FINANCIAL STABILITY REPORT

OCTOBER | 2026



FINANCIAL STABILITY COUNCIL

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TABLE OF CONTENTS

1. EXECUTIVE SUMMARY..... 1

2. GLOBAL FINANCIAL STABILITY..... 3

3. REGIONAL FINANCIAL STABILITY..... 5

4. DOMESTIC FINANCIAL STABILITY..... 7

5. SOVEREIGN RISKS..... 11

6. CREDIT AND LEVERAGE RISKS..... 16
Commercial Bank Credit..... 16
Household Borrowing..... 17
Non-Financial Corporates Credit..... 21
Property Market Credit..... 21

7. LIQUIDITY AND FUNDING RISK..... 23
Banking Sector Liquidity and Funding..... 23
Interbank Funding..... 23
Foreign Currency Funding..... 25
Capital Markets – Equity Funding..... 26
Capital Markets – Bond Market Funding..... 29

8. CONTAGION RISK..... 31

9. BANKING SECTOR ANALYSIS..... 34
Asset Quality and Performance..... 34
Stress Test Scenarios..... 35
Stress Test Results..... 37

10. FINANCIAL MARKET INFRASTRUCTURES AND PAYMENTS SYSTEMS RISKS..... 41

11. REGULATORY AND OTHER DEVELOPMENTS..... 44

12. CONCLUSION AND OUTLOOK..... 47

LIST OF CHARTS, FIGURES AND BOXES

CHARTS

Chart 4.1: Estimated Financial Cycle for Botswana..... 10
Chart 6.1a: Total Credit Growth..... 16
Chart 6.1b: Credit-to-GDP Gaps..... 16
Chart 6.1c: Sectoral Loans to Total Loans..... 16
Chart 6.1d: NPL Ratio..... 16
Chart 6.2a: Growth in Household Debt..... 18
Chart 6.2b: Contribution to Credit Growth..... 18
Chart 6.2c: Household NPL Ratio..... 18
Chart 6.2d: Composition of Household Credit (P Million)..... 18
Chart 6.3a: Distribution of Household Assets..... 19
Chart 6.3b: Total Household Net Worth (P Billion)..... 19
Chart 6.4a: Mortgage Loans..... 22
Chart 6.4b: Commercial Real Estate Loans..... 22
Chart 6.5: Distribution of Mortgages by LTV..... 22
Chart 7.1a: Banks FX Exposure..... 25
Chart 7.1b: FX Volatility..... 25
Chart 7.2a: Market Capitalisation..... 28
Chart 7.2b: BSE Trading..... 28
Chart 7.2c: Liquidity Ratio..... 28
Chart 7.2d: DCI..... 28
Chart 7.2e: FCI..... 28
Chart 7.2f: Market Volatility..... 28
Chart 7.3a: Bonds Nominal Values (P Million)..... 30
Chart 7.3b: Bond Yields..... 30
Chart 7.3c: Number of Bonds..... 30
Chart 7.3d: Bond Indices..... 30
Chart 7.3e: Corporate Spread..... 30
Chart 7.3f: Bonds Volatility..... 30
Chart 8.1a: Structure of the Financial System in 2016..... 32
Chart 8.1b: Structure of the Financial System in December 2025..... 32
Chart 8.1c: Financial System Assets..... 32
Chart 8.1d: Financial Assets to GDP (Percent)..... 32
Chart 9.1a: Capital Adequacy..... 35

Chart 9.1b: Asset Quality..... 35
Chart 9.1c: Liquidity..... 35
Chart 9.1d: Profitability..... 35
Chart 9.2a: Concentration Shock..... 39
Chart 9.2b: Sectoral Shock..... 39
Chart 9.2c: Overall NPL Shock..... 39
Chart 9.2d: NPL Ratio..... 39
Chart 9.2e: Liquidity Test..... 39
Chart 9.2f: Interest Shock..... 39
Chart 9.3a: D-SIBs Scenario..... 40
Chart 9.3b: D-SIBs Scenario..... 40
Chart 10.1a: EFTs..... 42
Chart 10.1b: BISS Transactions..... 42

FIGURES

Figure 1.1: Summary of Risk Assessment..... 2
Figure 4.1: Botswana Financial System Heatmap..... 9
Figure 8.1: Macro-Financial Linkages (June 2026)..... 33

BOXES

Box 5.1: Assessing Fiscal Dominance in Botswana 14
Box 6.1: Household Indebtedness Survey Report 2025/26..... 20
Box 7.1: Pension Fund Rule 2 – Domestic Investment and Financial Stability..... 24
Box 10.1: Bank of Botswana's Regulatory Sandbox – Progress Towards Live Testing..... 43
Box 11.1: Money Laundering and Terrorist Financing Risks – Implications for Financial Stability in Botswana..... 46

ABBREVIATIONS

AI	Artificial Intelligence
AML	Anti-Money Laundering
BACH	Botswana Automated Clearing House
BBI	Botswana Bond Index
BETP	Botswana Economic Transformation Programme
BISS	Botswana Interbank Settlement System
BSEL	Botswana Stock Exchange Limited
CAR	Capital Adequacy Ratio
CFT	Combating the Financing of Terrorism
CorpI	Corporate Bond Index
CPF	Counter Proliferation Financing
CRE	Commercial Real Estate
CSDB	Central Securities Depository Company of Botswana
DCI	Domestic Company Index
DCTRI	Domestic Company Total Return Index
DISB	Deposit Insurance Scheme of Botswana
D-SIB	Domestic Systemically Important Banks
D-SIFI	Domestic Systemically Important Financial Institution
D-SII	Domestic Systemically Important Insurer
D-SIPS	Domestic Systemically Important Payment Systems
DSTI	Debt-Service-to-Income
DTI	Debt-to-Income
ECB	European Central Bank
EFT	Electronic Funds Transfer
EPS	Electronic Payment Services
ESG	Environmental, Social and Governance
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
ETF	Exchange Traded Funds
FATF	Financial Action Task Force
FCI	Foreign Company Index
FIA	Financial Intelligence Agency
FinTech	Financial Technology
FMI	Financial Market Infrastructure
FSB	Financial Stability Board
FSC	Financial Stability Council
FSDS	Financial Sector Development Strategy
FSR	Financial Stability Report
FX	Foreign Exchange
GDP	Gross Domestic Product
GFSR	Global Financial Stability Report
GovI	Government Bond Index
IMF	International Monetary Fund
LTV	Loan-to-Value
ML	Money Laundering
MoF	Ministry of Finance
NBFI	Non-Bank Financial Institutions
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
NCO	National Coordination Office
NDP	National Development Plan
NFC	Non-Financial Corporate
NGFS	Network for Greening the Financial System

NPL	Non-Performing Loan
NPS	National Payment System
NRA	National Risk Assessment
OFCs	Other Financial Corporations
PF	Proliferation Financing
PFR2	Pension Fund Rule 2
PLR	Prime Lending Rate
RHS	Right Hand Side
RMCI	Real Monetary Conditions Index
RTGS	Real-Time Gross Settlement
SACU	Southern African Customs Union
SADC	Southern African Development Community
SDR	Special Drawing Rights
SOE	State Owned Entreprise
SSA	Sub-Saharan Africa
TF	Terrorist Financing
US	United States
USD	United States Dollar
ZAR	South African Rand

ACKNOWLEDGEMENT

The October 2026 issue of the Financial Stability Report (FSR) was prepared by the Bank of Botswana (the Bank) in collaboration with member institutions of the Financial Stability Council (FSC) viz., Ministry of Finance (MoF), the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), the Financial Intelligence Agency (FIA), the Deposit Insurance Scheme of Botswana (DISB), the Botswana Stock Exchange Limited (BSEL) and National Coordinating Office on Anti-Money Laundering, Combating the Financing of Terrorism and Counter Proliferation Financing (AML/CFT/CPF). The Report was approved for publication by the FSC, a statutory body established by the Bank of Botswana (Amendment) Act, 2022 and with five members, being the Governor of the Bank of Botswana (Chairperson); Permanent Secretary of the Ministry of Finance; Chief Executive Officer, NBFIRA; Director General, FIA; and Director, DISB. The Chief Executive Officer, BSEL, and National Coordinator (AML/CFT/CPF) are observer members, thus without voting powers.

PREFACE

Purpose of the Report

The Financial Stability Report (FSR) provides an assessment of the vulnerabilities that could elevate risks to the stability and resilience of the Botswana financial system by the FSC. It evaluates financial stability conditions in Botswana and, where necessary, outlines remedial measures to address risks, vulnerabilities and instability. The Report also provides analytical and performance updates for the financial sector, examining its impact on economic activity and welfare. It thus, enables information access to support stakeholders' interests and self-reflection on financial risk assessment processes, thereby encouraging public discourse and engagement on financial stability issues. The FSR is published twice a year following discussion and approval at the FSC meetings.

Macroprudential Policy Framework

The work of the FSC and publication of the FSR relates to implementation of the macroprudential policy framework, whose primary objective 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, which manifests in transmission of risks within and among financial sector entities that can rapidly spill over into the real economy. At the same time, sectoral or broader economic weaknesses could adversely disrupt the functioning of the financial system and trigger instability or cause a systemic financial crisis.

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 for domestic systemically important financial institutions (D-SIFIs); reducing the systemic impact of misaligned incentives with a view to moderating moral hazard; monitoring systemic risks from activities outside the banking system; implementing appropriate policy responses to contain such risks; as well as strengthening related infrastructure to mitigate aggregate shocks and to enhance resilience of the financial system.

Given the structure of the Botswana economy, the macroprudential policy framework recognises the external sector vulnerabilities of the domestic economy as emanating from market shocks and capital flows and that these have the greatest potential for elevated financial stability risks. There are also potential risks to the stability of the domestic financial system emanating from economic and trade policy shifts and related disruptions induced by geopolitical tensions and geoeconomic fragmentation. Other risks relate to the exposure to cyber threats due to the increasing integration of technology in finance, and the prevalence of climate-related financial risks. The FSR provides an analysis of these vulnerabilities, highlights where they persist and their interaction, as well as the potential impact, and outlines responses to spillovers from regional and global financial stability developments and trends. Macroprudential indicators, complemented by financial soundness and macroeconomic indicators, are used to assess risks to and within the financial system. Relevant and appropriate macroprudential policy instruments and tools are available for intervention to mitigate risks and during periods of financial instability. The instruments and policy tools would be deployed or adjusted accordingly and timeously to mitigate the envisaged threats, and such interventions would be communicated through FSC circulars or by individual member regulators.

Decision-Making Process

The FSC, a multi-agency statutory body, was established under Section 20 (54B) of the Bank of Botswana (Amendment) Act, 2022, to, among others, collaborate and share information on financial sector vulnerabilities and risks, as well as policy and other related issues that strengthen the resilience of the financial system and make it more robust against financial stability risks. The FSC takes prompt action in response to a perceived build-up of systemic risks; ensures a coordinated response to financial stability issues that may require

cross-agency collaboration and information sharing and communicates systemic risk warnings to promote financial stability. The Governor chairs the FSC, and the Bank serves as the secretariat.

The work of the FSC was previously governed by a memorandum of understanding signed in February 2019, which has since been adapted into the FSC Charter.

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 on the stability of the domestic financial system. The Press Release further highlights the key risks in the financial system, recommendations and actions to address such vulnerabilities. Policy and regulatory decisions are communicated through a circular to all affected financial institutions. The circular provides a brief description that links the identified risk to the intermediate objective and explains how the measures taken are expected to mitigate the risk.

1. EXECUTIVE SUMMARY

1.1 **Global financial stability remains fragile despite generally resilient financial markets and financial institutions.** Financial stability assessments published during 2026 point to persistent vulnerabilities from stretched asset valuations, elevated sovereign debt, geopolitical and geoeconomic fragmentation, as well as leverage and liquidity risks in non-bank financial institutions (NBFIs). The October 2026 International Monetary Fund (IMF) Global Financial Stability Report (GFSR) further identifies sharp increases in sovereign bond yields, an abrupt correction in artificial intelligence (AI)-related asset valuations and severe cyber incidents as potential triggers of market stress. These shocks could interact with, and amplify, existing leverage, liquidity mismatches and interconnected exposures, resulting in abrupt repricing and tighter global financial conditions. Credible fiscal adjustment, stronger NBFI oversight, enhanced operational resilience and international coordination remain important for safeguarding global financial stability.

1.2 **Financial stability risks across sub-Saharan Africa (SSA) remain moderate but increasingly sensitive to global and domestic shocks**. The IMF's October 2026 Regional Economic Outlook suggests that regional growth has remained resilient, but high interest burdens, relatively low foreign reserve buffers in several countries and declining development assistance leave limited space to absorb further shocks. At the same time, increased reliance on domestic borrowing has strengthened sovereign-bank interlinkages, raising the potential for fiscal stress to transmit through financial institutions, domestic liquidity and private sector credit. These vulnerabilities leave regional financial systems particularly sensitive to tighter global financing conditions, commodity and energy shocks, capital flow volatility and sudden changes in investor risk sentiment.

1.3 **Botswana's financial system remains broadly stable**, supported by robust regulatory frameworks, strong prudential capital and liquidity buffers, profitable financial institutions and sound financial market infrastructures. Nonetheless, the financial cycle remains subdued as fiscal pressures, weak diamond market conditions, and cautious risk appetite continue to constrain financial intermediation and economic activity. Banking sector liquidity remains unevenly distributed, reflecting subdued fiscal performance, structural funding concentration and competition for deposits. While policy interventions have alleviated some immediate liquidity pressures and foreign exchange reserves have recovered from earlier lows, the financial system remains exposed to renewed weakness in diamond receipts, fiscal pressures and shifts in government financing requirements. The Bank of Botswana (Bank) reported that reserves provided 7.5 months of import cover at the end of June 2026, indicating an improvement in external buffers, although continued preservation of reserve adequacy remains important.

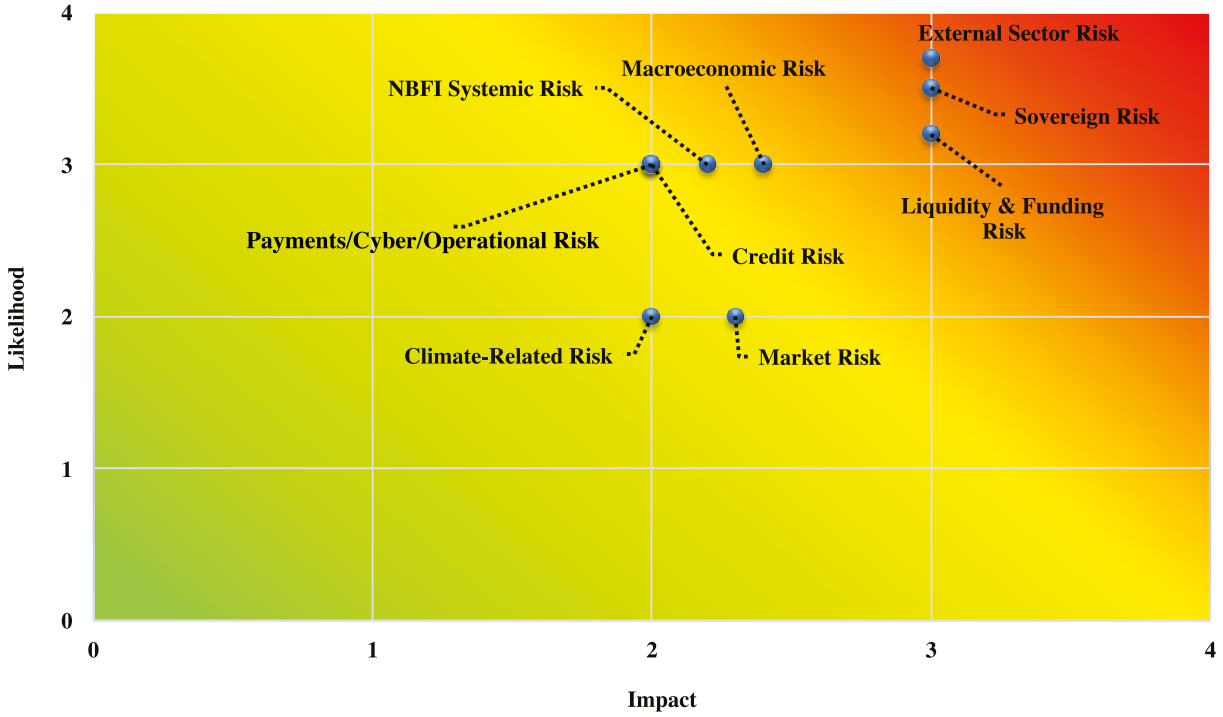
1.4 **Credit conditions remain subdued amid weaker economic activity, liquidity constraints and cautious bank risk appetite.** Although the negative credit-to-gross domestic product (GDP) gap suggests that systemic risks from excessive credit expansion remain contained, vulnerabilities persist within household and corporate balance sheets. Household borrowing remains concentrated in unsecured credit and debt service burdens remain elevated, increasing sensitivity to weaker incomes, higher borrowing costs or employment shocks. Corporate borrowers are similarly exposed to subdued activity, tighter financing conditions and delayed government payments. Asset quality remains broadly contained, although prolonged macroeconomic faltering could weaken repayment capacity. At the same time, fiscal pressures and greater reliance on domestic financing continue to deepen the sovereign-financial sector nexus, creating potential transmission through tighter liquidity, crowding out of private credit, higher funding costs and concentrated sovereign exposures across banks and institutional investors. Recent sovereign rating actions continue to underscore concerns around fiscal pressures, structural dependence on diamonds and the pace of economic diversification.

1.5 **The risk assessment (Figure 1.1), complemented by the financial stability heatmap (Figure 4.1), indicates that systemic risk pressures remain elevated but broadly contained,** with vulnerabilities principally arising from sovereign-financial sector linkages, liquidity and funding pressures, external sector risks and concentrated exposures. The growing systemic footprint of NBFIs primarily reflects their increasing size, concentration and interconnectedness with banks, government securities and financial markets, rather than specific evidence of

instability within the sector. These linkages could nevertheless amplify shocks through common exposures, liquidity needs and asset valuations. Notably, the interaction of fiscal pressures, liquidity constraints and weaker economic activity remains particularly important, as deterioration in one area could reinforce vulnerabilities elsewhere in the financial system.

1.6 **While Botswana's financial system remains sound, its resilience is increasingly being tested by the interaction of external shocks and domestic structural vulnerabilities.** Prolonged weakness in diamond revenues could constrain fiscal expenditure and increase domestic borrowing requirements, intensifying competition for funding and potentially crowding out private sector credit. Tighter credit conditions and weaker income prospects could, in turn, affect household and corporate debt servicing capacity and asset quality, reinforcing cautious lending behaviour and subdued financial intermediation. Cross-sector sovereign exposures could further transmit fiscal and liquidity shocks across banks, pension funds and insurers, while climate, cyber and operational risks remain important emerging vulnerabilities requiring continued surveillance. Against this background, policy priorities remain centred on maintaining strong capital and liquidity buffers, strengthening liquidity and funding risk management, rebuilding fiscal and external buffers, improving sovereign debt management, deepening cross-sector monitoring and developing stress testing scenarios that capture the interaction and propagation of shocks across the financial system.

Figure 1.1: Summary of Risk Assessment



Source: Bank of Botswana

2. GLOBAL FINANCIAL STABILITY

The global financial system remains resilient

2.1 Global financial stability remains fragile despite the continued resilience of most financial institutions and generally orderly market functioning. Financial stability assessments published during 2026 by the IMF, Financial Stability Board (FSB) and major central banks point to common vulnerabilities and risks, including elevated sovereign debt and yields, stretched asset valuations, leverage and liquidity risks in NBFIs, geopolitical fragmentation and increasing operational and cyber risks. The October 2026 IMF GFSR reinforces this assessment, noting that unresolved vulnerabilities could interact with and amplify adverse shocks, with abrupt market repricing, liquidity stress and tighter global financial conditions.

2.2 Geopolitical and geoeconomic tensions remain an important potential trigger for financial instability. Continued conflicts in the Middle East, trade fragmentation and supply chain disruptions could increase energy and commodity prices, prolong inflationary pressures and further weaken economic activity. Such developments could delay anticipated monetary policy easing and sustain higher global interest rates, increasing debt servicing burdens across sovereigns, households and businesses.

2.3 Meanwhile, sovereign vulnerabilities have become increasingly important given high public debt, persistent fiscal deficits and large refinancing requirements across several economies. Higher borrowing costs could further weaken fiscal positions and increase sovereign risk premia, particularly where policy space is constrained. Financial stability concerns arise from growing interconnectedness between sovereigns and financial institutions, as banks, pension funds, investment funds and leveraged investors maintain significant government securities exposures. The October 2026 GFSR and European Central Bank (ECB) assessments note that a sharp increase in sovereign yields could generate valuation losses, funding pressures and reduced market liquidity, transmitting fiscal stress to the wider financial system.

