: P1 997 000).

Other Related Party Balances and Transactions

- (a) Amounts due to related parties.

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

	2016	2015
	P'000	P'000
Botswana Savings Bank	1 557	1 172
Botswana Unified Revenue Service	112 575	72 872
Total	114 132	74 044

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

- (b) Remuneration of Key Management Personnel

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

Gross emoluments of the key management personnel are:

	2016	2015
	P'000	P'000
Non-Executive Board members	94	214
Executive Management		
Salaries, allowances and other short term benefits	13 057	13 252
Post-employment benefits	5 366	2 356
	18 517	15 822

Of the Staff Loans and Advances per Note 5, P1 548 000 (2015 : P1 682 000) are attributable to Executive Management.

33. CONTINGENCIES

The Bank is defending an action instituted by one of the depositors of Kingdom Bank Africa Limited that is now under liquidation. Although liability is not admitted, if the defence against the action is unsuccessful, the claim against the Bank, and legal costs could amount to the equivalent of approximately P32 million.

34. EVENTS AFTER THE REPORTING DATE

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

PART B

THE BOTSWANA ECONOMY IN 2016 AND THEME CHAPTER

BANK OF BOTSWANA

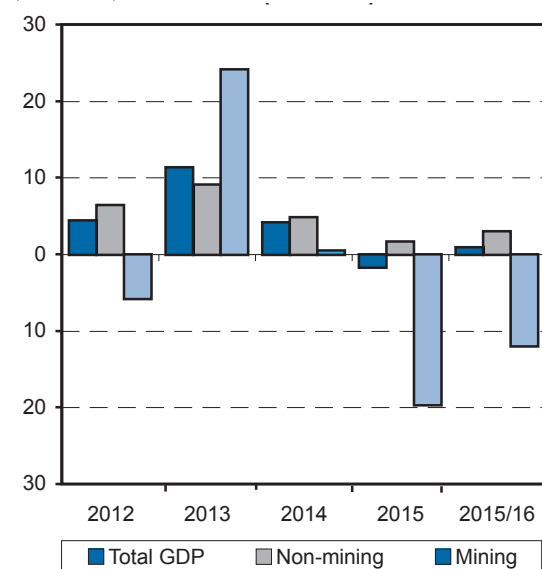
1. OUTPUT, EMPLOYMENT AND PRICES

(a) National Income Accounts

Overview

1.1 Real GDP grew by an estimated 0.9 percent in the twelve months to September 2016 (Chart 1.1), compared to a revised contraction of 0.1 percent in the corresponding period ending in September 2015.¹ The non-mining sectors expanded moderately by 3 percent, higher than growth of 2.1 percent in the twelve months to September 2015. In contrast, the contraction of mining output by 11.9 percent in the year ending in September 2016 compared to 11.8 percent in the corresponding period ending in September 2015, weighed down overall GDP growth. Nonetheless, the mineral sector remains the largest in the economy, with a share of 18.5 percent of GDP² in current prices.

CHART 1.1: REAL GDP GROWTH 2012 – 2015/16 (PERCENT)



Source: Statistics Botswana

1 Estimates for the final quarter of 2016 are yet to be published.
 2 See Statistics 2016, Part C, Table 1.3, in this Report, for the rest of sectoral shares of GDP in current prices.

Sectoral Performance

1.2 All economic sectors, except agriculture and mining, recorded an increase in output in the twelve-month period to September 2016, hence, contributing positively to real GDP growth (Chart 1.2). Within the various sectors, performance at industry level was mixed, with output expanding in some industries, but contracting for others (Chart 1.3, overleaf).

1.3 The contraction in mining output was mainly due to a decline in diamond output, as producers scaled down production. Debswana's rough diamond production declined by 8.6 percent from 21.6 million carats to 19.7 million carats, in the twelve-month period to September 2016, while output from the smaller mines of Karowe and Ghaghoo³ also followed the same trend.⁴

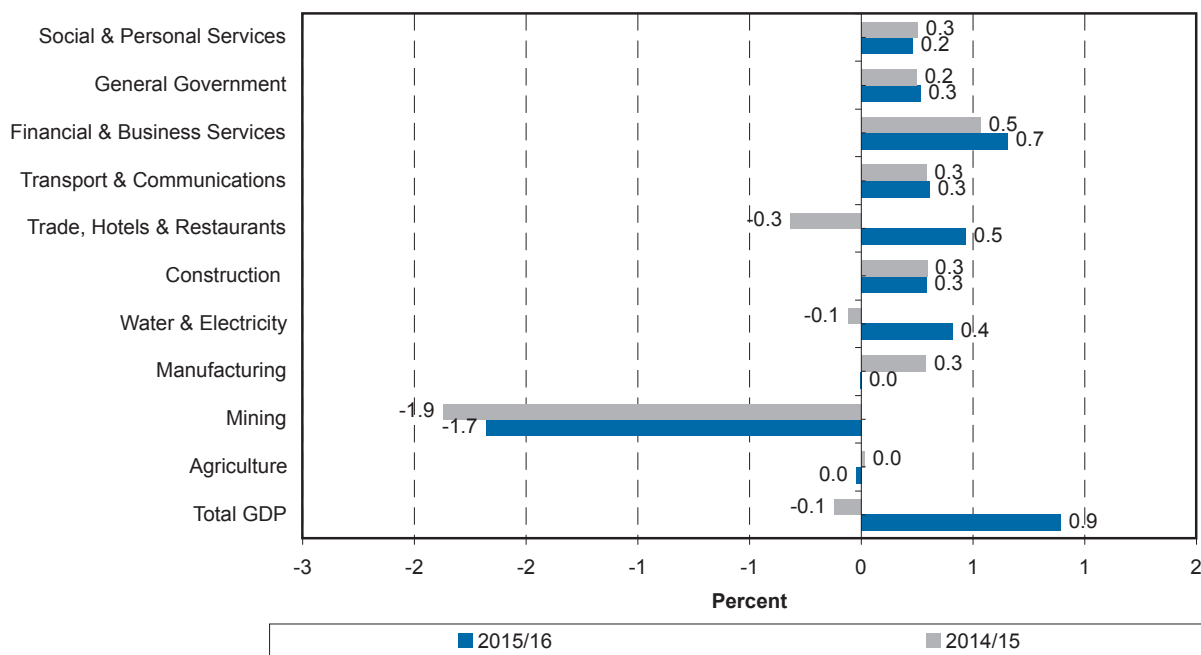
1.4 With respect to *copper-nickel*, output declined by 26.9 percent in the year ending September 2016, following the closure of the Mowana and Thakadu copper mines in the final quarter of 2015.⁵ Output of *coal* declined by 6.1 percent in the same period, largely attributable to Morupule B power station operating below full capacity in the first half of 2016, while *soda ash* production grew by 21.1 percent, and *other*

3 Production at the Ghaghoo mine was first recorded in the first quarter of 2015. The mine's output declined by more than 50 percent between 2015 and 2016, leading to its placement under care and maintenance in February 2017.

4 Nevertheless, the Karowe mine continued to perform well, boosted by sales of exceptionally large, high value stones. Total sales were boosted by the record sale of the 813-carat "The Constellation" for USD63.1 million in May 2016. In addition, the second largest diamond ever found in the world by carat size, "Lesedi La Rona", was not sold at the Sotheby's auction in June 2016; its highest bid price of USD61 million fell below the reserve price of USD70 million. It is scheduled for sale in the first half of 2017. Furthermore, exceptional stones are expected as Karowe mine plans to invest more on x-ray technology.

5 Going forward, the cessation of operations by BCL and Tati Nickel Mining Company in October 2016, following the decision by Government to place the BCL group of companies under provisional liquidation, will further adversely affect the output of copper and nickel.

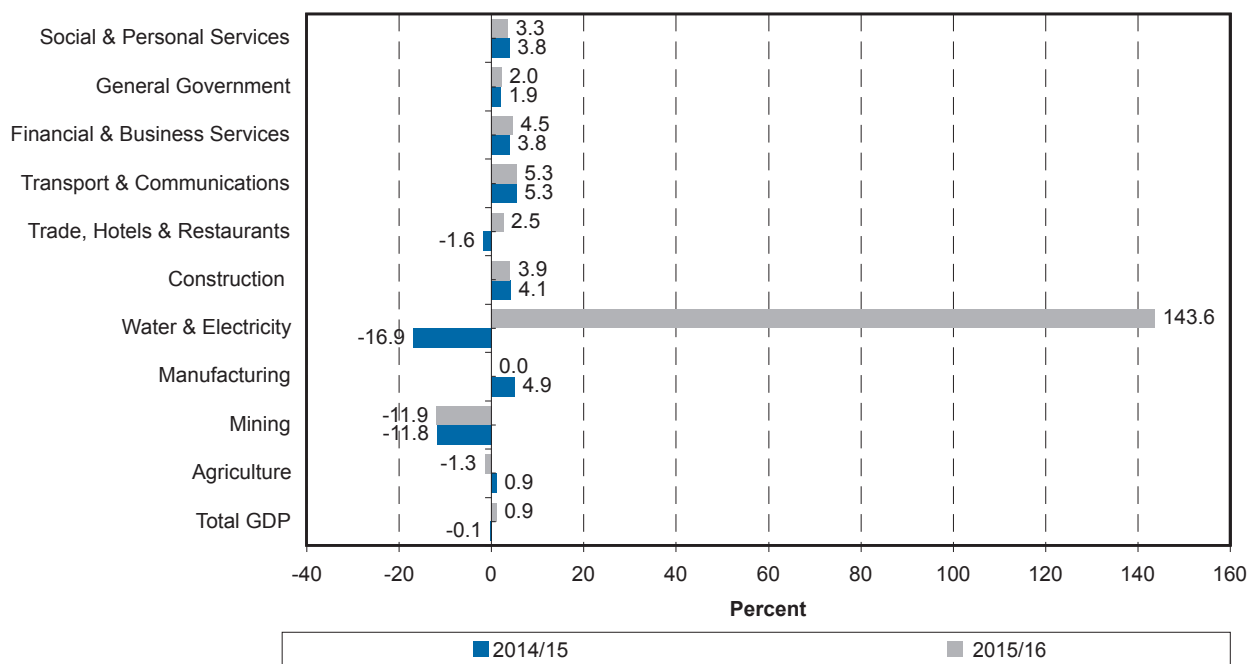
CHART 1.2: CONTRIBUTION TO REAL GDP GROWTH BY SECTOR (PERCENT)¹



1. Percentage contribution to growth is measured by multiplying the current sector growth by the sector's previous year share of GDP
2. GDP data for the two periods are for the twelve-month period ending September

Source: Statistics Botswana

CHART 1.3: REAL GDP GROWTH BY SECTOR (PERCENT)



1. GDP data for the two periods are for the twelve-month period ending September.

Source: Statistics Botswana

mining contracted by 2.1 percent.

- 1.5 The *water and electricity* sector expanded by 143.6 percent, significantly reversing the contraction of 16.9 percent in twelve-month period ending September 2015 (Chart 1.3). The increase was mainly attributable to a 97.5 percent growth in the electricity sub-sector (a reversal of a substantial previous decline), due to fewer disruptions in domestic generation of electricity, and relatively stable electricity supply since the beginning of 2016. The *water* sub-sector grew by 14.9 percent in the twelve-month period to September 2016, on account of substantial rainfall experienced across some parts of the country in the early part of 2016, and infrastructure developments, including Phase II of the North-South Carrier Project. In addition, the introduction of a dual billing system by the Water Utilities Corporation (WUC), where customers are charged for both potable and waste water, helped performance in the *water* sub-sector.
- 1.6 Growth in *transport and communications* was constant at 5.3 percent in the twelve-month period ending in September 2016 as in the prior year, mainly supported by a 12.7 percent expansion in the *railways* sub-sector, following the commencement of passenger train services in March 2016. Furthermore, other main sub-sectors recorded positive growth, with the exception of the Central Transport Organisation (CTO), which contracted mainly because of a large cut in internal travel and transport charges.
- 1.7 *Finance and business services* grew by 4.5 percent in the twelve months to September 2016 compared to 3.8 percent in the year ending in September 2015. All the sub-sectors recorded positive growth, led by *real estate* (8 percent), *business services* (7.2 percent) and *owner-occupied residential housing* (7 percent). Growth in *construction* slowed marginally from 4.1 percent to 3.9 percent in the same period.
- 1.8 *Trade, hotels and restaurants* grew by 2.5 percent compared to a contraction of 1.6 percent in the twelve-month period ended September

2015. All sub-sectors posted strong growth in the review period, with the exception of *wholesale trade* which contracted by 26.1 percent, owing to the weak performance of the mining sector, as diamond marketing is an activity of the wholesale trade sub-sector.

- 1.9 Production in *agriculture* decreased by 1.3 percent compared to a 0.9 percent increase in the prior year, due to a contraction in output of *other agriculture* (horticulture). *Manufacturing* production remained flat in the twelve-months to September 2016 compared to a growth of 4.9 percent in the year to September 2015, due to offsetting movements of sub-sectoral output.

(b) Economic Growth Prospects

- 1.10 Real GDP is forecast to expand by 4.2 percent in 2017 compared to an estimate of 2.9 percent for 2016, although the uncertain global and domestic economic environment suggest that the forecast for 2017 could be optimistic. Global output growth is projected at 3.4 percent in 2017, higher than 3.1 percent in 2016 (Table 1.1).⁶ Thus, the modest pace of recovery in the global economy continues to constrain prospects for growth in Botswana. Notably, uncertainty surrounding the trade policy direction of the new USA administration, the process towards withdrawal of the United Kingdom from the European Union, moderation of growth in China and risks to stability of the euro area could alter medium-term growth prospects. In addition, the weak growth outlook for South Africa due to political uncertainty and slow pace of structural reform, is likely to have an adverse impact on neighbouring countries, including Botswana.
- 1.11 Domestically, government revenues continue to be heavily reliant on mineral and customs and excise receipts, which are susceptible to exchange rate and international market fluctuations. Continued challenges in water and electricity related infrastructure are a risk to the economic performance (value addition) of other sectors. In addition, business confidence re-

⁶ World Economic Outlook (WEO) Update, January 2017, International Monetary Fund.

TABLE 1.1: GLOBAL GROWTH ESTIMATES AND FORECASTS 2015 – 2017 (PERCENT)

	2015	2016	2017 (Projections)
Global	3.2	3.1	3.4
Advanced economies, of which,	2.1	1.6	1.9
USA	2.6	1.6	2.3
Euro area	2.0	1.7	1.6
Japan	1.2	0.9	0.8
Emerging markets, of which,	4.1	4.1	4.5
Sub-Saharan Africa	3.4	1.6	2.8
China	6.9	6.7	6.5
India	7.6	6.6	7.2
South Africa	1.3	0.3	0.8
Botswana ¹	-1.7	2.9	4.2

1. Projections for Botswana are sourced from the 2017 Budget Speech.

Source: International Monetary Fund, World Economic Outlook, January 2017 update and Ministry of Finance and Economic Development.

mains modest, thus a likelihood of constrained investment and contribution of the private sector to economic growth. However, there is an expectation that relatively low global oil prices as well as improved performance in emerging and developing economies will provide some stimulus to the global economy. At the same time, it is envisaged that the current government expenditure on infrastructure and tolerance of relatively small deficits will support economic activity, while stable electricity and water supply should also improve growth prospects. Furthermore, the ongoing recovery in the commodity markets and the prospects for reopening of closed mines, including the Mowana Copper Mine, and commencement of new operations, bodes well for future performance of the domestic economy.

(c) Employment

1.12 Formal sector employment increased by one percent from 341 115 in September 2015 to 344 490 in September 2016⁷, attributable to a slight increase in the number of private sector employees, especially in the construction sec-

⁷ The formal sector employment figures exclude workers engaged in the labour intensive public works programme, Ipelegeng, a part of the poverty reduction strategy as well as the Botswana Defence Force (BDF).

tor. The limited movements in overall and composition of formal employment by sector was maintained in the past five years (Chart 1.4), with the private sector accounting for about 60 percent of the formal sector work force.

1.13 The most recent domestic unemployment data are from the Botswana AIDS Impact Survey IV (BAIS IV) for 2013, which estimates a national unemployment rate of nearly 20 percent of the labour force.⁸ The unemployment rate was higher for women than men (22.3 percent compared to 17.8 percent). However, it is worth noting that, for more effective policy-making and monitoring, more up-to-date estimates on unemployment are necessary.

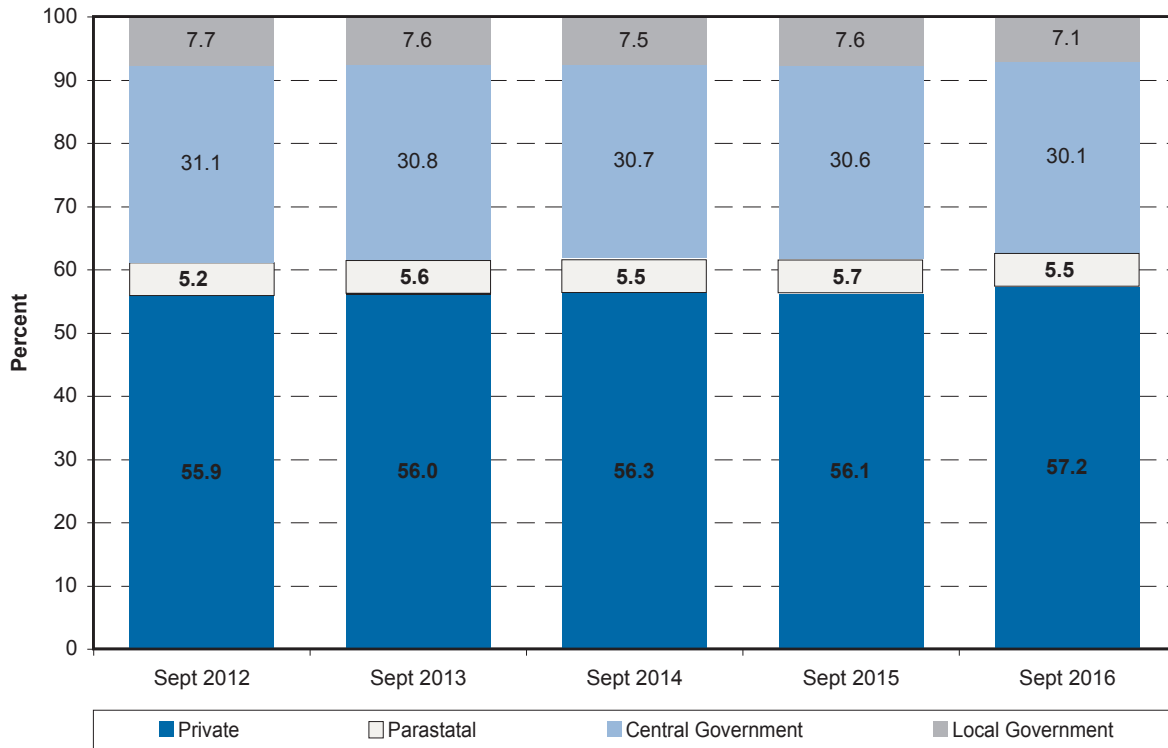
(d) Inflation

1.14 Global inflation remained low, increasing slightly from 2.8 percent in 2015 to 2.9 percent in 2016, mainly reflecting low commodity (including oil) prices, restrained global demand and persistent excess capacity in major economies. Despite modest global demand and a well-supplied market, international oil prices increased late in 2016 in response to the agreement by the Organisation of Petroleum Exporting Countries (OPEC) and some non-OPEC oil producers (such as Russia) to limit production, but they remained relatively low by historical standards. The price of the major international benchmark, Brent crude, increased by 40.3 percent from USD38.01 per barrel in December 2015 to USD53.32 per barrel in December 2016.⁹ Similarly, international food prices increased by 11 percent in December 2016 compared to a decline of 17.5 percent in December 2015.

⁸ This is based on standard international definitions where the labour force includes all persons aged 15 and above who are working or actively looking for work. It neither takes account of the extent of underemployment within the working age population nor does it include the so-called “discouraged workers”, i.e., those who are available for work, but not actively looking for employment.

⁹ Another major benchmark, West Texas Intermediate, averaged USD51.97 per barrel in December 2016, which was an increase of 39.7 percent from USD37.19 per barrel in December 2015. Meanwhile, the OPEC reference crude oil basket increased by 53.6 percent from USD33.64 per barrel to USD51.67 per barrel in the same period.

CHART 1.4: SECTORAL COMPOSITION OF FORMAL SECTOR EMPLOYMENT (EXCLUDING IPELENG)

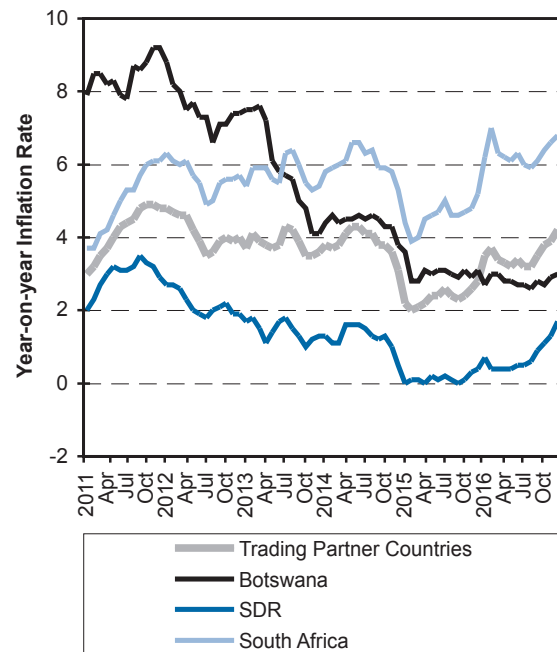


Source: Statistics Botswana

1.15 With respect to Botswana’s trading partner countries, trade-weighted average inflation¹⁰ increased from 2.8 percent in December 2015 to 4.2 percent in December 2016. For the SDR countries (USA, UK, Japan, Eurozone and China), inflation increased from 0.4 percent to 1.2 percent in the same period. Meanwhile, headline inflation in South Africa increased from 5.2 percent in December 2015 to 6.8 percent in December 2016, breaching the South African Reserve Bank’s target range of 3 – 6 percent (Chart 1.5).

1.16 Domestic inflation fluctuated around the lower end of the Bank’s medium-term objective range of 3 – 6 percent¹¹ during 2016, falling from 3.1 percent in December 2015 to 3 percent in December 2016. The rate of increase in prices was lower for most categories of goods and services. In particular, fuel prices fell by 3.3

CHART 1.5: BOTSWANA AND TRADING PARTNER COUNTRIES’ INFLATION (2011 – 2016)



Source: Statistics Botswana, Bank of Botswana and Bloomberg

10 Being the average inflation of the countries whose currencies comprise the IMF’s Special Drawing Rights (SDR) and South Africa inflation.

11 Inflation was in the objective range only in February, March and December, at 3 percent in each month, and was lower than 3 percent in the other months (including a record low of 2.6 percent in August 2016).

percent in the year to December 2016¹² follow-

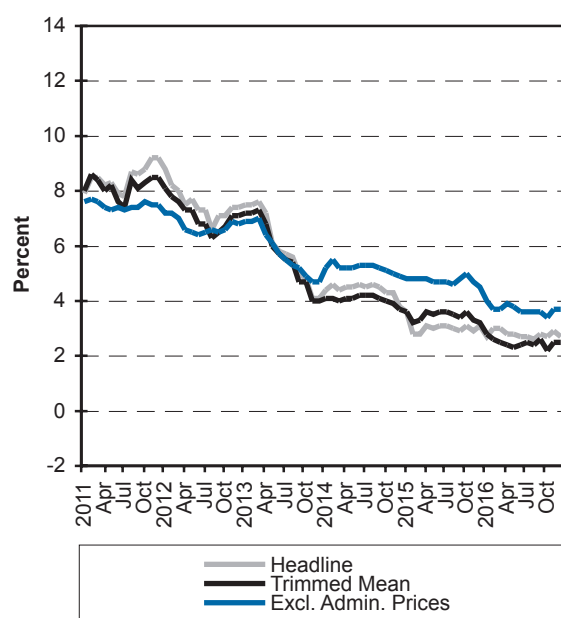
12 This was in the context of a reduction in fuel prices in

ing a 15.7 percent decrease in 2015. However, food price inflation increased from 0.7 percent in December 2015 to 3.9 percent in December 2016. On average, the net effect of adjustments to administered prices was a reduction in inflation by approximately 0.11 percentage points in 2016 compared to a reduction of 0.71 percentage points in 2015. Regarding core inflation measures, the 16 percent trimmed mean inflation decreased from 3.2 percent in December 2015 to 2.5 percent in December 2016, while inflation excluding administered prices decreased from 4.5 percent to 3.7 percent in the same period (Chart 1.6).

(e) Inflation Outlook

1.17 It is anticipated that global inflationary pres-

CHART 1.6: BOTSWANA HEADLINE AND CORE INFLATION (2011 – 2016)



Source: Statistics Botswana

ures will be restrained, largely reflecting subdued commodity prices (expected to recover only partially) and sluggish global demand. However, global inflation is forecast to increase from 2.9 percent in 2016 to 3.3 percent in 2017. Inflation increased in several ad-

February 2016. Fuel prices were decreased in February 2016, with the price of petrol, diesel and paraffin falling by 1.96 percent, 5.91 percent and 8.23 percent, respectively.

vanced economies in 2016, and it is projected to increase further in 2017 as the effect of the earlier decrease in energy prices dissipates. In emerging market economies, it is expected that inflation will moderate as the effect of previous currency depreciation tapers off in 2017. For Botswana, given prospects of the modest increase in foreign prices, domestic demand as well as the projected moderate impact of higher administered prices, it is forecast that inflation will remain within the 3 – 6 objective range in the medium-term.

2. PUBLIC FINANCE AND THE 2017/18 BUDGET

2.1 The Government budget for 2017/18 marks the first year of implementation of National Development Plan (NDP) 11, Vision 2036 (the country's new long-term vision) and the transition to the Sustainable Development Goals (SDGs). The budget was presented in the context of continuing external economic challenges arising from weak the global recovery, lower commodity prices and, hence, subdued demand and market opportunities. Domestically, economic prospects were affected by weak performance of the mining sector, which has been the mainstay of the Botswana economy, and lingering constraints in the supply of electricity and water.

2.2 The prevailing economic challenges have further strengthened Government's commitment to pursue the country's six national medium-term priorities outlined in NDP 11. These are: (a) *Development of Diversified Sources of Economic Growth and Revenues*; (b) *Human Capital Development*; (c) *Social Development*; (d) *Sustainable Use of Natural Resources*; (e) *Consolidation of Good Governance and Strengthening of National Security*; and (f) *Monitoring and Evaluation*. The nation's priorities are also interrelated with objectives of the SDGs, Vision 2016 and the ongoing Economic Stimulus Programme and, therefore, guided the formulation of the 2017/18 budget proposals.

2.3 Furthermore, in formulating the 2017/18 budget and NDP 11, Government was mindful of

volatility in mineral revenues, hence the need to strike an appropriate balance between the short-term fiscal objective of stimulating the economy and the medium-term to long-term goal of promoting fiscal sustainability. In this regard, a proposal has been made to adopt a comprehensive fiscal rule. The elements of the proposed fiscal rule are: financing the recurrent budget from non-mineral revenues; and splitting the spending of mineral revenue, with 60 percent invested in physical and human capital, while 40 percent is saved as financial assets for future generations. Additional elements of the fiscal rule include restricting the ratio of total government expenditure to GDP to no more than 30 percent; maintaining a 70:30 percent allocation between the recurrent and development budgets; and maintaining the statutory limit of the total debt-to-GDP ratio at 40 percent. Nevertheless, with the anticipated levels of non-mineral revenue during the Plan period, the proposed component that seeks to limit the financing of the recurrent budget to non-mineral revenues is not likely to be achieved, especially in the first half of the Plan period.¹³

- 2.4 According to NDP 11, the proposed rule for the allocation of mineral revenue (60 percent for human and physical capital and 40 percent for financial savings) may prove difficult to implement during the Plan period due to the sluggish performance of the mining sector. However, Government is committed to a gradual move towards the targeted allocation rule for mineral revenues in the medium to long-term (NDP 12). For this to be achieved, there will need to be a significant improvement in mobilisation of domestic revenues, especially tax revenue to finance the recurrent budget and, also, control growth in government expenditure.

