FINANCIAL STABILITY REPORT

BANK OF BOTSWANA
BANKA YA BOTSWANA

PULA
REPUBLIC OF BOTSWANA
MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

NBFIRA
Non-Bank Financial Institutions Regulatory Authority

MAY 2021

FINANCIAL STABILITY COUNCIL

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ABBREVIATIONS

AML/CFT	Anti-Money-Laundering and Combating the Financing of Terrorism
AUM	Assets Under Management
BES	Business Expectations Survey
BISS	Botswana Interbank Settlement System
CIRT	Computer Incident Response Team
CorpI	Corporate Bond Index
CSD	Central Securities Depository
DPF	Deposit Protection Fund
D-SIFIs	Domestic Systemically Important Financial Institutions
FATF	Financial Action Task Force
ERTP	Economic Recovery and Transformation Plan
FMI	Financial Market Infrastructure
FSC	Financial Stability Council
GFSR	Global Financial Stability Report
LTV	Loan-to-Value
Mancos	Asset Managers and Management Companies
MPC	Monetary Policy Committee
NAV	Net Asset Value
NBFIs	Non-Bank Financial Institutions
RPC	Regulatory Policy Committee
SDR	Special Drawing Right
WEO	World Economic Outlook

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The May 2021 issue of the Financial Stability Report (FSR) was prepared by the Bank of Botswana in collaboration with the Ministry of Finance and Economic Development (MFED), Non-Bank Financial Institutions Regulatory Authority (NBFIRA) and Financial Intelligence Agency (FIA). The Report was approved for publication by the Financial Stability Council (FSC), a multi-agency body launched in February 2019 to collaborate and exchange information on financial stability issues affecting Botswana's financial system. The FSC comprises senior officials from the MFED, Bank of Botswana, NBFIRA and FIA. These Authorities have signed a Memorandum of Understanding (MoU) for the purpose of information sharing, cooperation and communication in the implementation of macroprudential policy for Botswana.

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PREFACE

Purpose of the Report

The Financial Stability Report (FSR) provides an assessment of the vulnerabilities to the stability and resilience of the Botswana financial system by the Financial Stability Council (FSC). The Report provides analytical and performance updates for the financial sector and its impact on economic activity and welfare; encourages informed 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.

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 financial crises can spill-over more rapidly to the real economy. At the same time, sectoral or broader economic weaknesses could adversely affect the financial system and trigger instability or 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 number 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.

The macroprudential policy framework identifies the external sector of the domestic economy, through trade shocks and capital outflows, as having the greatest potential for elevated financial stability risks. In addition, the COVID-19 pandemic and the necessary disease containment measures have elevated the risk of a macroeconomic shock, a result of depressed global diamond market and disruption of the tourism and related hospitality industries. The FSR provides an analysis of these domestic vulnerabilities, how they interact internally, 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. These 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 by the FSC periodically.

Decision-making process

The FSC of Botswana, a multi-agency body, was established to, among others, collaborate and share information on policy and other related issues on strengthening the financial system and making it more robust, in order to mitigate financial stability risks, and take prompt action in response to a perceived build-up of systemic risks; ensure a coordinated response to financial stability issues that may require cross-agency collaboration; request information from any financial institution, exchange information on financial stability issues, and communicate systemic risk warnings. The FSC is not a statutory body; rather it is a coordinating and cooperation mechanism. It is the responsibility of the respective entities to ensure that relevant macroprudential instruments are timeously activated to combat vulnerabilities, with a view to maintaining long-term financial stability.

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

Announcement of macroprudential policy decisions

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

1. EXECUTIVE SUMMARY

1.1 **Divergent and incomplete economic recovery across countries threatens global financial stability. Global risks to financial stability have thus far been contained, but the likelihood of unequal distribution of COVID-19 vaccines could translate into incomplete global economic recovery, thus posing a risk to global financial stability.** At the same time, the varying speed and intensity of economic recovery between advanced and emerging countries has the potential to create imbalances in the global financial system (April 2021 Global Financial Stability Report (GFSR)). Policy support is, therefore, still required to establish a sustainable recovery path and minimise persistent economic damage (scarring), and thereby enhance financial stability. However, it is equally important to deal with vulnerabilities building-up in the low interest rate environment and the unintended consequences of policy support, and its eventual unwinding, by promoting timely activation of macroprudential policy tools.

1.2 **The resurgence of COVID-19 infections, new variants of the virus and the slow pace of the roll-out of the vaccine could limit expected global economic recovery in 2021.** Global economic activity recovered in the second half of 2020 leading to a global economic contraction of 3.3 percent. The 2020 economic contraction is smaller than the 4.4 percent projected in the October 2020 World Economic Outlook (WEO). This is due to growth outturns in the second half of the year as most regions reopened from the Great Lockdown. The recovery is expected to be stronger in 2021 but could be limited by the resurgence of COVID-19 infections, new variants of the virus, associated logistical constraints to vaccine distribution, and reintroduction of lockdowns and stricter COVID-19 containment measures by some countries.

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

1.4 **Domestic real gross domestic product (GDP) outturn slightly worse than expected. The economy contracted by 7.9 percent in 2020 against a projected contraction, by the MFED, of 7.7 percent.** The 2020 GDP growth rate is significantly lower than a growth of 3.3 percent in 2019 and the MFED's pre-COVID-19 growth forecast of 4.4 percent. The sluggish economic performance is mainly on the backdrop of a reduction in mining and non-mining output resulting from the negative impact of the COVID 19 pandemic and the necessary disease containment measures on economic activity. However, the economy is expected to recover to a growth rate of 8.8 percent in 2021. The prevailing accommodative monetary conditions, reforms to further improve the business environment, vaccine rollouts and government interventions against COVID-19, including the implementation of the Economic Recovery and Transformation Plan (ERTP) and the Industry Support Facility (ISF) are key inputs into the optimistic growth projections for 2021. Moreover, the global vaccine-powered recovery as well as the subsequent return of business confidence and sentiment are expected to boost global demand and positively affect exports, including those of diamonds, as well as tourism and hospitality industry. Meanwhile, the International Monetary Fund (IMF) expects the domestic economy to grow by 8.3 percent in 2021 and 6.4 percent in 2022.

1.5 **Domestic credit growth remains moderate, posing minimal risk to financial stability.** Commercial bank credit grew by 1.6 percent to P66 billion in the year to March 2021, lower than the 10.7 percent growth in the corresponding period in 2020. The growth in credit was mainly attributable to the 6.3 percent increase in lending to households, which in turn was driven by unsecured lending. Business credit decreased by 6.6 percent over the same period. Commercial bank credit continued to be dominated by household borrowing, at 66 percent, during the period under review. Household borrowing also dominate credit in the non-bank financial institutions sector, although the level of household exposure in the sector remains relatively low compared to commercial banks.[2] The level of household indebtedness in Botswana is, however, considered low by international standards, at 23.7 percent of GDP in the fourth quarter of 2020, compared to, for example, 26.2 percent, 33.9

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1 Locally, the COVID-19 vaccine was rolled out in March 2021.

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

percent and 52.8 percent in Mauritius, Namibia and South Africa, respectively.[3] According to the 2020 Household Indebtedness Survey, household borrowing appears to be in line with the growth trends in personal incomes (reflected in the low debt to income ratio), representing a relatively stronger debt servicing capacity. Additionally, credit extension contributes to cross-generational welfare enhancement and is supportive of economic growth. The ratio of non-performing loans (NPLs) to total bank credit remained modest at 4.4 percent in March 2021, relatively unchanged from March 2020. To maintain low to modest NPLs and help vulnerable groups in the context of COVID-19 induced economic disturbances, there is a need to keep in place targeted support to illiquid but solvent firms and affected households[4]. Overall, there is no indication of excessive and rapid credit growth that could threaten the stability of the financial system.

