



FINANCIAL STABILITY REPORT

MAY | 2025



FINANCIAL STABILITY COUNCIL



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ABBREVIATIONS

| | |
|---------|---|
| AI | Artificial Intelligence |
| AGC | Attorney General’s Chamber |
| AML | Anti-Money Laundering |
| ATM | Automated Teller Machine |
| BIS | Bank for International Settlements |
| BISS | Botswana Interbank Settlement System |
| BPC | Botswana Power Corporation |
| BSEL | Botswana Stock Exchange Limited |
| BWP | Botswana Pula |
| CAR | Capital Adequacy Ratio |
| CDD | Customer Due Diligence |
| CFT | Combating the Financing of Terrorism |
| CIU | Collective Investment Units |
| CorpI | Corporate Bond Index |
| CPF | Counter Proliferation Financing |
| CRE | Commercial Real Estate |
| DCI | Domestic Company Index |
| DCTRI | Domestic Company Total Return Index |
| DISB | Deposit Insurance Scheme Botswana |
| D-SIBs | Domestic Systemically Important Banks |
| D-SIFIs | Domestic Systemically Important Financial Institutions |
| D-SIIs | Domestic Systemically Important Insurers |
| DSTI | Debt-Service-to-Income |
| DTI | Debt-to-Income |
| ECB | European Central Bank |
| EFTs | Electronic Funds Transfers |
| ELA | Emergency Liquidity Assistance |
| EMDEs | Emerging Market and Developing Economies |
| EMEs | Emerging Market Economies |
| EPS | Electronic Payment Service |
| ESAAMLG | Eastern and Southern Africa Anti-Money Laundering Group |
| ESG | Environmental, Social and Governance |
| EU | European Union |
| FED | Federal Reserve Bank of the United States |
| FATF | Financial Action Task Force |
| FCI | Foreign Company Index |
| FIA | Financial Intelligence Agency |
| Fintech | Financial Technology |
| FMI | Financial Market Infrastructures |
| FSAP | Financial Sector Assessment Programme |
| FSB | Financial Stability Board |
| FSC | Financial Stability Council |
| FSDS | Financial Sector Development Strategy |
| FSR | Financial Stability Report |
| FSSA | Financial System Stability Assessment |
| FX | Foreign Exchange |
| GDP | Gross Domestic Product |
| GFSR | Global Financial Stability Report |
| GovI | Government Bond Index |
| HIS | Household Indebtedness Survey |

| | |
|--------|---|
| IADI | International Association of Deposit Insurers |
| IMF | International Monetary Fund |
| LTV | Loan-to-Value |
| MMFs | Money Market Funds |
| MoF | Ministry of Finance |
| MPC | Monetary Policy Committee |
| MPR | Monetary Policy Report |
| MoPR | Monetary Policy Rate |
| MSMEs | Micro, Small and Medium Enterprises |
| NBFIs | Non-Bank Financial Institutions |
| NBFIRA | Non-Bank Financial Institutions Regulatory Authority |
| NCO | National Coordination Office |
| NFCs | Non-Financial Corporates |
| NFIRS | National Financial Inclusion Roadmap and Strategy |
| NGFS | Network for Greening the Financial System |
| NIIP | Net International Investment Position |
| NMMFs | Non-Money Market Funds |
| NPLs | Non-Performing Loans |
| OFCs | Other Financial Corporations |
| PLR | Prime Lending Rate |
| QMTS | Quarterly Multi-Topic Survey |
| RCG | Regional Consultative Groups |
| RHS | Right Hand Side |
| RMCI | Real Monetary Conditions Index |
| SADC | Southern African Development Community |
| SCAV | FSB Standing Committee on Assessment of Vulnerabilities |
| SDR | Special Drawing Rights |
| STR | Suspicious Transactions Report |
| SSA | Sub-Saharan Africa |
| UNODC | United Nations Office on Drugs and Crime |
| USA | United States of America |
| USD | United States Dollar |
| VASPs | Virtual Assets Service Providers |
| WEO | World Economic Outlook |
| ZAR | South African Rand |

ACKNOWLEDGEMENT

The May 2025 issue of the Financial Stability Report (FSR) was prepared by the Bank of Botswana (the Bank) in collaboration with the Ministry of Finance (MoF), the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), the Financial Intelligence Agency (FIA), the Deposit Insurance Scheme of Botswana (DISB) and the Botswana Stock Exchange Limited (BSEL). The Report was approved for publication by the Financial Stability Council (FSC/Council), a statutory body established by the Bank of Botswana (Amendment) Act, 2022. The Council consists of 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; while the Chief Executive Officer, BSEL is an observer member, thus a non-voting member.



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 Financial Stability Council (FSC/Council). The Report provides analytical and performance updates for the financial sector and its impact on economic activity and welfare; encourages public discourse and engagement on financial stability issues; and helps provide information that major participants in the Botswana financial industry and elsewhere may use as input into their own financial risk assessment processes. The FSR is published twice a year (that is May and October) following discussion and approval at the FSC meetings.

Macroprudential Policy Framework

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

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

Given the structure of the Botswana economy, the macroprudential policy framework views the external sector vulnerabilities of the domestic economy through trade shocks and capital outflows, as having the greatest potential for elevated financial stability risks. There are also potential risks to the stability of the domestic financial system emanating from economic and trade disruptions induced by geopolitical tensions and economic fragmentation; continued exposure to cyber threats due to increasing usage of technology, as well as climate-related financial risks. The FSR provides an analysis of these vulnerabilities where they persist - their interaction, as well as the potential impact and response to spill overs from regional and global financial stability developments and trends. Financial soundness and macroeconomic indicators are used to assess risks to and within the financial system. Relevant and appropriate policy instruments and tools are available for use as intervention measures during periods of financial instability. The instruments and policy tools would be adjusted accordingly and timeously to mitigate the envisaged threats. Macroprudential interventions in this regard would be communicated through circulars issued, periodically, by the FSC.

Decision-making process

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

The FSC is a statutory body as per Section 20 (54B) of the Bank of Botswana (Amendment) Act, 2022. It is responsible for (a) preserving the stability of the financial system; (b) ensuring cooperation between its members with respect to the assessment of the build-up of economic and financial sector systemic risks in Botswana; (c) developing coordinated policy responses to risks including crisis management; and (d) making recommendations, issuing warnings or opinions addressed to regulatory bodies regarding financial institutions.

The FSC is chaired by the Governor, and the Bank acts as the secretariat. The work of the FSC used to be governed by a memorandum of understanding signed in February 2019 and has since been subsumed 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 regarding the stability of the domestic financial system. The Press Release further highlights the key risks in the financial system and recommendations to address such vulnerabilities. Policy decisions are communicated through a circular to all affected financial institutions. The circular provides a brief description that links the identified risk with the intermediate objective and explains the way measures taken are expected to mitigate the risk.

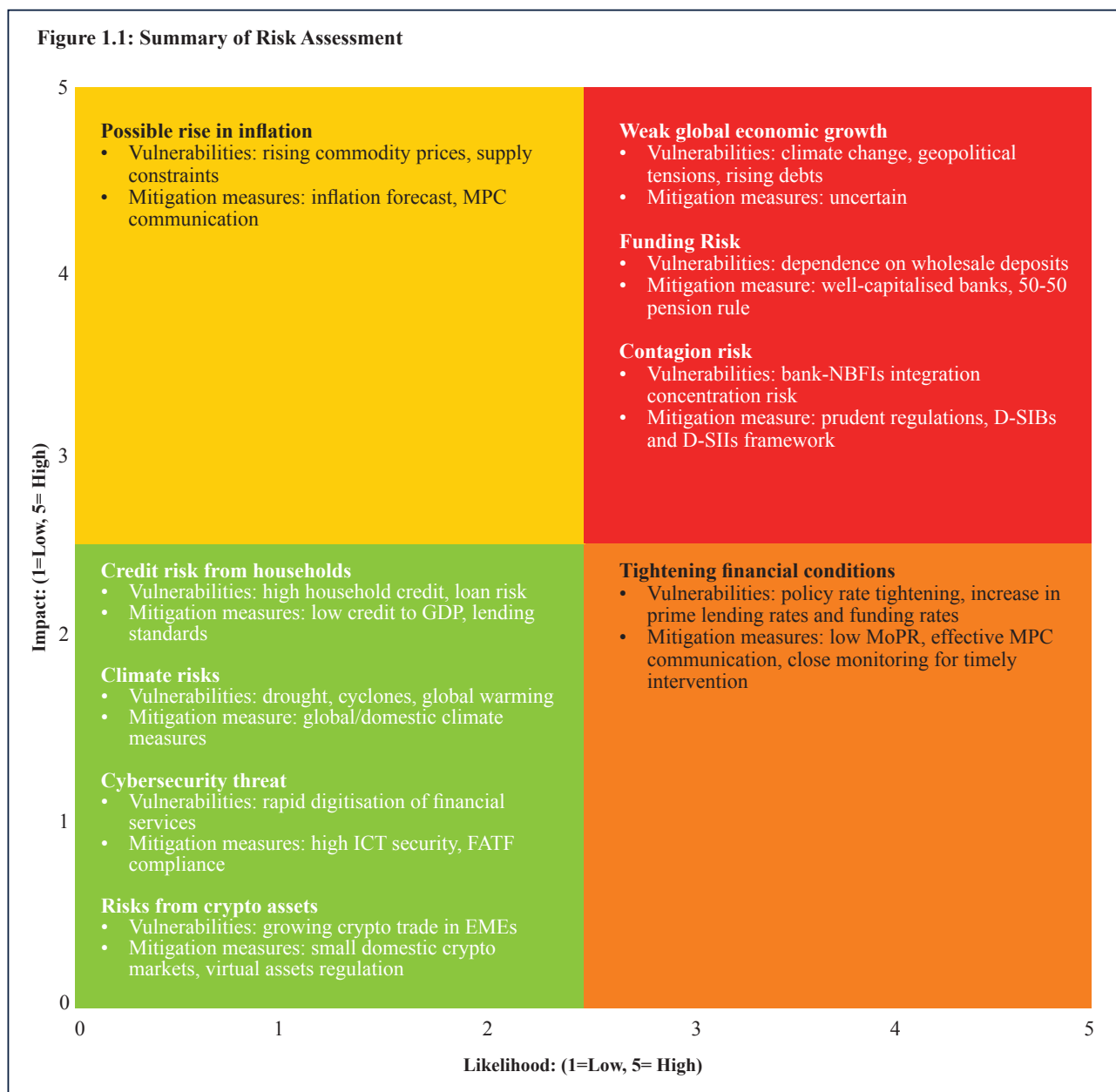
1. EXECUTIVE SUMMARY

- 1.1 **The April 2025 Global Financial Stability Report (GFSR) points to increased financial stability risks** owing to growing market uncertainty, stretched asset valuations, high sovereign debt, shifting trade policies and patterns as well as high leverage. The report indicates that sovereign vulnerabilities have intensified due to tighter global financial conditions, elevated debt levels and fiscal pressures and warns of further market turbulence in sovereign bond markets and associated higher refinancing costs for Emerging Market and Developing Economies (EMDEs). The GFSR further indicates that a sharp repricing in equity markets, fuelled by shifting trade policies and policy uncertainty is driving heightened market volatility and weakening investor sentiment. At the same time, highly leveraged and interconnected non-bank financial institutions (NBFIs) have the potential to amplify systemic vulnerabilities and undermine global financial stability. In the circumstances, the Financial Stability Board (FSB) observes that long-standing underlying vulnerabilities persist and could be amplified by a range of shocks. In its assessment of vulnerabilities for the first half of 2025, the FSB considers asset price valuations to still be elevated and stretched, accompanied by high non-financial sector debt and associated debt servicing pressures, as well as leverage and liquidity challenges in NBFIs. The FSB further considers geopolitical tensions and associated uncertainty, as well as higher interest rates, to be potential triggers that could interact with underlying vulnerabilities to destabilise the global financial system.
- 1.2 **Regional financial stability risks remain moderate, even though global developments could amplify financial system vulnerabilities in the Sub-Saharan African (SSA) region.** Common vulnerabilities (structural risks) in the region include high public debt and associated debt servicing costs, high levels of concentration on financial institutions' balance sheets, elevated interconnectedness in the financial system, climate vulnerabilities and financial system integrity issues that have led to greylisting by the Financial Action Task Force (FATF). On the back of rising public debt in EMDEs, the April 2025 IMF GFSR recommends communication with creditors, multilateral cooperation and increased support from the international community to debt-burdened countries to mitigate sovereign debt risks.
- 1.3 **Domestically, the macroeconomic environment remains uncertain amid weak fiscal position.** Fiscal challenges emanate from pressured public revenues due to weaker diamond market performance. These macroeconomic conditions exacerbate some of the vulnerabilities in the financial system, specifically management of liquidity by banks. Excess liquidity in the banking sector was at a historic low of P764 million in March 2025, compared to the P10.5 billion in the corresponding period in 2024, largely due to net foreign exchange (FX) outflows (given low diamond sales) and a slowdown in government spending. Under these circumstances, the Bank of Botswana (Bank) intervened twice to support market liquidity, first by slashing the primary reserve requirement to zero, which released about P1.8 billion into the market. Furthermore, the Bank, effective 22 April 2025, extended the duration of repurchase agreements (repos) with commercial banks from overnight to 7 days to enhance liquidity management options. Despite the changed liquidity situation, banks continued to maintain healthy liquidity positions and met the minimum liquidity requirement of 10 percent. Overall, underlying structural issues, including asset/funding concentrations, as well as deep interconnections also present contagion risks that could be triggered by liquidity and leverage shocks.
- 1.4 **Notwithstanding the forementioned sources of risk, the latest financial stability indicators suggest that both banks and NBFIs remain resilient, with strong liquidity, profitability, and solvency indicators.** The banking sector experienced steady asset growth supported by an increase in lending, thus credit expansion continues to be positive and supportive of economic growth. Furthermore, a negative Credit-to-GDP gap in 2024 indicates limited risks of economic overheating emanating from commercial bank credit. There is also some notable recovery in the domestic capital market as reflected in the appreciation of key market indices, while financial market infrastructures remain stable and robust, thus promoting domestic financial stability. Overall, the strong leverage and capital positions,

liquidity buffers, profitability and effective regulatory and supervisory frameworks reinforce the sectors' resilience.

1.5 **Notwithstanding, vulnerabilities have increased in the financial system due to weakening macroeconomic fundamentals (Figure 1.1).** The combination of contraction of economic activity, which continues to be subdued, lower export earnings, elevated foreign exchange outflows to cover imports and government financial obligations has led to a decline in foreign exchange reserves and a worsening external position. At the same time, continuing increase in government expenditure, in part meant to address the country development needs, further strains the fiscal position. In turn, the weakening of both fiscal and external buffers could have implications for the exchange rate framework. Therefore, there is need to respond to both the recent and the structural sources of vulnerabilities in order to safeguard financial stability over the short and long term. These vulnerabilities and policy responses were discussed by the Financial Stability Council (FSC) at its 8 May 2025 meeting, with emphasis on the need for financial sector regulators and financial institutions to continue being vigilant in monitoring risks and liquidity related developments, including distribution and pricing, to inform timely intervention, as warranted, to safeguard financial stability. Box 1 presents the press release of the FSC, which summarises key outcomes of the 8 May 2025 meeting.

Figure 1.1: Summary of Risk Assessment



Box 1: Financial Stability Council Press Release

The Financial Stability Council (FSC/Council) met on 8 May 2025 to discuss the prevailing state and outlook of financial stability, including related risks emanating from the domestic and global environments as well as appropriate policy responses to avert the buildup of vulnerabilities. Members also deliberated on prospective developments affecting the financial sector and ongoing FSC work programme. These include harmonisation of corporate governance principles, and enhancement of resolution and crisis management frameworks for the financial sector.

Fundamentally, the FSC judged that the financial system remains safe, sound and key for supporting economic activity. However, the increasingly uncertain macroeconomic environment, characterised by a deteriorating fiscal position, slow economic growth and structurally lower levels of liquidity in the financial system, were a potential source of risk to financial stability. The rising interconnectedness and funding concentration across the entire financial system were also concerning. It was observed that funding concentration limits market activity and distribution of liquidity, resulting in higher funding costs that potentially undermine monetary policy transmission. In the circumstances, financial sector regulators and financial institutions should continue to be vigilant in monitoring risks to credit exposures and liquidity related developments, including distribution and pricing, to inform timely intervention, as warranted, to safeguard financial stability.

Since the last FSC meeting in November 2024, risks to global financial stability have increased. This is due to growing market uncertainty, elevated valuations of financial assets, liquidity vulnerabilities in non-bank financial institutions (NBFIs), high sovereign and private debt and associated repayment pressures, as well as impact of geoeconomic fragmentation. These spillovers to the domestic sources of risks and vulnerabilities that include low economic growth rates, weakened and deteriorating fiscal position and the impact of concentrated and low levels of liquidity on pricing of funding and credit quality and, in turn, financial stability.

The domestic macroeconomic environment has recently become increasingly challenged by weaker diamond market performance, with adverse implications for fiscal and external sector stability. The fiscal conditions elevate the potential to negatively impact the rest of the economy, including the financial sector; given the relative size and influence of government and diamonds market. An immediate outcome, in this regard, is the historic low level of commercial bank's liquidity, occasioned by net foreign exchange outflows and a slowdown in government spending. This development has implications for the overall cost of funding, both deposits and credit, notwithstanding the accommodative policy stance.

Under these circumstances, the Bank of Botswana (Bank) intervened to support market liquidity, firstly by adjusting the primary reserve requirement to zero, in December 2024, which released about P1.8 billion into the market and secondly, by extending the maturity of repurchase agreements contracts (repos) with commercial banks from overnight to seven days (effectively, longer duration for lending to commercial banks by the Bank of Botswana). As is the case with excess liquidity, the Bank's monetary operations instruments are structured to similarly cater for the advent of market liquidity shortage.

It is observed, nevertheless, that there is need to address structural aspects including prospective lasting transition to low levels (and shortages) of liquidity, funding concentration and relatively

large foreign currency holdings by commercial banks, as well as risk of sustained misalignment of the market pricing of funds with the monetary policy transmission. Therefore, the member regulatory institutions, collectively and individually are pursuing relevant and appropriate policy and regulatory responses, including engagements with key stakeholders and market players. Moral suasion and other regulatory measures will continue to be used by regulators to ensure financial stability and consumer protection.

Other risks to financial stability pertain to cyber threats and climate change, which continue to be monitored and addressed through continuous institutional capacity and risk management enhancements. Specific to climate risks, the Bank joined the Central Banks and Supervisors Network for Greening the Financial System (NGFS), as a Plenary Member on 4 March 2025. Membership of the NGFS is expected to strengthen the country's participation and collaboration on global climate dialogue, while concurrently providing an opportunity for development and calibration of frameworks and mechanisms for integrating climate change considerations for effective financial stability surveillance.

There are also strong macro-financial linkages, and related concentration risks, involving the financial and external sectors and fiscal performance. The interconnectedness is a source of possible contagion risk; wherein a weakness in one of the elements could easily be transmitted into others, creating broader instability. This particular risk to financial stability, along with others, is mitigated by financial policy initiatives undertaken over time, and the legislative reviews that help evolve effective regulatory and supervisory mechanisms to be in line with emerging market developments; for example, financial innovation and technology, digitalisation, cybersecurity and climate change.

Forthcoming regulatory developments aimed at protecting the consumer and enhancing financial inclusion comprise Banking Regulations, Policyholder Protection Fund rules, Non-Bank Lenders Bill, Electronic Payment Services Regulations and the Health Insurance Bill, among others.