(a) Budget Performance: 2015/16 and 2016/17¹⁴

2015/16 Budget Outturn

- 2.5 The budget outturn for the 2015/16 financial year was a deficit of P7 billion, significantly higher than the revised estimated deficit of P4.2 billion (and a surplus of P1.2 billion in the original budget). The greater than anticipated budget deficit was largely attributable to receipt of lower revenues and grants (Table 1.2), which resulted in a deficit of 4.7 percent of GDP, against the government set limit of 4 percent.
- 2.6 Revenue decreased by P8.5 billion (15.2 percent) to P47.4 billion in 2015/16, compared to the previous year, as a result of a decrease in mineral and Value Added Tax (VAT) receipts. Total expenditure and net lending increased from P50.6 billion in 2014/15 to P54.4 billion, but was slightly below the revised budget estimate of P56 billion. The less than anticipated total expenditure was due to underspending of recurrent and development budgets, by P1.3 billion and P1.5 billion, respectively, while net lending increased by P1.3 billion.

2016/17 Revised Budget Estimates

- 2.7 The revised estimates of the budget for 2016/17 show a lower deficit of P1.1 billion, compared to the original projection of a much higher deficit of P6 billion. This is due to receipt of more-than-anticipated revenue and grants. This resulted from higher mineral revenue occasioned by increased demand for rough diamonds and, hence, an improvement in sales during 2016.
- 2.8 Revenue estimates were revised upwards by 15.6 percent from P48.4 billion in the original budget to P55.9 billion, as a result of higher mineral and VAT receipts. Meanwhile, the estimate for expenditure and net lending was also revised upwards from P54.4 billion to P57 billion. This was mainly due to the development

¹³ National Development Plan 11, April 2017 – March 2023.

¹⁴ Calculation of percentages are based on figures in Table 1.2, and may differ from those calculated from rounded off figures in the text.

TABLE 1.2: GOVERNMENT BUDGET 2015/16 – 2017/18 (P MILLION)

	2015/16			2016/17		2017/18
	Budget	Revised	Final	Budget	Revised	Budget
Revenue	55 382	51 764	47 420	48 398	55 926	57 187
Mineral Revenue	20 144	18 299	14 438	17 033	20 854	16 334
Non-mineral Revenue	35 238	33 465	32 983	31 365	35 072	40 853
Expenditure	54 153	55 961	54 411	54 445	57 031	59 544
Recurrent Expenditure	41 296	41 719	40 413	39 699	39 663	43 071
Personal Emoluments	16 057	16 072	18 544	18 107	18 107	21 450
Grants & Subventions	10 864	10 969	11 269	10 986	11 100	12 496
Public Debt Interest	1 079	1 079	827	736	736	903
Other Charges	13 296	13 600	9 774	9 871	9 720	8 222
Development Expenditure	12 933	14 318	12 773	14 821	16 277	16 520
Net Lending	-76	-76	1 225	-76	1 091	-47
Balance	1 229	-4 197	-6 991	-6 046	-1 106	-2 357

Source: Ministry of Finance and Economic Development

budget which increased by P1.5 billion to accommodate additional funding for Botswana Power Corporation (BPC). Recurrent expenditure, inclusive of funding for the BCL liquidation process, declined marginally by 0.1 percent.

(b) The 2017/18 Budget Proposals

2.9 The proposed budget allocations for 2017/18 were mainly informed by the need to address development challenges associated with unemployment, poverty, income inequality and the need for diversification of the country's revenue base, all of which are key to promoting sustainable and inclusive economic growth. Moreover, spending will be executed with prudence to ensure fiscal sustainability in the medium-term. In this regard, the 2017/18 budget underscores the need for prudent financial management in pursuit of the national goals. Therefore, a budget deficit of P2.4 billion or 1.4 percent of GDP is forecast for 2017/18, and it is anticipated that the revenue shortfall will be financed by drawing down of government savings and a combination of domestic and foreign borrowing.

Revenue

2.10 Revenue for 2017/18, including grants, is projected to be P57.2 billion, which is 2.3 percent higher than the revised budget for 2016/17 (Table 1.3) and mainly reflects a 48.1 percent increase in SACU revenues from P11.5 billion in 2016/17 to P17.1 billion in 2017/18. Non-mineral income tax revenue is projected to increase by 7.7 percent to P12.3 billion, thus accounting for 21.6 percent of the budgeted revenue. Estimates suggest that VAT collections will grow by 7.7 percent from P7.5 billion in the 2016/17 revised budget to P8.1 billion in 2017/18, comprising 14.2 percent of expected total revenues. In contrast, mineral receipts are forecast to fall substantially by 21.7 percent from P20.9 billion in 2016/17 to P16.3 billion in 2017/18, given the uncertain global diamond market. Nonetheless, minerals will remain the largest source of revenue, representing 28.6 percent of the total, although volatility in the commodity markets underscores the need to diversify the revenue base.

Expenditure

2.11 Total expenditure and net lending for 2017/18 is budgeted at P59.5 billion, which is an

TABLE 1.3: GOVERNMENT BUDGET 2012/13 – 2017/18

Fiscal Year (FY)	2012/13	2013/14	2014/15	2015/16	2016/17*	2017/18*
GDP, current prices (P Million)	112 256	131 221	148 027	148 353	156 094	167 374
Growth rate (percent)	3.2	16.9	12.8	0.2	5.2	7.2
	Budget				Revised Budget	Budget
Revenue & Grants	41 658	48 951	55 904	47 420	55 926	57 187
Recurrent Expenditure	32 106	33 220	37 583	40 413	39 663	43 071
Development Expenditure	8 280	8 909	13 072	12 773	16 277	16 520
Net Lending	351	-399	-91	1 225	1 091	-47
Expenditure & Net Lending	40 736	41 730	50 564	54 411	57 031	59 544
Balance	922	7 222	5 530	-6 991	-1 106	-2 357
Share of GDP (percent)						
Revenues & Grants	37.1	37.3	37.8	32.0	35.8	34.2
Recurrent Expenditure	28.6	25.3	25.4	27.2	25.4	25.7
Development Expenditure	7.4	6.8	8.8	8.6	10.4	9.9
Expenditure & Net Lending	36.3	31.8	34.2	38.0	36.5	35.6
Balance	0.8	5.5	3.6	-4.7	-0.7	-1.4

* Projections

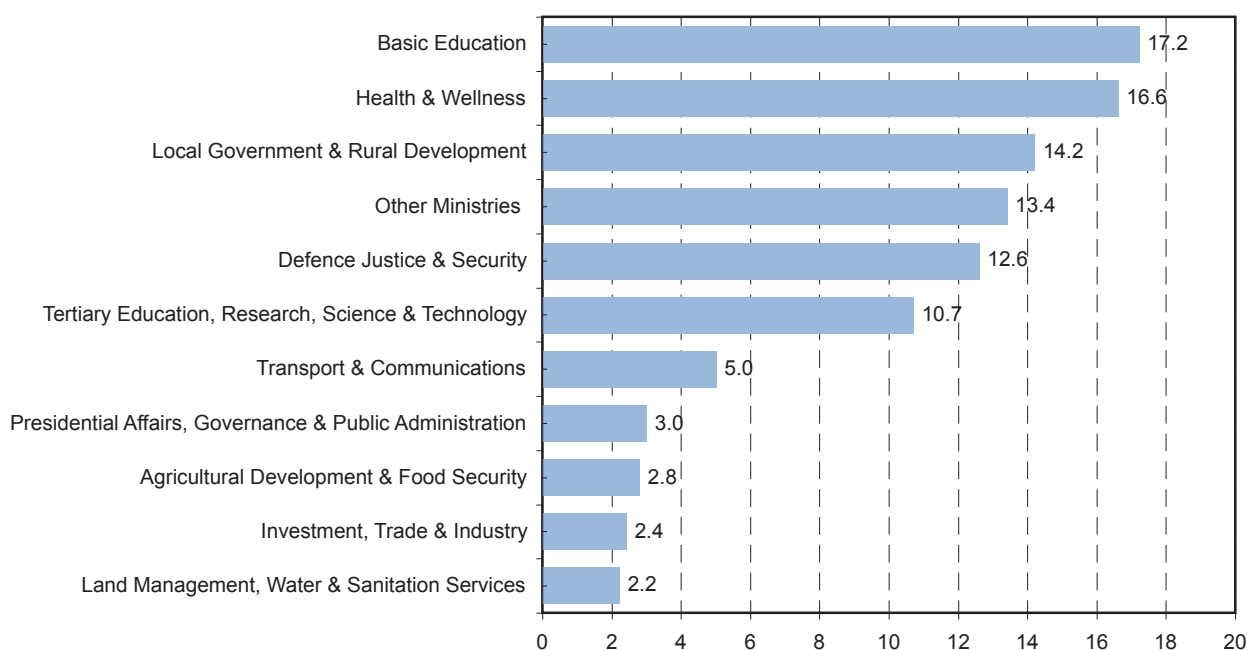
Source: Ministry of Finance and Economic Development

increase of 4.4 percent from the P57 billion in the revised estimates for 2016/17 (Table 1.3). Recurrent expenditure is projected to grow by 8.6 percent, from revised budget of P39.7 billion in 2016/17 to P43.1 billion in 2017/18, accounting for 72.3 percent of total spending. Development spending is forecast to grow slightly by 1.5 percent from a revised P16.3

billion in 2016/17 to P16.5 billion in 2017/18.

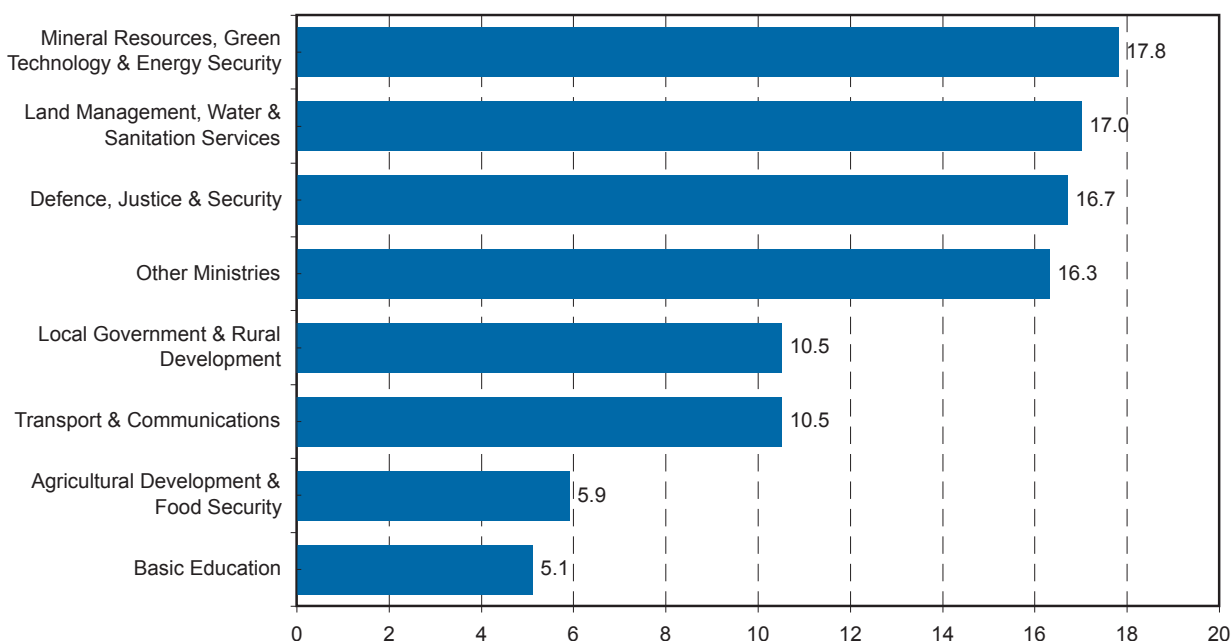
2.12 The bulk of 2017/18 recurrent spending, P21.5 billion (49.8 percent), is on personal emoluments, which includes wages and salaries as well as pensions and gratuities. The balance is accounted for by grants and subventions to parastatals and local authorities, which amount to P12.5 billion (29 percent), “other charges” at

CHART 1.7: PROPOSED ALLOCATION OF THE RECURRENT BUDGET (PERCENT)



Source: Ministry of Finance and Economic Development

CHART 1.8: PROPOSED ALLOCATION OF THE DEVELOPMENT BUDGET (PERCENT)



Source: Ministry of Finance and Economic Development

P8.2 billion (19.1 percent), and interest on public debt at P902.6 million (2.1 percent). Ministerial allocations are led by Basic Education with a share of 17.2 percent as reflected in Chart 1.7.

2.13 More than fifty percent (51.5 percent) of the development budget was allocated for electricity, water and security-related projects (Chart 1.8). Thus, the largest share of P2.9 billion or 17.8 percent was allocated to the Ministry of Mineral Resources, Green Technology and Energy Security, and includes P1.5 billion for the Botswana Power Corporation (BPC). The Ministry of Land Management, Water and Sanitation Services received the second largest proportion (17 percent), mostly to finance the implementation of water projects, followed by the Ministry of Defence, Justice and Security with 16.7 percent of the development budget.

Debt Management

2.14 As at the end of the 2016/17 fiscal year, government and government-guaranteed debt is projected at P34.8 billion,¹⁵ of which P24.9 billion

is Government's own debt, and the balance is government-guaranteed debt (Table 1.4). Total external debt amounts to P25.1 billion or 16.1 percent of GDP, while domestic debt and guarantees at 6.2 percent of GDP, amounts to P9.7 billion. Overall, total projected debt and guarantees as at March 31, 2017, is equivalent to 22.3 percent of forecast GDP, thus remaining below the statutory ceiling of 40 percent of GDP, with both domestic and external debts falling below the 20 percent of GDP limit, each.¹⁶

3. EXCHANGE RATES, BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION

(a) Exchange Rates

3.1 The exchange rate policy supports competitiveness of domestic industries in the international and domestic markets by maintaining a

¹⁵ An increase of 2.3 percent compared to the balance outstanding at the end of the 2015/16 fiscal year.

¹⁶ Most figures reported for government debt are obtained from Tables VII and VIII of the Financial Statements, Tables and Estimates of the Consolidated and Development Funds Revenues. These may differ in some instances from those included in the Budget in Brief, 2017.

TABLE 1.4: GOVERNMENT DEBT AND GUARANTEES 2013/14 – 2017/18 (P MILLION)

Financial Year	2013/14	2014/15	2015/16	2016/17	2017/18
		Actual		Projected	
External					
External Debt	16 591	17 981	17 060	16 162	15 463
External Guarantees	6 401	7 160	8 010	8 960	8 960
Total External Debt	22 992	25 141	25 069	25 122	24 423
Internal					
Internal Debt	7 018	7 466	8 102	8 701	9 362
Internal Guarantees	781	792	886	1 004	1 004
Total Internal Debt	7 799	8 257	8 988	9 704	10 365
Grand Total	30 791	33 399	34 058	34 827	34 788
GDP for FY	131 221	148 027	148 353	156 094	167 374
Percent of GDP					
External Debt & Guarantees	17.5	17.0	16.9	16.1	14.6
Internal Debt & Guarantees	5.9	5.6	6.1	6.2	6.2
Total Debt & Guarantees	23.5	22.6	23.0	22.3	20.8

Source: Ministry of Finance and Economic Development

stable real effective exchange rate (REER)¹⁷ of the Pula against a basket of currencies of major trading partner countries. In 2016, the weights of the Pula basket currencies were maintained at 50 percent each for the South African rand and the Special Drawing Rights (SDR). In October 2016, the Chinese renminbi was included in the SDR basket, thus becoming part of the Pula basket. This change followed the regular quinquennial (5-year) review of the SDR basket.

3.2 Consistent with the policy objective of maintaining a stable REER of the Pula, an upward rate of crawl of 0.38 percent was implemented to the nominal effective exchange rate (NEER) as the projected domestic inflation was close to the lower end of the Bank's medium-term inflation objective and lower than the trading partner countries' forecast average inflation. Consequently, the trade-weighted NEER of the Pula appreciated by 0.38 percent in the twelve months

to December 2016. Given the relatively large negative differential between inflation in Botswana and that in trading partner countries, the REER depreciated by 0.8 percent in the twelve months to December 2016. Although the REER depreciation may indicate gains in competitiveness, it should be noted that the exchange rate alone is not sufficient to ensure sustainable competitiveness of local producers. The attainment of durable competitiveness of domestic producers is mainly through a sustained improvement in productivity, which also contributes to lower inflation.

(b) Balance of Payments

3.3 The balance of payments was in overall surplus of P2.8 billion in 2016 compared to a deficit of P57 million in 2015 (Chart 1.9 and Table 1.6). The surplus was attributable to the improvement in the trade balance as exports of rough diamonds increased in 2016.

Current Account¹⁸

3.4 The current account surplus is estimated at

¹⁷ The REER is a trade-weighted exchange rate of the Pula (against a fixed basket of currencies, after allowing for relative inflation). It is used as an indicator of the relative competitiveness of the country's tradeable goods and services.

¹⁸ The current account comprises trade in goods and services, the income account and the net current transfers.

TABLE 1.5: PULA EXCHANGE RATES AGAINST SELECTED CURRENCIES

Nominal Exchange Rates (Foreign Currency per Pula)			
As at end of			
Currency	2015	2016	Change (Percent)
SA rand	1.3830	1.2792	-7.5
US dollar	0.0890	0.0939	5.5
British pound	0.0600	0.0765	27.4
Japanese yen	10.72	10.95	2.2
SDR	0.0642	0.0699	8.9
Euro	0.0814	0.0891	9.4
Chinese yuan	N/A	0.6544	N/A
NEER (Sept. 2016 = 100)	99.7	100.1	0.4

Real Pula Exchange Rate Indices¹ (Sept. 2016 = 100)²

Currency	2015	2016	Change (Percent)
SA rand	110.9	99.0	-10.8
US dollar	92.0	97.9	6.5
British pound	79.9	103.2	29.2
Japanese yen	107.0	112.3	4.9
Euro	93.0	103.7	11.5
SDR	91.9	101.5	10.4
Chinese yuan	N/A	100.3	N/A
REER	101.0	100.2	-0.8

- All real indices calculated using headline inflation.
- The indices have been revised due to the rebasing of the Consumer Price Index (CPI) to September 2016.

Source: Bank of Botswana

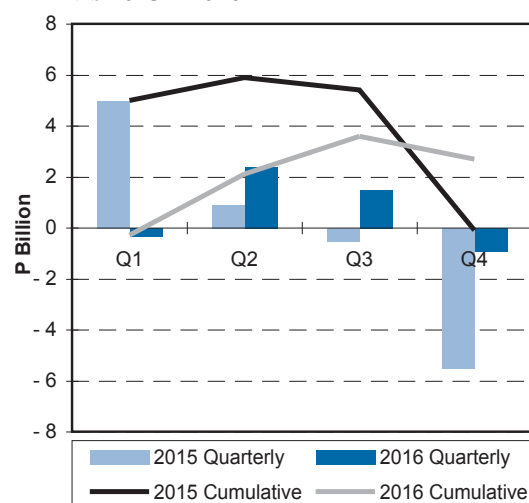
P19.9 billion in 2016 compared to a revised surplus of P12.1 billion in 2015. The larger surplus is primarily the result of the merchandise trade surplus arising mainly from the increase in mineral exports. The surplus is also supported by inflows from the Southern African Customs Union, albeit lower in 2016 than in 2015.

Merchandise Trade¹⁹

3.5 Trends in merchandise trade continue to be driven by diamond trade following the relocation of the De Beers aggregation and sales

¹⁹ Note that the trade data used in preparing the balance of payments does not fully match the monthly trade statistics prepared by Statistics Botswana. For some exports, the trade statistics are supplemented by additional information collected directly from exporters.

functions from the United Kingdom to Botswana in 2012 and 2013, respectively. This relocation established a substantial re-export trade for rough diamonds in the country²⁰ and continues to benefit local diamond cutting and polishing businesses (Table 1.7). The relocation also shifted the direction of diamond trade (exports) from the United Kingdom to other global diamond processing centres such as Belgium and India (Table 1.8, overleaf).

CHART 1.9: QUARTERLY BALANCE OF PAYMENTS 2015 – 2016


Source: Bank of Botswana

3.6 Total exports rose by 9.1 percent, buoyed by a significant 13.9 percent increase in exports of rough and polished diamonds, which was supported by higher demand in global markets. External sales of gold and soda ash also increased by 21.5 percent and 1.6 percent, respectively (Table 1.9, overleaf). The overall growth in exports was weighed down by a 31.3 percent decrease in copper and nickel sales; the financial constraint faced by the state-owned BCL led to closure of both the Selebi-Phikwe and Tati

²⁰ In addition to Botswana, De Beers Global Sightholder Services (DBGSS) processes rough diamonds from other countries where De Beers has mining operations in Canada, Namibia and South Africa. The aggregation and sales processes add value to the imported rough diamonds, which is reflected in the trade balance. Some aspects of the statistical treatment of diamond trade flows continue to be reviewed and, as such, published data may be subject to further revision.

TABLE 1.6: BALANCE OF PAYMENTS 2012 – 2016 (P MILLION)

	2012*	2013*	2014*	2015*	2016#
Current Account	-1 275	11 619	22 219	12 052	19 878
<i>Of which</i>					
Merchandise Trade	-16 715	-2 339	4 674	-9 114	3 372
Services	1 836	2 954	5 184	6 985	7 865
Income	331	-3 152	-3 102	-2 322	-2 768
Net Current Transfers	13 272	14 156	15 463	16 504	11 409
Financial Account	1 523	-8 101	2 658	-7 160	-4 733
Capital Account	–	1	–	2	1
Net Errors and Omissions	-1 110	-2 179	-13 473	-4 951	-12 304
Overall Balance	-862	1 340	11 404	-57	2 843

* Revised

Provisional

Source: Bank of Botswana

TABLE 1.7: DIAMOND TRADE 2014 – 2016 (P MILLION)

Period	Exports			Imports (5)	Re-Exports (6) = (2)-(1)	
	Rough		Polished Exports (3)			
	Botswana Exports (1)	Total Exports (2)				
	Total (Rough and Polished) (4) = (2) + (3)					
2014	35 512	57 953	7 375	65 328	25 980	22 441
2015	25 809	48 286	4 444	52 730	25 232	22 477
2016:						
Q1	9 256	11 712	571	12 284	5 645	2 457
Q2	10 698	13 647	1 094	14 741	4 504	2 948
Q3	12 967	16 550	1 365	17 916	3 653	3 583
Q4	10 725	13 748	1 364	15 112	5 103	3 022
Total	43 647	55 657	4 394	60 052	18 905	12 010

1. **Botswana Exports:** Refer to the value of rough diamonds mined in Botswana and sold abroad. These are accompanied by financial inflows reported in the financial account.

2. **Total Exports:** Represent the value of rough diamonds from Botswana, including re-exports. Subtracting Botswana diamonds from this total approximates the gross value of re-exports. However, this is subject to distortions due to time lags, which means that the two sets of data are not fully comparable, especially over short time periods.

Source: Bank of Botswana

Nickel mine operations during the year. Weak performance of the manufacturing sector also resulted in lower exports for textiles and beef, which declined by 24.6 percent and 11.9 percent, respectively. Overall, the merchandise trade recorded a surplus of P3.4 billion in 2016 compared to a deficit of P9.1 billion in 2015.

3.7 Imports for 2016 are estimated at P66.1 billion, which is a decrease of 9.2 percent from the revised P72.8 billion in 2015 (Table 1.10, over-

leaf). The decrease is largely as a result of the 25.1 percent contraction in diamond imports. Total imports were also lower with respect to textiles and footwear (-6.3 percent), vehicles and transport equipment (-5.5 percent) and fuel (-5.2 percent), developments that indicate the generally weak economic activity in 2016.

Services

3.8 In 2016, the services account recorded a sur-

TABLE 1.8: TOTAL EXPORTS BY DESTINATION 2011 – 2016 (PERCENT)

	2011	2012	2013	2014	2015	2016
United Kingdom	62.4	60.4	31.0	0.9	0.8	1.5
Belgium	2.7	4.3	12.0	23.6	19.8	17.9
Namibia	0.5	1.9	11.7	9.8	11.8	11.6
United Arab Emirates	0.2	0.3	1.0	4.3	5.4	9.6
Israel	5.2	5.4	5.7	7.7	6.0	5.4
India	1.3	1.1	0.3	13.7	12.4	14.1
United States of America	1.1	1.2	1.3	2.7	2.5	2.1
South Africa	13.7	13.2	15.4	13.4	15.6	13.2
Canada	0.0	0.0	6.3	6.5	6.3	4.7
Norway	4.8	5.3	4.4	2.6	4.1	2.1
Hong Kong	0.2	0.3	0.7	2.7	1.9	2.1
Switzerland	1.5	1.7	1.8	3.3	4.3	2.6
Singapore	0.0	0.0	0.4	3.7	3.3	7.0
Other	1.5	4.9	8.0	5.1	5.7	6.1
Total	100	100	100	100	100	100

Source: Bank of Botswana

TABLE 1.9: EXPORTS 2015 – 2016 (P MILLION)

			Percentage Share		Percentage Change
	2015	2016	2015	2016	
Total Exports	63 675	69 498			9.1
<i>of which:</i>					
Diamonds	52 730	60 052	82.8	86.4	13.9
Copper-Nickel	3 790	2 602	6.0	3.7	-31.3
Beef	1 057	931	1.7	1.3	-11.9
Soda Ash	924	939	1.5	1.4	1.6
Gold	283	344	0.4	0.5	21.5
Textiles	374	280	0.6	0.4	-24.6
Vehicles & Transport Equipment	701	529	1.1	0.8	-24.5
Other Goods	3 817	3 280	6.0	5.5	0.1

Source: Bank of Botswana

plus of P7.9 billion compared to the revised surplus of P7 billion in the previous year (Chart 1.10). Total exports of services, at P15.4 billion, were 11.4 percent higher than the previous year. *Transportation* declined by 7.2 percent, while *travel* (mainly tourism receipts) and *other services*, increased by 14.5 percent and 3.3 percent, respectively. Total imports of services increased by 10.2 percent to P7.5 billion, with *transportation*, *travel* and

other services increasing by 100.2 percent, 8.2 percent and 5 percent, respectively. A significant amount of transportation is from freight services.