1.6 **Average daily market liquidity in the banking system decreased to P8.4 billion in March 2021 from P10.9 billion in December 2020.** Market liquidity was adversely affected by foreign exchange outflows and settlement of Government Treasury Bills. Nevertheless, banks continued to be compliant with the minimum liquid asset ratio requirement of 10 percent and supported borrowing demands, with a financial intermediation ratio of 82.2 percent in March 2021. Commercial banks' funding structure, however, continues to be concentrated in a few depositors, mainly businesses, reflecting an imbalance in the market and the potential increase in funding costs due to the volatile nature of wholesale deposits. This notwithstanding, the funding risks are mitigated by inherently long-term structure of bank deposits, mainly fixed deposits, thus giving banks an opportunity to respond accordingly in case of short-term funding shocks. Moreover, current deposits, which are considered stable/core, account for a sizable proportion (26 percent) of total deposits.

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

1.8 **Strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies, governance and misconduct issues relating to misappropriation of funds in the non-bank financial sector continue to undermine the integrity of the domestic financial system.** The country's blacklisting by the European Union poses additional risks, especially relating to the need for enhanced due diligence in establishing correspondent banking relationships and investing in offshore markets. However, progress continues to be made on rectifying the identified deficiencies, hence the country has obtained positive re-ratings on some of the previously adversely rated FATF recommendations. As such, the likelihood of elevated risk to financial stability due to ongoing strategic AML/CFT deficiencies is expected to recede going forward.

1.9 **Policy support adopted by the Bank and other financial sector regulators in response to the COVID-19 impact continues to cushion the financial industry from possible financial constraints.** In April 2020, the Bank adopted several policy measures including the reduction in the primary reserve and capital requirements, expansion of the eligible collateral pool for access to central bank Credit Facility, the increase in the tenure of the repo transactions and reduction in the cost of the Credit Facility. These measures continue to support domestic economic activity in terms of reducing borrowing costs in the economy and provide a sound springboard for future recovery; sustain, in the short term, the cash flow position and balance sheets of businesses and households; and allow commercial banks to perform the necessary financial intermediation to support economic activity.

1.10 **Overall, vulnerabilities to financial stability are judged to be moderate in the short term.** The heat map (Appendix Chart A1), which is the FSC's vulnerability indicator, shows elevated sovereign vulnerabilities due to the budget deficit and deteriorating balance of payments; but these are lessened by moderate levels of risks to the non-financial sector; stable housing prices and stock market valuations; low funding costs and sufficient market liquidity; and moderate risk of contagion in the domestic market. These conditions could be worsened by the delayed recovery and stricter, but necessary, disease containment measures.

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

4 IMF Staff April 2021 Article IV Mission to Botswana.

2. FINANCIAL STABILITY DEVELOPMENTS AND TRENDS

(a) Global Financial Stability Developments

Divergent and incomplete economic recovery across countries threatens global financial stability

2.1 The approval and roll-out of vaccines has boosted expectations of a global recovery and increased risk asset prices, despite rising COVID-19 cases and persistent uncertainties surrounding the economic outlook as well as effective deployment of vaccines and treatments (April 2021 GFSR). However, the vaccine roll-out continues to be uneven, which could delay global economic recovery and, thus, pose risk to global financial stability. Moreover, the latest GFSR of April 2021 notes a divergence in the recovery of advanced and emerging economies that could tighten global financial conditions, in turn, delaying the recovery. Hence, policy support continues to be necessary to establish a sustainable growth recovery process and address vulnerabilities stemming from COVID-19, while also taking cognisance of the build-up of vulnerabilities arising from the currently low interest rate environment as well as the unintended consequences of policy support measures.

2.2 Most importantly, the April 2021 GFSR notes that the non-financial sector entered the pandemic over leveraged, which has been exacerbated by ongoing public intervention measures to support household and business welfare. Furthermore, loose financial conditions harbour downside risks to future domestic economy activity and financial stability because of moral hazard and adverse selection of risker borrowers. As such, strengthening the regulatory framework for the non-bank financial sector and revamping prudential supervision to contain underlying risks remains a priority currently and during the post-pandemic era. There is also a need to timely activate macroprudential policy tools to deal with the build-up of systemic risks in the global financial system.

Global economic recovery on track

2.3 On average, regions across the world experienced stronger-than-expected recovery in economic activity in the second half of 2020 as many economies reopened from the Great Lockdown. As a result, the April 2021 World Economic Outlook (WEO) estimates the global economy to have contracted by 3.3 percent in 2020, better than the January 2021 (-3.5 percent) and October 2020 (-4.4 percent) forecasts. For 2021, global GDP is projected to grow by 6 percent, 0.5 percentage points better than the January 2021 forecast. The roll-out and effectiveness of COVID-19 vaccines as well as additional fiscal support in a few large economies are expected to power economic recovery. The growth expansion, however, depends on the trajectory of the disease, effectiveness of policy support and timely withdrawal of such measures, capacity adjustment and the evolution of financial conditions as well as commodity prices (GFSR, April 2021).

(b) Regional Financial Stability Developments and Trends

Sub-Saharan Africa economic output to recover in 2021

2.4 The April 2021 WEO estimates economic output in Sub-Saharan Africa (SSA) to have contracted by 1.9 percent in 2020; 0.7 percentage points better than the January 2021 WEO Update forecast of -2.6 percent. Regional growth is expected to recover to 3.4 percent in 2021, slightly higher than the 3.2 percent projected in the January update. The anticipated improvement is subject to easing of mobility restrictions and reduction of COVID-19 transmissions due to widespread vaccinations and development of sufficient herd immunity. Downside risks could emanate from overwhelmed health systems due to the resurgence of new infections and new variants as well as the limited fiscal space to address the health and economic consequences of COVID-19. The two largest economies in the region, Nigeria and South Africa, experienced economic contraction in 2020, of 1.8 percent and 7 percent, respectively.

2.5 Meanwhile, the South African Reserve Bank (SARB) projects economic growth of 3.8 percent in 2021, against 2.2 percent forecasted by IMF, on the back of an improvement in business activity and confidence. The SARB further expects the South African economy to grow by 2.4 percent and 2.5 percent in 2022 and 2023, respectively. The expected recovery of these economies augurs well for regional economic and financial stability.

SARB maintains the repo rate at 3.5 percent

2.6 At the meeting of the Monetary Policy Committee held on March 25, 2021, the SARB maintained the repo rate at 3.5 percent. The SARB considered the risks to both the growth and inflation outlook to be balanced and expected inflation to be contained and remain below the 4.5 percent midpoint of the target range in 2021. The South African inflation is expected to rise to 4.3 percent in 2021 compared to 3.3 percent in 2020 and to further rise to 4.4 percent and 4.5 percent in 2022 and 2023, respectively.

(c) Domestic Financial Stability Developments

Domestic economy expected to rebound notwithstanding declining fiscal and external buffers

2.7 The domestic macroeconomic environment remains conducive for financial stability, notwithstanding the likely rise in sovereign vulnerabilities due to the current depressed global economic situation (Table A1 in the Appendix). Real GDP declined by 7.9 percent in 2020, compared to an expansion of 3.0 percent in 2019. The decline in output is attributable to the contractions in outputs of both mining (26 percent) and non-mining output (5.9 percent) sectors, resulting from the negative impact of COVID-19 containment measures. However, the economy is projected to rebound to a growth rate of 8.8 percent in 2021 buoyed by the expected improvement in global business confidence and sentiments, leading to a demand for local diamonds and resumption of tourism services.[5] In addition, reduction in global supply chain disruptions, as well as easing of measures to curb the spread of COVID-19 should result in the resumption of domestic production and consumption, especially with the implementation of ERTP. The vaccination rollout that started in March 2021 holds promise for a vaccine-powered recovery.

2.8 The Government budget had a deficit of P9.9 billion for the fiscal year 2020/21 (April 2020 - January 2021). The deficit is mainly due to less than anticipated revenue and grants, at 92 percent of the budget, resulting from lower domestic taxes and other revenues. Non mineral revenue was lower than expected in the revised budget, largely because of the negative impact of travel restrictions, aimed at containing the spread of the COVID-19 pandemic. As a result, the Government budget was revised, and revenues and grants projections reduced from P52.3 billion to P48.3 billion. On the other hand, expenditure estimates were increased from P66 billion to P69.4 billion for the 2020/21 fiscal year as a counter-cyclical fiscal measure. Ultimately, the budget deficit was revised upwards to P21.02 billion, or 11.6 percent of GDP, from the initial estimate of P13.6 billion. It is expected that the deficit will be partly funded through domestic[6] and external borrowing.