Ongoing regular identification and designation of domestic systemically important financial institutions by relevant regulatory authorities serve to enhance surveillance for systemic (and interconnected) institutions, to help prevent and pre-empt systemic (contagion induced) crises. Other key aspects of the work programme of the FSC include harmonising corporate governance principles, to avert regulatory arbitrage, and enhancement of resolution and crisis management frameworks for the financial sector.

Council further noted that financial conduct and integrity risks are generally contained, and there is continuing progress towards strengthening the Anti-Money Laundering/Countering the Financing of Terrorism/Counter Proliferation Financing (AML/CFT/CPF) framework. A mock mutual evaluation was conducted in June 2024 to identify deficiencies in the framework and gauge the country's preparedness for the 2027 Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) mutual evaluation. The report and action items from the exercise are being addressed by relevant authorities with a view to closing gaps in the AML/CFT/CPF framework and informing appropriate and timely interventions before the mutual evaluation. Notably, the Financial Intelligence (Amendment) Act, 2025 established a National Coordination Office, which shall be responsible for AML/CFT issues at a national level. Accordingly, an AML/CFT Strategy for 2025–2030 has been developed to provide strategic direction and approach on handling money laundering and terrorist funding risks nationally.

Overall, the domestic financial system continues to be financially sound and stable, with sufficient capital, liquidity and profitability levels. The non-performing loans ratio for the banking system and non-bank lenders was modest, with low credit exposure risk (as indicated by the negative Credit-to-Gross Domestic Product gap); thus, providing room for further prudent credit extension to support economic development. This situation, along with other positive sectoral developments, such as the increase in the value of shares listed on the stock exchange and robust financial market infrastructures, contribute to the growth of the financial system and its effectiveness in supporting broader economic activity. The resilience of the financial sector is underpinned by appropriate policy frameworks that entail effective regulatory and supervisory frameworks.

The FSC, therefore, affirms its commitment to domestic financial sector surveillance and swift remedial responses to threats to financial stability, as well as contributing to related legal, policy and institutional advancements.

The next meeting of the FSC is scheduled for 6 November 2025.

2. GLOBAL FINANCIAL STABILITY

The IMF warns of potential further market corrections

2.1 The April 2025 GFSR warns of heightened risk of market correction driven by high valuations in some asset classes such as technology sector equities, highly leveraged non-bank financial institutions linked to banking systems, indebted sovereigns facing debt sustainability challenges, and geopolitical tensions, which can trigger stock price drops and raise sovereign risk premiums. Key drivers include tight financial conditions involving increasing borrowing costs, trade policy uncertainty from tariff change announcements which can spark asset sell-offs; high leverage in hedge funds risking rapid unwinding; high government debt threatening bond market stability, and geopolitical events causing immediate declines in stock prices. These risks transmit through asset price volatility, capital flow reversals, and cross-border spillovers, amplifying instability, particularly in emerging markets with currency depreciation and liquidity strains.

2.2 The report further warns that due to the uncertain conditions, long-term growth prospects for emerging market economies (EMEs) have become less optimistic leading to growing risk premiums associated with EME financial assets. Consequently, there is a growing appetite for United States of America (USA) stocks, which is further weighing down on stock prices for EMEs, especially for commodity exporters who are the most likely to be negatively impacted by trade disruptions. Furthermore, monetary policy easing to boost economic growth in EMEs is expected to push down risk-adjusted returns on carry trades involving EME currencies, amplifying capital outflows.

The IMF warns against growing sovereign debt

2.3 The IMF's April 2025 Fiscal Monitor warns of a deteriorating global fiscal environment, with public debt to GDP projected to rise by 2.8 percentage points in 2025 and exceed 100 percent of global GDP by 2030. In a severe downside scenario, global debt could reach 117 percent of GDP by 2027, raising the risk of systemic financial crises and market

disruptions. Key drivers include sluggish growth, persistent inflation, elevated interest rates, geopolitical tensions, and increasing defence spending funded by debt, particularly in Europe. High debt levels could restrain policy space to address future shocks, elevate sovereign risk premiums, while also rationing out debt burdened economies from the sovereign bond market. Such shifts could trigger tighter credit conditions, generating full-scale liquidity stress and fiscal fragility.

2.4 The debt dynamics for advanced economies are somewhat different, with pressures emanating from ageing populations and structural spending needs that jeopardise long-term debt sustainability. Meanwhile, emerging and developing economies contend with volatile capital flows, declining commodity prices, tighter financing, and reduced concessional funding that compound sovereign debt risks. These could spill over into banking sectors through increased non-performing loans and thus undermine financial stability. The composition of public debt adds further risks: where countries with short debt maturities or high foreign investor participation face elevated rollover risks and sudden capital outflows that amplify fiscal and financial vulnerabilities.

2.5 Rising debt vulnerabilities, stemming from a combination of high public and private debt levels, high interest rates, currency depreciations, and sluggish economic growth are a growing concern for emerging markets and developing economies (EMDEs). For most EMDEs, these vulnerabilities have been perpetuated by commodity price volatility, structural economic and governance weaknesses, and limited access to capital over concerns on debt sustainability. Many EMDEs borrowed heavily during the low-interest rate era (2010s) and in 2020/21 to alleviate the impact of the COVID-19 pandemic. Advanced countries started increasing policy interest rates in 2022 to fight high inflation and, subsequently, borrowers face significantly high debt service costs. For EMDEs, this has been worsened by currency depreciations against the US dollar, increasing the burden of foreign-currency-denominated debt, especially for countries with weak external buffers and

those with high dependence on commodity export earnings. Public Debt-to-GDP ratios are therefore surging, along with widening fiscal deficits. Moreover, debt fundamentals worsen due to slowing economic growth, which means that debt is growing faster than economic output.

- 2.6 In response, the IMF calls for countermeasures to mitigate these risks, including among others, developing credible medium-term fiscal consolidation policies, broadening tax bases, strengthening public financial management, and pursuing timely debt restructuring. Without decisive reforms, fiscal shocks could destabilise financial systems, deepen vulnerabilities, and hinder economic recovery.

Growing geopolitical tensions and trade fragmentation

- 2.7 The April 2025 GFSR highlights rising global risks stemming from escalating geopolitical tensions and reduced international cooperation (global fragmentation), which contribute to increased uncertainty in the global economic outlook. In particular, the US trade policies and retaliatory actions by other countries, have the potential to fuel inflation, destabilise markets, and reduce global output. These developments are likely to interact with and accentuate the existing vulnerabilities such as high asset valuations, and the rising and persistently high private and government debt, with implications on global financial stability.
- 2.8 The FSB Standing Committee on Assessment of Vulnerabilities (SCAV)¹ report for the first half of 2025 (VA:2025H1) identifies the same risks. However, in addition, it alludes to the deepening scale of technological advancements and resultant interconnectedness which continues to pose a threat to operational resilience. At the same time, climate-related risks could have widespread impact and challenge already existing vulnerabilities related to insurance cover shortfalls. Box 2 summarises the global vulnerabilities as assessed by the FSB.

¹ The Standing Committee on Assessment of Vulnerabilities (SCAV) is the FSB's main mechanism for identifying and assessing risks and vulnerabilities in the financial system. To access current members names and profiles go to the following link. <https://www.fsb.org/about/organisation-and-governance/members-of-standing-committee-on-assessment-of-vulnerabilities/>

Box 2: Salient Points from the FSB Vulnerabilities Assessment for the First Half of 2025

a) Introduction

The FSB SCAV released the results of the Vulnerabilities Assessment for the first half of 2025 (VA:2025H1). The survey was completed in January 2025 with 27 responses from the SCAV members and 50 responses from Regional Consultative Groups (RCGs), including SSA countries such as Botswana. The survey summarises participants views on the overall level of global vulnerabilities, net of mitigants/resilience. SCAV defines global vulnerabilities as those judged to be present in the global financial system either because, by their nature, they are relevant to a large number of jurisdictions or have the potential to spill over to other jurisdictions.

b) Vulnerability Assessment

The survey identifies elevated asset price valuations, high levels of non-financial sector debt, and leverage and liquidity vulnerabilities in NBFIs as long-standing vulnerabilities in the global financial system which, have the potential to cause instability should the associated triggers or shocks manifest, for example, sharp market corrections. According to the survey, geopolitical risks, higher interest rates, debt servicing dynamics in emerging markets, and operational vulnerabilities including cyber-attacks could act on the underlying vulnerabilities with severe consequences for financial stability. It is noteworthy that the respondents generally assessed global vulnerabilities as being higher than their domestic/regional vulnerabilities, with two-thirds of SCAV survey respondents and more than half of RCG respondents rating global vulnerabilities as “high”. The FSB attributes high ratings of global vulnerabilities to concerns around the downside risks emanating from global challenges and the associated uncertainties that may not have been fully considered by market participants. The vulnerabilities assessment heatmap (Figure B2.1) shows enduring concerns around assets prices for both financial markets and banks, as well as elevated vulnerability for banks’ assets quality across RCGs. Cross-border interconnectedness seems to be a concern amongst SCAV respondents; rated “high” or just below “high”, and thus reflective of their potential to propagate risk across financial systems.

c) Assessment of Surveillance Indicators

An assessment of surveillance indicators shows that some lowly rated vulnerabilities still deserve attention. In particular, the low rating (i.e. sovereign debt) explains the relative comparison across vulnerabilities with new vulnerabilities considered more urgent, thus reflecting the tendency to accept long-standing vulnerabilities and rate new or unfamiliar ones higher. Otherwise, the surveillance indicator heatmap (Figure B2.2) shows that most of the vulnerability indicators are at an unusually high level by historical standards. The survey further shows that most concerns around the vulnerability of the financial system emanate from financial markets and the non-financial sector, being government and households, specifically associated with sovereign borrowing, household assets, cross border interconnections, and financial assets prices. Sovereign debt has been above historical levels and a major source of vulnerability since 2020, and this reflects elevated borrowing to finance COVID-19 related government expenditure. The banking system fares better than all other sectors, owing to strong and robust post-global financial crisis micro prudential supervision. Nevertheless, financial assets are susceptible to sudden unwinding in the market, and these coupled with sustained market volatility could spill over to banks, and non bank investors alike, triggering vulnerabilities such as leverage and liquidity mismatches. Additionally, the interlinkage between banks and NBFIs, could easily propagate shocks in domestic financial systems and across borders leading to financial instability in and across countries.

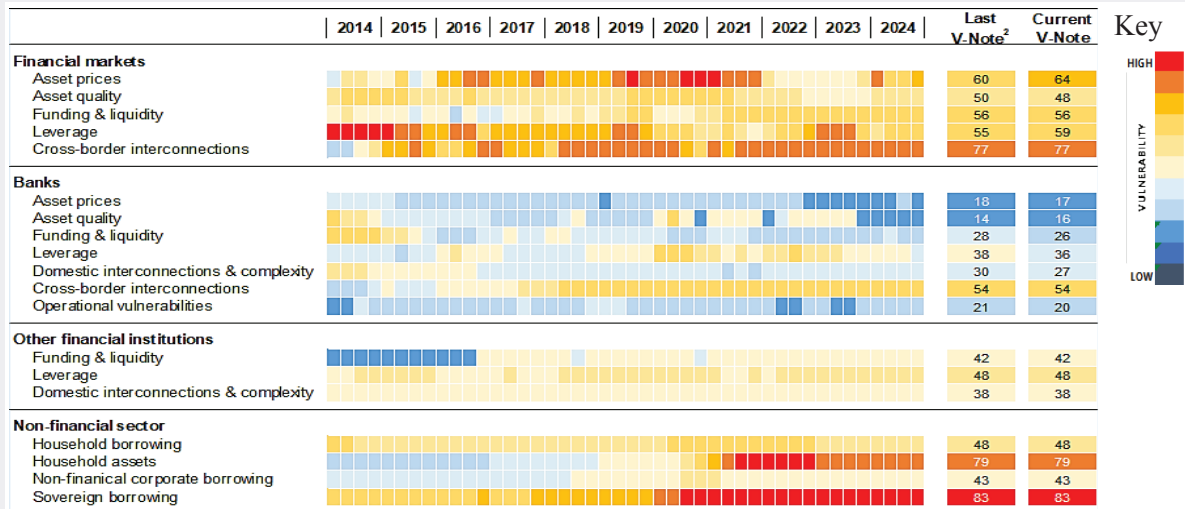
Figure B2.1: FSB Vulnerabilities Survey Heatmap



Note: The survey asked participants to name their top three vulnerabilities in terms of impact. The column for the Current V-Note shows the latest data point for the vulnerability indicators, while the column for the Last V-Note shows the reading for the previous vulnerability indicator. The numbers within each cell indicate the percentage of respondents citing each vulnerability in the survey.

Source: Financial Stability Board

Figure B2.2: FSB Surveillance Indicator Heatmap



Source: Financial Stability Board

d) Conclusion

The FSB report shows that while economic growth is forecast to continue at a moderate rate, there exists significant uncertainty about the economic and financial outlook. The downside risks such as adverse geopolitical developments and possible high interest rates could easily trigger the underlying vulnerabilities in the global financial system. With the likely realignment in bond yields and further strengthening of the US dollar, the high sovereign debt for EMDEs is likely to result in volatile capital flows. The global financial system must contend with emerging climate-related risks, transition risks from abrupt changes in government climate policies, potential repricing of climate exposed assets, alongside emerging vulnerabilities in crypto assets and increasing technological complexity and interconnectedness as well as related cyber-attacks. Countries must therefore continue to monitor and assess vulnerabilities and discussion of potential actions to stabilise the financial systems.

Currency depreciation and exchange rate volatility for EMDEs

- 2.9 EMDEs face persistent currency depreciation and exchange rate volatility driven by narrowing US - EMDE interest rate differentials, capital flow instability, geopolitical shocks, and structural vulnerabilities. The IMF, Bank for International Settlements (BIS) and The World Bank highlighted these challenges in 2024, and according to the April 2025 GFSR these have spilled over into 2025 with significant implications for global financial stability. The reports note that the maintenance of the Federal Reserve Bank (FED) interest rate at higher levels for longer is the major reason for the continuous depreciation of EMDE currencies against the US dollar.
- 2.10 The World Bank's "Finance and Prosperity 2024" report highlighted that 40 percent of small-state EMDEs were in debt distress, amplifying currency depreciation as foreign exchange reserves for EMDEs fell by 7 percent since 2022 (BIS, 2024), while NBFIs' growing leverage spiked market swings. Debt distress is also eminent, with the October 2024 Global Financial Stability Report (GFSR) warning that a 100-basis points FED rate hike, would slash EMDE economies' GDP by 0.8 percent against about USD320 billion debt due in 2025, leading to heightened debt roll over risk. The report concludes that some major EMDEs may stabilise as inflation pressures ease in 2025, while frontier markets face high depreciation risks if oil prices were to increase due to escalating conflicts in the Middle East. This could increase debt distress and might trigger defaults, precipitating global financial instability. Ultimately, resilience to these shocks hinges on global policy coordination with the World Bank observing that IMF quota reforms expected in June 2025 could unlock USD100 billion that could sustain frontier markets and avoid prolonged economic instability.

Growing sovereign-bank nexus in EMDEs

- 2.11 The sovereign-bank nexus in EMDEs, characterised by the increasing exposure of domestic banks to their governments' debt, poses a significant threat to global financial stability. Both the IMF and the World Bank

highlight persistently high public debt, in part, traceable to COVID-19 responses, which continue to present sovereign vulnerabilities in EMDEs, including the increased interconnectedness of government and banks. According to the April 2025 GFSR, as EMDEs and frontier countries face difficulties in raising funds in premium markets, they have resorted to domestic borrowing comprising issuance of bonds and direct private borrowing from banks. This has created a feedback loop where sovereign distress can destabilise banks. This is particularly relevant as concerns about possible tightening of both monetary and financing conditions persist with the potential to amplify debt sustainability risks, thus potential for sovereign defaults at the expense of banking sector stability. Given these growing concerns, there is an urgent need for fiscal consolidation in EMDEs to alleviate negative market sentiments and sustain global financial stability.

Concerns about spillovers from China

- 2.12 According to IMF World Economic Outlook update and the April 2025 GFSR, China's growth has slowed due to the property market collapse and weak consumer demand, with deflation persisting. Stimulus measures, including policy interest rate cuts and a USD1.4 trillion stimulus package, triggered a 2024 stock market rally that, however, could not deliver the desired growth levels. At the same time, US tariffs are expected to put pressure on the renminbi, while exports and high-technology sectors remain strong.
- 2.13 The interconnected nature of the global economy means that China's economic health has far-reaching consequences. Several key concerns dominate, including the fact that many economies, particularly in Asia and commodity-exporting nations are heavily reliant on demand in China. Furthermore, China's central role in global supply chains means disruptions in its production can also cause widespread economic challenges.

- 2.14 Ongoing concerns about China’s real estate sector, debt levels, and overall economic slowdown necessitate careful monitoring and proactive risk mitigation strategies on a global scale.

EMDEs battling continually narrowing policy space

- 2.15 EMDEs contend with persistent high inflation, limiting their ability to stimulate growth through monetary policy. This narrowing policy space increases the risk of sudden capital outflows as investor sentiments dampen, potentially triggering currency crises and asset price declines. The World Bank’s “Finance and Prosperity 2024” report argues that prudent fiscal and monetary policies, along with international support, are essential to maintain stability in EMDEs and frontier markets.

Economic growth prospects revised down

- 2.16 The April 2025 World Economic Outlook (WEO) indicates that optimistic growth sentiments captured in the January 2025 WEO update have been interrupted by growing trade tensions amid the ongoing tariff stand-off between the US and China, as well as the imposition of tariffs by the US on other countries. As such, the April 2025 WEO forecasts global growth at 2.8 percent for 2025 and 3.0 percent for 2026, a significant downward revision from the January 2025 WEO Update’s 3.3 percent for both years. Overall, risks associated with growing geopolitical tensions and anticipated financial market repricing threaten further slowdowns, although tariff relief or fiscal stimulus could offer an upside.

- 2.17 Inflation dynamics have shifted since January, with global headline inflation projected at 4.3 percent in 2025 and 4.4 percent in 2026, compared to January’s 4.2 percent and 3.5 percent, respectively, as tariff-induced supply shocks slow disinflation. Thus, there are emerging concerns of renewed pressures from trade policies, which could potentially complicate monetary policy normalisation and sustaining inflation risks.

- 2.18 In the prevailing global macroeconomic conditions, the IMF recommends that countries should balance growth-inflation strategies, rebuild fiscal buffers, and pursue structural reforms to boost productivity. The WEO also emphasises urgent international cooperation to stabilise trade, mitigate risks like financial tightening, and address demographic pressures.

3. REGIONAL FINANCIAL STABILITY

High public debt levels and debt distress

3.1 The April 2025 Regional Economic Outlook for Sub-Saharan Africa (SSA) underscores severe sovereign debt vulnerabilities, with the public debt-to-GDP ratio at 59.8 percent in 2023, projected to ease to 59.3 percent by 2025 per the IMF's October 2024 data, though earlier estimates suggested 56.8 percent. External borrowing costs for market-access countries have risen by about 3 percentage points over three years, driving domestic borrowing, raising domestic yields, shortening maturities, and increasing bank exposure to sovereign risk. Reliance on costly non-concessional borrowing and syndicated loans diverts funds from health, education, and infrastructure. Macroeconomic imbalances, including double-digit inflation and exchange rate pressures, inflate foreign debt costs, while climate vulnerabilities spur costly borrowing for disaster recovery amid scarce concessional finance.