Income Account

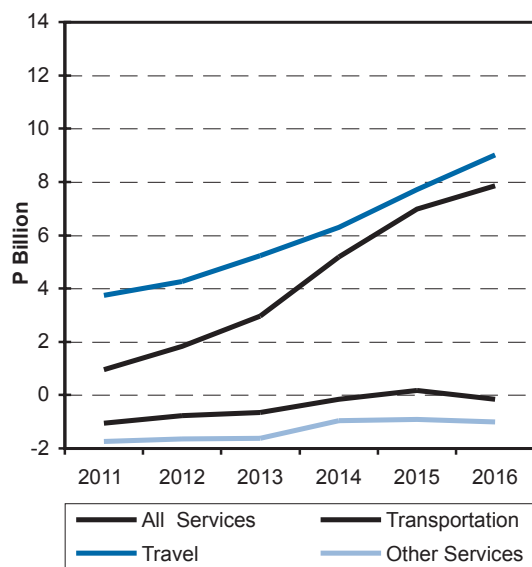
3.9 The income account registered a deficit of P2.8 billion in 2016, slightly higher than the revised deficit of P2.3 billion in 2015. The credit side of this account comprises mainly earnings

TABLE 1.10: IMPORTS 2015 – 2016 (P MILLION)

	2015	2016	Percent		Percentage Change
			2015	2016	
Total Imports	72 788	66 126			-9.2
of which:					
Diamonds	25 232	18 905	34.7	28.6	-25.1
Fuel	9 117	8 647	12.5	13.1	-5.2
Food	7 023	7 460	9.6	11.3	6.2
Machinery & Electrical Equipment	9 208	9 178	12.7	13.9	-0.3
Chemicals & Rubber Products	6 386	6 557	8.8	9.9	2.7
Metals & Metal Products	2 908	3 044	4.0	4.6	4.7
Textiles & Footwear	2 173	2 036	3.0	3.1	-6.3
Vehicles & Transport Equipment	5 324	5 031	7.3	7.6	-5.5
Other	5 417	5 268	7.4	8.0	-2.8

Source: Bank of Botswana

CHART 1.10: BALANCE OF TRADE IN SERVICES (2011 – 2016)



Source: Bank of Botswana

from foreign exchange reserves, which decreased by 5.8 percent to P1.8 billion in 2016. The debit component of the income account consists of dividends and retained earnings²¹ of foreign companies operating in Botswana and interest payments on external debt, which increased by 9.7 percent to P4.4 billion in 2016.

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

Current Transfers

3.10 In 2016, net current transfers decreased as both SACU receipts and private transfers were lower than in 2015. Net current transfers decreased from a surplus of P16.5 billion in 2015 to P11.4 billion in 2016, with net Government transfers declining by 24.8 percent from P15.7 billion to P11.8 billion, while net private transfers decreased from a surplus of P787 million to a deficit of P362 million during the same period.

Capital and Financial Accounts

3.11 The capital account records transfers of financial assets by migrants to and from Botswana and, as in previous years, such transfers remained insignificant in 2016.

3.12 The financial account, which is made up of direct investment, portfolio investment and other investment,²² registered a net outflow of P4.7 billion in 2016 compared to the revised net outflow of P7.2 billion in 2015.²³ This is attributable to an increase in equity offshore.

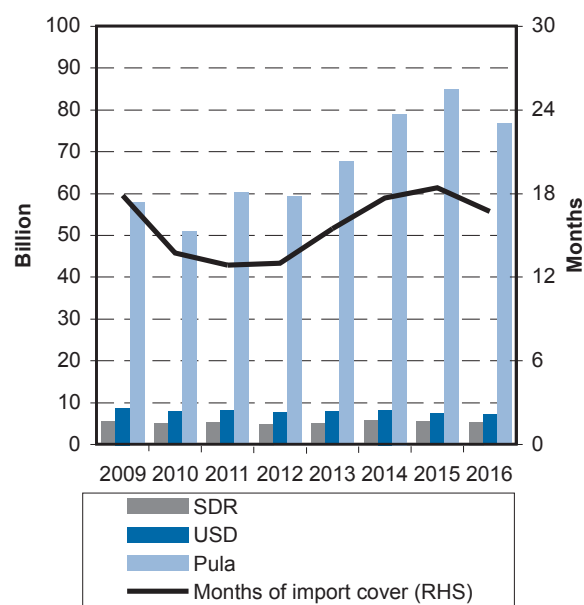
22 'Other investment' comprises borrowing from and lending to foreign entities not classified as direct investment and portfolio investment. These include; government and non-government loans, currency and deposits, trade credits and other equity.

23 The 2016 position is based on preliminary estimates.

Foreign Exchange Reserves

3.13 Foreign exchange reserves decreased by 9.5 percent from P84.9 billion in December 2015 to P76.8 billion in December 2016 (Chart 1.11). This was equivalent to 17 months of import cover²⁴ in December 2016 compared to 18.4 months the previous year. In foreign currency terms, the level of reserves decreased by 4.7 percent to USD 7.2 billion and decreased by 1.9 percent to SDR 5.4 billion. The decrease in foreign exchange reserves (both in Pula and foreign currency terms) reflects, among others; market revaluation losses; foreign currency translation losses, which resulted from the appreciation of the Pula against currencies in which the reserves are held and a drawdown of reserves to meet government obligations.

CHART 1.11: LEVEL OF FOREIGN EXCHANGE RESERVES (2009 – 2016)



Source: Bank of Botswana

(c) Balance of Payments Outlook

3.14 It is expected that the current account balance will remain positive in the medium term, supported by growth in merchandise exports, especially diamonds, which recovered in 2016 in line with improved global demand, which is projected to strengthen further in 2017.

²⁴ The calculation of import cover excludes imports of rough diamonds, as these are mainly for re-export.

It is also anticipated that an improvement in global economic activity and demand as well as trade, will bolster travel receipts emanating from tourism and improve customs revenue from SACU. However, given the narrow export base, the economy remains vulnerable to economic shocks, especially to those affecting the diamond market, which could undermine the external balance outcome.

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

(i) International Investment Position²⁵

3.15 Preliminary estimates for 2016 indicate that Botswana's net international investment was P57.6 billion, which was 12.9 percent lower than P66.1 billion in 2015. The decrease is due to a 1.6 percent decline in foreign assets from P153 billion in 2015 to P150.6 billion in 2016 and the increase in foreign liabilities by 7 percent from P87 billion to P93.1 billion in the same period. By component, the stock of 'direct investment', 'portfolio investment' and 'other investment' increased by 59.4 percent, 0.6 percent and 3.4 percent, respectively. However, 'reserve assets' decreased by 9.5 percent, but remain the largest contributor to the total stock of foreign assets. On the liabilities side, inward 'direct investment' and 'portfolio investment' increased by 10.2 percent and 12.8 percent, respectively, while 'other investment' remained unchanged.

(ii) Investment in Botswana by Industry and Country Classification in 2015

3.16 Tables 1.11 and 1.12²⁶ show the stock of Botswana's foreign liabilities at the end of 2015, classified by industry and country. 'Direct investment' is for foreign enterprises holding at least a 10 percent share in resident enterprises and 'other investment' records all other liabilities, including 'portfolio investment'. The

²⁵ There have been revisions to the data to align the IIP with balance of payments flows.

²⁶ These figures are based on the 2015 Balance of Payments Survey conducted by Bank of Botswana.

TABLE 1.11: LEVEL OF FOREIGN INVESTMENT IN BOTSWANA BY INDUSTRY 2015 (P MILLION)

Industry	Foreign Direct Investment	Other Investment	Total
Mining	23 731	172	23 902
Manufacturing	327	38	366
Finance	7 793	2 704	10 497
Retail and wholesale	3 696	516	4 212
Electricity, gas and water	0	7 432	7 432
Real estate and business services	292	0	292
Transport, storage and communications	181	0	181
Construction	146	0	146
Hospitality	401	8	409
Public administration	0	17 244	17 244
Other	1 437	151	1 588
Total	38 004	28 265	66 269

Source: Bank of Botswana

TABLE 1.12: LEVEL OF FOREIGN INVESTMENT IN BOTSWANA BY REGION AND SELECTED COUNTRIES 2015 (P MILLION)

Country	Foreign Direct Investment	Other Investment	Total
North and Central America	1 145	360	1 505
<i>of which</i>			
United States	309	354	663
Europe	20 712	807	21 519
<i>of which</i>			
United Kingdom	12 715	636	13 351
Netherlands	363	0	363
Luxembourg	6 644	14	6 658
Other Europe	990	157	1 147
Asia Pacific	384	7 378	7 762
Africa	15 546	16 400	31 946
<i>of which</i>			
South Africa	8 214	1 633	9 847
Ivory Coast	0	14 680	14 680
Middle East	212	0	212
Other	6	3 320	3 326
Total	38 004	28 265	66 269

Source: Bank of Botswana

mining and finance sectors continue to have the largest shares of foreign direct investment at 62.4 percent and 20.5 percent, respectively. Europe is the major source of direct investment in mining in Botswana accounting for 54.5 percent, of which investment from United Kingdom and Luxembourg makes up 33.5 percent and 17.5 percent, respectively. Africa is also a major source of foreign direct invest-

ment (mostly in the finance sector) at 40.9 percent, of which 21.6 percent is from South Africa.

3.17 'Other investment' is mainly driven by loans to government. In 2015, government external debt, classified under 'public administration' was 61 percent of 'other investment'. This was followed by the electricity, gas and water

category at 26.3 percent, which is dominated by debt finance from China for the Morupule B power plant. By region, the largest share of ‘other investment’ is from Africa and constitutes 58 percent, with public borrowing from the African Development Bank (AfDB) accounting for 51.9 percent. Asia Pacific constitutes 26.1 percent followed by ‘other countries’ with 11.7 percent, which represents public borrowing from multilateral development banks, such as the World Bank.

4. MONEY AND CAPITAL MARKETS

(a) Monetary Policy and Liquidity Management

- 4.1 The primary objective of the Bank’s monetary policy is to achieve price stability, which is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. In addition, policy formulation incorporates the objective of safeguarding the stability of the financial system. A low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers, thus contributing towards the broader national objective of sustainable economic development.
- 4.2 The monetary policy framework is forecast based, with a medium-term outlook that primarily guides the Bank’s response to projected movements in inflation, while taking account of prospects for economic growth and developments in financial soundness and other indicators relevant for monitoring risks to financial stability. To this end, in assessing the policy stance, the Bank takes into account forecast real monetary conditions²⁷ in the context of other relevant domestic and international

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

factors²⁸ as well as their impact on the output gap and, consequently, on inflation. The framework recognises the importance of effective communication to foster policy credibility and influence inflation expectations; as such, there is a press release after each meeting of the Bank’s Monetary Policy Committee to announce the policy decision and its rationale.²⁹

(b) Interest Rates and Bank of Botswana Certificates

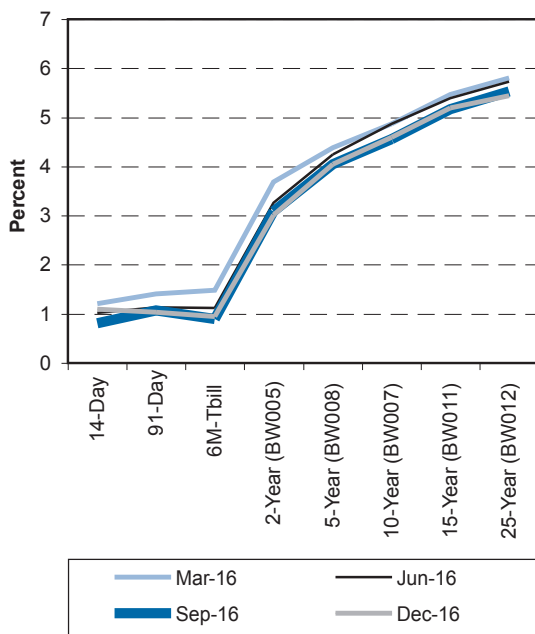
- 4.3 During 2016, monetary policy was conducted in an environment of slow growth in global economic activity, benign inflationary pressures and lower commodity prices, particularly for oil. Below-trend domestic economic growth indicated a non-inflationary output gap, while modest domestic demand and subdued external price pressures contributed to the positive inflation outlook in the medium term. Thus, an accommodative monetary policy stance was maintained, with further lowering of the Bank Rate by 50 basis points from 6 percent to 5.5 percent in August 2016, to support economic activity. As a result, the prime lending rate for commercial banks declined from 7.5 percent to 7 percent. The yield on the 14-day Bank of Botswana Certificates (BoBCs) decreased from 0.97 percent in December 2015 to 0.84 percent in December 2016, while the 3-month BoBC yield also declined from 1.17 percent to 1.01 percent (Chart 1.12).³⁰
- 4.4 The real yield on BoBCs fell in 2016 due to a larger decrease in nominal BoBC rates compared to the decline in inflation. The real 14-day BoBC rate decreased from -2.07 percent in December 2015 to -2.1 percent at the end of 2016, while the real 3-month BoBC yield

28 A key demand indicator is the “output gap”, i.e., the difference between actual output and long-term trend output (as an indicator of productive capacity). A negative output gap means the actual level of output for a given period is below the trend level for that period, thus indicating the economy is operating below its estimated potential.

29 From the beginning of 2017, there will be a press briefing at the conclusion of each MPC meeting.

30 The quoted yields for both the 14-day and 91-day maturities are a weighted average of winning bids’ yields at auction.

CHART 1.12: YIELD TO MATURITY ON BANK OF BOTSWANA CERTIFICATES AND GOVERNMENT BONDS



Source: Bank of Botswana

decreased from -1.87 percent to 1.93 percent in the same period.

4.5 The conduct of monetary policy entailed open market operations through which BoBCs were sold to absorb excess liquidity in order to achieve interest rates consistent with the policy stance. The value of outstanding BoBCs was P7.9 billion in December 2016, down from P8.2 billion at the end of the previous year

(Chart 1.13). Reverse repurchase agreements (reverse repos) were used to manage liquidity between weekly auctions. In December 2016, the amount of excess liquidity absorbed through reverse repos was P1.3 billion compared to P1.7 billion in December 2015.

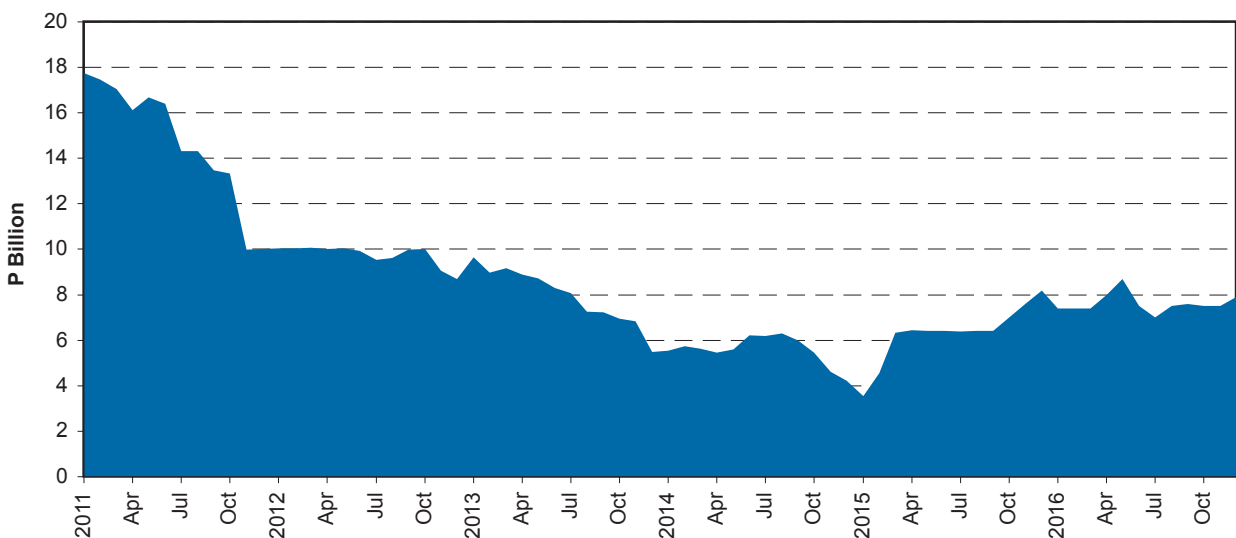
(c) Banking System

Domestic Credit

4.6 Year-on-year growth in commercial bank credit decelerated from 7.1 percent in 2015 to 6.2 percent in 2016, against a background of subdued economic activity and restrained growth in personal incomes. The slowdown in annual credit expansion was mostly associated with the decrease in growth in lending to the household sector from 12.8 percent in 2015 to 7.6 percent in 2016. In contrast, yearly growth in business credit increased from -0.3 percent to 4.2 percent in the same period (Chart 1.14, overleaf). As at December 2016, household credit constituted a larger share of total private commercial bank credit at 60.1 percent.

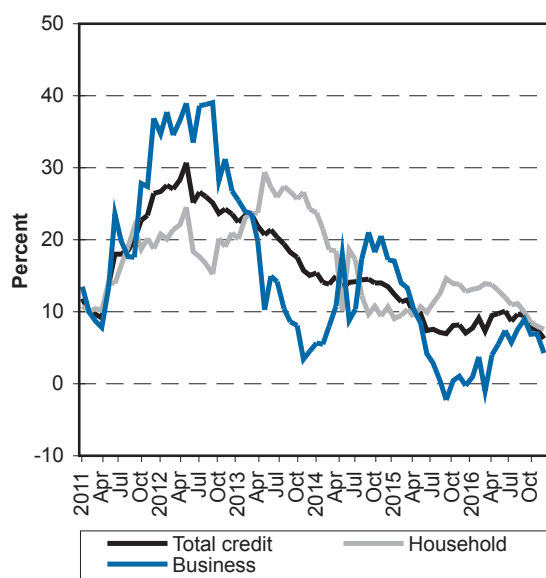
4.7 By component of household credit, annual growth of unsecured lending decreased from 15.5 percent in 2015 to 8.3 percent in 2016, while yearly expansion in mortgage loans declined from 7.2 percent to 6.3 percent. The slower growth in these categories of credit

CHART 1.13: OUTSTANDING BANK OF BOTSWANA CERTIFICATES



Source: Bank of Botswana

CHART 1.14: YEAR-ON-YEAR COMMERCIAL BANK CREDIT GROWTH



Source: Bank of Botswana

was consistent with the subdued activity in the property market and modest growth of personal incomes, which engendered a cautious approach to lending by banks.

- 4.8 Overall, banking system performance indicators suggest a stable financial environment. Specifically, the moderation of mortgage credit growth in the context of a slowdown in the property market bodes well for maintaining potential risks in this area at modest levels. The concentration of household credit in the unsecured lending category (66 percent) continues to be a cause for concern. Nonetheless, any risks emanating from this type of lending to households is moderated by the extent to which unsecured credit is diversified and its potential contribution to economic activity, wealth-creation and growth³¹ activities that it finances. Unsecured household lending represents relatively small amounts spread across many borrowers, thus mitigating the possibility of an escalation of bad debts. The recent loss of employment income from the closure

³¹ For example, there can be wealth gains if such borrowing is used to acquire, construct or improve property that subsequently increases in value and acquisition of assets that improve production/productivity and give rise to a prospective increase in income. Moreover, consumption generates business and economic activity.

of several companies, including BCL and its subsidiary, could be a source of some possible strain on individuals and entities involved. However, the impact on individual banks and the banking system at large is expected to be minimal, mitigated by collateral, insurance and adequate provisioning in the context of satisfactory levels of profitability and capital. The aggregate ratio of non-performing loans to total loans increased from 3.3 percent in December 2015 to 4.9 percent in December 2016.

Monetary Aggregates

- 4.9 Annual growth in broad money supply decreased substantially from 19.9 percent in 2015 to 5.4 percent in 2016. This deceleration in growth resulted from the impact of the contraction in net foreign assets and lower annual growth in credit to the private and parastatals sectors. By component, currency outside depository corporations increased by 4.7 percent, while other deposits rose by 2.8 percent, in the year to December 2016. Meanwhile, transferable deposits (i.e., current accounts) grew by 17.1 percent in the same period. The Pula value of deposits in foreign currency accounts (FCAs) increased by 13.3 percent in the twelve months to December 2016 compared to annual growth of 16.4 percent in 2015 and accounted for 16.9 percent of total deposits at commercial banks in December 2016.

Bank of Botswana

- 4.10 Total assets and liabilities of the Bank of Botswana contracted by 9.2 percent, from P85.4 billion in December 2015 to P77.6 billion in December 2016. The contraction in the balance sheet in 2016 reflected the impact of a 9.5 percent decrease in foreign exchange reserves. The total shareholder's funds, which largely comprise the Government Investment Account (GIA), decreased by 15.6 percent, from P66 billion in December 2015 to P55.7 billion in December 2016. Commercial bank deposits at the Bank of Botswana (including primary reserve requirement balances)

increased from P3 billion in December 2015 to P3.6 billion in December 2016. Over the same period, the value of outstanding BoBCs declined by 3.3 percent from P8.2 billion to P7.9 billion.

Other Depository Corporations

- 4.11 The overall balance sheet of commercial banks increased by 5.2 percent from P76.7 billion in December 2015 to P80.7 billion in December 2016. On the assets side, loans and advances increased by 5.7 percent from P47 billion to P49.7 billion, while debt securities held by banks rose by 59.5 percent. Year-on-year to December 2016, deposits of domestic banks in foreign banks decreased by 2.3 percent, while “other assets” increased by 2.5 percent. With respect to liabilities, deposits at commercial banks rose by 4.4 percent in the same period. Wholesale business deposits remained the main source of commercial banks’ funding (73 percent of total deposits in December 2016), sustaining the net debtor position of households. The ratio of commercial bank assets to nominal GDP was relatively stable at around 50 percent in both 2015 and 2016, while the credit to GDP ratio was 42.1 percent in 2016 (third quarter) compared to 42.4 percent in the corresponding period in 2015.
- 4.12 Total assets and liabilities of the Botswana Building Society declined by 11.7 percent from P4.3 billion in December 2015 to P3.8 billion in December 2016, following annual growth of 24.6 percent in 2015. Loans and advances increased by 2.3 percent, while the Society’s cash and deposits declined by 58.7 percent in the same period. On the liabilities side, the level of capital reserves increased by 3 percent to P1.1 billion in December 2016, while public deposits fell by 15.3 percent.
- 4.13 For Botswana Savings Bank, total assets and liabilities expanded by 25.5 percent year on year to December 2016 after growing by 25.1 percent in 2015, with lending increasing by 37.1 percent (faster than 28.9 percent in 2015). Mobilisation of deposits resulted in annual growth of 33.3 percent in savings during 2016,

an improvement from the annual growth of 14.8 percent in the previous year.

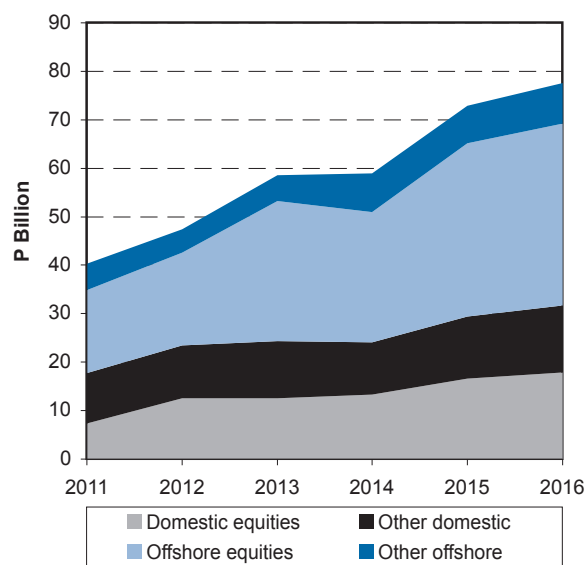
(d) Other Financial Corporations

- 4.14 The balance sheet of the National Development Bank increased by 13.2 percent, from P1.5 billion in December 2015 to P1.7 billion in December 2016. This was a significant improvement compared to the 21.2 percent contraction in the year to December 2015. The increase reflected the substantial growth in liquid assets funded by the capital injection from the Government and borrowing from the commercial banks.
- 4.15 The assets of Botswana Development Corporation grew by 11.8 percent to P2.6 billion in December 2016, from P2.3 billion in December 2015. This performance was underpinned by growth of 44.9 percent in loans, advances and leasing, which more than offset the decline in investments in related companies.
- 4.16 The Domestic Companies Index of the Botswana Stock Exchange (BSE) decreased by 11.3 percent in 2016 to 9 400.7; this contrasts with the growth of 11.5 percent in 2015. Activity improved in 2016, with 1 448.4 million shares traded, albeit with a low value of P2.6 billion compared to the exchange of 834.1 million shares valued at P3 billion in 2015. The market capitalisation of domestic companies fell by 7.4 percent from P50 billion in December 2015 to P46.3 billion in December 2016 due to the decrease in the share prices of most of the listed companies. The number of listed domestic companies in 2016 increased to 24 following the listing of Botswana Telecommunications Corporation Limited. The Foreign Companies Index (FCI) increased by 0.8 percent in 2016, ending the year at 1 585.8, following a contraction of 0.4 percent in 2015.
- 4.17 Assets of pension funds increased by 1.7 percent, from P73.8 billion in December 2015 to P75.1 billion in December 2016 (Chart 1.15). By class of assets, investment in domestic equities grew by 14.2 percent to P18.3 billion in

the twelve months to December 2016, while holdings of offshore equities decreased by 0.4 percent to P36.8 billion. Meanwhile, the value of domestic bonds held by pension funds declined by 8.7 percent to P8.2 billion, while offshore bonds increased by 4.1 percent to P8.2 billion in the same period. The proportion of assets invested offshore by pension funds decreased marginally from 60.8 percent in December 2015 to 60.1 percent in December 2016. The ratio of pension funds assets to nominal GDP was 48.1 percent in 2016 (third quarter) compared to 48.3 percent in the corresponding period in 2015.

agencies, Moody’s Investors Service (Moody’s) and Standard & Poor’s (S & P), reaffirmed the ratings of ‘A-’ for long-term bonds and ‘A-2’ for short-term bonds in domestic and foreign currency denominated borrowing, respectively. The ratings are supported by the strong external and fiscal balance sheets, net external creditor position and low public debt. The agencies recognised the presence of robust institutional frameworks, resulting in prudent policy-making and continuing political stability. Notwithstanding this positive assessment, the ratings are constrained by the persistent concern about heavy dependence on diamond mining, the narrow economic base and relatively slow progress in economic diversification.

CHART 1.15: BOTSWANA PENSION FUND ASSETS (2011 – 2016)



Source: NBFIRA

4.18 The P15 billion Government Bond Programme remains in place, with the focus on the development of the capital market, while also providing an alternative source of government funding. Outstanding bonds of various maturities and Treasury Bills increased from P7.196 billion at the end of 2015 to P9.258 billion in December 2016. The Bank held P20 million (0.28 percent) of the total outstanding securities for possible repo transactions.

(e) Credit Rating

4.19 The international sovereign credit rating

BOTSWANA'S TRADE PATTERN, INTERNATIONAL INVESTMENT AND REGIONAL ECONOMIC INTEGRATION: OPPORTUNITIES FOR INDUSTRIAL DEVELOPMENT AND INCLUSIVE GROWTH

1. INTRODUCTION

- 1.1 Botswana remains a largely open economy with exports and imports each amounting to approximately 40 percent of GDP. However, trade remains heavily skewed in both product and direction. Largely unprocessed minerals dominate exports to a few markets in Europe and Asia, while imports of capital and consumer goods, including food, mostly come from South Africa. Increasingly, however, there has been some progress in improving downstream activity in the mining sector, potentially fostering diversification of both products and markets for mineral-based exports and associated employment opportunities. On the other hand, domestic economic growth has resulted in increased imports of capital goods for infrastructure development and processing industries, while consumption goods have dominated overall imports. The other notable changes in trade patterns are the increase in services trade (tourism in particular) and the importance of trade with emerging market countries in Asia, including India and China. At the same time however, the potential with respect to the cattle and textile industries appears to be faltering, despite the existence of favourable trade arrangements and substantial government support. An additional dimension of Botswana's external relationships is the financial flows, including both inward and outward investment.
- 1.2 The country's openness to trade and capital flows is supported by several policies and institutional arrangements. The foreign direct investment (FDI) component of capital flows is critical as a source of new investment capital, promoting technology and skills transfer, enhancing market access and, as a result, serving as a catalyst for the process of economic diversification and promotion of inclusive growth. The thrust of Botswana's trade policy is pur-

suit of an outward-looking strategy in order to support market expansion and easy access to imports. Among others, this strategy is fostered by an exchange rate policy that supports competitiveness of domestic industry, absence of exchange controls and trade agreements that facilitate market access and support local industries. In addition, efforts towards regional integration are aimed at easing constraints on regional trade and, therefore, promoting efficiency, productivity and, hence, competitiveness in the context of broader market opportunities. The supportive institutional arrangements include: promotional entities (such as Botswana Investment and Trade Centre and Botswana Innovation Hub) that identify and promote opportunities for domestic industrial development, including services; access to external markets as well as those which ease administrative processes for establishing and facilitating effective conduct of local businesses; and favourable access to financing. Ultimately, through resulting business and job opportunities, enhanced competition and broadening of consumer choices, this leads to rising living standards on a sustainable and inclusive basis, and allows absorption of currently unemployed resources as well.