2.4 The systemic importance of NBFIs continues to increase, alongside vulnerabilities from leverage, liquidity mismatches and financial sector interconnectedness. The IMF, FSB, Bank of England and ECB have highlighted the potential for leveraged investment strategies and liquidity transformation to amplify financial market shocks. The IMF further identifies liquidity mismatches among insurers and pension funds, leverage and contingent liquidity risks in private credit, and crowded hedge fund positions. Under stress, margin calls, redemptions and tighter funding could trigger asset sales, reinforcing price declines and transmitting stress across sovereign bond, credit and funding markets.

2.5 Banking systems globally remain broadly resilient, supported by stronger capital and liquidity positions, but resilience is uneven. Weaker banks could become vulnerable should higher sovereign yields, weaker economic activity and funding pressures materialise simultaneously. This suggests that strong system-wide indicators may coexist with institution-specific vulnerabilities, particularly where funding structures, business models or exposures are concentrated. Financial stability surveillance therefore needs to assess both aggregate resilience and the distribution of vulnerabilities across institutions.

2.6 Stretched valuations in some global financial markets remain another vulnerability. Strong expectations regarding technological innovation, particularly AI, have supported significant technology related investment and valuations. The Bank of England and IMF indicate that AI investment is increasingly financed through corporate debt and private credit, expanding financial sector exposure to the technology cycle. A material reassessment of expected earnings or productivity gains could therefore trigger adjustments across equity, credit and private markets, with leverage and concentrated exposures potentially amplifying losses.

2.7 Operational and cyber risks are also becoming increasingly relevant for systemic stability, aided by common technological dependencies across financial institutions and market infrastructures. The Reserve Bank of Australia, FSB and IMF highlight the possibility that disruptions affecting common service providers or severe cyber incidents could simultaneously impair several institutions and critical financial services. Advances in AI may

further accelerate the speed and scale of cyber threats thus requiring safe adoption underpinned by vigilance, agility and adaptation to support sustainable economic growth.

2.8 Overall, the global financial stability outlook is characterised less by a single dominant vulnerability than by the potential for risks to interact. A geopolitical or commodity shock could increase inflation, sustain higher interest rates, weaken growth and increase sovereign financing costs. Resulting market volatility could expose leverage and liquidity vulnerabilities among NBFIs, while weaker economic conditions could reduce household and corporate debt servicing capacity. An abrupt market correction or operational disruption could further amplify these pressures. Surveillance therefore increasingly requires assessment of interconnected risks and amplification mechanisms rather than isolated risk monitoring.

2.9 Against this background, global policy priorities remain centred on rebuilding fiscal buffers, strengthening both banking and NBFI oversight, addressing leverage and liquidity vulnerabilities, improving the resilience of sovereign debt markets and strengthening cyber and operational resilience. Greater transparency, system-wide stress testing and international coordination remain important given the potential for shocks to transmit rapidly across institutions, sectors and jurisdictions.

3. REGIONAL FINANCIAL STABILITY

Regional financial stability could be challenged by growing risks and vulnerabilities

3.1 Financial systems across Sub-Saharan Africa (SSA) remain broadly resilient, although the region's capacity to absorb additional shocks remains constrained. The October 2026 IMF Regional Economic Outlook projects regional growth of 4.5 percent in both 2026 and 2027, supported by earlier macroeconomic adjustment, favourable export receipts in some economies and continued resilience in resource-intensive countries. However, this aggregate resilience masks significant differences across countries, while high interest burdens, relatively low foreign reserve buffers in several economies, declining development assistance and costly market financing continue to limit policy space. Consequently, otherwise manageable external shocks could have greater macro-financial consequences where fiscal, external and financial buffers are already stretched.

3.2 Sovereign-financial sector interconnectedness remains a critical regional vulnerability as limited access to affordable external and concessional financing has increased reliance on domestic private sector funding for fiscal support. While this provides a cushion against external funding shocks, it creates new sovereign-specific transmission channels. A deterioration in fiscal positions or increase in sovereign risk premia could therefore generate valuation and liquidity pressures within the financial system, while higher government financing requirements could absorb domestic savings and constrain private credit growth. The re-emergence of stronger sovereign-bank linkages identified in Zambia illustrates this broader regional transmission mechanism.

3.3 The interaction between sovereign financing needs and relatively shallow domestic financial markets could also reinforce adverse feedback between fiscal conditions, financial intermediation and economic activity. Increased government borrowing may raise domestic funding costs and reduce the availability of private sector credit, weakening investment and economic activity. Weaker activity could, in turn, constrain tax revenues and increase fiscal financing requirements, further strengthening financial institutions' exposures to government. These dynamics are particularly important where domestic investor bases are concentrated, as the capacity of financial institutions to accommodate additional sovereign issuance without increasing concentration or liquidity risk may be limited. The IMF therefore continues to emphasise improved debt management and transparency, deeper domestic capital markets and preservation of productive private sector financing as important elements of regional resilience.

3.4 External shocks remain an important potential trigger for these domestic vulnerabilities. Many economies remain sensitive to commodity and energy prices, global financing conditions and exchange rate movements, although the channels differ between commodity exporters and import-dependent economies. A renewed energy or supply shock could increase import costs and inflation in energy-importing economies while weaker global demand could reduce export and fiscal revenues in commodity-dependent countries. These pressures could simultaneously weaken foreign exchange buffers, increase financing costs and reduce household and corporate debt servicing capacity. Rwanda's 2026 assessment, for example, identifies higher energy and import costs, supply-chain disruption and weaker borrower repayment capacity as important channels through which global shocks could reach the financial system, while Mauritius' assessment highlights the importance of strong external buffers in containing international spillovers[1].

3.5 Credit and balance sheet vulnerabilities could consequently become more pronounced if adverse macroeconomic conditions persist. Higher living and operating costs, tighter financing conditions and weaker activity can place simultaneous pressure on household disposable income and corporate cash flows, potentially increasing credit losses and reinforcing cautious lending behaviour. These pressures are evident to varying degrees across regional assessments: the South African Reserve Bank

1. https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2026/september

identifies household financial distress and weaker corporate conditions as important transmission channels, while the National Bank of Rwanda identifies credit risk as the primary channel through which external shocks could affect its banking system. The regional concern is therefore less the current level of credit risk in any single jurisdiction than the possibility that prolonged macroeconomic stress could weaken borrower resilience and interact with already constrained financial conditions.

3.6 Growing financial sector interconnectedness adds further potential amplification channels. Banks, pension funds, insurers and other NBFIs increasingly share exposures to sovereign securities, domestic funding markets and, in some jurisdictions, international financial markets. Mauritius, for example, combines a well-capitalised banking system with significant cross-border financial activity and a growing NBFI sector, illustrating how external market developments can become increasingly relevant even where domestic prudential indicators remain strong. At the same time, greater digitalisation and reliance on interconnected payment and technology infrastructure raise operational and cyber risks across the region. Rwanda's rapidly expanding digital payments ecosystem and South Africa's assessment of operational risks associated with emerging technologies demonstrate the increasing importance of operational resilience alongside traditional credit and liquidity risks.

3.7 South Africa remains an important regional amplification and transmission channel because of its comparatively deep financial markets and extensive trade, banking and investment linkages with neighbouring economies. The South African Reserve Bank assesses geopolitical tensions as capable of reinforcing sovereign, household, corporate and market vulnerabilities through weaker growth, higher inflation, tighter financial conditions and volatile capital flows. Adverse developments in South Africa could therefore transmit regionally through weaker trade demand, cross-border banking and investment flows, exchange rate movements and changes in investor risk sentiment. This creates an additional channel through which global shocks can affect Southern African economies even where their direct exposure to international financial markets is relatively limited.

3.8 Overall, the regional financial stability outlook is characterised by broadly resilient financial institutions operating against reduced macroeconomic policy space and increasingly interconnected vulnerabilities. The principal risk is that an external shock - such as renewed commodity or energy disruption, tighter global financing conditions or severe weather events could simultaneously weaken fiscal and external positions, increase sovereign financing needs, tighten domestic liquidity and impair household and corporate repayment capacity. Concentrated sovereign exposures and cross-sector financial linkages could then amplify these pressures across banks and NBFIs. Consistent with the October 2026 IMF Regional Economic Outlook, policy priorities should therefore balance continued fiscal adjustment with targeted support for vulnerable households, preservation of productive investment and measures to contain inflation, while rebuilding fiscal and foreign exchange buffers. Financial sector authorities should complement these efforts through stronger sovereign and liquidity risk surveillance, cross-sector monitoring and forward-looking stress tests that capture the joint materialisation and propagation of macro-financial shocks.

4. DOMESTIC FINANCIAL STABILITY

The financial system remains broadly resilient

4.1 The financial system heatmap indicates that Botswana's financial system remained broadly resilient during the review period, with overall systemic risk contained at moderate levels (Figure 4.1). Risks nevertheless remain unevenly distributed, with comparatively elevated readings associated with the real economy and the growing systemic importance of NBFIs, while banking, household and non-financial corporate sector risks remain generally contained. The elevated NBFI readings do not indicate sectoral distress, as institutions remain broadly sound, but rather reflect the increasing size, concentration and interconnectedness of the sector. Consequently, the principal domestic financial stability concern is less broad-based weakness within individual institutions than the potential for shocks to propagate rapidly through common exposures, funding relationships and financial markets.

4.2 The main source of vulnerability remains the interaction between subdued economic conditions and the balance sheets of households, businesses, Government and financial institutions. Weak diamond sector activity and associated fiscal pressures can reduce incomes, corporate revenues and Government cash flows, weakening household and business debt servicing capacity while simultaneously increasing sovereign financing requirements. Banks may respond to weaker borrower conditions by tightening credit standards and preserving balance sheet buffers, which can further constrain consumption and investment. If weaker activity reduces fiscal revenues and increases Government financing needs, an adverse feedback loop can emerge between the real economy, credit conditions and sovereign-financial sector exposures. Improved liquidity conditions and the recovery in some external and fiscal buffers have moderated these pressures relative to earlier in 2026, but credit intermediation remains subdued and the underlying transmission channels persist.

4.3 The banking sector remains well positioned to absorb moderate shocks, supported by strong capital, adequate liquidity and profitability. Stress test results similarly indicate resilience to moderate credit deterioration, although severe credit shocks could materially erode prudential buffers. Current credit conditions provide some mitigation insofar as subdued lending limits the build-up of excessive leverage. However, prolonged weak economic conditions could progressively dampen borrower resilience. Household exposures warrant continued attention given the dominance of unsecured borrowing and elevated debt-service burdens, while businesses remain sensitive to weaker demand, high financing costs and delayed Government payments. A sustained deterioration in these conditions could increase non-performing loans (NPLs) and provisioning requirements, reduce profitability and reinforce cautious lending, thereby weakening financial intermediation even while banks remain adequately capitalised.

4.4 Funding conditions have improved substantially from the tight environment experienced earlier in 2026, supported by higher Government spending, Southern African Customs Union (SACU) inflows and budget-support financing. This has eased immediate funding pressures and supported orderly money-market conditions. However, improved aggregate liquidity does not eliminate structural funding vulnerabilities because liquidity remains unevenly distributed and banks continue to rely materially on large institutional depositors. Pension funds, insurers and other NBFIs hold significant deposits with banks, creating a channel through which changes in portfolio allocation or liquidity preferences can rapidly affect bank funding. Such adjustments need not originate from NBFI distress; precautionary liquidity management, portfolio rebalancing or shifts toward alternative assets could reduce wholesale deposits, increase bank funding costs and tighten lending conditions. The financial stability risk therefore lies in the concentration and interconnectedness of funding relationships rather than the prevailing level of system liquidity alone.

4.6 The increasing scale of NBFIs reinforces these cross-sector transmission channels. Pension funds, insurers and collective investment undertakings are major participants in domestic funding and capital markets, significant holders of Government securities and important investors in offshore assets. Their offshore investments provide valuable diversification but also expose domestic portfolios to global market and valuation shocks. At the same time, their holdings of bank deposits and domestic securities connect

them closely to banks and the sovereign. A sharp international market correction, sovereign repricing or change in institutional portfolio preferences could therefore generate simultaneous effects through asset valuations, Government bond markets and bank funding. NBFIs are consequently more relevant as potential amplifiers and transmitters of system-wide shocks than as an originating source of current instability.

4.6 External conditions remain an important potential trigger for these domestic vulnerabilities given Botswana's dependence on diamond exports and foreign exchange inflows. Foreign exchange reserves increased to P63.2 billion in July 2026, equivalent to approximately eight months of import cover, strengthening the economy's capacity to absorb external shocks and supporting confidence in the exchange rate framework. Nonetheless, prolonged weakness in diamond demand, tighter global financial conditions or geopolitical and commodity market disruptions could reduce export and fiscal revenues and weaken foreign exchange inflows. The financial stability consequences would arise primarily through their interaction with existing domestic vulnerabilities: weaker government revenues could increase financing requirements, lower household and corporate income could weaken credit quality, and reduced external inflows could again place pressure on domestic funding conditions. The recovery in reserves therefore, provides an important buffer but does not eliminate the structural exposure to external shocks.

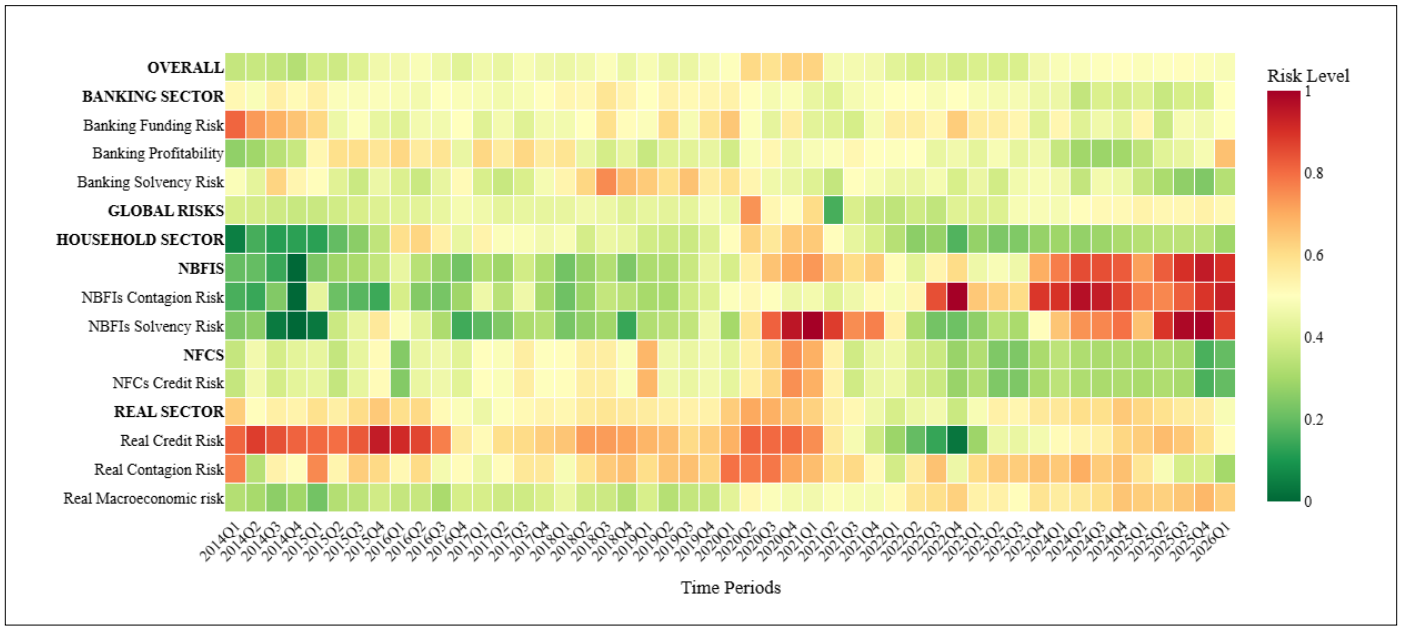
4.7 Climate-related risks could further intensify these macro-financial pressures. Physical events such as drought and other extreme weather conditions can weaken agricultural production, household income and business cash flows while increasing government expenditure requirements and insurance claims. Where affected households and firms are already highly indebted, income losses could translate more quickly into debt servicing difficulties and credit losses. Climate shocks could therefore interact with fiscal pressures and existing credit vulnerabilities rather than remain confined to climate-sensitive sectors. Transition-related changes in technology, regulation and market preferences may also alter business models and asset valuations over time. Incorporating climate risk into credit assessment and system wide scenario analysis is therefore, important for understanding how environmental shocks could propagate through borrower balance sheets, government finances and financial institutions.

4.8 Digitalisation creates a similar combination of resilience benefits and new transmission channels. Wider use of electronic payments and digital financial services supports efficiency, inclusion and continuity of financial services, but increases dependence on common technology infrastructure and third party providers. Fraud incidents involving unauthorised account access, social engineering and fraudulent electronic transfers during 2026 have not posed a systemic threat but demonstrate the increasingly innovative operational environment. A materially larger cyberattack or failure of shared technology, telecommunications or payment infrastructure could simultaneously disrupt transactions, customer access and institutions' liquidity management operations, potentially affecting confidence and economic activity. The systemic concern therefore, lies less in individual fraud losses than in the possibility of correlated operational disruption across interconnected financial institutions and infrastructures.

4.9 Strong prudential and institutional safeguards continue to mitigate these vulnerabilities. The orderly transition following the exit of one credit bureau preserved continuity in credit information services, which remains important for effective underwriting and credit risk management. Ongoing payment system, Financial Technology and financial inclusion reforms can further improve efficiency and resilience, while strengthening Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) arrangements supports financial integrity and confidence. The development of Emergency Liquidity Assistance Framework would add an additional safeguard by providing temporary liquidity to solvent banks facing idiosyncratic liquidity stress, while the Deposit Insurance Scheme of Botswana reduces the potential for depositor confidence shocks to translate into destabilising withdrawals. These arrangements complement strong capital and liquidity buffers by reducing the likelihood of institution-specific stress developing into system-wide disruption.

4.10 Overall, Botswana's financial system remains sound and capable of absorbing moderate shocks, but its sensitivity to common and interacting shocks has increased as financial sector interconnectedness has deepened. The principal risk is a compound scenario in which prolonged diamond sector weakness and subdued activity weaken household and corporate balance sheets and government revenues, while higher sovereign financing requirements and institutional portfolio adjustments affect bank funding, credit conditions and asset valuations. A climate, cyber or external market shock occurring at the same time could further amplify these pressures. Strong bank buffers, sound NBFI balance sheets, improved system liquidity, recovering foreign exchange reserves and an expanding financial safety net currently contain these risks. Financial stability surveillance should therefore, focus increasingly on cross-sector exposures, concentrated funding relationships and scenarios that jointly assess sovereign, credit, market, funding, climate and operational shocks, with the objective of preventing localised vulnerabilities from propagating into broader systemic stress.

