FINANCIAL STABILITY REPORT

BANK OF BOTSWANA
BANKA YA BOTSWANA

PULA
REPUBLIC OF BOTSWANA
MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

NBFIRA
Non-Bank Financial Institutions Regulatory Authority

OCTOBER 2021

FINANCIAL STABILITY COUNCIL

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ABBREVIATIONS

AML/CFT/CPF	Anti-Money Laundering, Combating the Financing of Terrorism and Countering Proliferation Financing
ATM	Automated Teller Machine
AUM	Assets Under Management
Bank	Bank of Botswana
BBI	Botswana Bond Index
BES	Business Expectations Survey
BIHL	Botswana Insurance Holdings Limited
BIS	Bank for International Settlements
BoBCs	Bank of Botswana Certificates
BoE	Bank of England
BPOPF	Botswana Public Officers Pensions Fund
BSE	Botswana Stock Exchange
BSEL	Botswana Stock Exchange Limited
CAR	Capital Adequacy Ratio
CBD	Central Business District
CorpI	Corporate Bond Index
CRE	Commercial Real Estate
DCI	Domestic Company Index
DPF	Deposit Protection Fund
D-SIFIs	Domestic Systemically Important Financial Institutions
EFTs	Electronic Funds Transfers
ELA	Emergency Liquidity Assistance
ERTP	Economic Recovery and Transformation Plan
ETFs	Exchange Traded Funds
FATF	Financial Action Task Force
FCI	Foreign Company Index
FIA	Financial Intelligence Agency
FMI	Financial Market Infrastructure
FSB	Financial Stability Board
FSC	Financial Stability Council
FSR	Financial Stability Report
FX	Foreign Exchange
GDP	Gross Domestic Product
GFSR	Global Financial Stability Report
GovI	Government Bond Index
IADI	International Association of Deposit Insurers
IBRD	International Bank for Reconstruction and Development
ICRG	International Cooperation Review Group
IMF	International Monetary Fund
ISF	Industry Support Facility
LTV	Loan-to-Value
MFED	Ministry of Finance and Economic Development
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
NAV	Net Asset Value
NBFIs	Non-Bank Financial Institutions
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
NPLs	Non-Performing Loans
POS	Point-of-Sale
RCG	Regional Consultative Group
ROAA	Return on Average Assets
ROE	Return on Equity
RPC	Regulatory Policy Committee

SACU	Southern African Customs Union
SARB	South African Reserve Bank
SDR	Special Drawing Rights
SOE	State Owned Enterprises
S&P	S&P Global Ratings
SSA	Sub-Saharan Africa
T-Bill	Treasury Bill
UK	United Kingdom
USD	United States Dollar
WEO	World Economic Outlook

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PREFACE

Purpose of the Report

The Financial Stability Report (FSR) provides an assessment of the vulnerabilities to the stability and resilience of the Botswana financial system by the Financial Stability Council (FSC). The Report provides analytical and performance updates for the financial sector and its impact on economic activity and welfare; encourages public discourse and engagement on financial stability issues; and helps provide information that major participants in the Botswana financial industry and elsewhere may use as input into their own financial risk assessment processes. The FSR is published twice a year; during the first and second half of the year, following approval by the FSC.

Macroprudential Policy Framework

The primary objective of the macroprudential policy framework is to limit systemic risk and its transmission to the broader economy. This is predicated on the observation, and understanding, that the financial system is interconnected and vulnerable to contagion risk, with the result that crises emanating from the financial sector can spill-over more rapidly to the real economy. At the same time, sectoral or broader economic weaknesses could adversely affect the financial system and trigger instability or cause a systemic financial crisis. In turn, this can cause widespread disruption to the provision of financial services, with serious negative consequences for macroeconomic stability and the real economy.

In order to limit systemic and spill-over or contagion risks, financial sector regulators pursue a variety of key intermediate objectives, among others: minimising and mitigating excessive credit growth and leverage; mitigating and preventing significant maturity mismatches and market illiquidity; controlling structural vulnerabilities in the financial system that arise through interlinkages; limiting direct and indirect exposure concentrations from domestic systemically important financial institutions (D-SIFIs); reducing the systemic impact of misaligned incentives with a view to reducing moral hazard; monitoring systemic risks from activities outside the banking system and implementing appropriate policy responses to contain such risks; and strengthening the resilience of the financial system and related infrastructure to mitigate aggregate shocks.

Given the structure of the Botswana economy, the macroprudential policy framework views the external sector vulnerabilities of the domestic economy, through trade shocks and capital outflows, as having the greatest potential for elevated financial stability risks. In addition, the COVID-19 pandemic and the necessary disease containment measures elevated the risk of a macroeconomic shock, arising out of the depressed global diamond market and disruption of the tourism and related hospitality industries for most of 2020, though improvements were noted in the first half of 2021. The FSR provides an analysis of these vulnerabilities, their interaction, as well as the potential impact and response to spill-overs from regional and global financial stability developments and trends. Financial soundness and macroeconomic indicators are used to assess risks to and within the financial system. Relevant and appropriate policy instruments and tools are available for use as intervention measures during periods of financial instability. The instruments and policy tools would be adjusted accordingly and, on time, to mitigate the envisaged threats. Macroprudential interventions in this regard would be communicated through circulars issued, periodically, by the FSC.

Decision-making process

The FSC of Botswana, a multi-agency body, was established to, among others, collaborate and share information on policy and other related issues on strengthening the financial system and making it more robust, in order to mitigate financial stability risks, and take prompt action in response to a perceived build-up of systemic risks; ensure a coordinated response to financial stability issues that may require cross-agency collaboration; request information from any financial institution, exchange information on financial stability issues, and communicate systemic risk warnings.

The FSC is not a statutory body; rather it is a coordinating and cooperation mechanism. It is the responsibility of the respective entities to ensure that relevant macroprudential instruments are timeously activated to combat vulnerabilities, with a view to maintaining long-term financial stability.

The FSC comprises senior officials of the Ministry of Finance and Economic Development (MFED), the Bank of Botswana (Bank), Non-Bank Financial Institutions Regulatory Authority (NBFIRA) and the Financial Intelligence Agency (FIA). The Botswana Stock Exchange Limited (BSEL) is an observer member. The FSC is chaired by the Governor, and the Bank acts as the secretariat. The work of the FSC is governed by a memorandum of understanding (MoU), which underscores the FSC's commitment to ensuring a stable and resilient domestic financial system.

Announcement of macroprudential policy decisions

Proceedings of the FSC are communicated through a Press Release, shortly after a Council meeting, to inform the public of the discussions and conclusions regarding the stability of the domestic financial system. The Press Release further highlights the key risks in the financial system and recommendations to address such vulnerabilities. Policy decisions are communicated through a circular to all affected financial institutions. The circular provides a brief description that links the identified risk with the intermediate objective and explains the manner in which measures taken are expected to mitigate the risk.

1. EXECUTIVE SUMMARY

1.1 **The October 2021 International Monetary Fund (IMF) Global Financial Stability Report (GFSR) indicates that global risks to financial stability have thus far been contained, but uneven access to vaccines and the varying intensity of fiscal support measures between advanced and emerging markets have resulted in a dual-paced recovery process that threatens global financial stability.** The October 2021 IMF World Economic Outlook (WEO) downgraded global economic prospects for 2021 by 0.1 percentage points to 5.9 percent, due to supply disruptions in advanced economies and worsening pandemic dynamics in developing economies. However, prospects for 2022 remain unchanged at 4.9 percent. Growth in advanced economies continues to be backed by significant fiscal support, while many emerging market economies have started to reduce policy support in view of rising inflationary pressures. Policy support, vaccine access and supportive financial conditions will continue to play a pivotal role in establishing a sustainable recovery path and minimise persistent economic damage (scarring), and thereby enhance financial stability. Notwithstanding, long periods of extreme eased financial conditions could exacerbate financial vulnerabilities as asset valuations become overly stretched. In this regard, there is need to continually monitor the possible build-up of vulnerabilities in the current low interest rate environment and the unintended consequences of extraordinary policy support measures, and its eventual unwinding, by promoting timely activation of appropriate macroprudential policy tools.

1.2 **Botswana's financial system is resilient, characterised by strong capital and liquidity buffers, as well as moderate profitability.** Vulnerabilities relating to the potential for excessive and rapid credit growth; increased liquidity and funding risk; elevated corporate leverage; inflated asset valuations; and the risk of contagion between banks and non-bank financial institutions (NBFIs) have, thus far, been generally contained, but the protracted COVID-19 pandemic could elevate the risk of financial instability. Stress tests suggest some degree of resilience even though this could be weakened by a delayed recovery, especially if infections grow at a faster pace than the rollout of vaccines[1]. The financial system has not amplified the shock, but instead continued to support the real economy, while market infrastructures remain robust. Thus, the financial sector has not been part of the problem though it is uncertain how the COVID-19 scarring effects could affect both the supply of and demand for credit, as well as the profitability of banks going forward.

1.3 **Domestic economic performance outturn is much better in the second quarter of 2021.** Over the twelve months to June 2021, the domestic economy expanded by 4.9 percent, compared to a contraction of 5.1 percent in the same period in 2020[2]. The improved economic performance is predicated on the expansion in production in both the mining and non-mining sectors, resulting from an improved performance of the economy from a low base due to the negative impact of the pandemic and its containment measures, on economic activity. Meanwhile, the IMF expects the domestic economy to grow by 9.2 percent in 2021 and 4.7 percent in 2022, while MFED projects growth of 9.7 percent and 4.3 percent in the same periods, respectively. The prevailing accommodative monetary conditions; reforms to further improve the business environment; Government interventions against COVID-19, including vaccine roll-out to the productive population; implementation of the Economic Recovery and Transformation Plan (ERTP) and the Industry Support Facility (ISF) are key inputs in the growth projections for 2021. The global vaccine-powered recovery, as well as the subsequent improvement in business confidence, are expected to boost global demand and exports, including those of diamonds, as well as the tourism and hospitality industries.

1.4 **Domestic credit growth remains moderate, posing minimal risk to financial stability.** Commercial bank credit grew by 7.4 percent to P68.5 billion in the year to September 2021, higher than the 4.4 percent growth in the corresponding period in 2020. The growth in credit was mainly attributable to the 8.5 percent increase in lending to households, that was driven by unsecured lending. Commercial bank credit continued to be dominated by household borrowing at 65.4 percent during the period under review. Household borrowing also dominates credit granted by the NBFI sector, although the level of household exposure in the sector remains relatively low compared to that of commercial banks[3]. The level of household indebtedness in Botswana is, however, considered low by international standards, at 24.9 percent of GDP in the first quarter of 2021, compared to, for example, 26.2 percent, 33.9 percent and 52.8 percent for Mauritius, Namibia and South Africa, respectively[4]. The quality of bank

[1] As November 26, 2021, 33.3 percent of the eligible population had been fully vaccinated.

[2] According to Statistics Botswana, real GDP registered a year-on-year increase of 36 percent in the second quarter of 2021.

[3] As at December 31, 2020, household loans from micro-lenders represented 11 percent of household credit from commercial banks.

[4] Bank of Mauritius, December 2020 FSR, South African Reserve Bank, Financial Stability Review (Second Edition 2020), Namibia April 2020 FSR, Namibia Statistics Agency and staff calculations.

credit improved in August 2021 as indicated by the decline in the ratio of non-performing loans (NPLs) to total loans to 3.7 percent in August 2021, from 4.5 percent in August 2020. To maintain low to modest NPLs and help vulnerable groups in the context of COVID-19 induced economic disturbances, there is need to keep in place targeted support to illiquid but solvent firms and affected households and make the support state-contingent or conditional to reduce moral hazard[5]. Overall, there is no indication of excessive and rapid credit growth that could threaten the stability of the financial system.

1.5 **Average daily market liquidity in the banking system[6] fell to P5.4 billion in October 2021 from P6.2 billion in September 2021.** The fall in market liquidity is due to persistent foreign exchange outflows. Nevertheless, banks continued to comply with the minimum liquid asset ratio requirement of 10 percent and supported moderate growth in demand for credit, with a financial intermediation ratio of 81.3 percent in August 2021, which is slightly above the desired range of 50 – 80 percent. Commercial banks' funding structure continues to be concentrated in a few large depositors, mainly business deposits, highlighting potential funding risks due to the undiversified deposit base. This notwithstanding, funding risks are mitigated by the inherently long-term structure of bank deposits, mainly fixed deposits, thus giving banks an opportunity to respond accordingly in case of short-term funding shocks. In August 2021, fixed deposits (including savings deposits) accounted for 46 percent of the deposit base and were further augmented by the 27 percent for checking/current accounts, which are behaviourally stable/core deposits.

1.6 **In terms of macro-financial interlinkages and contagion risk, banks continue to have significant linkages with the rest of the financial system and the real sector.** The strong interconnectedness between the banking system and NBFIs, as well as the non-financial sector (households and corporates) pose a risk of contagion in the domestic financial system, although effective regulation across the system, as well as proper governance and accountability structures moderate the risk. Furthermore, most of the retail and household loans have credit life protection, mortgage repayment policies and retrenchment cover policies provided by insurance companies, effectively shifting banking risks to the insurance sector.

1.7 **Risks from anti-money laundering, combating the financing of terrorism and countering proliferation financing (AML/CFT/CPF) deficiencies are expected to subside following the removal of Botswana from the Financial Action Task Force (FATF) grey list.** Following numerous evaluations on Botswana regarding AML/CFT/CPF deficiencies and an on-site assessment on August 18-20, 2021, the FATF Plenary meeting of October 19, 2021, recognised that the country had strengthened its AML/CFT/CPF regime and had addressed the strategic deficiencies that FATF identified in October 2018. Consequently, FATF removed Botswana from the list of countries subject to FATF enhanced monitoring. Botswana's exit from the grey list is expected to boost confidence in the domestic financial system, which is supportive of economic activity.

1.8 **Overall, vulnerabilities to financial stability are judged to be moderate in the short term.** The heat map (Appendix Chart A1), which is the FSC's vulnerability indicator, shows that there are sovereign vulnerabilities because of the weakened fiscal position and deteriorating balance of payments. However, these vulnerabilities are lessened by moderate levels of risks to the non-financial sector; relatively stable housing prices and stock market (asset) valuations; low funding costs and sufficient market liquidity; and moderate risk of contagion in the domestic market. Vulnerabilities could be worsened by the delayed recovery and possible stricter, but necessary, disease containment measures, especially if the vaccination programme does not achieve the sated objective of vaccinating at least 64 percent of the target population by December 2021.

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[5] IMF Staff April 2021 Article IV Mission to Botswana.

[6] Average daily market liquidity is defined as average daily excess liquidity over the duration of a month. Excess liquidity in the banking sector is the sum of commercial banks' overnight deposits at the central bank (current account), money absorbed through Bank of Botswana Certificates, outstanding reverse repos less repos, and the Credit Facility.

2. FINANCIAL STABILITY DEVELOPMENTS AND TRENDS

(a) External Sector Vulnerability Assessment

Botswana susceptible to external sector risks

2.1 The external sector presents the greatest potential for elevated financial stability risks to the domestic economy due to the country's overdependence on external trade and related revenue, that is, the Southern African Customs Union (SACU) receipts and mineral exports revenue. Thus, the deceleration in output growth of the domestic mining sector due to weaker global demand for diamonds in 2020 highlights Botswana's susceptibility to external sector risks. This vulnerability to external macroeconomic developments, hence external shocks, is exacerbated by the narrow export base, dominated by diamonds, which poses a threat to the balance of payments outcomes.

External buffers deteriorate

2.2 In September 2021, foreign exchange reserves amounted to P52.1 billion, including a Special Drawing Rights (SDR) allotment by the IMF, equivalent to P3 billion. The SDR allotment contributed approximately 7.6 percent to total foreign reserves. The foreign exchange reserves decreased by 11.4 percent from P58.8 billion in September 2020. The decrease was due to drawdowns to finance the balance of payments deficit and other government obligations, such as external loan servicing and funding of embassies. In foreign currency terms, the level of foreign exchange reserves decreased by 9.8 percent, from USD5.1 billion in September 2020 to USD4.6 billion in September 2021. The reserves also decreased by 11.1 percent from SDR3.6 billion to SDR3.2 billion in the same period. The level of foreign exchange reserves in September 2021 was equivalent to 9.8 months of import cover of goods and services. The relatively low level of external balances has the potential to erode the country's traditionally strong fiscal and external buffers in the medium term, thereby increase fiscal risks.

2.3 The overall BoP was in a deficit of P3.3 billion during the second quarter of 2021, compared to a deficit of P3 billion during the corresponding period in 2020. The deficit mainly resulted from an increased outflow of foreign exchange to meet import demand and government obligations, such as external loan servicing and funding of embassies.

(b) Global Financial Stability Trends

Vulnerabilities in the global financial system persist in some sectors

2.4 According to the IMF's October 2021 GFSR, vulnerabilities in the global financial system have generally decreased, but remain high in a number of sectors amid the low interest rate environment. The GFSR indicates that policy makers are confronted with a dilemma of ensuring continued support for economic recovery in the near term, while ensuring that the unprecedented, extraordinary fiscal and other policy support measures do not undermine financial stability in the medium term. Long periods of extreme easy financial conditions could exacerbate financial vulnerabilities as asset valuations become overly stretched. Looking ahead, market volatility associated with possible repricing of risks in the market and, consequent tightening of financial conditions in the event of sudden increases in interest rates could undermine macro-financial and economic stability. As investor confidence falters and investors possibly avoid risk-taking, this could affect emerging markets and negatively affect their ability to gain access, in a cost-effective manner, to global financial markets. Consequently, authorities should develop a carefully constructed policy mix, specific to country circumstances, with central banks communicating clearly on the intended path of monetary policy. In this regard, a measured and gradual transition towards tightening monetary conditions, taking into account specific country and economic circumstances, is necessary for the achievement of smooth adjustments in the financial market.