3.2 Social and political unrest, driven by poverty and high living costs, complicates debt-stabilising reforms like the potential to increase taxes, requiring balance to protect vulnerable groups. The IMF recommends strengthened public finances, revenue enhancing measures, and pro-growth reforms, and alludes to historical debt reductions averaging 12 percentage points over three years. Increased concessional international support is vital to ease borrowing cost pressures and support development, as debt service consumes 40 percent of revenue versus 10 percent in advanced economies. Challenges like inflation and foreign currency debt demand resilient policymaking for a sustainable recovery in SSA. The cost of external borrowing for market-access countries has increased in the past three years by close to 3 percentage points, in line with global benchmark yields. This has resulted in increased borrowing by some countries, which has contributed to higher domestic interest rates. The IMF observes that a trend shift to non-concessional and market-based borrowing, recent reliance on

higher-cost debt and increased exposure to the sovereign have added to the region's fiscal burden.

Global economic headwinds threaten SSA growth

3.3 The uneven global economic growth, exacerbated by ongoing geopolitical conflicts, economic fragmentation and elevated uncertainty regarding trade policies, pose significant threats to economic growth for SSA countries, amplifying financial system vulnerabilities. Several countries in the Southern African Development Community (SADC) are heavily reliant on export of primary commodities for revenue, and therefore, face reduced demand (where there are product substitutes and/or because of weak performance of importing country) that could undermine fiscal performance and consolidation efforts. These risks have the potential to escalate fiscal imbalances and worsen the debt burden for the SSA economies.

4. DOMESTIC FINANCIAL STABILITY

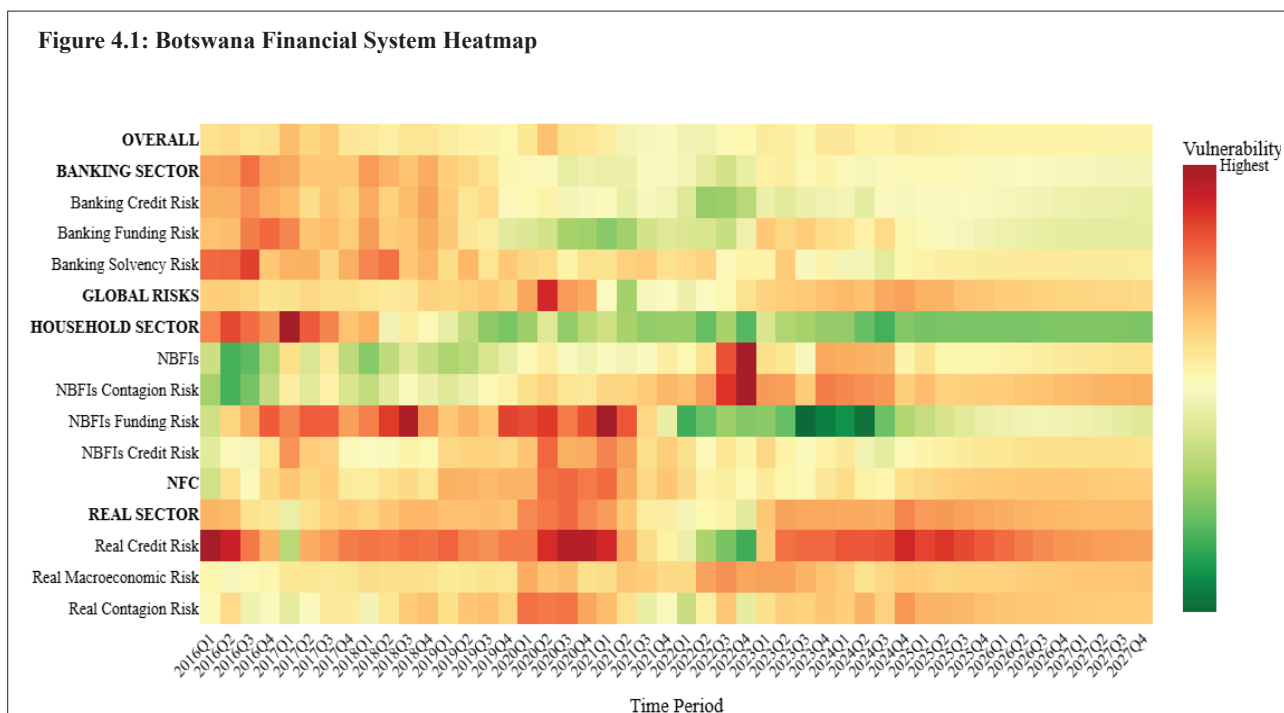
Domestic systemic vulnerabilities are intensifying

- 4.1 Botswana's financial system vulnerabilities mainly emanate from a landscape historically prone to diamond-driven economic shocks, with recent significant manifestations during 2018 - 2020 and 2022 - 2023, due to global economic downturns and the COVID-19 pandemic. The heatmap in figure 4.1 shows moderate-to-high stress levels, driven by a 3 percent GDP contraction in 2024 due to a sharp decline in diamond sales, weak global demand and adverse weather. The April 2025 WEO forecasts a -0.4 percent GDP growth for 2025, a lower contraction than 2024, suggesting a slight easing of adverse effects, although structural vulnerabilities persist. In relation to financial stability, this necessitates a holistic analysis of systemic risks, transmission channels, and identification of mitigation responses.
- 4.2 The interconnectedness of Botswana's financial system entities amplifies systemic risks, through the variety of interlinked transmission channels involving risk to overall stability. For instance, the real sector's high vulnerability, evident in the heatmap's red zones during periods of diamond price slumps, directly impacts Non-Financial Corporations (NFC), particularly mining firms, leading to increased default risks that cascade into the banking sector through rising non-performing loans (NPLs). This stress is visible in the banking sector's high funding and credit risks, which, in turn, potentially limits credit availability to NFC and households, further depressing economic activity. Simultaneously, the household sector faces elevated credit risks from reduced incomes threatening asset quality that could exacerbate banking sector stress. NBFIs also exhibit moderate-to-high funding and contagion risks, which could reduce liquidity provision to other sectors, amplifying systemic liquidity risks. The heatmap's trends, such as banks' funding risk remaining high and NFC default risks peaking in the fourth quarter of 2024, underscore the bidirectional and multifaceted nature of these transmission channels, creating
- a feedback loop that heightens overall financial instability. Meanwhile, shocks originating from the real sector could serve as the initial trigger, especially with a weaker fiscal position (given the dependence on government).
- 4.3 Stress levels, as of the fourth quarter of 2024 reflect the economic contraction. The banking sector's funding risk is high due to reliance on wholesale funding and low liquidity resulting from constrained government spending amid faltering diamond exports. The NFC sector shows high default risks, possibly coming from diamond-related firms, while the household sector faces significant credit stress from economic contraction and potential food price inflation, despite headline inflation being low so far in the first half of 2025. NBFIs exhibit persistent funding risks, though less severe than in previous years, with the heatmap projecting a gradual decline in vulnerability to low levels by 2026 - 2028. The projected smaller 0.4 percent GDP contraction by the IMF in 2025 (3 percent in 2024) suggests slight easing of adverse factors. However, structural fragilities, such as the banking sector's funding concentration and the economy's diamond dependency, pose ongoing risks. External factors, including global economic uncertainty and adverse weather events (for example, drought in 2024 and flooding in March 2025), worsens these vulnerabilities, necessitating a proactive approach to manage systemic risks and resultant stress.
- 4.4 To mitigate these systemic risks, Botswana must adopt a multifaceted strategy that addresses the interconnected vulnerabilities across sectors. Fundamental in this regard is economic diversification to reduce over reliance on diamond exports and enhance resilience. Expanding key sectors such as eco-tourism, sustainable agriculture, and value-added manufacturing, in line with national development aspirations, can create more resilient economic foundations.
- 4.5 Enhancing the financial sector's resilience requires improving liquidity management, particularly by reducing dependence on wholesale funding for banks and NBFIs, and

strengthening capital buffers to absorb shocks, as recommended in the IMF’s 2024 Article IV report for Botswana. At the same time, development of financial safety nets, such as the establishment of the emergency liquidity assistance (ELA) facility would underpin systemic stability and, therefore, concrete efforts should be made to implement the recommendations of the recently completed Technical Assistance on ELA by the IMF.

Supportive fiscal and monetary policies are also essential to sustain price stability, and to rebuild fiscal buffers to handle future shocks, underpinning long term sustainable economic growth. Overall, by addressing these interconnected risks, Botswana can mitigate shock transmission channels, such as NFC defaults impacting banks and households, and strengthen financial stability in the face of ongoing economic challenges.

Figure 4.1: Botswana Financial System Heatmap



Electricity supply challenges to exacerbate macroeconomic vulnerabilities

4.6 The Botswana Power Corporation (BPC) started electricity load management in March 2025, citing maintenance issues at the Morupule B power station. The subsequent power outages, should they prolong, are expected to further dampen economic activity and prospects for the macroeconomic recovery. A resultant fall in private sector activity would lead to a reduction in tax revenue, which has the potential to worsen the fiscal deficit. At the same time, power disruptions are likely to impair the implementation of government projects, with adverse consequences, including with respect to financial sector liquidity.

Unlicensed entities dominate illegal deposit taking

4.7 The Financial Intelligence Agency’s (FIA) suspicious transactions reports (STR) for the period April to September 2024 indicate that the banking sector filed 94.5 percent of the STRs. During the same period, 60 percent of STRs were related to illegal deposit taking, whereby funds were solicited from the public for purported “investments” by unlicensed entities. Collectively, STRs on illegal deposit taking amounted to P25.8 million, whereas STRs related to large cash deposits amounted P40 million. FIA, working with law enforcement agencies and the courts continue to enforce the laws and strive for compliance

with the AML/CFT requirements. During the April to September 2024 period, the Agency attended to 42 requests for financial information to support financial investigations on money laundering and associated predicate crimes, which included possession of illicit substances as well as corruption and economic crimes.

4.8 Meanwhile, the domestic virtual assets market is still developing and relatively unsophisticated, thereby posing limited risks to financial stability. Cyber risks arising from financial technology (Fintech) are also considered minimal but may rise with increased technological complexity and interconnectedness. Notwithstanding, cyber risks overall remain among the top five national security risks (Box 3) and as such, the development and adoption of appropriate laws, regulations, frameworks, and surveillance tools is crucial to the early detection and prevention of cyber threats.

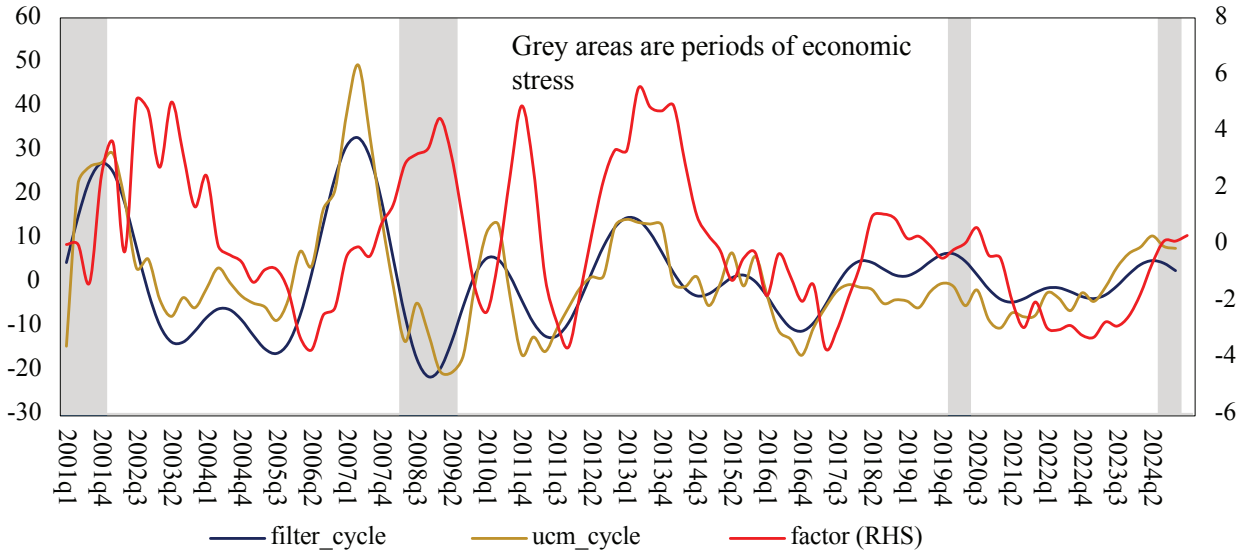
4.9 According to the Botswana Communications Regulatory Authority 2024 annual report, there were approximately 99,100 cybersecurity incidents in 2024, with the top five cyber security incidents by ranking being botnet infections (malware infected network of computers, devices, or servers which are controlled remotely by a hacker), leaked credentials, blocklists, compromised email services, and website defacements. These incidents have the potential to compromise the integrity of the country's cybersecurity infrastructure. Accordingly, the Cybercrime and Computer Related Crimes Act of 2018 and institution-based counter-cybercrime measures aim to curtail vulnerabilities in the technology landscape in support of financial stability. Relatedly, a National Fintech Working Group was launched on 30 January 2024, to provide strategic direction on Fintech matters. The working group was specifically established to develop an inclusive National Fintech Strategy and a Fintech Analytical Assessment Framework that integrates into the development of the financial services sector consistent with national priorities on payment systems. The group comprises key national stakeholders including the Bank of Botswana, government, regulatory authorities, financial

services infrastructure providers and relevant stakeholders.

Financial cycle indicators exhibit increasing volatility

4.10 The financial cycle indicators portend a volatile future trend as macroeconomic conditions continue to falter. The somewhat volatile cycle indicators suggest growing market uncertainty amid weakened fiscal position that also involves a market liquidity squeeze. The indicators show a downturn at the end of 2024, projected to extend into 2025, affecting market perceptions about the pricing of assets and the risk premiums attached to both private and public investments. In this context, it is expected that the market will price down assets including equities, property and land in line with subdued macroeconomic conditions. However, the negative sentiment might be mitigated by the optimism for a diamond market driven economic recovery. In general, the market is expected to face stringent lending standards as financial institutions adjust their risk pricing and appetite, which could in turn, lead to tightening financing conditions. In this regard, there is need for appropriate responses and clear forward guidance by the Bank and other regulators/stakeholders to ensure that the anticipated financial and economic stress are not negatively self-reinforcing.

Chart 4.1: Botswana Financial Cycle Indicators



Box 3: Top Five National Security Risks Emanating from the Financial Sector

Introduction

The financial sector plays a crucial role in economic development and the welfare of citizens by allocating funds for viable investments and providing payment services. However, the liberalisation of financial markets and greater connectivity between global financial markets, have increased financial system risks and crisis, and enabled the proliferation of criminal activities. Moreover, rapid technological advancement has facilitated adoption of borderless technology-based platforms in the financial system. These developments, could, if progressive and significant become an increasing concern to the health of the financial sector and the general economy. The aim of this article is to present the top five national security risks that could emanate from the financial sector in Botswana and their mitigations measures.

| RISK | MITIGATION MEASURES |
|---|--|
| <p>Money Laundering and Terrorism Financing: Evolution of digital platforms and digital payment instruments that promote anonymity of transactions present an opportunity for money laundering in the financial sector. With the complexity of recent financial technology developments, illicit funds can be transmitted globally with relatively low detection risks, particularly through intricate financial investment vehicles and other cyber-enabled crimes.</p> <p>According to the 2023 national risk assessment for money laundering and terrorist financing, the national vulnerability and threat to money laundering were rated medium and medium-high, respectively. This presents a likelihood for the country to be used as conduit to move funds or be used to raise funds for terrorism activities. Therefore, money laundering remains a national security risk.</p> | <ul style="list-style-type: none"> • Ensuring that VASPs, such as cryptocurrency exchanges comply with Anti-Money Laundering/Counter Financing of Terrorism and Counter Proliferation Financing (AML/CFT/CPF) regulations is crucial to prevent the misuse of virtual assets for terrorist financing activities. This can be achieved through enhanced offsite monitoring and frequent engagements with the virtual assets sector (meetings/inspections). • Market surveillance and collaboration with other law enforcement agencies/authorities to detect illegal operators. • Strong AML/CFT/CPF legislation and supervisory capabilities. • Virtual Assets Act, 2022 |
| <p>Cybercrime and Financial Fraud: Cybercrime covers a wide range of criminal activities that are carried out using digital devices and/or networks. These crimes involve the use of technology to commit financial fraud, identity theft, data breaches, computer viruses and financial scams. With the increasing digitisation of financial services, including online banking, mobile payments and digital currencies, cybercrimes pose a significant threat to the financial sector and the economy.</p> <p>Malicious actors target institutions and individuals to steal sensitive information, conduct fraudulent transactions, and disrupt financial systems, leading to financial losses and undermining consumer confidence.</p> | <ul style="list-style-type: none"> • The Cybercrimes and Computer Related Crimes Act, 2018 by Botswana Communications Regulatory Authority • Enhanced oversight and frequent inspections of licenced entities. • Customer Due Diligence (CDD). • Public Awareness/notices. • Issuance of guidance notices. • Enforcement action for gross negligence and noncompliance. |

| RISK | MITIGATION MEASURES |
|--|--|
| <p>Physical Security Threats such as cash heists and Automated Teller Machine (ATM) bombings have increased in Botswana. Armed robbers organise cash-in-transit heists, overpowering security company guards and making off with large sums of money. In the past, these incidences have led to significant losses of central bank currency, as well as losses of lives. Financial institutions and businesses also incur costs to improve their security. Generally, these crimes do not only strip businesses off their hard-earned cash, but they also threaten confidence and security in the financial sector.</p> | <ul style="list-style-type: none"> • Enhanced stakeholder cooperation at all levels (regulatory, surveillance and law enforcement agencies). • Improved security measures by security companies. • Community responsibility initiatives. |
| <p>Asset Misappropriation in the NBFIs Sector: The complexity of retirement fund structures and investment vehicles, coupled with inadequate internal controls and oversight, can create opportunities for asset misappropriation to go undetected for extended periods. This lack of transparency and accountability increases the vulnerability of retirement funds to fraud. Asset misappropriation within retirement funds can have devastating consequences for members, jeopardising their financial security and retirement savings. It erodes trust in the retirement savings system and undermines the integrity of fund administrators, leading to reputational damage and legal repercussions.</p> | <ol style="list-style-type: none"> 1. Enhanced oversight and frequent inspections. 2. Public awareness and Issuance of guidance notices. 3. Enforcement action for gross negligence and non-compliance. 4. Enforcement of guidelines on corporate governance |
| <p>Illegal Deposit Taking/ Pyramid and Ponzi Schemes: Illegal deposit taking refers to an act of receiving, taking, or accepting deposits from members of the public without a valid banking licence. There has been an increase in illegal deposit taking activities, where some companies solicit deposits from members of the public without a licence to do so, for example, by way of recruitment into investing in virtual assets and other digital investments for seemingly significant prospective returns.</p> <p>Meanwhile, pyramid schemes and other illegal deposit-taking activities such as Ponzi schemes or fraudulent investment vehicles are unlawful in Botswana, they are a criminal offence, punishable by law. Illegal deposit taking activities lead to loss of savings and pensions for those who participate in them, additionally they harm consumers' confidence in financial institutions and can potentially destabilise the financial system.</p> | <ul style="list-style-type: none"> • Capacity building and intensified public education by all stakeholders to capacitate consumers with undertaking due diligence at an individual level. • Cooperation and collaboration among regulators and law enforcement agencies. • Proper due diligence by financial institutions. |

5. SOVEREIGN RISKS

Protracted diamond sales slump likely to accentuate sovereign vulnerabilities

5.1 Botswana's economic growth was subdued in 2024, with real GDP contracting by 3 percent, compared to a growth of 3.2 percent in 2023. The observed recession is on the back of weak global demand and geopolitical conflicts which have disrupted world trade networks, thus weakening demand for Botswana's diamonds. Consequently, the mining sector economic output declined by 24.1 percent, led by a 25.7 percent drop in diamond mining. Coal, copper, nickel, and gold production also fell due to various operational challenges at production level. Conversely, non-mining GDP growth declined by 2.8 percent in 2024, down from the 3.3 percent in 2023, with the diamond traders and manufacturing sectors particularly impacted by global conditions, and several other sectors, like Agriculture, Forestry and Fishing, experiencing slower growth.