- 1.3 The country's industrial and privatisation policies and some of the initiatives in support of the agricultural sector are, by and large, outward looking, geared towards improving productive capacity, with a view to expanding exports and reducing dependency on imports (or increase the scope for choice between imports and local products). More recently, there are suggestions to promote selected manufacturing activities and services through the cluster/hub approach, including the establishment of special economic zones. Nonetheless, outside the mining, finance and retail sectors, success, thus

far, in attracting foreign investment has been limited.

- 1.4 Progress in advancing the regional economic integration (REI) agenda has been slow; a process which, as with other Southern African Development Community (SADC) member states, Botswana should recognise entails both costs and benefits. In particular, with its limited industrial base, Botswana may not realise much benefit from REI in the near term, despite its favourable business and economic climate for investment. While regional trade has the potential to offer greater opportunities for consumers, businesses and workers, local business may be ill-equipped to compete with more efficient producers elsewhere in the region. At the same time, greater regional integration should result in more trade, including access to inputs by local producers, opportunities for new business activities and, more significantly, a large market for Botswana's goods and services.
- 1.5 Section 2 examines international trade and policy developments, current issues on free trade, FDI and REIs. Section 3 analyses recent trends and performance in trade and capital flows specifically for Botswana, while Section 4 provides an overview of trade agreements and negotiations and regional integration. Institutional support for trade, investment and regional integration is presented in Section 5, while Section 6 discusses opportunities for manufacturing and services (selected industries) and broad-based growth. Section 7 concludes, examining policy considerations and alternatives going forward.

2. OVERVIEW OF INTERNATIONAL TRADE AND POLICY DEVELOPMENTS: THE GAINS FROM FREE TRADE, FDI AND REI

Overview of International Trade and Policy Developments

- 2.1 For much of the period since the mid-1980s, global trade has been buoyant, expanding

at rates exceeding growth in income levels (Chart 2.1). According to the International Monetary Fund (IMF), for the period 1985 – 2007, world trade measured in real terms expanded by almost twice the pace of increase in global income. This trend was apparent across developed, emerging market and developing economies.¹

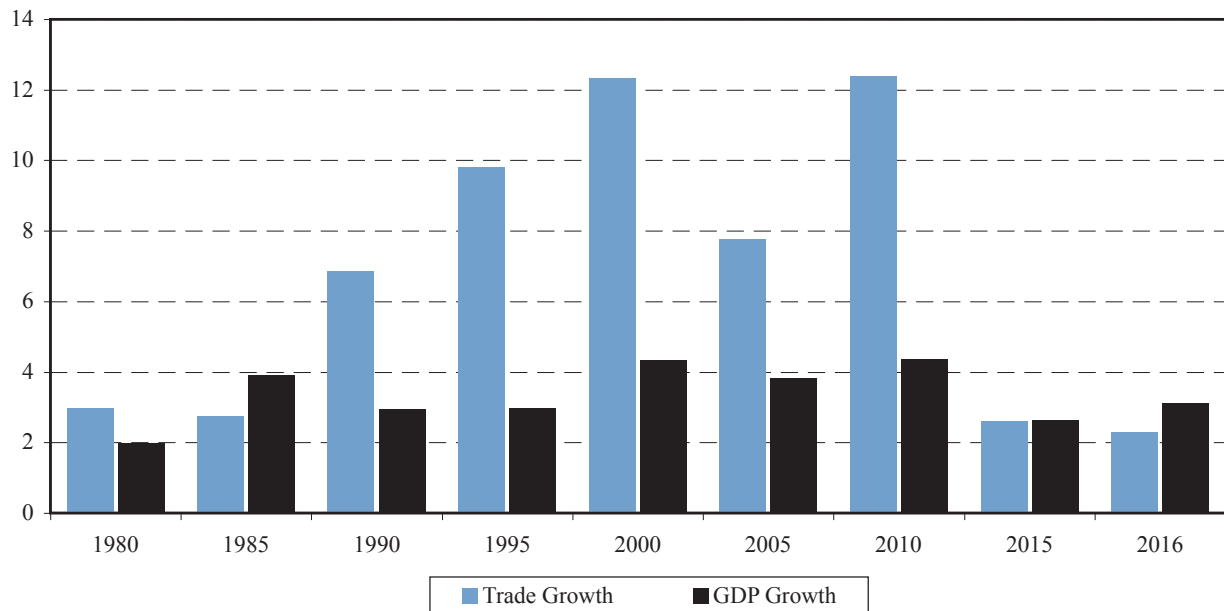
- 2.2 The more rapid growth in global trade was supported by a combination of technological developments and policy changes, which favoured greater economic openness.² Notably, new technologies and efficiencies in transport and communications resulted in relative reduction in trade costs. In addition to facilitating acquisition of goods and services from other countries, this has engendered the development of global value chains, where production is spread across multiple locations.³ Furthermore, a more favourable geopolitical environment and balanced global growth as well as broad acceptance of a positive correlation between openness and inclusive economic growth, resulted in more outward-looking domestic policies.
- 2.3 More recently, however, there has been a marked slowdown in growth of global trade. According to some estimates, there has been little or no increase in global trade since the start of 2015. In part, this can be explained by the generally slow pace of global GDP growth in the wake of the 2007 - 2008 economic and financial crises, together with the changing composition of demand. Contributing factors include: reduced spending on investment (which is more dependent on trade than is the case for consumption goods), including the rebalancing of the Chinese economy away from capital expenditure to consumption-led expansion; an increase in the relative demand for

1 IMF, World Economic Outlook, October 2016.

2 As measured by the ratio of trade to GDP, at the global, regional and national levels.

3 See, for example, Baldwin, R., 2016. "The Great Convergence: Information Technology and the New Globalisation".

CHART 2.1: GROWTH IN VOLUME OF WORLD TRADE AND REAL GDP (1980 – 2016)



Source: WTO and World Bank

non-tradeable services as incomes rise⁴; and slower growth in cross-country value chains as these reach maturity.

- 2.4 Beyond these structural reasons, an emergent resistance to globalisation has also contributed to the slowdown in global trade. This is particularly apparent at the detailed product-level analysis, which indicates that the slowdown is heavily skewed towards commodity groups that are subject to trade restrictions.⁵ To some extent, the increase in protectionism is also a consequence of deterioration in growth trends as policymakers seek to mitigate the domestic impact of the global economic slowdown by raising local productive capacity. In addition, the consensus that increased openness results in prosperity has been eroded by the apparent uneven distribution of the benefits of globalisation, including reduced income and opportunities for some members of society. It is significant that a resurgence of protectionist policies is most evident among advanced economies, where growth has been lower and

the perceived threat to domestic industry and employment from low-cost foreign producers is more pronounced. In this respect, there are mixed prospects for regional integration, international trade agreements and economic unions, which appear to be viewed favourably by the emerging markets and developing economies, while a push-back is apparent for the advanced economies.

Examining the Link Between Economic Openness and Growth and Social Indicators

- 2.5 A wide range of empirical studies (Billmeier and Nannicini, 2007) offer a positive link between economic openness and growth; also indicated by the strong correlation between growth in global output and trade.⁶ Moreover, to the extent that GDP growth is closely linked with other key development indicators (for example, poverty reduction), a generally positive link between openness and welfare exists.
- 2.6 A number of studies have shown that productivity and competitiveness of domestic producers is enhanced by trade openness and a wider

4 Demand for services tends to be relatively strong among higher-income groups. More generally, continued innovation, especially related to information and communications technology, has helped lower the cost of many services.

5 See Footnote 3.

6 Billmeier, A., and Nannicini, T., "Trade Openness and Growth: Pursuing Empirical Glasnost", IMF Working Paper 07/156, July 2007.

skills base.⁷ However, this generally positive conclusion is subject to several important qualifications. In particular, it is not always the case that openness results in growth that is inclusive across all sections of the population, both within and across countries. This perception about the skewed benefits of openness contributes to public skepticism, especially in advanced economies, about the potential gains from globalisation, hence it serves to explain some of the increase in support for protectionism.

- 2.7 Some studies also suggest that the link between openness and growth is not limited to the narrow focus on trade policy, but rather encompasses a holistic range of supportive economic policies. This entails both the micro aspects (for example, approaches to regulation and bureaucracy) and prudent macroeconomic policies that foster stability and, importantly, avoid misalignment of exchange rates to the detriment of competitiveness.⁸
- 2.8 Similarly, the link between openness and employment generation can also vary, depending on conditions in the domestic labour market. The growth-promoting effects of increased openness are likely to be associated with labour market adjustments, and the impact on employment is more likely to be positive to the extent that wages can be aligned with productivity; workers have access to relevant training opportunities; and government social welfare programmes do not discourage job searching as underlying patterns of employment adjust (OECD, 2010).⁹ Given the close link between unemployment and poverty, this is clearly a key consideration, especially in light of the concern that trade liberalisation will result in job losses in domestic industries that are not

able to compete on the global market.

- 2.9 There is an important role for government in a more open economic environment in terms of effective provision of public goods, including necessary infrastructure, efficient administration and social safety nets. In this regard, Rodrik (1998) reports a tendency for more open economies to have bigger governments, suggesting that this is explained by public expenditure to protect workers from risks associated with more open markets.¹⁰ More generally, recent experience from advanced economies suggests that policymakers should temper support for openness and free trade with measures that provide reassurance that national sovereignty is not being unduly sacrificed. Among such measures are effective control of national borders to monitor immigration and ensuring that foreign investors are subject to the same obligations, including, in particular, taxation, as domestic businesses.¹¹ Such issues have grown in prominence at a time when international trade agreements are increasingly less focused on tariffs and encompass the broader business environment (including environmental standards and workers' rights). Moreover, multinational enterprises and global value chains are increasingly prevalent, adding to the impression that they are not subject to national control.
- 2.10 As regards the distribution of income and benefits, while a variety of measures are available,¹² the main conclusion is that globalisation has reduced the extent of inequality across countries. This is primarily because of the positive impact on previously less-developed economies, notably China, that have been major beneficiaries of growth in global trade. In turn, this has resulted in a large reduction in global poverty. As an indicator of this, World Bank

7 See Jae, B. A. and Moon, J. C., 2016. "From Firm-Level Imports to Aggregate Productivity: Evidence from Korean Manufacturing Firms Data," IMF Working Paper 16/162.

8 Baldwin, R. E., "Openness and Growth: What's the Empirical Relationship?" NBER Working Paper No. 9578, March 2003.

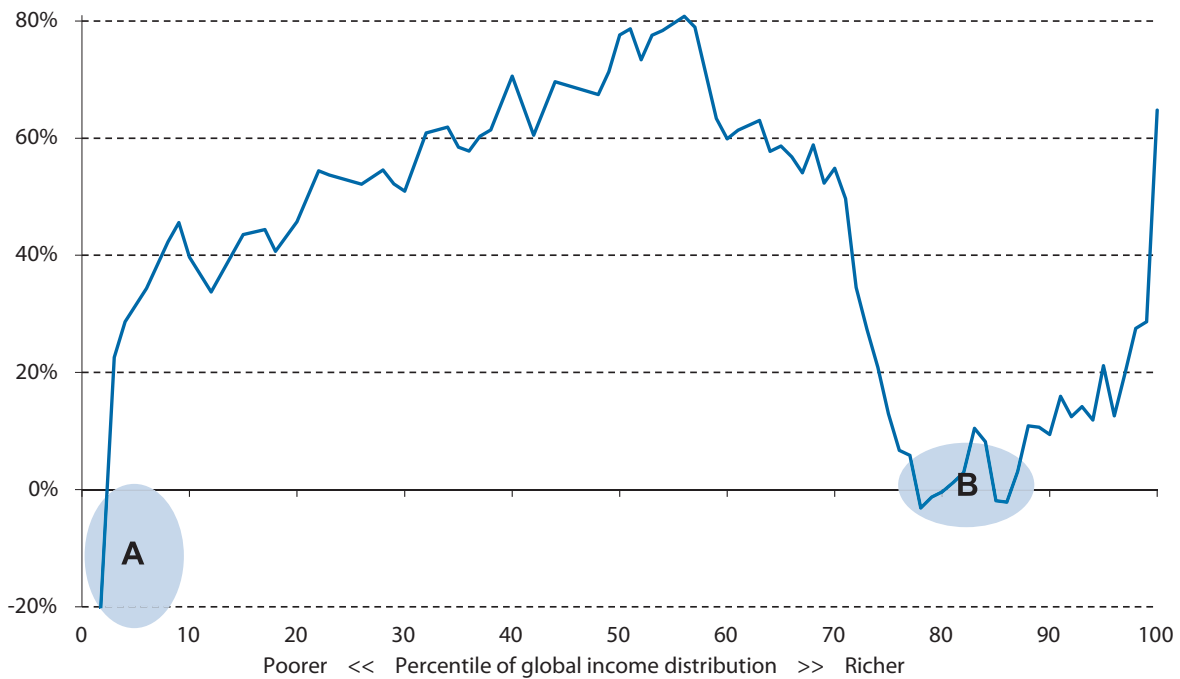
9 "Trade and the Economic Recovery: Why Open Markets Matter", Organisation for Economic Cooperation and Development, May 2010.

10 Rodrik, D., "Why Do More Open Economies Have Bigger Governments?" *Journal of Political Economy* 106(5), October 1998.

11 For instance, the outcome of the 2016 referendum where the United Kingdom citizens voted to leave the European Union (EU) is widely attributed to dissatisfaction over such issues.

12 See, for example, Milanovic, B., 2011. "Global Inequality: A New Approach for the Age of Globalisation"

CHART 2.2: THE "ELEPHANT CURVE": GROWTH IN AVERAGE PER CAPITA INCOME ACROSS THE GLOBAL POPULATION (1998 – 2008)



estimates suggest that the proportion of the world's population living in poverty fell from 35 percent in 1990 to 12.4 percent in 2012.¹³

2.11 The benefits have, however, not been shared equally among all income groups. Chart 2.2 illustrates this with the so called "elephant curve"¹⁴ which plots the percentage change in per capita income levels broken down (from poorest to richest) by percentiles across the world population. Although income levels have risen substantially in real terms for the vast majority, the shaded areas point to two particular areas of concern:

A: While the major gains have been heavily concentrated in the lower sixty percent of the global income distribution (in line with the conclusion that inequality has been reduced

at the global level), this has not been the case for the very poorest households where, in the extreme cases, incomes may even have fallen. This provides support for the view that the poorest households (the so-called "Bottom Billion" (Collier, 2007)¹⁵ should be the central focus of social safety nets, if they are not to be left behind.

B: This group, for which real gains of 20 percent or less have been relatively modest,¹⁶ is interpreted as largely corresponding to the low-income households within the advanced economies. More recent research¹⁷ has suggested

13 As a result, the First Millennium Development Goal of halving the proportion of people living on less than \$1.25 a day between 1990 and 2015 was achieved five years early. There were reductions in all regions, although most notably in East Asia and the Pacific, again consistent with patterns of globalisation. The smallest reductions were in Sub-Saharan Africa, where integration into global trade has lagged behind.

14 So-called because the shape resembles the profile of an elephant with its trunk raised.

15 Collier, 2007, argues that the vast majority of the global population have benefited from open, market-based economies. However, the poorest group (the "Bottom Billion" of the book's title) has been left behind and requires additional targeted assistance. This hypothesis is broadly consistent with the "elephant curve", although the latter suggests that the number requiring such assistance may be considerably less than one billion.

16 Twenty percent over 10 years is equivalent to only 1.6 percent per annum.

17 See Corbett, A., 2016. "Examining an Elephant: Globalisation and the Lower Middle Class of the Rich World", Resolution Foundation. Problems include: i) the data for the two periods is not fully consistent in terms of coverage; ii) faster growth

TABLE 2.1: COUNTRY COMPARISON: GDP PER CAPITA, TRADE OPENNESS, UNEMPLOYMENT AND INEQUALITY

	GDP per Capita (US\$)		Trade Openness		Unemployment Rate (Percent)		Inequality ¹	
	2010	2015	2010	2015	2010	2015	2010	2014
Kenya	991	1 377	54.2	44.8	9.3	9.2	0.53	0.55
Namibia	5 143	4 674	108.4	112.0	22.1	28.1	0.61	0.63
Botswana	6 244	6 360	94.9	105.9	17.9	20.2	0.68	0.70
South Africa	7 393	5 724	56.0	62.5	24.7	25.4	0.64	0.67
Mauritius	8 000	9 252	113.5	107.9	7.7	7.9	0.76	0.78
Malaysia	9 069	9 768	157.9	134.2	3.4	3.4	0.77	0.78
Chile	12 785	13 416	69.7	60.2	8.2	6.2	0.81	0.83
United Kingdom	38 709	43 876	59.2	56.5	7.9	5.4	0.91	0.91
Singapore	46 570	52 889	372.1	326.1	3.1	1.9	0.90	0.91
United States	48 374	56 116	28.2	28.0	9.7	5.0	0.91	0.92
Sweden	52 076	50 580	86.9	86.4	8.7	6.7	0.90	0.91
Norway	87 646	74 400	68.4	69.3	3.6	4.5	0.94	0.94

1. As measured by the inequality-adjusted human development index (IHDI) which takes into account not only the average achievements of a country on health, education and income, but also how those achievements are distributed among its population by “discounting” each dimension’s average value according to its level of inequality. Higher values indicate more even income distribution, while lower values represent a larger degree of inequality.

Source: World Bank

has suggested that this conclusion may not be so clear cut once more detailed like-for-like comparisons between the two data sets, together with allowance for country-specific effects, are taken into account. Nonetheless, the suggestion that growth in middle-income economies has been at the expense of low income, unskilled workers in more developed countries, appears to be in line with growing discontentment in those countries towards globalisation, which is mainly concentrated in lower-income groups.

2.12 Such misgivings about the consequence of globalisation have been further aggravated by concern that inequality within countries has likewise been increasing. This is also partly evident from Chart 2.2, where the wealthiest

is not fully consistent in terms of coverage; ii) faster growth among lower income countries may itself have impacted on the ordering of the income distribution, with the seemingly low growth among this relatively well-off cohort due, in part, to rapid growth in incomes among the better off in emerging economies who were previously in lower percentiles of the overall distribution.

percentiles of the global population (which are heavily concentrated in the advanced economies), are among the major beneficiaries. But this is not limited to the advanced economies, with concern that reduced inequality measured on a global basis is occurring side-by-side with growing inequality within countries across the income range. One manifestation of this concern is that the majority of people in the world classified as living in poverty do not come from “poor” countries.¹⁸

2.13 However, the suggestion that any trend towards widening inequality is the consequence of globalisation is less compelling. More important may be the impact of rapid advances in labour-saving technologies that, in turn, have compressed wages, resulting in job losses, especially for low-skilled workers. To the extent that these have largely originated within the developed economies, policies to restrict openness may have little effect on reducing inequality.

2.14 The positive association between trade, growth

18 Lancet Commission on Investing in Health, 2012.

TABLE 2.2: UNEMPLOYMENT, TRADE OPENNESS AND INEQUALITY IN BOTSWANA

	GDP per capita (US\$)	Unemployment Rate (Per-cent)	Trade Openness	Inequality ¹
2005	5 328	22.0	88.5	0.61
2006	5 342	17.6	86.3	N/A
2007	5 667	18.5	95.1	N/A
2008	5 562	21.9	96.7	N/A
2009	5 115	18.4	86.7	N/A
2010	6 244	17.9	94.9	0.68
2011	7 505	17.8	101.4	0.69
2012	6 886	17.7	108.7	0.69
2013	6 807	17.6	123.8	0.70
2014	7 154	18.2	117.5	0.70
2015	6 360	20.2	105.9	N/A
2016	6 771	22.0	106.3	N/A

1. N/A – data not available.
Source: World Bank

and social development is clearly evident in the case of Botswana with the exception of unemployment (Tables 2.1 and 2.2), where the value of the national natural resource endowment (mainly rough diamonds) has been realised and generated an increase in welfare through a combination of export revenues and access to imported consumption and investment goods and services. In addition, external sector performance for Botswana has enabled government intervention involving the provision of infrastructure, social services and social safety nets; which, in aggregate, has been positive for inclusive growth. Also, the strength of the external balance has supported Botswana's high sovereign credit rating. Table 2.1 shows selected country indicators.

Aspects of Free Trade – Benefits and Limitations

2.15 The major advantages of free trade accrue when a country specialises in goods and services in which it is naturally endowed or most suited to produce as indicated by availability of inputs to production, including natural resources and local labour skills, capital goods and infrastructure. With such specialisation, economic openness is not a “zero-sum game” where the benefits of trade accruing to one party are offset by losses of others. Rather, the development of strong external linkages is a necessary

pre-condition for the effective exploitation of mutually-beneficial economic opportunities.

2.16 Free trade has several important implications for the direction of policy as follows:

- (a) generally, unhindered access to imports enhances consumer welfare through access to a wider range of competitively-priced goods and supports the efficiency of local producers with widest range (in terms of quality and cost) of inputs to production, in turn, improving their capacity to compete in both domestic and export markets. Furthermore, a country's exports would be more likely to have unrestricted entry into other markets if it provides reciprocal treatment to imports (which are, after all, other countries' exports);
- (b) a commitment to free trade should not be confined to tariff reduction, since protectionism includes both tariff and non-tariff barriers that impede imports, such as deliberate restrictions, inefficient administration and infrastructure (for example, at border posts). Indeed, as tariffs have been progressively reduced over the years, non-tariff barriers have become the major impediments to free trade;

- (c) free trade with respect to goods and services needs to be complemented by openness to investment, as well as technology and skills transfer, which supplements domestic productive capacity;
- (d) for countries to maximise the benefits of economic openness, domestic markets should be competitive and efficient, with factors of production rewarded in line with their productivity. This helps to avoid the risk of failure by local producers, even where comparative advantage exists, either due to very high costs or if factor payments (rewards) are too low to secure the necessary quality of inputs;
- (e) a consequence of free trade and alignment of production with comparative advantage is specialisation, whereby countries should not expect to be major producers across a wide range of industrial and service sectors. This consideration is especially relevant for small economies with limited inputs of production. Thus, for these countries, the welfare benefits of specialised local production and effective access to international markets for both exports and imports are particularly pronounced.

2.17 Nonetheless, a commitment to free trade is not necessarily associated with a *laissez-faire* approach to economic management that excludes a significant role for government in guiding development. The experience of some of the successful East Asian economies provides evidence that an interventionist approach by government can be consistent with an outward-looking and export-led growth model. In addition, governments play a key role in the provision of essential public infrastructure and services that complement economic openness. In addition, adequate social safety nets are necessary to ensure that the benefits of economic progress are shared widely. Even then, it is important that government has sufficient capacity for effective and beneficial intervention.

2.18 Indeed, there may be cogent reasons for a cautious approach to trade liberalisation. Some

degree of protection for domestic firms, appropriately calibrated with respect to coverage and duration, may be justified where there is need to mitigate adjustment costs and help develop capacity in sectors where competitive advantage can be achieved over time. It may also be necessary to intervene in order to compete with monopolies/cartels and industries that are supported by other governments (for example, agricultural products). National interest, including security of supply (for example, in energy provision), could also warrant restrictions for some sectors or markets.

2.19 While some support for local industries can be justified, imposition of tariffs and other trade barriers to restrict imports is not, in many cases, the most efficient option. Such restrictions do not directly address the reasons for local producers not being competitive; and may lower the purchasing power and welfare of consumers (through higher cost and sometimes lower quality). Indeed, tariffs and similar measures obscure the extent to which local industry is being subsidised by consumers through higher prices and, in the process, encourage rent-seeking behaviour. In this respect, explicit subsidies, financed through taxation, are generally preferable as they are transparent and can be subjected to public scrutiny.

Import Substitution

2.20 Historically, several countries have used import substitution as the basis for successful industrialisation, which might appear consistent with a dynamic view of comparative advantage whereby local productive capacity is nurtured through “infant industry protection”. Moreover, promotion of import substitution could be viewed as being amenable to direct influence of domestic policy initiatives. However, some of the earlier successes achieved through import substitution have been hard to replicate. In particular, small economies are not suited to such inward-focused development strategy, given the paucity of domestic demand and the range of inputs necessary for sustainable broad-based

industrial development. Furthermore, a focus on import substitution is, in general, at variance with a commitment to free trade.

2.21 Broadly, a strategy centred on import substitution faces several disadvantages:

- (a) a focus on products for which there is significant domestic demand can be a poor guide to a country's productive potential as imports are typically most prevalent in areas where the importing country has the least productive potential. Food is a case in point in this respect. To be sustainable, all countries require adequate supplies of food; however, beyond subsistence levels of development, only a few countries can provide for all their food requirements. Free trade in agricultural products is, therefore, a major contributor to consumer welfare and food security;
- (b) import substitution encourages diversification that leads to inefficient distribution of resources; therefore, ignoring the benefits of specialisation in production where requirements in terms of labour, capital, natural resources and other inputs to production are more in line with national endowments;
- (c) excessive support for local industry can encourage unproductive "rent-seeking" by special interest groups representing local producers. Notably, support for "infant" industries has often been sustained with a continuing and increasing cost to local consumers and with the implicit admission that, fundamentally, the protected industry is not viable; and,
- (d) administrative expenses of maintaining a restrictive trade regime may also be significant, with costs tending to fall heavily on excluded groups, such as the poor and unemployed that, overall, benefit little if at all, from protectionist policies. At the same time, these costs represent an additional burden on governments, adding to expenditure with no commensurate boost to revenues. In addition to fiscal policy

implications, there could be undue pressure from inappropriate use of exchange rate and interest rate policies, exposing a country to a risk of macroeconomic imbalance, which could further undermine production and distribution efficiencies.

2.22 These limitations suggest that a policy more aligned with the conventional model of free trade, that is, developing local industry through export promotion, may be appropriate. However, this is in the context of current trends in globalisation that require a full commitment to efficiency and openness, with appropriate planning to mitigate any negative impact of accompanying structural adjustments. Moreover, participation within global value chains, with movements of intermediate rather than final products increasingly dominating trade patterns, may not be fully compatible with beneficiation objectives that seek to concentrate on downstream processing, final manufacture and distribution using natural resources in the originating country. It is recognised, in this regard, that finished diamond products and jewellery, with the primary product originating from Botswana are widely sold across the world, predominantly in the USA, Japan and China. While there is limited comprehensive data, more lucrative tourism involves visitors from the advanced countries, emerging market economies and South Africa.

2.23 An additional challenge is that the benefits of greater openness in terms of growth, employment and other indicators take time to filter through; while effective cooperation with other countries is also necessary for the full potential of the benefits to be realised. In this context, small countries face the paradox that, while there is a potential to gain most from economic openness, they lack the capacity and influence to effectively engage at the international level in order to realise and optimise the benefits.