2.5 The GFSR highlights that there has been a rapid growth of crypto assets in some emerging markets, as the volume of transactions in crypto assets has become as high as those of equities, and could present risks to financial stability, given the volatile nature of crypto asset prices. These developments suggest close monitoring, and establishment of a regulatory framework to enable management of financial stability risks. Meanwhile, in Botswana, the crypto asset market is considered insignificant and currently not posing any threat to domestic financial stability. The Bank, however, recognises the potential for pervasive and significant effect of the crypto assets business on its functions and mandates and, in general, the broader financial sector of Botswana and it continues to monitor crypto assets developments. As a response to persistent public enquiry on crypto assets, the Bank released a press statement on November 10, 2021. The release cautioned the public that there is no specific legal or regulatory framework pertaining to, or proscribing investment in crypto assets in Botswana, and that investment in such is at the risk of investors like with any other investment.

2.6 At a time when the global economy is recovering from the COVID-19 pandemic, the GFSR highlights the importance of calibrating the recovery to achieve a green economy, as well as the need to monitor and factor in climate risks on financial stability frameworks so as to safeguard global financial stability. The report calls for concerted and accelerated efforts in fast-tracking implementation of the much-needed global climate actions, to avoid disastrous environmental outcomes. This requires substantial additional global investment by both the public and private sectors. The report notes that the global financial sector has the potential to play a catalytic role in this regard, by mobilising private investment to accelerate the transition to a low carbon economy and mitigate climate change. The GFSR sets a tone for a global green recovery and green finance, which deserve the attention of developing economies like Botswana. Meanwhile, catastrophic climate events that have an impact on the health of the financial system have not been observed domestically. The risk from climate change therefore remains low, although vulnerabilities need to be monitored. Overall, Botswana could benefit from climate change aligned financing, green investments policies and frameworks, which have the potential to reinforce financial stability and accelerate economic growth.

Financial stability vulnerabilities elevated in Europe

2.7 The Bank of England (BoE) projects further improvement in economic growth in the fourth quarter of 2021, but risks to the recovery remain (BoE, October 2021). The financial system in the United Kingdom (UK) has provided support to households and businesses to weather the economic disruption from the pandemic, but continuing support will be essential as the economy recovers. Risks to the financial sector in the UK are elevated, owing to rising corporate and household debt, as well as rising prices of risky assets in some markets, with asset valuations appearing elevated relative to historical norms. The positive economic outlook, coupled with a 'search for yield' in a low interest rate environment are partly responsible for increased asset valuations, creating potential sources of vulnerability in the financial system.

(c) Regional Financial Stability Trends

Sub-Saharan Africa economic output to recover in 2021

2.8 The October 2021 WEO estimates that economic output in Sub-Saharan Africa (SSA) will recover from a contraction of 1.7 percent in 2020 to a growth of 3.7 percent in 2021, an upward revision of 0.3 percentage points from the July 2021 WEO Update. However, the forecast for 2022 is slightly down at 3.8 percent compared to the 4.1 percent in July 2021. The anticipated improvement in 2021 largely reflects the expected increase in commodity prices that outweighs the COVID-19 related effects on the economy. Downside risks to growth could emanate from overwhelmed health systems due to the resurgence of new infections and new variants, as well as the limited fiscal space to address the health and economic consequences of COVID-19 pandemic. The two largest economies in the region, Nigeria and South Africa, experienced economic contractions in 2020 of 1.8 percent and 6.4 percent, respectively. The Nigerian economy is expected to grow by 2.6 percent in 2021 and 2.7 percent in 2022.

2.9 For South Africa, growth prospects were revised upwards by 1 percentage points to 5 percent for 2021, as a result of positive economic performance in the first quarter of 2021, while the forecast for 2022 remains unchanged at 2.2 percent. The South African Reserve Bank (SARB) meanwhile projects economic growth of 5.3 percent in 2021.

3. DOMESTIC MACROPRUDENTIAL ANALYSIS

(a) Sovereign Vulnerabilities

The domestic economy is expected to rebound, despite declining fiscal and external buffers

3.1 The domestic macroeconomic environment remains conducive for financial stability, notwithstanding the elevated sovereign vulnerabilities due to the current depressed global economic environment (Table A1, Appendix) and the progressively declining fiscal and external buffers. GDP expanded by 4.9 percent in the twelve-month period ending in June 2021, compared to a contraction of 5.1 percent in the corresponding period ending in June 2020.

3.2 The growth in output is attributable to the expansion in production of both the mining (3 percent) and non-mining (5.4 percent) sectors, resulting from the improved performance of the economy from a low base, emanating from the negative impact of the COVID-19 pandemic containment measures on overall domestic economic activity.

3.3 The domestic economy is projected to rebound to a growth rate of 9.7 percent in 2021, buoyed by the expected improvement in global business confidence and sentiments, leading to an improvement in demand for local diamonds and resumption of tourism and related services. In addition, the reduction in global supply chain disruptions, as well as the easing of measures to curb the spread of COVID-19 should result in increased domestic economic activity, especially with the implementation of the ERTP.

3.4 Despite the below potential economic performance due to the COVID-19 pandemic, the preliminary budget outturn shows a lower than anticipated deficit of P14.6 billion for the 2020/21 fiscal year (April 2020 – March 2021) on the backdrop of better-than-expected revenues and grants. The prevailing fiscal deficits point to increasing pressure on the already limited public revenue sources. The deficits are mainly due to Government's drive to pursue counter-cyclical fiscal policy to minimise the impact of COVID-19 on the citizenry and the economy at large. It is expected that the current fiscal deficit will be partly funded through domestic and external borrowing. Botswana should, therefore, continue to pursue a policy mix that supports growth and promotes economic, export and revenue diversification, while retaining fiscal stability.

3.5 Government debt and guarantees increased to P43 billion in September 2021 from P38.3 billion in September 2020, but, as a percent of GDP was relatively unchanged at around 22 percent. Total domestic borrowing and guarantees amounted to P23.9 billion (12 percent of GDP) in September 2021; substantially below the statutory domestic borrowing limit of 20 percent. External debt is estimated at 10.1 percent of GDP in the same period, which is also below the 20 percent threshold for Botswana. Meanwhile, it is expected that the fiscal impact of the COVID-19 pandemic will be felt until the 2022/2023 fiscal year. The resultant high budget deficits imply a substantial funding requirement to stimulate economic activity amid the COVID-19 pandemic and bolster the economy's resilience to future shocks, which is met through domestic government bond issuance, as well as external borrowing. During the second half of 2021, Government secured a USD250 million (P2.8 billion) loan under the Programmatic Economic Resilience and Green Recovery Development Policy Loan, International Bank for Reconstruction and Development (IBRD), for the financing of economic recovery.

3.6 The country's long-term borrowing costs are likely to be positively affected by the upgrade from "negative" to "stable" outlook conferred by S&P Global Ratings (S&P) in September 2021. The "stable" outlook is on the back of the anticipated economic recovery, which is to be driven by the expected strong recovery in the diamond market which, in turn, should result in a substantial improvement in performance of the domestic fiscal and external sector over the next two years. The rating agency (S&P) also affirmed the sovereign credit ratings for long and short term foreign and domestic currency at "BBB+/A-2". The ratings are underpinned and supported by the country's robust and predictable institutional and monetary policy frameworks; modest net general government debt levels and relatively strong net external position; all of which support durable macroeconomic stability.

(b) Credit Growth and Leverage

Commercial Banks

Moderate growth in commercial bank credit

3.7 Commercial bank credit increased by 7.4 percent annually in September 2021, higher than the 4.4 percent growth in the corresponding period in 2020. The acceleration in commercial bank credit growth was largely due to the higher growth in household credit over the review period. In addition, credit growth has been trending upwards since the end of the first quarter, partly reflecting base effects associated with the fall in credit in the previous year, and an improvement in demand for and supply of credit.

3.8 Table 3.1 shows the distribution of commercial bank credit to businesses, households and Government, wherein household credit increased to P44.8 billion in September 2021, from P41.3 billion in September 2020, on the back of a significant increase of 11 percent in personal loans. Business loans, on the other hand, increased by 5.5 percent over the period under review, due to an increase in credit to parastatals and finance sectors. However, loans extended to the mining, electricity and water, construction, trade, restaurants and bars, manufacturing and transport and communications sectors decreased. The share of business credit to total credit decreased from 35.2 percent in September 2020 to 34.6 percent in September 2021, while that of households increased from 64.8 percent to 65.4 percent during the same period.

Table 3.1: Sectoral Distribution of Commercial Bank Loans

	2020Q1		2020Q2		2020Q3		2020Q4		2021Q1		2021Q2		2021Q3	
	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Amount (P ’million)	Percent of Total
Business	**13.2**	**37.0**	**13.6**	**36.6**	**13.1**	**35.2**	**13.1**	**34.6**	**12.8**	**34.0**	**12.5**	**34.5**	**23 674**	**34.6**
Parastatals	1.2	9.3	1.3	9.7	0.9	6.8	1.0	7.3	0.8	6.1	1.0	8.0	1 932	8.2
Agriculture	0.8	6.2	0.8	5.8	0.8	6.2	0.8	5.8	0.8	5.9	0.7	5.5	1 263	5.3
Mining	0.4	2.7	0.4	2.7	0.4	2.8	0.3	2.2	0.2	1.7	0.3	2.2	504	2.1
Manufacturing	1.4	10.5	0.8	6.1	1.0	7.4	0.9	7.0	0.9	6.8	0.8	6.5	1 667	7.0
Construction	0.5	4.1	0.6	4.5	0.6	4.6	0.5	4.1	0.5	4.0	0.5	4.0	909	3.8
Trade	2.7	20.3	2.9	21.6	2.7	20.6	2.8	21.4	2.9	22.3	2.4	19.6	4 741	20.0
Transport[2]	0.3	2.5	0.3	2.5	0.3	2.6	0.3	2.5	0.3	2.4	0.3	2.0	505	2.1
Finance[3]	2.6	19.7	2.9	21.6	2.8	21.6	3.1	23.7	3.2	24.9	3.4	27.1	6 296	26.6
Real Estate	2.4	18.5	2.6	19.1	2.7	20.7	2.6	19.8	2.5	19.6	2.4	18.9	4 401	18.6
Electricity and Water	0.1	0.4	0.1	0.4	0.1	0.4	0.0	0.4	0.0	0.3	0.0	0.3	68	0.3
Other[4]	0.8	5.9	0.8	6.0	0.8	6.2	0.7	5.7	0.8	5.9	0.7	5.9	1 389	5.9
Households	**22.6**	**63.0**	**23.5**	**63.4**	**24.2**	**64.8**	**24.8**	**65.4**	**24.9**	**66.0**	**23.7**	**65.5**	**44 835**	**65.4**
Unsecured Lending	15.9	70.4	16.6	70.6	17.1	70.8	17.8	71.5	17.9	71.8	17.1	72.4	32 518	72.5
Motor Vehicle	1.1	5.0	1.2	4.9	1.2	4.9	1.2	4.9	1.2	4.8	1.1	4.6	2 034	4.5
Mortgage	5.5	24.5	5.8	24.5	5.9	24.3	5.9	23.6	5.8	23.3	5.4	23.0	10 282	22.9
Total Commercial Bank Credit	**35.8**		**37.1**		**37.3**		**38.0**		**37.8**		**36.1**		**68 509**	

Source: Commercial Banks

[1] Sectoral contributions are calculated as percentage of total commercial banks loan, and subsector contributions are calculated as percentage of sector loans.

[2] Transport and Communications.

[3] Finance and Business Services.

[4] Includes non-resident businesses.

3.9 Total credit as a percentage of GDP grew steadily between 2010 and 2020, at an average rate of 12.4 percent. Credit growth is in line with its long-term trend and thus not likely to overheat the economy (see Box 3.1 for an assessment of excessive credit growth). In this context, there is scope for increased, disciplined and prudent credit extension to support economic activity.

3.10 Commercial banks' leverage ratio was 7.8 percent in August 2021, a decrease from the 8.5 percent in August 2020; but indicative of the banking sector's strength to withstand negative shocks to the industry's statement of financial position. Furthermore, commercial banks' average capital adequacy ratio was 18.5 percent in August 2021, thus indicating the sector's resilience to unexpected losses (Table 3.8). The industry's strong capital base is further augmented by the modest level of NPLs to total loans ratio of 3.7 percent in August 2021 (4.5 percent in August 2020). However, the full effects of the COVID-19 pandemic on corporate performance, banks' level of NPLs, profitability and capitalisation are yet to be observed.

The Household Sector

Households remain vulnerable to sudden and sharp changes in financial conditions

3.11 Household credit grew by 8.5 percent in the twelve months to September 2021, higher than the 7.4 percent growth recorded in the year to September 2020 (Chart 3.1). The relatively higher growth rate of household credit was due to base effects and an improvement in credit conditions, both supply and demand. Credit to households continued to dominate total commercial bank credit, at P44.8 billion (65.4 percent) in September 2021 and was mostly concentrated in unsecured lending (72.5 percent). The proportion of unsecured loans to total credit remains higher than the 24.4 percent and 30.8 percent reported in South Africa and Namibia, respectively[7]. The significant share of unsecured loans and advances has the potential to cause household financial distress, given the inherently expensive and short-term nature of such credit[8]. Therefore, households remain vulnerable to sudden and sharp tightening of financial conditions.

Household debt aligned to trends in income

3.12 Household debt as a proportion of household income is estimated 37.5 percent in the third quarter of 2021, a decrease from the 47 percent in the same period in 2020[9] (Chart 3.2). The ratio remains relatively low when compared to the 79.9 percent and 75 percent for Namibia and South Africa, respectively[10]. In this respect, domestic household borrowing is in line with trends in personal incomes, implying a relatively strong debt servicing capacity. Consequently, the ratio of household NPLs to total household credit was modest at 3.5 percent in June 2021, slightly lower than the 3.9 percent in June 2020 and significantly better than the industry average of 4.1 percent in June 2021 (Chart 3.2).

3.13 Moreover, households are net savers when their non-discretionary contractual pension savings are included (Table 3.2). Although pension assets may not immediately alleviate short-term cashflow constraints or meet immediate financial needs, such assets may improve the long-term financial welfare of households and, in general, underpin wealth creation and financial security for retirees. Other household assets, which could increase the household net wealth, such as rental income, commercial farmland and retail shareholding at the Botswana Stock Exchange (BSE) are not accounted for because of data limitations.

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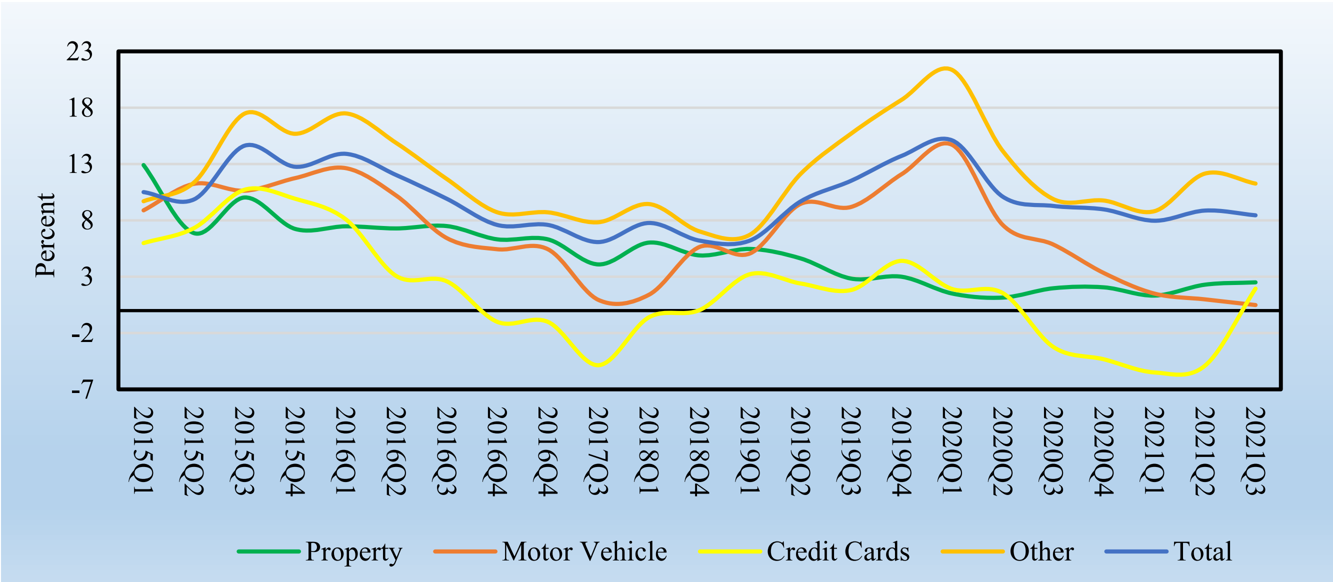
7 SARB Financial Stability Review – Second Edition 2020 and Namibia FSR – April 2021.

8 It is worth noting that for a given quantum of credit, debt servicing requirements (total monthly repayments) are much higher for short-term (unsecured) credit than for long-term (secured) credit, due to the higher (small) interest rates for short-term (long-term) credit, and the differing proportion of the principal that has to be repaid each period.

9 The measure of income used is the compensation of employees (maximum quarterly earnings), obtained from the Quarterly Multi Topic Survey by Statistics Botswana. Data for 2021 is not available and was proxied with data for the fourth quarter of 2020.