5.2 Growth prospects remain subdued and well below the long-term growth rate required to transition Botswana to high income status by 2036. The output growth outlook for 2025 has been revised from 3.3 percent growth to a contraction of 0.4 percent due to continued weakness in the diamond industry and global output downturn due to adverse effects of US trade policies. Overall, the country remains vulnerable to external sector shocks that could undermine domestic financial stability through the significant role of the public sector in business performance and household incomes.

Deteriorating fiscal buffers increase the risk of sovereign debt distress

5.3 The total public outstanding debt at the end of the 2024/25 fiscal year, including sovereign guarantees amounted to P77.3 billion thus, 28 percent of GDP. While public debt levels are still sustainable, under the 40 percent statutory limit, the deteriorating fiscal buffers due to disproportionate increase in spending relative to revenue, underly a probable increase in public borrowing. As such, the potential for a sharp increase in public debt if not sustainably managed, could raise the risk of sovereign debt distress.

5.4 In light of this, continued fiscal prudence is required, hence the MoF introduced a three-year Medium-Term Debt Strategy in the 2024/25 financial year. The strategy emphasises managed domestic resource mobilisation, with a planned increase in government debt securities under the P55 billion Bond Issuance Programme.

External buffers deteriorating

5.5 The sustained increase in public expenditure against limited export earnings accruing to government, partially contributes to the decline in foreign exchange reserves, which amounted to P46.3 billion in March 2025, a decrease of 28.4 percent from P64.7 billion in March 2024. At this level, the foreign exchange reserves were equivalent to 5.9 months of import cover of goods and services, a historical low level. Thus, deliberate and concerted fiscal consolidation efforts are required to help restore buffers, hence anchor external sector, macroeconomic and financial stability.

Botswana maintains investment grade status

5.6 Botswana's credit ratings by Moody's (A3, negative outlook) and S&P (BBB+, negative outlook) in 2025 affirm its investment-grade status but the related commentary highlights escalating fiscal and financial risks. The rating agencies noted that the country is grappling with a widening fiscal deficit, which was projected at 9 percent of GDP for the 2024/25 fiscal year, and a rising debt burden, expected to climb from 28 percent to 40 percent of GDP by 2025/26, largely due to declining diamond revenue. The negative outlook signals that without swift fiscal consolidation – through measures like rationalisation and prioritisation of spending cuts, expansion of tax coverage and collection, and wage bill restraint – Botswana faces the threat of a downgrade, which would increase borrowing costs and deepen financial strain. Compounding these challenges, depleted fiscal reserves have pushed the government toward untested domestic and external borrowing. This shift raises concerns about liquidity pressures and debt affordability, especially if reliance on costlier commercial loans grows, further jeopardising fiscal stability.

5.7 Furthermore, Botswana’s heavy dependence on diamonds remains a core economic vulnerability, with the sector’s downturn undermining growth, exports, and fiscal revenues. The ratings reports argue that efforts to diversify the economy, though vital, have progressed slowly, leaving the country exposed to external shocks and casting doubt on its ability to pivot effectively. On the positive side, Botswana benefits from strong governance, demonstrated by a peaceful 2024 election transition and a history of prudent resource management. Coupled with a relatively low debt burden and robust institutions, these strengths provide a foundation for reform and an opportunity to stabilise the credit ratings. However, the negative outlook from Moody’s and S&P underscore the urgency of decisive action on fiscal consolidation, financing strategies, and economic diversification. There is thus the need for meaningful progress, in this regard to safeguard Botswana’s favourable credit rating and long-term development prospects.

loans continue to dominate household credit at 69.4 percent (Chart 6.4d), which presents a potential channel of debt distress in the event of loss of employment, or sudden and sharp tightening of financial and borrowing conditions (for example, increase in interest rates). Overall, household credit dominated total credit at 64.3 percent against the 35.7 percent for business credit (Chart 6.2b).

6.3 Credit developments currently pose limited risks to financial stability as shown by a negative credit-to-GDP gap. The gap was at 2.8 percent in December 2024, indicating 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 6.1). The credit to GDP gap is calculated as the credit-to-GDP ratio less its long-term average or trend. A gap of 10 percent is a reference threshold and any value above this threshold indicates excessive and rapid credit growth that could overheat the economy.

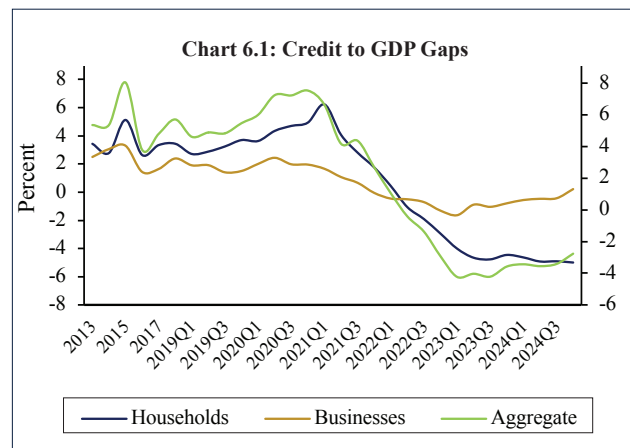
6. CREDIT AND LEVERAGE RISKS

(a) Commercial Bank Credit

Growth in overall commercial bank credit decelerates

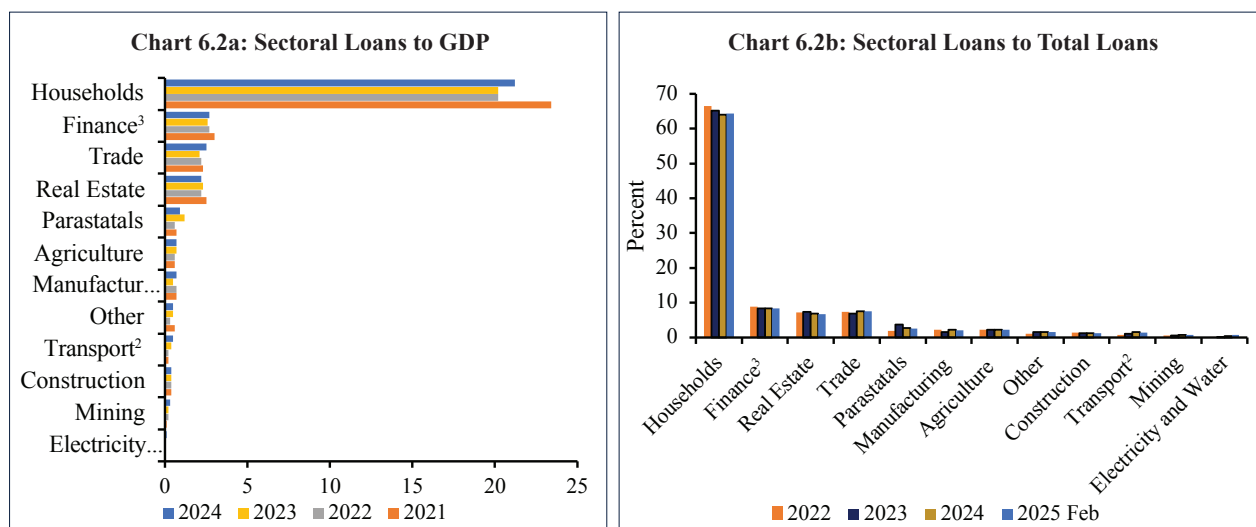
6.1 Annual growth in commercial bank credit accelerated from 7.9 percent in March 2024 to 8.1 percent in March 2025. The increase in credit growth was attributable to a rise in the utilisation of overdraft and credit facilities by businesses as well as increased acquisition of new loans by households. Meanwhile, credit quality increased slightly, with an overall non-performing loans (NPLs) ratio of 3.4 percent in March 2025, compared to the 3.8 percent in March 2024.

6.2 Household borrowing remains a key driver of total credit, having grown by 6.2 percent year-on-year in March 2025, higher than 5.4 percent in March 2024 (Chart 6.4a). Motor vehicle and personal or unsecured loans were the significant drivers of growth in credit to households. The more expensive unsecured



Composition of Banking Sector Loans¹

Household loans dominate commercial banks' loan portfolio



Notes:

¹ Sectoral contributions are calculated as a percentage of total commercial banks loans and sub-sector contributions are calculated as a percentage of sector loans.

² Transport and Communications.

³ Finance and Business Services.

Source: Bank of Botswana

(b) Household Borrowing

Unsecured borrowing drive household debt

6.4 Household debt grew by 6.2 percent in March 2025, driven by personal loans, which contributed 4.2 percentage points to the total household debt growth while the other loan categories drove the remaining 2 percentage points. This trend captures the historical dynamics of household debt where most of the borrowing has been by public sector employees with deduction from source scheme arrangements. This arrangement increases repayment and recovery rates, but the current macroeconomic conditions marred by growing fiscal pressures presents a challenge for banks in the treatment of household loans under the expected credit loss models. In addition, failure by government to process timely third-party payments amid growing fiscal pressures, could disrupt banks' day-to-day operations including liquidity management. As such, the continued dominance of unsecured

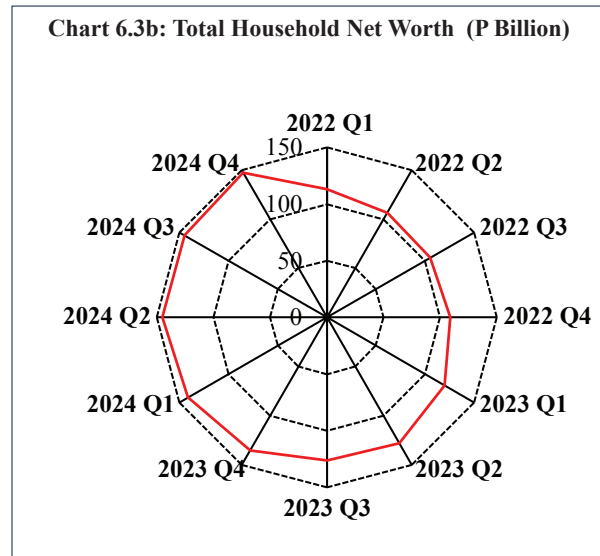
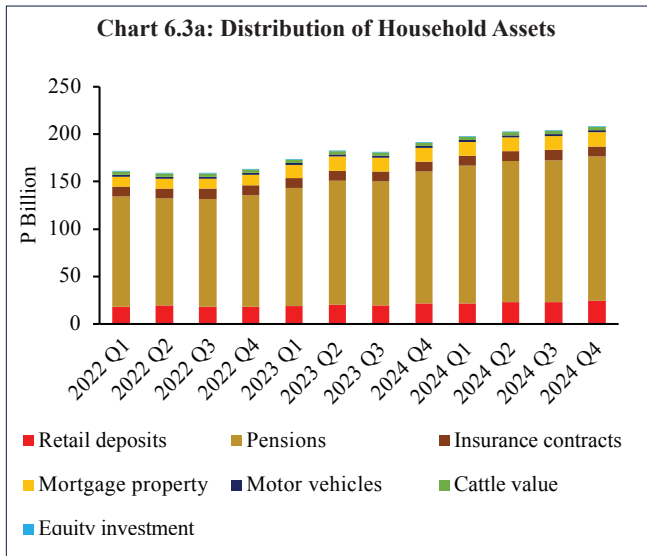
borrowing in household credit presents growing structural vulnerabilities with the potential to amplify credit losses in case of insurmountable fiscal strain and failure.

6.5 On the other hand, 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, underpin wealth creation and financial security for retirees. Chart 6.3b indicates a positive net worth of households, which indicates a healthy financial standing. The estimated net worth of households as a percentage of GDP increased to 56 percent in the fourth quarter of 2024 from 51.4 percent in the fourth quarter of 2023, reflecting a higher increase in net worth compared to the growth in GDP.

Household Net Worth Estimation

Pension savings dominate household assets

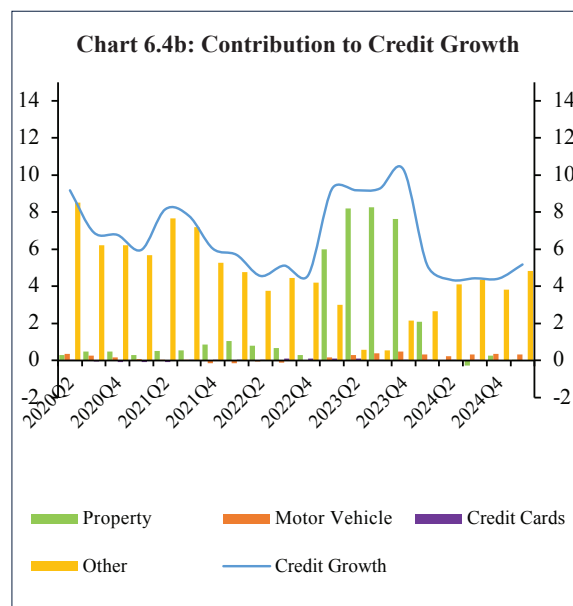
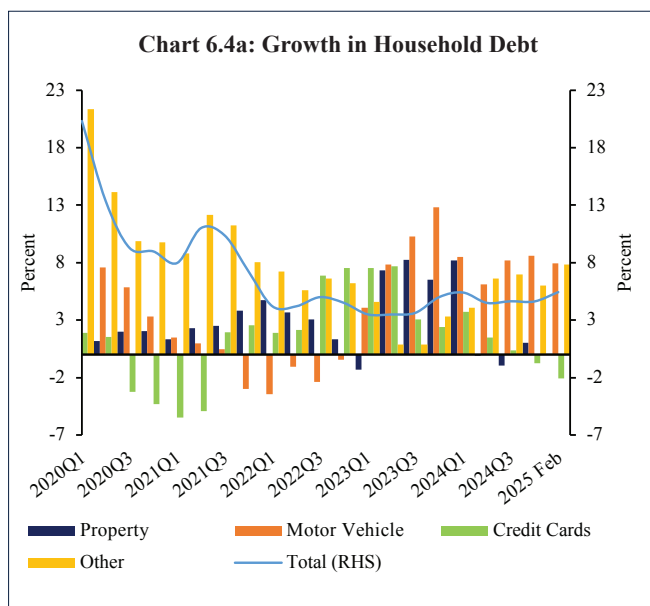
Households' net worth is increasing



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

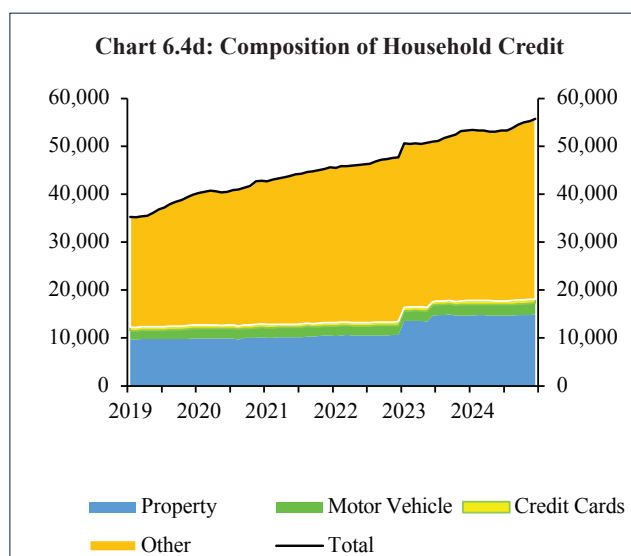
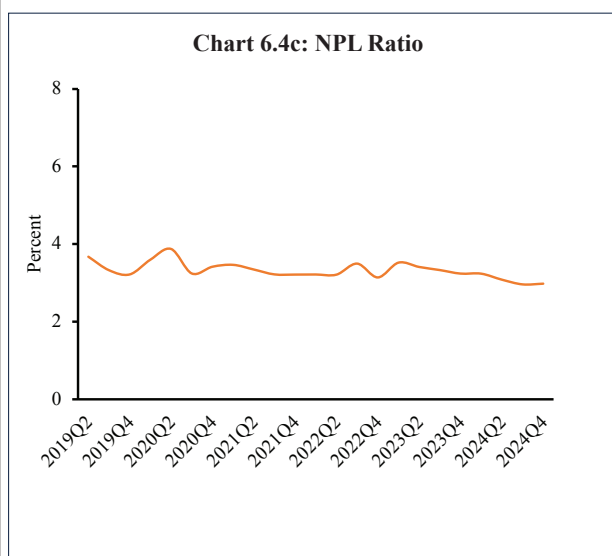
Household Debt Analysis

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



Both the debt burden and default rates are decreasing

Personal loans dominate household debt



(c) Non-Financial Corporates Credit

Corporate sector exposures increase

- 6.6 Total commercial bank credit to the non-financial corporate sector increased from P26 billion in February 2024 to P28.2 billion in February 2025. As a result, the proportion of corporate loans to total commercial banks credit rose marginally from 31.4 percent to 32.1 percent. Relative to GDP, bank credit to the corporate

sector was 10.7 percent in December 2024 from 9.7 percent in December 2023 and remains low by region standards. For instance, South Africa had a ratio of 32 percent in December 2023² while Namibia recorded 72.4 percent at the end of 2023³. This reflects room for prudent credit mobilisation to support business activity and, in turn, domestic economic growth.

2 South African Reserve Bank (SARB) Financial Stability Review, First Edition 2024.
3 Namibia Financial Stability Report, April 2024.

(d) Property Market Credit

Limited risks from commercial real estate

- 6.7 Commercial real estate (CRE) credit decreased from P6.1 billion in February 2024 to P5.8 billion in February 2025 and constituted 6.7 percent of total loans (Chart 6.5b). The CRE sector recorded a moderate NPLs ratio of 1.4 percent in December 2024 and poses limited risks to domestic financial stability. There are, however, outstanding concerns about concentration (location) risk, given that most loans finance properties in or around Gaborone⁴.

Mortgage lending short of development needs

- 6.8 Residential real estate loans were relatively unchanged at P14.8 billion in February 2024 and February 2025, constituting 27.7 percent and 26.3 percent of total household credit and total credit, respectively (Chart 6.5a). These proportions are very low compared with South Africa and Namibia, where mortgages constituted 61 percent and 70 percent, respectively, of total household loans, thus suggests that the level of domestic housing finance is not commensurate with the needed development and growth path to fill the apparent need for housing, as well as the financing gap. 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, or availability of land and affordability of building materials).

Limited credit risk from mortgage lending

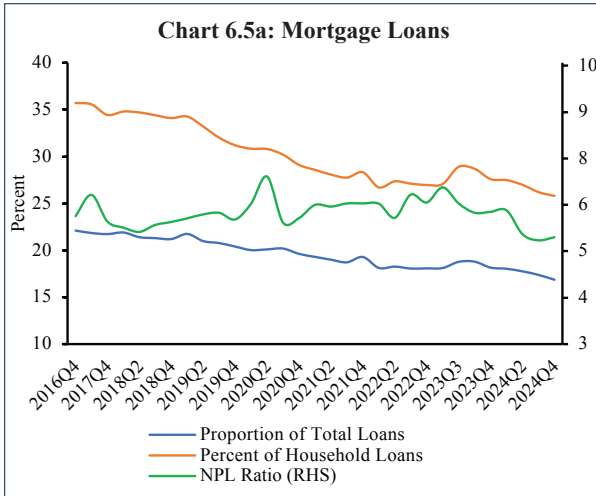
- 6.9 Credit risk in the mortgage sub-sector remains low, with commercial banks maintaining moderate loan-to-value (LTV) ratios, although the ratios have reached 105 percent in some isolated cases (Chart 6.6). The moderate LTV ratios, as well as security in the form of property financed limit the expected losses of banks from mortgage credit default. The proportion of impaired mortgage loans to total mortgage declined from 6.3 percent in December 2023 to 5.7 percent in December 2024, reflecting

in part, the diminishing adverse effects of the COVID-19 pandemic on households. Overall, given the limited exposure as well as the self-secured nature of real estate facilities, vulnerabilities in the sector pose minimal risk to financial stability, but prospective developments require continuous close monitoring and assessment.