Figure 4.1: Botswana Financial System Heatmap



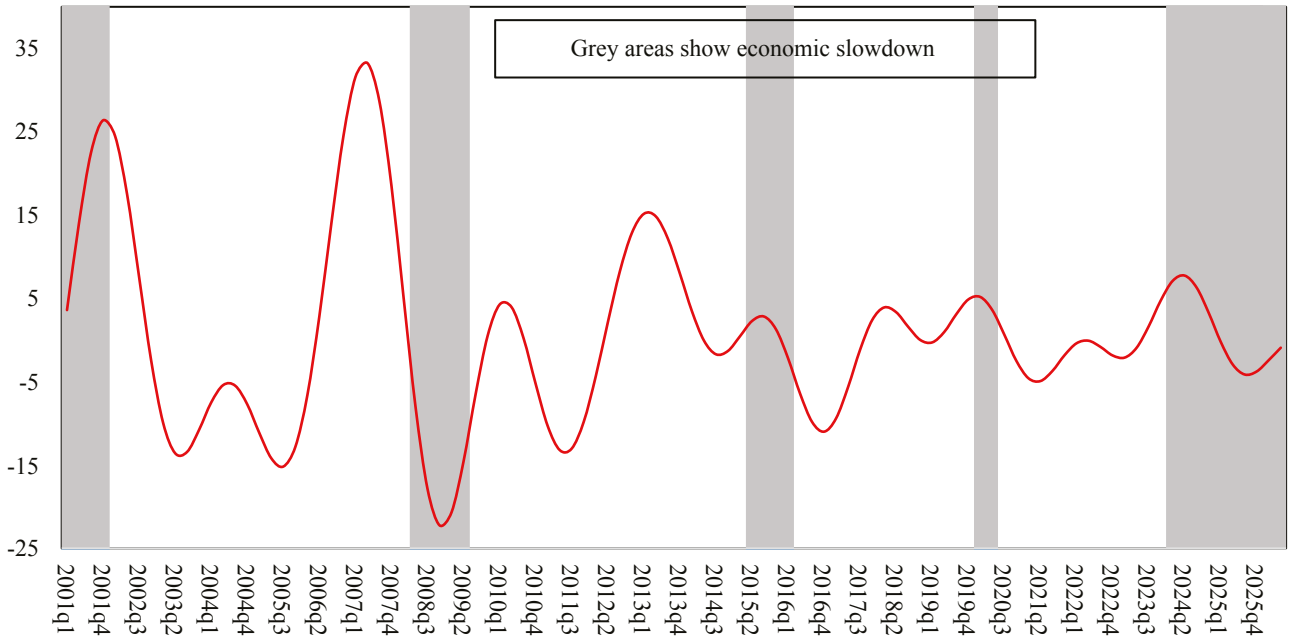
Financial cycle evolution signals moderate recovery

4.11 The financial cycle shows signs of a gradual recovery following a pronounced downturn, although underlying financial conditions remain subdued (Chart 4.1). The estimated cyclical component improved from a trough of -4.15 in 2025Q3 to -0.93 in 2026Q2, signalling a moderation in cyclical weakness rather than a broad-based expansion in financial activity. The emerging recovery is occurring against a backdrop of improved banking system liquidity, supported by government-related inflows and monetary policy interventions. Nevertheless, the improvement has yet to translate into a sustained recovery in financial intermediation, as commercial bank credit contracted by 2.3 percent in the year to August 2026, reflecting declining lending to both households and businesses. This underscores the persistence of constraints on credit supply and demand, including subdued economic activity, elevated funding costs, weak household purchasing power and cautious lending behaviour. Consequently, while the upward movement in the financial cycle is encouraging, its sustainability remains uncertain, particularly given the financial system's continued exposure to fiscal pressures and structural funding vulnerabilities.

4.12 The sustainability of the recovery remains vulnerable to persistent fiscal and external sector pressures, particularly subdued diamond revenues, which could constrain government spending and intensify domestic financing requirements.

Increased government borrowing could exert pressure on banking system liquidity and crowd out private sector credit, weakening household and business debt-servicing capacity. A deterioration in asset quality could, in turn, reinforce cautious lending behaviour, prolonging subdued financial intermediation and economic activity. Furthermore, growing sovereign exposures and interconnectedness between banks and non-bank financial institutions could amplify the transmission of fiscal and liquidity shocks. Accordingly, maintaining adequate capital and liquidity buffers, strengthening surveillance of credit and funding risks, and monitoring sovereign-financial sector linkages remain essential to preserving financial stability.

Chart 4.1: Estimated Financial Cycle for Botswana



Source: Bank of Botswana

5. SOVEREIGN RISKS

Fiscal shocks remain a potential source of systemic risk

5.1 Botswana's sovereign risk position remains elevated due to continued reliance on borrowing to finance budget deficits, on account of subdued mineral revenues, reduced fiscal buffers and increased government financing requirements. Although the near-term fiscal position has improved relative to earlier projections, the underlying vulnerability remains structural because government revenue continues to depend heavily on the diamond sector. A renewed or prolonged weakness in mineral receipts could widen fiscal imbalances, increase borrowing requirements and slow the rebuilding of financial buffers. Conversely, the recent narrowing of the projected fiscal deficit and recovery in some revenue sources reduce immediate financing pressure and, if sustained, could stabilise the sovereign balance sheet and strengthen confidence.

5.2 Policy adjustments during 2026 have increased Government's capacity to manage financing pressures in a more orderly manner. Parliament raised the statutory public debt ceiling from 40 percent to 60 percent of GDP in March 2026, while the Government Bond Issuance Programme ceiling was increased from P55 billion to P85 billion in August 2026. These measures provide greater flexibility in the timing and composition of government financing and can support development of a deeper domestic capital market. However, the additional headroom does not remove the underlying fiscal constraint. If persistent deficits result in sustained debt accumulation, higher debt-service and refinancing requirements could progressively reduce the fiscal space and increase the financial system's exposure to sovereign conditions.

The sovereign-financial sector nexus could be an important risk transmission channel

5.3 Greater reliance on domestic financing could deepen the sovereign-financial sector nexus as banks, pension funds and insurers increase their holdings of government securities. Government securities provide financial institutions with relatively liquid domestic investment assets and a deeper sovereign market can improve price discovery, broaden investment opportunities and provide benchmarks for wider capital market development. Nonetheless, increasing concentration in a common sovereign exposure could make several parts of the financial system more sensitive to the same fiscal shock. A deterioration in the sovereign outlook or sharp increase in required yields could raise government refinancing costs and, where securities are subject to market repricing, generate valuation pressures across institutional balance sheets. The financial stability concern therefore, lies in the degree of concentration and interconnectedness rather than government borrowing in itself.

5.4 Higher sovereign financing requirements could also affect the allocation of domestic savings. Increased government bond issuance may absorb funding that could otherwise support households and businesses or make government securities relatively more attractive than private sector lending. The immediate risk of significant crowding out is moderated by currently subdued credit demand and improved domestic funding conditions. Moreover, orderly government financing can help sustain public expenditure and economic.

Fiscal dominance risks remain contained, but rising sovereign exposures warrant continued monitoring

5.5 Against this backdrop, maintaining fiscal sustainability remains important for containing sovereign risks and preserving macroeconomic and financial stability. While increased domestic borrowing can support fiscal financing needs and contribute to capital market development, it also underscores the importance of ensuring that fiscal pressures do not undermine monetary policy credibility or amplify systemic vulnerabilities. In this regard, the fiscal dominance assessment presented in Box 5.1, provides additional context for evaluating sovereign-related risks. The assessment concludes that fiscal dominance is not currently evident in Botswana. Nevertheless, rising public debt, increasing financing requirements and growing sovereign exposures within the financial system underscore the need for continued monitoring of sovereign vulnerabilities and the channels through which they could impair financial system resilience.

Fiscal conditions can also affect financial stability through the real economy and credit quality

5.6 Sovereign vulnerabilities can transmit to the financial system even without stress in government securities markets. Weak mineral revenues may require expenditure restraint, while constrained government cash flows can contribute to delayed payments to suppliers. Firms dependent directly or indirectly on public sector expenditure may consequently experience weaker revenues and working capital pressures, reducing their capacity to service debt, pay suppliers or maintain employment. These effects could subsequently weaken household incomes and repayment capacity and increase credit losses for banks. The downward revision of the projected fiscal deficit reduces the immediate scale of adjustment required, while banking sector asset quality remains broadly contained; nevertheless, prolonged fiscal weakness could strengthen this sovereign-to-credit-risk channel and reinforce cautious lending.

Debt and buffers determine the sovereign's capacity to absorb future shocks

5.7 The broader sovereign vulnerability therefore extends beyond the current level of debt to the trajectory of the government balance sheet and its capacity to absorb future shocks. The February 2026 Budget Speech projected total public debt, including guarantees, to increase from about 33 percent of GDP at end of 2025 to 44.7 percent by March 2027 under the original fiscal assumptions. Subsequent improvement in the projected 2026/27 deficit suggests lower near term financing pressure than initially envisaged. If fiscal consolidation is sustained, slower debt accumulation and rebuilding of financial assets could preserve the fiscal space and strengthen the sovereign's capacity to respond countercyclically to future economic or financial stress. Conversely, persistent deficits would gradually replace accumulated financial assets with interest-bearing liabilities, increasing debt service requirements and weakening that shock absorption capacity.

5.8 The recovery in fiscal and external buffers provides additional mitigation. Foreign exchange reserves increased to P63.2 billion in July 2026, equivalent to around 8 months of import cover, while the Government Investment Account has begun to recover from earlier lows. Stronger buffers improve resilience to revenue and external shocks, reduce the likelihood of abrupt policy adjustment and support investor confidence. However, their durability remains linked to diamond and SACU receipts, expenditure discipline and the success of fiscal adjustment. A renewed deterioration in these revenue sources could therefore, weaken buffers and increase dependence on borrowing.

Contingent liabilities and sovereign ratings remain important forward-looking considerations

5.9 State Owned Enterprises (SOEs) represent an additional source of potential sovereign vulnerability through guarantees, recurrent financial support and possible recapitalisation requirements. These obligations have the potential to increase government financing needs and reduce the resources available to absorb other shocks. Ongoing reforms to strengthen SOE ownership, governance, accountability and financial performance are intended to reduce this exposure by improving financial discipline and limiting reliance on government support. Effective implementation could, therefore, strengthen the sovereign balance sheet, whereas continued underperformance by SOEs would present contingent fiscal risk.

5.10 Sovereign credit rating developments similarly reflect the balance between increased fiscal pressures and Botswana's remaining credit strengths. In September 2026, S&P Global Ratings affirmed Botswana's long-term sovereign ratings at BBB- with a negative outlook, while Moody's Investors Service downgraded the long-term issuer rating from Baa1 to Baa2 and revised the outlook from negative to stable. Botswana remains investment grade under both agencies, supported by comparatively moderate debt and interest burdens relative to peers, institutional strength and recovering external buffers as the basis for the favourable grading. Nonetheless, failure to sustain fiscal adjustment could weaken investor confidence and raise government borrowing costs, while credible implementation of revenue, expenditure and debt management reforms could stabilise financing conditions and support the sovereign outlook.

Systemic risk depends on how these vulnerabilities and policy responses interact

5.11 Overall, sovereign-related systemic risk remains contained, but the financial system has become increasingly sensitive to fiscal developments. Greater domestic borrowing could then increase common sovereign exposures across financial institutions and compete with private sector financing, while expenditure restraint or delayed government payments could weaken corporate and household repayment capacity. If these effects reduced credit provision and economic activity, weaker tax revenues could feed back into the fiscal position and generate further financing requirements. The systemic risk therefore, arises from the possibility that sovereign, financial sector and real economy pressures become mutually reinforcing rather than from any single fiscal indicator.

5.12 The measures being implemented by Government are intended to weaken these transmission channels and improve the underlying economic and financial environment. Fiscal consolidation, and stronger revenue mobilisation can reduce financing requirements; the revised debt management framework and enhanced public financial management can facilitate orderly financing and development of domestic capital markets; rebuilding fiscal and external buffers can increase shock-absorption capacity; and SOE reforms can contain contingent liabilities. At the same time, implementation of the Twelfth National Development Plan (NDP 12) and the Botswana Economic Transformation Programme (BETP) is intended to broaden productive activity, diversify the revenue base and reduce dependence on volatile mineral income. If implemented coherently, these measures should reduce sovereign-financial sector vulnerabilities over time. Financial stability surveillance should therefore continue to assess both the evolution of sovereign vulnerabilities and whether the policy response is effectively reducing debt accumulation, and concentration of sovereign exposures.

BOX 5.1: ASSESSING FISCAL DOMINANCE IN BOTSWANA

Introduction

The interaction between fiscal and monetary policy has attracted increasing attention globally amid rising public debt levels, elevated borrowing costs and growing fiscal pressures. A key concern is whether fiscal financing requirements could influence the conduct of monetary policy and constrain the ability of central banks to achieve their primary policy objectives. This phenomenon, commonly referred to as fiscal dominance, arises when fiscal considerations exert a significant influence on central bank's policy decisions, particularly monetary policy. As discussed in the October 2026 Monetary Policy Report, an assessment was undertaken to determine whether fiscal dominance is evident in Botswana and this box summarises the main findings and relevance for sovereign risk and broader financial stability.

Understanding Fiscal Dominance

Fiscal dominance refers to a situation in which fiscal policy effectively constrains monetary policy. Under such circumstances, the central bank may be unable to adjust monetary policy in a manner consistent with achieving its inflation objective because of concerns relating to government financing costs, debt sustainability or broader fiscal outcomes. Consequently, monetary policy becomes subordinate to fiscal requirements rather than being guided primarily by macroeconomic stability considerations. In contrast, monetary dominance exists when fiscal policy is conducted in a manner that supports debt sustainability, thereby allowing the central bank to pursue price stability without constraint.

More broadly, fiscal dominance can pose financial stability risks if persistent fiscal pressures constrain monetary policy and weaken macroeconomic policy credibility. Such conditions could contribute to higher inflation, increased interest rate volatility, rising sovereign borrowing costs and a deterioration in investor confidence. These developments could adversely affect the balance sheets of banks, pension funds and insurance companies through valuation losses on sovereign securities, tighter funding conditions and weaker asset quality, thereby amplifying vulnerabilities within the financial system.

Assessment of Fiscal Dominance in Botswana

As outlined in the October 2026 Monetary Policy Report, the assessment considered several indicators relating to monetary policy independence, government financing arrangements, inflation dynamics and fiscal sustainability. Collectively, these indicators provide a basis for evaluating whether fiscal developments are constraining the conduct of monetary policy.

The assessment concluded that fiscal dominance is not currently evident in Botswana. Monetary policy decisions continue to be guided by the Bank's price stability objective and remain responsive to prevailing and anticipated inflationary developments. Furthermore, government financing continues to be undertaken primarily through domestic and external market-based borrowing rather than direct monetary financing. Moreover, statutory limits governing central bank lending to Government provide an important institutional safeguard against excessive fiscal reliance on central bank resources, while inflation expectations remain broadly anchored, suggesting continued confidence in the monetary policy framework. Nevertheless, several developments warrant continued monitoring. Public debt has increased in recent years, reflecting persistent fiscal deficits and elevated financing requirements. At the same time, increased reliance on domestic borrowing has contributed to a growing stock of government securities held by domestic financial institutions. While these developments have supported fiscal financing needs and contributed to the development of domestic capital markets, they also highlight the importance of maintaining a sustainable fiscal position over the medium term.

Implications for Financial Stability

The findings of the fiscal dominance assessment have important implications for the evaluation of sovereign-related financial stability risks. The absence of fiscal dominance suggests that monetary policy credibility remains intact and reduces the likelihood that fiscal pressures could undermine macroeconomic stability through inflationary financing or policy distortions. This supports confidence in the broader macro-financial environment and contributes positively to financial system resilience.

Although fiscal dominance is not currently evident, rising public debt and increasing domestic financing requirements have strengthened interconnections between the sovereign and the financial sector through growing holdings of government securities by banks, pension funds and insurance companies. Consequently, fiscal sustainability remains an important consideration in the assessment of sovereign risk, particularly given the potential for adverse fiscal developments to affect financial institutions through valuation, concentration and funding channels.

Conclusion

The October 2026 Monetary Policy Report concludes that fiscal dominance is not currently evident in Botswana. Monetary policy remains focused on achieving price stability, while government financing continues to be undertaken largely through market-based mechanisms. From a financial stability perspective, these findings support the assessment that sovereign-related systemic risks remain contained. Nevertheless, rising public debt, increasing financing requirements and strengthening sovereign-financial sector linkages underscore the importance of maintaining fiscal sustainability and preserving confidence in the macroeconomic policy framework.

6. CREDIT AND LEVERAGE RISKS

Commercial Bank Credit

Annual commercial bank credit growth hits decade low

6.1 Commercial bank credit growth hit a decade low in August 2026 with an annual and month-on-month negative growth of 2.3 percent and 0.4 percent, respectively (Chart 6.1a). The deceleration in credit growth partly owes to the prudent measures deployed by commercial banks to maintain credit quality amid economic uncertainty. On product basis, the lower uptake of overdraft and revolving credit facilities by businesses, as well as minimal acquisition of personal and motor vehicle loans by households drove overall credit developments. Meanwhile, credit quality slightly worsened, with an NPLs ratio of 3.7 percent in June 2026 compared to 3.1 percent in June 2025 (Chart 6.1d).

6.2 Consistently, the credit-to-GDP gap suggests that credit developments currently pose limited risks to financial stability. The gap, which has widened further from -0.9 percent in the second quarter of 2025 to -4.5 percent in the second quarter of 2026, indicates the absence of rapid and excessive credit growth that could cause a credit bubble, but rather suggestive of room for prudent credit extension to sustain economic activity (Chart 6.1b).

Banking Sector Loans

Commercial bank credit trends downwards

Chart 6.1a: Total Credit Growth

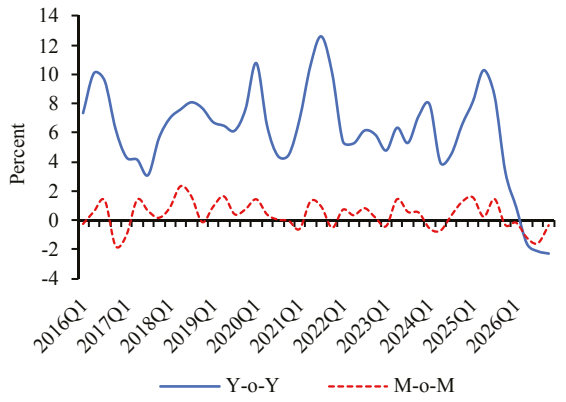


Chart 6.1b: Credit-to-GDP Gaps

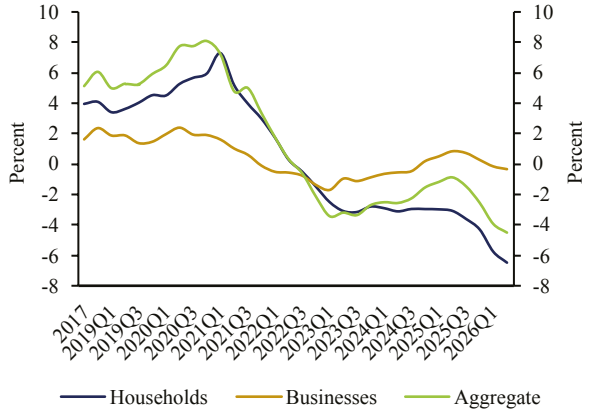


Chart 6.1c: Sectoral Loans to Total Loans

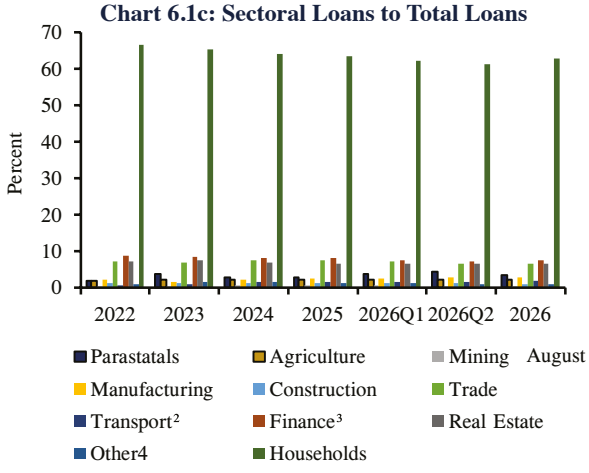
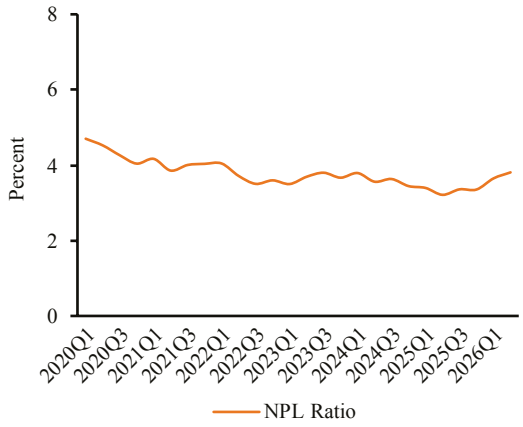


Chart 6.1d: NPL Ratio



Source: Bank of Botswana

Household Borrowing

Subdued household credit growth

6.3 Against the backdrop of subdued economic activity and tighter lending conditions, household credit growth has trended downwards since 2022, reaching a low of -4.3 percent in August 2026, compared with 6.8 percent in August 2025 and highs of around 30 percent before the COVID-19 pandemic. Despite this contraction, household credit continued to dominate total credit at 62.9 percent, compared with 36.3 percent for business credit (Chart 6.1c), while relatively expensive unsecured loans accounted for 69.2 percent of household lending (Chart 6.2d). The Household Indebtedness Survey Report 2025/26 (Box 6.1) provides further insight into underlying borrower vulnerabilities, with average debt-to-income ratios of 50.8 percent for males and 50.7 percent for females, alongside an elevated banking sector debt-service-to-income ratio of 63 percent. Furthermore, government employees accounted for 74 percent of household bank lending, highlighting the potential transmission of fiscal and employment-related income shocks to household debt-servicing capacity. The Survey also reported an average bank default rate of 4.7 percent in 2025, and an increase in the banking sector NPL ratio from 3.2 percent June 2025 to 3.8 percent in June 2026. Household NPLs have also trended upwards from 1.9 percent in June 2025 to 2.2 percent in June 2026 (Chart 6.2c) and continue to be mitigated by deductions from source scheme arrangements for public sector employees. While subdued credit growth limits the immediate accumulation of excessive household leverage, persistent income pressures, elevated debt-servicing obligations and the concentration of unsecured lending could increase repayment difficulties, weaken bank asset quality and reinforce cautious lending behaviour, further constraining credit availability and economic activity.