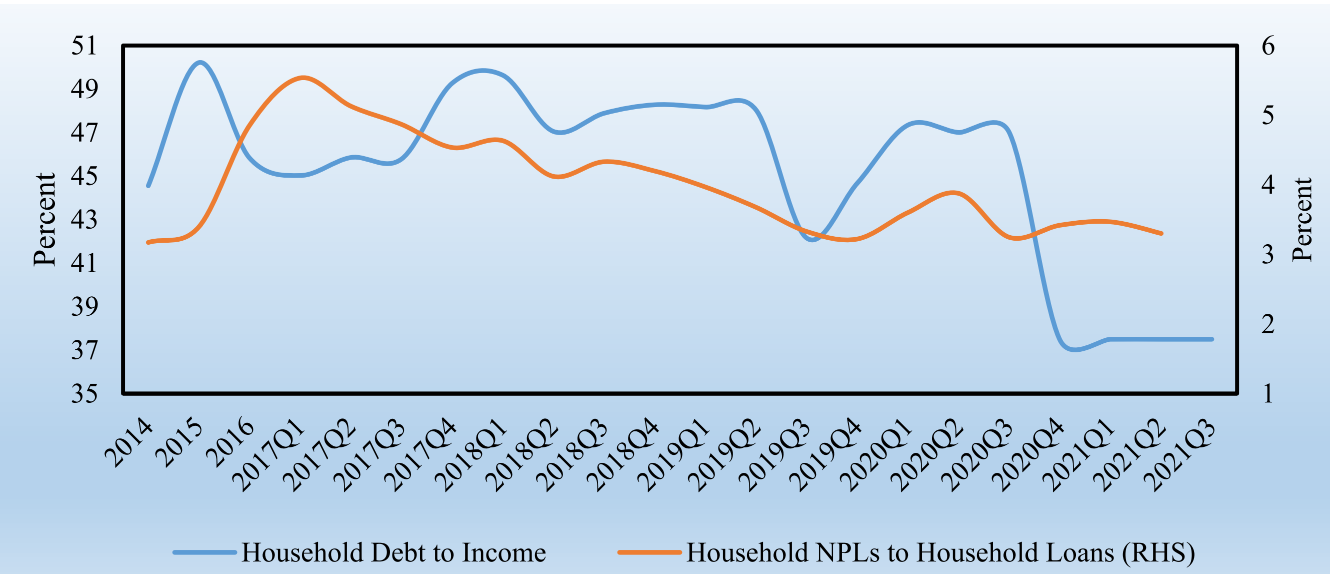
10 Namibia FSR – April 2021 and SARB Financial Stability Review – First Edition 2021.

Chart 3.1: Growth in Household Debt (Year-on-Year)



Source: Commercial Banks

Chart 3.2: Household Debt to Income and NPLs



Source: Statistics Botswana and Bank of Botswana

Table 3.2: Household Net Wealth

Asset	2019 (P' million)	2020 (P' million)	2021Q1 (P' million)	2021Q2 (P' million)	2021Q3 (P' million)
Retail deposits	15 384.2	16 996.0	17 570.7	18 891.1	18 657.2
Pensions	93 133.2	105 174.6	108 495.3	109 873.7	*115 258.1*
Insurance contracts	13 423.6	*10 847.6*	*11 035.0*	*11 035.0*	*11 035.0*
Mortgage property	9 929.5	10 134.6	10 117.4	10 170.6	10 282.4
Motor vehicles	2 017.5	2 084.5	2 087.6	2 023.2	2 034.1
Cattle value	*3 500.0*	*3 500.0*	*3 500.0*	*3 500.0*	*3 500.0*
Equity investment	178.5	66.2	*66.2*	*66.2*	*66.2*
Total assets (a)	134 587.0	148 803.6	152 872.2	159 404.7	160 833.0
Total household debt (b)	45 475.9	49 101.5	49 745.1	50 682.5	51 376.3
Total household net wealth (a) – (b)	**89 111.1**	**99 702.1**	**103 127.1**	**108 722.2**	**109 456.6**

Source: Bank of Botswana, Botswana Stock Exchange Limited and Statistics Botswana
Note: Figures in italics are estimates.

Box 3.1: Tools for Assessing Excessive Credit Growth

Background

One of the objectives of macroprudential policy is to mitigate systemic financial stability risks, which are sometimes precipitated by excessive credit growth. Credit growth that is out of line with trends in economic growth often leads to the build-up of systemic risks to financial stability, which may trigger banking crises. It is, therefore, important to monitor growth in credit. In this regard, the Bank is continually developing and adopting means and tools of assessing whether or not credit growth is excessive. Currently, the Bank measures excessive credit growth based on the Credit-to-GDP Gap.

The Desired Range for Credit Growth

Early tools included the desired objective range for credit, which the Bank specified annually. Following the development of better forecasting techniques and the adoption of an inflation forecasting framework, the Bank discontinued credit-targeting. The desired objective range was deemed to be compatible with the inflation objective. The calculation of the range took into account the inflation target, the projected GDP growth rate, and a measure of financial deepening. In 2004, the objective range was calculated as follows:

Assuming (in percent):

Inflation objective range	3.0 – 4.5
+ GDP growth rate	4.0 – 5.0
+ Financial deepening	2.0 – 2.0
= Credit Growth Rate Target	9.0 – 11.5

After applying expert judgement, the range was ultimately set at 12 – 15 percent, as inflation was high during that period.

Given the current 3 – 6 percent inflation objective range, and assuming a GDP growth rate of 4 – 5 percent (excluding COVID-19 effects – long term trend), and with the same values for financial deepening, the desired range would be 9 – 13 percent. Credit growth was 7.4 percent in September 2021, and higher than the 4.4 percent in September 2020, thus below the desired range and not posing any threat to the stability of the financial system.

The Credit-to-GDP Gap

The Bank for International Settlements (BIS) defines the Credit-to-GDP gap ("credit gap") as the difference between the Credit-to-GDP ratio and its long-term trend. Borio and Lowe (2002 and 2004) first documented the Credit-to-GDP gap as a very useful early warning indicator for banking crises. This finding has been subsequently confirmed for a number of countries over a long-time span that includes the most recent global financial crisis.

Commercial bank credit growth is moderate, as measured by the Credit-to-GDP gap of 1.9 percent, which was below the 10 percent threshold in June 2021 (Chart 3.3a). The low Credit-to-GDP gap reflects room for sustained economic expansion. Furthermore, the gap has been positive since the global financial crisis, mainly reflecting the decline in the rate of GDP growth, which in the main, was due to the overall subdued performance of the mining sector. A Credit-to-GDP gap that moves significantly above its trend or exceeds some critical threshold (typically 10 percent) portends emerging financial imbalances and risk of financial distress.

Chart 3.3a: Aggregate Credit-to-GDP Gap

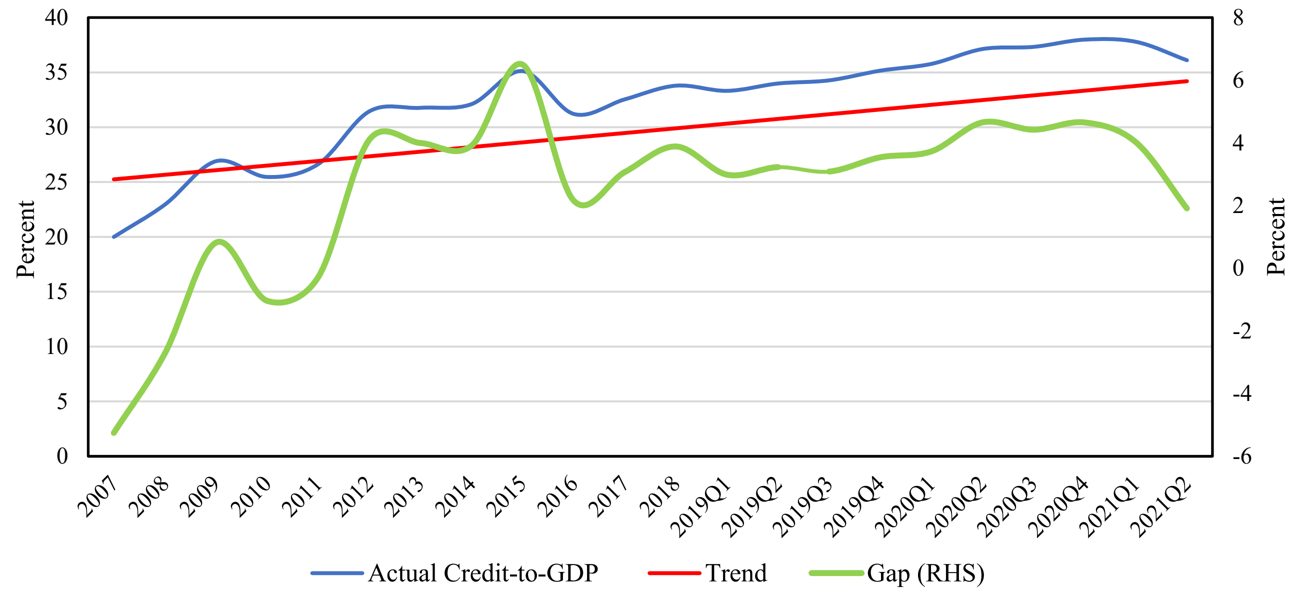


Chart 3.3b: Household Credit-to- GDP Gap

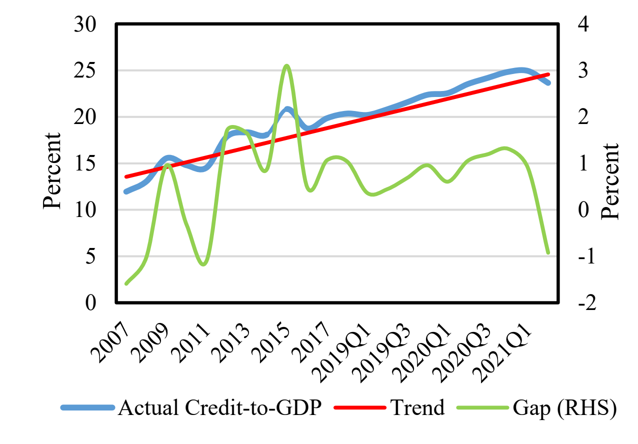
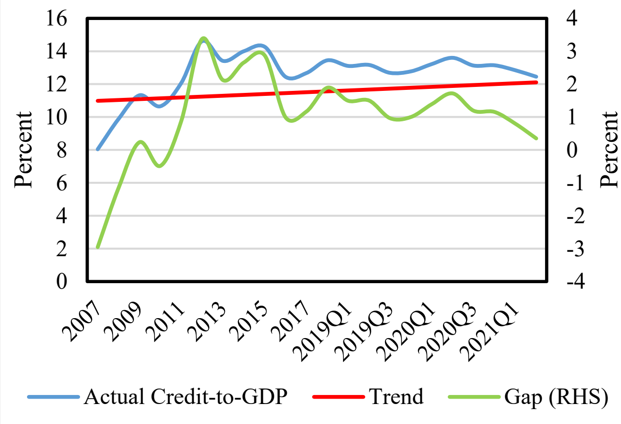


Chart 3.3c: Business Credit-to-GDP Gap



Source: Bank of Botswana

The Non-Financial Corporate Sector

Corporate sector borrowing continues to show a declining trend

3.14 Total commercial bank credit to the non-financial corporate sector increased slightly, by 1.3 percent to P20.8 billion in the year to September 2021 from P20.6 billion in September 2020. However, the proportion of corporate loans to total commercial banks' credit fell to 30.4 percent in September 2021 from 32.3 percent in September 2020 as other sectoral exposures gathered more pace. Commercial banks' exposure to this sector fell to 30.4 percent in September 2021 from 32.3 percent in September 2020. Relative to GDP, domestic bank credit to the private sector was 35.1 percent in June 2021 compared to 35.8 percent in June 2020 and remains significantly lower than the 79.5 percent and 139.5 percent for Namibia and South Africa, respectively[11].

The corporate sector remains financially sound

3.15 Selected financial soundness indicators of the 14 domestic non-financial corporates listed on the BSE indicate a financially sound corporate sector during the period January 1, 2020 to December 31, 2020 (Table 3.3). Corporate leverage was moderate, with a Debt-to-Equity ratio of 45.3 percent in December 2020. However, risks associated with governance, accountability and compliance failures remain elevated in parastatal corporations that fail to produce audited annual financial statements.

[11] https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS

Corporate sector NPLs fell in June 2021

3.16 The ratio of NPLs to total loans in the corporate sector was 6.8 percent in June 2021, down from the 7.3 percent in June 2020. Nevertheless, the ratio remains higher than the banking sector average of 4.1 percent. Meanwhile, the number of liquidated companies rose slightly from 10 in 2019 to 11 in 2020 and fell to 7 at the end of November 2021, suggesting that the negative impact of COVID-19 is yet to be felt and has not yet translated into bankruptcies.

3.17 Notwithstanding, stable profits and the low level of bankruptcies in the period under review suggest that corporates should be able to continue servicing their loans. The profitability ratio, as measured by the return on equity (ROE), fell slightly from 12 percent in 2019 to 11.6 percent in 2020 (Table 3.3).

Recovery in industries primarily affected by COVID-19

3.18 The COVID-19 pandemic and associated containment measures implemented since April 2020 throttled economic activity and negatively affected contact industries[12] in 2020. However, recent economic data points to notable economic recovery, led by the mining (diamond) sector. In the twelve-months to June 2021, mining GDP and diamond trade grew by 3 percent and 59.1 percent, respectively; while output from construction, transport and storage, information communication and technology, and wholesale and retail sectors grew by 0.7 percent, 3.1 percent, 7.1 percent and 13.1 percent, respectively. In contrast, output from the accommodation and food services sector fell by 19.2 percent, while that of the manufacturing sector declined by 1.8 percent.

3.19 Excluding mining and diamond trade, the six sectors namely manufacturing; construction; accommodation and food services; wholesale and retail; transport and storage; and information and communication contributed a combined average of 32.5 percent to GDP in the year to June 2021. Therefore, performance of these sectors has the potential to significantly constrain prospects for strong economic growth especially if coronavirus infections do not abate or the vaccination rollout programme stalls. Nonetheless, Government implemented a number of measures intended to support and sustain ailing businesses, among others, by providing loan guarantees, direct credit support and deferral of tax payments and/or tax concessions. While crucial, these measures, combined with the low interest rate environment, could engender unintended consequences such as excessive leverage in the non-financial corporate sector, hence, result in inter-temporal trade-off between policy support, financial stability and economic prosperity in the medium to long-term.

Firms optimistic about economic activity

3.20 The September 2021 Business Expectations Survey (BES) indicates that firms were optimistic about economic activity in the third quarter of 2021. Firms expect the domestic economy to expand by 4 percent in 2021 compared to the 2.9 percent projected in the June 2021 BES. The optimism reflects the anticipated improvement in business conditions and the envisaged global economic recovery.

3.21 The expected global economic recovery is threatened by the emergence of new variants of the COVID-19 virus, unequal distribution of COVID-19 vaccines and effectiveness of policy support deployed to limit the consequences of the crisis. In light of these developments, potential vulnerabilities in the corporate sector are assessed to pose moderate to high risk to financial stability in the medium term.

Table 3.3: Non-Financial Corporates' Financial Soundness Indicators (Percent)

Ratios	2017	2018	2019	2020
Non-Financial Corporates Credit-to-GDP	10.7	11.2	10.7	12.5
Cost-to-Income Ratio	60.0	60.3	65.1	56.0
Total Debt to Equity Ratio (Leverage)	42.1	46.9	46.3	45.3
Return on Equity	13.8	15.7	12.0	11.6
Price/Earnings Ratio (Times)	13.3	11.2	12.4	10.8
Dividend Yield	4.4	5.1	4.8	4.1

Source: Botswana Stock Exchange Limited, Statistics Botswana and Financial Statements of Corporates

Notes: Non-Financial Corporates Credit-to-GDP was calculated using total credit from commercial banks to non-financial corporations.

[12] Contact industries in this instance refer to industries which require the physical presence of workers, making the working from home arrangement impossible. These include construction, tourism, mining, manufacturing, and agriculture.

The Real Estate Sector

Commercial real estate lending poses limited risk to financial stability

3.22 Credit to commercial real estate (CRE) segment decreased from P4.6 billion in September 2020 to P4.4 billion in September 2021. At these levels, the proportion of commercial real estate loans to total loans is relatively low and has averaged 7 percent over the five years to 2020 and 6.3 percent over the period 2015Q2 to 2021Q3 (Chart 3.4). The CRE sector has maintained relatively good quality assets, with moderate level of NPLs and limited foreclosures. Sectoral NPLs constituted 3 percent of total commercial real estate loans in June 2021 (March 2021: 3.9 percent), while foreclosed properties represented 4.6 percent of total real estate loans in 2020. As such, domestic commercial real estate lending poses minimal risk to domestic financial stability. There are, however, concerns about concentration (location) risk in the real estate sector, with most loans originating in Gaborone and surrounding areas[13].

Growth trends in mortgage loans not commensurate with housing needs

3.23 In the residential real estate sector, primarily owner-occupied mortgage loans, were relatively stable at approximately P14.1 billion in September 2021 and September 2020. Residential property loans constituted 27.8 percent of total household credit and 18.7 percent to total credit in September 2021 (Chart 3.5). This development suggests that housing finance is not commensurate with the needed development and growth path to fill the apparent need for housing, as well as the financing gap[14]. Thus, the size of housing finance in Botswana lags developments, for example, in South Africa and Namibia, where residential mortgage loans accounted for 23.6 percent and 40.2 percent of total loans in June 2021 and March 2021, respectively[15]. The stagnant ratio might be reflective of the restrained growth in incomes relative to the increase in residential house prices over the years (possibly reflecting limited housing stock in various categories, or availability of land and prices of building materials).

3.24 Credit risk in the mortgage sub-sector remains low, with commercial banks recording Loan-to-Value (LTV) ratios ranging between 45 percent and 85 percent, and extremes of 105 percent in some isolated cases. The low to medium LTV ratios limit the exposure of banks to mortgage credit default. For example, the default rates (loans tainted by arrears and/or impaired) for mortgage loans were moderate at 6.8 percent in June 2021.

Residential property price weakened in the second quarter of 2021

3.25 According to the latest (2021Q2) Riberry Report, the residential market performance for both rentals and sales was mixed. Demand for rentals and sales of medium-end houses decreased, while supply increased. Upper-end houses continued to experience weaker demand for both rentals and sales, as was the case in the previous quarters. In contrast, the lower-end market was resilient, with reasonable demand and supply, as has been the case in the previous periods. The average price for residential properties sold in the second quarter decreased by approximately 9 percent from P800 000 in the first quarter of 2021 to P728 000 in the second quarter of 2021.