2.9 According to the 2021 Budget Speech, there has been a substantial reduction in the Government Investment Account balances and, hence further drawdowns would be unsustainable. The low level of balances has the potential to erode the country's traditionally strong fiscal and external buffers in the medium term, posing fiscal risks. Botswana should, therefore, continue to pursue a policy mix that supports growth and promotes economic and revenue diversification. In an effort to boast revenues, the Government announced several adjustments to the tax regime. These include an increase in the value added tax from 12 percent to 14 percent, fuel levy, tax on dividends, and the introduction of a levy on sweetened beverages effective April 1, 2021. The Government also intends to operationalise the plastic levy as a way of reducing pollution while also raising fiscal revenues.

2.10 In relation to public debt, Government debt and guarantees stood at P38.3 billion in September 2020 (21 percent of GDP) compared to P36.9 billion in June 2020 (20.9 percent of GDP). Public debt declined to P35.3 billion in December 2020 partly owing to the redemption of the P2.1 billion Government bond (BW008). Total domestic borrowing and guarantees amounted to P19 billion (11 percent of GDP); substantially below the statutory domestic borrowing limit of 20 percent. In this regard, Parliament approved the increase of government bond issuance limit from P15 billion to P30 billion, partly to provide funding options for restoring the fiscal balance.

2.11 This notwithstanding, the country's long-term borrowing costs are likely to be affected by the "Negative" outlook conferred by S&P Global Ratings (S&P) in September 2020 and maintained in March 2021 as well as the sovereign credit downgrade by Moody's Investors Service (Moody's). The adverse outlook is on the back of anticipated higher pressures on the country's economic, external, and fiscal performance, stemming from the impact of the COVID-19 pandemic. Meanwhile, Moody's downgraded of the country's sovereign credit rating for long-term bonds, denominated in both domestic and foreign currency, from 'A2' to 'A3 in April 2021 duea to relatively weaker economic resilience and lower economic diversification compared to peer countries in the 'A' rating category. Nevertheless, Moody's changed the outlook from "Negative" to "Stable" reflecting broadly balanced risks, hence Botswana's financial strength is expected to remain commensurate with Moody's 'A3' sovereign credit rating.

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5 IMF expects Botswana's GDP to grow by 8.3 percent and 6.4 percent in 2021 and 2022, respectively (IMF Article IV Mission, April 2021).

6 The National Assembly approved an increase of the Government bond issuance programme from P15 billion to P30 billion on September 15, 2020 in order to fund the national budget.

3. DOMESTIC MACROPRUDENTIAL ANALYSIS

(a) Sovereign Vulnerabilities

External sector risks elevated in the near term and could rise further in the medium term

3.1 The external sector presents the greatest potential for elevated financial stability risks to the domestic economy. The contraction in global output in 2020 and the deceleration in output growth of the domestic mining sector due to weaker global demand for diamonds highlight Botswana's susceptibility to risks emanating from the external sector. The country's overdependence on external trade and related revenue i.e., Southern African Customs Union (SACU) and mineral exports revenue, could further amplify vulnerability from external macroeconomic developments.[7] Given the narrow export base, external shocks, especially in the diamond markets, lead to weaker external balance outcome.

3.2 Foreign exchange reserves decreased by P2 867 million (4.9 percent) from P58 638 million in January 2021 to P55 771 million in February 2021. In foreign currency terms, the reserves decreased by USD267 million (5 percent) to USD5 081 million and by SDR181 million (4.9 percent) to SDR3 525 million in February 2021. The decrease in the foreign exchange reserves was mainly attributable to an increase in demand for foreign currency by some of the country's main importers. The level of reserves translated to 10.5 months of import cover as at February 2021 (February 2020:12.5 months), reflecting relatively low external buffers. The prevailing fiscal deficits also point to increasing pressure on the already declining and undiversified revenues. The deficits are mainly borne by Government's drive to pursue counter-cyclical fiscal policy to minimise the impact of COVID-19 on the health sector and the economy at large.

3.3 The overall balance of payments was in a deficit of P5.3 billion in December 2020 compared to a smaller deficit of P63.9 million in the previous month. For the twelve months to December 2020, the overall balance of payments was in a cumulative deficit of P20.1 billion compared to twelve-month cumulative deficit of P12 billion in December 2019.

(b) Credit Growth and Leverage

Commercial Banks

Growth in bank credit modest

3.4 Commercial bank credit increased by 1.6 percent to P65.6 billion in the year to March 2021, lower than the 10.7 percent growth in the corresponding period in 2020 and posing limited threat to the stability of the financial system. The deceleration in commercial bank credit growth was largely due to constrained growth in household credit growth over the review period. The latter comes as a result of deterioration in financial conditions of households, and on the other hand, by tighter bank lending standards of banks as a result of uncertain economic conditions. However, lending was supported by an accommodative monetary policy stance during 2020.[8] Policy measures undertaken by the Bank in 2020, such as the reduction in the Bank Rate and primary reserve requirement are expected to facilitate financial intermediation by commercial banks to support economic activity during the course of the COVID-19 pandemic.

3.5 Table 3.1 shows the distribution of commercial bank credit to businesses, households and Government, wherein household credit increased to P43.3 billion in March 2021, from P40.7 billion in March 2020, on the back of significant increase of 8.8 percent in personal loans. Business loans, on the other hand, decreased by 6.6 percent as the significant reduction in credit to parastatals, mining, manufacturing, and electricity and water sectors largely offset the increase in the uptake of loans by finance. As a result, the share of business credit in total credit decreased from 37 percent in March 2020 to 34 percent in March 2021, while household credit accounted for 66 percent in March 2021 from 63 percent in March 2020.

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

Commercial banks are adequately capitalised

3.7 Commercial banks leverage ratio was 9.7 percent in March 2021, an increase from 8.7 percent in

7 Diamonds accounted for about 88.2 percent of total exports in 2020.

8 The Bank Rate was reduced from 5 percent to 4.75 percent in August 2019, 4.25 percent in April 2020 and further to 3.75 percent in October 2020.

December 2020; indicative of the banking sector's strength to withstand negative shocks to the balance sheet. Furthermore, the average commercial banks' capital adequacy ratio was 20.2 percent in March 2021; an improvement from the 19.7 percent registered in March 2021, thus indicating the sector's resilience to unexpected losses (Table 3.8). The industry's strong capital base is further augmented by the modest ratio of NPLs to total loans ratio of 4.4 at the end of December 2020, compared to 4.8 percent in March 2020. However, the current economic conditions arising out of the COVID-19 pandemic are likely to put pressure on corporate performance, and in turn, negatively affect bank profitability and capitalisation. To counter these effects, commercial banks granted customers with a good repayment history, a repayment holiday,[9] while the Bank is exercising regulatory forbearance in relation to the assessment of NPLs and determination of expected credit losses for regulatory and compliance purposes.

COVID-19 affected businesses benefit most from loan moratoria

3.8 Since the implementation of the discretionary loan repayment holiday by banks, loans that have benefited from this measure accounted for 8.5 percent of aggregate commercial bank loans and advances, translating to P5.6 billion in December 2020. This was a decrease from 11.4 percent that was recorded in June 2020 (P7.3 billion). Business loans granted the repayment holiday accounted for 85.2 percent of the total loans given moratoria, while household loans accounted for 14.8 percent. In terms of sectoral distribution, commercial real estate loans accounted for the largest share of private businesses granted repayment holiday (35.7 percent), followed by business services at 16.9 percent. On the other hand, banks restructured loans amounting to P6.2 billion (9.5 percent of total credit extended by commercial banks), with private businesses accounting for the largest share (76.3 percent), while households accounted for 12.3 percent. These actions further cushioned the economy from the consequences of the COVID-19 pandemic, in turn, moderating the risk of instability in the domestic financial system.