Regional Economic Integration (REI)

2.24 A primary focus on REI (for example, through regional trading blocs) is, in part, a response to

recognition that full global integration may be ambitious as an immediate objective. Regional integration among less-developed economies is further motivated by the conspicuous previous neglect of regional trade linkages, while it is also consistent with “gravity” models which emphasise the importance of distance as a determinant of trade flows between countries.¹⁹ Overall, the expectation is that negotiating trade agreements, sharing the costs of infrastructure development and harmonising regulatory frameworks among members of regional groupings may be straightforward. The challenge, however, is that, while there are clear benefits arising from improved regional infrastructure, there are often frictions arising from competition among countries with similar resource endowments, industrial development aspirations and resistance towards perceptions of dominance by larger economies in the region. Hence, the generally poor track record of regional integration in Africa, and notably low levels and slow growth of intra-regional trade.

Free Movement of Capital and Labour

2.25 Related to trade in goods and services is the issue of the extent to which countries benefit from free movement of capital and labour. In this regard, the importance of FDI (either through “greenfield” development or substantial equity investment in existing operations) is not solely measured in terms of capital, but also in terms of access to technology, skills, managerial knowhow and positioning within global value chains. Thus, it should be accepted that FDI implies a long-term significant and beneficial foreign presence, including personnel, in local businesses.

¹⁹ Empirical analysis using such models indicates that doubling the distance between trading partners halves trade between them, and this effect persists despite reduced transport costs (<https://www.gtap.agecon.purdue.edu/resources/download/3699.pdf>). This applies not only to goods, but also to trade in services where the effect of distance appears to be at least strong; however, this may be less pronounced for low-value added services (business service outsourcing, for example, compared to high-value, more personalised services such as law or management consultancy) that may be more relevant to developing economies.

2.26 Free movement of labour can result in major economic benefits through supplementing the range of skills available within a country. It is, nevertheless, recognised that such movement is also accompanied by broader economic and social factors affecting both international discourse and domestic imperatives. This is an issue across the various categories of labour and skills and almost invariably involves trade-offs where some of the potential gains from the perspective of economic efficiency need to be balanced against other considerations, including the concern that globalisation may undermine national sovereignty (Rodrik, 2011) and the frictions and social pressures arising from large-scale immigration.²⁰

3. BOTSWANA’S TRADE PATTERN AND FINANCIAL FLOWS: IMPACT ON THE ECONOMY

Overview of Botswana’s Trade Pattern

3.1 A sectoral breakdown of Botswana’s trade²¹ highlights the dominance of diamonds with a share of around 80 percent in total exports of goods (Table 2.3 and Chart 2.3). In contrast, the share of copper-nickel, hitherto the second most important mineral export commodity, has declined since 2011 to less than 10 percent of total exports of goods (1.2 percent in October 2016). This is against the background of a resurgence in copper-nickel mining from 2006 when prices rose significantly, but later on fell and remained low for a protracted period, leading to the closure of mines from 2015. Overall, exports of goods and services outside minerals remains limited; performance is either declining or has stagnated.

²⁰ “The Globalisation Paradox: Democracy and the Future of the World Economy” argues that it is impossible to pursue, simultaneously, democracy, national self-determination and economic globalisation; and that when the social arrangements of democracies inevitably clash with the international demands of globalisation, national priorities should take precedence.

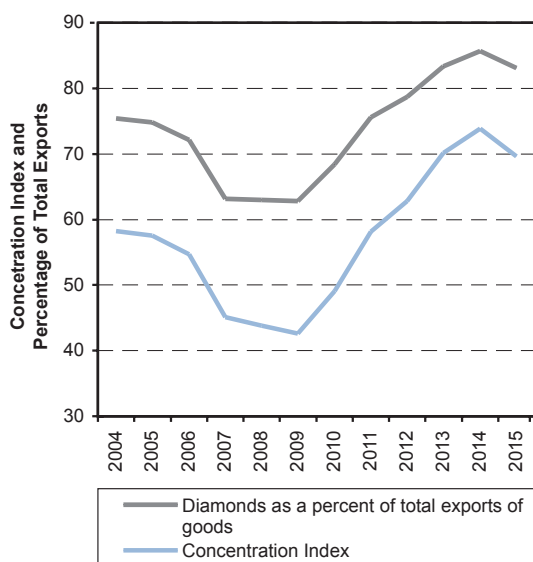
²¹ Although this is for exports of goods only, a significant feature of Botswana’s recent development with respect to trade is the growth of exports of services, notably from the tourism sector.

TABLE 2.3: EXPORTS BY PRINCIPAL COMMODITIES (PERCENTAGE DISTRIBUTION BY VALUE)

	Copper -Nickel	Diamonds	Gold	Machinery & Electri- cal Equip- ment	Meat & Meat Prod- ucts	Salt & Soda Ash	Textiles	Vehicles & Transport Equipment	Other Goods
2006	15.6	72.1	0.8	0.9	2.0	0.7	3.7	1.0	3.2
2007	21.4	63.2	1.0	1.3	2.2	0.6	6.9	0.6	2.8
2008	18.9	63.0	2.0	2.4	1.8	0.7	5.5	0.9	4.8
2009	15.4	62.8	2.2	2.3	3.3	1.3	5.9	1.6	5.2
2010	13.4	68.4	1.7	2.2	3.4	2.0	3.5	0.9	4.5
2011	7.5	75.6	1.4	2.5	0.9	1.2	4.5	2.1	4.3
2012	7.9	78.7	1.4	2.3	1.1	1.0	1.3	2.2	4.1
2013	7.1	83.4	0.7	1.8	1.6	0.8	0.6	1.0	3.0
2014	5.8	85.7	0.5	1.9	1.4	0.8	0.5	0.8	2.6
2015	6.0	83.1	0.5	3.2	1.8	0.9	0.6	1.1	2.8

Source: Statistics Botswana

CHART 2.3: MEASURE OF CONCENTRATION OF EXPORTS



Note: The concentration index used is the Herfindahl Index multiplied by 100. It is derived using various commodities as they appear in Table 2.

Source: Bank of Botswana using data from Statistics Botswana.

3.2 By destination, Botswana's exports have become less concentrated (Table 2.4, overleaf). The importance of changes in trading arrangements and domestic policy is pertinent in this regard. In particular, the UK's dominant position in the share of exports has declined significantly following the relocation of De Beers' aggregation and sightholder sales functions

from the UK to Botswana in 2012 - 2013. In turn, as a result of this development, the share of exports to Belgium and India, which are the world's largest diamond polishing centres, has increased, while re-exports of rough diamonds to Namibia are equally significant.

3.3 The recent trends in imports indicate that diamonds have become increasingly dominant (Table 2.5, overleaf), accounting for approximately 33 percent on average of total imports between 2012 and 2015. This largely reflects the shift in global diamond aggregation activities from the UK to Botswana in 2012. As a result, Botswana receives substantial imports of diamonds from other De Beers subsidiaries in Namibia, South Africa and Canada. Other significant imports are mainly consumer and production goods (machinery and electrical equipment, fuel, food beverages and tobacco, chemicals and rubber products and vehicles).

Terms of Trade

3.4 Chart 4 indicates that the commodity terms of trade in Botswana worsened between 2006 and 2009, largely reflecting the then depreciation of the Pula against the South African rand (the main currency of import payments) and the effects of the 2008 global financial crisis. Since 2012, Botswana's terms of trade have generally improved, albeit with a drop in 2015 attrib-

TABLE 2.4: DIRECTION OF TRADE (PERCENTAGE SHARE IN TOTAL VALUE)

	EXPORTS			IMPORTS		
	2011	2013	2015	2011	2013	2015
AFRICA	18.9	30.1	29.2	68.6	76.3	79.9
SADC	18.9	29.5	29.2	68.4	75.3	79.9
SACU	14.3	27.1	27.4	66.9	74.2	78.2
Lesotho	–	–	–	0.1	0.1	–
Namibia	0.5	11.7	11.8	0.8	12.9	15.5
Swaziland	–	–	–	–	–	0.1
South Africa	13.7	15.4	15.6	65.9	61.1	62.6
Zambia	1.3	0.6	0.7	0.3	0.2	0.5
Zimbabwe	3.0	1.6	0.9	0.7	0.4	0.4
Angola	–	–	–	–	–	–
DRC	0.1	0.1	0.1	–	–	–
Malawi	–	–	–	–	0.1	–
Mozambique	–	0.1	–	0.5	–	0.6
Tanzania	0.1	–	–	–	–	–
Madagascar	–	–	–	–	–	–
Mauritius	–	–	–	0.1	0.2	–
Seychelles	–	–	–	–	–	–
Other Africa	–	0.6	–	0.2	1.0	–
EU	65.2	43.5	22.2	12.4	10.5	4.5
UK	62.4	31.0	0.8	9.8	5.8	0.8
Belgium	2.7	12.0	19.8	1.2	3.6	2.9
Sweden	–	–	–	0.3	0.2	0.1
Italy	–	–	0.2	0.3	0.1	0.1
France	–	0.1	–	0.2	0.2	0.2
Other EU	0.0	0.4	1.3	0.6	0.6	0.4
Norway	4.8	4.4	4.1	–	–	–
Switzerland	1.5	1.8	4.3	0.2	0.1	0.2
USA	1.1	1.3	2.5	2.1	2.3	1.1
Canada	–	6.3	6.3	0.1	5.1	7.0
Israel	5.2	5.7	6.0	1.4	1.2	1.0
India	1.3	2.7	12.4	1.4	0.8	0.9
Others	2.1	4.1	12.9	13.8	3.9	5.4
Total	100	100	100	100	100	100

Source: Statistics Botswana

uted to a decrease in global demand for diamonds. The improvement since 2012 is mainly due to the aggregation in 2012 and sales functions of De Beers that relocated to Botswana in 2013, an exchange rate effect (depreciation

of the Pula against the US dollar, which is the main currency of export receipts and the appreciation against the rand) and improvement in global economic performance.

TABLE 2.5: IMPORTS BY PRINCIPAL COMMODITY (PERCENTAGE DISTRIBUTION BY VALUE)

	Chemicals & Rubber Products	Diamonds	Food Bev- erages & Tobacco	Fuel	Machin- ery & Electrical Equip- ment	Metals & Metal Products	Textiles & Footwear	Vehicle & Transport Equip- ment	Other Goods
2005	12.3	1.1	13.8	13.6	17.9	7.6	4.9	13.2	15.7
2006	13.1	2.2	13.8	16.6	17.2	7.9	4.9	10.0	14.2
2007	12.6	3.1	13.7	15.5	18.6	8.1	4.7	11.6	12.0
2008	10.5	8.8	12.5	16.8	17.8	7.8	4.0	10.7	11.1
2009	11.1	7.7	13.8	13.4	17.2	7.1	4.5	12.5	12.9
2010	10.9	11.5	12.9	14.3	17.5	7.4	4.0	9.6	11.8
2011	9.2	11.8	10.9	16.6	22.9	7.4	3.6	9.2	8.5
2012	8.8	26.6	9.9	16.1	14.6	4.7	3.1	9.0	7.3
2013	8.3	34.9	9.1	15.5	10.8	4.3	2.7	7.3	7.1
2014	8.1	35.9	8.7	15.0	11.4	3.9	2.8	7.8	6.4
2015	8.7	34.5	9.6	12.5	12.6	4.0	3.0	7.3	7.9

Source: Statistics Botswana

Regional Trade Developments

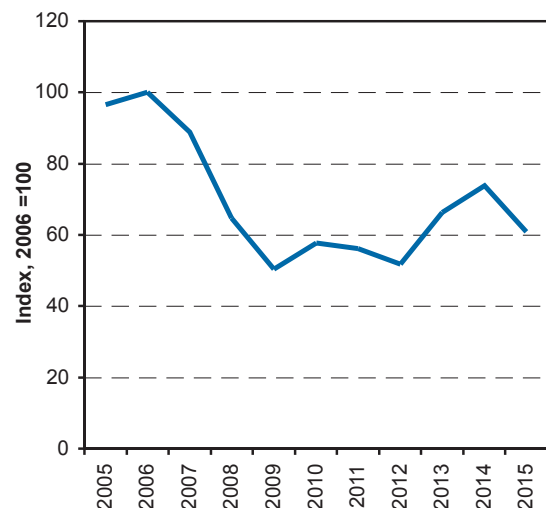
3.5 Within the region, the share of exports to the Southern African Customs Union (SACU) countries has grown, reflecting domestic industrial expansion²² and the existence of favourable trade arrangements, albeit with South Africa continuing as the dominant regional market. In turn, the share of exports to Southern African Development Community (SADC) has been dominated by exports to SACU countries, reflecting more trade integration within SACU than with the rest of the SADC countries²³ as well as slow take-off and the subdued practical effect of the SADC customs union (was planned to commence in 2010).

3.6 As shown in Table 2.4, the SACU region dominates Botswana's imports of goods, which accounted for an average of 76.8 percent of total imports of goods between 2005 and 2015. Within the SACU region, South Africa is the

22 This also includes diamond beneficiation and aggregation activities after the relocation of De Beers Global Sightholder Services (DBGSS) from UK to Botswana in 2012.

23 The SADC countries are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

CHART 2.4: TERMS OF TRADE



Source: Statistics Botswana

main source of Botswana's imports due to its proximity and size as the largest and most economically developed and industrialised country in the region. This indicates that the process of diversification of sources of imports is slow. This is also attributed to the tariff structure of the SACU arrangement which discourages imports from beyond the region in favour of "regional" industrialisation. South Africa accounted for an average of over 80 percent of non-diamond imports between 2010 and 2015.²⁴

24 These imports include South African re-exports, given the

Financial Flows and International Investment Position

3.7 Botswana has no foreign exchange restrictions and has, over time, attracted capital flows, mostly foreign direct investment (FDI), particularly in the mining sector, while portfolio investment has been modest (and at times net outflows). The overall inflow of FDI is associated with activity in areas of natural endowments such as mineral resources. The most recent statistics (Table 2.6) indicate that Botswana received the largest annual FDI inflows of about P15.9 billion between 2010 and 2012, reflect-

ing further investment in diamond mining by the De Beers group. While the mining sector continues to dominate, FDI inflows to other sectors are similarly increasing (Table 2.7). In contrast, and despite the relatively high interest rates (particularly prior to 2008) and stock market returns, portfolio flows have been limited because of the relatively small size of the Botswana Stock Exchange (BSE) and a paucity of local investment opportunities. Therefore, the benefits accruing from dual listing have been modest.

3.8 Europe continues to be the main source of the

TABLE 2.6: INTERNATIONAL INVESTMENT POSITION (P MILLION)

As at end of	2008	2010	2012	2014	2016 ¹
Net International Investment Position	73 797	46 654	36 860	56 096	61 933
Foreign Financial Assets	100 904	87 804	100 258	133 635	149 801
Direct investment abroad	6 420	6 486	6 474	8 131	9 923
Portfolio investment abroad	17 051	21 328	23 917	35 084	45 494
Other investment abroad	8 822	9 143	10 551	11 308	13 999
Reserve Assets	68 612	50 847	59 317	79 111	80 384
Foreign Liabilities	27 107	41 150	63 398	77 540	87 868
Direct investment in Botswana	18 605	21 582	37 476	49 499	57 789
Portfolio investment in Botswana	2 779	2 981	2 777	2 793	3 153
Other investment in Botswana	5 723	16 587	23 146	25 248	26 927

1. Preliminary estimates

Source: Bank of Botswana

TABLE 2.7: FOREIGN DIRECT INVESTMENT BY SECTOR (P MILLION)¹

Sector	2006	2008	2010	2012	2014	2015
Mining	6 101	3 553	4 877	16 608	14 946	23 902
Manufacturing	238	211	193	210	743	366
Finance	7 043	4 184	5 249	6 706	9 098	10 497
Retail and Wholesale	350	463	1 334	604	2 168	4 212
Electricity, Gas and Water	287	103	106	406	6 602	7 432
Real Estate and Business Services	131	493	137	229	310	292
Transport, Storage and Communications	165	73	12	157	196	181
Construction	32	40	140	0	38	146
Hospitality	22	26	19	1	148	409
Public Administration ²	2 143	1 772	9 289	13 810	15 861	17 244
Other	64	116	90	1 190	2 744	1 588
Total	16 576	11 034	21 446	39 921	52 854	66 269

1. Data for Tables 2.6 and 2.7 are from different sources and hence the discrepancy.

2. Public Administration largely comprises public sector debt from multilateral organisations and development partners.

Source: Bank of Botswana

agency relationship with international suppliers.

TABLE 2.8: DISTRIBUTION OF SOURCES OF FOREIGN DIRECT INVESTMENT BY COUNTRY (PERCENT)

Country	2006	2008	2010	2012	2014
North and Central America	7.7	4.4	0.9	0.9	1.8
<i>Of which</i>					
United States	3.1	4.4	0.9	0.1	1.5
Europe	40.4	42.3	28.0	42.4	18.2
<i>Of which</i>					
United Kingdom	6.8	14.9	14.2	3.1	3.6
Netherlands	0.3	0.1	0.1	0.1	0.4
Luxembourg	16.1	26.3	12.5	38.7	11.1
Other Europe	17.1	0.9	1.2	0.6	3.0
Asia Pacific	3.1	0.6	7.3	2.6	13.3
Africa	36.3	34.0	19.9	18.6	27.4
<i>Of which</i>					
SADC	35.4	24.4	16.8	18.1	27.0
DRC	–	–	–	–	–
Zimbabwe	2.1	–	1.1	1.2	1.0
Mauritius	0.1	–	1.1	3.1	8.9
Mozambique	2.7	–	–	–	–
Zambia	1.0	–	0.4	0.3	–
Malawi	–	–	0.2	0.1	0.2
Tanzania	1.3	–	–	–	–
Angola	–	–	–	–	–
Madagascar	–	–	0.1	–	–
Seychelles	–	–	–	–	–
SACU	28.2	24.4	13.9	13.4	16.9
South Africa	28.2	24.4	13.0	11.6	16.2
Namibia	–	–	0.7	1.4	0.6
Swaziland	–	–	0.2	0.4	0.1
Lesotho	–	–	–	–	–
Rest of Africa	0.9	9.7	3.2	0.4	0.4
Middle East	1.1	0.0	0.3	0.4	0.5
Other	11.4	18.6	43.5	35.1	38.8
Total	100	100	100	100	100

Source: Bank of Botswana

stock of FDI, accounting for an average of 36 percent of total FDI in the last decade, with Luxembourg at 22.1 percent on average due to the residence status of the major mining investors in Botswana (Table 2.8). On average in the last decade, Africa accounted for 23.3 percent of the total stock of FDI, including 20.7 percent from SADC, which incorporates 17.1 percent of SACU (16.7 percent from South Africa). FDI from Asia, while historically it did not play an important role, it is increasingly

becoming significant, with its average share rising from 2.7 percent between 2005 and 2009 to 9.2 percent between 2010 and 2014.

Balance of Payments and Foreign Exchange Reserves

3.9 In the last decade, the current account balance has, on average, been positive, except in 2009, 2010 and 2012 where negative balances were recorded. The negative current account balances were mainly a result of the effects of the

TABLE 2.9: CURRENT ACCOUNT, OVERALL BALANCE AND FOREIGN EXCHANGE RESERVES AS A PERCENTAGE OF GDP

	P Million			Percent of GDP	
	Current Account Balance	Overall Balance	Foreign Exchange Reserves	Current Account	Foreign Exchange Reserves
2007	10 140	10 694	58 518	15.1	87.1
2008	1 006	7 452	68 612	1.3	91.8
2009	-4 680	-4 563	57 908	-6.4	78.8
2010	-2 420	-6 511	50 847	-2.8	58.5
2011	3 250	3 430	60 271	3.1	57.4
2012	-1 275	-862	59 317	-1.2	54.0
2013	11 619	1 340	67 772	9.3	54.1
2014	22 219	11 404	79 111	15.2	54.2
2015	12 052	-57	84 881	8.3	58.2
2016 ¹	8 727	1 545	79 990	7.1	65.2

1. Data covers up to September 2016.

Source: Statistics Botswana and Bank of Botswana

2008 global financial crisis and the sudden rise in imports due to the relocation of diamond aggregation from the UK to Botswana in 2012, respectively (Table 2.9). The current account surpluses have been driven by higher growth in exports compared to imports of diamonds, which have been dominating the export market over the years. The surpluses have also been supported by inflows from SACU and, recently, exports of travel services, mainly for tourism. As indicated in Table 9, the overall balance mainly reflects changes in the level of foreign exchange reserves, which have been, since 2008, growing at a slower pace than the economy, hence a decrease in the ratio of reserves to GDP.

Current Challenges with Respect to Economic Diversification and Inclusive Growth

3.10 Inclusive growth refers to long-term sustainable output growth that is broad-based across economic sectors; creates productive employment opportunities and reduces poverty. Higher levels of trade and capital flows are generally positive for an economy, resulting in arguably faster growth rates and greater prospects for employment creation. However, for Botswana, the benefits have been mixed in terms of industrialisation and impact on employment. As a result, the country's social indicators re-

lating to unemployment (20 percent), inequality (IHDI of 0.7) and poverty (19.3 percent) continue to be a concern, albeit with noticeable progress with respect to the last two. Meanwhile, the country's openness with respect to inward investment and exports has made positive contribution in terms of increased fiscal revenues, provision of infrastructure and social services, as well as discretion in macro-economic policy-making.

3.11 Being the largest contributor to export earnings and the dominant recipient of FDI, the mining sector, particularly diamonds, continues to play a key role in fostering economic growth and contributing substantially to government revenue. However, this development has not been matched by equally substantial employment creation in the economy, reflecting the capital intensive nature of diamond mining in Botswana and, previously, limited beneficiation of the natural endowments. As a result, the mining sector contributes around 3 percent directly to total employment, with intermittent temporary employment opportunities created by special projects, such as the Jwaneng Cut 8 Project, which generated around 1 500 jobs during the expansion phase. The extension of the life span of the diamond mining operations to the envisaged year 2050 and beyond is expected to help sustain employment in the mining sector.

- 3.12 Mining activities, in general, have limited durable forward and backward linkages with other sectors of the economy such that, in the absence of more extensive beneficiation, upstream and downstream investments and employment opportunities related to the mineral sector have been modest. This, therefore, suggests that the multiplier effect has been somewhat muted. The relocation of the De Beers group aggregation in 2012 and sales activities from the UK to Botswana in 2013 and further development of polishing and manufacturing offer the potential for higher employment and greater positive spillovers to the national economy. Even then, success of the diamond polishing sector would depend on proper alignment of labour productivity and relative wages; given the low margins involved these factors tend to weigh more heavily on competitiveness and profitability of the domestic secondary diamond operations. Thus, the significance of recent retrenchments/closures by local diamond polishing companies as a result of competition from “low cost-higher productivity” secondary diamond activity in other international centres, such as in India.
- 3.13 Historically, copper-nickel has been the second most important mineral resource in Botswana; several mines operated with varying duration, size and viability over time, while secondary activity in the form of providing a smelter for regional producers was also a credible option at some point. However, recent prolonged subdued commodity prices have adversely affected viability of copper production, resulting in several operations closing down, including the decision by Government to place the state-owned BCL and Tati Nickel mines under provisional liquidation.²⁵
- 3.14 Botswana also has extensive coal resources which, to date, remain largely unexploited, except the output at the Morupule mine used primarily for generation of electricity for the domestic market. There is potential for coal to support economic activity (including employment opportunities) through direct export, use in generation of surplus electricity for export and production of gas, petroleum and associated chemicals. However, the commercial case for coal remains uncertain. Notably, there is a significant infrastructure requirement for mining and transportation of coal to foreign markets. Moreover, the use of coal to generate electricity in excess of the domestic requirement would need external uptake, including tariff guarantees, which involves complex negotiations, accentuated by individual country self-interest. The prospects for conversion of coal to petroleum, gas and other chemicals are technically sound, but, as with the other potential operations, there are complications relating to the scale of investment required and associated organisational and funding arrangements, such as the extent of involvement of government, private sector and foreigners.
- 3.15 The need to address environmental and pollution issues associated with coal mining and processing operations is also fundamental. As a party to both the Kyoto Protocol and the Paris Agreement, Botswana is committed to reduce greenhouse gas emissions from coal mining and processing. Therefore, any coal mining operations have to take into account the environmental impact and associated costs of compliance with both local and international standards. Even then, aspects of adherence to standards and compliance present business opportunities. Overall, it is apparent that, going forward, the potential for coal mining to have a sustainable long-term impact on broader economic activity and inclusive growth lies in

²⁵ The BCL mine in Selebi-Phikwe and its subsidiary, the Tati Nickel Mining Company (TNMC) in North-Eastern Botswana, were affected by the worldwide decline in copper and nickel prices, rendering production at the mines not economically viable. Following the provisional liquidation decision, operations at both Selebi-Phikwe and TNMC, with a combined workforce of over 5 000 people, ceased and only around 400 employees remained for care and maintenance activities during the liquidation process. Other mines that ceased operations are the Mowana Mine, owned by African

Copper, and Boseto mine, operated at the time by Discovery Metals and subsequently acquired by Khoemacau. On a positive note, the ongoing recovery in the commodity markets and the prospects for reopening of closed mines, including the Mowana Copper Mine, and commencement of new operations, bodes well for future performance of the domestic economy.

enhanced beneficiation and innovative operational structures (public private partnerships in particular) that afford effective funding and viable operations.

3.16 Manufacturing, considered to be key to an export-oriented and labour-intensive growth strategy, has generally remained stagnant, with a relatively small and static contribution to both economic growth and employment. In the last decade, on average, manufacturing contributed approximately 6 percent to overall GDP, while the share of employment has increased from around 6.7 percent in 2005/06 to 9.2 percent in 2016. Broadly, these outcomes emphasise the need to address structural issues and (mostly industrial) microeconomic policy impediments that constrain the potential benefits from the economy's openness and a robust macroeconomic policy framework.²⁶

3.17 Agriculture is critical for poverty alleviation and has the potential for broad-based employment creation. However, the agricultural sector has not offered much potential for export development and growth because of, among others, adverse weather conditions and limited uptake of appropriate technology and skills relevant for local conditions. The sector contributes less than 3 percent to Botswana's GDP, but it generates more than 15 percent of total employment, most of which is for the rural economy. It should also be noted that an important factor contributing to high unemployment in Botswana is the migration of labour from involvement in subsistence agriculture in pursuit of employment in other potentially more remunerative areas of economic activity.

3.18 The services sector²⁷ has increasingly be-

26 The robust macroeconomic policy framework is reflected in Botswana's National Development Plans, which are the main instruments for implementing policies and programmes in order to advance the country's development. Successive IMF Article IV Missions and Ratings Agencies have also indicated the benefits that Botswana has derived from a stable macroeconomic environment and associated strong institutions.

27 For the purpose of this analysis, the focus is on the service sub-sectors of trade, hotels and restaurants; transport and communications; and, finance and business services. These

come one of the biggest contributors to GDP and employment growth. It accounted for up to 36 percent of GDP in 2016 and around 27.4 percent of formal employment in 2016. However, within the services sector, knowledge-based sectors, such as information and communications technology and financial services, provide jobs largely to the highly-skilled and more educated cohort of the labour force. Meanwhile, there is potential for widespread employment opportunities in the tourism and trade sectors that have greater backward linkages with the agricultural sector and the rural economy, hence a likely larger impact on poverty reduction. Overall, an appropriate strategy for employment creation and inclusive growth needs to encompass promoting conditions that encourage the effective exploitation of economic opportunities across a broad range of economic sectors, involving primary, secondary and tertiary activities. However, given the limitation of resources, specialisation around the areas of natural endowments and comparative advantage is warranted (Section 6).