Office space supply outstrips demand

3.26 The Ribbery Report points to a continued weak commercial real estate market, as the supply of office space continues to exceed demand. The supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the central business district (CBD) by Botswana Housing Corporation and Water Utilities Corporation. These are expected to further exert downward pressure on rentals, especially in the decentralised office locations. The working-from-home arrangements adopted by many companies due to COVID-19 protocols also have the potential to suppress demand for office space, and consequently rental market prices if they are adopted as long-term work strategies. Nevertheless, vulnerabilities from the real estate sector, relating to the potential increase in NPLs, posed minimal risk to financial stability in the second quarter of 2021, but prospective developments require continuous close monitoring and assessment.

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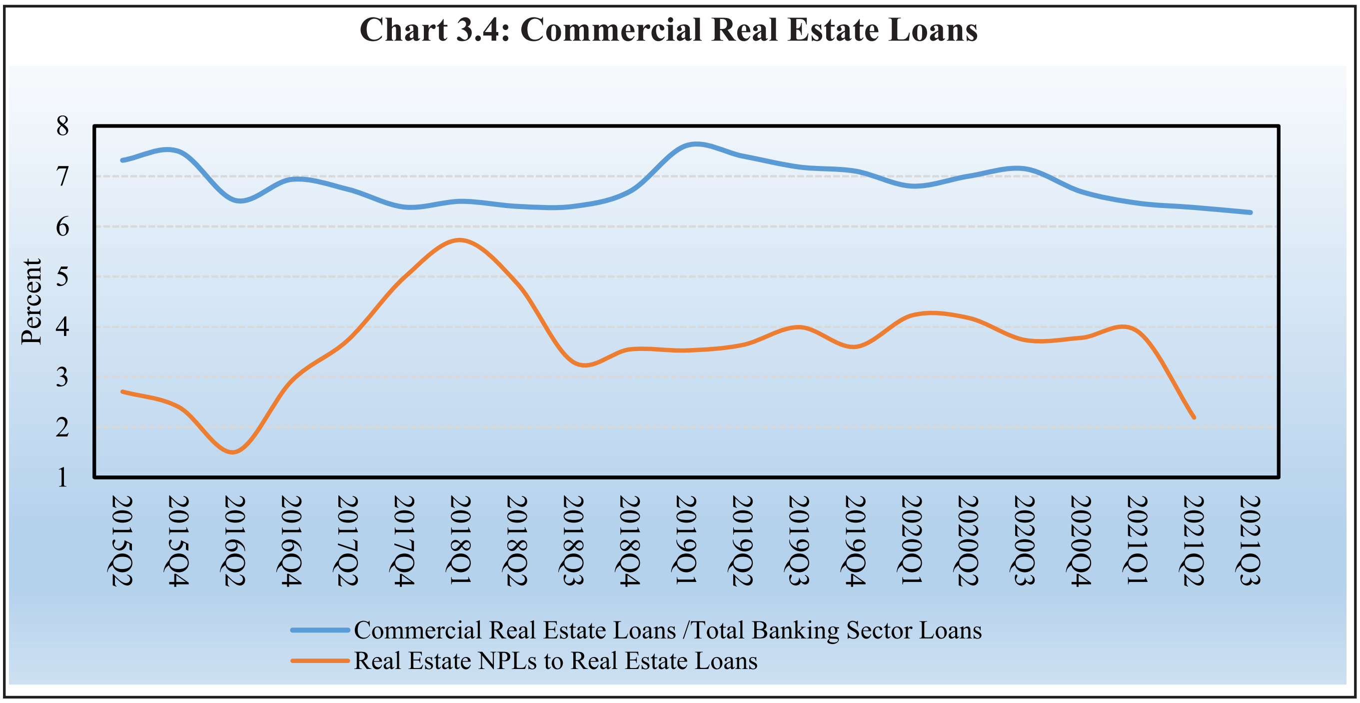
[13] Bank of Botswana Residential Property Survey Report (2017) and Riberry Property Market Report, 2020 fourth quarter.

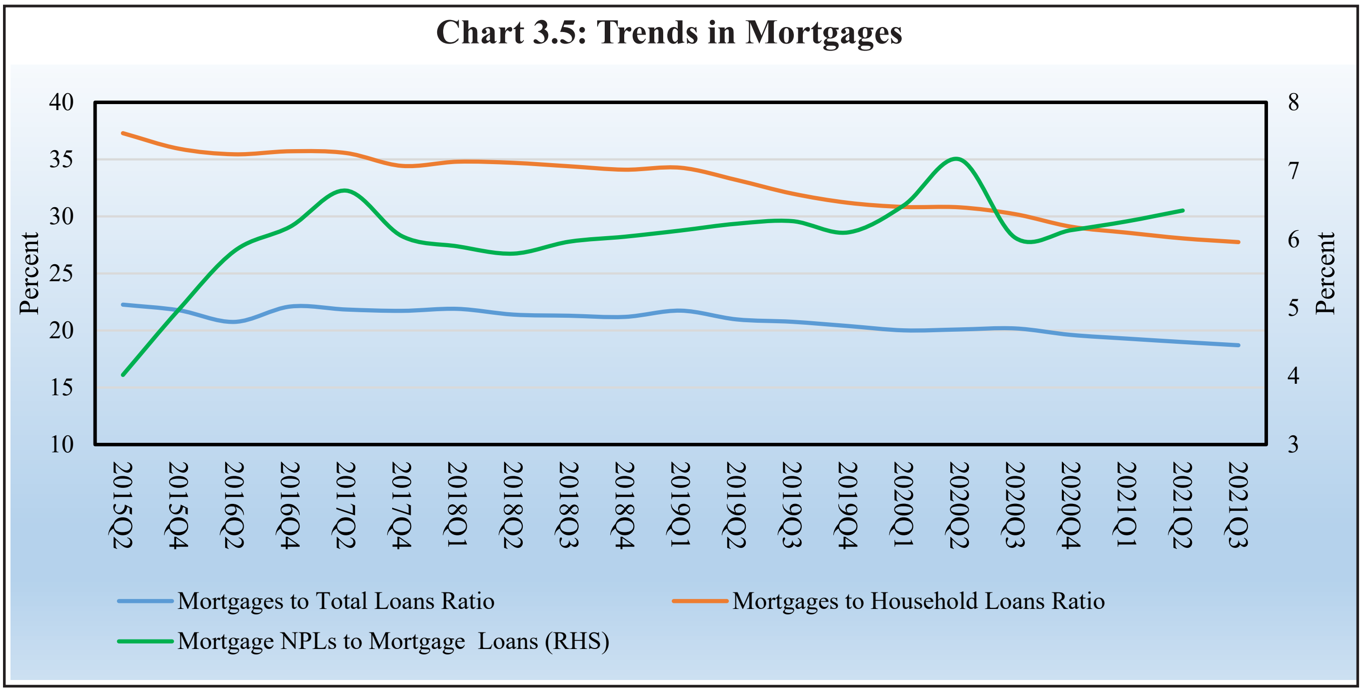
[14] Challenges in accessing mortgages viz., land tenure, relatively low average incomes and strict funding requirements have, however, shifted house financing to unsecured personal loans.

[15] SARB Financial Stability Review (2020) and Namibia FSR (April 2020).



Source: Bank of Botswana and Commercial Banks

Note: Real estate NPLs to Real Estate Loans Ratio is calculated using commercial banks data only.



Source: Bank of Botswana

Leverage in NBFIs

Vulnerabilities in global NBFIs elevated

3.27 NBFIs are increasingly playing an important role in financing the real economy. In the process, NBFIs have become interconnected with the rest of the financial system and present a potential source of systemic risk. According to the October 2021 GFSR, despite some improvements since the last GFSR, vulnerabilities within the NBFIs sector remain elevated globally. The sector is challenged with increased financial risk-taking and rising fragilities, which threaten financial stability.

3.28 Furthermore, the October 2021 GFSR notes excessive risk-taking behaviour as investors seek higher yields, spurred by the low interest rate environment. For example, pension funds have increased their share of investments in alternative assets such as private equity, infrastructure, and real estate strategies with greater leverage and liquidity risks to meet their return objectives and targets. Insurance companies have also increased their investments in less liquid and riskier lower-rated corporate bonds, foreign bonds, and other illiquid exposures. This could pose a risk to financial stability risks in the medium term and spill over to the domestic economy.

3.29 Similarly, the domestic NBFI sector is experiencing vulnerabilities exacerbated by the COVID-19 pandemic and the necessary disease containment measures. These include the increase in insurance claims, as well as early pension withdrawals emanating from the increase in the number of patients and loss of employment, leading to constrained liquidity in the relevant institutions. The domestic financial system is also at risk of contagion emanating from the increased interconnectedness between NBFIs and banks as NBFIs seek more or alternative funding. Furthermore, domestic NBFIs face profitability concerns, as well as diminished investment returns as both domestic and global economic activity continue to operate below potential.

3.30 *Domestic NBFIs experience COVID-19 related losses*

The increase in the number of COVID-19 related cases and deaths has led to an increase in insurance claims in the domestic insurance sector. Claims increased from P720 million in the fourth quarter of 2020 to P921 million in the second quarter of 2021. Specifically, the Botswana Insurance Holdings Limited (BIHL), a leading financial services company, recorded a 48 percent year-on-year decline in operating profit as at June 30, 2021, largely due to increased claims resulting from excess mortalities experienced because of the COVID-19 pandemic. NBFIRA continues to monitor NBFIs to ensure compliance and restore financial stability.

Assets of NBFIs increase

3.31 Total insurance assets amounted to P20.6 billion in the second quarter of 2021 compared to P19.9 billion in the second quarter of 2020, while pension fund assets stood at P113.7 billion, compared to the P92.9 billion during the same period. Trends in solvency ratios (assets to liabilities) show that the insurance sector, pension funds and microlenders were all solvent during the period under review. Overall, the risk to domestic financial stability arising from NBFIs is considered low.

(c) Liquidity and Funding Risk Banking Sector

COVID-19 continues to exert downward pressure on market liquidity

3.32 Since the onset of the COVID-19 pandemic at the beginning of 2020, average market liquidity of the banking sector has been trending downwards mainly due to net foreign exchange outflows as a result of dampened trade, payments for external obligations, as well as settlement of some Government bonds while foreign exchange receipts dwindled.

3.33 Persistent foreign exchange outflows continued to reduce market liquidity, from P6.2 billion in September 2021 to P5.4 billion in October 2021. This level of liquidity was significantly low compared to the P8.4 billion in March 2021, and P10.9 billion at the end of 2020. However, the banking industry recorded a liquid asset ratio of 19.4 percent in August 2021, from 20.2 percent in August 2020. This is far more than the statutory requirement of 10 percent; hence banks had scope to upscale credit support for economic activity without undue prudential liquidity constraint.

The banking sector vulnerable to funding risk arising from a concentrated deposit base

3.34 The banking sector remains vulnerable to funding risk arising from a concentrated deposit base, and the negative effects of the COVID-19 pandemic. The ratio of large deposits to total deposits has consistently ranged between 30 and 40 percent over the years and presents a potentially unstable source of funding. In June 2021, the ratio was 36.5 percent. However, the risk is moderated by the higher proportion of savings and fixed deposits in the deposit base, which are inherently long-term, thus giving banks an opportunity to respond accordingly in case of short-term funding shocks. Long-term deposits accounted for 43.1 percent of the deposit base and were further augmented by the 27 percent for checking/current accounts, which are considered or behaviourally stable and a core source of funding.

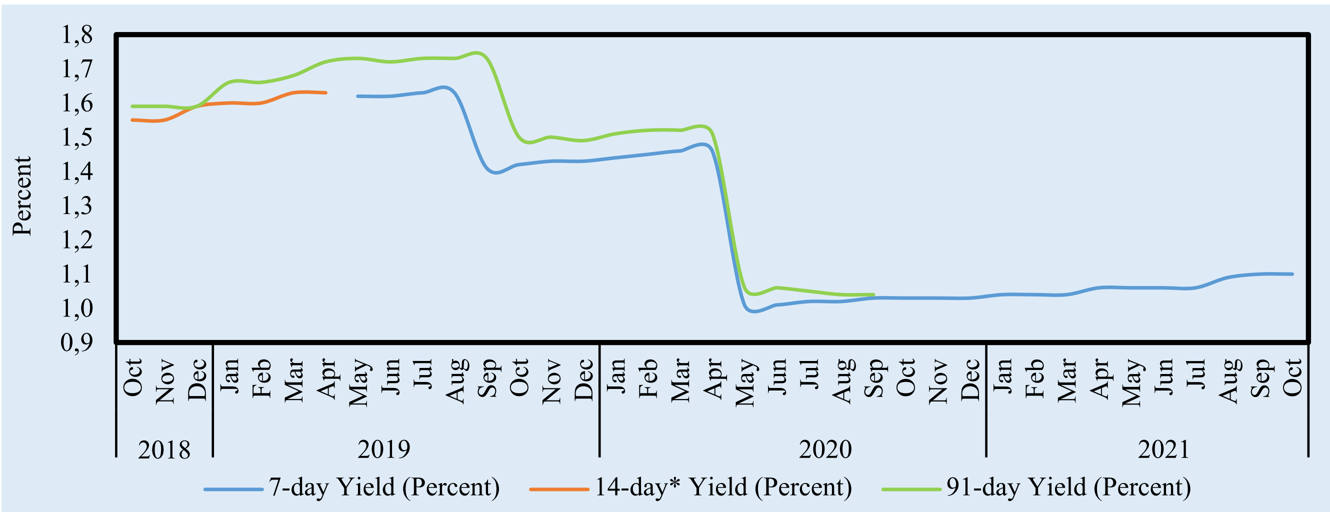
3.35 In other developments, the banking industry continues to experience high levels of credit intermediation, with a financial intermediation ratio of 81.3 percent in August 2021. The ratio was lower than the 82.3 percent observed in August 2020 but slightly above the 50-80 percent desired range. While this pace of intermediation could exacerbate maturity mismatches in banks' balance sheets, further amplifying liquidity risk in the sector, it provided the necessary economic support during the pandemic. Moreover, relative to global trends, the banking system financial intermediation ratio is low at less than 100 percent. In many jurisdictions, with deeper, liquid and sophisticated markets as well as structured financial instruments and products, the deposit multiplier tends to be higher and, therefore, the financial intermediation ratio invariably exceeds 100 percent.

Money Market

Money market interest rates remain low and in line with accommodative monetary conditions

3.36 Money market interest rates remained low and in line with the Bank's accommodative monetary policy stance. The stop-out yield on the 7-day BoBCs remained unchanged at 1.1 percent between September and October 2021 (Chart 3.6). The yield on the 3-month Treasury Bill (T-Bill) was relatively stable at 1.4 percent in October 2021. The stop out yield for the 6-month T-Bill also remained unchanged at 1.5 percent in October 2021, and investors maintained a healthy appetite for T-Bills albeit at lower yields and higher bid-to-offer ratios. At the September 29, 2021 auction, the demand for T-Bills was lacklustre, with P250 million allotted on the 3-month T-Bill out of the P500 million offered, while only P100 million out of the P500 million on offer was allotted on the 6-month T-Bill.

Chart 3.6: BoBC Stop-out Yields



NB: *The 7-day BoBC started trading in May 2019 following the discontinuation of 14-day BoBC in April 2019.*

Source: Bank of Botswana

Note: The bank discontinued the offering of the 91-day BoBCs in October 2020 following the reintroduction of the 3- Month T-Bill, with a view to support the building up of the Government T-Bill market, and in turn, allow for a clear separation between debt management and monetary policy operations.

Large banks continue to dominate the interbank lending market

3.37 Interbank activity decreased from P12.5 billion in September 2021 to P10.7 billion in October 2021, but remained relatively high, as banks turned to the interbank market to finance their daily operations, following a fall in average market liquidity. Large banks dominated interbank trades in October 2021, representing 96.2 percent (December 2020: 95.6 percent) of total interbank borrowing and 79.2 percent (December 2020: 59.3 percent) of interbank lending.

Foreign Exchange Market

Vulnerabilities from US dollar funding remain limited in the domestic banking system

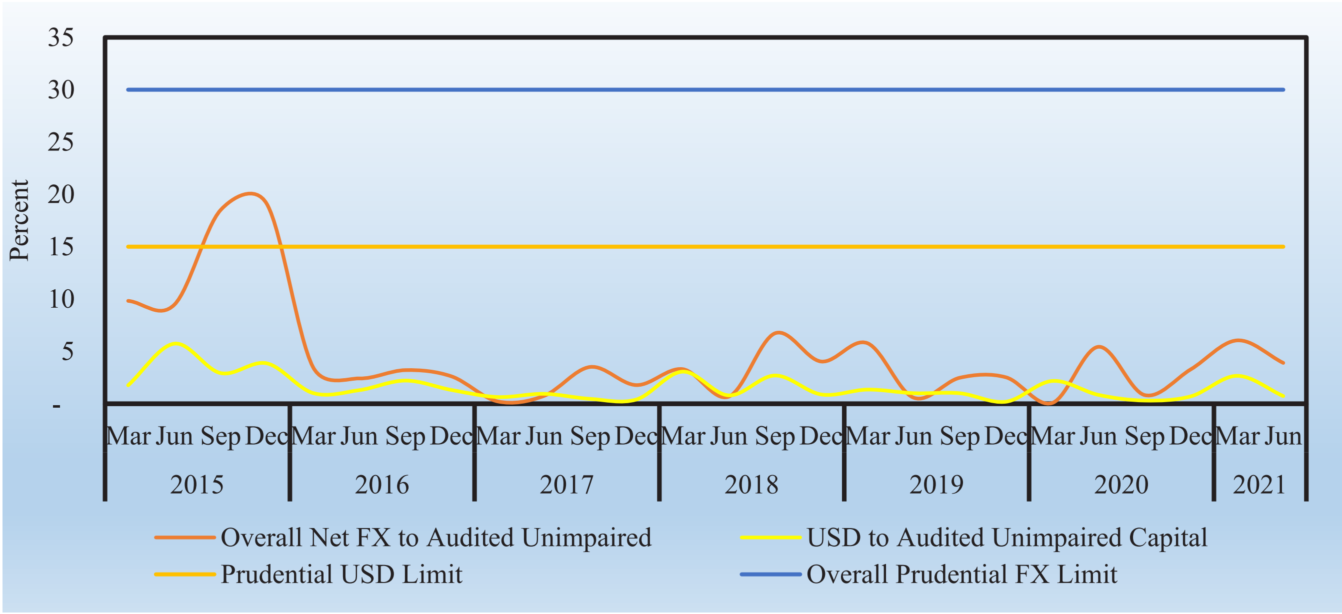
3.38 Domestic banks' exposure to foreign exchange risk decreased in June 2021. The overall net open position declined from P865 million in March 2021 to P554 million in June 2021, translating to 4 percent of the industry's unimpaired capital (June 2020: 5 percent) and, thus, within the 30 percent prudential limit (Chart 3.7). In addition, the Pula equivalent overall net exposure of the domestic banking system to the US dollar fell slightly from P103 million in June 2020 to P102 million in June 2021. The exposure is equivalent to 1 percent of the industry's unimpaired capital and, therefore, presents limited vulnerabilities from US dollar funding.