9 Banks assess customers on a case-by-case basis to establish their need for a longer repayment holiday.

Table 3.1: Sectoral Distribution of Commercial Bank Loans

Sector	QUARTERLY											
	2019Q4		2020Q1		2020Q2		2020Q3		2020Q4		2021Q1	
	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Credit to Total GDP (Percent)	Percent of Total	Amount (P'million)	Percent of Total	Amount (P'million)	Percent of Total
Business	**11.6**	**36.3**	**12.0**	**37.0**	**12.6**	**36.6**	**12.3**	**35.2**	**22 688**	**34.6**	**22 311**	**34.0**
Parastatals	0.9	8.1	1.1	9.3	1.2	9.7	0.8	6.8	1 654	7.3	1 339	6.0
Agriculture	0.8	6.6	0.7	6.2	0.7	5.8	0.8	6.2	1 325	5.8	1 077	4.8
Mining	0.3	2.7	0.3	2.7	0.3	2.7	0.4	2.8	509	2.2	922	4.1
Manufacturing	1.0	8.6	1.3	10.5	0.8	6.1	0.9	7.4	1 581	7.0	983	4.4
Construction	0.6	4.8	0.5	4.1	0.6	4.5	0.6	4.6	936	4.1	950	4.2
Trade	2.3	19.9	2.4	20.3	2.7	21.6	2.5	20.6	4 863	21.4	5 562	24.9
Transport[2]	0.3	2.9	0.3	2.5	0.3	2.5	0.3	2.6	577	2.5	514	2.3
Finance[3]	2.3	20.2	3.3	19.7	2.7	21.6	2.9	21.6	5 388	23.7	5 484	24.6
Real Estate	2.3	19.7	2.2	18.5	2.4	19.1	2.6	20.7	4 483	19.8	4 422	19.8
Electricity and Water	0.05	0.4	0.05	0.4	0.05	0.4	0.0	0.4	80	0.4	74	0.3
Other[4]	0.7	6.2	0.7	5.9	0.8	6.0	0.0	6.2	1 292	5.8	887	4.0
Households	**20.3**	**63.7**	**20.5**	**63.0**	**21.7**	**63.4**	**22.7**	**64.8**	**42 865**	**65.4**	**43 330**	**66.0**
Unsecured Lending	14.2	70.1	14.4	70.4	15.3	69.3	15.7	70.8	30 646	71.5	33 213	76.7
Motor Vehicle	1.0	5.1	1.0	5.0	1.1	4.9	1.1	4.9	2 085	4.9	2 088	4.8
Mortgage	5.0	24.9	5.0	24.5	5.3	24.5	5.5	24.3	10 135	23.6	10 118	23.4
Total Commercial Bank Credit	**31.8**	**100**	**32.5**	**100**	**34.3**	**100**	**35.1**	**100**	**65 554**	**100**	**65 642**	**100**

Source: Commercial Banks

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

2 Transport and Communications.

3 Finance and Business Services.

4 Includes non-resident businesses.

The Household Sector

Household credit still concentrated in unsecured lending

3.9 Household credit grew by 6.3 percent in the twelve months to March 2021, lower than the 15.1 percent growth recorded in March 2020 (Chart 3.1). Credit to households continued to dominate total commercial bank credit, at P43.3 billion (66 percent) in March 2021, and was mostly concentrated in unsecured lending (71.8 percent). The proportion of unsecured loans to total credit remains higher than the 24.4 percent and 35.4 percent reported in South Africa and Mauritius, respectively.[10] The significant share of unsecured loans and advances has the potential to cause financial distress for households, given the inherently expensive and short-term nature of such credit. Therefore, households remain vulnerable to sudden and sharp tightening of financial conditions.

Household debt aligned to trends in income

3.10 Household debt as a proportion of household income was 37.5 percent in the fourth quarter of 2020, a decrease from 44.7 percent in the same period in 2019 (Chart 3.2).[11] The ratio remains relatively low when compared to the 78.7 percent and 72.7 percent for Namibia and South Africa, respectively.[12] In this respect, domestic household borrowing is in line with trends in personal incomes, implying a relatively strong debt servicing capacity. Consequently, the ratio of household NPLs to total household credit was modest, at 3.5 percent in March 2021, slightly lower than the 3.6 percent in March 2020 and way better than the industry average of 4.4 percent in march 2021 (Chart 3.2).

10 SARB Financial Stability Review – Second Edition 2020.

11 Banking sector loans to households divided by total compensation of formal employees.

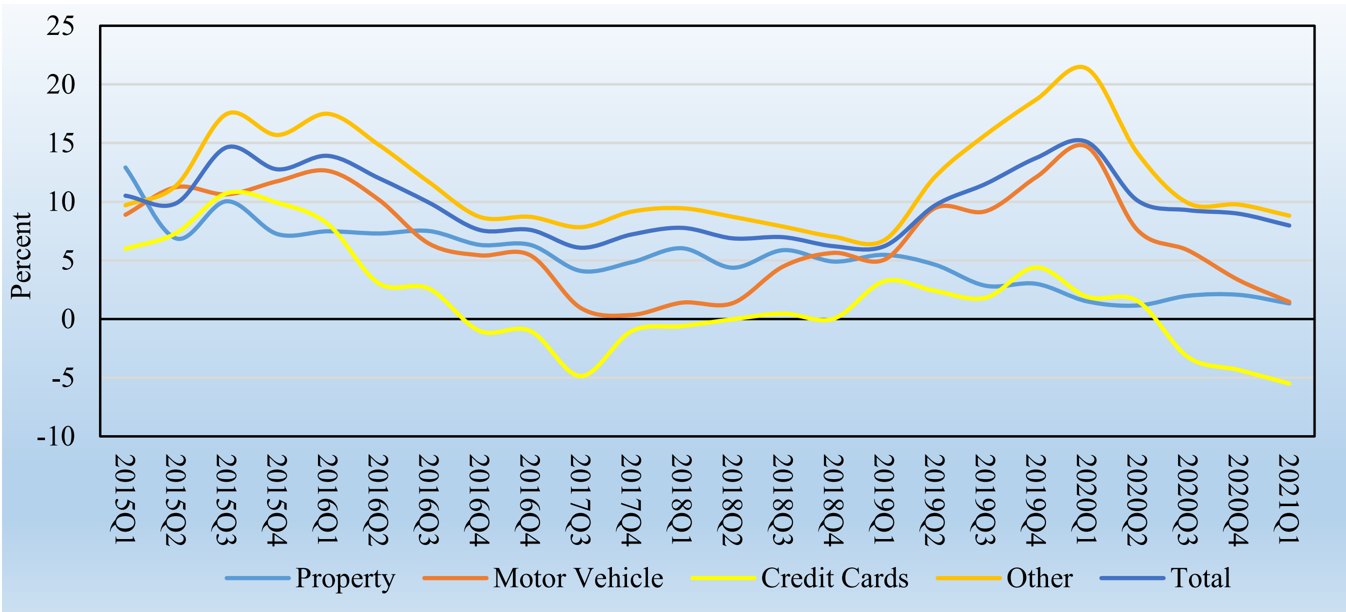
12 Namibia FSR – April 2020 and SARB Financial Stability Review – Second Edition 2019.

3.11 Moreover, households are net savers when their contractual pension savings are incorporated (Table 3.2). Other household assets such as livestock, commercial farmland and shareholding in listed companies, not accounted for because of data limitations, are likely to increase household net wealth.