Opportunities and Challenges in Relation to Export Growth and Inflows of FDI

3.19 Botswana's trade performance does not reflect a transition towards diversification of exports across commodities (Table 3 and Chart 3). However, recently, there has been modest diversification within the mining sector, in particular from raw minerals (essentially diamond) towards value-added products. There is a circular relationship in that the slow pace of industrial diversification and beneficiation limits the potential development of markets as well as prospects for capital inflows and the generation of clusters of industrialisation. In such circumstances, business development and entrepreneurship as well as employment opportunities and long-term growth potential are also constrained.

3.20 The country's ability to exploit trade opportu-

sub-sectors have the potential to form a basis for an export-oriented service economy.

TABLE 2.10: LOGISTICS PERFORMANCE INDEX AND THE GLOBAL COMPETITIVENESS INDEX (RANKING ON INNOVATION) FOR BOTSWANA AND SELECTED COUNTRIES

Country	Logistics Performance Index				Global Competitiveness Index (Innovation)	
	2007	2010	2012	2014	Index	Rank
Belgium	3.89	3.94	3.98	4.04	5.0	15
Botswana	–	2.32	2.84	2.49	3.2	84
China	3.32	3.49	3.52	3.53	4.0	30
India	3.07	3.12	3.08	3.08	4.0	29
Israel	3.21	3.41	–	3.26	5.7	2
Namibia	2.16	2.02	2.65	2.66	3.3	74
Norway	3.81	3.93	3.68	3.96	5.1	12
South Africa	3.53	3.46	3.67	3.43	3.8	35
Switzerland	4.02	3.97	3.8	3.84	5.8	1
United Kingdom	3.99	3.95	3.9	4.01	5.0	13
United States	3.84	3.86	3.93	3.92	5.6	4
Zimbabwe	2.29	–	2.55	2.34	2.6	129

1. The Logistics Performance Index overall score reflects perceptions of a country's logistics based on efficiency of customs clearance process, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time. The index ranges from 1 to 5, with a higher score representing better performance.
2. For Global Competitiveness, the indices range from 1 to 7, with 1 being the lowest level and 7 the highest level. The rankings are based on 138 countries.

Source: World Bank and the Global Competitiveness Report 2016 – 2017

nities and attract capital inflows may be limited by the low productivity of domestic firms. Some apparent deficiencies in management systems and persistent under-provision of basic infrastructure, including, among others, inadequate (unreliable) transport, electricity, water, telecommunication and internet connectivity²⁸, continue to undermine productivity of firms and constitute a major constraint on competitiveness of export-oriented and import-competing sectors and, hence, job creation. Therefore, being a landlocked country, proper management systems and a well-developed physical infrastructure are integral to boosting productivity that will contribute to Botswana's regional and

international competitiveness.

3.21 In general, countries that do more to improve logistics and facilitate trade tend to develop faster. Botswana's average score on the World Bank Logistics Performance Index (LPI) has been relatively low (Table 2.10). The country performs below the successful emerging Asian markets of China and India and, regionally, South Africa. Thus, the weak development of trade logistics might be a factor in explaining differences in trade performance between Botswana and the selected group of countries in Table 2.10 and, hence, attraction of FDI.

3.22 Innovation is also a key determinant of trade, enabling businesses to produce more at lower relative costs, achieve economies of scale, and introduce cheaper, better quality products. Overall, Botswana's performance in innovation is weak as indicated by the latest rankings

28 Although the country has invested heavily on the information and communication technology (ICT) infrastructure, with the recent initiative being the rolling out of Wi-Fi hotspots across the country, the costs of internet services in Botswana are still relatively high, while internet speed is low.

(Table 2.10) from the 2016 - 2017 Global Competitiveness Report (GCR). Therefore, the lack of innovation could be another key factor explaining the difference between Botswana and the successful economies in stimulating export growth and diversification and attracting capital inflows. Hence, the need for Botswana to consider allocation of resources for clearly defined research and development programmes and innovation in the ICT area, including through incentives to encourage private sector participation. The Botswana Innovation Hub (BIH), established in 2012, is expected to play a leading role in this regard.

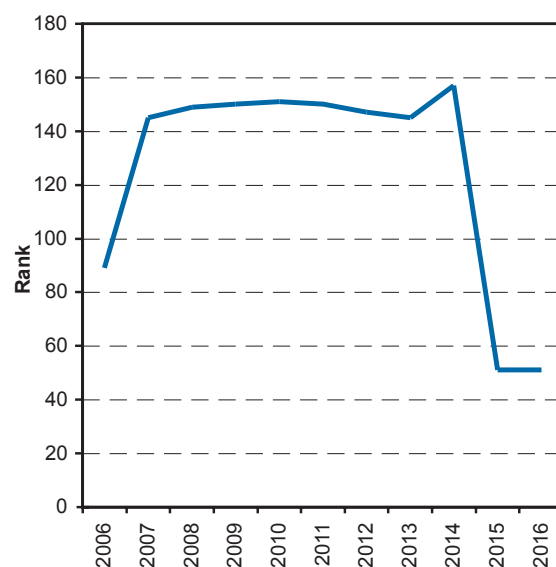
3.23 The high costs of doing business in Botswana may also be a constraint on export growth and attraction of capital flows. Initial research suggests certain costs, such as labour, transport and internet connectivity, are relatively high in Botswana. In addition, compared to the SACU regional average, the cost²⁹ of importing and exporting a standardised shipment of goods in Botswana are higher by US\$1200 and US\$800, respectively. As a result, such high costs of doing business hinder export growth and also lead to loss in potential FDI inflows into the country.

3.24 Protection of some industries by government, however well meant, may be another reason constraining improvements in productivity and competitiveness, export growth and attraction of FDI. For example, while the cattle industry traditionally played an important role in the Botswana economy and society, with significant contribution to GDP, in recent years, there has been a substantial decline or stagnation of exports and employment for this sector. There is perhaps a need to review the beef marketing arrangements that give the Botswana Meat Commission (BMC) monopoly over the export of beef and related products. Although the system is well intended to help ensure quality control, it appears to contribute to slow modernisation and investment in the livestock industry. In some respect, the envisaged cluster and beneficiation framework for industrialisa-

tion (Section 6) should help improve prospects for the industry.

3.25 Overall, the pace of improvement in the local business environment has not been as rapid as in the more successful comparator countries, as important gaps remain in some key areas. For example, according to the World Bank's Doing Business Index (DBI), Botswana's ranking for trading across borders remained at 51 in 2015 and 2016 (Chart 2.5). Therefore, performance and infrastructure challenges highlighted above constrain entrepreneurship as well as business and product development, marketing efforts and related investment. Moreover, such constraints hamper the success of industrialisation policies.

CHART 2.5: BOTSWANA'S RANKING ON TRADING ACROSS BORDERS



1. Effective 2015, there was a substantial revision to the methodology for this indicator to increase its relevance.

Source: World Bank

²⁹ World Bank database.

4. OVERVIEW OF TRADE AGREEMENTS AND NEGOTIATIONS, AND REGIONAL INTEGRATION

Trade Agreements

- 4.1 Trade across countries is commonly subject to, among others, regulation, restrictions, duties, taxes, levies, quotas and subsidies with a view to supporting local industry and raising government revenue. However, it is generally considered that easing trade across borders, through trade agreements, enhances potential for greater industrialisation and more rapid economic advancement, as well as providing an impetus to economic integration. Accordingly, Botswana is a signatory to a number of bilateral, regional and international trade agreements, including those shown in Table 11, principally in pursuit of an outward-looking strategy of enhancing access to foreign markets and facilitating inward investment and uninterrupted availability of imports (both for consumption and as inputs to production).
- 4.2 Bilateral, regional and international trade agreements encompass easing of restrictions and cost of trade; for example, relating to tariffs, quotas, licensing and other industrial support. These are essentially preferential trade arrangements because they benefit only the countries to which they relate. Thus, specific to trade, three alternative or progressive arrangements can exist, namely:
- (a) free trade area, whereby a group of countries eliminate tariff and non-tariff barriers on substantially all trade amongst themselves, but with each country maintaining its own tariff schedule with respect to non-members;
 - (b) customs union representing a single territory for a group of countries in which duties and other restrictive trade regulations are eliminated for substantially all intra-member country trade, but a common external tariff schedule is applied to trade with non-members; and

- (c) a common market, whereby, in addition to having a customs union, restrictions on the free movement of capital and labour are removed.

Assessment of Selected Trade Agreements: Impact and Trade Developments

(a) Southern African Customs Union (SACU)

- 4.3 SACU, the oldest customs union in the world, was established in 1910 and currently operates under the *SACU Agreement, 2002*, with Botswana, Lesotho, Namibia, South Africa and Swaziland as members. For Botswana, SACU is the most enduring and integrated arrangement with cultural and social linkages potentially reinforcing economic integration beyond the benefits of free trade. The SACU vision of “*an economic community with equitable and sustainable development, dedicated to the welfare of its people for a common future*” provides the backdrop for shared industrialisation, market access and distribution of trade taxes, a common external tariff structure for non-SACU members and duty free movement of goods originating from within SACU member countries. However, in practice, the outcome in terms of equitable benefits is mixed, primarily because of economic imperatives as well as apparent dominance of self-interest with respect to industrialisation policies.
- 4.4 The economic imperatives relate to polarisation, whereby industrialisation gravitates to areas with more productive resources and larger markets; in this instance the more developed South Africa, with a comparatively larger population, advanced industrial and financial infrastructure as well as greater national income. Although the SACU agreement allows infant industry protection and there is scope for non-tariff restrictions to support producers in the BNLS³⁰ countries, South African suppliers continue to dominate on account of entrenched business (including supply and agency) arrangements, ramifications of rules of origin

³⁰ The BNLS countries are Botswana, Namibia, Lesotho and Swaziland.

TABLE 2.11: SELECTED TRADE AGREEMENTS INVOLVING BOTSWANA

Name of Agreement	Type of Agreement	Countries	Main Objective/Terms	Products	Achievements
General Agreement on Tariffs and Trade (1987), World Trade Organisation (1995)	Trade Liberalisation	GATT/WTO Members (164 members)	A forum for facilitating international trade by ensuring a level playing field for members in order to encourage economic growth and development.	All products	There is little benefit as Botswana mainly exports raw minerals; with limited volumes and diversity of exports, the country has not taken full advantage of the opportunities.
ACP-EC/EU Partnership Agreement ¹ (1975-2008), Interim SADC-EU Economic Partnership Agreement (EPA) (2008-2016)	Preferential Trade Agreement	Most of the African, Caribbean and Pacific Countries and some European States	Fairer and more equitable world order, promotion of industrialisation, regional and inter-regional trade among developing countries.	Most products, mainly agricultural	Botswana's beef/cattle industries benefited, but were unable to reach the allotted quota of 19 000 tonnes. In general, the country did not make the most of the preferential trade agreement and move up into the higher value-added activities of the cattle value chain.
Botswana-Zimbabwe Trade Agreement (1956, 1988, 2010)	Preferential Trade Agreement	Botswana and Zimbabwe	Duty and quota free trade	Goods from the two countries satisfying 25 percent local content requirement.	Trade (formal) with Zimbabwe is very small with exports at 0.9 percent of the total value in 2015, down from 4.3 percent in 2005; while the share of imports fell from 1.5 percent to 0.4 percent in the same period.
SACU (1910, 1969, 2002)	Customs Union	SACU Member States	Duty and quota free trade - liberalisation of intra-regional trade.	Goods and services	Trade is dominated by exports to, and imports from RSA. In addition, Botswana has, over the years, benefited from SACU revenues. Polarisation and decision making on tariff structure constrains industrialisation in BNLS countries.
SADC (1980, 1992)	Free Trade Agreement	Botswana and other SADC Member States	Guided by the SADC Trade Protocol – The FTA requires Member States to accord each other Most Favoured Nation Treatment and tariff reduction on goods traded between them.	Exports and imports of goods and services	Slow increase in intra-SADC trade. South Africa remains the dominant trading partner for the other SADC states.
SACU - European Free Trade Association (SACU - EFTA) (2006)	Free Trade Agreement	SACU Member States and Norway, Iceland, Switzerland, Liechtenstein (EFTA States)	Regional cooperation with Europe, trade liberalisation.	All goods	Botswana exports to Norway and Switzerland constituted 8.4 percent of total exports in 2015.

Name of Agreement	Type of Agreement	Countries	Main Objective/Terms	Products	Achievements
SACU-USA Trade, Investment and Development Cooperation Agreement (2008)	Cooperative Framework Agreement	SACU Member States and USA	Trade expansion and facilitation.	As per matrix on areas of cooperation	While Botswana's trade with USA remains low, the framework provides a viable forum for discussing and resolving USA-SACU trade and investment issues.
SACU – Mercado Común del Sur (MERCOSUR) PTA Agreement (2009)	Preferential Trade Agreement	SACU Member States and MERCOSUR States – Argentina, Brazil, Paraguay, Uruguay and Venezuela (suspended since December 2016).	Market access to South America.	Specified goods	There is little to no trade between Botswana and MERCOSUR States.
African Growth and Opportunity Act (2000)	Preferential Trade Agreement	USA and eligible Sub-Saharan African countries, which includes Botswana.	Improve trade and economic co-operation, quota and duty free trade to USA.	Over 6 500 products are eligible for tariff reduction.	Botswana's trade with USA is stagnant. Exports to the USA constituted 2.2 percent of total exports in 2002 and 2.5 percent 10 years later. Initially, textile exports were promising, but have since faded because of, among others, market competition and inability to meet USA quality regulations.
SADC – EU Economic Partnership Agreement (2016)	Free Trade Agreement	SADC EPA Group and EU	Duty and quota free trade to EU. SADC EPA Group countries also afford EU countries duty free and quota free access into their markets, albeit asymmetrical in their favour.	All goods	Trade with the EU has been dominated by exports to the UK; namely diamonds and beef. However, exports to the UK have fallen significantly since 2013 with relocation of De Beers Global Sight-holder Services (DBGSS) from UK to Botswana.

- 1 The Cotonou Agreement between the members of the African, Caribbean and Pacific (ACP) Group of States and the European Community (EC) and its Member States.
- 2 The SADC countries are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

Source: Ministry of Investment Trade, and Industry (Botswana); SACU and SADC Websites

to access the SACU market, and possible inability to meet quality and continuity of supply requirements by producers in the smaller countries (Tables 2.4 and 2.8 in Section 3 show intra-SACU performance with respect to trade and financial flows).

- 4.5 In recognition of the dominance of South Africa in SACU, the revenue sharing formula (RSF), which distributes the revenue collected from the common external tariffs and excise revenues from within the SACU region, helps compensate the BNLS countries for the effects of polarisation by rewarding those countries that import more from other member states, together with an explicit development component. South Africa is primarily responsible for the collection of the common external tariff and, in practice, determining tariff levels. These are set with the two main purposes of raising revenue and protecting domestic industry and, in this regard, South Africa has a vested interest in promoting its own industrialisation. Thus, although the RSF appears to disproportionately benefit the smaller countries in that their revenue shares, ultimately, exceed the amount of customs and excise duties on imports into these countries, there is recognition that the respective countries have less discretion on the level and structure of tariffs, hence the loss of possible revenue that could be collected and the influence over industrialisation.
- 4.6 Charts 2.6 and 2.7 indicate that Botswana's trade with the other SACU members (dominated by South Africa) in terms of both exports and imports as well as associated revenue, has generally trended upwards. Also, despite Botswana enjoying overall current account surpluses over the years, trade with SACU is characterised by persistent current account deficits. This is attributable to heavy reliance on imported consumption and intermediate items from South Africa, while exports are mainly destined to the rest of the world. However, the ratio of SACU revenue to Botswana's nominal GDP has been static at around 10 percent, indicating limited tax buoyancy.³¹ In turn, the ra-

tio of SACU revenue to imports has generally fallen in the ten years to 2015/16 (Chart 2.9, overleaf), while receipts from SACU are among the major sources of government revenue (Chart 2.8, overleaf).

- 4.7 While the SACU market and a wider SADC market provide opportunities for smaller countries to increase local production capacity, manufacturing as a ratio of GDP in many of the members has been, at best, stagnant (Table 2.12). For South Africa, the decrease in the share of manufacturing is more a reflection of diversification into other growth areas, including services. In addition, the polarisation applies to other areas of economic activity, including primary production (agriculture) and services. The perennial current account surpluses between South Africa and the other SACU countries emphasise the impact of polarisation. In this regard, it is appropriate to consider the extent to which the focus on the revenue aspect detracts from the leeway to use customs and excise duties to leverage trade and industrialisation policies.

TABLE 2.12: SACU COUNTRIES - MANUFACTURING AS A PERCENT OF GDP

	2000	2005	2010	2015
Botswana	5	4	4	6
Lesotho	14	20	13	11
Namibia	13	14	8	9
South Africa	19	18	15	13
Swaziland	39	40	42	36

Source: SACU Website

(b) Southern African Development Community (SADC)

- 4.8 SADC was formed in 1992, being a transformation of the Southern African Development Coordinating Conference which had been established in 1980. Its overall aim is regional integration and poverty alleviation within the Southern African region. It is one of the eight regional economic communities (RECs) in Africa. The SADC mission is guided

revenue mobilisation to growth in Gross Domestic Product or National income.

³¹ Tax buoyancy refers to efficiency and responsiveness of

CHART 2.6: BOTSWANA TRADE WITH SACU

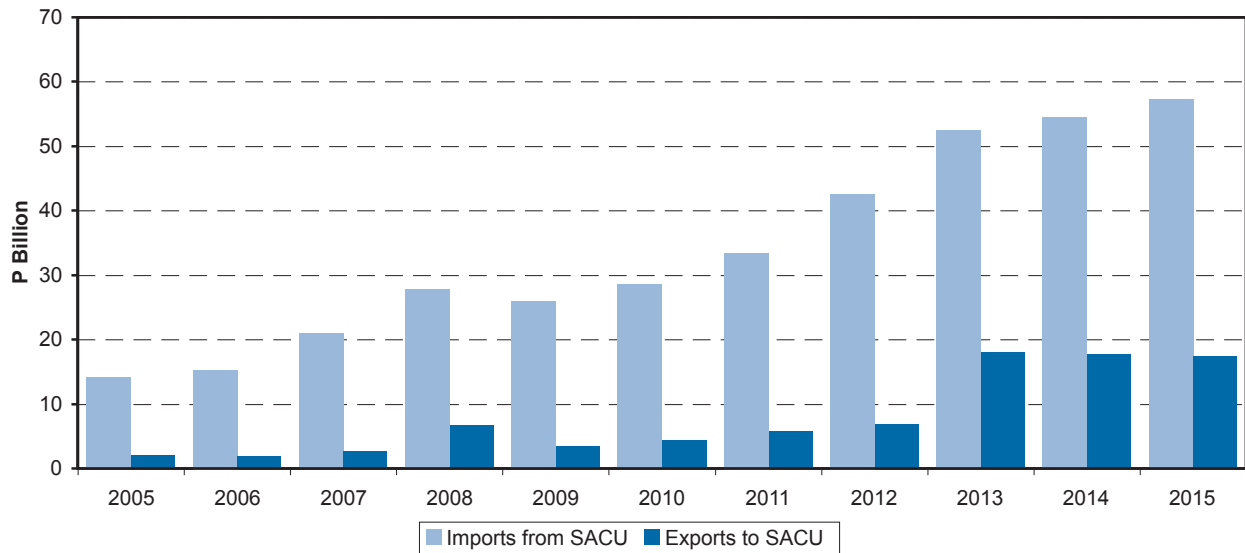
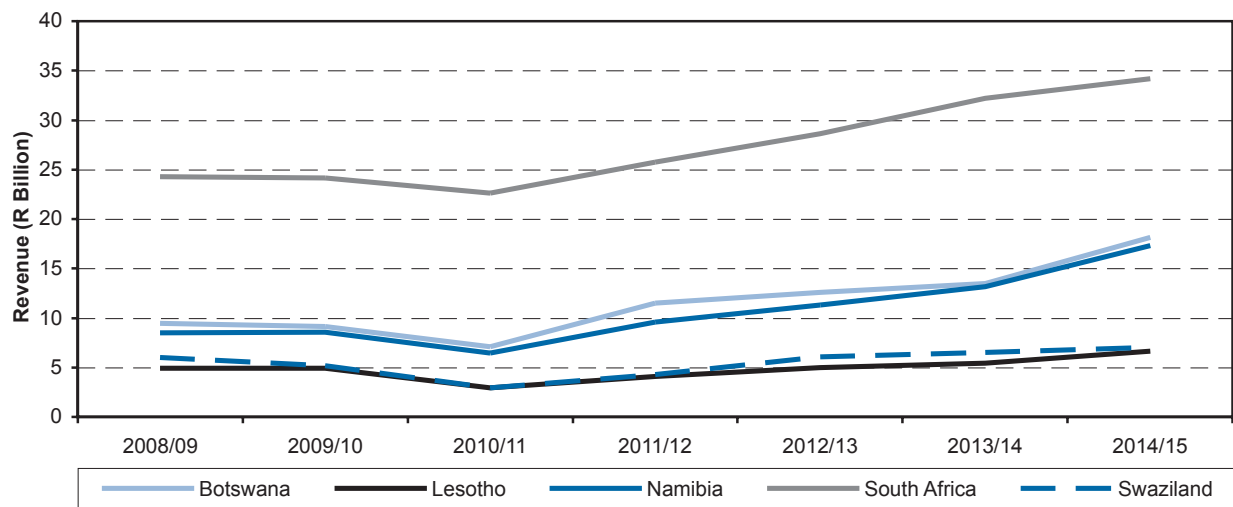


CHART 2.7: TRENDS IN SACU REVENUES



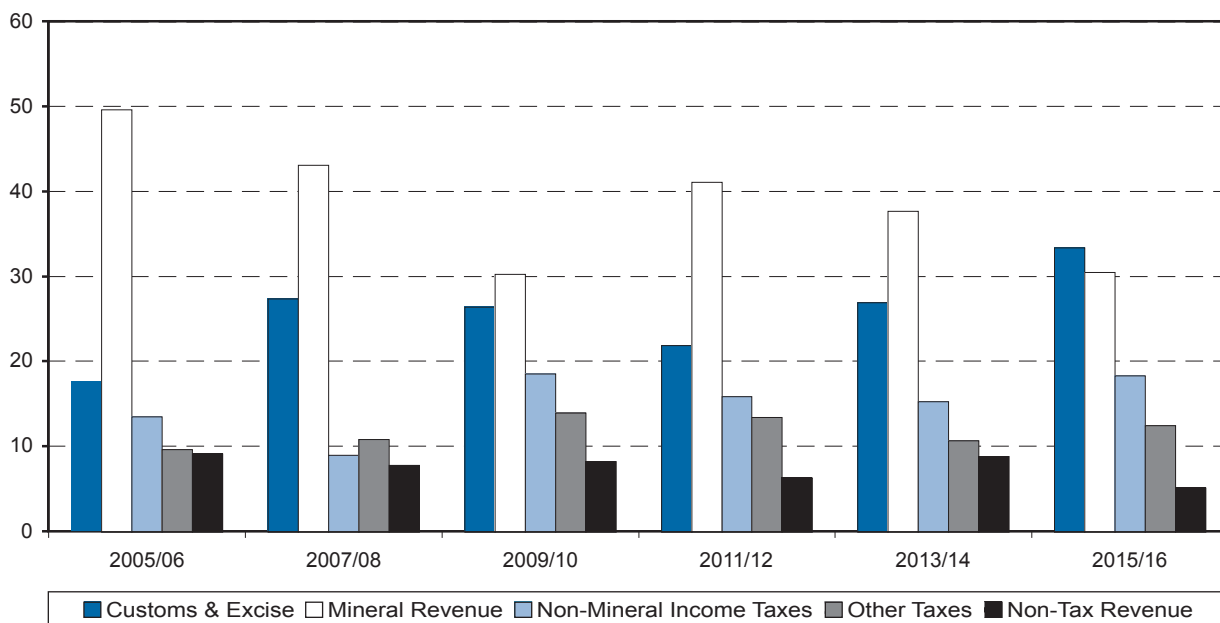
Source: Bank of Botswana, SACU Website

by several protocols, among which are the Protocol on Trade and the Regional Indicative Strategic Development Plan. Implementation of the trade protocol entails liberalisation of trade among member countries and ultimately deeper regional integration. Thus a free trade area was declared in 2012 following completion of the tariff phase down process for sensitive products.³²

32 A product is considered sensitive if trade liberalisation impacts negatively on the production or trade of the said product. Criteria for selecting sensitive products comprise of revenue contribution, importance of the product to a country's economy, potential of the sector to contribute to regional economic development.

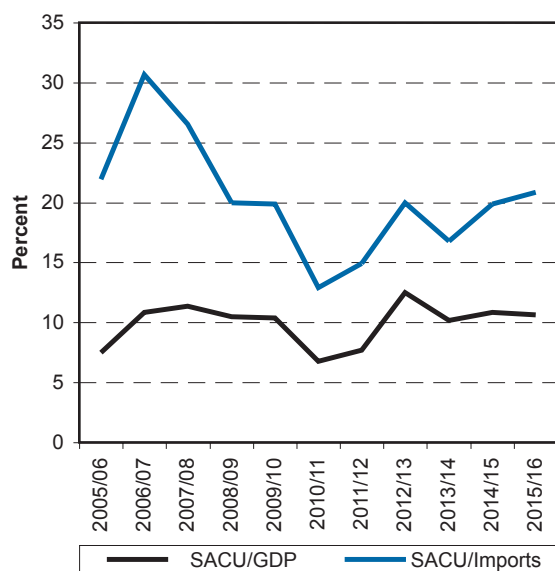
4.9 Charts 2.10 and 2.11 (overleaf) show Botswana's export and import trends within the region and globally. Trade with South Africa continues to be substantially dominant. Imports from South Africa averaged 72 percent of the total in the past ten years ending 2015, while the share of total exports averaged 12.7 percent with only a mild upward trend from 2009. The decrease in the share of imports from South Africa in 2013 is due to the increase in imports of diamonds from Namibia which form part of the aggregation process of De Beers' production. Thus, apart from South Africa, there is modest trade with Namibia as well as Zimbabwe, while trade is virtually

CHART 2.8: SELECTED SOURCES OF GOVERNMENT REVENUE IN BOTSWANA (PERCENT OF TOTAL REVENUE)



Source: Bank of Botswana, SACU Website

CHART 2.9: BOTSWANA'S REVENUE FROM SACU (PERCENT OF GDP AND IMPORTS)



Source: Bank of Botswana, SACU Website

non-existent with the other member states of SADC (Table 2.4 in Section 3).

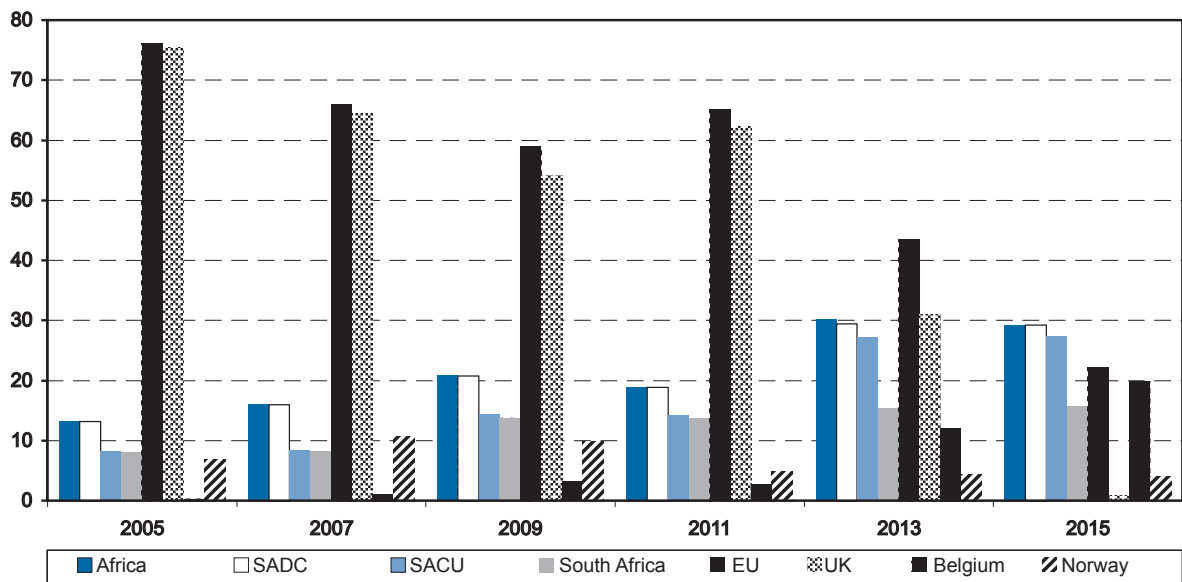
4.10 However, a notable achievement is the creation of the SADC Integrated Regional Electronic Settlement System which facilitates settlement of financial transactions by SADC banks. In addition, monitoring of macroeconomic

convergence under the Committee of Central Bank Governors facilitates maintenance of prudent policy frameworks, which augurs well for fostering a conducive environment for productive economic activity and cross-border trade and investment.