Household Debt Analysis

Personal loans (other) are the major driver of household credit growth

Chart 6.2a: Growth in Household Debt

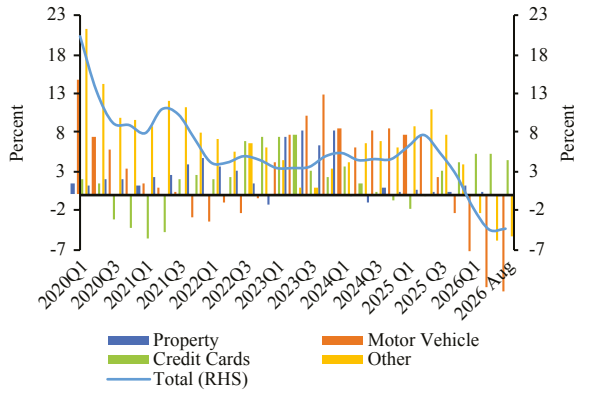
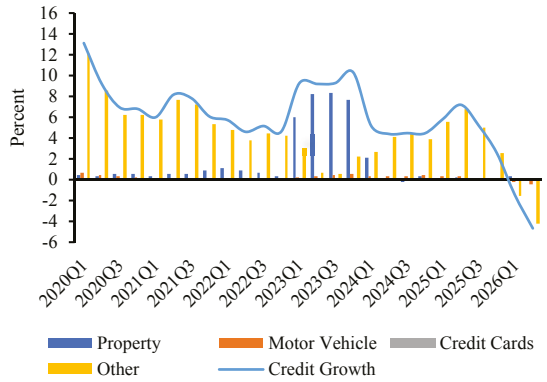
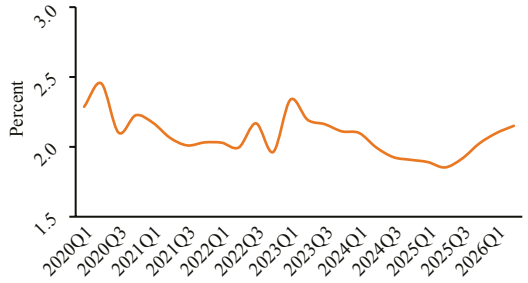


Chart 6.2b: Contribution to Credit Growth



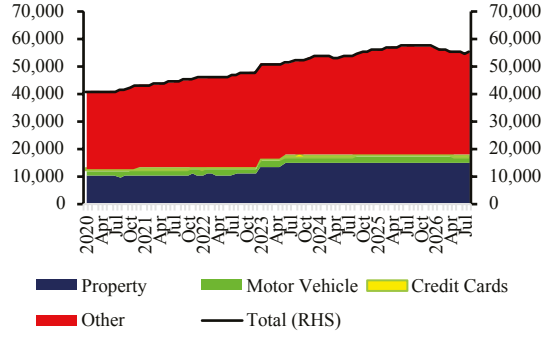
Household default rates on the rise

Chart 6.2c: Household NPL Ratio



Personal loans dominate household debt

Chart 6.2d: Composition of Household Credit (P Million)



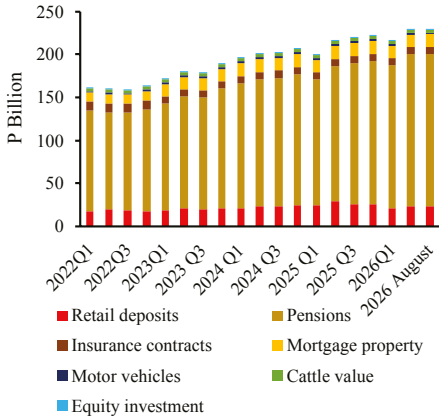
Source: Bank of Botswana

6.4 That notwithstanding, households are net savers when considering their non-discretionary contractual long-term pension savings and other assets (Chart 6.3a). Pension assets are important for mortgage debt relief under the Retirement Funds Act of 2022 but also improve the long-term financial welfare of households and in general, underpinning wealth creation and financial security for retirees. Chart 6.3b indicates a positive net worth of households, which suggests a healthy financial standing. The estimated net worth of households as a percentage of GDP was 60.8 percent in the second quarter of 2026, an improvement from 58.5 percent recorded in the corresponding period in 2025.

Household Net Worth Estimation

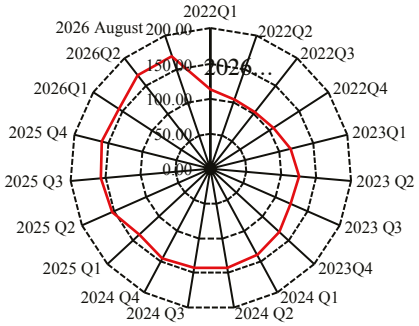
Pension savings dominate household assets

Chart 6.3a: Distribution of Household Assets



Households' net worth is increasing

Chart 6.3b: Total Household Net Worth (P Billion)



Source: Bank of Botswana, Botswana Stock Exchange Limited and Statistics Botswana

BOX 6.1: HOUSEHOLD INDEBTEDNESS SURVEY REPORT 2025/26

The Bank's Household Indebtedness Survey Report 2025/26 provides insights into household borrowing patterns, debt-servicing capacity and associated financial stability vulnerabilities. Household debt increased moderately by 2.5 percent to P70.3 billion in December 2025, from P68.6 billion in December 2024, while the household debt-to-GDP ratio increased slightly from 26 percent to 26.1 percent. Banks remained the dominant source of household credit, accounting for 88 percent of total lending, followed by micro-lenders (11 percent) and hire-purchase providers (1 percent). The moderate expansion in household credit, together with a negative credit-to-GDP gap, suggests that risks associated with excessive credit growth remain contained.

Household borrowing was concentrated among middle-aged and formally employed individuals, particularly government employees, who account for 74 percent and 79 percent of lending by banks and micro-lenders, respectively. This concentration partly reflects stable public-sector incomes and the prevalence of scheme loans supported by deduction from source arrangements, which strengthen repayment discipline and mitigate credit risk. Nevertheless, the dependence on public sector employment creates a potential transmission channel between fiscal developments and household credit performance. Prolonged fiscal pressures, arising partly from subdued diamond revenues, could constrain economic activity, employment prospects and household incomes, with adverse implications for debt-servicing capacity and financial institutions' asset quality.

The Survey also reveals notable borrower-level vulnerabilities. Average debt-to-income (DTI) ratios stood at 50.8 percent for male borrowers and 50.7 percent for female borrowers, with individuals aged 40-49 years recording the highest ratio at 52.7 percent. Meanwhile, the banking sector debt-service-to-income (DSTI) ratio stood at 63 percent, indicating substantial repayment obligations relative to income. These debt burdens could limit households' financial flexibility and capacity to absorb adverse income and macroeconomic shocks. Such vulnerabilities are compounded by the predominance of unsecured lending, which accounted for 68.3 percent of household bank credit by value, and relatively high borrowing costs. The average default rate reported by banks increased from 2 percent in 2024 to 4.7 percent in 2025, although the NPL ratio remained broadly stable at 3.3 percent, suggesting that emerging repayment difficulties have not yet translated into a material deterioration in reported asset quality.

Mortgage-related vulnerabilities also warrant attention, particularly in Gaborone and surrounding areas, where the average loan-to-value (LTV) ratio reached 93.7 percent, compared with the national average of 81.9 percent. Higher leverage exposes borrowers and lenders to potential losses from adverse movements in property values and household incomes. Nevertheless, the broader household sector retains financial buffers, with estimated aggregate household net worth equivalent to 59.6 percent of GDP at the end of 2025, supported partly by pension savings and other assets. However, the concentration and illiquidity of the assets that constitute households' wealth may limit their effectiveness in mitigating immediate debt-servicing pressures.

Overall, household indebtedness does not currently pose significant systemic risks, although elevated debt-servicing burdens, credit concentration and emerging repayment difficulties warrant continued vigilance. Prolonged weakness in household incomes could increase defaults and impair bank asset quality, potentially prompting tighter lending conditions and further constraining consumption and economic activity. Accordingly, macroprudential surveillance should continue to assess DTI, DSTI and LTV distributions, credit quality and borrower concentration, complemented by stress testing of household income, employment and property market shocks to identify emerging vulnerabilities and inform timely policy responses.

Non-Financial Corporates Credit

Corporate sector borrowing constrained

6.5 Corporate loan demand remained strong at the onset of 2026 but subdued as financial conditions tightened and banks took a more prudent lending approach. Corporate credit growth slowed to 1 percent in August 2026, from 11.5 percent in the corresponding period in 2025, owing to the cost containment measures taken by government to reduce issuance of purchase orders.

6.6 Proportionally, corporate loans to total commercial bank credit rose marginally from 33 percent to 34.2 percent between August 2025 and August 2026. Relative to GDP, bank credit to the corporate sector was 11 percent in June 2026 from 11.6 percent in June 2025 and remains low by regional standards. Notwithstanding, Chart 6.1c shows corporate sector credit dynamics as disconnected from real economic activity, highlighting vulnerabilities that have the potential to propagate through concentration and leverage rather than broad-based credit expansion. Mining and construction activities are highly volatile thus attract little credit, so shocks in these sectors transmit mainly through external channels, such as commodity prices and foreign direct investment, leading to fiscal stress and liquidity squeeze. In contrast, trade and real estate sectors dominate the corporate loan book, exposing banks to domestic demand shocks. Tighter capital requirements for infrastructure exposures, enhanced liquidity monitoring, limits on concentrated lending, forward-looking provisioning, and the gradual integration of countercyclical buffers supported by improved data infrastructure are all necessary in mitigating any potential vulnerabilities.

Property Market Credit

Secured lending to households weakens

6.7 Household demand for mortgage and residential property facilities was low owing to higher pricing costs and reduced affordability as spreads widened in line with price adjustments commensurate with rising funding and liquidity constraints in the market. Additionally, appetite for secured lending by banks weakened in response to repayment risk from government schemes as government continues to grapple with fiscal constraints.

6.8 Residential real estate loans remained relatively unchanged at P15.5 billion between August 2025 and 2026, constituting 26.1 percent and 16.7 percent of total household credit and total credit, respectively (Chart 6.4a). These proportions are very low compared to Namibia, where mortgages constituted 65.1[2] percent of total household loans, which suggests that the level of domestic property finance is not commensurate with the needed development and growth path to fill the apparent need for housing, as well as the financing gap. At the same time, growth in incomes could be restrained relative to the increase in residential house prices over the years – possibly reflecting limited housing stock in various categories, scarce availability of land or affordability of building materials.

Credit risk from mortgage lending on the rise but contained

6.9 Credit risk in the mortgage sub-sector remains broadly contained, supported by commercial banks maintaining moderate loan-to-value (LTV) ratios, as well as the self-collateralised nature of real estate exposures. In 2025, mortgage lending remained concentrated in low LTV segments, which translated into safer lending practices and minimised potential losses by banks in the event of borrower default (Chart 6.5). Meanwhile, the proportion of impaired mortgage loans to total mortgage loans increased from 5.6 percent in June 2025 to 6.2 percent in June 2026, reflecting, in part, financial pressures arising from the subdued macroeconomic environment.

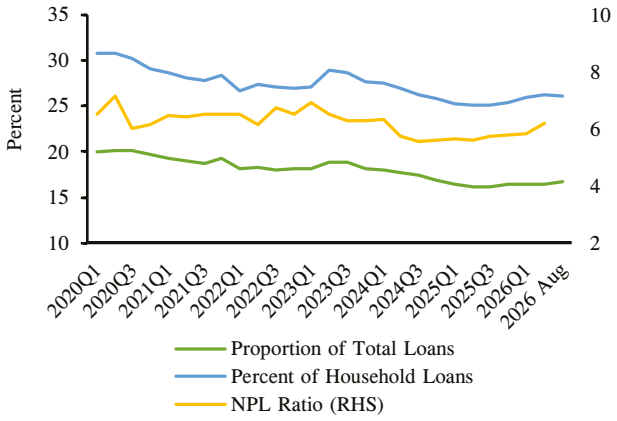
6.10 While these developments are not indicative of systemic stress, the emergence of marginal deterioration in asset quality underscores the need for heightened macroprudential vigilance to mitigate incipient risk build-up. In this context, consideration may be given to the introduction of indicative LTV benchmarks or enhanced supervisory oversight of higher LTV exposures, as part of a forward-looking and proportionate policy approach aimed at preserving the resilience of the mortgage sub-sector amid a weak economic environment.

2. Bank of Namibia Financial Stability Report, April 2026

Property Market Developments

Mortgages as a percentage of both total loans and household loans are stable while NPLs on the rise

Chart 6.4a: Mortgage Loans



The proportion of Commercial Real Estate (CRE) loans to total loans is stable and the NPL ratio is modest

Chart 6.4b: Commercial Real Estate Loans

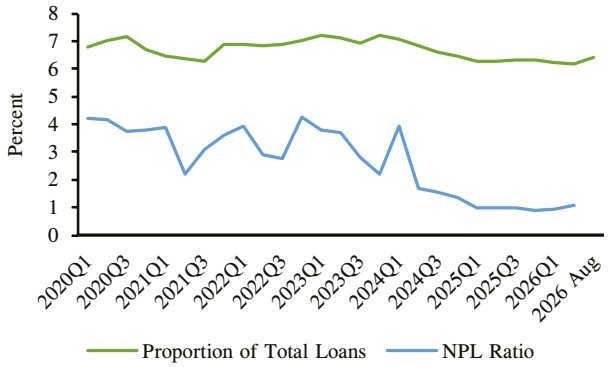
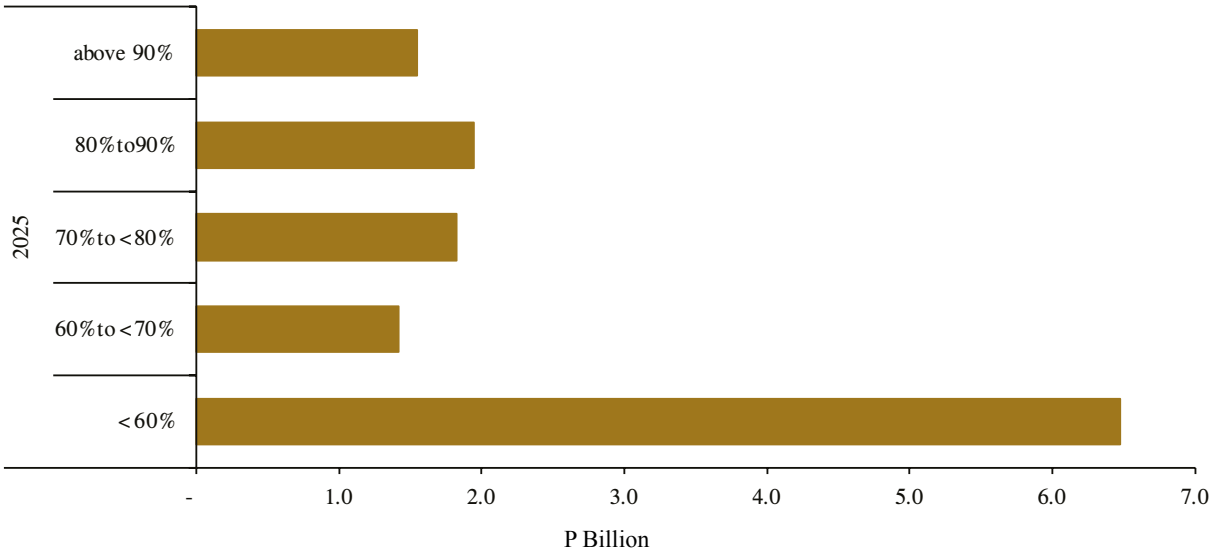


Chart 6.5: Distribution of Mortgages by LTV



Source: Bank of Botswana

7. LIQUIDITY AND FUNDING RISK

Banking Sector Liquidity and Funding

Market liquidity improving but uneven

7.1 Average market liquidity improved markedly during the year to September 2026, rising from P3.4 billion in the third quarter of 2025 to P10.8 billion in the third quarter of 2026, primarily driven by net government spending, diamond receipts, SACU inflows, loan receipts and the Bank's dividend payment to Government. The implementation of the Pension Fund Rule 2 (PFR2) also supported domestic liquidity, with NBFIRA estimating that commercial bank excess liquidity averaged P2.2 billion above levels expected without the reform (Box 7.1). Improved liquidity conditions exerted downward pressure on wholesale deposit rates, easing funding costs. However, credit extension remained subdued amid weak economic activity, heightened credit risk perceptions and cautious lending practices. Liquidity also remained unevenly distributed across banks, while concentrated institutional deposits could expose some banks to funding volatility. Meanwhile, banks maintained wider lending margins above Prime Lending Rates (PLRs), reflecting prevailing credit risks and funding considerations. Consequently, improved liquidity has not fully translated into lower effective borrowing costs or stronger credit growth, highlighting persistent weaknesses in monetary policy transmission. However, the lifting of the moratorium on adjustments of the commercial bank's Prime Lending Rate (PLR) by the Monetary Policy Committee on 29 October 2026 restores banks' flexibility to adjust lending rates in response to prevailing market conditions. Easing liquidity and funding conditions could support lower lending rates, while an improvement in economic activity and borrower creditworthiness could further reduce credit risk premia and strengthen credit intermediation.

Deposit concentration exposes banks to funding risks

7.2 The banking sector remains vulnerable to funding risk arising from a concentrated deposit base as reflected in the top 20 deposits[3] to total deposits ratio of 40.1 percent in July 2026 from 35.4 percent in July 2025. This increase underscores heightened vulnerability to sudden withdrawal pressures and the potential for increased funding costs, given the inherently volatile and expensive nature of wholesale deposits. Looking ahead, to further mitigate potential financial stability risks while enhancing policy transmission, commercial banks with elevated deposit concentration may be required to hold additional capital. This would align incentives with risk management culture in line with the regulatory capital standards under Basel III.

7.3 That notwithstanding, the banking industry continues to ably conduct its credit allocation responsibilities, with a credit intermediation, with an intermediation ratio[4] of 74.3 percent in July 2026 (2025:81.2 percent). This level of intermediation is within the 50 – 80 percent range and supportive of economic growth.

Interbank Funding

Non-D-SIBs dominate the interbank market

7.4 Consistent with the increase in liquidity, the interbank market recorded a sustained decline in trading levels during the twelve months to June 2026. Daily interbank averages decreased from P555 million in the second quarter of 2025 to P267 million in the second quarter of 2026. However, market structure remained unchanged as Non-Domestic Systematically Important Banks (Non-D-SIBs) continued to dominate the interbank market, accounting for 59 percent of total interbank borrowing and 98 percent of interbank lending.

3. Banks are statutorily required to report their 20 largest depositors as a monitoring tool to track vulnerabilities from wholesale funds.

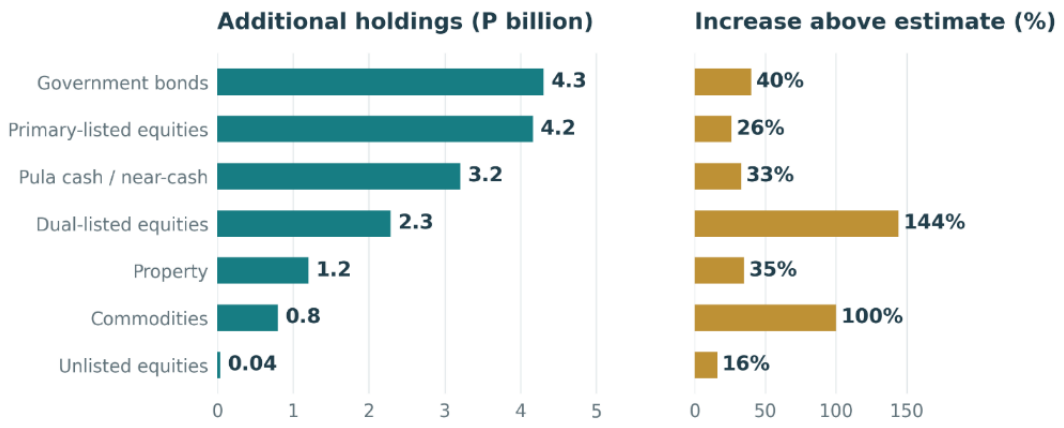
4. Measured as a ratio of loans to deposits, the financial intermediation ratio measures the extent to which funds (excess) are made available to those who need them.