⁴ Bank of Botswana Residential Property Price Index Report (Second quarter of 2024) and Riberry Property Market Report for the third quarter of 2024.

Property Market Developments

Mortgages as a percentage of both total loans and household loans and the NPL ratio are stable



The proportion of CRE loans to total loans is stable and the NPL ratio is modest

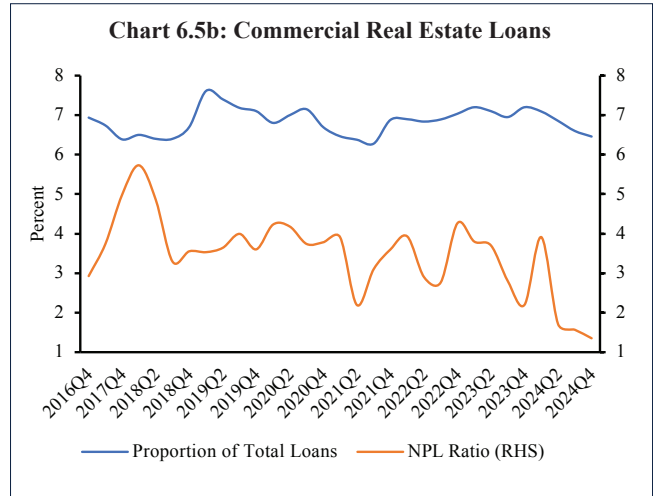
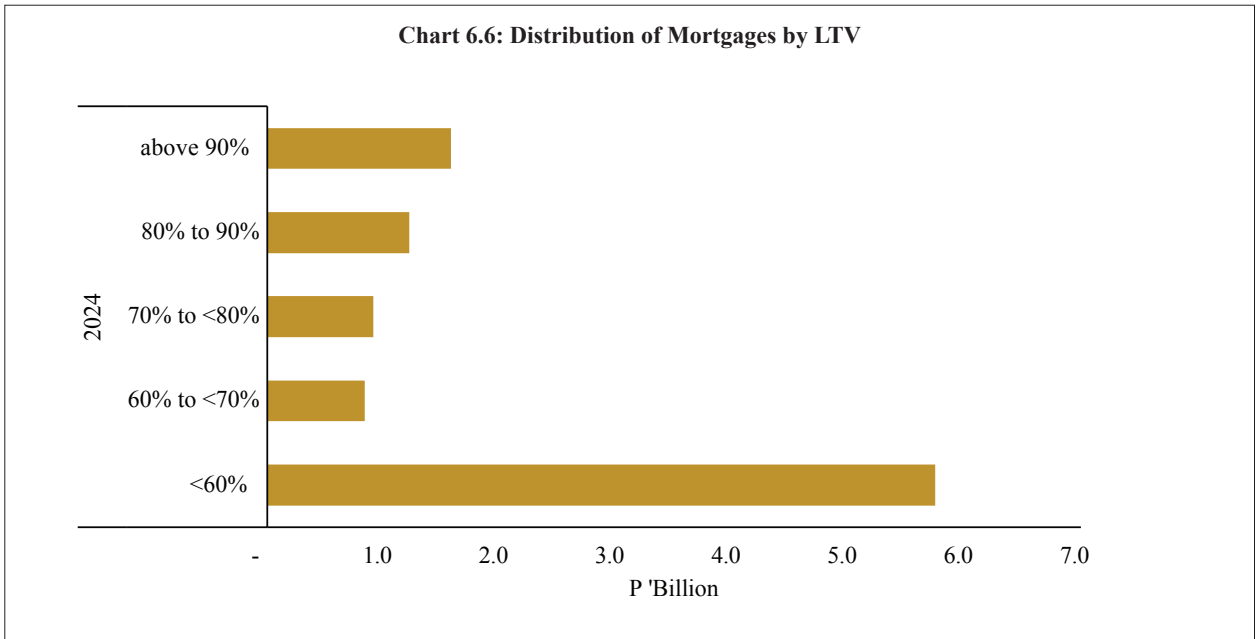


Chart 6.6: Distribution of Mortgages by LTV



7. LIQUIDITY AND FUNDING RISK

(a) Banking Sector Liquidity and Funding

Market liquidity declining

- 7.1 Average daily market liquidity decreased significantly from P2.7 billion in January 2025 to a shortage of P305 million in February 2025 due to persistent foreign exchange outflows and the continued slowdown in the pace of net government spending. In March 2025, market liquidity recovered to P764 million buoyed by the repatriation of pension funds and a net redemption of Government Bond BOTSGB0325. The redemption of the bond injected P1.69 billion into the market liquidity and could not turnaround liquidity levels to their historic levels. As a result, there is significant bidding up of funding interest rates. In turn, banks are considering countermeasures such as raising the prime lending rate (PLR) as part of their liquidity management strategies (banks have so far raised the PLR by a range of 75 – 175 basis points) with spillover consequences on overall cost of credit and monetary policy transmission as well as credit intermediation. There are also emerging trends of decreasing foreign currency holdings by commercial banks in anticipation to lend to government, which could further deepen the sovereign-bank nexus if it materialises.
- 7.2 Under these circumstances, the Bank of Botswana intervened twice to support market liquidity, first by slashing the primary reserve requirement to zero, which released about P1.8 billion into the market and secondly, by extending the maturity of repurchase agreements (repos) with commercial banks from overnight to 7 days. The latter is expected to aid effective liquidity risk management by enhancing predictability of banks liquidity projections and asset/liability maturity mapping. With the current liquidity conditions, it is, therefore, imperative that the daily settlement performance of the banks is closely monitored for decisive policy intervention.

- 7.3 That notwithstanding, banks maintained adequate liquidity positions, with a liquidity ratio of 16.4 percent in February 2025, partly supported by the onshoring of pension funds.

Deposit concentration exposes banks to funding risks

- 7.4 The banking sector remains vulnerable to funding risk arising from a concentrated deposit base. Commercial banks' funding structure is concentrated in few wholesale deposits as reflected in the top 20 deposits to total deposits ratio of 43 percent in December 2024 from 44 percent in December 2023. The annual movement was largely exacerbated by repatriated pension funds that are yet to be deployed into long-term assets. The position suggests high funding costs due to the inherent volatility and expensive nature of wholesale deposits.
- 7.5 That notwithstanding, the banking industry continues to provide healthy levels of credit intermediation, with an intermediation ratio⁵ of 81.3 percent in December 2024 (2023:78.6 percent). The rate of intermediation is marginally above the 50 – 80 percent range and continues to support enduring economic growth.

(b) Interbank Funding

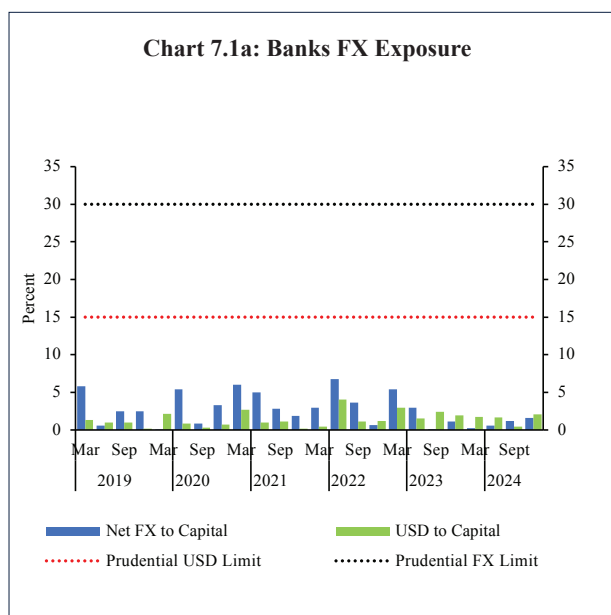
Interbank activity remained high

- 7.6 Consistent with the decline in overall market liquidity, interbank activity remained high at P9.2 billion in March 2025 from P12.3 billion in February 2025. This is indicative of the fact that banks are cultivating interbank relations to navigate the prevailing low liquidity conditions. This is expected to support efforts by the bank to shore market liquidity and support intermediation activity in the short-term.

⁵ Measured as a ratio of loans to deposits, the financial intermediation ratio measures the extent to which funds (excess) are availed to those who need them.

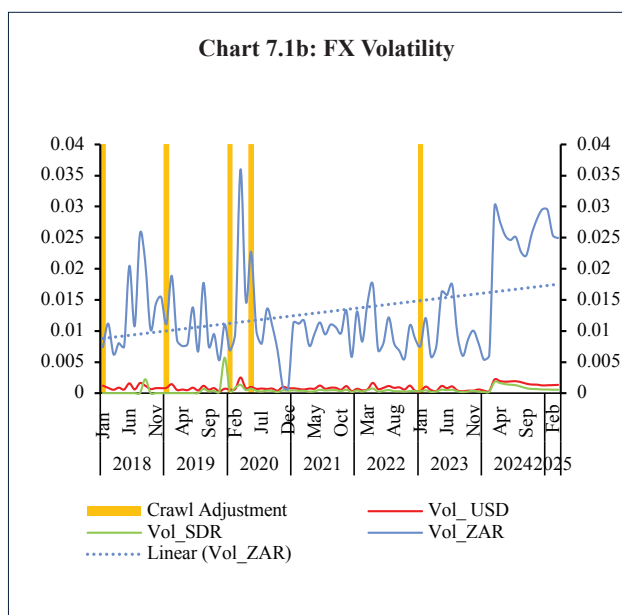
Foreign Currency Funding and Exposure

Banks FX exposure is well below the prudential limits



Source: Bank of Botswana

ZAR exchange rate volatility is high



(c) Foreign Currency Funding

US dollar funding risks remain limited

- 7.7 Domestic commercial banks' exposure to foreign exchange risks is highly limited and poses minimal threat to overall financial stability. This is reflected in both the overall net foreign exchange position and US dollar net open position of the banks. The overall net open position of banks increased from P191 million in December 2023 to P299 million in December 2024, representing 2 percent of unimpaired capital and remained significantly within the prudential limit of 30 percent (Chart 7.1a). At the same time, the Pula equivalent overall net exposure of the domestic banking system to the US dollar increased to P390 million in December 2024 from P335 million in December 2023, also translating into 2 percent of the industry's unimpaired capital and, therefore, showing limited risks from US dollar funding.

Limited exchange rate volatility

- 7.8 In the year to March 2025, the nominal Pula exchange rate depreciated by 3.2 percent against the South African Rand but remained relatively stable against the Special Drawing

Rights (SDR). The movement of the Pula against the SDR constituent currencies largely reflected the performance of the South African Rand against SDR constituent currencies.

- 7.9 In that regard, the South African rand appreciated by 3.4 percent against the SDR. In general, volatility in the Pula exchange rate has been contained since May 2020 (Chart 7.1b), hence presenting limited risks to the domestic financial system and economy.

(d) Capital Markets – Equity Funding

Market capitalisation and liquidity improves

- 7.10 The total equity market value of domestic listed companies gained 12.6 percent, year on year, to P54 billion in December 2024 (2023: P48 billion). The gains largely reflect the increased participation of institutional investors in their efforts to place repatriated pension funds. In that respect, and coupled with good company fundamentals, some share counters experienced significantly positive valuations, with CA Sales recording a 77.8 percent in its valuation and followed by Sechaba at 41.4 percent.

7.11 Due to the net valuation gains on stock exchange, turnover for traded equities increased significantly in 2024, and the momentum is expected to carry on into the medium term, leading to an improvement in market liquidity (Chart 7.2c). Coupled with BSEL's public awareness campaigns, this led to a surge in the liquidity ratio from 2.1 percent in December 2022, 9.3 percent in December 2023 to 11.4 percent in September 2024. However, the dwindling macroeconomic performance due to mounting fiscal pressures might derail domestic market sentiment if the global diamond market does not recover as expected.

The domestic stock market is profitable but volatile

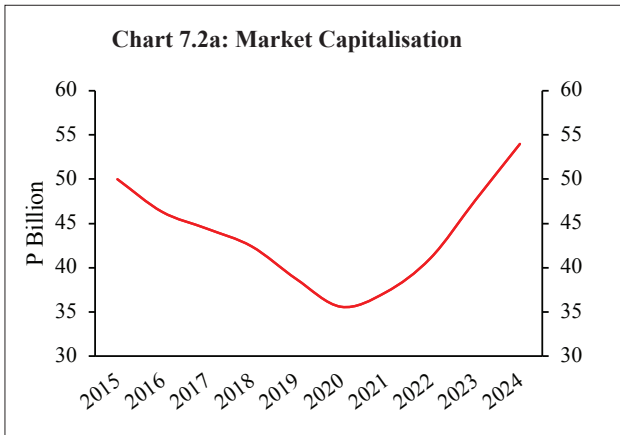
7.12 Profitability in the domestic market improved significantly as demonstrated by a sustained 22.6 percent appreciation in the domestic company total return index (DCTRI) in December 2024 from an appreciation of 25.5 percent in the corresponding period in 2023⁶. Furthermore, developments in market capitalisation in the twelve months to December 2024 translated into a stronger performance of the domestic company index (DCI) (Chart 7.2d). On the other hand, volatility⁷ in the stock market at the end of 2023, and into the first few months of 2024, has since abated for both primary and secondary listings. However, stock market volatility remains generally high, potentially reflecting the inherently risky nature of equity markets (Chart 7.2f). Despite falling twofold between November and December 2024, volatility in the foreign company index (FCI) also remains relatively high compared to its historical average, owing to significant upward revaluations of equity prices for Anglo-American Company, CA Sales, and Investec over the twelve months to December 2023.

⁶ The DCTRI shows gains (or losses) in equity positions due to market capitalisation appreciation (or depreciation) and dividend returns.

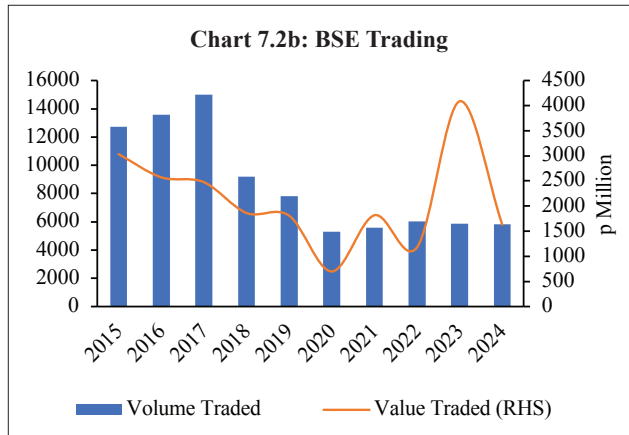
⁷ Measured as the 12-month standard deviation of the DCI.

Stock Market Developments

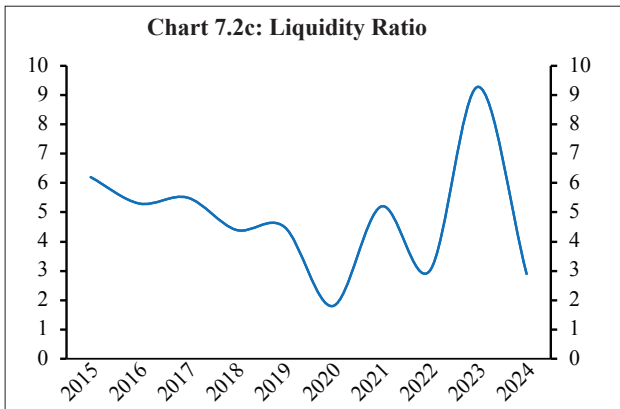
Stock market capitalisation is increasing



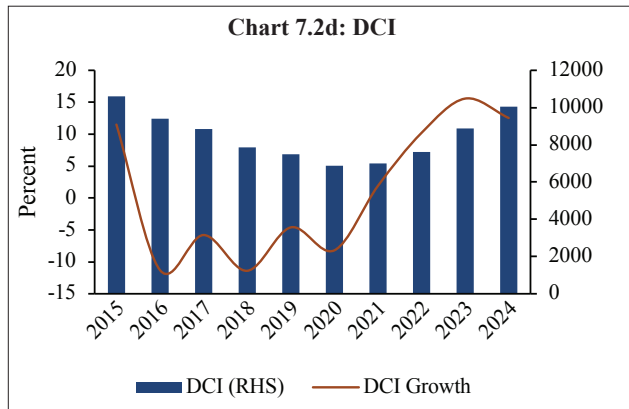
BSE trade by value and volume is decreasing



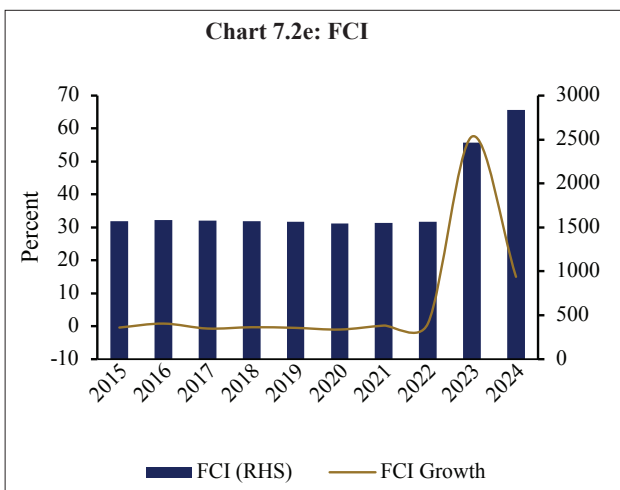
Liquidity in the BSE is decreasing



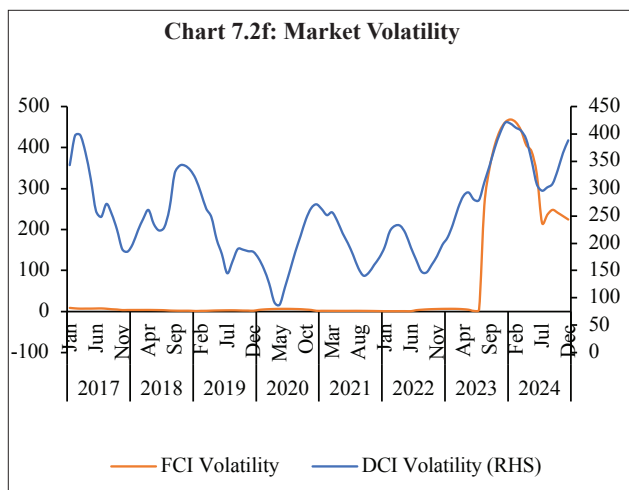
The DCI is improving



The Foreign Company Index is improving



Stock market volatility increasing



Source: Botswana Stock Exchange Limited

(e) Capital Markets – Bond Market Funding

Government bonds drive market capitalisation

7.13 Bond market capitalisation increased by 42.9 percent to P36.2 billion in the twelve months to December 2024 from P25.3 billion in December 2023, owing to new corporate listings and re-opening of existing government bonds amid growing financing needs (Chart 7.3a). The nominal value of government bonds rose from P23.1 billion in 2023 to P32 billion in 2024, while corporate bond valuations increased by 5.8 percent to P6 billion.