Moderate outlook for demand for credit

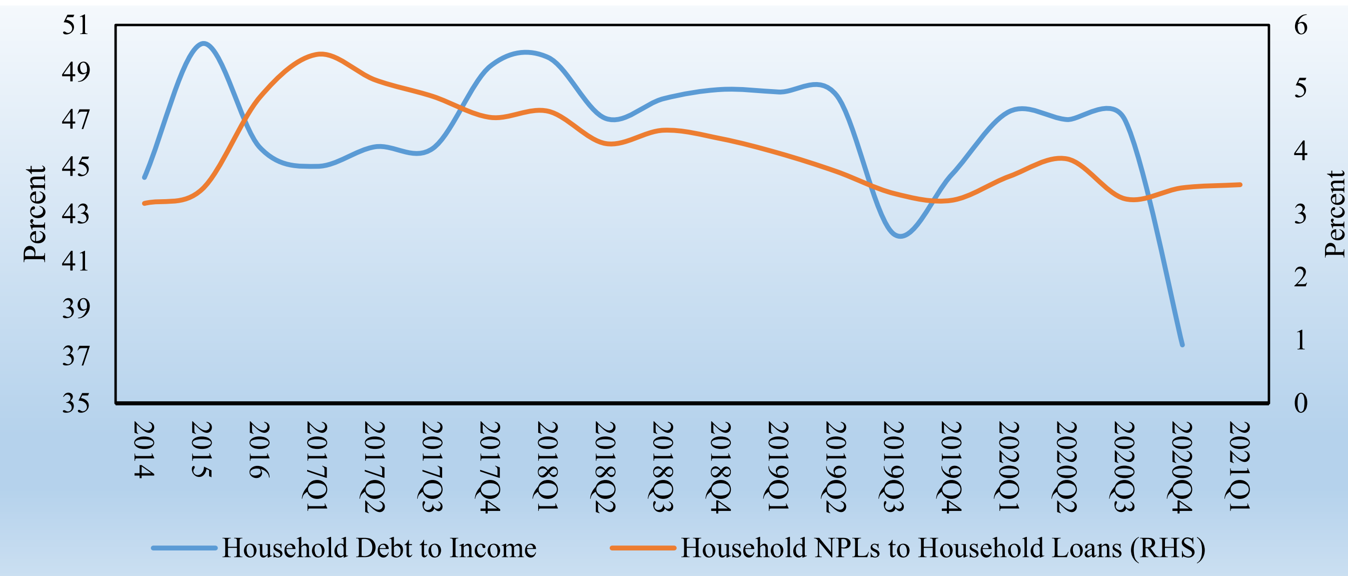
3.12 The 2020 Household Indebtedness Survey indicates that the majority of credit providers expected moderate to high demand for credit in 2020, as a result of progressive reductions in the Bank Rate and the increase in salaries of public sector employees. However, the survey also indicated that the demand for credit was negatively affected by the loss of incomes and possible losses of employment due to the COVID-19 pandemic. Overall, the results of the survey suggested minimal risks to financial stability posed by the level of household indebtedness.

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



Source: Commercial Banks

Chart 3.2 Household Debt to Income and NPLs



Source: Statistics Botswana and Bank of Botswana

Table 3.2: Household Net Wealth

Asset	2018 (P'million)	2019 (P'million)	2020				2021
			2020Q1 (P'million)	2020Q2 (P'million)	2020Q3 (P'million)	2020Q4 (P'million)	2021Q1 (P' million)
Retail deposits	13 843.9	15 384.2	15 258.5	16 669.5	17 152.0	16 996.0	17 570.7
Pensions	78 971.9	93 133.2	87 906.2	92 898.2	97 616.3	*97 616.3*	*106 113.2*
Insurance contracts	12 874.7	13 423.6	*13 423.6*	*13 423.6*	*13 423.6*	*13 423.6*	*13 423.6*
Mortgage property	9 639.9	9 929.5	9 984.5	9 941.8	10 030.1	10 134.6	10 117.4
Motor vehicles	1 799.7	2 017.5	2 057.5	2 003.4	2 024.3	2 084.5	2 087.6
Total assets (a)	117 130.1	133 888.0	128 630.3	134 936.5	140 247.1	141 638.7	149 312.5
Total household debt (b)	40 571.2	45 490.5	46 273.0	46 200.2	47 275.7	48 708.2	49 304.1
Total household net wealth (a) – (b)	76 558.9	88 397.5	82 357.3	88 736.3	92 971.6	92 930.6	100 008.4

Source: Bank of Botswana
Note: Figures in italics are estimates

Box 3.1: Tools for Assessing Excessive Credit Growth

Background

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

The Desired Range for Credit Growth

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

Assuming (in percent):

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

Expert judgement was also taken on-board, and the range was ultimately set at 12 – 15 percent, as inflation was high during that period.

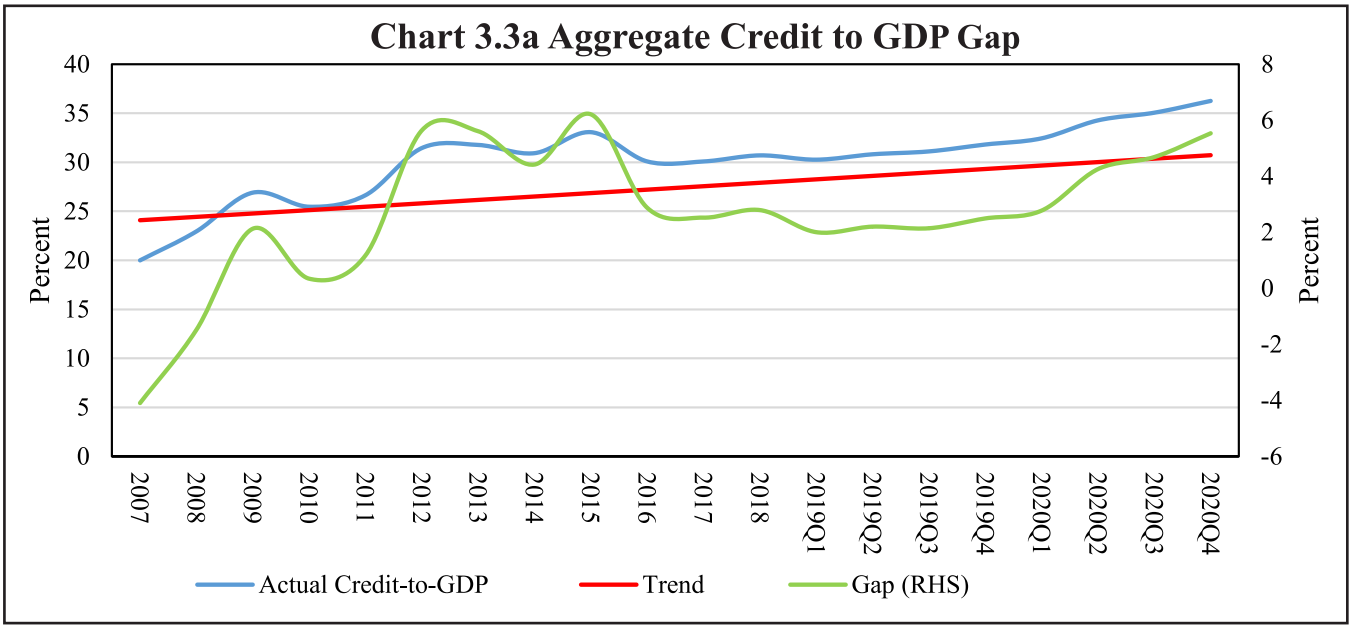
Given the current 3 – 6 percent inflation objective range, and assuming a GDP growth rate of 4 – 5 percent (excluding COVID-19 effects), and with the same values for financial deepening, the desired range would be 9 – 13 percent. Credit growth was 1.6 percent in March 2021, and lower than the 10.7 percent in March 2020., thus below the desired range and not posing any threat to the stability of the financial system.