The Pula exchange rate generally stable

3.39 The exchange rate provides another channel through which adverse developments in international markets could destabilise the domestic financial system. As such, the volatility of the Pula against major trading partner currencies was monitored to establish the vulnerability of local economic agents to exchange rate movements, as well as the competitiveness of domestic goods and services in the local and international markets. In this sense, a highly volatile exchange rate can increase output volatility and, in turn, become a source of vulnerability.

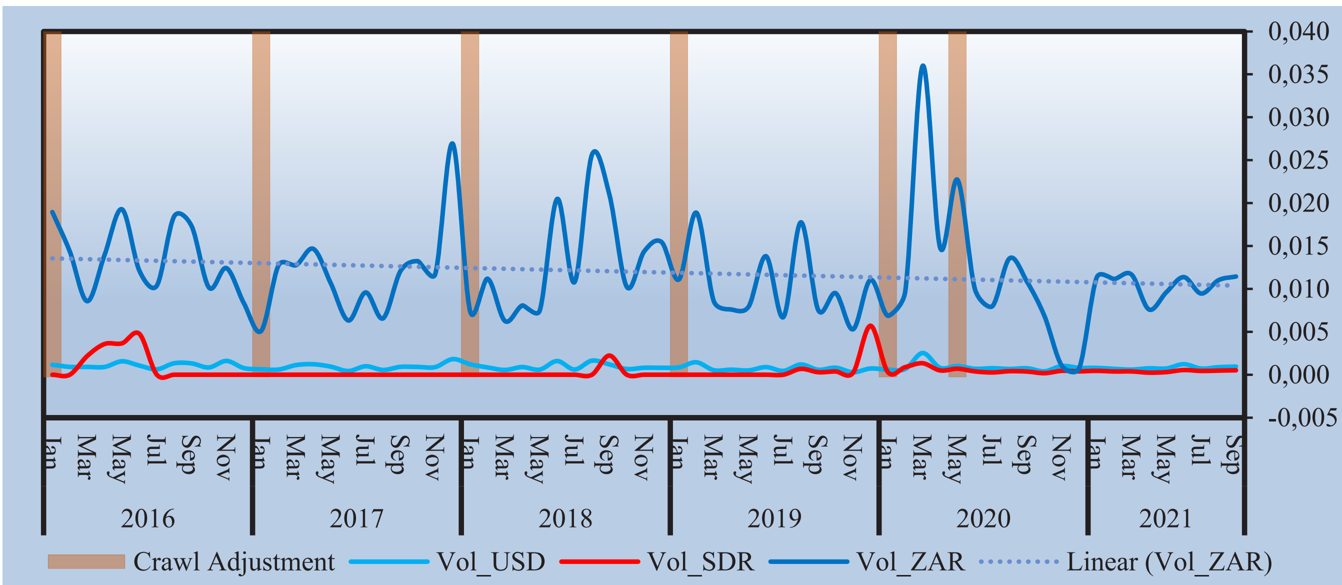
3.40 During the twelve-month period to September 2021, the Pula depreciated against the South African rand but appreciated against the SDR. The movement of the Pula against the SDR constituent currencies largely reflected the appreciation of the South African rand against the SDR constituent currencies. The South African rand appreciated against most of the major currencies during this period, buoyed by positive prospects from the external environment due to rising commodity prices, which provided support to South Africa's significant raw material and precious metal export sector, thus boosting the country's trade balance. Overall, volatility in the Pula exchange rate was muted since May 2020, hence presented limited risks to the domestic financial system and economy (Chart 3.8).

Chart 3.7: Commercial Banks' Foreign Exchange (FX) Exposure



Source: Bank of Botswana and Commercial Banks

Chart 3.8: Exchange Rate Volatility



Source: Bank of Botswana and Commercial Banks

Capital Markets

Stock market capitalisation recovering

3.41 Total equity market value of domestic listed companies gained 1 percent, year-on-year, to P36.1 billion in October 2021 (October 2020: P35.6 billion). The gains mainly reflect the reflect the takeover of Banc ABC Botswana by Access Bank, as well as the overall recovery of the domestic market due to the opening of the economy. In general, the market is showing signs of recovery, with month-on-month increases in the last seven months, leading to a cumulative gain of P2.2 billion since March 2021.

3.42 Market liquidity in the domestic bourse remained the same at 1.8 percent between December 2020 and October 2021. Prospects for the domestic market are becoming increasingly optimistic as economic activity improves. It is worth noting that more shares were traded between January and October 2021 than in the same period in 2020, at 281 million and 274 million, respectively.

Stock market volatility rising

3.43 Developments in market capitalisation in the twelve months to October 2021 translated into a stronger performance of the domestic company index (DCI), which increased to 6940 from 6890 in October 2020. The DCI was volatile in the months to December 2020, and into the first half of 2021. However, the volatility subsided in the past 3 months but remains significant (Chart 3.9). Volatility of the DCI could reflect the inherently risky nature of equity markets. Given recent developments in the economy and the capital markets, investor confidence is expected to improve, especially given the optimistic GDP projections for 2021. Nonetheless, the currently low interest rate environment is expected to push investors to high-yielding assets such as equity and, in turn, sustaining the equity index value.

Digitisation of the capital market likely to generate cybercrimes

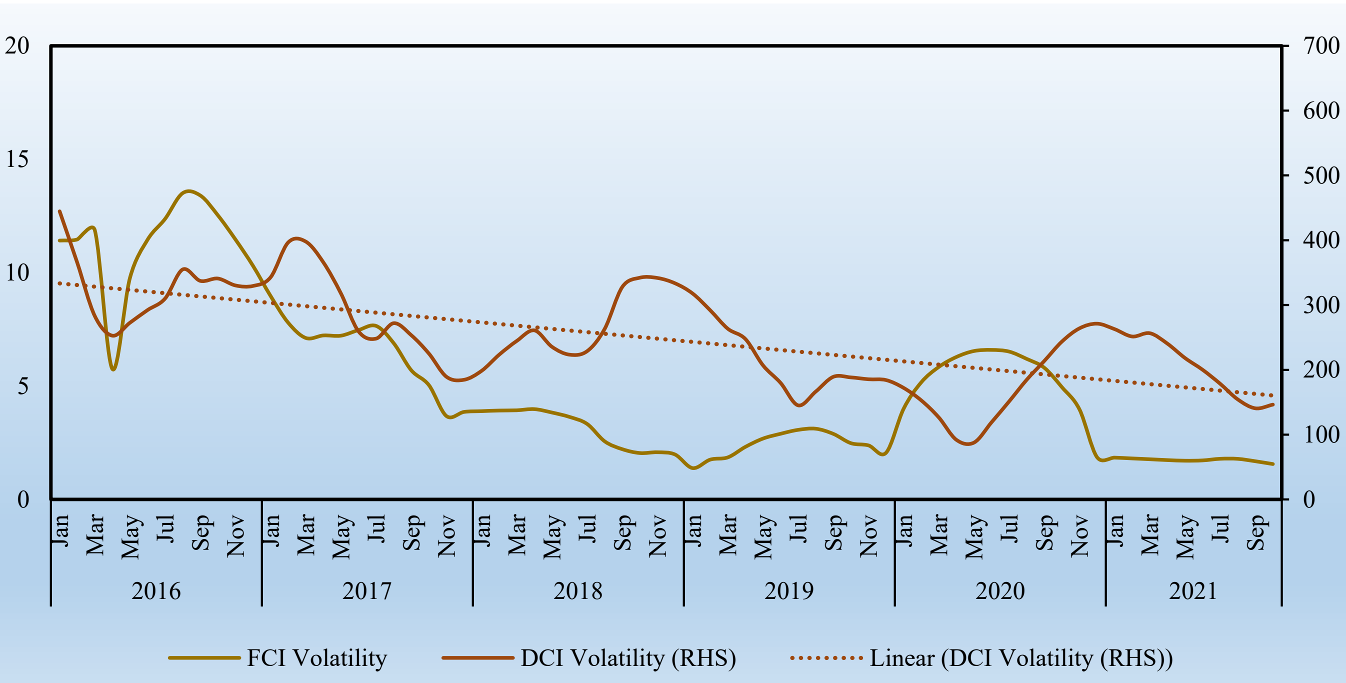
3.44 The capital market in Botswana managed to weather the COVID-19 storm, with minimal interruptions to operations, as companies utilised digital platforms for service provision. The impact of the pandemic was prominent on new entrants or newly licensed companies (which are very few), especially the retail businesses, which faced market penetration challenges as movement restrictions and social distancing measures deterred physical interactions with clients. Notwithstanding, there are emerging risks pertaining to cybercrime, as a result of increased use of technology and virtual private networks; digital misinformation risk as more inaccurate information is made available on public digital domains. To avert these vulnerabilities, industry players need to invest in cyber and information security, as well as enhance due diligence and scrutiny when handling business transactions, in order to ensure the safety and integrity of the capital market, and the overall stability of the financial system.

Table 3.4: Selected Botswana Stock Exchange Indicators

Period	Shares Traded		Domestic Stock Market Capitalisation (P 'Million)	Liquidity Ratio (Percent)[1]	Equity Indices			
	Volume (Million)	Value (P 'Million)			Domestic Company Index (DCI)	DCI Growth (Percent)	Foreign Company Index (FCI)	FCI Growth (Percent)
2015	834	3 034	49 993	6.2	10 602	11.5	1 572	-0.4
2016	784	2 573	46 304	5.3	9 401	-11.3	1 586	0.8
2017	775	2 477	44 408	5.5	8 860	-5.8	1 575	-0.7
2018	583	1 862	42 406	4.4	7 854	-11.4	1 570	-0.3
2019	628	1 811	38 709	4.5	7 495	-4.6	1 562	-0.5
2020	430	699	35 573	1.8	6 865	-8.2	1 547	-1.0
2021Jan-Oct	900	1 619	36 144	1.8	6 940	-1.5	1 549	0.1

Source: Botswana Stock Exchange Limited
Notes: Liquidity ratio is calculated as turnover divided by average market capitalisation

Chart 3.9: Twelve-Month Equity Indices Volatility



Source: Bank of Botswana

Bond market capitalisation rises due to new listings

3.45 The nominal value of Government bonds increased from P16.1 billion in April 2021 to P17.2 billion in October 2021. Furthermore, demand for Government bonds was satisfactory at the September 29, 2021 auction. As a result, the nominal value of Government bonds increased to P17.2 billion in October 2021 from P16.7 billion in September 2021 (Table 3.5). Total bond market capitalisation increased to P23 billion in October 2021 from P22.5 billion in September 2021 (P21.6 billion in April 2021). The number of listed bonds was unchanged at 46 in September and October 2021 (43 in April 2021). The bond market is dominated by corporate bonds (39), while government bonds are 7 in number.

3.46 The proportion of Government bonds in the nominal value of the fixed income market remained high at 74.7 percent, compared to the 25.3 percent for corporate bonds in October 2021, demonstrating Government's ongoing efforts to deepen and develop the domestic bond market. Current sovereign borrowing presents minimal fiscal risks given that, relative to GDP, the debt ratio remains within the 40 percent statutory limit. However, the fiscal space for Botswana has narrowed significantly due to the decrease in revenue, resulting from low diamond sales and overall decline in economic activity, coupled with increased spending in the quest to the stimulate economic activity amid the COVID-19 pandemic. As a result, the ratio of total government debt to GDP increased to 27 percent at the end of the 2020/21 financial year, from 17 percent in the previous financial year and, it is estimated to remain at 27 percent through the current financial year. Total government debt for the current financial year is estimated at P59 billion, of which 56 percent is domestic debt and 44 percent is external debt. Overall, fiscal vulnerabilities are slightly elevated and will continue to be closely monitored to assess the overall impact on financial stability.

Corporate bonds yield spread tightening

3.47 The difference between average yields on corporate and government bonds (spread) has been declining since August 2020 and was at its lowest in September 2021 (Chart 3.10). The narrowing spread is largely due to increasing yields on government bonds, against the backdrop of a challenging economic environment that has seen a slight increase in Government borrowing from domestic capital markets to finance the fiscal deficit.

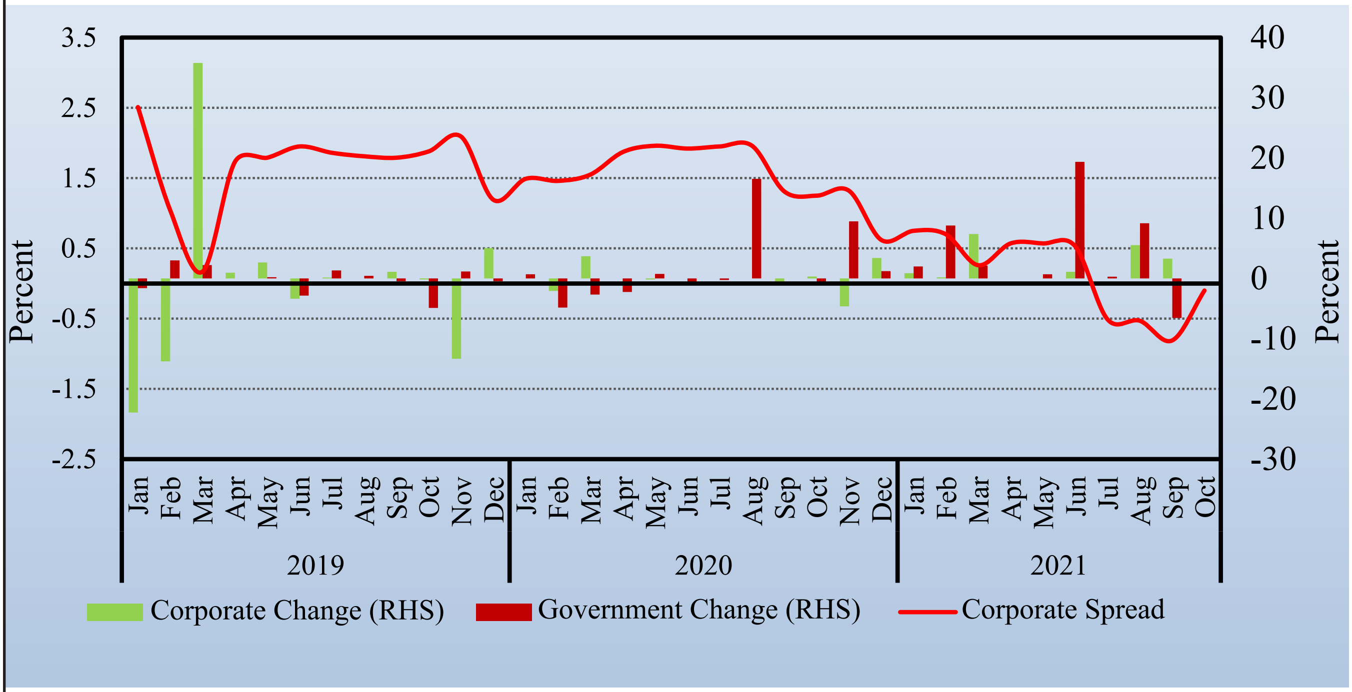
Average bond yields increased

3.48 Average corporate bond yields increased to 6.9 percent in October 2021 from 6.7 percent in September 2021. Meanwhile, the risk in corporate bonds, as reflected in the volatility of the corporate bond index (CorpI), has increased marginally since August 2021 (Chart 3.11).

3.49 Corporate bonds, however, remain relatively risky and, as such, there is potential for tightening of corporate funding in the bond market, although the associated consequences are currently judged to be minimal due to the accommodative monetary conditions. In that sense, funding opportunities in money markets would augment any decline in capital market funding.

3.50 *Net asset value of exchange traded funds rising*
Developments in international financial markets have a significant bearing on domestic asset valuations. Asset classes that reference on international commodities or indices in other countries have the potential to transmit instability to local asset classes. More specifically, exchange traded funds (ETFs) present a conduit for transmission of shocks into local asset prices. The net asset value (NAV) of ETFs listed on the BSE declined from P19.9 billion in December 2020 to P18.7 billion in October 2021 despite listing of new ETFs in the domestic bourse, BAMIB50 and BASBI (Table 3.6). In terms of market capitalisation, ETFs valuations represented less than 1 percent of equity market capitalisation in October 2021 (December 2020: 5.3 percent), hence pose minimal risk to the stability of the capital markets.