7.14 The proportion of government bonds in the nominal value of the fixed income market was 84.2 percent in 2024 from 80.4 percent in 2023, indicative of continued government funding needs. It is also in the context of ongoing commitment by government to deepen and develop the domestic capital markets. Nevertheless, a sustained dominance of government securities has the potential to crowd out capital funding for the private sector and may need to be proportionately scaled down as capital markets mature.

Bonds yield spread tightening

7.15 The spread between average yields on corporate and government bonds decreased from 0.57 percent in December 2023 to 0.22 percent in December 2024 (Chart 7.3f), driven largely by the increasing yields on government bonds and reflective of sovereign risk pricing by the market. Yields on corporate bonds also increased for the most part of 2024, albeit at a slower pace; indicative of a growing risk premium required by fixed income investors.

Bond market volatility is high

7.16 The riskiness of all bonds remains high as reflected in the relatively high volatility of the bond indices compared to historical figures (Chart 7.3f). The potential for tightening of funding in the bond market therefore remains, especially in light of the deteriorating macroeconomic environment and mounting pressure on the government to consolidate the fiscal position. However, the generally accommodative financial conditions domestically, as judged from the real monetary conditions index (RMCI), present funding opportunities in the money markets that could augment any shortfall in capital market funding.

Bond Market Developments

Government bonds dominate the bonds market

Bonds yields still above pre-COVID-19 levels, indicating higher uncertainty

Chart 7.3a: Bonds Nominal Values (P Million)

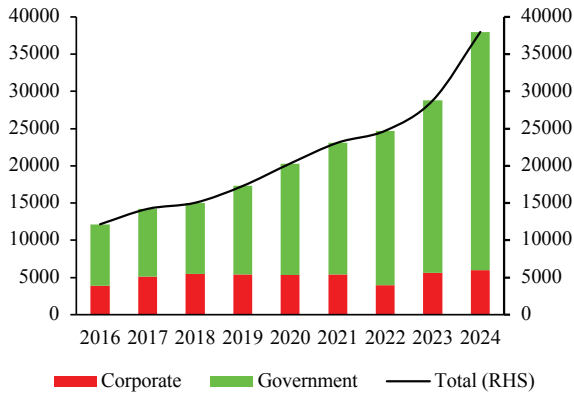
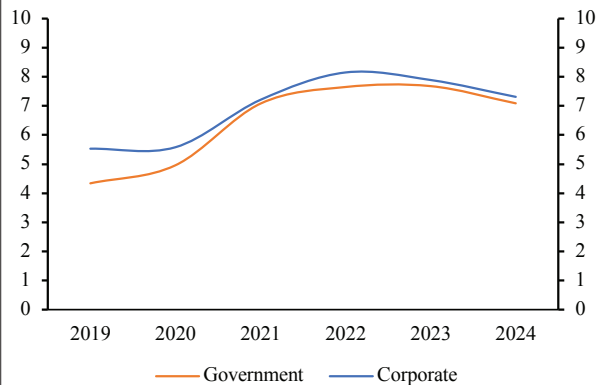


Chart 7.3b: Bond Yields



Corporates have many low-value bonds listed on the BSE

Bond indices are trending upwards

Chart 7.3c: Number of Bonds

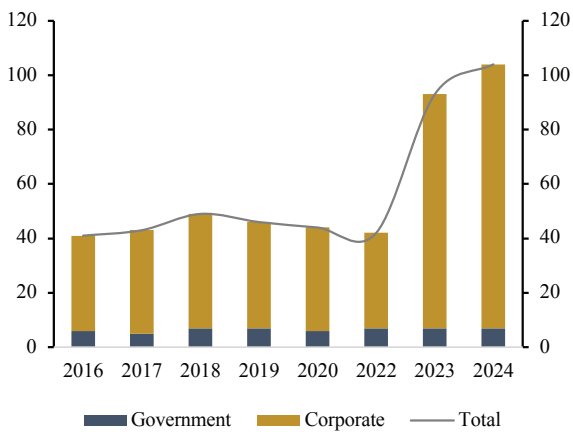
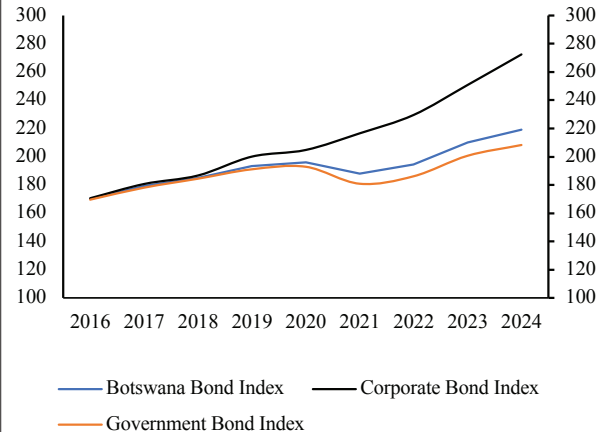


Chart 7.3d: Bonds Indices



The corporate spread is narrowing

Bond market volatility is declining

Chart 7.3e: Corporate Spread

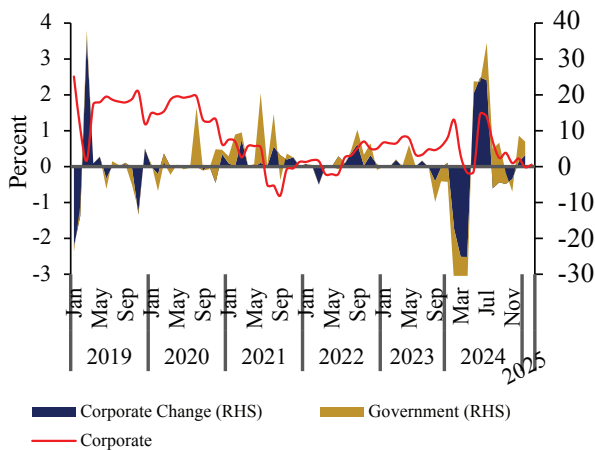
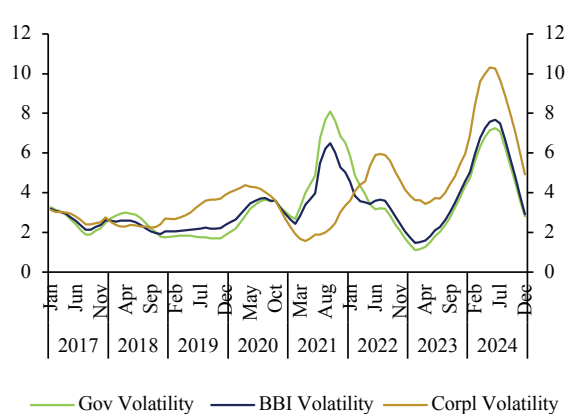


Chart 7.3f: Bonds Volatility



Source: Botswana Stock Exchange and Bank of Botswana Calculations

8. CONTAGION RISK

Systemically important institutions are sound

8.1 Similar to 2024, the Bank has designated First National Bank Botswana and Absa Bank Botswana Limited as the Domestic Systemically Important Banks (D-SIBs) for 2025. In the non-bank financial institutions space, NBFIRA identified Domestic Systemically Important Insurers (D-SIIs), as Botswana Life Insurance Limited (life insurer), Hollard Insurance Company of Botswana (general insurer) and Continental Reinsurance Company (reinsurer). Consistently, the regulatory authorities continue to place greater focus on their solvency, profitability and operational safety. These institutions have the potential to disrupt the entire financial system when faced with operational challenges or when facing insolvency. Therefore, targeted supervisory measures are being put in place to safeguard financial stability. In this respect, the Bank is developing regulatory requirements specific to D-SIBs while NBFIRA has also strengthened its supervisory framework for D-SIIs. As at December 2024, D-SIBs and D-SIIs were adequately capitalised, liquid and solvent, hence posed limited threat to domestic financial stability.

Significant interlinkages pose a risk of contagion

8.2 The structure of Botswana financial system continues to be highly interconnected with the banking sector driving the flow funds. As shown in the interlinkages chart, Figure 8.1, the banking sector is highly exposed to households, who in turn are significantly exposed to NBFIs through pension assets. Moreover, a significant amount of NBFi assets (55.3 percent) were held abroad at the end of December 2024, exposing NBFIs to external financial and economic shocks. NBFIs are also inter-linked with the rest of the financial system through multiple channels, such as deposits held with banks, funding avenues and capital market activities.

8.3 NBFIs had a net lending position to commercial banks (deposits held with banks less loans from banks) of P22.6 billion in December 2024. Similarly, NBFIs had bonds

worth P2.7 billion and a listed equity market capitalisation of P8.9 billion in the same period. Furthermore, pension funds and asset managers have a broad range of investments in the financial system and the broader economy including equity holdings and real estate, providing another conduit for the transmission of systemic risks. In view of the potential risks of cascading shocks due to interconnectedness, the FSC continues to strengthen regulatory and legislative frameworks to mitigate the potential for propagation of idiosyncratic, sectoral or institutional shocks to the whole of financial system.

Sovereign-banks nexus is growing

8.4 Government bonds held by commercial banks stood at P32 billion in December 2024, a significant jump from P23.1 billion in December 2023. As at December 2024, the exposure represented 12.2 percent of GDP, compared to 8.8 percent in December 2023. This shows a growing interconnection between banks and the sovereign, thus strengthens the transmission channels for fiscal stress. This is particularly relevant in the current macroeconomic environment of declining government revenues and mounting pressure on the government to consolidate accounts in the medium term.

8.5 Perceptions about the riskiness of the government securities also has the potential to spillover to the pricing of other financial products and possibly serve as a channel for the transfer of adverse information in the domestic financial system. At the 20 February 2025 bond auction, the demand for government bonds was subdued, with upward pressure on government yields as investors sort higher risk premiums, reflecting perceptions of higher fiscal risk. That notwithstanding, public debt fundamentals remain favourable, supported by sustainable public debt levels projected at 24.2 percent for fiscal year 2024/25, which is also well below the 40 percent threshold.

NBFIs are critical sources of banks funding

- 8.6 NBFIs were net lenders to banks in December 2024, with a net lending position of P19 billion. Total deposits by NBFIs comprised 24.7 percent (P26.4 billion) of total customer deposits while they took up only 4.4 percent (P3.8 billion) of total borrowing from banks. The dominance of NBFIs for banks, which has been the case for years, presents a significant structural vulnerability with the potential for a system-wide disruption in case NBFIs funding falls significantly. In the current macroeconomic and liquidity conditions, wholesale funding by NBFIs is accompanied by high funding costs for banks which in turn would lead to the tightening of domestic funding conditions. This would amplify economic stress and drive economic activity further down.

Insurance sector is highly concentrated and interconnected

- 8.7 By nature, insurance companies warehouse financial risks associated with different economic activities and thus underlie economic protection. In the domestic market, insurance services are highly concentrated in D-SIIs. This has the potential to cascade losses in the event of distress in any of the D-SIIs, which could impair the provision of insurance services, with negative consequences for the economy. In view of this, NBFIRA identified and designated D-SIIs with a view to continuously monitoring and assessing their operational soundness.
- 8.8 The December 2024 data shows that Life insurers dominate the insurance industry, with a market share of 82.3 percent (P20.9 billion) against the 11.1 percent (P2.8 billion) for general insurers and 6.5 percent (P1.7 billion) for reinsurers. The data shows that life insurance and overall insurance sector assets are highly concentrated in the top 5 biggest life insurers at 96.7 percent of life insurance assets and 79.7 percent of total insurance sector assets. In total, insurance sector assets made up 9.6 percent of GDP in 2024.
- 8.9 Furthermore, a large part of the industry's assets (63.9 percent) is invested through Collective Investment Units with the largest proportion of the funds going to asset managers (68.8 percent) with the local collective investments

units (CIUs), comprising both money market funds and non-money market funds (MMFs and NMMFs). Furthermore, life insurers are exposed to local CIUs (at 55 percent) than both general insurers and reinsurers. Local NMMFs hold 91 percent of the life insurance industry assets, hence pose a low risk of asset-liability mismatch since NMMFs invest in long-term assets. General insurance is equally exposed to Botswana residents (31 percent), commercial banks, statutory banks and the Savings and Credit Cooperative Society (31 percent). About 41 percent of reinsurance companies' assets are held by residents. That notwithstanding, the risk-based supervision and regulatory approach currently applied by NBFIRA is effective in mitigating the risks identified in the NBFIs sector.

Financial sector assets increase

- 8.10 The size of the financial system as reflected by total assets of banks and NBFIs increased by 17.8 percent to P345 billion in 2024 from P293 billion in 2023. NBFIs financial assets (mainly, pension funds) grew, reflecting improved performance in global financial markets. In 2023, the NBFIs sector accounted for the largest share of financial system assets at 58 percent, compared with 54 percent of the banking sector. The size of the entire financial system represented approximately 131 percent of GDP in December 2024, compared to the 121 percent in December 2023, 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

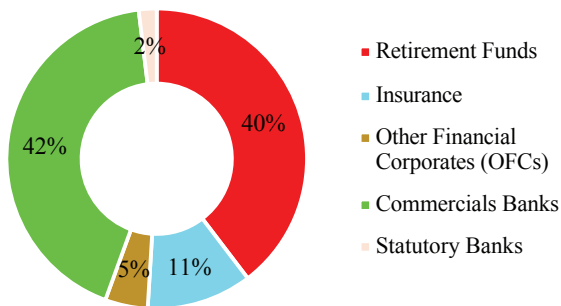
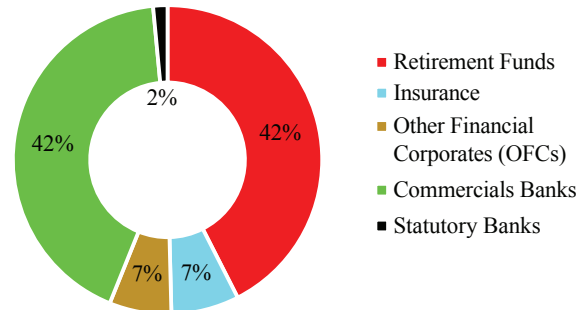


Chart 8.1b: Structure of the Financial System in December 2024



Retirement funds and commercial bank assets are relatively high

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

Chart 8.1c: Financial System Assets

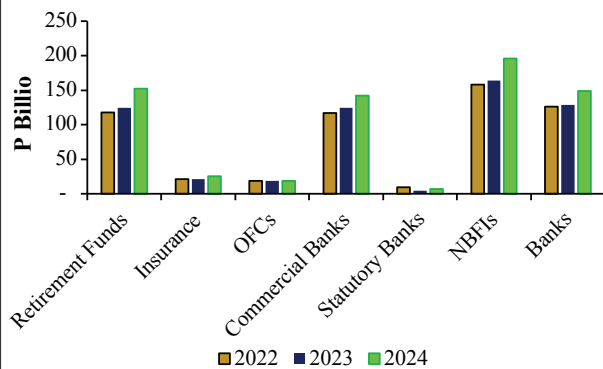
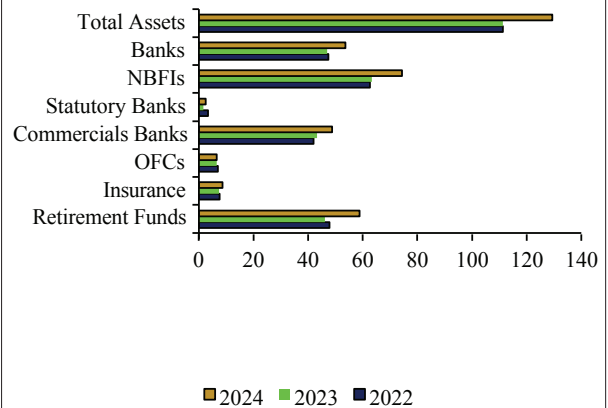


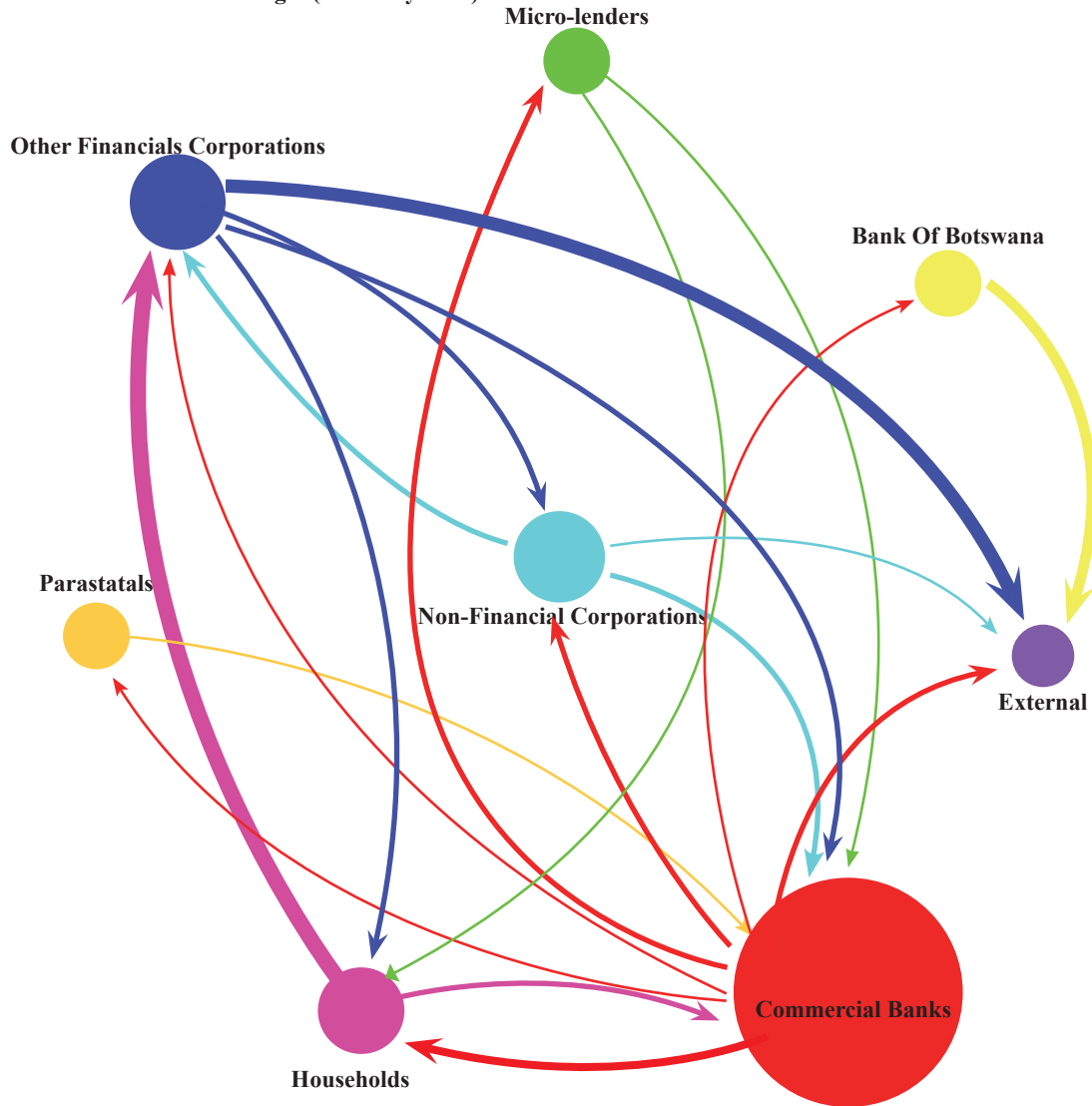
Chart 8.1d: Financial Assets to GDP (Percent)



Financial Sector Inter-linkages

Banks are highly interconnected with the rest of the financial system

Figure 8.1: Macro-Financial Linkages (February 2025)



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, 76 percent are retirement funds assets.