(c) SADC–EU Economic Partnership Agreement (SADC – EU EPA)

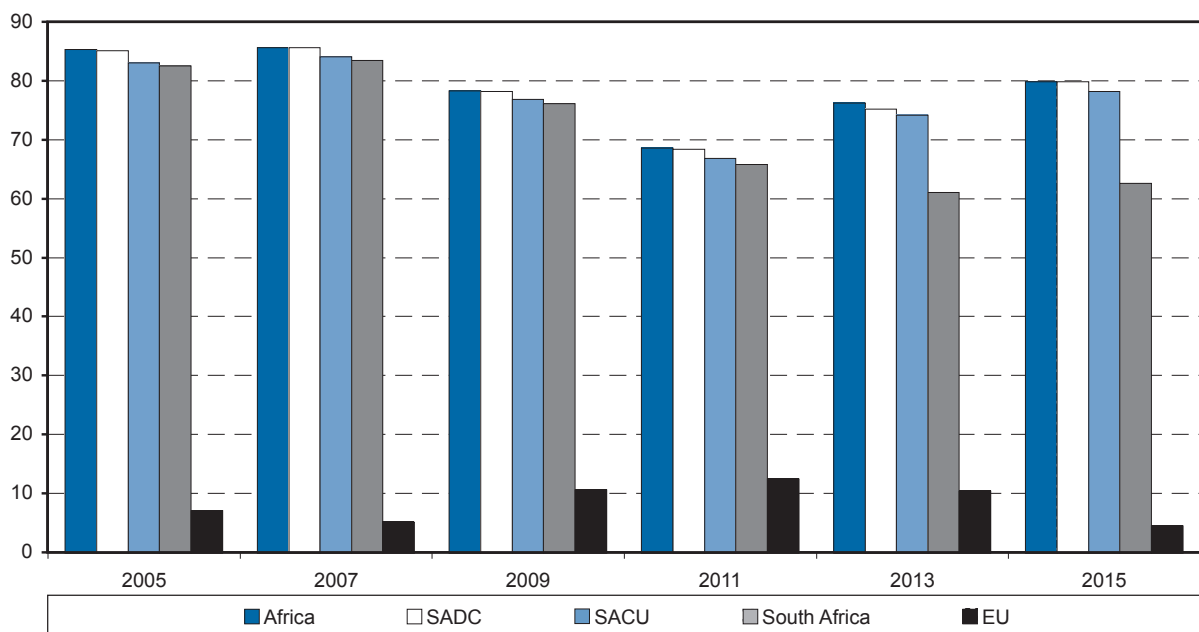
4.11 The SADC-EU EPA was signed in 2016 as a realignment of the Cotonou Agreement (which allows for the export of products from African, Caribbean and Pacific countries to the EU). Under the SADC–EU EPA, Botswana, Lesotho, Mozambique, Namibia and Swaziland are guaranteed 100 percent free access of goods into the EU market; while, for South Africa, the EU has fully or partially removed custom duties on 98.7 percent of the categories of imports. The Agreement is not fully reciprocal; and for that reason, the SADC countries removed custom duties on 86 percent of the categories of imports coming from the EU. The EU is the SADC–EPA group's largest trading partner, with South Africa accounting for the largest share of EU imports and exports from the region. The SADC-EPA countries include major diamond exporters

CHART 2.10: EXPORTS – SELECTED DESTINATION (PERCENTAGE SHARE IN TOTAL)



Source: SACU website

CHART 2.11: IMPORTS – SELECTED SOURCES (PERCENTAGE SHARE IN TOTAL)



Source: SACU website

and these constitute a dominant share of their exports to the EU. Other exports from the region include agricultural products; beef in the case of Botswana. Despite beef exports accounting for less than 5 percent of Botswana's total exports (Table 2.3 in Section 3), the bulk of which are to the EU, the sector is important for economic diversification, notwithstanding

current difficulties (see Section 3). It is also notable that, despite the large national cattle herd and extensive government support for the agricultural sector, Botswana has been unable to meet the full quota allocation for beef exports to the EU.

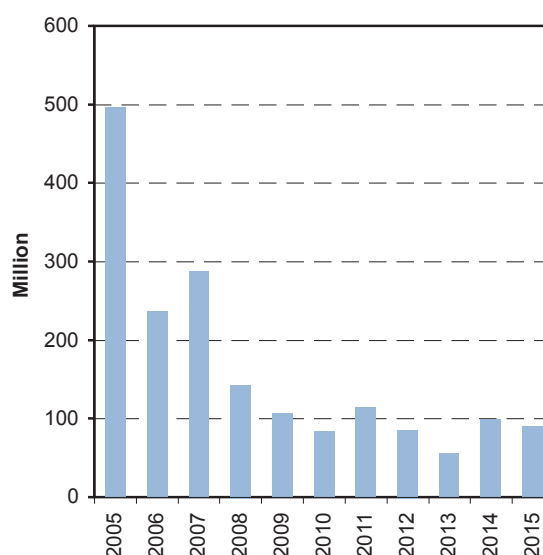
(d) The African Growth and Opportunity Act (AGOA)

4.12 AGOA was enacted in 2000 to run for eight years and was initially extended to 2015 and subsequently to 2025. The Act provides eligible Sub-Saharan African countries, including Botswana, duty-free access to the United States market for certain exports. AGOA builds on existing USA trade programmes by expanding the benefits previously available only under the country’s Generalised System of Preferences (GSP) programme. Botswana has been a beneficiary of AGOA since inception of the programme and, from 2002, was eligible for enhanced access afforded to less developed countries.

4.13 Since the commencement of AGOA, Botswana has participated in eight sectors, namely, textiles and apparel, chemicals, machinery, minerals, metals, forestry, transport equipment and electronic products. However, the more visible impact was with respect to local production and export of textiles, which have relatively low technology and skills requirements. Chart 2.13 shows that textile exports declined sharply from about P500 million in 2005 to just below P100 million in 2015. In terms of overall export performance, the initial surge in growth of exports to the USA has not been

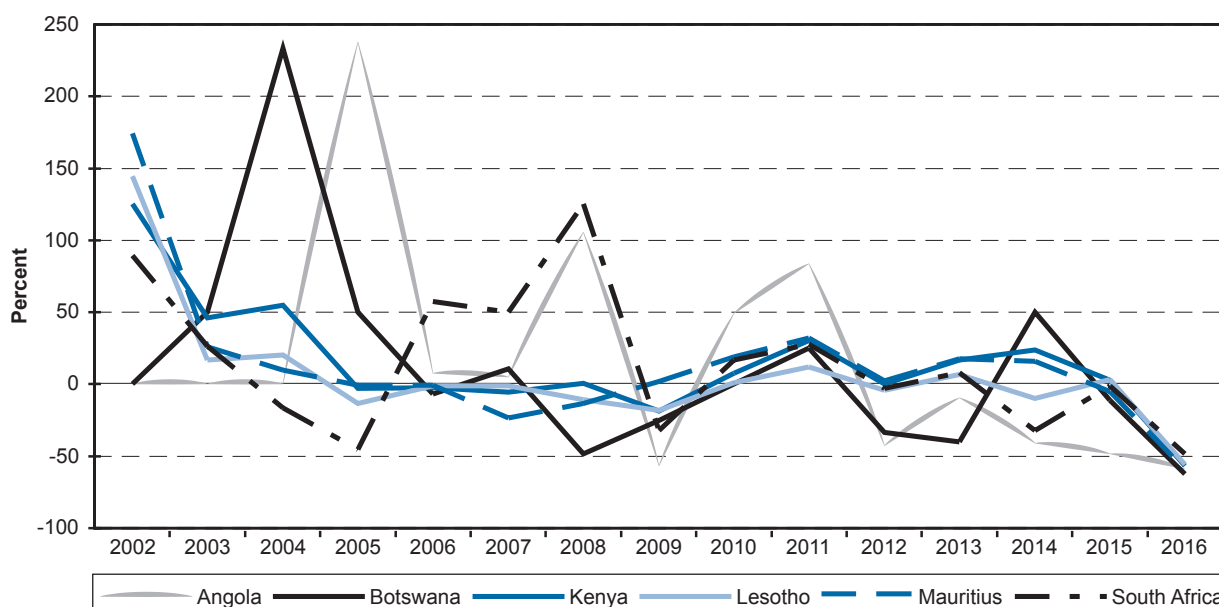
sustained, with an average annual decline of 12 percent between 2006 and 2016. The weak utilisation of the AGOA potential is also indicated by a decline from 13 companies that were involved in the inaugural programme in 2000 to only two at the end of 2016. Challenges cited by local businesses for poor performance include supply-side constraints and high operating costs that undermine their competitiveness and stringent US regulations on goods entering the country.

CHART 2.13: TEXTILE EXPORTS TO THE USA (P MILLION) 2005 – 2015



Source: AGOA information website

CHART 2.12: AGOA ANNUAL EXPORT GROWTH TO USA, EXCLUDING GSP – SELECTED COUNTRIES (PERCENT)



Source: AGOA information website

4.14 In general, trade, investment and access to markets are important for economic growth and job creation. However, trade arrangements must be geared towards supporting a coherent economic development agenda that encompasses inclusive growth, which involves credible and sustainable policies as well as effective institutions. Accordingly, in Botswana, Government has promoted several initiatives aimed at fostering domestic productive capacity and cultivating access to the larger external markets (Section 5).

5. TRADE, INVESTMENT AND REGIONAL ECONOMIC INTEGRATION: INSTITUTIONAL SUPPORT

5.1 Institutional support plays a critical role in providing a conducive environment for trade, investment and regional economic integration to thrive, while promoting international competitiveness. A wide range of support and facilitation arrangements that form part of a business climate exist in the broad categories of specialised and targeted legislation, institutions, policies and strategies, which have to be well balanced and coordinated to ensure the attainment of desirable outcomes.

Legislation

5.2 Legislation and affirmation of trade agreements underpin institutional support and facilitation of cross-border trade, affording transparency, predictability and reliability of the investment environment for both domestic and foreign investors. Furthermore, some legislation, such as that on competition, is focused on achieving equitable, free and fair trade for investors, as well as enabling positive tangible results in terms of improved consumer welfare and contribution to economic development. Another range of legislation fosters appropriate regulation of activity, maintenance of predetermined national and international standards and the promotion of free entry into and exit from the market, as espoused in the National Trade Policy. Nevertheless, there are instances,

where, out of necessity, legislation is deliberately biased towards the protection of interests of citizen and resident businesses and entrepreneurs. Legislation is also used to establish relevant institutions and to safeguard and implement specific policies and strategies as well as coordination and collaboration arrangements. In this regard, authorities in Botswana continuously adopt and refine legislation to benefit trade and economic activity generally and to conform to global developments.

Institutions

5.3 The Ministry of Investment, Trade and Industry (MITI) is the overarching authority that spearheads the institutional framework for trade, investment and regional economic integration. Thus, the Ministry is responsible for formulation and implementation of policies relating to industrialisation, investment and trade arrangements. To support these policies, MITI facilitates negotiations and implementation of various bilateral, multilateral and regional agreements, and the development and enforcement of related domestic regulations. A key support institution under the supervision of MITI is the Botswana Investment and Trade Centre (BITC), which has a broad mandate for attracting investment and promoting exports and, in this respect, also manages the National Brand that promotes Botswana. Thus, BITC helps develop external markets for domestic producers, while fostering the development of local industry and foreign direct investment. Among others, BITC undertakes research to identify growth sectors, with the current focus on mining and energy, agriculture, education, transport and logistics, financial and business services, and tourism. Furthermore, BITC is involved in the implementation of the Special Economic Zones (SEZs) Policy, which is designed to attract domestic and foreign investors on the basis of availability of infrastructure, skills and state of the art technology, targeted economic incentives, and beneficial inter-sectoral linkages (Section 6).

5.4 Alongside the MITI and BITC, there is a

support network for trade, investment and regional economic integration, comprising a wide variety of institutions that play key roles in fostering market access, enhancing productivity and competitiveness, quality control and standards, business/entrepreneurship development and access to finance (Table 2.13).

Policies and Strategies

5.5 Botswana’s strategic policies for trade, investment and regional economic integration are intended to provide a holistic approach to industrialisation that would contribute to employment creation and sustainable economic growth through enabling private industries, in particular, and business operations that would compete with imports and in external markets. The National Trade Policy (NTP) is at the apex of the trade-promoting strategies and policies

in Botswana and, in particular, encompasses the complete framework of laws, regulations, international agreements and negotiating positions that Botswana has adopted. Furthermore, it covers the various guidelines and pronouncements Government has espoused on the conduct of trade with bilateral, regional and multilateral trading partners. While the NTP is founded on the principles of free trade and competition to influence the flow of goods and services between Botswana and her trading partners, there is recognition that, in practice, trade is in the context of a mixture of restrictive and free trade policies. At the same time, it is critical that the country adopts complementary policies, which can help to adapt the domestic institutions to the requirements of free trade and financial flows, accommodate any adjustment costs arising from the adoption of new

TABLE 2.13: KEY INSTITUTIONAL SUPPORT AND RELATED INSTITUTIONS¹

Institutional Support	Institution(s)	Comment
Ensuring quality infrastructure and standards	BOBS, MADFS, BURS, NFTRC, BMC and National Veterinary Laboratory	For BURS, in particular, the Customs Division
Technology transfer	BITRI, BQA, MIHD, BIH and NFTRC	
Promotion of competition in the business sector	MITI, Competition Authority	Ensures fair and transparent business practices in the economy
Enforcement of sanitary and phyto-sanitary measures	MADFS	It is also the institution in charge of the allocation of import licences and/or the banning of importation of selected agricultural products, which is viewed as a way to protect local producers
Facilitation of business access to financing	BDC, CEDA, CEDA Venture Capital Fund, NDB, BECI, IFC, Botswana Trade Commission, private commercial banks and WFH	Facilitate business access to financing for micro and small enterprises
Entrepreneurial development	LEA, BB, CEDA, USAID, UNDP, WIBA, BEMA, WFH and BIH	Promotes and supports entrepreneurial development
Trade Policy	BOBS, PPADB and MITI	Facilitates implementation of the trade policy
Energy infrastructure and supply	MMRGTES, BOC	Ensures the security and efficiency of the domestic supply and promotes active citizen involvement in the petroleum industry
Regulation of exports and imports	MITI, BOTC	Regulates the export and import of goods within the Common Customary Area
Promotion of FDI	WB, MIGA and BITC	Promotes FDI into developing countries to help support economic growth and reduce poverty
SADC programmes	MFED, SADC National Committee	The SADC National Committee brings together all national stakeholders, including ministries, non-governmental organisations and business representatives

1. The list and information is indicative and not exhaustive. See abbreviation list for the full names of the institutions.

trade agreements and maintain the stable macroeconomic environment necessary to support related economic activities.

- 5.6 In addition to the NTP, an array of other supportive and complementary key policies and strategies exist (Table 2.14).

Coordination

- 5.7 The National Committee on Trade Policy Negotiations (NCTPN) served as a forum for inter-agency information-sharing among government, relevant parastatals and the private sector. In particular, it potentially enabled discussion of business and market opportunities arising from trade agreements and addressed related obstacles. Several sub-committees also handled sectoral issues and

specific policy aspects (Table 2.15, overleaf).

- 5.8 The National Economic Diversification Council (NEDC) was established in 2011 to foster the Economic Diversification Drive (EDD). The NEDC, chaired by the Minister of Investment, Trade and Industry, had a membership drawn from Government ministries, parastatals, private sector, labour organisations and the civil society. It had various sub-committees/thematic teams responsible for different strategic thematic areas as reflected in Table 2.16 (overleaf).
- 5.9 In order to minimise the potential for duplication of duties and mandates, simplify their programmes and activities, as well as promote efficient use of resources, the NCTPN and NEDC were merged to form the Economic Diversification and Trade Council (EDTC),

TABLE 2.14: POLICIES THAT SUPPORT TRADE AND INVESTMENT IN BOTSWANA

Policy/Strategy	Objectives
Vision 2036 and the National Development Plans	➤ Vision 2036 and the subsidiary elements of national development planning seek to achieve economic prosperity in which trade plays an important role in the realisation of economic diversification, inclusive growth, poverty reduction, equitable income distribution and the transition to a developed, high income country.
National Trade Policy	➤ Encompasses trade related guidelines, policies, pronouncements and strategies that define how Botswana will conduct trade with bilateral, regional and multilateral trading partners. ➤ Specifically, it aims to promote a private sector driven strategy, with government playing a facilitative role of providing a conducive business environment.
Competition Policy	➤ Aims to maximise the benefits derived by both businesses and consumers from trade and investment liberalisation, deregulation and privatisation, while avoiding the erosion of such benefits through anti-competitive practices. ➤ Aims to address problems that can arise from the globalisation of cartels, abuse of market dominance and monopolisation of key sectors.
Industrial Development Policy	➤ Aims to create a conducive environment for the sustainable development of the private sector under conditions of free and fair trade. ➤ Sets out a road map for establishing diversified, sustainable and globally competitive industries using trade liberalisation and removal of tariffs and non-tariff barriers.
National Export Strategy	➤ Seeks to assist Botswana firms to develop export competencies, access financial resources and market information, and thus achieve competitiveness that allows them to penetrate global markets.
Investment Strategy	➤ Intends to create a conducive environment for both domestic and foreign firms to invest and to be sustainable in Botswana.
Private Sector Development Strategy	➤ Focuses on developing a vibrant and globally competitive private sector that is capable of taking advantage of the market access opportunities opened by the national trade policy.
Regional Economic Integration	➤ Intends to foster greater opportunities for trade, industrial development and inclusive growth, enhance competitiveness, as well as to promote efficiency, productivity and innovation.

Source: Republic of Botswana, Revised National Trade Policy for Botswana

TABLE 2.15: NATIONAL COMMITTEE ON TRADE POLICY NEGOTIATIONS' TECHNICAL COMMITTEES

Technical Committees	Responsibilities
Market Access for Industrial Goods	<ul style="list-style-type: none"> ➤ supports implementation of bilateral, regional and multilateral agreements ➤ facilitates formulation and implementation of national policies and strategies for regional and global integration ➤ helps harmonise national and international standards as well as conformity assessments
Export Development and Investment Promotion	<ul style="list-style-type: none"> ➤ development of the national export strategy and ensuring its integration into the national development plans ➤ promotion of investment and the national brand ➤ creates awareness and understanding of international trade issues ➤ identifies and addresses possible administrative and other bottlenecks hindering trade and investment
Trade in Services and e-Commerce	<ul style="list-style-type: none"> ➤ supports the development of an umbrella trade in services development policy ➤ facilitates formulation and implementation of national policies as well as strategies dealing with services, to ensure realisation of regional and global integration ➤ supports implementation of bilateral, regional and multilateral agreements covering trade in services
Agriculture	<ul style="list-style-type: none"> ➤ promotes and encourage comprehensive analysis of national agricultural trade issues, and possible impact of the same on the economy at large ➤ supports implementation of bilateral, regional and multilateral agreements on the agricultural sector issues
Trade Capacity Building	<ul style="list-style-type: none"> ➤ systematically coordinates various trade related training and technical assistance programmes offered by different institutions in order to maximise benefits from such initiatives ➤ ensuring effective utilisation of different technical assistance programmes on trading capacity building ➤ identifies programmes aimed at building and strengthening Botswana's capacity to effectively integrate into emerging multilateral trading systems ➤ helps identify capacity building programmes for trade negotiations and implementations of various trade agreements
Intellectual Property Rights (IPR)	<ul style="list-style-type: none"> ➤ drafts Botswana's position on IPR for bilateral, regional and multilateral negotiations ➤ develops strategy for enforcement of IPR legislation in Botswana
Competition Policy	<ul style="list-style-type: none"> ➤ prepares national position for negotiations with multilateral partners on competition policy ➤ encourages a fair and competitive environment in the economy ➤ supports effective implementation of the competition policy
Trade and Environment	<ul style="list-style-type: none"> ➤ helps prepare national position on trade and environment negotiations at WTO and SACU ➤ evaluates implications of environmental issues in existing trade agreements ➤ increases awareness on trade and environmental issues
Labour	<ul style="list-style-type: none"> ➤ harmonises Botswana's position at the ILO with trade negotiations ➤ elaborates the national position on trade and labour standards

Source: Republic of Botswana, Revised National Trade Policy for Botswana

with their respective mandates combined under the new Council. The EDTC's main role is to spearhead economic diversification and trade facilitation through sectoral development and linkages; export development and promotion; entrepreneurship development; and establishment of a conducive business environment and dialogue among stakeholders. The Council has various technical committees

whose responsibilities are as indicated in Table 2.17.

5.10 To reinforce commitment to transforming Botswana into a business friendly economy, in 2011, the Government established the National Doing Business Committee, with representatives from the public and private sectors, including labour unions. The Committee, which reports to the Cabinet sub-Committee on

TABLE 2.16: NATIONAL ECONOMIC DIVERSIFICATION COUNCIL THEMATIC TEAMS

Thematic Teams	Responsibilities
Sectoral Development and Linkages	➤ develops priority sectors through the maximisation of local content; promotion of technology transfer and innovation, the transfer of modern management know-how, development of the SMME sector and the attraction of foreign direct investment (FDI)
Export Development and Promotion	➤ develops strategies that aim to maximise growth of the export sector and its contribution towards diversification of the economic and export base of Botswana
Investment and Finance	➤ creation of a conducive environment for investment and provision of investment finance for the priority sectors
Entrepreneurship Development	➤ helps in the development and inculcation of entrepreneurship culture in locals
Technological Development, Transfer and Innovation	➤ making Botswana a vibrant technology driven economy through technological development, adaptation, transfer and innovation
Quality Control, Standards and Production	➤ assists local companies to produce goods and services that comply with accepted local and international quality standards, with a view to enhancing their competitiveness
Research and Development	➤ undertakes need-based research to assist with informed EDD business decisions

Source: Ministry of Investment, Trade and Industry

TABLE 2.17: ECONOMIC DIVERSIFICATION AND TRADE COUNCIL TECHNICAL COMMITTEES

Technical Committees	Responsibilities
Market Access	➤ regional and multilateral trade on goods, services and intellectual property rights
Export Development and Promotion	➤ development of strategies that will maximise growth of the export sector and its contribution towards diversification of the economic and export base
Trade Facilitation	➤ implementation of the WTO trade facilitation agreement
Technology Development Innovation and Transfer	➤ technology development ➤ intellectual property rights
Finance and Investment	➤ business financing ➤ investment promotion
Sectoral Development and Research and Development	➤ priority sector development ➤ cluster and value chain development
Enterprise Development and Competitiveness	➤ quality control, standards and production ➤ business competitiveness ➤ entrepreneurship development

Source: Ministry of Investment, Trade and Industry

Economy and Employment, has the responsibility for improving Botswana's business climate. As highlighted in the Bank of Botswana 2015 Annual Report, work in this regard resulted in adoption of the Doing Business Reforms Roadmap and Action Plan in 2015,³³ with mixed impact so far on the relevant indicators.

Policy Assessment

5.11 The National Trade Policy Assessment Report (MITI, 2015) reviews the 2009 NTP implemented over the period 2010 – 2015. The assessment covers existing trade related policies, laws and regulations and their contribution to Botswana's trade performance, as well as the trade support network, including institutions and policies. This is carried out with a view to developing a new NTP for 2016 – 2020 and, hence, aims to improve on trade performance. The five key messages emanating from the

³³ Some of the reforms included in the Roadmap pertain to the reduction of government bureaucracy, elimination of unfriendly business laws and regulations, improvement of service delivery, as well as leveraging ICT applications.

Assessment Report are highlighted below:

- (a) Botswana has not achieved the level of economic diversification expected from the various trade-related instruments that the country has adopted. To diversify away from heavy dependence on the mineral sector, it is proposed that SEZs are established by building a culture of clustering and value chain retention, to drive the competitive advantage of enterprises and nurture emerging industries that have been shielded from competition so that they can become internationally competitive.
 - (b) the trade policy institutional framework and regulatory environment need to be re-considered to effectively address the formulation, implementation and evaluation of the policy. Institutions dealing with trade-related matters are numerous and complex, with overlapping functions and responsibilities. Hence, the need to rationalise and strengthen the institutional mechanisms so that they can provide timely and effective implementation of the adopted policies.
 - (c) Botswana enjoys preferential market access to the world's main markets, including, inter alia, the EU, through the recently concluded EPA, the USA through the AGOA, Africa; through the COMESA-EAC-SADC tripartite agreement and agreements with MERCOSUR and India. However, traders face major constraints as importers have to deal with a series of conditions and licence requirements, de facto quantitative restrictions, which impede the importation of defined products that are intended to protect certain areas of the economy. Exporters may not be able to export Botswana-originated products owing to non-compliance with the technical requirements imposed by the receiving country. In addition, some products may not qualify as originating in Botswana under the rules of origin for specific countries, thus limiting benefits of preferential market access.
 - (d) addressing the impediments faced by the private sector pertaining to lack of a competitive business environment can be important in determining whether or not the objectives of the NTP are achieved. Issues regarding unfair competition, environmental regulations and labour laws, among others, play a critical role in determining the private sector's competitiveness and, therefore, trade performance.
 - (e) being able to monitor trade agreements and trade flows is essential for an open trade policy framework. Currently, there is very little monitoring of trade indicators and regional integration indicators in order to gauge the success of agreements and/or to seek new trade opportunities. Similarly, in the absence of monitoring, it is difficult to introduce appropriate trade defence instruments timely. Overall, a monitoring mechanism is needed to continuously assess the potential benefits derived from the trade agreements and propose measures to remedy any constraints; thus be able to maintain a pro-active trade policy.
- 5.12 Other observations relate to the need for rationalisation of the number of committees and forums dealing with trade-related matters to ensure meaningful linkages in the decision-making process; this would allow time for implementation and establishment of a precise point of coordination, perhaps within the MITI, comprising relevant stakeholders. Capacity constraints and lack of continuity in membership of committees and coordinating forums also hinder progress, while the private sector organisations have limited policy formulation capability, which also weakens effectiveness in advocacy and consultations.
- 5.13 Despite capacity constraints at both governmental and private-sector levels, it was observed that Botswana is making efforts to implement the applicable multilateral and bilateral agreements such as the SADC-EU EPA.