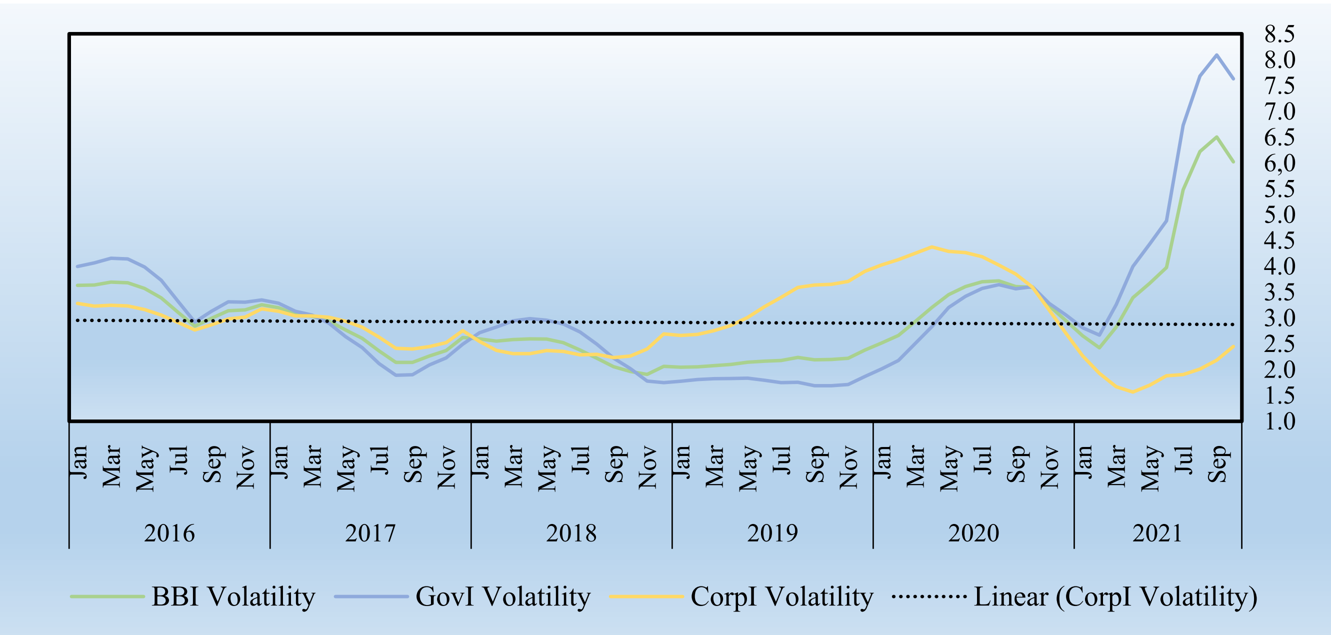
Chart 3.10: Corporate Credit Spread



Source: Botswana Stock Exchange Limited

Note: Corporate Change and Government Change refer to the changes in the average corporate bond yield and the average government bond yield, respectively.

Chart 3.11: Twelve-Month Bond Indices Volatility



Source: Botswana Stock Exchange Limited

Table 3.5: Selected Bond Market Indicators

Period	Government			Corporate1			Total Number of Bonds	Total Value of Bonds (P'Million)	Goverment Bonds Value / Total (Percent)	Corporate Bonds Value / Total (Percent)	Bond Indices		
	Number of Bonds	Nominal Value (P'Million)	Average Yield (Percent)	Number of Bonds	Nominal Value (P'Million)	Average Yield[2] (Percent)					Botswana Bond Index	Government Bond Index	Corporate Bond Index
2016	6	8 258	4.5	35	3 888	7.2	41	12 146	68.0	32.0	170.1	169.6	170.6
2017	5	9 083	4.5	38	5 129	7.1	43	14 212	63.9	36.1	179.4	178.1	180.7
2018	7	9 588	4.6	42	5 446	8.8	49	15 034	63.8	36.2	185.1	184.4	186.7
2019	7	11 859	4.7	39	5 429	8.1	46	17 288	68.6	31.4	193.5	191.1	200.1
2020	6	14 957	5.3	38	5 352	8.1	44	20 309	73.6	26.4	195.9	192.9	204.8
2021Mar	6	16 132	5.6	38	5 438	8.4	44	21 570	74.8	25.2	193.9	190.0	206.7
2021June	7	16 407	5.7	37	5 394	6.3	44	21 801	75.3	24.7	192.6	187.5	211.0
2021Oct	7	17 157	7.0	40	5 815	6.9	47	22 972	74.7	25.3	185.3	178.4	212.4

Source: Botswana Stock Exchange Limited

1. Includes bonds listed by corporate, quasi-government, parastatal, and supranational institutions.
2. The average of daily implied yields calculated by the BSE.

Table 3.6: Selected Exchange Traded Fund Indicators

ETF	NewGold			NewPlat			NewFunds[3]			BAMIB50			BASBI		
Underlying Assets	Gold			Platinum			South African Government Bonds			South African Government Bonds			South African Government Bonds		
Period	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)
2016	1.02	137.60	13 152	0.9	95.7	7 471	–	–	–	–	–	–	–	–	–
2017	0.08	10.00	12 525	0.14	13.1	7 174	–	–	–	–	–	–	–	–	–
2018	0.28	33.70	7 906	2.75	246.4	5 742	0.00	0.00	0.00	–	–	–	–	–	–
2019	0.00	166.20	10 007	0.34	29.9	10 279	0.00	0.02	0.00	–	–	–	–	–	–
2020	0.00	61.50	13 494	0.0	76.8	6 329	0.00	0.00	0.00	–	–	–	–	–	–
2021Oct	0.00	60.03	12 692	0.0	10.9	5 491	0.00	0.03	81.7	0.00	0.11	98.4	0.00	0.05	373.1

Source: Botswana Stock Exchange Limited

Funding Sources for NBFIs

Gross insurance premiums increased in 2020

3.51 Gross premium incomes for life insurance companies increased by 5.1 percent from P3.9 billion in 2019 to P4.1 billion in 2020. The pandemic has, however, not led to massive policy surrenders and termination of insurance contracts. In response to the pandemic, some insurers became more innovative in their business offerings, distribution channels and customer service as evidenced by a shift towards investment in online/digital sales platforms (Box 3.2). Furthermore, some insurers introduced measures such as flexible payment terms and premium holidays to retain customers. All life assurance companies maintained adequate capital levels as at December 31, 2020. Insurance penetration ratios remained low at 3.1 percent in 2020 (2019: 2.7 percent) but in line with industry trends across SSA.

Pension industry highly liquid

3.52 Annual pension contributions increased from P4.6 billion in 2019 to P5.2 billion in 2020. The industry continued to match current assets to current liabilities, recording a liquidity ratio of approximately 97 percent in 2020. As such, the industry was able to meet short-term pension obligations. In addition, the pensions industry held cash of P9.3 billion in August 2021, translating into a prudent liquidity ratio (cash and near cash-to-assets) of 11.7 percent. Moreover, in August 2021, 90.6 percent of the cash was held in domestic currency, further enhancing the liquidity profile of the pension industry. In this regard, the pension funds industry was financially sound and stable as at August 30, 2021.

3.53 Pension penetration ratios averaged 45 percent over the period December 2015 to December 2019[17]. The ratio was 60.9 percent in June 2021.

(d) Macro Financial Linkages and Contagion Risk

Significant macro financial linkages exist

3.54 Significant interlinkages persist in the financial system, with the banking sector being largely exposed to households (Figure 3.1). In addition, households are highly exposed to NBFIs, with P115.3 billion of their assets, mostly pension assets, held by the sector. Non-financial corporations accounted for 46.9 percent of total commercial bank deposits, while their borrowing represented 27.4 percent of commercial bank credit. Meanwhile, deposits from other financial corporations or NBFIs represented a significant portion of bank funding at 20.5 percent of total deposits in September 2021. A sudden withdrawal of these funds would present a potential funding risk to banks.

3.55 The interlinkages also extend to State Owned Enterprises (SOEs), which account for 4.6 percent of bank deposits, while loans to the sector account for 2.8 percent of total bank lending. In August 2021, a significant amount of NBFI assets (65.9 percent) were held abroad, exposing them to external financial and economic shocks, albeit providing some portfolio diversification opportunities. Consequently, there are notable vulnerabilities emanating from the interconnectedness between the banking system, household sector, NBFIs and the external sector.

Financial sector assets increase

3.56 The size of the financial system, as reflected by the total assets of banks and NBFIs increased to P256.8 billion in December 2020, registering a 7 percent growth from the P240 billion reported in December 2019 (Table 3.7). The increase is largely driven by a 9.7 percent increase in the NBFI sector, which, in turn, was influenced by a 12.9 percent growth in the retirement funds sub-sector. As a result, the NBFI sector accounted for 56.6 percent of the financial systems' assets in 2020 compared to the 43.4 percent of the banking sector[18].

3.57 The size of the entire financial system translated into 148.8 percent of GDP in 2020 compared to 134 percent in 2019, demonstrating the significance and importance of the financial system to the economy. The strong interconnectedness and size of the financial system pose a risk of contagion within the financial system, and to the rest of the economy, although effective regulation across the system, as well as proper governance and accountability structures moderate the risk. Furthermore, most of the retail and household loans have credit life protection, mortgage repayment policies and retrenchment cover policies provided by insurance companies, effectively shifting banking risks to the insurance sector.

[17] The pension penetration ratio is a measure of development of the pension industry. It is calculated as pension fund assets as a percentage of GDP.

[18] The financial results for most NBFIs are not yet published hence, a few, but large, NBFIs were used to estimate the relative size of the financial system in 2019.

Box 3.2: Impact of COVID-19 on the Insurance Sector in Botswana

Measures Implemented by Insurers to Alleviate the Impact of the Pandemic

The COVID-19 pandemic and associated containment measures negatively affected the insurance industry, nonetheless, the industry remains resilient. In response to the pandemic, some insurers adopted digital solutions. Some businesses opted to maintain their insurance policies even during lockdown periods, including liability covers and workmen's compensation, in the hope that COVID-19 was a short-term shock. The main areas of focus for insurers in responding to the pandemic were to retain clients, ensure business continuity and prepare for a surge in claims. Responses included the following:

- The Association of Life Underwriters Botswana increased public engagements and advertisements where they stated their support to policyholders through covering COVID-19 related claims.
- Promotion of business continuity through the introduction of additional engagement channels such as online portals, WhatsApp lines, systems integration to a CLOUD environment (online data storage and servers) and virtual private network, to enabling remote working, as well as new digital products.
- Regular assessment of exposure to the most vulnerable classes of businesses to detect and quantify risks and address them accordingly:

Measures Implemented by NBFIRA to Alleviate the Impact of the Pandemic

To limit systemic risk and maintain financial stability in the NBFIs sector, NBFIRA adopted the following measures:

- Companies were offered a one-month extension on submission of audited financial statements during the national lockdown but, thereafter, no extensions were permitted. This was to ensure timely detection of irregularities and other financial risks.
- The prescribed capital target calculation for general insurers accommodates catastrophe risk through calculation of a maximum event retention. Therefore, where the risk increases, the required amount of capital should also increase to factor in the change in the level of risk, and this was the case for COVID-19 related mortalities.
- Virtual quarterly meetings with industry associations to discuss industry concerns and emerging risks.

Emerging Risks and Vulnerabilities in the Insurance Sector

Possible emerging risks and vulnerabilities as a result of the COVID-19 pandemic pertain to the following:

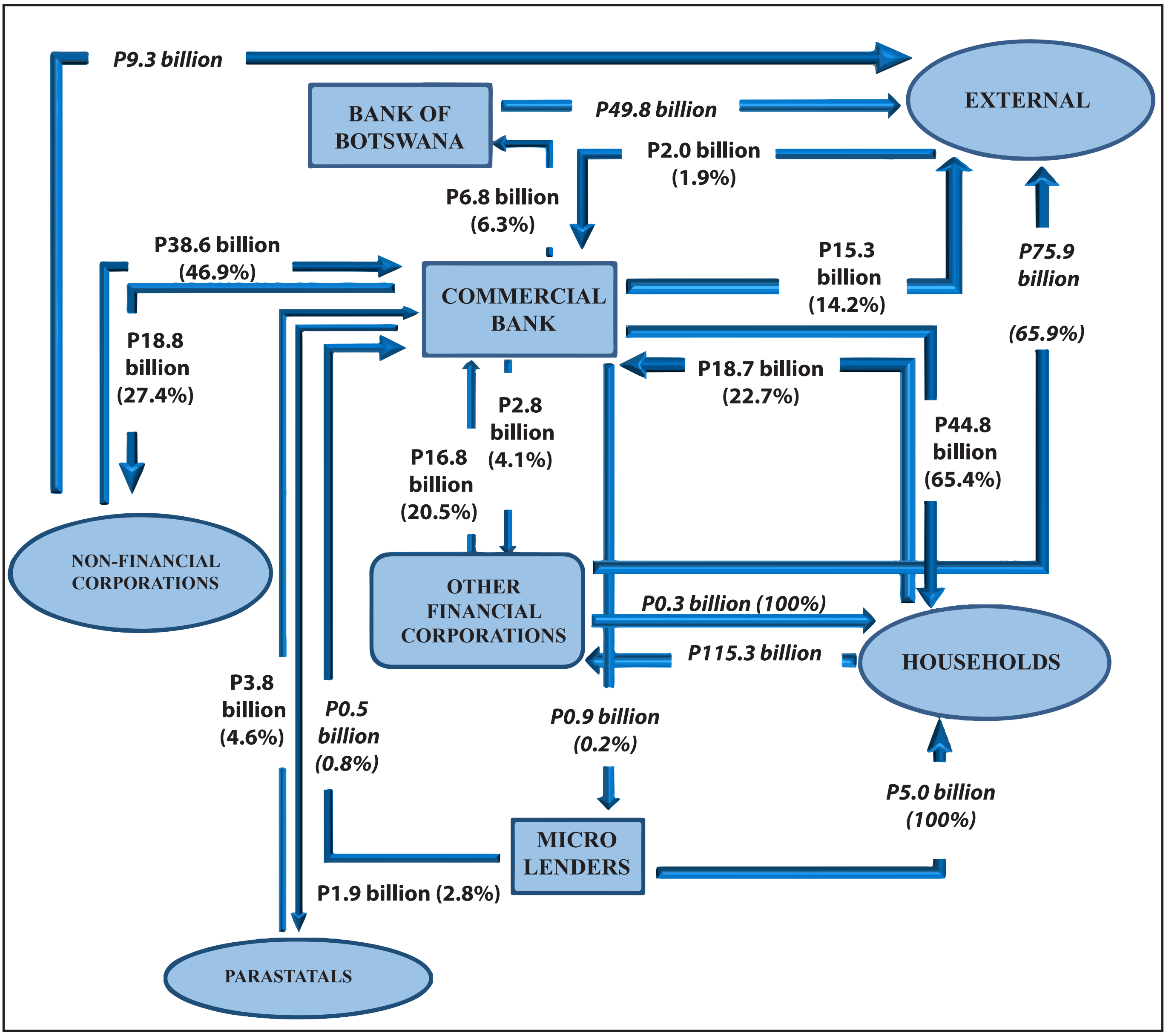
- Increased claims relating to business interruption, retrenchment, life cover, funeral, and associated insurance covers.
- Insurance fraud and increased risk of mis-selling due to pressure to keep businesses afloat.
- Cybercrime risks arising from increased use of digital platforms.
- Increased operational costs associated with the physical restructuring of office spaces, and procurement of health necessities in adherence to the Government's COVID-19 protocols, and thus, closure of small entities such as corporate agencies and brokers.
- Delayed submission of audited financial statements due to COVID-19 related challenges, which may hinder early detection of vulnerabilities.

Table 3.7: Structure and Size of the Financial System

Sector/Sub-Sector	2018				2019				2020			
	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP
NBFIs	**114 560**	**100.0**	**53.7**	**66.4**	**132 472**	**100.0**	**55.2**	**74.2**	**145 384**	**100.0**	**56.6**	**84.3**
Retirement Funds	78 972	68.9	37.0	45.8	93 133	70.3	38.8	52.2	105 175	72.3	41.0	61.0
Insurance	18 596	16.2	8.7	10.8	19 958	15.1	8.3	11.2	20 386	14.0	7.9	11.8
Other Financial Corporations	**16 992**	**14.8**	**8.0**	**9.8**	**19 381**	**14.6**	**8.1**	**10.9**	**19 823**	**13.6**	**7.7**	**11.5**
Banks	**98 813**	**100.0**	**46.3**	**57.3**	**107 511**	**100.0**	**44.8**	**60.2**	**111 446**	**100.0**	**43.4**	**64.6**
Commercial Banks	91 331	92.4	42.8	52.9	98 685	92.4	41.1	55.3	103 259	92.4	40.2	59.8
Statutory Banks	7 482	7.6	3.5	4.3	8 825	7.6	3.7	4.9	8 187	7.6	3.2	4.7
Total Financial System Assets (P' million)	**213 373**			**123.7**	**239 983**			**134**	**256 829**			**148.8**
GDP (P' million)				**172 525**				**178 480**				**172 552**

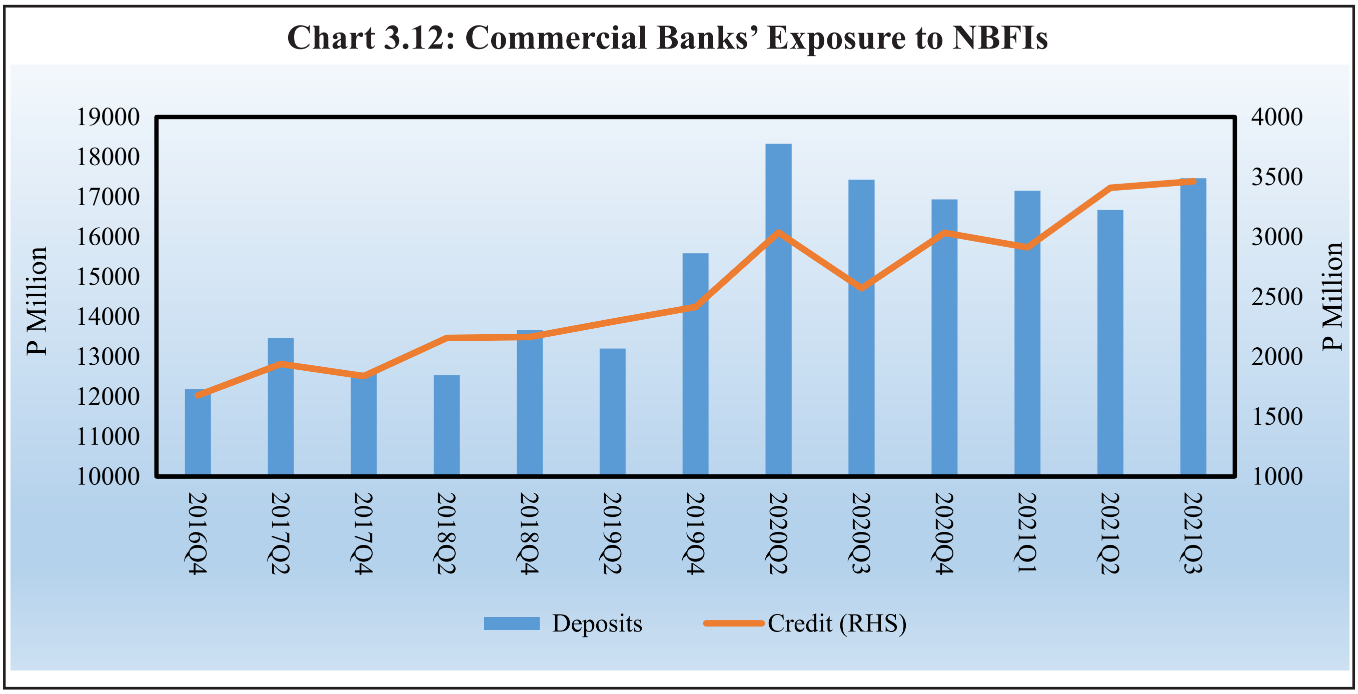
Source: Bank of Botswana and NBFIRA

Figure 3.1: Macro-Financial Linkages (September 2021)



Source: Bank of Botswana and NBFIRA

Notes:
1. Percentages indicate shares of loans/deposits for the sector.
2. Balances from the Bank to the external sector represents net foreign assets.
3. Balances from other financial corporations to the external sector are pension fund assets invested offshore.
4. Balances from commercial banks to the external sector are commercial banks' balances due from foreign banks.
5. Figures in italics are either estimates or for August 2021.