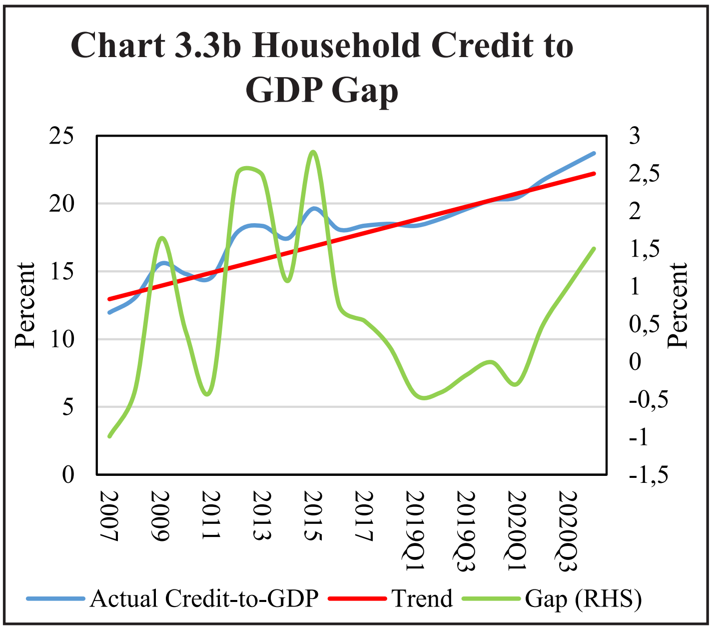
The Credit-to-GDP Gap

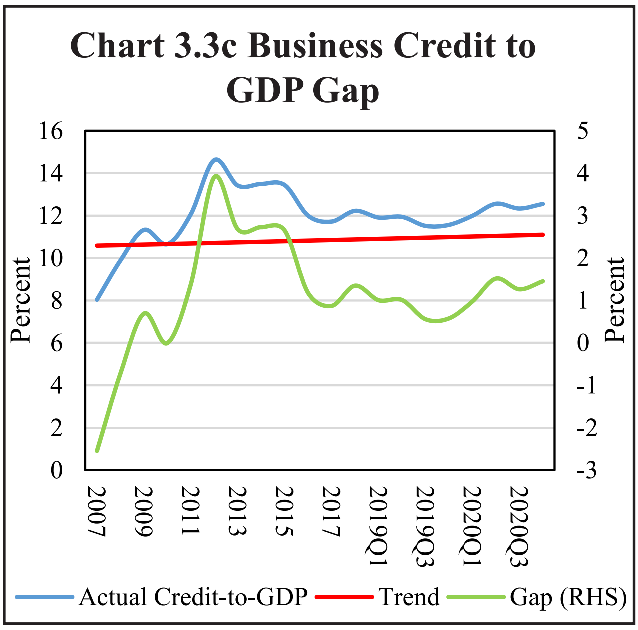
The Bank for International Settlements (BIS) defines the Credit-to-GDP gap ("credit gap") as the difference between the Credit-to-GDP ratio and its long-term trend. Borio and Lowe (2002, 2004) first documented the property of the Credit-to-GDP gap as a very useful early warning indicator for banking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

Box 3.1: Tools for Assessing Excessive Credit Growth (Continued)

Commercial bank credit growth is moderate, as measured by the Credit-to-GDP gap, which was below the 10 percent threshold at the end of December 2020 (Chart 3.3a). The low Credit-to-GDP gap reflects room for sustained economic expansion from positive shocks to financial conditions. Furthermore, the gap has been positive since the global financial crisis, mainly reflecting the decline in the rate of GDP growth, which in the main, was due to the overall subdued performance of the mining sector. A Credit-to-GDP gap that moves significantly above its trend or exceeds some critical threshold (typically 10 percent) portends emerging financial imbalances and risk of financial distress. Charts 3.3b and 3.3c show a slightly positive Credit-to-GDP gap for households and businesses in December 2020, indicating that there is room enough for healthy credit expansion in the two sectors.







The Non-Financial Corporate Sector

Corporate sector borrowing decreased marginally

3.13 Total commercial bank credit to the non-financial corporate sector declined by P2.4 billion to P20.1 billion in March 2021 from P22.4 billion in March 2020. This was, however, slightly higher than the P20.3 billion in December 2020 and continues to show a declining trend experienced since March 2020. The decline in the credit figure continued since March 2020, even though firms continued to target the domestic market for their funding needs (Business Expectations Survey (BES), March 2021). The commercial banks' exposure to this sector fell to 30.6 percent in March 2021 from 34.7 percent in March 2020. Relative to GDP, domestic credit to the private sector was 32.1 percent in December 2020 compared to 28.3 percent in December 2019 and remains significantly lower than the 79.5 percent and 139.5 percent for Namibia and South Africa, respectively.[13]

Corporate sector remains financially sound

3.14 Selected financial soundness indicators of the 14 domestic non-financial corporates listed on the Botswana Stock Exchange Limited (BSEL) indicate a financially sound corporate sector during the period January 1, 2020 to December 31, 2020 (Table 3.3). Corporate leverage was moderate, with a Debt-to-Equity ratio of 45.3 percent in December 2020, and thus global concerns relating to the significant leverage positions by corporates appear to be contained locally (See GFSR, April 2020). This notwithstanding, risks associated with governance, accountability and compliance failures remain elevated in parastatal corporations that fail to produce audited annual financial statements.

Corporate sector NPLs have decreased but are likely to rise

3.15 The ratio of NPLs in the corporate loans was 7.4 percent in March 2021, down from 7.8 percent in March 2020. The reduction in the NPLs was mainly accounted for by the agriculture and manufacturing sectors. Nevertheless, the ratio remained higher than the banking sector average of 4.4 percent and is likely to rise further, with companies forced to shut down or scale down production due to the travel restrictions and other disease containment measures.

3.16 That notwithstanding, stable profits and low level of bankruptcies in the period under review suggest that corporates should be able to continue servicing their loans. The profitability ratio, as measured by the return on equity (ROE), was relatively stable, averaging 12.6 between 2016 and 2020 (Table 3.3).

Industries primarily affected by COVID-19 continue to drag down economic performance

3.17 The COVID-19 pandemic and associated containment measures implemented since April 2020 have had a disproportionate impact on economic sectors, with contact industries being severely affected. In particular, economic output from trade, hotels and restaurants, mining, construction, manufacturing, and transport and communications sectors were mainly affected and declined by 14.8 percent, 26.2 percent, 11 percent, 8.7 percent and 7.7 percent, respectively.

3.18 The four non-mining sectors viz., manufacturing, construction, trade, hotels and restaurants, and transport and communication, contributed a combined average of 36.7 percent to GDP in 2020. Therefore, these sectors have the potential to significantly affect future economic performance if infections do not abate or vaccination rollout stalls. Nonetheless, Government rolled out numerous measures to sustain ailing businesses by among others, providing loan guarantees, direct credit support and tax concessions. While crucial, these measures, along with the low interest rate environment, could prompt excessive leverage in the non-financial sector, hence result in inter-temporal trade-off between policy support, financial stability and economic prosperity in the medium to long-term.

3.19 Notably, some state-owned enterprises (SOEs) were already experiencing operational and financial challenges before the outbreak of COVID-19. These include National Development Bank (NDB), Botswana Railways, Botswana Meat Commission (BMC) and Air Botswana. The latter announced restructuring plans in November 2019 and suspended flights from 27 March 2020. The airline, however, resumed domestic flights on July 17, 2020 and has gradually reintroduced all operations, while continually exploring possible recovery strategies meant to address its commercial viability and business sustainability. In essence, the supply chain disruption and slowdown caused by COVID-19 is expected to affect freight and passenger transport business at a significant cost to the national airline.

3.20 Meanwhile, NDB's financial statements for 2017/18, published in July 2019, indicated another challenging year characterised by a shrinking asset base. The bank recorded a loss of P154 million owing largely to the reduction in interest income, while impairments on loans and advances increased significantly. Botswana Railways, on the other hand, presented a loss of P18.7 million for the year ending March 2019, while BMC made a loss of P92.2 million for year ending

13 https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS

December 2019. As stated in the 2021 Budget Speech privatisation remains an important strategic reform to restore the financial viability of some of these SOEs and, at the same time, ease the public burden of non-performing SOEs. Hence, Government has prioritised the review of its Privatisation Master Plan, which is expected to be completed and submitted to cabinet by July 2021. Meanwhile the Public Enterprises Evaluation and Privatisation Agency (PEEPA) has completed the review of all the 65 SOEs and there is expectation that Cabinet will approve the rationalisation and merging of some parastatals.