BOX 7.1: PENSION FUND RULE 2 - DOMESTIC INVESTMENT AND FINANCIAL STABILITY

Pension Fund Rule 2 (PFR2), introduced in June 2023, seeks to increase pension savings invested domestically. Its financial stability significance has grown as the diamond-market downturn has weakened government revenue and domestic financing conditions. Because pension funds supply long-term capital to government, banks and markets, their reallocation can cushion funding pressures but also change how shocks spread through the financial system. The NBFIRA examined these effects by comparing observed pension fund investments with estimates of how assets might have evolved had previous investment patterns continued. By April 2026, total investments reached P150.91 billion, about P23.7 billion (18.9 percent) above the estimated level without the reform. Domestic holdings were P17.0 billion higher, alongside P6.9 billion more in offshore investments. Thus, the shift towards domestic assets occurred alongside continued growth in retirement savings, although the estimates cannot establish that PFR2 alone caused the increase.

Against this backdrop, the additional domestic investment appears to have supported financial stability. NBFIRA estimates that commercial bank excess liquidity averaged P2.2 billion (38 percent) above the level otherwise expected, while pension fund holdings of government bonds were P4.3 billion (40 percent) higher. As diamond revenues weakened, stronger demand for public debt may have eased government financing pressures, while additional banking liquidity strengthened funding buffers. These channels may have limited the immediate spillover of external pressures into the financial system, even though weak credit demand and borrowers' repayment capacity continued to constrain lending. These benefits, however, have strengthened financial institutions' exposure to fiscal conditions. Should government borrowing pressures push up bond yields, the value of securities held by pension funds and banks could fall. Portfolio rebalancing in Botswana's relatively shallow markets might then intensify price declines and raise sovereign borrowing costs further. In this way, a fiscal shock could weaken institutional balance sheets and subsequently tighten bank funding and private sector credit, reinforcing pressure on economic activity.

Figure B7.1: Estimated changes in pension-fund holdings following PFR2



The pattern of investment helps explain this vulnerability. Estimated additional holdings were concentrated in government bonds (P4.3 billion), primary listed equities (P4.16 billion), Pula cash and near-cash instruments (P3.2 billion) and dual listed equities (P2.28 billion), while unlisted equities increased by only P0.04 billion (Figure B7.1). Although established instruments accommodated additional domestic capital, limited investment in unlisted assets suggests that higher onshore allocations have not translated into comparable financing for businesses and infrastructure. Moreover, dual-listed securities may preserve international exposure rather than directly increase domestic production.

This concentration in readily available assets also links market and funding risks. If pension funds adjust similar portfolios simultaneously, selling pressure could amplify price volatility; meanwhile, shifting large institutional cash balances from bank deposits into securities could strain liquidity at individual banks. Where these movements coincide with sovereign bond repricing, funding pressures may further restrict credit. Limited investment in productive assets also reduces the capacity of pension savings to support economic diversification and resilience to future diamond-related shocks.

Accordingly, the priority is to safeguard PFR2's liquidity and financing gains while containing common exposures. Surveillance should jointly assess sovereign holdings across banks and pension funds, institutional deposit concentrations and market capacity to absorb portfolio changes. Stress tests combining bond repricing with large deposit withdrawals would clarify potential spillovers into credit supply. Over time, concerted efforts should be made to convert regulatory compliance into measurable economic transformation and preserve the long-term financial stability of pensioners. Deeper capital markets and a broader pipeline of viable domestic investments would improve diversification and support productive activity, provided pension funds remain guided by prudent risk management and their obligations to protect members' savings.

Source: NBFIRA

Foreign Currency Funding

US dollar vulnerabilities remain limited

7.5 Domestic commercial banks' exposure to foreign exchange risk is limited and poses minimal threat to financial stability, as reflected in both the net foreign exchange position and the US dollar net open position. Despite an increment in the absolute overall net open position of banks from P258 million in June 2025 to P322 million in June 2026, the position represented just 2 percent of unimpaired capital and remained significantly below the prudential limit of 30 percent (Chart 7.1a). At the same time, the Pula equivalent absolute net exposure of the domestic banking system to the US dollar increased from P445 million in June 2025 to P610 million in June 2026, translating into 3 percent of the industry's unimpaired capital and therefore indicating limited risks from US dollar vulnerabilities.

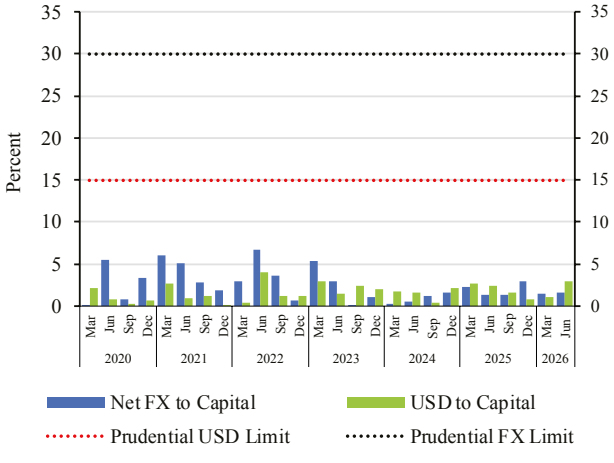
Exchange rate volatility is falling

7.6 In the year to September 2026, the nominal Pula exchange rate depreciated by 5.8 percent against the South African Rand but appreciated by 0.4 percent against the Special Drawing Rights (SDR). The appreciation was driven by strong performance against the Japanese Yen, Euro and Pound which rose by 5.0 percent, 2.7 percent and 0.8 percent respectively. Conversely, the Pula depreciated against the Chinese Renminbi and US Dollar by 6.2 percent and 0.1 percent respectively. Volatility of the Pula against the Rand continued to subside (Figure 7.1b), indicating growing exchange rate stability and consequent stabilisation of import and export pricing expectations, thereby reinforcing domestic financial system resilience.

Foreign Currency Funding and Exposure

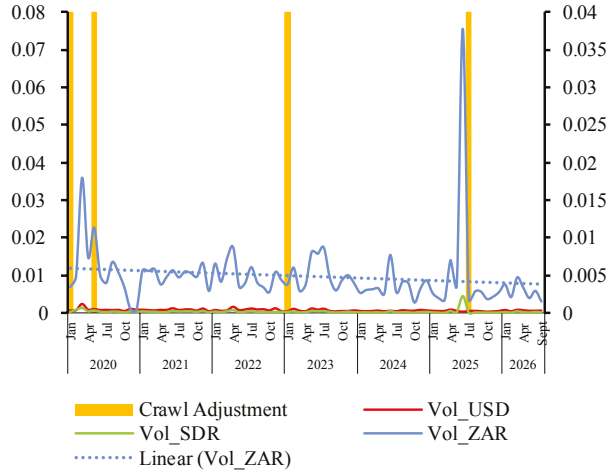
Banks FX exposure is well below the prudential limits

Chart 7.1a: Banks FX Exposure



Exchange rate volatility is decreasing but remains elevated

Chart 7.1b: FX Volatility



Source: Bank of Botswana

Capital Markets – Equity Funding

The capital market remains resilient

7.7 Botswana's equity market remained resilient during the review period, supported by favourable company performance, sustained institutional investor participation and continued market development. Domestic equity market capitalisation increased to P60.98 billion in September 2026 from P57.51 billion a year earlier (Chart 7.2a), while the Domestic Company Index (DCI) maintained its upward trajectory (Chart 7.2d). Total equity market capitalisation also surpassed P1 trillion for the first time, although the increase was predominantly driven by valuation gains in foreign listed counters, reflected in the strong performance of the Foreign Company Index (FCI) (Chart 7.2e). The increase in total market capitalisation therefore reflects strong overall market valuations, while growth in the domestic segment remained comparatively more moderate.

7.8 Equity trading activity also remained relatively strong, with turnover reaching P2.10 billion in the nine months to September 2026 (Chart 7.2b), exceeding the full year levels recorded in 2021, 2022 and 2024. However, turnover has been uneven over time and influenced by large institutional transactions. In particular, the record P5.91 billion turnover in 2025 was largely driven by pension fund asset manager transition trades, which accounted for about P4.4 billion. This suggests that stronger aggregate turnover should not necessarily be interpreted as a broad-based improvement in underlying market depth. Nonetheless, trading activity in 2026 points to continued participation in the secondary market, while favourable liquidity conditions supported price discovery and orderly execution of transactions (Chart 7.2c)

Institutional flows continue to support market activity, but have increased investor concentration

7.9 The phased increase in domestic investment requirements for pension funds has materially changed the composition of market participation. Local institutional investors accounted for 92.6 percent of equity turnover during the first nine months of 2026, compared with 77.2 percent in 2024 and 44 percent in 2023. The resulting increase in domestic institutional demand supports capital formation and provides a relatively stable source of investment for the market. However, the growing dominance of a relatively narrow institutional investor base also increases the potential for common investment strategies or simultaneous portfolio adjustments to have a greater effect on market liquidity and valuations. Trading activity was similarly concentrated across a limited number of sectors, with Retail and Wholesaling, Banking, Financial Services and Insurance, and Property accounting for over 90 percent of equity turnover during the first nine months of 2026.

Shifting ownership prospects in the banking sector create new investment opportunities

7.10 Standard Chartered Bank Botswana (Stanchart) continues to trade under caution given its notice to sell its wealth and retail banking business in Botswana in November 2024. To that effect, the Bank issued cautionary trading statements in January and October 2026, wherein its Board informed the shareholders of Standard Chartered PLC's, majority shareholder, interest to explore the sale of its entire interest in the company. That has however, not affected the banks operations as it continues to do business in line with its prevailing banking license conditions, including adherence to domestic prudential and regulatory requirements. Accordingly, Stanchart remains a going concern and continues to meet the capital and liquidity standards while being profitable. At the same time, the proposed initial public offering of Stanbic Bank Botswana, floating 20 percent ordinary shares in the local bourse, provides investment opportunities for the public, retail and institutional investors, in turn, deepening the capital markets for effective price discovery and capital formation. To raise P1.37 billion, Stanbic Africa Holdings Limited will offer up to 319 362 050 shares. The bank is anticipated to list on 7 December 2026 subject to meeting all listing and regulatory requirements.

Product diversification is expanding investment opportunities and market resilience

7.11 Continued product innovation and market development initiatives are helping to broaden investment opportunities and improve the capacity of the domestic capital market to intermediate long-term savings. Exchange-traded fund (ETF) turnover increased to P1.62 billion during the first nine months of 2026, almost three times the full-year level

recorded in 2025 and equivalent to about 77 percent of ordinary equity-market turnover. The introduction of internationally focused feeder ETFs has also expanded access to diversified global exposures through locally traded instruments, while new listings and cross-border initiatives provide additional opportunities to broaden the issuer and investor base. These developments can reduce concentration in traditional domestic assets and support deeper capital markets, although the growing importance of new products and cross border exposures requires continued monitoring of associated valuation, liquidity and market risks. Overall, equity market risks remain contained, but continued broadening of the range of actively traded securities and investors would strengthen the market's capacity to absorb growing institutional investment without generating excessive concentration or price pressures.

Elevated volatility warrants continued monitoring

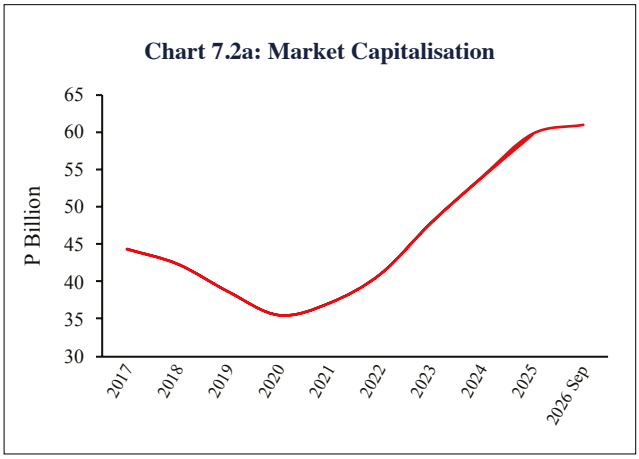
7.12 Equity market volatility increased during the review period and remained elevated relative to historical levels for both domestic and foreign listed securities (Chart 7.2f), with larger fluctuations observed among foreign counters. While this has not disrupted orderly market functioning, elevated volatility increases the potential for abrupt valuation changes and associated portfolio losses. In combination with concentrated institutional participation and uneven liquidity across securities, sharp market movements could prompt portfolio adjustments that reinforce price changes and temporarily weaken market liquidity. Volatility therefore remains an important amplifier of existing market vulnerabilities rather than an indication of underlying market instability.

Market outlook remains favourable

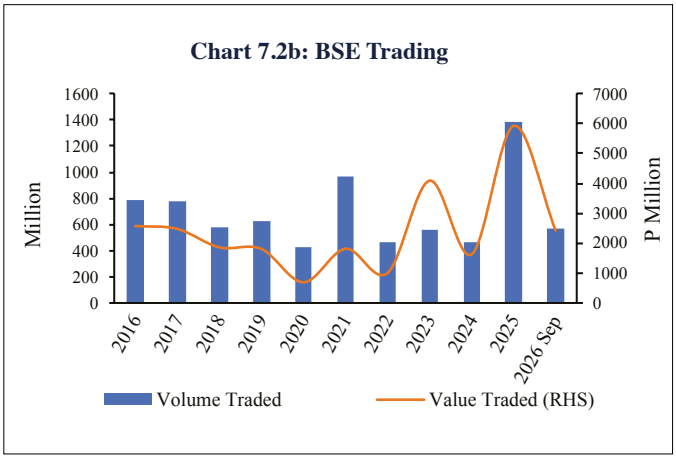
7.13 Overall, risks in the equity market remain contained, supported by positive market performance, sustained institutional demand, generally orderly trading conditions and continued product and market development. Looking ahead, the phased increase in pension fund domestic investment requirements, new listings and expansion of exchange-traded and cross-border products are expected to support market activity and deepen domestic capital markets. However, the increasing volume of institutional funds directed towards a relatively small domestic market could intensify existing concentration and liquidity pressures if the supply of investable assets does not expand correspondingly. In addition, elevated market volatility and greater exposure to global assets could increase the sensitivity of institutional portfolios to external market corrections. The outlook therefore remains broadly positive, but continued expansion of the issuer and investor base, deeper secondary market liquidity and a wider range of investable securities will be important for ensuring that growing institutional participation strengthens, rather than concentrates, financial-system risk.

Stock Market Developments

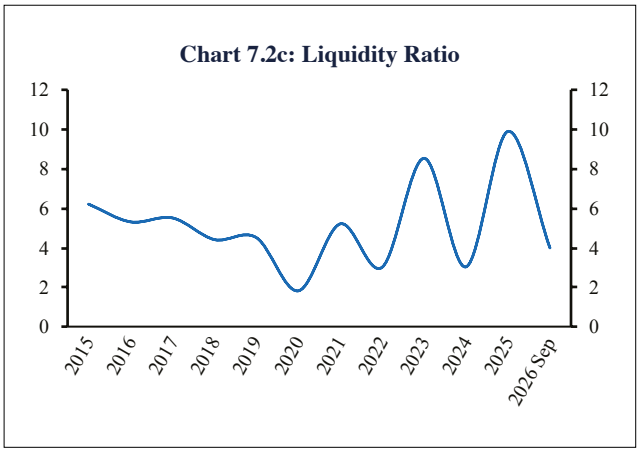
Stock market capitalisation is increasing



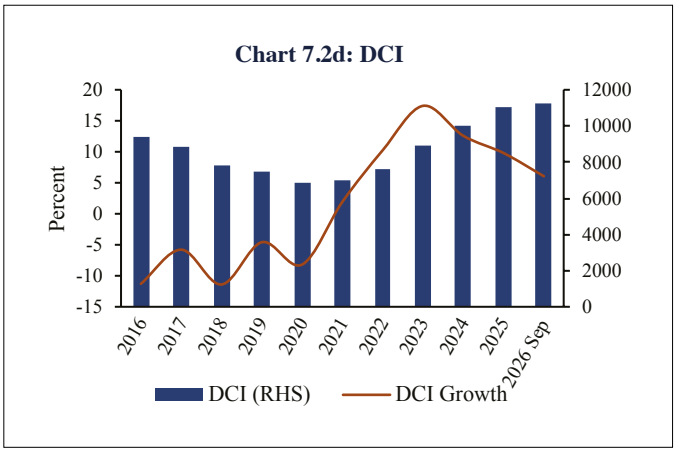
BSE trade by value and volume is increasing



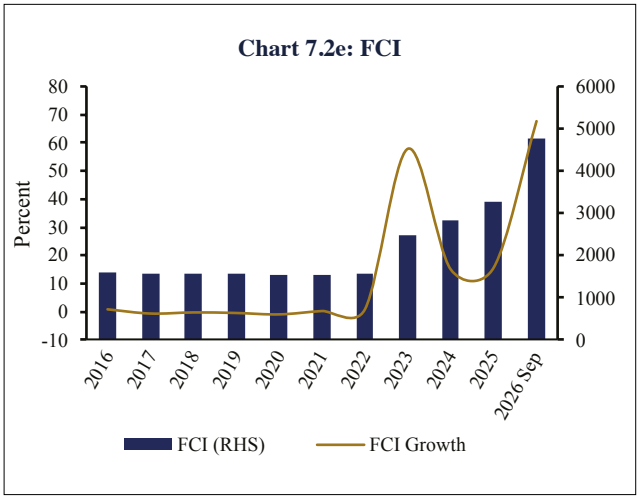
Liquidity in the BSE is increasing



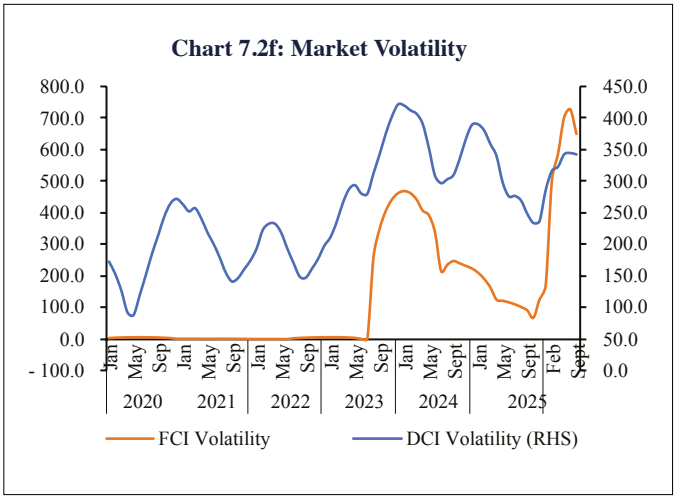
The DCI is improving



The Foreign Company Index is improving



Stock market volatility increasing



Source: Botswana Stock Exchange

Capital Markets – Bond Market Funding

Government bonds drive market capitalisation

7.14 Bond market capitalisation grew by 14.9 percent to P45.4 billion in the twelve months to September 2026, from P39.5 billion in September 2025. This was driven by the Government Note Issuance Programme, new government bonds and additional tranches of existing ones, which continues to serve as a key source of funding in the prevailing fiscal environment (Chart 7.3a). Strong investor appetite reflected in full allocations at robust bid-to-offer ratios, contributed to a decline in yields across the curve, supportive of improving funding conditions for government and confidence in government fiscal consolidation measures. The nominal value of government bonds increased by 17.3 percent from P34.0 billion to P39.9 billion, while the nominal value of corporate bonds remained largely unchanged at P5.5 billion, as new corporate listings offset maturing bonds during the period.

7.15 Government bonds accounted for 87.8 percent of the nominal value of the domestic bond market in September 2026, underscoring the continued dominance of government borrowing requirements and the government's commitment to developing the domestic capital market. The successful introduction of the 25-year benchmark bond has further strengthened the long end of the curve, enhanced market depth and supported domestic bond market development. In addition, liability management operations through switch auctions have been conducted successfully, extending the maturity profile of government securities while providing investors with opportunities to rebalance portfolios. Despite their importance, the sustained dominance of government securities has the potential to crowd out capital funding for the private sector and deepen the sovereign-financial sector linkage. As the domestic capital market continues to mature, a more balanced composition between government and corporate issuances will be important to support broader market development, diversification and private sector participation.