Source: Commercial Banks

(i) Risk Concentrations

Insurance and pensions sectors highly concentrated

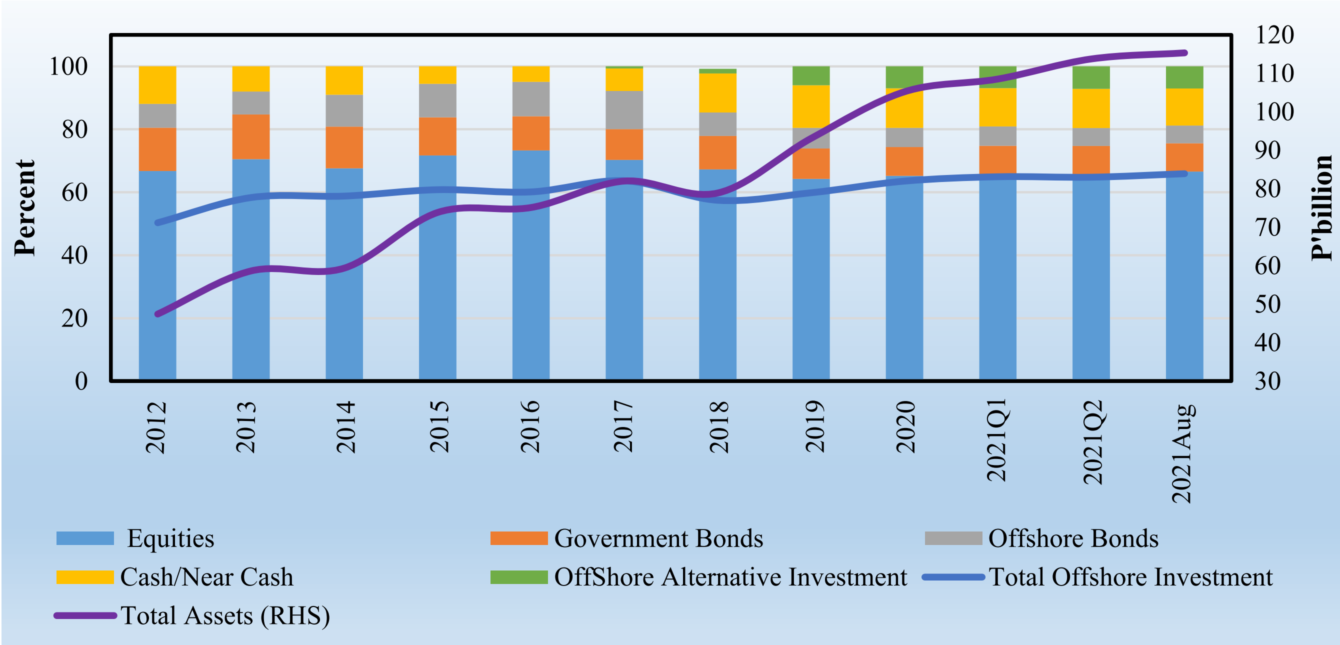
3.58 Insurance companies could affect financial stability and contribute to systemic risk through three potential transmission channels, namely, failure to provide critical services; inability to mitigate risk and compensate for loss with respect to systemically important counterparties; and with regard to risk to systemically important financial institutions[19]. In a highly concentrated market, such as the domestic market, failure by a dominant insurance company may leave a significant gap in the provision of critical risk mitigation services to the economy as remaining companies may not have the capacity to fill the void. Lack of alternative service providers could amplify the effect of an insurance company's distress on the real economy. The dominance of Botswana Insurance Holdings Limited (BIHL) in the local insurance sector exacerbates these risks and warrants enhanced supervision. The top five largest life insurance companies have a market share of over 90 percent of the assets of the life insurance sector and consequently dominate in gross premiums written. Furthermore, more than 80 percent of total industry pension funds are accounted for by or attributed to the Botswana Public Officers Pensions Fund (BPOPF). Measured in relation to the size of the domestic economy, total assets of pension funds were 60.9 percent of GDP in June 2021 compared to 53.9 percent in June 2020.

Pension fund assets increased amid COVID-19

3.59 Pension fund assets increased by 18.2 percent from P97.6 billion in August 2020 to P115.3 billion in August 2021. Investment in equities increased from P64.9 billion in August 2020 to P76.8 billion in August 2021 and accounted for the biggest share (66.6 percent) in the portfolio investment allocation of pension funds (Chart 3.13). This could be indicative of an increase in high yield, risky assets for portfolio growth. Furthermore, 65.9 percent of the funds were invested offshore in August 2021, compared to 65.3 percent in August 2020. Generally, the investment allocation of pension funds remained broadly unchanged with an average of 60 percent invested offshore since 2009. This is in line with the retirement funds prudential regulations that require that at least 30 percent of assets should be invested locally. The regulations also require that annuities must be purchased exclusively from insurance providers operating in Botswana; potentially restricting consumer choices due to limited competition and shortage of annuity-related products.

[14] French et al., (2015). *Insurance and Financial Stability*, Bank of England Quarterly Bulletin.

Chart 3.13: Investment Allocation of Pension Funds



Source: NBFIRA

The asset management sub-sector is highly interconnected with the rest of the financial system

3.60 Asset managers play a vital role in the intermediation of funds in the financial system. They provide investors with an opportunity to invest in a diversified portfolio of securities. By pooling funds from a large group of investors, asset managers reduce investment risk through diversification.

3.61 At the end of 2020, there were 29 asset managers and management companies (Mancos). Total Assets Under Management (AUM) increased to P51.1 billion in 2020 from P49.9 billion in 2019. In December 2020, 80.7 percent of the AUM were for pension funds. Other AUM belonged to retail investors, insurance companies and other professional investors. As such, the asset management sub-sector is highly interconnected with other parts of the financial system through ownership linkages, common asset exposures and the provision of wholesale funding to banks. Therefore, the level of systemic risk posed by the sub-sector is mitigated by profitability and adequate capitalisation of asset management companies.

(e) Banking Sector Stress Test Results

3.62 The stress test analysis relied on statutory returns as at June 30, 2021 and banks were subjected to moderate and severe COVID-19 shocks to reflect the daunting effects of the pandemic and determine the industry's resilience to the consequences of the pandemic (COVID Event). Financial soundness indicators as at June 30, 2021 were used as the baseline scenario. The stress test covers two simulations, namely liquidity and credit shocks. The liquidity stress test assesses the ability of a bank to survive unexpected liquidity drain without recourse to any outside liquidity support, such as the central bank or interbank market.

3.63 The credit shock is associated with the depletion of incomes of both households and businesses due to the slowdown in economic activity during the COVID-19 era. The credit risk tests simulate the impact of credit concentration shocks, sectoral specific shocks and system-level shocks on the level and adequacy of a bank's capital. All credit shocks are modelled as a percentage of performing loans becoming non-performing within the one-year stress testing horizon. Given the uncertainty relating to the trajectory of the virus and economic recovery, slow income growth and weak business conditions could add to existing vulnerabilities in the banking sector and elevate credit risks.

3.64 Prevailing conditions, which form the baseline, indicate that the banking sector continues to be adequately capitalised, liquid and profitable (Table 3.8). The relatively high prudential ratios, however, suggest that banks are hoarding capital and liquidity amid the economic and business uncertainty brought about by COVID-19.

Banks generally resilient but extreme credit shocks would deplete their capital

3.65 Stress tests results indicate that commercial banks are generally resilient to stress, save for credit shocks that could result in significant prudential capital breaches. Under the system-wide moderate scenario, where an additional 10 percent of performing loans are assumed to become NPLs, bank capital adequacy levels decline to 12 percent, thus marginally breaching the prudential capital adequacy requirement of 12.5 percent. The industry capital position worsens to 3 percent in the severe scenario, where 20 percent of performing loans are assumed to become NPLs. Resultantly, asset quality declines under the COVID Event, with the ratio of NPLs to total loans rising from a baseline of 4.3 percent to 14 percent and 23.5 percent under moderate and severe scenarios, respectively.

3.66 Sector specific tests were also conducted to capture the impact of COVID-19 on sectors whose economic activity has been significantly affected by the pandemic and related disease containment measures. Termed the 'red sectors', these sectors include mining; trade, hotels and restaurants; construction; manufacturing and transport and communications[20]. Under the moderate scenario, where 15 percent of performing loans in the 'red sectors' are assumed to become non-performing (10 percent for the other sectors), banks' capital adequacy ratio falls to 9.5 percent while the NPLs ratio increases to 16.7 percent. The capital adequacy ratio falls further to 5.1 percent under the severe COVID-19 scenario, where 20 percent of performing loans in the 'red sectors' become non-performing, and the NPLs ratio increases to 21.4 percent.

3.67 Regarding credit concentration shocks, banks breach the capital adequacy requirement at 9.6 percent under the assumption that the largest borrower defaults for each bank (moderate scenario). The capital adequacy ratio further drops to 5.6 percent under the severe scenario, which assumes that the largest two counterparties would default. The assumed counterparty defaults would increase the NPLs ratio to 14.5 percent and 19.2 percent in the moderate and severe scenarios, respectively. In general, credit risk tests show that the overall COVID-19 NPLs shock, simulating a proportional increase in NPLs, has more prominence in the capital and asset quality position of banks than the other shocks. Nevertheless, the credit stress tests do not consider credit mitigation measures such as underlying collateral.

Large banks are more resilient to liquidity shocks

3.68 In the liquidity risk test, banks show resilience to a liability run in the moderate COVID Event, particularly large banks, which will be able to withstand liability drawdowns for 22 days (March 2021: 24 days). Small banks experience significant liquidity squeeze and would withstand drawdowns for 14 days (March 2021: 12 days) (Table 3.16). Under the severe COVID-19 stress conditions, large banks will withstand drawdowns for 11 days (March 2021: 10 days), while it will take 6 days (March 2021: 4 days) for small banks. Shorter survival horizons for small banks reflect the large proportion

20 Following the reclassification of sectors in the compilation of GDP by Statistics Botswana, reconciliation of data for the stress testing exercise is ongoing. Therefore, the current stress testing used the December 2020 identification of red sectors.

of illiquid assets in their portfolios, being loans and advances, relative to a highly liquid deposit base that is dominated by wholesale deposits. This asset/liability mismatch, therefore, limits their ability to swiftly respond to emerging liquidity needs.

3.69 The above scenarios do not consider the availability of liquidity support provided by the Bank through the Credit Facility nor liquidity support available from related companies or holding banks. Accordingly, the stress results should not be interpreted to mean that banks would default under these conditions.

Table 3.8: Banking Sector Financial Soundness Indicators

Capital Adequacy (Percent)	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021	Jun 2021	Aug 2021
Core Capital to Unimpaired Capital	66.3	65.5	68.0	68.0	70.9	70.1	70.2
Tier 1 Capital to Risk-Weighted Assets[1]	12.9	13.3	13.5	13.5	14.1	14.1	12.4
Capital Adequacy Ratio (CAR)[2]	18.2	18.5	19.8	19.7	19.9	20.1	18.5
Asset Quality (Percent)							
NPLs to Gross Loans	4.4	4.4	4.1	4.2	4.4	4.3	3.7
NPLs Net of Specific Provisions to Unimpaired Capital	8.5	8.8	7.4	7.4	9.1	7.2	6.0
Specific Provisions to NPLs	62.3	58.9	62.7	62.8	54.7	64.5	66.0
Liquidity (Percent)							
Liquid Assets to Deposits (Liquidity Ratio)[3]	16.3	21.2	20.8	21.4	20.4	20.9	19.4
Advances to Deposits (Intermediation Ratio)	89.3	85.1	84.3	81.4	82.2	82.8	81.3
Profitability/Efficiency (Percent)							
Return on Average Assets (ROAA)	8.9	1.8	2.1	1.6	2.3	1.8	1.7
Return on Equity (ROE)	7.7	15.4	19.2	15.1	21.0	16.1	19.4
Cost to Income	32.1	69.3	65.5	64.9	59.7	59.3	62.3

Source: Bank of Botswana
Note: 1. The prudential Limit is 7.5 percent - Basel II/III
2. The prudential Limit is 12.5 percent
3. The Minimum statutory requirement is 10 percent

Table 3.9: June 2021 Stress Test Results for Commercial Banks

SCENARIOS	CREDIT RISK		
	Concentration Risk	**Sectoral Shocks***	**Overall NPL Shock**
BASELINE SCENARIO: BANKING CONDITIONS AS AT JUNE 30, 2021	CAR of 20.1 percent. 4.3 percent NPLs/total loans.	CAR of 20.1 percent. 4.3 percent NPLs/total loans.	CAR of 20.1 percent. 4.3 percent NPLs/total loans.
MODERATE COVID-19 SCENARIO			
DESCRIPTION OF SHOCK	Largest Exposure defaults or becomes non-performing.	15 percent of 'red sectors' performing loans become non-performing and 10 percent of other sectors' performing loans become non-performing.	10 percent of performing loans become non-performing.
RESULTS	Banking system breaches the prudential limit with CAR of 9.6 percent. NPLs/total loans ratio increases to 14.5 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 9.5 percent. NPLs/total loans ratio increases to 16.7 percent, a sign of increasing vulnerability.	Banking system slightly breaches the prudential limit with CAR of 12 percent. NPLs/total loans ratio increases to 14 percent, a sign of increasing vulnerability.
SEVERE COVID-19 SCENARIO			
DESCRIPTION OF SHOCK	Largest two exposures default or become non-performing.	20 percent of 'red sectors' performing loans become non-performing and 15 percent of other sectors' performing loans become non-performing.	20 percent of performing loans become non-performing.
RESULTS	Banking system breaches the prudential limit with CAR of 5.6 percent. NPLs/total loans ratio increases to 19.2 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 5.1 percent. NPLs/total loans ratio increases to 21.4 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 3 percent. NPLs/total loans ratio increases to 23.5 percent, a sign of increasing vulnerability.

* Sectoral shocks have been applied to sectors that have been significantly affected by the COVID-19 pandemic and related disease containment measures, termed the 'red sectors'.

SCENARIOS	LIQUIDITY RISK
BASELINE SCENARIO: BANKING CONDITIONS AS AT JUNE 30, 2021	Perfect asset liability match, leading to 30 days survival.
MODERATE COVID-19 SCENARIO	
DESCRIPTION OF SHOCK	Bank run simulation based on Assets Haircuts and Liabilities Run-off Rates.
RESULTS	On average, banks survive for 20 days. Large banks survive for 22 days. Small banks survive for 14 days.
SEVERE COVID-19 SCENARIO	
DESCRIPTION OF SHOCK	Bank run simulation based on higher Assets Haircuts and Liabilities Run-off Rates than in the moderate scenario.
RESULTS	On average, banks survive for 9 days. Large banks survive for 10days. Small banks survive for 6 days

Source: Bank of Botswana

4. FINANCIAL MARKET INFRASTRUCTURE (FMI) AND REGULATORY DEVELOPMENTS

(a) Payment and Settlement Systems

FMIs largely resilient

4.1 Clearing systems have been largely resilient in handling large volumes of transactions without any major disruption. Meanwhile, the value and volume of cheque transactions continue to show a declining trend (Table 4.1).

Developments and trends in payments and settlement platforms point to an economy that is increasingly becoming digitalised, with growing usage of electronic funds transfers (EFTs), and other digital payment methods such as internet and mobile banking, as well as card-based Point-of-Sale (POS) and automated teller machine (ATM) transactions, compared to cheque clearances.

4.2 Generally, FMIs (that is, payment systems, central securities depository, and securities settlement systems) remain stable and resilient, thus strengthening and preserving domestic financial stability.