6. OPPORTUNITIES FOR MANUFACTURING AND SERVICES (SELECTED INDUSTRIES) AND BROAD-BASED GROWTH

- 6.1 Over the years, Botswana has introduced a number of industrial development initiatives, including the promotion of opportunities in the manufacturing and services sectors. The various trade agreements, industrial development initiatives, institutional support, policies and strategies provide the impetus for targeted sectoral development as well as broader economic activity. In addition, Botswana promotes an enabling business environment through largely accommodative policies relating to tariff and non-tariff barriers, tax incentives (especially, Development Approval Orders and a lower tax rate for manufacturing and financial services), as well as local preference schemes. More recently, special initiatives, such as the EDD, the Hubs and Clusters and the SEZs are spearheading the industrialisation agenda for Botswana (Bank of Botswana Annual Report, 2015).
- 6.2 In this regard, the Cluster Development Strategy³⁴ potentially offers a cogent industrialisation path based on harnessing of natural endowments and areas of comparative advantage. Thus, diamonds, tourism, cattle, mining, financial and health services provide opportunities for beneficiation, extensive and deeper value chains and economic backward and forward linkages. The endowment areas (diamonds, aspects of mining, tourism and cattle) represent products and services that are unique (or can be transformed to such) to Botswana and lend themselves to significant value addition through appropriate branding (Table 2.18, overleaf). The case for diamonds is evident from the effect of the relocation of aggregation activity to Gaborone and beneficiation arrangements currently in place, and as supported by
- the Kimberly Certification Process. Similarly, despite the negative impact of protracted low commodity prices, there is potential for higher value addition and viable activities to be derived from copper and coal mining in particular, both as refined raw materials, inputs to production and secondary manufacturing (and related services).
- 6.3 It is self-evident that the value chain and product derivation/enhancement from the cattle industry is currently sub-optimal; thus, there is significant scope for high-value branding and marketing of naturally produced beef. There is also significant scope for industrialisation and additional value that can be derived from other cattle products, notably leather. Unlike mining and the cattle industry, tourism has been a growth area for Botswana in the recent past and continues to represent potential for expansion and wider community benefit.
- 6.4 The cluster development strategy also covers financial and health services premised on comparative advantage and capacity relating to political and economic stability, adherence to the rule of law and economic openness. Specific to health, it is considered that the experience in handling pandemic diseases (notably HIV/AIDS) represents a comparative advantage that can be harnessed. In all these areas, it is considered that development of the related infrastructure and services and the endeavour to acquire and raise the requisite skills and work attitudes also involve expansion and integration of economic activity.
- 6.5 Related to implementation of the cluster development is the establishment of SEZs. The intention is to accelerate the pace of industrialisation by attracting high-calibre domestic and foreign investors to conduct business within a specialised operational environment and incentive structure to boost the country's competitiveness in the global export markets, especially in the non-mineral sector. The 2010 SEZ Policy for Botswana provides for "*development of public sector and private sector partnership SEZs across the country and sectors, as the market would dictate.*" To this

³⁴ The Cluster Development Strategy came to prominence in 1990 following a book by Professor Michael Porter, "The Competitiveness of Nations". Following work between Professor Porter and the National Strategy Office, an announcement of the adoption of the Cluster Development Strategy in Botswana was made in 2013. This section draws extensively on the suggested strategy.

TABLE 2.18: RESOURCES, ENDOWMENTS AND ARISING OPPORTUNITIES

Resource/Endowment	Opportunities
Diamonds	<ul style="list-style-type: none"> ➤ Polishing and manufacturing of diamond products ➤ Secondary activities and support services ➤ Infrastructure development ➤ Improved quality of specialised financial services
Other Minerals <ul style="list-style-type: none"> • Copper & Nickel • Coal • Other metals 	<ul style="list-style-type: none"> ➤ Same as under 'diamonds', including: ➤ Secondary processing and concession ➤ Targeted investment in resources with a high potential ➤ Enhanced regional cooperation for better market access
Population	<ul style="list-style-type: none"> ➤ Growing incomes and market ➤ Increased demand and quality of services (education, health, communications and financial services) ➤ Job creation
Agriculture <ul style="list-style-type: none"> • Arable • Livestock 	<ul style="list-style-type: none"> ➤ Extension of value chains ➤ Improved support services (farm and industry management, veterinary services, etc.) ➤ Better land management and utilisation under arid conditions
Tourism	<ul style="list-style-type: none"> ➤ Full exploitation of unique attractions ➤ Preservation of wildlife ➤ Improved linkages in related activities - logistics, transportations, hospitality and agro-business
Financial Services	<ul style="list-style-type: none"> ➤ Harnessing existing liquidity for productive purposes ➤ Enhanced stability of the financial system ➤ Improved related operational, advisory and management services
Health Services	<ul style="list-style-type: none"> ➤ Transformation of quality and service delivery in healthcare service provision ➤ Harness comparative advantage in handling pandemic and endemic diseases (such as HIV)
Renewable Sun Energy (solar power)	<ul style="list-style-type: none"> ➤ Take advantage of the abundant solar energy resources ➤ Costs of generating renewable energy have gone down in recent years and are competitive with traditional sources

end, Government has embraced various types of SEZs, including Free Trade Zones, Export Processing Zones (EPZs), Enterprise Zones, Freeport, Single Factory EPZ and Specialised Zones (Box 2.1).

6.6 The SEZ policy was followed up by an enactment of the SEZ Act, 2015, and the creation of an autonomous body, the Special Economic Zone Authority (SEZA), which has the mandate to regulate and serves as the technical advisor on the SEZ Programme. So far, eight SEZs have been identified (Table 2.19).

6.7 The special features and incentives for SEZs include:

- (a) provision of infrastructure and utilities (including specialised and unique elements) on a reliable basis;
- (b) support with logistics, business facilitation

TABLE 2.19: THE EIGHT EARMARKED ECONOMIC ZONES AND AREAS OF SPECIALISATION

Zone	Activity
Gaborone	International diamond activities and specialised manufacturing
Gaborone	Financial services
Lobatse	Beef, leather and biogas
Palapye	Integrated coal
Selebi-Phikwe	Mineral beneficiation
Tuli Block	Horticulture
Francistown	Mining supplies
Pandamatenga	Integrated farming

Source: Ministry of Investment, Trade and Industry

tion arrangements and prioritising the ease of doing business;

- (c) corporate tax reductions or exemptions;
- (d) duty-free importation of raw materials, capital goods and intermediate inputs;

BOX 2.1: TYPES OF SEZs

Export processing zones are industrial estates aimed primarily at foreign markets. Hybrid EPZs are typically sub-divided into general zones open to all industries and separate EPZs are reserved for export-oriented, EPZ-registered enterprises.

Enterprise zones are intended to revitalise distressed urban or rural areas through the provision of tax incentives and financial grants.

A **Freeport** typically encompasses much larger areas, accommodating all types of activities, including tourism and retail sales, permits on-site residence, and provides a broader set of incentives and benefits.

Single factory EPZ schemes provide incentives to individual enterprises regardless of location; factories do not have to locate within a designated zone to receive incentives and privileges.

Specialised zones include science/technology parks.

Source: Ministry of Investment, Trade and Industry

- (e) no restrictions or taxes on capital and profit repatriation;
- (f) no charges on exports; and
- (g) exemption from local and indirect taxes.

Support Factors for Cluster Development

6.8 In addition to the special features and incentives provided for the SEZs, several support factors are important for successful cluster development, as indicated below:

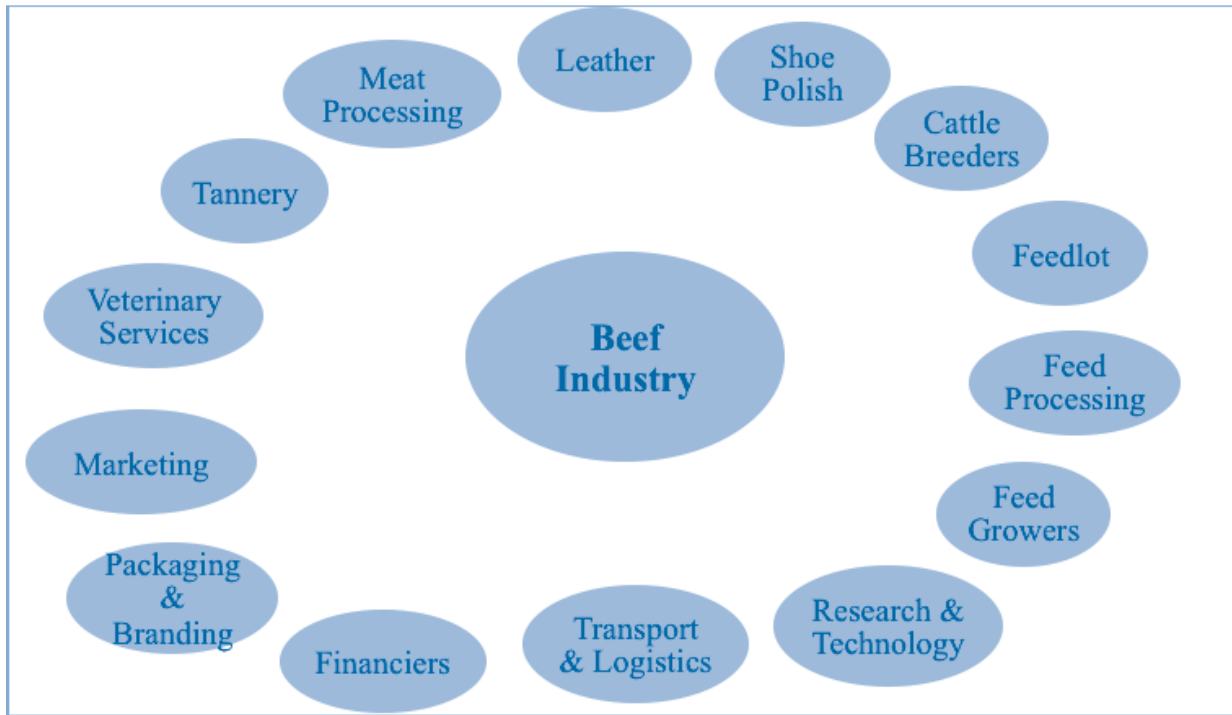
- (a) economic openness to facilitate access to inputs (labour, physical and financial capital, intermediate inputs and entrepreneurial and leadership interventions) to both domestic and external markets;
- (b) effective harnessing of public-private partnerships relating to development, financing and ownership of key organisations, infrastructure and service and utility providers. In particular, given limited fiscal space and to guard against perverse incentives as well as pursuit of effectiveness and efficiency, it might be necessary for Government to give way to the private sector in developing and operating infrastructure. In turn, Government may sometimes act

as a buyer/payer/distributor to meet the developmental aims and wider coverage of infrastructure and utilities;

- (c) institutional support towards capability in terms of meeting supply and wide-ranging quality standards, including safety, phyto-sanitary, operational and aesthetic elements;
- (d) effective organisation, governance and coordination of the various elements of cluster development, taking into account the need to rationalise use of resources;
- (e) market development and expansion strategies based on both demand and active product development and differentiation and utilising opportunities provided by trade agreements;
- (f) a recognition that the apparent current disadvantages and adverse factors represent opportunities for breakthrough research and innovation that can be a long-term growth factor.

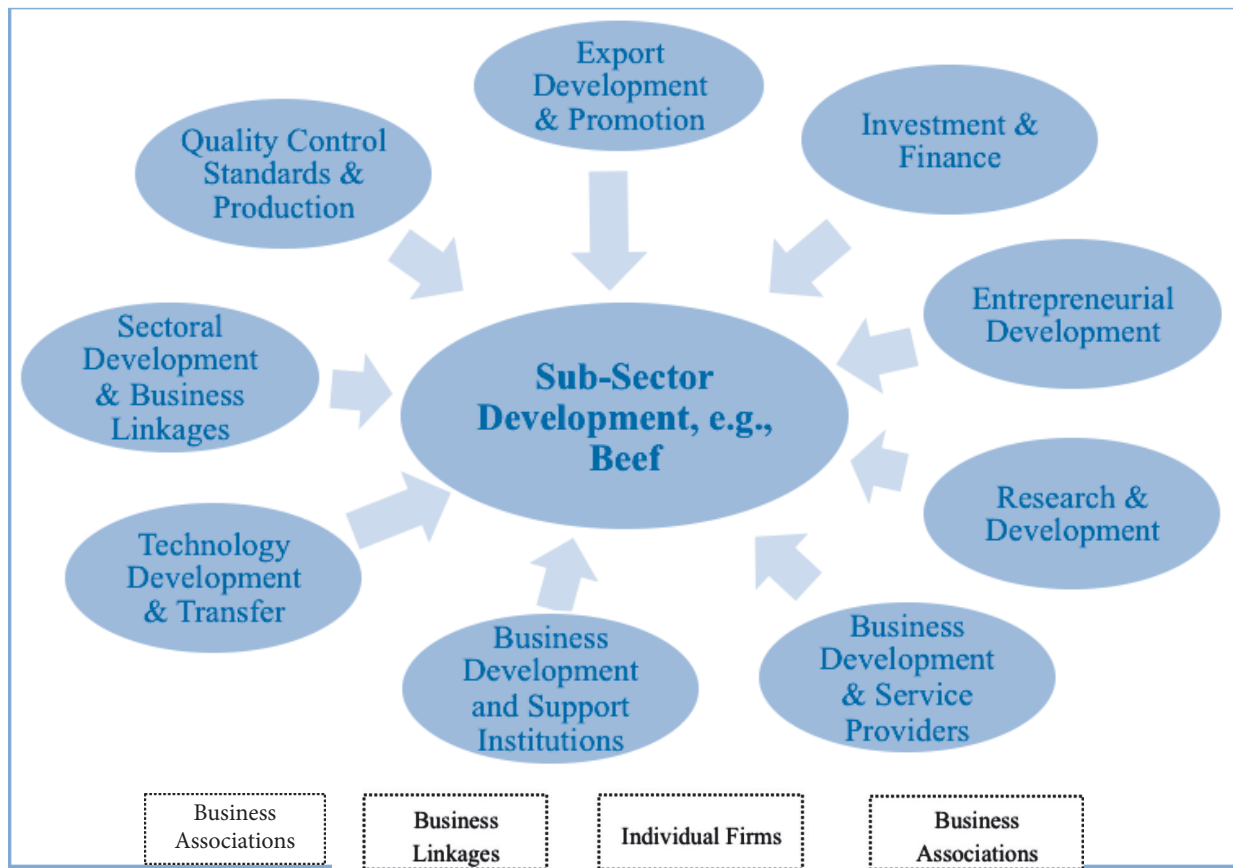
6.9 Operation of the cluster development strategy involves value chain mapping to inform viability and business proposition and to identify linkages of economic activities. Value chain

FIGURE 2.1: BEEF CLUSTER DEVELOPMENT FOR BUSINESS LINKAGES



Source: Ministry of Investment, Trade and Industry, Food and Agriculture Organisation and Ministry of Agriculture

FIGURE 2.2: BUSINESS CLUSTER – INSTITUTIONAL SUPPORT SERVICES



Source: Ministry of Investment, Trade and Industry

TABLE 2.20: EARMARKED MANUFACTURING INDUSTRIES

Manufacturing Sub-Sector	Opportunities	Challenges	Chances of Success
Leather Production and Leather Products	<ul style="list-style-type: none"> ➤ Lobatse Leather Park ➤ Close proximity to main raw material ➤ Readily available market for leather 	<ul style="list-style-type: none"> ➤ Environmental (air pollution) ➤ Weak manufacturing capabilities 	<ul style="list-style-type: none"> ➤ Availability of infrastructure and market for leather across several industries and consumer products
Textiles and Clothing	<ul style="list-style-type: none"> ➤ AGOA and EU markets 	<ul style="list-style-type: none"> ➤ Expiration of Multi-Fibre Arrangement/Agreement in 2004 ➤ Low skilled personnel ➤ Low productivity of the workforce ➤ Uncompetitive against Asian countries 	<ul style="list-style-type: none"> ➤ Weak input support and unlikely to be competitive against productive low cost centres
Dairy	<ul style="list-style-type: none"> ➤ Readily available domestic market 	<ul style="list-style-type: none"> ➤ Inadequate water supply ➤ Non-availability of grid electricity in farming areas ➤ High feed cost 	<ul style="list-style-type: none"> ➤ Very weak because of poor/inadequate supply of utilities
Beef	<ul style="list-style-type: none"> ➤ New markets and growing or maintenance of existing markets ➤ Unique (mostly organic) products ➤ Private extension and support services 	<ul style="list-style-type: none"> ➤ Stringent phyto-sanitary requirements by EU ➤ Land degradation ➤ Prevalence of diseases ➤ Frequent drought ➤ Inappropriate farming methods 	<ul style="list-style-type: none"> ➤ Strong market competition ➤ Extensive dependence on government support
Agro-Processing	<ul style="list-style-type: none"> ➤ Domestic market ➤ Horticulture ➤ Feed processing 	<ul style="list-style-type: none"> ➤ Inadequate irrigation infrastructure and water supply ➤ Requires significant investment in infrastructure 	<ul style="list-style-type: none"> ➤ Constrained supply of inputs
Diamond Cutting and Polishing	<ul style="list-style-type: none"> ➤ Availability of Debswana diamonds ➤ training facilities by reputable diamond cutting firms ➤ Strong institutional support 	<ul style="list-style-type: none"> ➤ Vulnerable global diamond demand ➤ Low productivity ➤ High cost producers relative to main cutting centres of India and China 	<ul style="list-style-type: none"> ➤ Realisation of potential depends on enhancement of productivity and skills

mapping also helps to determine the respective roles for Government, regulatory authorities, business operators and various support institutions and factors. More broadly, it facilitates assessment of the prospective impact on employment, import substitution and export potential, and overall economic growth and development. Figures 2.1 and 2.2 show the linkages and support factors related to the cluster industrialisation approach, using a hypothetical example of the beef industry, while Table 2.20 and Table 2.21 (overleaf) profile some of the products and services considered to have potential in promoting industrialisation and employment creation.

6.10 Overall, the envisaged cluster development/

SEZs industrialisation strategy indicates potential, but is susceptible to the perennial micro-economic policy and administrative challenges that Botswana continues to face. These relate to weak implementation capacity, inadequate monitoring and accountability mechanisms and performance indicators, largely accommodative remedial measures that often include creation of additional institutions and layers of bureaucracy. Moreover, the slow privatisation effort and close control and slow pace of the government divestiture programme can constrain the speed of development envisaged by the cluster development and SEZs.

6.11 To a significant degree, Botswana will continue to rely on external markets for vibrant

TABLE 2.21: SERVICES

Services	Opportunities	Challenges	Chances of Success
Tourism	<ul style="list-style-type: none"> ➤ New markets ➤ Growing or maintaining existing markets ➤ New products ➤ Okavango: World heritage site ➤ Strong institutional support ➤ New tourism policy 	<ul style="list-style-type: none"> ➤ Availability and quality of air transport ➤ Weak internet connectivity ➤ Industrial development in the neighbouring countries 	Strong
Financial	<ul style="list-style-type: none"> ➤ Large pension fund and insurance industry ➤ IFSC accreditation ➤ Fragmented institutional support ➤ Relatively strong regulatory environment ➤ Free movement of capital 	<ul style="list-style-type: none"> ➤ Modest skills set ➤ Significant pension management activities done offshore ➤ Poor ICT and internet connectivity 	Strong
Education	<ul style="list-style-type: none"> ➤ International students enrolment ➤ Critical shortage in certain educational fields and new areas of learning ➤ Strong institutional support 	<ul style="list-style-type: none"> ➤ Heavy reliance on Government by citizens ➤ Weak regional economic performance 	Strong
Communications-ICT	<ul style="list-style-type: none"> ➤ Domestic and international markets ➤ Upgrading of infrastructure, including fibre optic ➤ Strong institutional support 	<ul style="list-style-type: none"> ➤ Limited internet bandwidth and connectivity ➤ Increase uptake of other services 	Strong

domestic industrialisation; and to that extent the country remains vulnerable to adverse global and regional developments; but less so, to the extent it is more diversified. Even then, the extensive connectivity derived from beneficiation and involving a single sector signify both widespread benefits and potential adverse impact across the value chain and the backward and forward linkages. In addition, several of the prospective sectors and products entail a significant environmental impact for which there is need for appropriate mitigating strategies to forestall both domestic and international (market) resistance. Positively, the mitigating approaches to addressing adverse environmental impact can also involve beneficial and viable business/economic activity.

successful, appropriate policies and reforms, such as those envisaged in the Doing Business Roadmap and Plan, for example, should be adopted to create a business friendly environment that is attractive to investors. There is also a need to ensure that there are better synergies among the array of existing policies, strategies and legislation which have a bearing on the SEZs policy, to facilitate its implementation and effectiveness. Significantly, and unlike in the past, in the cluster approach, opportunities for manufacturing and services are not considered in isolation, but collectively in recognition of the intertwined relationship in which the services sector facilitates the development of manufacturing and other sectors.

6.12 However, for the value chains and, in general, the economic clusters framework to be

7. CONCLUSIONS AND WAY FORWARD

- 7.1 Botswana has benefited from economic openness, which facilitated the generally robust export performance, growth in government revenue and, in turn, accumulation of fiscal buffers. The openness has allowed uninterrupted access to capital as well as intermediate and consumption goods in support of industry and welfare of the population. These developments were against the background of largely favourable trade agreements and arrangements that provided scope for accessing foreign markets and products (goods and services). This performance was also in the context of a conducive policy and macroeconomic environment. Among others, this includes favourable performance with respect to exchange rate, fiscal and monetary policies, absence of exchange controls, modest tax regime and the signing of Double Taxation Agreements (DTA) with several countries, both regionally and internationally. Notwithstanding this, the pace of industrialisation, economic diversification and employment creation is judged to have been modest; in particular, not matching the nation's development objectives and aspirations.
- 7.2 Moreover, apart from investments in the resource and financial sectors, there has been modest performance in attracting FDI. A significant constraint in this regard remains the relatively undeveloped nature of the capital markets in terms of both depth and market infrastructure. In addition, there is need for appropriate balance between protecting and nurturing local (citizen) businesses and entrepreneurs on the one hand, and encouraging FDI on the other. Both are important for Botswana's growth prospects. In particular, supporting local businesses contributes to the spread of economic opportunities and shared growth, while FDI has benefits, such as adding to the capital stock and the transfer of technology and skills and, ultimately has potential to propel the growth of citizen-owned businesses.
- 7.3 The slow pace of economic diversification is evidenced by continuing concentration of output and trade in terms of both products and direction. In addition, the challenges of unemployment (20 percent), inequality (IHDI of 0.7) and poverty (19.3 percent) remain primary concerns, indicating the need for increased effort to accelerate inclusive growth. The predominance of exports of raw materials and dominance of imports in domestic production and consumption, respectively, suggest a weak impact of both the export-led and import-substitution policies and strategies. Proximity to a large economy that is also part of a customs union in which Botswana is a member further accentuates the challenges of industrial polarisation and the limited discretion the country has in using industrial/trade policy (including the structure and level of tariffs) to guide the path of industrialisation.
- 7.4 Given the extent of trade openness, the country's endowments and the largely favourable macroeconomic policy and social environment, it is apparent that the limits to business expansion and industrialisation essentially relate to the country's capacity in the various aspects of leadership, management, skills as well as policy and strategy implementation, monitoring and effectiveness. It is noted, in this regard, that there has been a continuous development and renewal of policies and institutions focused on sectoral development, broader industrialisation, economic diversification and employment creation. Although these efforts have yielded varying degrees of success, overall, the achievements so far and pace of progress fall short of the national objectives and aspirations.
- 7.5 A notable feature of institutional and policy development over time has been multiplication of efforts, with deficiencies and weak results addressed through creation of additional policies, institutions and additional layers of bureaucracy, rather than review and rationalisation of prevailing approaches. In the event, resources are thinly spread, with additional direct and indirect costs to Government and the economy, which could undermine the
- 7.3 The slow pace of economic diversification is

country's fiscal position. Furthermore, the preference by Government for continued ownership and control of institutions and strategy tends to restrain the pace of privatisation and private sector participation, including exploitation of economic opportunities.

- 7.6 Going forward, monitoring mechanisms for the various policies and supporting institutions need to be formalised and enforced to allow for regular assessment of both leadership and ex ante determined performance indicators and timely remedial action when expectations are not met. The Government has an important role in policy formulation, execution and provision of strategic direction. In playing this role, the focus should be on effective and efficient provision and delivery of services, infrastructure and policy/strategic support. Direct ownership, authority and distribution by Government is not always necessary for cost effective delivery and coverage. In contrast, allowing greater role for the private sector could help improve provision of infrastructure and services, while broadening scope for discovering and developing new economic opportunities. Nevertheless, it is also important to ensure existence of sound and efficient regulatory frameworks to protect the public interest. At the same time, the frameworks and the regulators implementing them must remain focused on the need to facilitate, rather than impede private sector development.
- 7.7 Therefore, it is important for Government to assess the respective roles of the public and private sectors and the regulatory environment surrounding the envisaged industrial development strategies relating to cluster development, economic processing zones and beneficiation more generally. With the exception of mining enterprises, such as BCL and Debswana, and parastatals, government efforts to facilitate business development are typically targeted towards small, medium and micro enterprises (SMMEs). Notably, while there is potential for SMMEs to accelerate economic development and generate employment, attention should also be directed towards promoting medium

and large enterprises in the country because of their potential for higher-level contribution to economic activity and growth. Thus, a reassessment of public-private sector partnerships and respective roles with respect to such ventures provides scope in this regard. This applies particularly to provision of infrastructure and utilities. There are advantages in terms of reduced cost for Government, harnessing relevant skills and ability to adjust quickly to changes in the business and economic environment, and disciplined and efficient use of scarce resources when charges are related to costs. Where necessary, targeted support (e.g., for disadvantaged communities) would apply to meet coverage, social and developmental needs. There is also a need for continuing assessment of the relative costs of universal subsidies vis-à-vis means-tested support, with a view to moderating the cost to Government, reduce distortions and to promote better allocation of resources and enhanced commitment and ownership of benefits and output.

- 7.8 Monitoring of performance also relates to the impact of trade agreements on domestic economic activity. In particular, it is useful to map the intended impact of trade arrangements and disseminate relevant aspects to stakeholders, especially businesses and parastatals, followed by systematic evaluation of trade performance. Such a proactive trade policy that involves regular assessment enables identification of opportunities and interventions as necessary; it also serves to prevent resources being misdirected towards areas that are not beneficial. Regarding SACU, in addition to engagement on the revenue sharing formula, focus should be maintained on trade policy and industrialisation prospects for Botswana in order to address issues of trade diversion, in general. In this regard, there is need to pursue some discussion and cooperation with respect to the tariff structure and shared industrialisation and, for Botswana (consumers and producers), to benefit from access to products and inputs from outside the customs union.
- 7.9 For Botswana, with a relatively small market,

it is crucial to persist with an open economy and export-led growth model. Such an approach encourages output of products (goods and services) that can effectively compete in foreign markets, with positive implications for local productivity, innovation and entrepreneurship. In turn, local producers are also able to compete with imports in the domestic market without resorting to additional government support. This contrasts with protectionism, which stifles, shields domestic producers from competition and is, ultimately, costly to consumers in terms of the price, variety and quality of products.

- 7.10 Trade facilitation and the promotion of industrialisation also involve rationalisation of administration with a view to achieving integrity and predictability of processes to support legitimate economic activity, and reducing opportunities for rent-seeking behaviour by service providers. To complement the institutional and macroeconomic environmental support for policy and initiatives aimed at promoting industrialisation, there is need to also focus on the human developmental issues (attitudes, work ethic and entrepreneurship). As previously highlighted, this involves education and skills development as well as engagement with employers (firms) in determining industry needs; firms also need to recognise their role in helping employees to adapt to the work environment (that is, in closing the so-called “skills gap”). Moreover, in an open economy environment, it should be accepted that foreign workers complement locals in various ways, including as part of the needed foreign direct investment and skills transfer.