Bonds yield spread widening

7.16 The spread between average yields on corporate and Government bonds narrowed from -3.01 percentage points in September 2025 to -0.96 percentage points in September 2026 (Chart 7.3e), but remained negative, indicating that average Government bond yields continued to exceed corporate bond yields. Given the structure of the domestic bond market, the negative spread should not necessarily be interpreted as indicating lower perceived credit risk for corporate issuers. Government bond yields declined during the review period as financial conditions improved and fiscal adjustment measures helped moderate near-term financing pressures; however, yields continued to incorporate risk premia associated with subdued mineral revenues, higher Government financing requirements and the deterioration in the sovereign credit outlook. Corporate bond yields, by contrast, increased, resulting in a narrower negative spread. The rise in corporate yields may reflect higher required compensation for corporate credit risk and more cautious investor risk appetite; however, the spread should be interpreted with caution as it compares average yields rather than maturity-matched securities, while relatively low trading activity in the corporate bond market may also affect observed yields (Chart 7.3b).

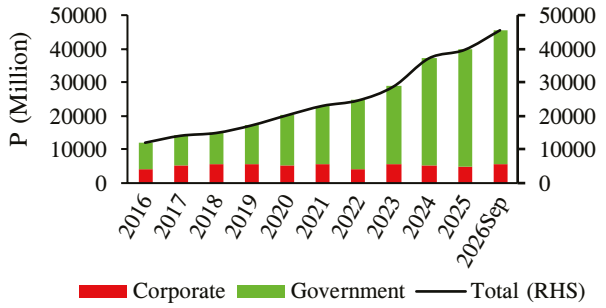
Bond market volatility is high

7.17 Volatility in the bond market eased during 2025 and remained relatively contained in 2026 compared to the elevated levels recorded in 2024 (Chart 7.3f), suggesting an improvement in overall funding conditions. Nevertheless, corporate bond volatility remains higher than that of the government bond index and composite bond index, indicating that funding conditions in the corporate bond market remain susceptible to tightening amid an uncertain macroeconomic environment and weakening corporate fundamentals. However, the generally accommodative domestic financial conditions, as judged from the real monetary conditions index (RMCI) and the positive returns generated by the bond indices (Chart 7.3d), continue to support funding opportunities in money markets that could augment any shortfall in capital market funding.

Bond Market Developments

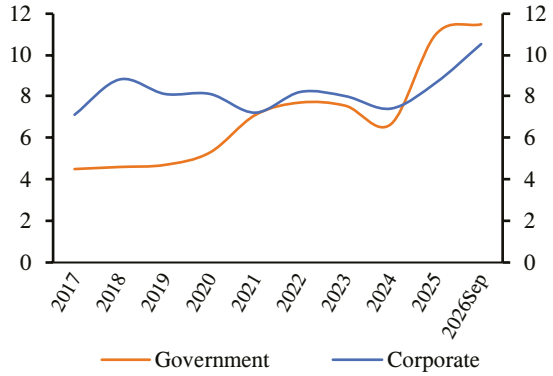
Government bonds dominate the bonds market

Chart 7.3a: Bonds Nominal Values (P Million)



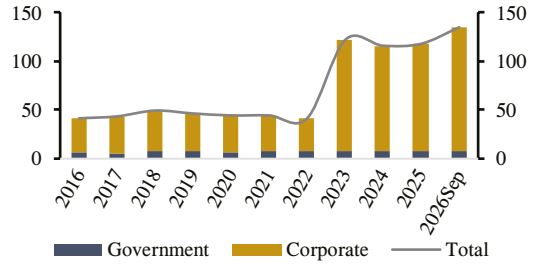
Bonds yields are rising, indicating higher uncertainty

Chart 7.3b: Bond Yields



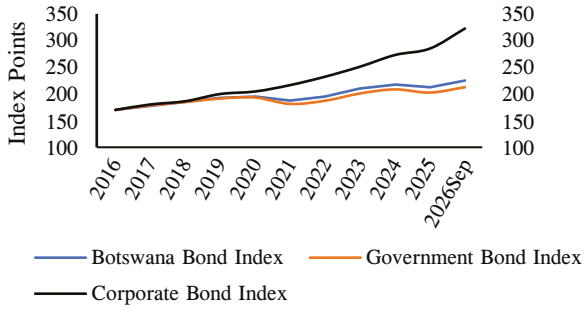
Corporates have many but low-value bonds listed on the BSE

Chart 7.3c: Number of Bonds



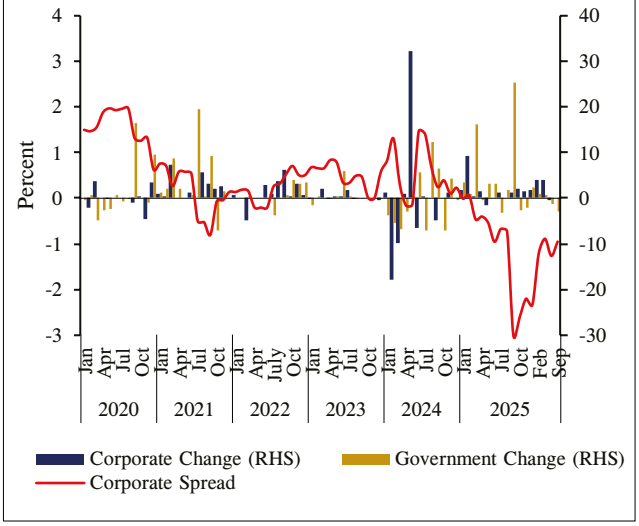
Bond indices are trending upwards

Chart 7.3d: Bonds Indices



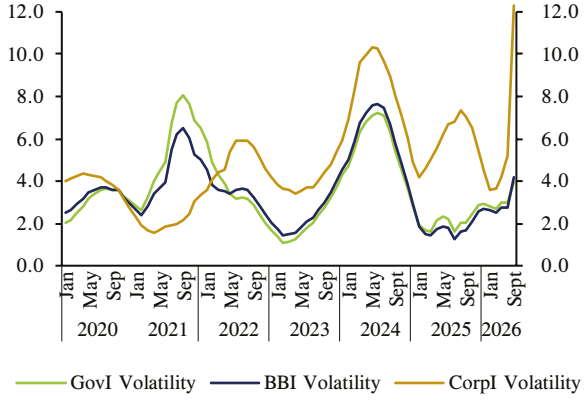
The corporate spread is widening

Chart 7.3e: Corporate Spread



Bond market volatility is low

Chart 7.3f: Bonds Volatility



Source: Botswana Stock Exchange and Bank of Botswana Calculations

8. CONTAGION RISK

Systemically important institutions are sound

8.1 During 2026, the Bank of Botswana assessment identified First National Bank Botswana Limited and Absa Bank Botswana Limited as Domestic Systemically Important Banks (D-SIBs), while NBFIRA identified Botswana Life Limited (life insurer), Hollard Insurance Company of Botswana (general insurer) and Continental Company (reinsurer) as Domestic Systemically Important Insurers (D-SIIs). Given their size and interconnectedness, these institutions have the potential to disrupt the entire financial system when faced with operational difficulties or insolvency, and therefore, enhanced or targeted supervisory measures should be implemented to safeguard their stability and systemic stability in general. Ongoing supervision thus focuses on their safety and soundness, supported by the Bank's D-SIB capital requirements and NBFIRA's reinforced D-SII framework. Both D-SIBs and D-SIIs were well capitalised, liquid, and solvent, with limited risks to domestic financial stability.

Significant interlinkages pose a risk of contagion

8.2 Significant interlinkages persist in the financial system, with the banking sector at the centre of the system. The banking sector is highly exposed to households (Figure 8.1) and at the same time, households are highly exposed to NBFIs, with most of their assets, mainly pension assets, held by the sector. Moreover, a significant amount of NBFI assets (56.2 percent) was held abroad as at the end of December 2025, exposing NBFIs to external financial and economic shocks. NBFIs are also interlinked with the rest of the financial system through their traditional roles in asset allocation and capital formation.

8.3 As of June 2026, the net lending position of NBFIs to commercial banks (deposits held with banks less loans) increased by 30 percent to P30 billion compared to December 2025. These interlinkages present an opportunity for the transmission of risks across sectors and thus, elevate the risk of contagion in the domestic financial system. In view of potential risks of cascading shocks due to interconnectedness, regulatory and legislative frameworks continue to be strengthened to mitigate the propagation of idiosyncratic, sectoral or institutional shocks to the entire financial system.

The insurance sector is concentrated and increasingly interconnected

8.4 The insurance sector remains an important stabilising component of the financial system but is highly concentrated and increasingly interconnected with banks and other financial institutions, particularly through investment and distribution channels. Life insurers account for 81.9 percent of total assets (P21.5 billion), with the largest firms holding over 80 percent of industry assets. While this concentration supports risk management through long term, liability matched investments, it also increases systemic importance and potential spillover risks.

8.5 Concentration risks are also evident across the broader non-bank financial sector. The micro lending industry is dominated by a few players and remains heavily exposed to households' credit, increasing vulnerability to income shocks. Meanwhile, pension funds significant offshore investments heighten sensitivity to external market developments. Overall, while risks remain contained, elevated concentration and interconnectedness increase the potential for cross-sector spillovers, underscoring the need for continued vigilance and adaptive supervision.

Financial sector assets increase

8.6 The total assets of banks and NBFI's increased by 11 percent in 2025, reaching P383 billion from P345 billion in 2024. The surge in NBFIs financial assets was primarily driven by pension funds, supported by improved global financial market and regulatory reforms boosting local investments in public and private equities. The size of the financial system represented approximately 143 percent of GDP in December 2025, compared with 131 percent in 2024, demonstrating the significant contribution of the financial sector to the economy.

Structure of the Financial System

The structure of the financial system has not changed significantly since 2016

Chart 8.1a: Structure of the Financial System in 2016

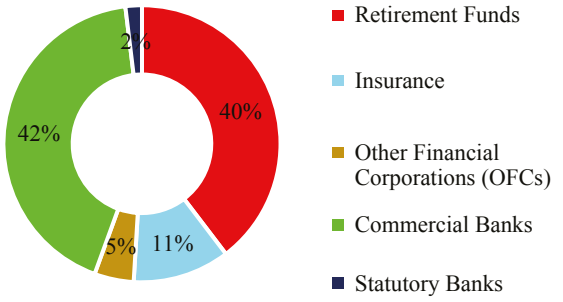
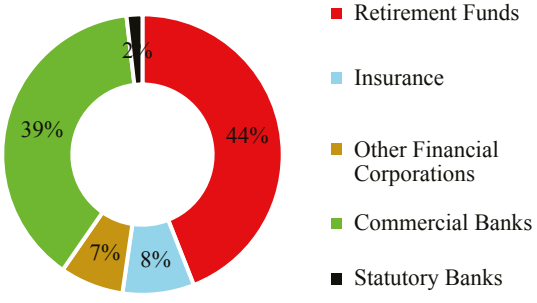
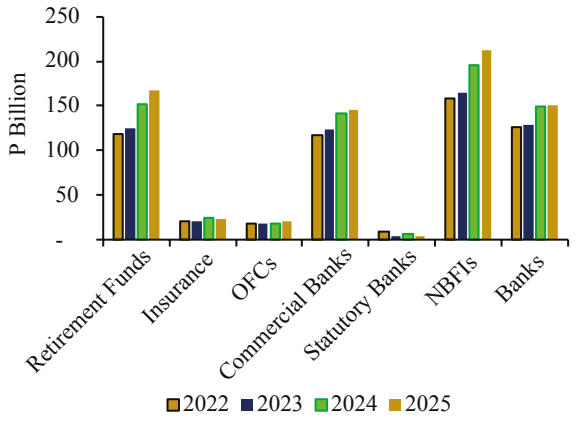


Chart 8.1b: Structure of the Financial System in December 2025



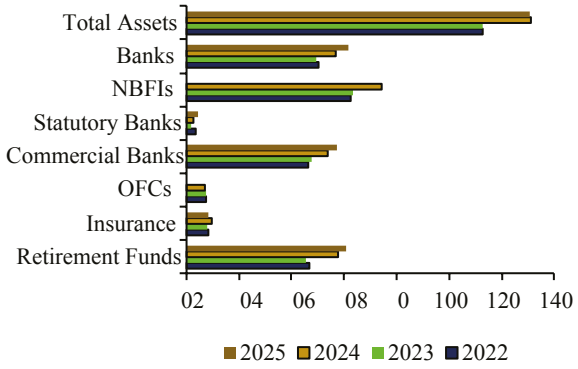
Retirement funds and commercial bank assets are relatively high

Chart 8.1c: Financial System Assets



NBFIs have the largest proportion to GDP owing to the relatively large retirement funds

Chart 8.1d: Financial Assets to GDP (Percent)

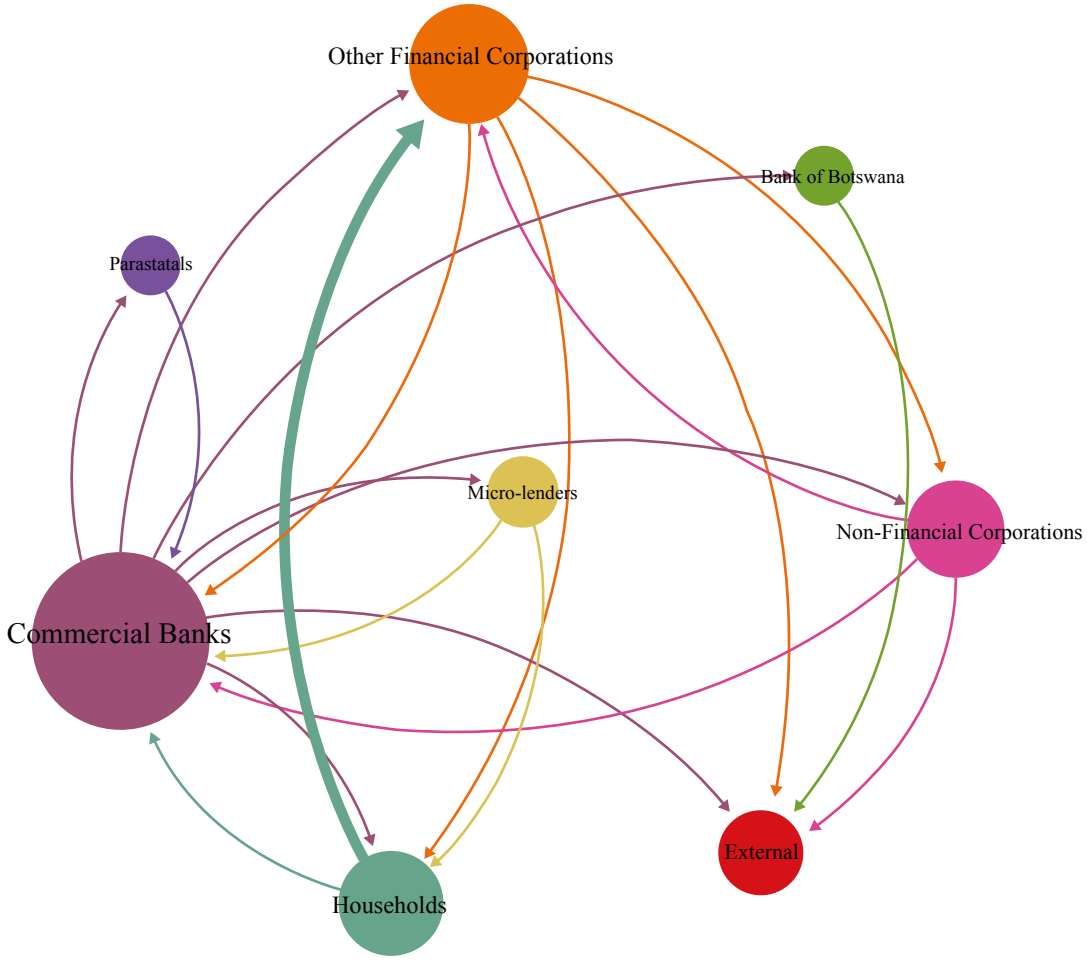


Source: BSEL, NBFIRA, BoB Calculations

Financial Sector Interlinkages

Banks are highly interconnected with the rest of the financial system

Figure 8.1: Macro-Financial Linkages (June 2026)



Notes:

1. A large node indicates a higher degree of interconnectedness across the financial system.
2. Thicker edges show a higher proportion of funds flowing out of the sector relative to the financial system.
3. Balances from the Bank to the external sector represent net foreign assets.
4. Balances from "Other Financial Corporations" to the external sector are pension fund assets invested offshore.
5. Balances from commercial banks to the external sector are commercial banks' balances due from foreign banks.
6. For "Other Financial Corporations", 85 percent are retirement funds assets.

Source: Bank of Botswana

9. BANKING SECTOR ANALYSIS

Asset Quality and Performance

9.1 The banking sector remained sound and resilient, supported by adequate capital and liquidity buffers and sustained profitability. Nevertheless, subdued economic activity and fiscal pressures, partly reflecting the prolonged downturn in the diamond sector, continued to pose risks to asset quality and funding conditions. In particular, weaker household incomes and business cash flows could impair debt servicing capacity, while fiscal pressures could affect deposit flows and liquidity conditions. Although aggregate liquidity remained adequate, supported by growth in liquid assets and measures implemented by the Bank of Botswana, its uneven distribution across banks and continued reliance on large institutional depositors presented funding vulnerabilities. Consequently, significant deposit withdrawals could increase funding pressures and constrain credit extension, underscoring the importance of continued monitoring of credit quality, funding concentration and liquidity risks. (chart 9.1a).

Banks have sufficient capital buffers

9.2 Banks demonstrated consistent profitability, with several institutions reporting growth in profit after tax for June 2026. The strong financial performance is driven by a combination of factors, including effective asset and liability management, growth in interest income, diversified revenue streams, and cost optimisation measures. The sector also boasts strong capitalisation levels, with capital adequacy ratios well above the prudential floor at 21.2 percent in June 2026 (June 2025: 18.7 percent). The capital levels provide a significant buffer against potential losses and enhance the sector's resilience to economic shocks, contributing to financial stability.

Banking industry concentration remains a concern

9.3 Despite modest balance sheet growth, the banking sector continues to face liquidity and funding vulnerabilities linked to the sector's structural dependence on wholesale deposits from institutional investors, which heightens concentration and rollover risk, increasing susceptibility to funding shocks and amplifying liquidity pressures during periods of market stress. Nonetheless, NPLs remain contained, although necessitating close monitoring under the uncertain business and economic conditions (Chart 9.1b). This is critical as government employees are the biggest borrowers from banks. In line with the Basel III Pillar 2 framework, the Bank is assessing targeted supervisory measures, including institution-specific capital add-ons for banks with elevated deposit concentration risk, alongside additional actions to strengthen liquidity risk management and reduce reliance on volatile wholesale funding.

Banks post impressive stock performance

9.4 An analysis of banking sector performance on the stock market indicates strong investor sentiment. The sector was the second-largest contributor to total equity market turnover, accounting for 27.9 percent during the nine-month period ended 30 September 2026. The two top-performing listed banks contributed 23.8 percent to equity market turnover and 85.4 percent to banking sector equity turnover. Overall, these results signal sustained investor confidence in the banking sector, anchored by expectations of continued profitability and resilience (chart 9.1d).

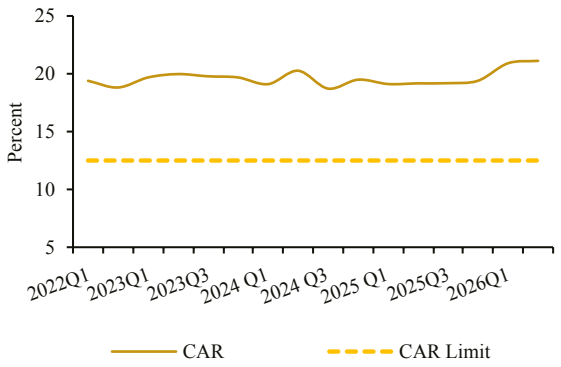
The Deposit Insurance Fund registers positive growth

9.5 The Fund sustained an upward growth trajectory, with total assets of P206.2 million as at June 2026, reflecting an increase of 59.2 percent from June 2025. The growth was primarily driven by additional investments in government securities, supported by premium contributions of P73 million from member institutions and the resulting expansion of the Fund's investment portfolio. Despite the strong performance, the target fund ratio, which measures the fund balance as a percentage of estimated total insurable deposits, remained significantly below the recommended minimum threshold of 2 percent. Meanwhile, the average total insurable deposits were estimated at P73.3 billion (December 2024: P72.7 billion) as at December 2025, translating to 61.2 percent of total deposit liabilities of member institutions.