Table 4.1: Selected Payment and Settlement Systems Indicators

Period	BISS Transactions		Cheques		EFTs	
	Volume (‘000)	Value (P’ billion)	Volume (‘000)	Value (P’ billion)	Volume (‘000)	Value (P’ billion)
2016	183	1 690	1 204	26	7 507	166
2017	178	1 273	1 038	22	8 135	165
2018	175	1 414	929	20	8 513	180
2019	183	1 899	810	19	9 161	209
2020	155	2 110	495	12	9 770	211
2021Jan - Sep	115	1 412	274	7	7 715	168

Source: Bank of Botswana

(b) Regulatory and other Developments Relevant to Financial Stability

Access Bank Botswana issued a banking licence

4.3 The Bank of Botswana granted Access Bank Botswana Limited a licence to transact commercial banking business in Botswana in November 2021. This follows the acquisition of the majority of shares (78.15 percent) of African Banking Corporation Holdings Limited in African Banking Corporation of Botswana Limited (BancABC) by Access Bank PLC, a pan-African bank with headquarters in Nigeria.

FSC concludes that the domestic financial system is resilient

4.4 The FSC met on November 1, 2021, to deliberate on recent global, regional, and domestic financial stability developments including regulatory and public interest issues relating to the performance and prospects for the domestic financial system. The FSC observed that since the meeting of May 2021, prospects for domestic economic recovery have improved, supported by positive global developments, recovery of diamond production and prices, the rollout of COVID 19 vaccines and ongoing policy support, including the implementation of the ERTP, as well as accommodative monetary policy. It, however, acknowledged the pre-existing structural weaknesses and vulnerabilities of the Botswana economy but observed that the agility of the domestic financial system played a crucial role in supporting the real economy in several ways including restructuring of credit facilities and other customer obligations. The FSC concluded that the domestic financial system continues to be resilient, characterised by strong capital and liquidity buffers, moderate profitability as well as being adaptive and innovative.

FSB Sub-Saharan Africa meets

4.5 The Financial Stability Board (FSB) Regional Consultative Group (RCG) for SSA Africa met virtually on June 8, 2021, to discuss global and regional macroeconomic and financial market developments, including the financial stability implications of the COVID-19 pandemic on the region. The meeting discussed challenges posed by COVID-19 and the strategies and adjustments on regulation and supervisory frameworks to enhance their potency and resilience amid the pandemic. The meeting also deliberated on exit strategies of the temporary public support measures aimed at fighting the pandemic. Furthermore, the meeting discussed topics of importance for SSA member jurisdictions, including work underway in the FSB to implement the G20 roadmap to enhance cross-border payments; support the transition away from LIBOR; strengthen cyber and operational resilience; and analyse and address climate-related financial risks.

Bank Rate maintained at 3.75 percent

4.6 The Monetary Policy Committee (MPC) meeting of October 21, 2021, noted that the domestic economy was projected to operate below full capacity in the short to medium term and, therefore, not creating any inflationary pressures. The projected increase in inflation in the short term was primarily due to transitory supply-side factors that, except for second-round effects and entrenched expectations (for example, through price adjustments by businesses, contractors, property owners and wage negotiations), would not normally attract a monetary policy response. It is against this backdrop that the MPC decided to continue with the accommodative monetary policy stance and maintain the Bank Rate at 3.75 percent.

Botswana exits the FATF grey listing

4.7 The FATF-Africa Middle East International Cooperation Review Group (ICRG) conducted an on-site visit to Botswana on August 18 - 20, 2021, and determined that the country had completed its FATF action plan and made a recommendation to the FATF Plenary that the country should exit the enhanced monitoring. At the FATF Plenary meeting held on October 19, 2021, the FATF recognised that the country had strengthened its AML/CFT/CPF regime and addressed the strategic deficiencies that the FATF identified in October 2018. Consequently, the FATF removed Botswana from the list of countries subject to FATF ICRG enhanced monitoring.

4.8 The removal from the grey list is expected to ease the burden of correspondent banking relationships for Botswana, and enhance confidence in the domestic financial system, which is beneficial for overall economic activity. Therefore, risks from AML/CFT/CPF are expected to diminish going forward.

Botswana becomes a member of IADI and the Egmont Group of Financial Intelligence Units

4.9 Botswana applied for and was admitted as an associate member of the International Association of Deposit Insurers (IADI) in September 2021. IADI is an international organization formed in 2002 to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation. Associate members of the IADI are entities that do not yet have a legal deposit insurance system but are considering its establishment. Notably, Botswana is at an advanced stage of setting up a deposit protection fund (DPF), which will serve as a financial safety net that enhances the stability of the domestic financial system. The associate membership provides benefits such as access to research on issues relating to deposit insurance; an opportunity to share expertise and information on deposit insurance through training, development and educational programmes; robust advice on establishing deposit insurance; an opportunity to be part of a team that develops principles and standards to enhance the effectiveness of deposit insurance systems. The membership is expected to contribute positively to the establishment of a DPF domestically.

4.10 In addition, Botswana became a member of the Egmont Group of Financial Intelligence Units, which provides Financial Intelligence Units around the world with a platform to exchange information on how best to address money-laundering, the financing of terrorism and other financial crimes.

BSEL registers new listings

4.11 The BSEL announced the listing of two ETFs, namely, Cloud Atlas S&P Africa Sovereign Bond Fixed Income and Cloud Atlas AMI Big50 ex-South Africa. The listings were facilitated by the investment firm, Cloud Atlas Limited. The two EFTs are primarily listed in the Johannesburg Stock Exchange and, the Cloud Atlas ETF will be registered under the Cloud Atlas Collective Investment Scheme in securities as a collective investment scheme portfolio and listed on the BSE as an ETF.

4.12 The Cloud Atlas S&P Africa Sovereign Bond Fixed Income offers investors access to listed African Hard Currency Bonds by tracking an index developed in conjunction with S&P, which offers investors a basket of quality credit-rated, high-yielding, and long-dated debt issued by African Sovereign countries. The Cloud Atlas AMI Big50 ex-South Africa offers investors exposure to African equity, ex-South Africa, and tracks 15 sectors across 14 countries. The new listings are a positive development in the stock exchange as they provide a diversified issuer base and are expected to enhance liquidity in the domestic stock market.

The RPC approves Guidelines for Bank Fees and Charges

4.13 At its meeting of October 5, 2021, the Regulatory Policy Committee (RPC) approved the Guidelines on Bank Fees and Charges, for implementation in 2022. The purpose of the guidelines is to provide guidance to banks on principles to be observed when setting fees and charges for their products and services, in order to ensure good market conduct. The RPC also considered a presentation on the Concept Paper on “Provision of Emergency Liquidity Assistance (ELA) to NBFIs by the Bank” and approved the recommendation to form a committee consisting of relevant regulatory oversight authorities to address issues related to ELA to NBFIs. The purpose of the guidelines is to provide terms for the provision of ELA to cover short-term liquidity shortages experienced by domestic systemically important financial institutions (D-SIFIs). The extension of liquidity coverage to D-SIFIs is expected to mitigate liquidity challenges during financial crises, thus reduce the possibility of a systemic crisis, and thus preserve financial stability.

On-going regulatory developments augur well for financial stability

4.14 On other regulatory developments, the drafting of the Secured Transaction on Movable Property Bill, which will enable the use of movable property as collateral, is at an advanced level of being enacted into law. Revisions of the Bank of Botswana Act, Banking Act, NBFIRA Act and Financial Intelligence Act are on-going and the Bills are expected to be presented to Parliament in 2022.

Credit Information Bill, 2021 published

4.15 In June 2021, MFED published the draft Credit Information Bill, 2021. The Bill is intended to provide for the regulation of credit reporting system, the licensing, regulation, and supervision of credit bureaus and other related matters. The Bill covers preliminary matters; licensing of credit bureaus; governance, regulation, and supervision of credit bureaus; obligations of data providers and data users; rights of data subjects relating to consumer information; investigation of complaints; and miscellaneous provisions. The Bill defines a credit bureau as a company licensed to collect credit reports and process information on the credit status of a data subject (an individual or business entity whose data is collected, processed and disclosed to third parties in the credit information sharing system). The Bank shall be responsible for licensing, regulating and supervising credit bureaus in Botswana.

4.16 The Bill creates an important infrastructure for facilitating access to credit, by reducing information asymmetry in credit underwriting processes, more especially for small businesses and low-income individuals thereby, promoting financial inclusion. Furthermore, credit bureaus support financial stability and credit market efficiency and stability. Firstly, banks and NBFIs can screen borrowers and monitor the risk profiles of existing loan portfolios through information from credit bureaus, thereby reduce credit risk. Additionally, regulators can use credit information to understand the interconnected credit risks faced by systemically important borrowers and financial institutions and undertake essential oversight functions. Therefore, it is expected that the Bill will have positive implications on domestic financial development and stability.

5. CONCLUSION AND OUTLOOK

The financial sector continues to be resilient but there are uncertainties due to COVID-19

5.1 Overall, notwithstanding the challenges resulting from the onset of the COVID-19 pandemic, the domestic financial system continues to be resilient, characterised by strong capital and liquidity buffers, as well as generalised institutional strength and good business performance across the industry. The enduring stability of the financial system is supported by the sound macroeconomic environment, efficient and robust market infrastructure, prudently managed banks, effective regulation and supervision. Therefore, the environment and performance of the industry provide for unconstrained capacity of the financial sector to perform its role and support economic activity. However, there is need to guard against the possibility of excessive leverage and moral hazard issues, hence, the need to consider implementation of macroprudential policy tools where necessary.

5.2 There are, however, vulnerabilities and risks relating to the structure and performance of the economy that need close attention. Notably, the dependence on the external sector and, in particular, reliance on a single commodity for export earnings presents fiscal risks and exposes the country to exogenous shocks that could undermine the external balance. In addition, strong sectoral inter-linkages that involve a relatively large exposure of banks to NBFIs in terms of significant sources of funding, elevates the risk of contagion in the domestic financial system, even as effective regulation and the strength of institutions significantly mitigate the risk. Bank lending that is dominated by credit to the household sector, including a significant proportion of the inherently expensive unsecured personal loans, also makes the sector vulnerable to tightening of borrowing conditions. Slow income growth and weak business conditions could add to existing vulnerabilities and elevate credit risk. Nevertheless, the rate of credit growth was moderate, thus did not present any indication of excessive and rapid credit increase and, household credit, in particular, appeared to be in line with trends in personal incomes.

5.3 Vulnerabilities to the financial system are exacerbated by the COVID-19 pandemic. Specifically, the potential increase in bank loan defaults and insurance premiums or contributions to pension funds, as well as early pension withdrawals emanating from loss of employment and, constrained liquidity, profits and investment returns for some institutions could further elevate risks to financial stability.

5.4 Prospects for the alleviation of the effects of the pandemic and full recovery of the economy are uncertain. However, while economic performance is undermined by the impact of COVID-19, proactive policy actions, including the prevailing accommodative real monetary conditions, injection of liquidity into the banking system, other measures instituted by the NBFIs to mitigate the negative effects of COVID-19 and expansionary fiscal policy continue to anchor the soundness of the financial sector. Moreover, the ERTP and vaccine rollout bode well for economic recovery in the medium-term.

5.5 Meanwhile, risks from AML/CFT/CPF deficiencies are expected to diminish going forward following the removal of the Botswana from the FATF grey list. Botswana's exit from the grey list is expected to boost confidence in the domestic financial system.

APPENDIX

Table A1: Macroeconomic and Financial Stability Indicators

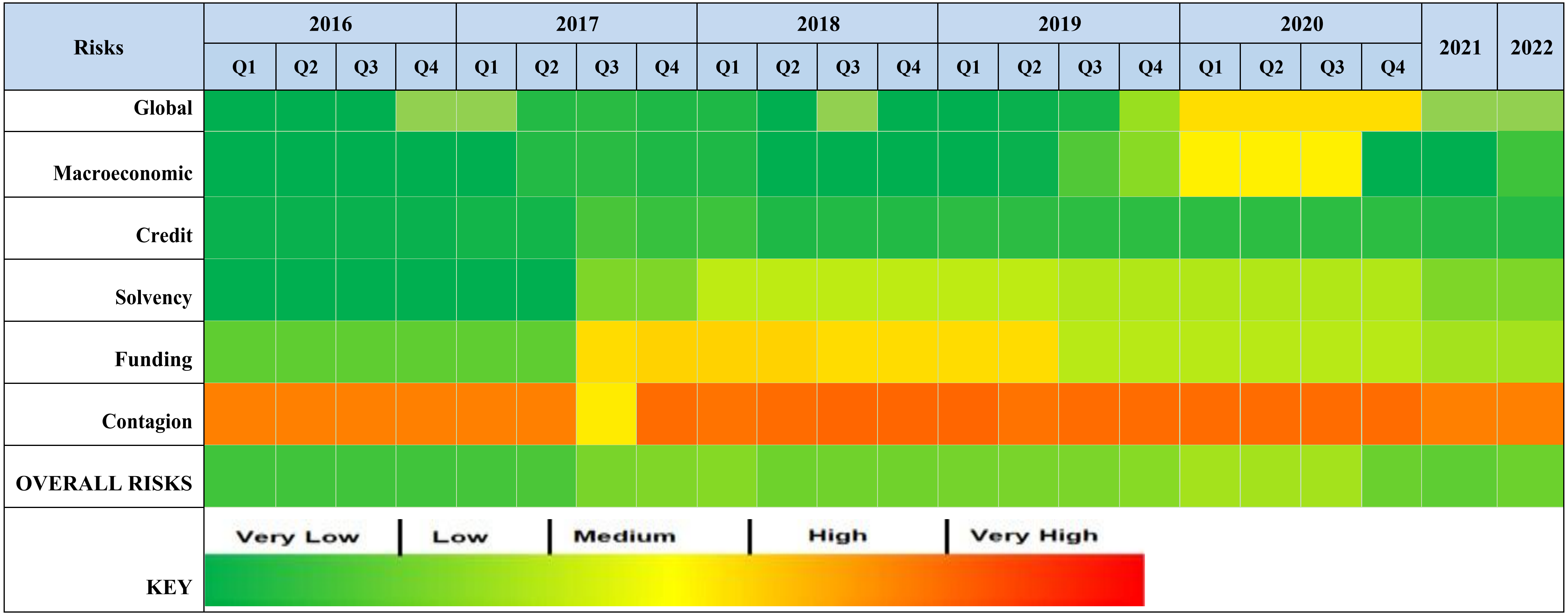
Financial Sector (Percent)	**Sep 2019**	**Dec 2019**	**Mar 2020**	**Jun 2020**	**Sep 2020**	**Dec 2020**	**Mar 2021**	**Jun 2021**
Relative Size of Financial Sector (percent of GDP)[1]	***109.9***	***112.4***	***110.1***	***118.6***	***123.5***	***125.5***	***127.4***	122.3
Pension Funds' Assets (percent of GDP)	***50.2***	***52.2***	***48.2***	***53.9***	***58.3***	***61.2***	***62.5***	60.9
Pension Funds Offshore Investments (percent of GDP)	***30.3***	***31.2***	***28.4***	***33.8***	***37.1***	***38.7***	***40.6***	39.4
Corporate Sector (Percent)								
Corporate Sector Debt to GDP	***12.7***	***12.8***	***13.2***	***13.6***	***13.1***	***13.1***	***12.8***	12.5
Debt to Equity	…	46.3	…	45.7	44.3	…	…	…
Household (Percent)								
Household Debt to GDP	***21.6***	***22.4***	***22.6***	***23.5***	***24.2***	***24.8***	***24.9***	23.7
Household Debt to Income	42.2	45.0	47.3	47.0*	47.0*	37.5	…	…
NPL (household)	3.2	3.2	3.6	3.9	3.2	3.4	3.5	3.3
Real Estate (Percent)								
Mortgage Loans to Total Loans	20.8	20.4	20.0	20.1	20.2	19.6	19.3	19.0
NPL (mortgages)/Total mortgage loans	6.2	6.1	6.5	7.2	6.0	6.1	6.3	6.4
Total Mortgage Loans/GDP	7.1	7.1	7.1	7.5	7.7	8.2	8.1	7.5
General Economic Indicators								
Economic growth	3.6	3.0	2.2	-5.1	-7.0	-8.5	-8.6	4.9
Inflation	3.0	2.2	2.2	0.9	1.8	2.2	3.2	8.2
Foreign Exchange Reserves (percent of GDP)	35.9	32.3	30.3	34.1	32.4	29.5	30.5	27.3
Current Account Balance (P' Million)	-6 499	-6 581	-3 791	-6 575	-3 848	-18 251	4 695	-2 696
Months of Import Cover	14.8	12.1	11.5	11.8	10.9	9.9	10.1	9.6
Exports (percent of GDP)	29.2	35.3	31.6	15.4	31.0	41.3	53.9	37.6
Imports (percent of GDP)	43.6	49.3	41.5	41.0	47.7	53.4	50.9	48.3
Government								
Government Debt to GDP	13.6	13.9	19.2	19.8	20.0	19.5	20.3	26.5
Government Debt to Revenue	47.5	50.1	53.9	61.0	63.1	74.4	103.8	…
Government Guaranteed Debt/GDP	…	…	4.5	4.6	4.8	4.8	…	…
Government Net Financial Position to GDP	10.2	8.7	5.6	8.0	9.8	-10.7	…	…
Government Interest Payments to Revenue	3.6	0.9	4.1	1.0	4.6	2.11	…	…
Government Interest Payments to GDP	1.0	0.2	0.9	0.4	1.1	0.04	…	…
Government Lending to State-Owned Enterprises (P 'Million)	2 209.6	2 209.6	…	…	…	…	…	…
General Government to GDP	14.7	14.7	15.3	20.2	17.6	16.6	...	…
Government Deposits to GDP	16.3	16.3	15.0	15.8	15.7	1.4	1.3	…
Government Expenditure to GDP	36.2	32.2	…	33.2	35.5	36.9	32.9	…
Government Employment to Total Employment	33.3	32.3	32.3	40.3	40.3*	40.3*	…	…

Source: Bank of Botswana, Statistics Botswana, MFED, NBFIRA, Botswana Stock Exchange Limited and Commercial Banks. Note: …denotes data not available

[1]Figures include Commercial Banks, Statutory Banks and Pension fund Assets only.

* are estimated figures.

Chart A1: Financial System Vulnerabilities - Heat Map



Source: Bank of Botswana