Source: Bank of Botswana

9. BANKING SECTOR RISK ANALYSIS

(a) Asset Quality and Performance

9.1 The Botswana banking sector continues to demonstrate robust financial health and a proactive approach to adapting to the evolving financial landscape. Capital adequacy ratios remain strong across the sector, indicating a healthy level of capitalisation and resilience to absorb potential losses (Chart 9.1a). Furthermore, analysis of recent financial reports shows an active adoption of digital technologies, and a commitment to customer-centricity.

Banks are profitable, adequately capitalised and solvent

9.2 Banks demonstrate consistent profitability, with several institutions reporting significant increases in profit before tax for December 2024. This strong financial performance is driven by a combination of factors, including effective asset and liability management, diversified income streams, and cost optimisation measures. The sector also boasts strong capitalisation levels, with capital adequacy ratios well above the regulatory requirements at 19.5 percent in December 2024 against the prudential limit of 12.5 percent. This robust capitalisation provides a significant buffer against potential losses and enhances the sector's resilience to economic shocks, contributing to overall financial stability.

Banks are on a digitalisation drive

9.3 The banking sector is actively embracing digital transformation by enhancing digital platforms, expanding mobile and internet banking services, and launching innovative solutions to enhance customer experience and promote financial inclusion. This proactive approach to digitalisation positions the sector for continued growth and adaptability in a rapidly evolving technological landscape. Banks are also increasingly prioritising customer-centricity, offering tailored products and services, and enhancing the customer experience to

build stronger relationships and maintain market share in a maturing financial system. The increasing technologies reliance and interconnectedness exposes the sector to cyber vulnerabilities and therefore, commensurate robust cybersecurity measures and continuous investment in security infrastructure are essential to mitigate cyber-attacks and maintain the integrity of the financial system.

Concentration risk in the banking sector is a concern

9.4 Despite the noted positive trends, the banking sector faces challenges that require careful consideration and proactive measures. Concentration risk remains a concern, with the four largest banks dominating the market (77 percent of total assets as at end of December 2024, of which 44 percent is the two D-SIBs). This necessitates continuous monitoring of systemic risk and policies to encourage greater competition within the sector and for the diversification of the banks funding and lending bases. NPLs, while generally on a declining trend (Chart 9.1b), still require close monitoring, particularly in the household sector given the ongoing fiscal strain. This is critical as government employees are the biggest borrowers from banks according to the Household Indebtedness Survey Report of 2023/24.

Listed banks show positive investor sentiments

9.5 An analysis of BSE data reveals overall positive investor sentiment towards the banking sector, even though one of the listed banks experienced a fall in trading prices in the twelve months to December 2024. The listed banks had an average equity price gain of 14.9 percent with the highest gain at 32.3 percent and one registering a downward repricing of 0.5 percent. The average net increase in share prices is signalling positive investment sentiments and underscores a positive outlook for the banking sector amid a challenging macroeconomic environment.

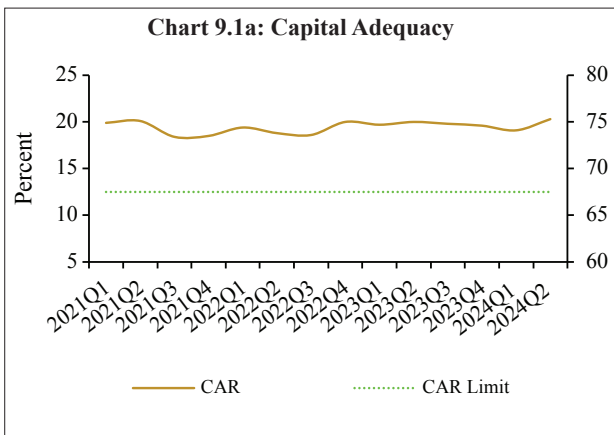
The target fund ratio of the Deposit Insurance Scheme still low

9.6 Total insurable deposits were estimated at P72.7 billion as at 31 December 2024, translating to 65 percent of total deposit liabilities of member institutions. However, as at 31 December 2024, the Deposit Insurance Scheme of Botswana (DISB) had a total Fund balance of P40.98 million, comprising of P10 million membership fees and P30.98 million in

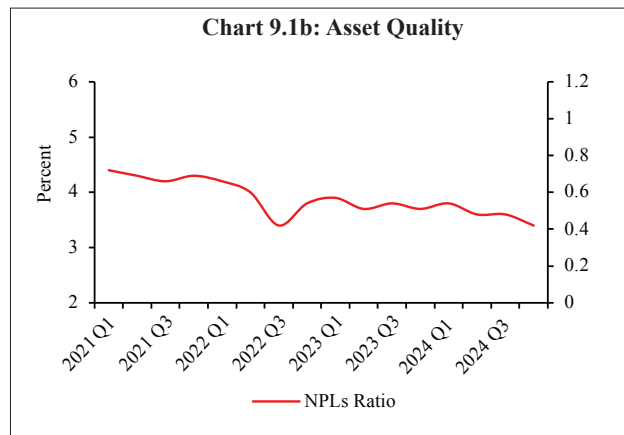
retained surplus. The target fund ratio, which is a measure of fund balance as a percentage of estimated total insurable deposits, was still very low when compared to the minimum 2 percent recommended as best practice. All member institutions were profitable, and none were considered distressed as at 31 December 2024.

Banking Sector Financial Soundness Indicators

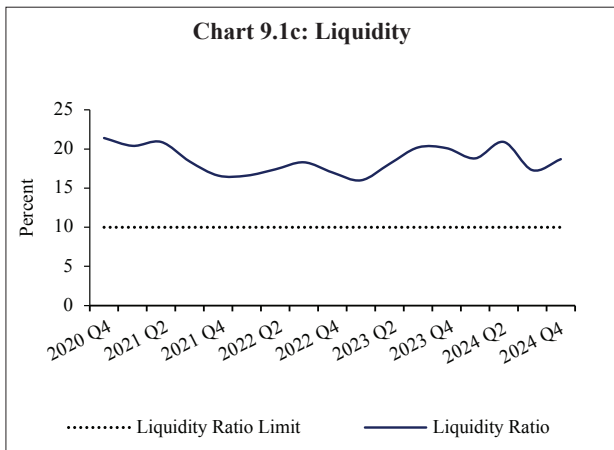
Banks are adequately capitalised



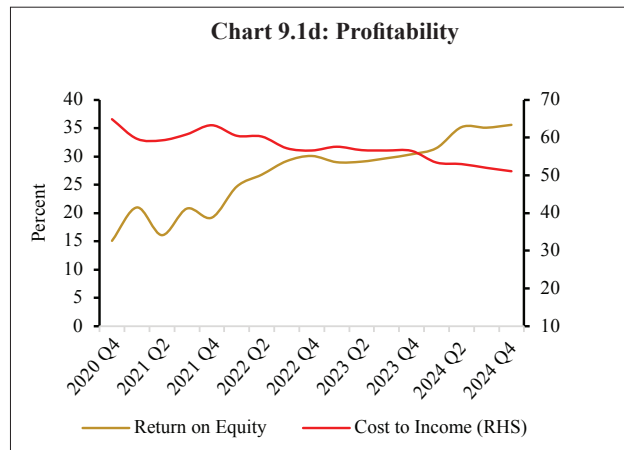
The NPLs ratio is stable



Banks are liquid



Banks are highly profitable, and costs are declining



Source: Bank of Botswana

(b) Stress Test Scenarios

9.7 Stress test scenarios assess the resilience of Botswana’s banking sector using the December 2024 data. The analysis considers global, regional and domestic factors contributing to the stability of the domestic financial system with a view to identify prevailing risks and vulnerabilities pertaining to the banking sector. Main assumptions used for the stress test include the performance of the diamond sector, household indebtedness, climate-induced vulnerabilities, and a combination of systemic risk factors including contagion risk and exposure to systemically important banks.

Deteriorating performance of the diamond market on financial stability

9.8 Botswana’s financial system has enduring interlinkages with the diamond industry. The diamond sector has historically fuelled economic growth and development, but it has also created a significant concentration risk. The stress test simulates a scenario where global demand for diamonds plummets, perhaps due to a global recession or a shift in consumer preferences towards alternative luxury goods. This shock reverberates through the economy, impacting government revenues, employment, and ultimately, the ability of borrowers to repay their loans.

9.9 Under these circumstances, a ripple effect is conceivable and could entail diamond mines scaling down operations, leading to job losses in mining and related sectors. In turn, household incomes could decline, impacting consumer spending and putting pressure on businesses, particularly those reliant on domestic demand. This scenario translates into higher NPLs for banks, eroding their profitability and capital buffers. The stress test reveals that while banks can withstand a moderate decline in diamond revenues, a severe and prolonged downturn could push some institutions below regulatory capital requirements.

Impact of potential employment losses

9.10 Botswana faces a growing challenge of concentrated unsecured household sector borrowing. This concentration risk raises concerns about the resilience of the banking sector to household income shocks. The stress test simulates a scenario where unemployment rises and real incomes stagnate, due to a global economic slowdown.

9.11 In this scenario, households will struggle to service their debt obligations, leading to an increase in NPLs, particularly in the unsecured lending segment.

Intensifying climate risks could destabilise the financial system

9.12 Botswana is highly susceptible to climate change, with increasing frequency and intensity of droughts posing a significant threat to the agricultural sector and the broader economy. The stress test incorporates scenarios where prolonged droughts lead to crop failures, livestock losses, and water shortages, impacting livelihoods and economic activity.

9.13 These climate-related shocks can affect the banking sector through various channels. For instance, reduced agricultural output can impact the income of farmers and businesses reliant on agriculture, leading to loan defaults. Additionally, droughts can strain government resources, potentially limiting its ability to support the economy and the financial sector in times of stress. The stress test underscores the need for banks to integrate climate risk assessments into their lending practices and develop strategies to manage the financial implications of climate change.

Contagion risk could have negative outcomes for the financial system

9.14 The stress test goes beyond analysing individual banks to assess the interconnectedness within the financial system and the potential for systemic risk. This involves considering the linkages between banks, NBFIs, and other

sectors of the economy. For instance, a shock originating in the insurance sector, such as a surge in claims related to drought-induced crop failures could potentially spill over into the banking sector through reduced insurance payouts and increased credit risk.

- 9.15 The stress test also examines the potential for contagion effects, where the distress of one bank could trigger problems in others. This is particularly relevant D-SIBs, whose failure could have significant repercussions for the entire financial system. The stress test results highlight the importance of close monitoring of D-SIBs, targeted supervisory measures, including capital buffers, and effective contingency plans to mitigate systemic risk.

(c) Stress Test Results

Banks resilient but susceptible to severe credit shocks

- 9.16 The results of credit shocks indicate that commercial banks are generally resilient to stress, save for severe credit shocks that could result in significant prudential capital breaches. Under the system-wide moderate scenario, where an additional 10 percent of performing loans are assumed to become NPLs, bank capital adequacy levels decline to 11.4 percent, breaching the prudential capital adequacy requirement of 12.5 percent. The industry capital position, however, worsens to 2.3 percent in the severe scenario, where 20 percent of performing loans are assumed to become NPLs. As a result, the asset quality declines, with the ratio of NPLs to total loans rising from a baseline of 3.4 percent to 13 percent and 22.7 percent under moderate and severe scenarios, respectively (Chart 9.2d).
- 9.17 For the sectoral shocks, under the moderate scenario, banks' capital adequacy ratio falls to 9.4 percent, while the NPLs ratio increases to 15.3 percent. The capital adequacy ratio falls further to -21.2 percent under the severe scenario, and credit quality deteriorates significantly with an NPL ratio of 41.5 percent. Regarding credit concentration shocks, banks

remain resilient with a capital adequacy ratio of 14.3 percent under the assumption that the largest borrower defaults for each bank (moderate scenario). The capital adequacy ratio further falls to 11.1 percent under the severe scenario, which assumes that the largest two counterparties will default.

- 9.18 Under the moderate concentration shock, D-SIBs are resilient, with a capital adequacy ratio above the prudential limit at 15.7 percent and 13.2 percent for the concentration shock and the overall NPL shock. For the severe concentration and overall NPL shocks, capital adequacy ratio falls to 13.1 percent and 4.6 percent, respectively (Chart 9.2a).
- 9.19 In general, credit risk tests show that the overall NPLs shock has more prominence in the capital and asset quality position of banks than other shocks. Nevertheless, credit stress tests do not consider credit mitigation measures, such as underlying collateral.

Banks are resilient to liquidity shocks

- 9.20 In the liquidity risk test, banks show resilience to a liability run in the moderate stress scenario, and all banks can withstand liability drawdowns for 15 days. Under severe stress conditions, all banks would be able to withstand drawdowns for 6 days. The results show that dependence on wholesale deposits is prevalent in both bank categories, with a range of 23 to 66 percent of total customer deposits. Therefore, there is need for banks to diversify their portfolios to mitigate liquidity risks.
- 9.21 However, the scenarios do not consider the availability of liquidity support provided by the Bank through the Credit Facility nor liquidity support available from related companies or holding banks. Accordingly, stress test results should not be interpreted to mean that banks would default under these conditions.

Bank profitability to increase with a policy rate decrease

- 9.22 Results of the moderate interest rate shock indicate that a fall in the policy rate by 100

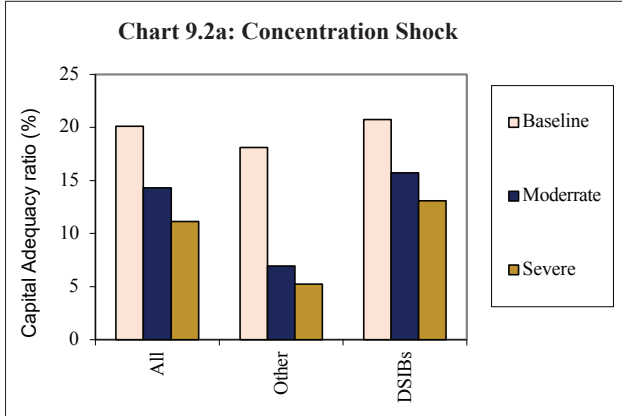
basis points would lead to an increase in interest income by P39 million, with an accompanying potential gain of P89 million from repricing of government bonds. Overall, banks' capital adequacy ratio would increase by 0.88 percentage points in the moderate interest rate shock scenario. For the severe scenario, banks would gain P58 million from interest earnings and P144 million from repricing of bonds, leading to an improvement of 0.94 percentage points for the capital adequacy ratio (Chart 9.2f).

9.23 The increase in profit reflects the banking industry's negative cumulative repricing gap over the next 12 months, where interest earning liabilities exceed interest earning assets in the stress horizon. Therefore, banks would gain from a fall in funding costs. Overall, domestic banks are highly liquid and can afford to hold bonds to maturity, therefore, there is limited risk stemming from the potential repricing of government bonds.

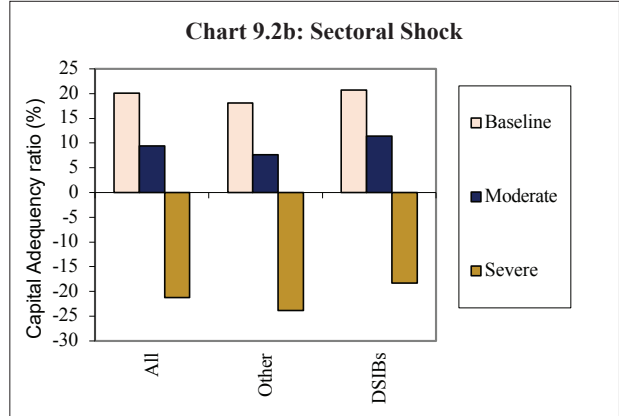
December 2024 Stress Test Results

Credit Shocks

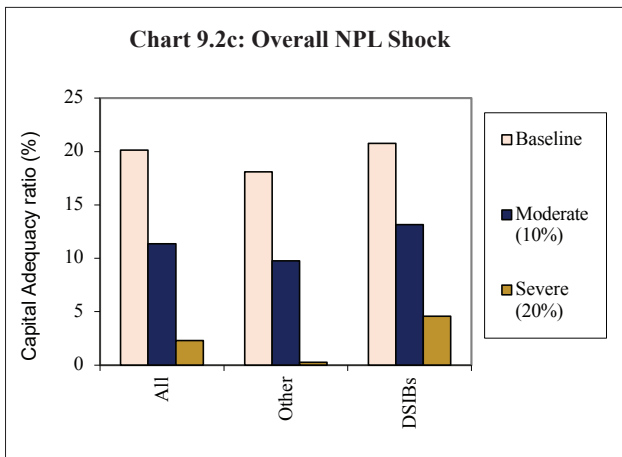
Banks are generally resilient to credit concentration shocks



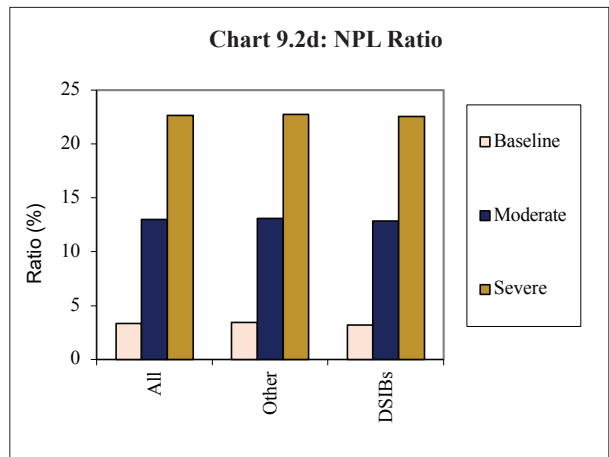
Severe sectoral shocks would lead to a significant breach in CAR



A severe aggregate credit shock would deplete banks' capital

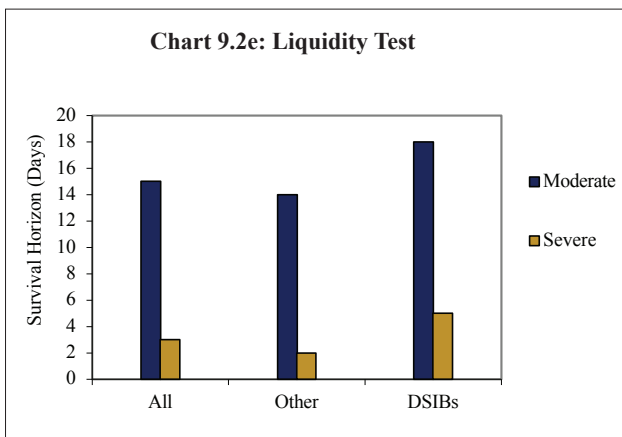


The NPL ratio for the aggregate credit shock increases significantly in the severe scenario

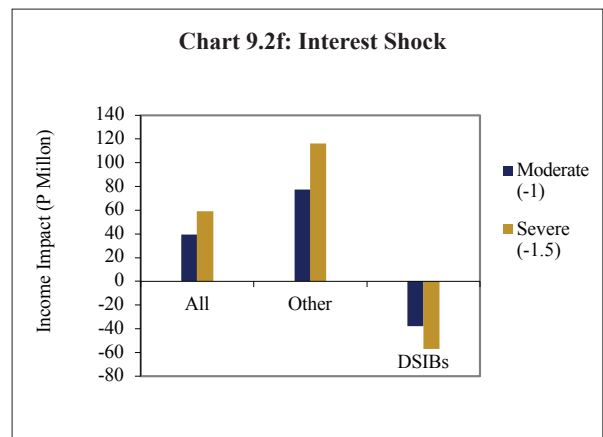


Liquidity and Interest Rate Shocks

Banks have low survival horizon under a severe liquidity shock



Bank profitability to increase with a policy rate decrease



Banks are resilient to a combination of shocks

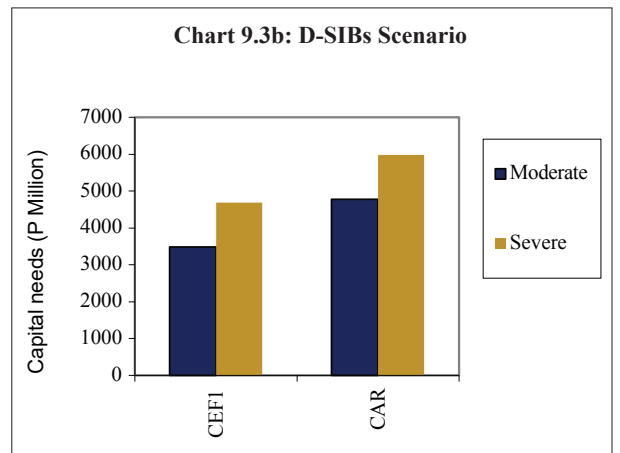
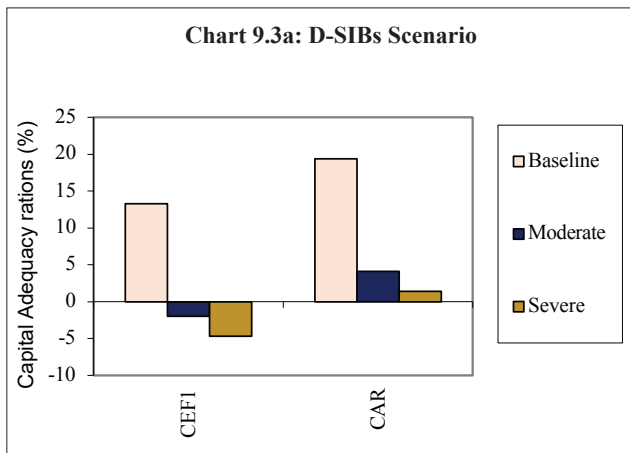
- 9.24 Considering a combination of shocks for scenario analysis, D-SIBs breach the prudential limit with a capital adequacy ratio of 4.1 percent in the moderate scenario and they are also insolvent in the severe scenario with a capital adequacy ratio of 1.4 percent (Chart 9.3a).
- 9.25 To capitalise D-SIBs, shareholders would have to inject capital amounting to P4.7 billion in the moderate scenario and P6 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 short-term funding markets and customer deposits in the moderate scenario and severe scenario and there is loss of short-term funding amounting to P13.4 billion, respectively. As a result, banks would experience a liquidity shortfall of P3.2 billion in both the moderate and severe scenario.