Banking Sector Financial Soundness Indicators

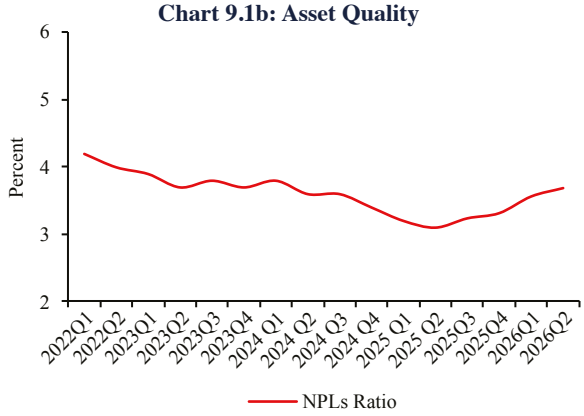
Banks are adequately capitalised

Chart 9.1a: Capital Adequacy



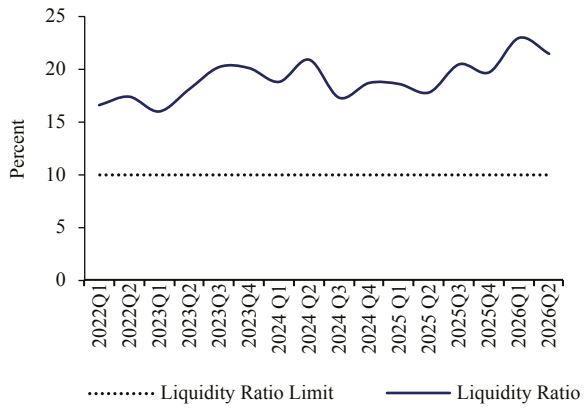
The NPLs ratio is stable

Chart 9.1b: Asset Quality



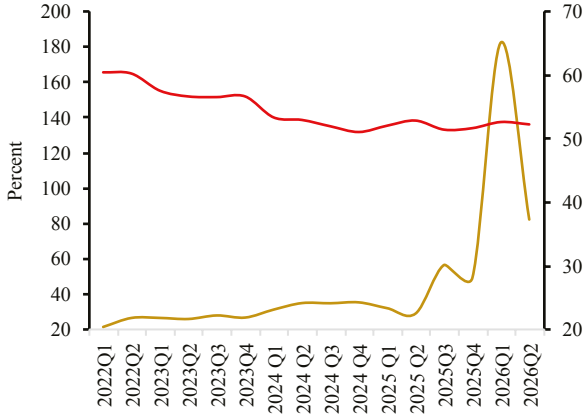
Banks are liquid

Chart 9.1c: Liquidity



Banks are highly profitable and costs are declining

Chart 9.1d: Profitability



Source: Bank of Botswana

Stress Test Scenarios

9.6 The stress test scenarios assess the resilience of Botswana's banking sector using June 2026 data, while considering evolving global, regional and domestic macro-financial conditions. The scenarios reflect a combination of tightening global financial conditions, heightened geopolitical uncertainty, an uneven recovery among key trading partners, and structural vulnerabilities within the domestic economy. The analysis focuses on key risks that could affect banking sector stability, notably continued weakness in the diamond sector, elevated household indebtedness, intensifying climate related shocks, and systemic and contagion risks arising from financial interconnectedness and concentration exposures.

Subdued diamond sector performance

9.7 Botswana's financial system remains highly exposed to developments in the diamond sector, which continues to be an important source of export earnings, fiscal revenues and economic activity. The stress test therefore considers a scenario of a sustained decline in global diamond demand, driven in part by a slowdown in global economic activity, weaker demand for luxury goods in key markets, and increasing competition from synthetic diamonds.

9.8 A prolonged weakness in the diamond sector could result in mining companies scaling down operations, associated job losses across the mining value chain, and reduced foreign exchange inflows. Lower household incomes could, in turn, constrain consumer spending and place additional pressure on

businesses, particularly those dependent on domestic demand. These developments would transmit to the banking sector through a deterioration in borrowers' repayment capacity and an increase in NPLs, thereby weakening bank profitability and capital buffers. The stress test results indicate that while the banking sector remains resilient to a moderate decline in diamond revenues, a severe and prolonged downturn could result in some institutions falling below regulatory capital requirements.

Impact of potential employment losses

9.9 Weak domestic economic conditions point to an elevated risk of employment losses materialising or intensifying in the near term. The stress test therefore incorporates a severe but plausible scenario characterised by rising unemployment and stagnating real household incomes, reflecting prevailing economic pressures. The scenario also captures structural vulnerabilities within the household sector, particularly the high concentration of unsecured borrowing, which increases households' sensitivity to labour market disruptions and income shocks.

9.10 Under this scenario, widespread employment losses would result in a significant reduction in household incomes and weaken debt-servicing capacity. This would increase household loan defaults and, consequently, result in a marked deterioration in banks' asset quality through higher NPLs. The associated increase in credit losses would weigh on bank profitability and place additional pressure on funding and liquidity conditions within an already constrained financial system. These effects would reinforce credit risk and weaken overall financial resilience, underscoring the employment channel as an important source of systemic stress under adverse conditions.

Intensifying climate risks could destabilise the financial system

9.11 The climate-related stress scenario assumes the occurrence of severe but plausible physical climate shocks, reflecting Botswana's high exposure to climate-related risks. The scenario considers the combined effects of the forecast El Nino and outbreaks of foot and mouth disease, which could disrupt agricultural production through crop failures, livestock losses, and damage to transport and logistics infrastructure. These disruptions would reduce rural incomes and weigh on overall economic activity.

9.12 The assumed shocks would affect the banking sector primarily through increased credit risk within climate-sensitive sectors. Lower agricultural output and household incomes would weaken borrowers' repayment capacity, resulting in higher loan defaults and deteriorating asset quality in these sectors. Similarly, declines in collateral values could amplify potential losses in the event of default. The impact of these shocks could be further exacerbated by limited fiscal space, which would constrain the government's capacity to provide economic support or liquidity backstops.

Contagion risk could have negative outcomes for the financial system

9.13 The stress test incorporates contagion risk to capture the high degree of interconnectedness within Botswana's financial system and the potential for shocks originating at individual institutions to propagate across the broader system. Financial linkages among banks, non-bank financial institutions and other sectors can facilitate the transmission of stress through multiple channels, including balance sheet exposures, funding relationships and confidence effects. Given the concentration of financial activities and common exposures across institutions, the potential for shocks to spread through the financial system is considered both relevant and plausible.

9.14 The assessment of contagion risk is further motivated by the presence of D-SIBs, whose size, interconnectedness and market significance could amplify financial stress in the event of distress. Accordingly, the stress test framework assumes that disruption at a systemically important institution could generate broader financial stability implications, including through confidence and funding effects, even where direct exposures to the affected institution are limited.

D-SIBs subjected to more severe stress conditions

9.15 For a subset of banks that are D-SIBs, a sensitivity scenario is assumed, whereby banks are simultaneously affected by a combination of shocks, including a general increase in NPLs and an upward adjustment in the policy rate, which could trigger a decrease in interest income. In addition, for the moderate scenario, the stress test exercise assumes credit losses for vulnerable sectors and the largest exposure. Under the severe scenario, credit losses are assumed for the total loan portfolio and two largest

exposures. To capture liquidity risks associated with the potential insolvency of the D-SIBs in the stress scenario, the threshold for the capital adequacy ratio (CAR) is set such that the banks are closed out of funding markets if the post-shock CAR breaches set hurdle rates.

Stress Test Results

Banks are susceptible to severe credit shocks

9.16 Credit stress test results indicate that the banking system's resilience varies with the nature and severity of the shocks, with significant deterioration in asset quality potentially resulting in substantial erosion of regulatory capital. Under the moderate system-wide credit shock, which assumes that an additional 10 percent of performing loans become non-performing, the industry's capital adequacy ratio (CAR) declines to 12.6 percent, marginally above the prudential requirement of 12.5 percent. This indicates limited capacity to absorb additional credit losses without breaching the minimum capital requirement. Under the severe scenario, where 20 percent of performing loans are assumed to become non-performing, the CAR declines substantially to 3.6 percent, significantly below the prudential minimum. Correspondingly, the ratio of non-performing loans (NPLs) to total loans increases from a baseline of 3.5 percent to 13.2 percent and 22.8 percent under the moderate and severe scenarios, respectively (Chart 9.2d). These results highlight the sensitivity of banks' capital positions to deterioration in asset quality, which could weaken their capacity to absorb losses and constrain credit extension, with adverse implications for economic activity.

9.17 Similarly, sectoral credit shocks reveal vulnerabilities in banks' capital positions, with the industry's CAR declining to 10.6 percent under the moderate scenario and 6.2 percent under the severe scenario, both below the prudential minimum. The corresponding NPL ratios increase to 15.4 percent and 20.2 percent, respectively. Notably, the breach under the moderate scenario indicates that deterioration in credit quality within the stressed sectors could materially weaken banks' capital positions. In contrast, banks demonstrate comparatively greater resilience to counterparty concentration shocks, with the CAR declining to 15.5 percent following the default of each bank's largest borrower and to 12.5 percent following the default of its two largest counterparties. Nevertheless, under the severe concentration shock, the industry's CAR falls to the prudential minimum, indicating that any additional losses could result in a regulatory breach. These findings demonstrate that the banking system's vulnerability to credit risk extends beyond individual large exposures, with the effects of deteriorating loan performance posing greater risks to capital adequacy.

9.18 D-SIBs demonstrate relatively greater resilience to credit shocks, although their capital positions also weaken under severe stress conditions. Under the moderate concentration and NPL shocks, their CAR remains above the prudential minimum at 17.3 percent and 16.9 percent, respectively. However, under severe conditions, the CAR declines to 14.6 percent for concentration shocks and 11.1 percent for NPL shocks, with the latter falling below the minimum requirement (Chart 9.2a). Given the systemic importance of these institutions, significant deterioration in their capital positions could constrain credit intermediation and increase the potential for spillovers across the financial system. Overall, the results indicate that the system-wide NPL shock has the most pronounced impact on capital adequacy under severe stress conditions, while sectoral credit shocks result in prudential breaches even under moderate conditions. Although the stress tests do not incorporate credit risk mitigation measures, including potential recoveries from underlying collateral, the findings underscore the importance of maintaining adequate capital buffers, strengthening credit risk management and closely monitoring asset quality and credit concentration.

Banks remain resilient to moderate liquidity shocks

9.19 Liquidity stress test results indicate that all banks can withstand liability withdrawals for 14 days under moderate stress conditions, compared with four days under the severe scenario. The significant reduction in the period over which banks can meet withdrawal demands under severe stress highlights their vulnerability to sudden and substantial funding outflows. This vulnerability is compounded by reliance on wholesale deposits, which account for between 32 percent and 61 percent of total customer deposits across banks. The concentration of funding among large depositors exposes banks to liquidity pressures arising from significant withdrawals, particularly given the uneven distribution of liquidity across the banking system. Consequently,

simultaneous funding withdrawals could intensify competition for deposits, increase funding costs and constrain banks' capacity to extend credit, thereby transmitting liquidity pressures to the wider economy.

9.20 Nevertheless, the liquidity stress scenarios do not incorporate potential liquidity support from the Bank's Credit Facility or related companies and holding banks, which could mitigate funding pressures under stressed conditions. Accordingly, the results should not be interpreted as indicating that banks would necessarily default under the assumed scenarios. Rather, they highlight the importance of maintaining adequate liquidity buffers, diversifying funding sources and strengthening contingency funding arrangements to reduce vulnerabilities associated with deposit concentration and unexpected liquidity withdrawals.

Rising market interest rates could adversely affect bank profitability

9.21 Interest rate stress test results indicate that the banking system remains relatively resilient to the capital adequacy effects of rising market interest rates, although profitability is vulnerable to higher funding costs and potential valuation losses on government securities. Under the moderate scenario, which assumes a 300 basis point increase in market interest rates, interest earnings decline by P55 million, while potential valuation losses arising from the repricing of government bonds amount to P175 million. Consequently, the industry's CAR declines by 0.2 percentage points. Under the severe scenario, involving a 500-basis-point increase, the corresponding losses increase to P93 million and P292 million, respectively, while the CAR declines by 0.3 percentage points (Chart 9.2f). Although the capital impact is relatively limited compared with credit shocks, the results indicate that adverse interest rate movements could exert pressure on bank earnings and the valuation of government securities holdings.

9.22 The decline in earnings reflects the banking industry's negative cumulative repricing gap over the 12-month stress horizon, indicating that interest-bearing liabilities reprice more rapidly or to a greater extent than interest-earning assets. Consequently, an increase in market interest rates raises funding costs relative to interest income, resulting in a reduction in net interest earnings. In contrast, D-SIBs record gains in interest earnings owing to their positive cumulative repricing gap, reflecting differences in the interest rate risk exposures of banks. Nevertheless, sustained pressure on profitability could constrain internal capital generation and, consequently, banks' ability to strengthen their capital positions through retained earnings. Furthermore, potential valuation losses on government securities could increase banks' exposure to market risk, particularly against the backdrop of increasing sovereign exposures. These findings reinforce the importance of prudent asset-liability management and effective monitoring of interest rate risk and government securities exposures.

Overall assessment and financial stability implications

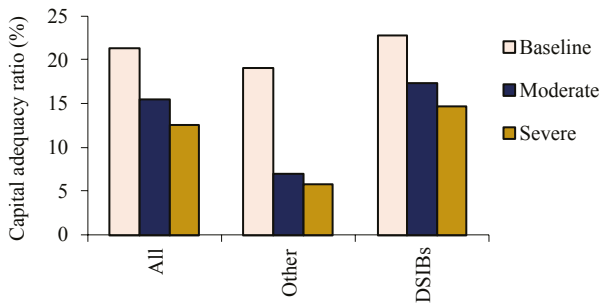
9.23 Overall, the stress test results indicate that credit risk poses the most significant threat to banks' capital adequacy, with severe deterioration in asset quality resulting in substantial breaches of prudential capital requirements. The limited margin above the regulatory minimum under the moderate system-wide NPL shock, together with the capital breaches recorded under sectoral shocks, highlights the banking system's sensitivity to adverse credit developments. Although banks demonstrate comparatively greater resilience to counterparty concentration and moderate liquidity shocks, significant funding withdrawals could exert additional pressure on liquidity positions and increase funding costs. Meanwhile, the relatively modest capital impact of interest rate shocks suggests that banks are better positioned to withstand market interest rate movements, although sustained earnings pressures could weaken their capacity to absorb future losses. Importantly, these vulnerabilities could reinforce one another, as deteriorating asset quality reduces capital adequacy, while funding pressures and lower profitability weaken banks' ability to sustain credit extension and replenish capital buffers. Accordingly, supervisory priorities should focus on ensuring adequate capital and liquidity buffers, strengthening credit and funding concentration risk management, and enhancing the monitoring of asset quality, interest rate risk and sovereign exposures. These measures would support the banking system's capacity to withstand adverse shocks and minimise potential spillovers to the broader financial system.

June 2026 Test Results

Credit Shocks

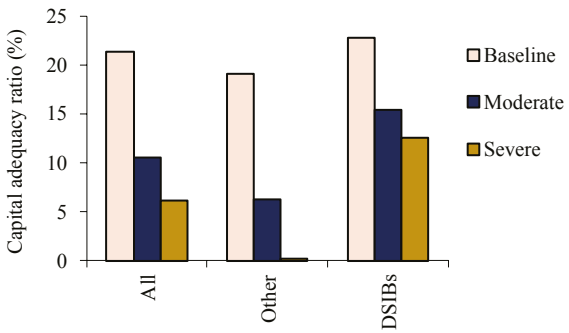
Banks are generally resilient to credit concentration shocks

Chart 9.2a: Concentration Shock



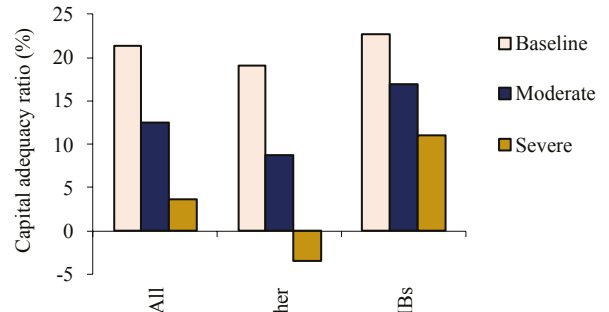
Severe sectoral shocks would lead to a significant breach in CAR

Chart 9.2b: Sectoral Shock



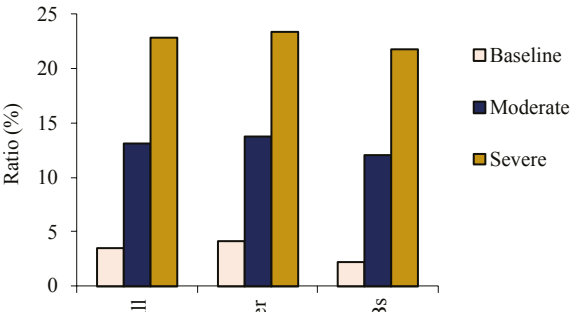
A severe aggregate credit shock would deplete banks' capital

Chart 9.2c: Overall NPL Shock



The NPL ratio for the aggregate credit shock increases significantly in the severe scenario

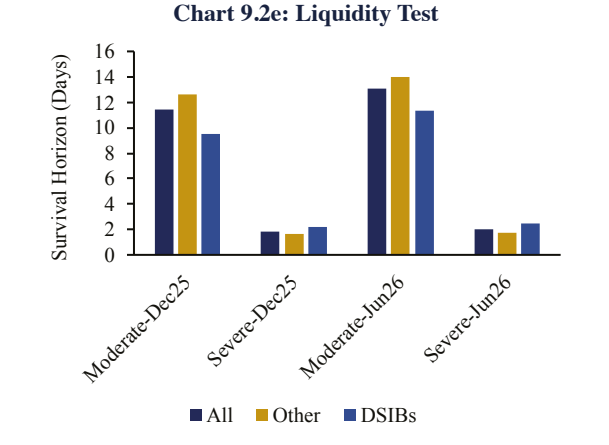
Chart 9.2d: NPL Ratio



Liquidity and Interest Rate Shocks

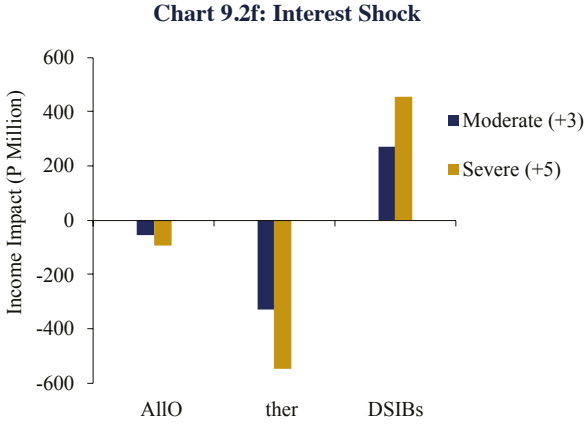
Banks have low survival horizon under a severe liquidity shock

Chart 9.2e: Liquidity Test



Bank profitability to decrease with an increase in market rates

Chart 9.2f: Interest Shock



Source: Bank of Botswana

Banks breach prudential limits due to a combination of shocks

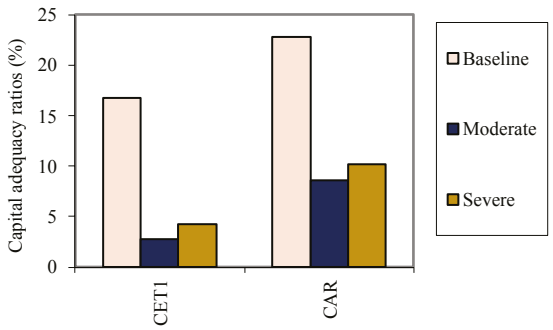
9.24 Considering a combination of shocks for scenario analysis, D-SIBs breach the prudential limit with a capital adequacy ratio of 8.6 percent in the moderate scenario, and they are also insolvent in the severe scenario with a capital adequacy ratio of 10.2 percent (Chart 9.3a).

9.25 To capitalise D-SIBs, shareholders would have to inject capital amounting to P2.4 billion in the moderate scenario and P2.8 billion in the severe scenario. Given that credit mitigants are excluded from the stress test scenario, and the loss given default is assumed to be 100 percent, D-SIBs are judged to be resilient to a combination of shocks, although susceptible to extreme shocks. To link liquidity risk and solvency of the D-SIBs, it is assumed that D-SIBs are closed out of funding markets if the capital adequacy ratio under stress scenario falls below set hurdle rates. Hurdle rates are set at 8 percent for customer deposits, 10 percent for short-term funding, and 4 percent for long term funding. Under these assumptions, D-SIBs are closed out of long-term funding markets in the moderate scenario and severe scenario, and there is loss of funding amounting to P6.2 billion. Consequently, banks would experience severe liquidity shortfall in both the moderate and severe scenarios.