Firms less optimistic about economic activity in 2021

3.21 The March 2021 BES shows that firms were less optimistic about economic activity in the first quarter of 2021 compared to the fourth quarter. They expected the economy to expand by 2.2 percent in 2021, which is a significantly less optimistic view compared to a growth projection of 8.8 percent by MFED. Expectations were, however, consistent with the anticipated improvement in business conditions and the envisaged global economic recovery. Nevertheless, the expected global economic recovery is threatened by the emergence of new variants, unequal distribution of COVID-19 vaccines and effectiveness of policy support deployed to limit the consequences of the crisis. In light of these developments, potential vulnerabilities from the corporate sector are assessed to pose moderate to high risk to financial stability in the medium term.

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

Ratios	2017	2018	2019	2020Q2	2020Q3	2020Q4
Non-Financial Corporates Credit-to-GDP	10.7	11.2	10.7	11.5	11.3	12.5
Cost-to-Income Ratio	60.0	60.3	65.1	65.3	66.1	56.0
Total Debt to Equity Ratio (Leverage)	42.1	46.9	46.3	45.7	44.3	45.3
Return on Equity	13.8	15.7	12.0	12.0	12.2	11.6
Price/Earnings Ratio (times)	13.3	11.2	12.4	10.7	11.0	10.8
Dividend Yield	4.4	5.1	4.8	5.8	4.1	4.1

Source: Botswana Stock Exchange Limited, Statistics Botswana, Financial Statements of Corporates
Notes: Non-Financial Corporates Credit-to-GDP was calculated using total credit from commercial banks to non-financial corporations.

The Real Estate Sector

Commercial real estate lending poses limited risk to financial stability

3.22 Credit to commercial real estate decreased marginally from P4.9 billion in December 2019 to P4.8 billion in December 2020 and further to P4.5 billion in March 2021. At these levels, the proportion of commercial real estate loans to total loans remains low and has averaged 7 percent over the five years to 2020 (Chart 3.4). As such, and against the global threats arising from commercial real estate loans,[14] commercial real estate lending poses minimal risk to domestic financial stability. Moreover, the level of NPLs in the sector remains moderate, constituting 3.9 percent of total commercial real estate loans in March 2021 (March 2020: 4.2 percent). There are, however, some concerns about concentration risk in the real estate sector, with most loans (about 90 percent) originating in Gaborone and surrounding areas.[15]

Growth trends in mortgage loans not commensurate with housing needs

3.23 In the residential real estate sector, mortgage loans were relatively stable at around P14 billion between March 2020 and March 2021. The loans constituted 28.7 percent of total credit, a slight decline from the 30.9 percent in March 2020 (Chart 3.5). This development suggests that housing finance is not commensurate with the needed development and growth path to fill the apparent need for housing, as well as the financing gap.[16] Thus, the size of housing finance in Botswana lags developments in South Africa and Namibia, where mortgages accounted for 58.2 percent and 66.1 percent of total loans in December 2019 and in April 2020, respectively.[17] These stagnant ratios might be reflective of the restrained growth in incomes relative to the increase in residential house prices over the years (possibly reflecting limited housing stock in various categories). It appears that the expected significant rise in mortgage lending

14 See GFSR, April 2021.

15 Bank of Botswana Residential Property Survey Report (2017) and Ribbery Property Market Report, 2020 third quarter.

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

17 SARB Financial Stability Review (2020) and Namibia FSR (April 2020).

following the amendments of Deeds Registry and Tribal Land Acts in 2017 has not materialised. The moderate growth in mortgage loans continued even though these two Acts facilitated the acquisition of property country-wide and eased transferability of property rights in tribal land areas.

3.24 Credit risk in the mortgage sub-sector remains low, with commercial banks maintaining Loan-to-Value (LTV) ratios ranging between 45 percent and 85 percent. The low to medium LTV ratios limit the exposure of banks to mortgage credit default. Moreover, default rates in mortgage loans remained tolerable at 6.1 percent in December 2020 similar to December 2019.

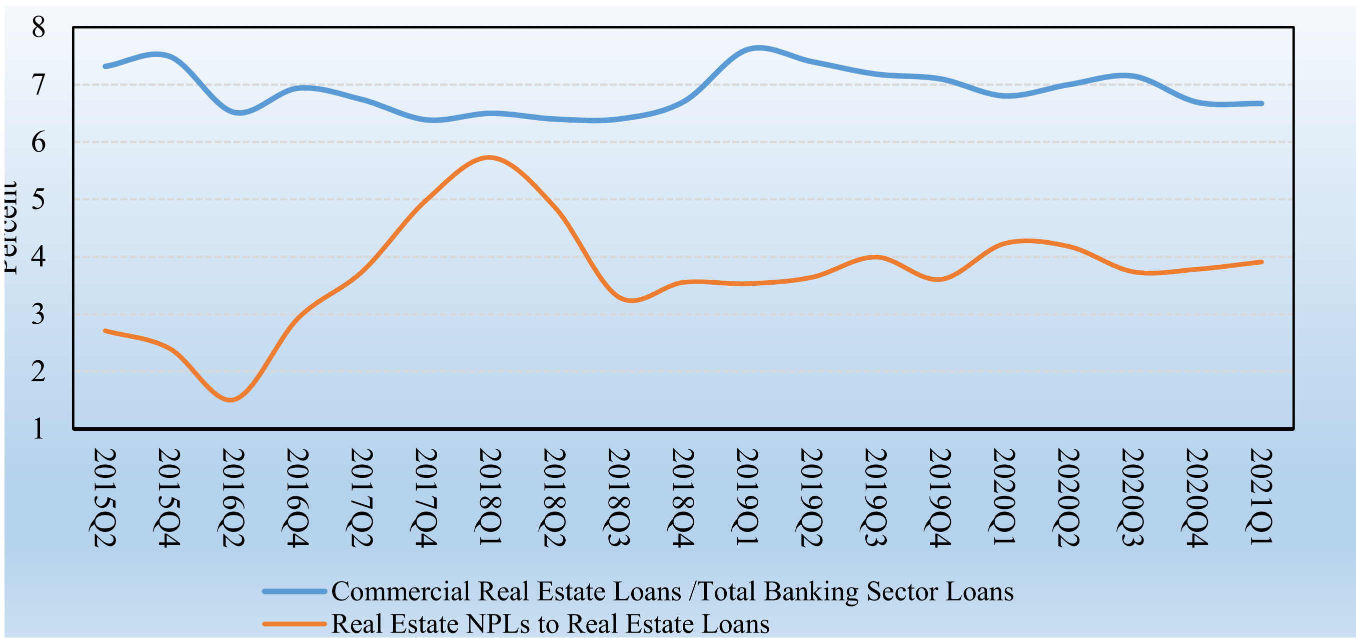
Residential market weakened in the fourth quarter of 2020

3.25 According to the latest (2020Q4) Riberry Report, the residential rental market weakened in the fourth quarter of 2020, compared to the third quarter of 2020, due to weaker demand for both the upper and middle-end properties. The lower-end market was resilient, with increased demand and supply amid the difficult circumstances imposed by the COVID-19 pandemic. The average price for residential properties sold in the fourth quarter of 2020 decreased by 17.4 percent to P720 000 compared to the previous quarter, reflecting the lower number of high valued properties traded in the quarter under review.