D-SIBs Scenario Analysis

Severe stress scenario completely erodes D-SIBs' capital base

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



10. PAYMENTS AND SETTLEMENT RISKS

Increased digitalisation presents cyber risks

10.1 Clearing systems are largely resilient in handling large volumes of transactions without any major disruption. Meanwhile, the value and volume of electronic fund transfers (EFTs) continue to increase (Chart 10.1a).

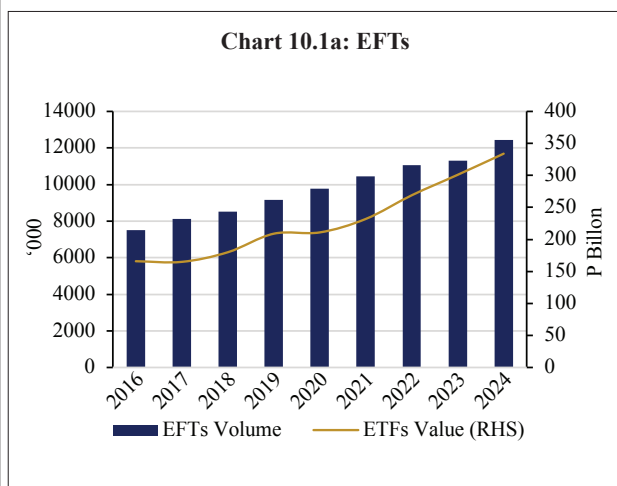
10.2 As at December 2024, the number of operating electronic payment service (EPS) providers was 23, while the number of authorised agents was more than 1 500. The emergence, growth

and promotion of electronic payments is well aligned with, among others, digitalisation and financial inclusion initiatives, forming part of the economic transformation and policy reform programme for Botswana. It is, however, recognised that digital and electronic payments methods also entail risks that need to be identified, measured, mitigated and controlled.

10.3 Generally, financial market infrastructures (FMIs) consisting of payment systems, central securities depository, and securities settlement systems, remain stable and resilient, thus strengthening and preserving domestic financial stability.

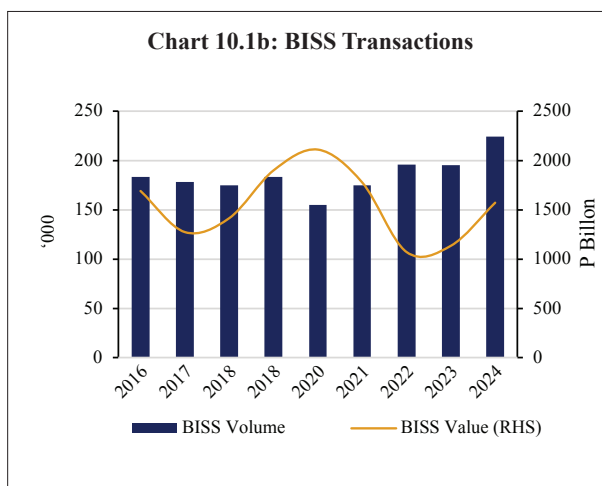
Payments and Settlement Systems Indicators

EFTs volume and value are trending upwards



Source: Bank of Botswana

BISS transactions volume and value are largely stable



11. REGULATORY AND OTHER DEVELOPMENTS

Regulatory overhaul promotes financial stability

11.1 The regulatory and supervisory environment has experienced extensive revisions between 2022 and 2023 with several amendments, enactments and re-enactments of many anchor laws⁸. MoF is currently working on a number of regulations amongst which include the Banking (Amendment) Regulations, Banking (Deposit-Taking Institutions) Regulations and Banking (Appeals Tribunal), which, once completed, should support commencement and operationalisation of the Banking Act, 2023. Similarly, the Ministry, in collaboration with the Attorney General's Chamber (AGC) is working on the Collective Investment Undertaking (Licensing, Recognition and Exemption) Regulations, 2024 and the EPS Regulations, 2024.

11.2 Meanwhile, the Non-Bank Lenders Bill, 2025, is planned to be presented to the July 2025 Parliament sitting. The bill aims to provide a regulatory framework for micro lending, pawn shops, and finance and leasing companies to create an enabling environment for the non-bank lending industry. Furthermore, the Medical Aid Funds Bill, 2025 was published on 10 March 2025 in the Government Gazette with the objective of making provisions for detailed regulations and supervision of medical aid funds by NBFIRA.

Three credit bureaus licensed to operate under the new Act

11.3 Transunion Proprietary Limited, Credbase Credit Bureau and Micro-Finance Credit Bureau have been licensed in Botswana to formally operate under the Credit Information Act, 2021. The entities' business is to facilitate availability and accessibility of credit information in the credit granting process.

NCO established to coordinate AML/CFT efforts

11.4 In an effort to align the country's Anti-Money Laundering/Countering the Financing of Terrorism/Counter Proliferation Financing (AML/CFT/CPF) framework with the recommendations of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the parliament of Botswana enacted the Financial Intelligence (FI) (Amendment) Act, 2025, which commenced on 24 January 2025. Similarly, the Trust Property Control (Amendment) Act, 2025, whose revision was to align it with the Financial Intelligence (Amendment) Act, 2025, came into operation on 24 January 2025. The Financial Intelligence (Amendment) Act, 2025 introduced the National Coordination Office (NCO) for effective coordination of AML/CFT/CPF policy. NCO duties include, amongst others, coordinating implementation of recommendations from mutual evaluations and coordinating the national risk assessment. To further enhance domestic financial safety nets, the NBFIRA is developing legislation (Policy Protection Regulations, 2024) that would facilitate the establishment of a fund to protect policyholders in the event of insolvency and failure of insurers.

11.5 Furthermore, the FI (Amendment) Act, 2025 aligns with global standards with specific focus on enhancing FIA's operational independence, clarifying the mandate of FIA and aligning the definition of Prominent and Influential Persons with the FATF definition for ease of implementation. Other reforms at FIA include the formation of a Botswana Public Private Partnership Task Force and the Intelligence, Law Enforcement and Prosecution Forum. The two Forums would primarily provide a platform for collaboration and information exchange between AML/CFT/CPF stakeholders, in turn, promoting financial integrity within the financial system.

⁸ The list includes Bank of Botswana Act, amended and effected on 14 February 2023; Banking Act, re-enacted and published as an Act of Parliament on 26 May 2023; Electronic Payment Services (Amendment) Regulations, 2023; Financial Intelligence Act, 2022; and the Virtual Assets Act, 2022.

In addition, the outcome of this collaboration through these forums is to streamline processes in line with best international practices, for the identification of suspicious transactions, their investigation and ultimate prosecution for financial crimes. FIA intends to sign a memorandum of understanding with relevant stakeholders to operationalise the forums.

Drafting of the 2025 - 2030 FSIDS expected to be completed in June 2025

- 11.6 The Government of Botswana (through MoF, the Bank, BSEL, and NBFIRA), in collaboration with the World Bank, have embarked on a project to develop a five-year Financial Sector Development Strategy (FSIDS) for Botswana which will be completed in June 2025. The FSIDS aims to provide a framework for growing the domestic financial system and it is founded on recommendations of the Botswana Financial Sector Assessment Program (FSAP) for 2022/23. The strategy has identified national priorities in line with the broader national development plan in order to strengthen the role of the financial system on economic development. To date, two draft chapters, viz., Banking Sector Stability and Digital Financial Services and Financial Inclusion, have been released and feedback provided by the technical committee of the FSIDS. The mission team is working to release three other chapters that include the Role of the State in Finance, Long Term Finance and Capital Markets and Insurance.

Bank of Botswana joins the NGFS

- 11.7 The Bank joined the Central Banks and Supervisors Network for Greening the Financial System (NGFS) on 4 March 2025. Joining NGFS demonstrated the Bank's efforts to build capacity, enhance understanding and uptake of climate related endeavours and related Environmental, Social and Governance (ESG) matters in line with best international standards on monetary, macroprudential, and bank supervision frameworks and policies (Box 4).

BSEL joins the Net Zero Financial Service Providers Alliance

- 11.8 On 26 May 2025, Botswana Stock Exchange Limited (BSEL) announced its membership in the Net Zero Financial Service Providers Alliance (NZFSPA), an initiative led by the United Nations Sustainable Stock Exchanges (UNSSSE). By joining the Alliance, BSEL has committed to align its capital markets with net zero emissions targets. This is expected to enhance BSEL's credibility, aligning it with global sustainability standards like the Paris Agreement and Africa's Agenda 2063, and positioning it as a regional leader in climate-conscious finance. The membership is also expected to improve climate-related disclosures and stakeholder collaboration, potentially attracting sustainable investments while strengthening the transparency and resilience of Botswana's capital markets.

National Financial Inclusion Roadmap and Strategy, 2024 - 2030 signed by the Minister of Finance

- 11.9 MoF in collaboration with the Southern African Development Community (SADC) Support Consortium engaged FinMark Trust to undertake the inaugural Micro, Small and Medium Enterprises (MSME) FinScope and the FinScope Consumer Surveys for 2024. The preliminary results of the FinScope Consumer Survey were presented to the Steering Committee on 26 March 2025. The final report will be produced following the incorporation of suggested amendments. Furthermore, the Ministry has engaged FinMark Trust to do a pilot study that assesses and helps to understand various aspects related to digital payments/non-cash payments. In addition, in March 2025, the Minister of Finance signed off the National Financial Inclusion Roadmap and Strategy (NFIRS), 2024 - 2030, to be launched during the first half of 2025.

Box 4: The Bank of Botswana joins the Network for Greening the Financial System

a) Introduction

The Bank of Botswana has joined the Central Banks and Supervisors Network for Greening the Financial System (NGFS), as a Plenary Member, with effect from 4 March 2025. The Bank's membership in the NGFS is expected to strengthen its international participation and collaboration on climate dialogue. It is also expected to provide an opportunity for development and calibration of better-informed frameworks and mechanisms for integrating climate change considerations in mandate frameworks and operations and related capacity building.

As at 11 March 2025, NGFS had 144 members across 90 countries, including Botswana and 21 observers. The Bank is part of the twenty-five (25) member institutions in Africa and twelve (12) in the SADC. The current chair of the NGFS is Ms Sabine Mauderer, Vice-President of the Deutsche Bundesbank and the vice-chair is Ms Fundi Tshazibana, Deputy Governor of the South African Reserve Bank. The NGFS Secretariat is hosted by the Banque de France.

NGFS was established in December 2017 to strengthen the global response to climate change and meet the goals of the Paris Agreement by the financial sector. The Network is a worldwide forum for central banks and supervisors to exchange experiences and best practices on central banking that contribute to the development of environment and climate risk management in the financial sector. It thus contributes to capacity building and peer learning on assessment and management of climate-related financial risks as well as playing a key role in mobilising mainstream finance to support the transition (transition finance) towards a sustainable and resilient global economy.

The Bank of Botswana (Bank) recognises and acknowledges developments relating to climate change and their influence on its mandates, activities and processes. In this regard, climate change considerations are integral to the Bank's, strategy, planning and operational initiatives; for example, the Bank's 2024 – 2026 Medium-Term Plan. In this regard, in alignment with the global protocols and response plans, domestic adaptation and compliance measures, as well as the internal organisational imperatives, climate change issues would be included in the envisaged ESG formal framework of the Bank.

Practically, the Bank already addresses and responds to climate issues in several respects, including the impact on prices and monetary policy responses; regulatory and financial stability considerations relating to strategy and operations of banks with respect to sectoral credit allocations and the handling of potentially stranded assets and transitioning as well as adaptation opportunities; foreign exchange reserves portfolios and management and adaptation of climate friendly operations, for example, digitalisation, energy and water efficient buildings and approaches to banknotes production. Accordingly, to solidify the Bank's path and goals to integrate climate considerations in its mandate, the Bank finds it valuable to join hands with other stakeholders and international institutions to gain collective insights and direction on the subject matter, hence the consideration to join the NGFS. The Bank's interest on NGFS was motivated by its plan to build capacity, promote collaboration mechanisms among members, enhance understanding and encourage uptake of climate related measures and risk assessment approaches in line with best international standards.

b) Action on Climate Change by Bank of Botswana

The Bank's footprint in the climate change agenda is demonstrated by its active participation in numerous national and institution-level greening initiatives, including the United Nations Development Programme's (UNDP) Biodiversity Finance Initiative Task Force (BIOFINTF), where it holds the chairmanship of the Green Finance Mainstreaming Working Group (GFMWG). The GFMWG is a platform for building and strengthening partnerships between BIOFINTF, the financial sector and entities to which green finance relates. Critically, GFMWG is a BIOFINTF think tank. This role demands that the Bank directs and conducts research on climate-finance issues and develops measures to mainstream green and sustainable finance in the financial sector of Botswana. Furthermore, the UNDP, in consultation with the Bank, has developed guidelines for climate related supervision for the banking and non-bank financial institutions of Botswana. The guidelines are expected to be issued to the market after consultation with relevant financial sector players. Consultations and adaptation with respect to NGFS approaches would be valuable in this regard.

The Bank's commitment to the global climate change agenda is also embodied in the recently redeveloped head office in Gaborone, Botswana. The smart building has waste management stations, enhanced occupier experience and renewable energy integration. Consequently, the building achieved a 6-star Green Building design rating and received the "Highest Rated Building Award" and the "African Award" from the Green Building Council of South Africa in November 2022. The facility is fitted with a grid-tied solar plant, designed to generate enough renewable energy to offset electricity consumption and supply excess to the national grid.

On a policy front, traditionally, the Bank infuses climate change considerations in policy application through expert judgement, although with no structured assessment processes. Efforts are underway to better understand and adopt, where necessary, formalised model approaches of capturing climate related risks into monetary policy and macroprudential policy. Therefore, envisaged growth areas are likely to be on the design of a climate disclosure framework for investment portfolios, development of a taxonomy and architecture around green bonds and stress test scenario design for climate change financial risks. The Bank is, therefore, building capacity through short-term training, as well as participation in platforms on climate change and it is envisaged that membership of NGFS will present additional complementary capacity building.

At a regional level, the Bank, in collaboration with other central banks in SADC, is actively participating in several climate related projects mostly under SADC central bank mandates to support the greening of the financial sector. These projects include development of a regional supervisory framework for climate related financial risks, development of a green financing framework (including promotion of green and sustainability bonds and ESG rating) and development of a regional climate change response framework that has capacity building, training on modelling climate risks and research work elements. Existing short research work is covered in the various Bank reports such as the Financial Stability Report (October 2023 and May 2024 reports⁹), Banking Supervision Annual Report (2019 and 2021)¹⁰ and in the Governor's 2023 Media Economic Briefing speech¹¹. Additionally, the Bank's 2022 Annual Report¹² theme chapter has a section on "*Climate Change and Sustainable Economic Development*" that unpacks the implications of climate change on economic development and assessed reforms, transitional and adaptation actions needed to build a resilient and sustainable economy and related policy frameworks.

c) Conclusion

The Bank is navigating transition and adaptation aspects relevant to its policy frameworks and operations, notably price and financial stability mandate; digitalisation of payments systems and currency design; foreign exchange reserves management guidelines; and office space design and working arrangements for energy and water use efficiency. In this regard, collaboration with, and participation in NGFS forums would be helpful in developing frameworks and mechanisms for integrating climate change considerations in mandate frameworks and operations and in related capacity building. Thus, support Botswana’s contribution to the global action on climate change, including transition and adaptation opportunities and enhancing resilience.

9 Available at [Financial Stability Report October 2023](#) and [Financial Stability Report May 2024](#).

10 Refer to Box 2 of the 2019 report titled “The Role of Green Finance and Responsible Banking in Addressing the Effects of Climate Change” available at [Bank of Botswana Banking Supervision Annual Report 2019](#) and Box 2 of the 2021 report titled “Adapting Banking Regulation and Supervision for Climate Change-Related Financial Risks”, available at [Bank of Botswana Banking Supervision Annual Report 2021](#).

11 Available at [Bank of Botswana 2023 Media Economic Briefing](#).

12 Available at [Bank of Botswana Annual Report 2022](#).

12. CONCLUSION AND OUTLOOK

- 12.1 The domestic financial system remains resilient and robust, thus continues to be safe and sound as well as unconstrained in providing and growing the range of financial services to support the economy. The enduring stability of the financial system is supported by a stable macroeconomic environment, characterised by the prevailing accommodative monetary conditions and despite sovereign vulnerabilities (i.e., reduced fiscal and external buffers) due to the current depressed global economic environment combined with long-term structural trends.
- 12.2 Global vulnerabilities remain and relate to challenges resulting from the subdued global growth, persistent geopolitical risks, as well as the high and rising sovereign debt burden. Furthermore, the enduring interconnectedness of the global economic system presents both opportunities for integration and trade, and a channel for global risk spillovers. For Botswana

and some emerging and developing economies, continued weakening of global demand is undermining efforts for fiscal consolidation and amplifying potential risks associated with a growing interconnectedness between the government and banks, and the government and the rest of the economy. Additionally, the ongoing domestic economic recession is raising concerns about expected credit losses and declining market liquidity amid subdued government spending. Even though the financial soundness indicators and other considerations point to a strong and enduring domestic financial system despite these challenges, the prevailing fiscal conditions pose a significant risk to financial stability in the short-to-medium term. Nevertheless, the guarded optimism around the performance of the global diamond market could anchor market expectations and support financial stability going forward.

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