D-SIBs Scenario Analysis

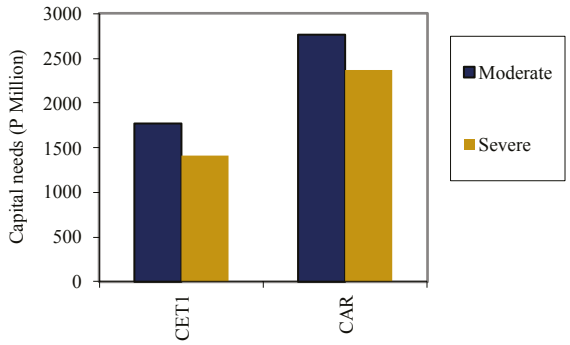
Severe stress scenario completely erodes D-SIBs' capital base

Chart 9.3a: D-SIBs Scenario



D-SIBs need a significant capital injection to recapitalise under severe stress conditions

Chart 9.3b: D-SIBs Scenario



Source: Bank of Botswana

10. FINANCIAL MARKET INFRASTRUCTURES AND PAYMENTS SYSTEMS RISKS

Payment systems remain resilient

10.1 The National Payment System (NPS) remained safe, efficient and operationally resilient during the review period, supporting financial intermediation and economic activity through the continued availability of payment, clearing and settlement services. Key Financial Market Infrastructures (FMIs), including the Botswana Interbank Settlement System (BISS), Botswana Automated Clearing House (BACH) and Central Securities Depository Company of Botswana (CSDB), remained stable. Reflecting their importance to the wider financial system, the Bank designated BISS, BACH and CSDB as Domestic Systemically Important Payment Systems (D-SIPs) under the framework developed in 2026. Their continued resilience is important because disruption to these infrastructures could impair payment and securities settlement, affect financial institutions' liquidity management and interrupt the provision of critical financial services.

Digitalisation increases operational interconnectedness

10.2 Electronic payment activity continued to expand, reflecting increased use of formal digital payment channels, improved transactional efficiency and changing customer preferences (Charts 10.1a and 10.1b). While greater digitalisation supports financial inclusion and efficiency, it also increases reliance on electronic platforms, telecommunications infrastructure and third-party technology providers. Concentration of activity among a relatively small number of Electronic Payment Service (EPS) providers further increases the importance of operational continuity and redundancy, as disruption at a major provider could affect a large number of users and financial institutions simultaneously.

10.3 The financial stability risk arises where a significant cyber incident, technology failure or prolonged outage disrupts payment flows and prevents institutions, businesses or households from meeting financial obligations on time. Disruptions affecting a major provider or FMI could create settlement delays and liquidity bottlenecks and, given the linkages between payment systems, banks and securities infrastructure, transmit operational stress across different parts of the financial system. Repeated or severe disruptions could also weaken confidence in digital financial services. The systemic concern therefore lies not in individual operational incidents, but in the potential for common dependencies and interconnected platforms to amplify a localised failure into wider financial system disruption.

Regulatory and infrastructure reforms strengthen resilience

10.4 Continued modernisation of the NPS and strengthening of the regulatory framework provide important mitigation against these risks. Cabinet approval of the National Payment Systems Bill and the gazetting of Electronic Payment Service Regulations in April 2026 are expected to strengthen governance, oversight and integrity across the payments ecosystem. Effective 1 February 2026, an additional settlement window was also introduced in BISS, increasing the number of BACH and BISS clearing and settlement sessions to four, together with mandatory crediting of customer accounts after each cycle. These measures support more timely availability of funds, improve settlement efficiency and strengthen the capacity of the payments infrastructure to support growing transaction volumes.

The regulatory sandbox supports safer financial innovation

10.5 The Bank progressed the establishment of its Regulatory Sandbox in 2026, marking an important step in strengthening the regulatory framework for financial innovation. The inaugural application round attracted 50 submissions, predominantly in inclusive payments, interoperability and digital banking, which were assessed for admission into the first cohort. The Sandbox is intended to provide a controlled environment for evaluating the functionality, risks and regulatory implications of new financial products and business models before wider market deployment (Box 10.1). This should enable operational, cyber, consumer protection and broader financial stability risks to be identified early, while allowing viable innovations to develop under appropriate safeguards. The concentration of applications in digitally enabled financial services also underscores the importance of operational resilience and sound risk management as the financial system becomes increasingly interconnected.

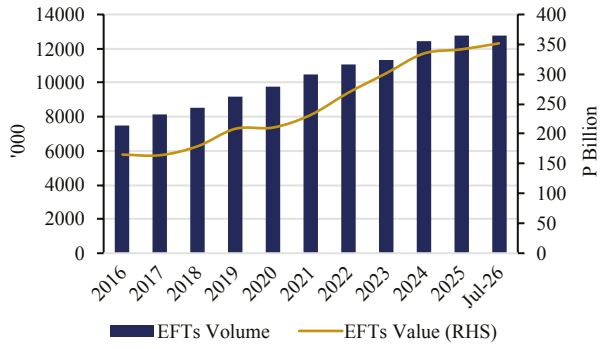
Operational risks remain contained but require continued vigilance

10.6 Overall, risks from payment and settlement systems remain contained, supported by resilient core FMIs, ongoing infrastructure modernisation and a strengthening regulatory framework. Looking ahead, continued growth in digital transactions, interoperability and dependence on common technology and service providers could increase the speed and reach through which operational disruptions propagate across the financial system. Continued strengthening of cyber resilience, business continuity and redundancy arrangements, third-party risk oversight, incident reporting and coordinated system-wide exercises will therefore remain important for ensuring that increased digitalisation enhances the efficiency and inclusiveness of the financial system without creating new channels of systemic vulnerability.

Payments and Settlement Systems Indicators

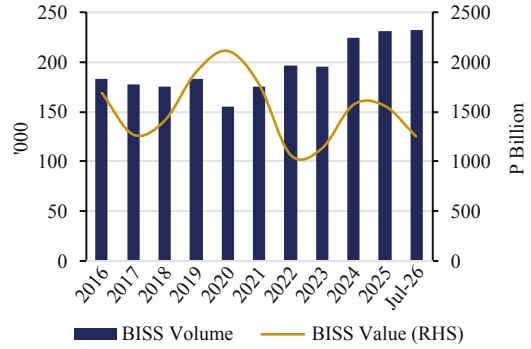
EFTs volume and value are trending upwards

Chart 10.1a: EFTs



BISS transactions volume and value are largely stable

Chart 10.1b: BISS Transactions



Source: Bank of Botswana

BOX 10.1: BANK OF BOTSWANA'S REGULATORY SANDBOX - PROGRESS TOWARDS CONTROLLED LIVE TESTING

Purpose of the Regulatory Sandbox

A regulatory sandbox provides a controlled environment in which innovative financial products, services and business models can be tested under regulatory oversight before wider market deployment. It enables the regulator to assess emerging technologies, associated risks and regulatory gaps, while generating evidence to support proportionate regulation and supervision. The sandbox therefore serves as both an innovation-enabling mechanism and a regulatory learning tool, while maintaining appropriate safeguards for consumers and the financial system.

Inaugural Cohort and Application Profile

The Bank opened applications for its inaugural Regulatory Sandbox cohort from 4 to 31 March 2026, focusing on Inclusive Payments, Digital Banks and Interoperability Solutions. A total of 50 applications were received, comprising 22 inclusive payment solutions, 12 interoperability solutions, four digital banking proposals and 12 applications outside the approved themes. The strong concentration in payments reflects growing market interest in payment mordernisation and, particularly, solutions that improve connectivity between payment platforms and instruments. Greater interoperability can reduce fragmentation within the payments ecosystem and support efficiency, competition and financial inclusion, while also increasing the importance of cybersecurity, operational resilience and common technical standards.

Technical Assessment and Regulatory Learning

Applications were assessed by the Regulatory Sandbox Technical Committee against established eligibility criteria, including innovation, governance, technological readiness, risk management, test design and regulatory relevance. Following the assessment, 26 applications were recommended for admission, comprising 14 inclusive payment solutions, eight interoperability solutions and four digital banks, while 24 were recommended for rejection. Importantly, admission was not limited to products operating outside existing regulation. Following the Electronic Payment Services (Amendment) Regulations, 2026, some solutions may already fall within regulated activities but still employ emerging technologies or business models that warrant controlled testing. The Sandbox therefore provides an avenue for regulatory observation and practical implementation of evolving regulatory requirements.

Progress towards Live Testing

The technical evaluation phase has been completed, and recommendations for admission or rejection have been presented by the Technical Committee to the Regulatory Sandbox Steering Committee. Recommended participants are currently undergoing security vetting, while their test plans are being finalised ahead of controlled live testing. The inaugural cohort has also highlighted emerging regulatory areas, including digital-only banking, API-driven interoperability, neutral third party switching, open banking and alternative data credit scoring. Testing these models under regulatory oversight should provide useful evidence for future policy development and strengthen the Bank's ability to support responsible innovation while safeguarding financial stability and market integrity.

11. REGULATORY AND OTHER DEVELOPMENTS

Deepening the legal foundations of the financial system

11.1 Regulatory authorities continued to implement reforms aimed at strengthening financial sector resilience, financial integrity, digital financial infrastructure and market development. Significant progress was made in advancing the legislative and regulatory framework underpinning the financial system, with a particular focus on payments, financial inclusion, anti-money laundering and financial sector development.

11.2 The development of the NPS Bill has reached an advanced stage, with the revised draft submitted to the Ministry of Finance (MoF) for processing in consultation with the Attorney General's Chambers. The Bill is expected to strengthen the legal foundations for payment system oversight, address emerging risks arising from technological innovation and align Botswana's payments framework with international standards and regional developments. Complementing this reform, the Electronic Payment Services (Amendment) Regulations, 2026 were gazetted and became effective in April 2026, introducing enhancements aimed at improving the efficiency, safety and inclusiveness of digital payment services.

11.3 Progress also continued on implementation of the National Payments System Strategy (2026-2030), the National FinTech Strategy and the National Financial Inclusion Roadmap and Strategy (2024-2030). Key initiatives include the establishment of a National Retail Payment Switch - Kamogano Switch - for interoperability between banks and electronic money issuers, development of a national citizen e-wallet linked to the Digital ID, and broader adoption of financial technologies. Collectively, these initiatives are expected to improve payment efficiency, deepen financial inclusion and support Botswana's digital transformation agenda.

11.4 Efforts to strengthen customer access to financial services also continued through initiatives promoting affordable banking products and increased interoperability between banking institutions and mobile money service providers. These developments are expected to support financial inclusion, improve payment system efficiency and contribute to broader financial sector development.

11.5 To improve payment system efficiency and support the BETP, the Bank implemented enhancements to the Electronic Funds Transfer clearing and settlement framework, including the introduction of a fourth weekday clearing window and mandatory near-immediate crediting of beneficiary accounts following settlement. In addition, implementation of interoperability between banks and electronic money issuers continues through the National Retail Payment Switch project and the interim Kamogano Switch initiative. These reforms are expected to promote competition, reduce market fragmentation and improve access to digital financial services.

11.6 At the regional level, Botswana continued to support the integration of the Southern African Development Community (SADC) payments ecosystem through ongoing participation in the SADC Real-Time Gross Settlement (RTGS) system and the Transactions Cleared on an Immediate Basis scheme. Progress was also made towards onboarding the Botswana Pula as a settlement currency in the SADC-RTGS system, which is expected to enhance regional payment efficiency and support cross-border financial integration.

Strengthening financial integrity and AML/CFT frameworks

11.7 Botswana continued to strengthen its Anti Money Laundering, Combating the Financing of Terrorism and Counter-Proliferation Financing (AML/CFT/CPF) framework. Notably, the implementation of the Financial Intelligence (Amendment) Act, 2025 established the National Coordination Office (NCO) under the Ministry of Finance and provided an institutional foundation for implementation of the National AML/CFT Strategy 2025–2030. These reforms reinforce inter-agency coordination, enhance risk-based supervision and strengthen compliance with international standards.

11.8 Preparations for Botswana's forthcoming AML/CFT assessment continued during the review period, supported by enhanced supervisory engagement and implementation of risk-based compliance frameworks across regulated institutions. These initiatives are expected to strengthen financial sector integrity, preserve correspondent banking relationships and mitigate risks associated with illicit financial flows.

11.9 In addition, the completion of the 2025 National Money Laundering and Terrorist Financing Risk Assessment provides an updated assessment of financial integrity risks facing the economy. The assessment identified several vulnerabilities associated with illicit financial flows, misuse of legal persons and increasing use of digital financial channels. The findings and their implications for financial stability are discussed in Box 11.1.

Two-tier banking framework opens the door to new market entrants

11.10 The Bank continued to implement the two-tier banking framework during the review period. This included the assessment of applications for new banking licences and engagement with prospective entrants seeking to establish operations in Botswana. Interest in the framework remains strong, reflecting its role in supporting greater diversity and competition within the banking sector. During the period, the Bank approved the application of one prospective Tier 1 commercial bank, subject to the fulfilment of specified licensing conditions prior to commencement of operations. In addition, the assessment of another Tier 1 commercial bank application remains ongoing. The Bank remains committed to facilitating orderly market entry and development while ensuring that all institutions operate in accordance with applicable prudential, governance and regulatory standards.

Advancing sustainable finance and financial sector development

11.11 The Bank continued efforts to integrate climate-related financial risks into financial sector regulation and financial stability monitoring. In this regard, the Bank joined the Network for Greening the Financial System (NGFS), reflecting its commitment to strengthening climate-risk assessment and supporting the transition towards sustainable finance. The incorporation of climate considerations into financial sector oversight is expected to enhance the resilience of financial institutions to both physical and transition climate risks. More recently, a national Environmental, Social and Governance (ESG) Strategy and Implementation Framework was developed to provide a coherent architecture that links sustainability standards to national planning, regulatory sequencing, enterprise competitiveness, public-sector accountability and community-level development. The strategy thus underpins broader domestic initiatives geared towards the attainment of the long-term vision for sustainable and inclusive economic growth, achievement of Sustainable Development Goals, and global climate commitments.

11.12 At the same time, work on the Financial Sector Development Strategy (FSDS) continued. The strategy is intended to provide a coherent framework for deepening, diversifying and modernising Botswana's financial sector while enhancing its contribution to sustainable and inclusive economic growth. A consolidated draft has been completed and is undergoing final review prior to adoption.

BOX 11.1: MONEY LAUNDERING AND TERRORIST FINANCING RISKS - IMPLICATIONS FOR FINANCIAL STABILITY IN BOTSWANA

Background

The integrity of the financial system is an important pillar of financial stability. Financial institutions that are exposed to money laundering (ML), terrorist financing (TF) and proliferation financing (PF) risks may face operational, legal, reputational and funding challenges that could undermine confidence in the financial system. Consequently, effective management of ML/TF risks contributes not only to financial integrity but also to the resilience and stability of the broader financial system.

Botswana completed its updated National Risk Assessment (NRA) on Money Laundering and Terrorist Financing) in 2025 to identify and assess money laundering and terrorist financing threats, vulnerabilities and emerging risks across the economy. The assessment supports risk-based supervision, regulatory reforms and the implementation of targeted AML/CFT measures

Key Findings of the National Risk Assessment

The NRA assessed Botswana's overall money laundering risk as Medium, while terrorist financing risk was assessed as Medium-Low for domestic activities and Medium for cross-border exposure. The assessment identified tax crimes, fraud, corruption, obtaining by false pretenses and environmental crimes as the principal domestic sources of illicit proceeds. The assessment further identified vulnerabilities associated with cross-border flows, misuse of legal persons and arrangements, and increasing use of digital financial channels. While the banking sector remains the most significant gateway for financial transactions due to its size and centrality within the financial system, the sector benefits from relatively strong AML/CFT controls and supervisory oversight.

Why ML/TF Risks Matter for Financial Stability?

Money laundering and terrorist financing risks are relevant to financial stability because weaknesses in anti-money laundering and counter-terrorist financing controls can expose financial institutions to operational, legal, reputational and funding risks, potentially undermining public confidence in the financial system. In addition, deficiencies in AML/CFT frameworks may adversely affect correspondent banking relationships and access to international financial markets, thereby disrupting cross-border financial transactions and financial intermediation. These risks can also amplify systemic vulnerabilities through interconnected financial institutions and shared financial infrastructure, particularly if weaknesses in one institution trigger broader confidence effects across the financial system. Furthermore, rapid technological innovation and the growing use of digital financial services, while enhancing efficiency and financial inclusion, increase the complexity of detecting and mitigating illicit financial flows. Consequently, effective management of ML/TF risks supports financial sector integrity, preserves market confidence, strengthens resilience against financial crime and contributes to the maintenance of overall financial stability.

Policy and Regulatory Responses

Botswana has continued to strengthen its AML/CFT framework through legislative, regulatory and supervisory reforms. These include implementation of the Financial Intelligence (Amendment) Act, 2025, enhancement of risk-based supervisory frameworks and development of the National AML/CFT Strategy 2025-2030.

In addition, Botswana achieved significant progress in strengthening compliance with international standards through the re-rating process conducted by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). These improvements reinforce confidence in the country's regulatory framework and support the integrity of the financial system. The NRA findings are also expected to enhance risk-based supervision by enabling regulatory authorities to focus resources on higher-risk sectors and activities.

Conclusion

The 2025 NRA indicates that Botswana's ML/TF risks remain moderate and manageable. While the financial system continues to operate within a strengthened AML/CFT framework, ongoing vigilance remains necessary given evolving financial technologies, increasing cross-border transactions and emerging criminal threats. Continued implementation of risk-based supervision, improved inter-agency cooperation and effective application of the National AML/CFT Strategy will support financial integrity, safeguard confidence and contribute to the preservation of financial stability.

12. CONCLUSION AND OUTLOOK

12.1 The domestic financial system remains stable and resilient, reflecting strong institutional performance, robust financial market infrastructures and effective regulatory and supervisory frameworks. Banking sector resilience is underpinned by strong capital and liquidity buffers, sustained profitability and low non-performing loans. Similarly, NBFIs remain solvent, profitable and adequately capitalised, while reliable financial market infrastructures facilitate financial intermediation and the provision of digital financial services.

12.2 However, subdued economic activity, an uncertain global outlook and funding concentration continue to pose risks. These risks are moderated by resilient financial institutions, improving domestic liquidity, recovering foreign exchange reserves and ongoing reforms. Earlier risks relating to government finances, and their impact on liquidity and the cost of funding, are being effectively addressed through fiscal consolidation and timely budget financing arrangements.

12.3 Nonetheless, continued attention is needed on vulnerabilities arising from sovereign-financial sector linkages, liquidity and funding pressures, external sector risks and concentrated exposures. Deeper interlinkages among banks, NBFIs, households, corporates and the public sector raise the possibility of risk transmission, requiring collaborative surveillance that integrates multi-source and multisectoral data.

12.4 Notably, fiscal consolidation measures and efforts to alleviate government financing pressures have significantly moderated both liquidity constraints and funding costs, while measures to address deposit concentration are ongoing.

12.5 Crypto-asset activities, climate-related financial exposures and cybersecurity threats are currently assessed as posing low risk to financial stability. However, their capacity to evolve rapidly and spread across the financial system warrants continued vigilance.

12.6 Systemic risks continue to be monitored through macroprudential indicators, which currently remain favourable. In particular, slow credit growth is producing a negative Credit-to-GDP gap, indicating limited risks from credit expansion. It should be noted, however, that disciplined and risk-mitigated credit growth is the core banking operation and the main source of profitability. It is also supportive of economic activity and, in turn, of a sound banking sector and a stable financial system. Against this background, banking sector stress tests indicate continued solvency and resilience to moderate shocks, although severe scenarios could result in prudential capital breaches.

12.7 Looking ahead, there is a concerted effort to strengthen crisis preparedness, including frameworks for bank recovery planning, bank resolution and emergency liquidity assistance. Efforts are also under way to enhance macroprudential surveillance and supervisory practices so that emerging systemic risks can be identified and mitigated.

12.8 The FSC continues to prioritise financial system integrity through implementation of AML/CFT/CPF measures ahead of the 2027 Financial Action Task Force (FATF) mutual evaluation. This is reflected in the expansion of the FSC to include the National Coordinator, AML/CFT/CPF, which elevates financial integrity within wider financial stability discussions.

12.9 Overall, the financial system remains capable of withstanding moderate shocks and supporting economic activity despite a challenging operating environment. Prudent risk management, adequate capital and liquidity buffers, and continued regulatory coordination and information-sharing continue to underpin the frameworks for addressing emerging systemic risks, enabling effective systemic assessment, early detection of emerging vulnerabilities and timely policy responses amid an increasingly complex risk environment.

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