Commercial real estate market remains weak

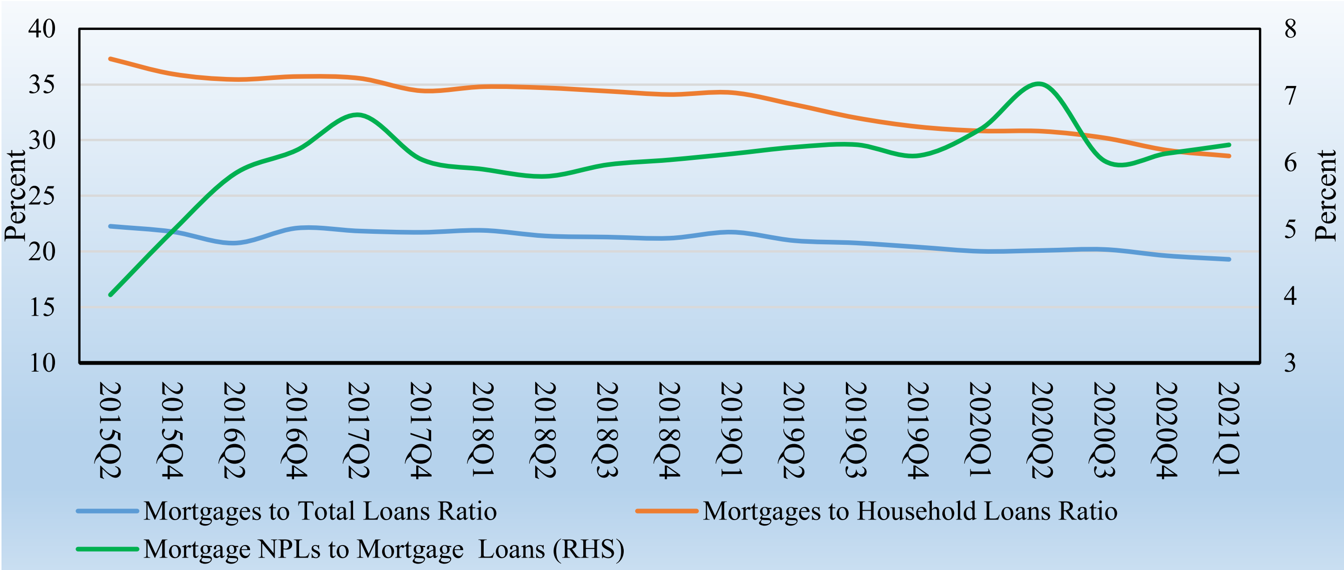
3.26 Commercial real estate market remains weak as the supply of office space continues to be outstripped by the demand due to completion of commercial developments, such as the Botswana Unified Revenue Service building in the Gaborone Central Business District (CBD). The supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the CBD by Botswana Housing Corporation and Water Utilities Corporation, for example. These will further exert downward pressure on rentals, especially in the decentralised office locations. The working-from-home practices adopted by many companies due to COVID-19 protocols also have the potential to suppress demand for office space, and consequently rental market prices. This notwithstanding, vulnerabilities from the real estate sector, such as potential NPLs, posed minimal risk to financial stability during the period under review, but prospective developments require continuous monitoring and assessment.

Chart 3.4: Commercial Real Estate Loans



Source: Bank of Botswana, Commercial Banks
Note: Real estate NPLs to Real Estate Loans Ratio is calculated using commercial banks data only.

Chart 3.5: Trends in Mortgage Loans



Source: Bank of Botswana

Non-Bank Financial Institutions (NBFIs)

Vulnerabilities in the global NBFIs sector remain elevated

3.27 NBFIs are increasingly playing an important role in financing the real economy. In the process NBFIs have become interconnected with the rest of the financial system and present another potential source of systemic risk. According to the IMF April 2021 GFSR, vulnerabilities within the NBFIs sector remain elevated. The sector is challenged with liquidity mismatches in the asset management sector as well as risk aversion that is causing episodes of illiquidity in the market. Moreover, the fragilities in the NBFI sector could have significant implications for the financial system if a more prolonged period of market stress were to occur, possibly due to or in conjunction with the lack of access to funding backstops.

3.28 Similarly, the domestic NBFI sector is experiencing vulnerabilities that have been exacerbated by the COVID-19 pandemic and the necessary disease containment measures. These include the potential increase in insurance payments, as well as early pension withdrawals emanating from the increase in the number of patients and loss of employment, leading to constrained liquidity in the relevant institutions. The domestic financial system is also at risk of contagion emanating from the increased interconnectedness between NBFIs and banks as NBFIs seek more or alternative funding. Furthermore, domestic NBFIs face profitability concerns as well as diminished investment returns as both domestic and global economic activity continue to operate below potential. That notwithstanding, domestic NBFIs were resilient and profitable as at December 31, 2020. Letshego Holdings Limited, the biggest microlender, recorded a profit of P631 million for the year ending December 31, 2020, albeit lower than the P726 million reported in 2019. Total assets, on the other hand, increased by 12 percent to P12.2 billion, while net advances to customers also increased by 12 percent to P10.2 billion. Similarly, Botswana Insurance Holdings Limited (BIHL), a leading financial services company, recorded a profit of P393 million for the financial year ended December 31, 2020, compared to the P376 million of the same period last year. These leading NBFIs continue to exhibit operational resilience amid uncertainty and challenges brought by the COVID-19 pandemic.

NBFIs maintain high solvency ratios

3.29 Trends in solvency ratios (assets to liabilities) show that pension funds in Botswana are highly solvent at 405 percent in 2019. The high solvency ratio is a result of prudent and profitable investments, which has led to significant growth in assets. The life insurance industry recorded high solvency ratio of 119 percent in 2019 (2018: 119 percent), while the general insurance sector was similarly solvent at 152 percent during the same period. Total insurance assets amounted to P20.4 billion compared to P20.0 billion in 2019. Microlenders were also highly solvent at 170 percent in 2019 compared to 165 percent in 2018. Overall, the risk to domestic financial stability arising from NBFIs is considered low.

(c) Liquidity and Funding Risk

Banking Sector

COVID-19 pandemic put downward pressure on liquidity in 2020

3.30 Since the onset of the COVID-19 pandemic at the beginning of 2020, average liquidity of the banking sector has been trending downwards mainly due to net foreign exchange outflows as a result of dampened trade, as well as settlement of some Government bonds. At the end of 2020, average daily liquidity was P10.9 billion compared to P10.3 billion in December 2019 but has since dropped to P8.4 billion in March 2021.

3.31 Owing to challenges presented by the pandemic, the Bank and the Government intervened in 2020 to alter the trajectory of market liquidity. Among others, the Bank reduced, the reserve requirement, while the Government provided a fiscal stimulus in the form of the Industry Support Facility. In turn, banks continued to perform their intermediation functions unconstrained, while at the same time complying with the 10 percent minimum liquidity requirements. The industry maintained a liquid asset ratio of 20.4 percent in March 2021 from 16.3 percent in March 2020. Going forward, economic inactivity associated with disease containment measures has the potential to further erode banks' liquidity in the short-to-medium term.

Banking sector vulnerable to funding risk arising from a concentrated deposit base

3.32 The industry remains vulnerable to funding risk arising from a concentrated deposit base, and the feed-effects of the COVID-19 pandemic. The ratio of large deposits to total deposits averaged 40 percent over the last three years and presents potentially volatile and unstable source of funding. However, the risk is moderated by the higher proportion of savings and fixed deposits in the deposit base, which are inherently long-term, thus giving banks an opportunity to respond accordingly in case of short-term funding shocks. The long-term deposits accounted for 43.1 percent of the deposit base and were further augmented by 27 percent of checking/current accounts, which are considered stable/core.

3.33 On other developments, the industry continues to experience high levels of credit intermediation, with a financial intermediation ratio of 82.2 percent in March 2021. The ratio was, nonetheless, lower than the 89.3 percent experienced in March 2020, but remains above the upper limit of the 50 – 80 percent preferred range. While this pace of intermediation could exacerbate maturity mismatches in banks' balance sheets, further amplifying liquidity risk in the sector, it provides the necessary economic support during this period of the pandemic.

Policy measures by the Bank expected to stimulate economic activity

3.34 Policy interventions by the Bank in response to COVID-19 ensured that banks remained unconstrained in supporting economic activity during the pandemic. However, the current environment of uncertainty and risk has led to banks applying stringent measures in assessing loan applications. This is evident in the slowdown in year-on-year credit growth to 1.6 percent in March 2021, against 10.7 percent in March 2020, as well as the slight decline in the ratio of past due loans from 6.6 percent to 6.2 percent over the same period. Nonetheless, funds availed to the banks through policy interventions are expected to stimulate economic recovery.

Money Market

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

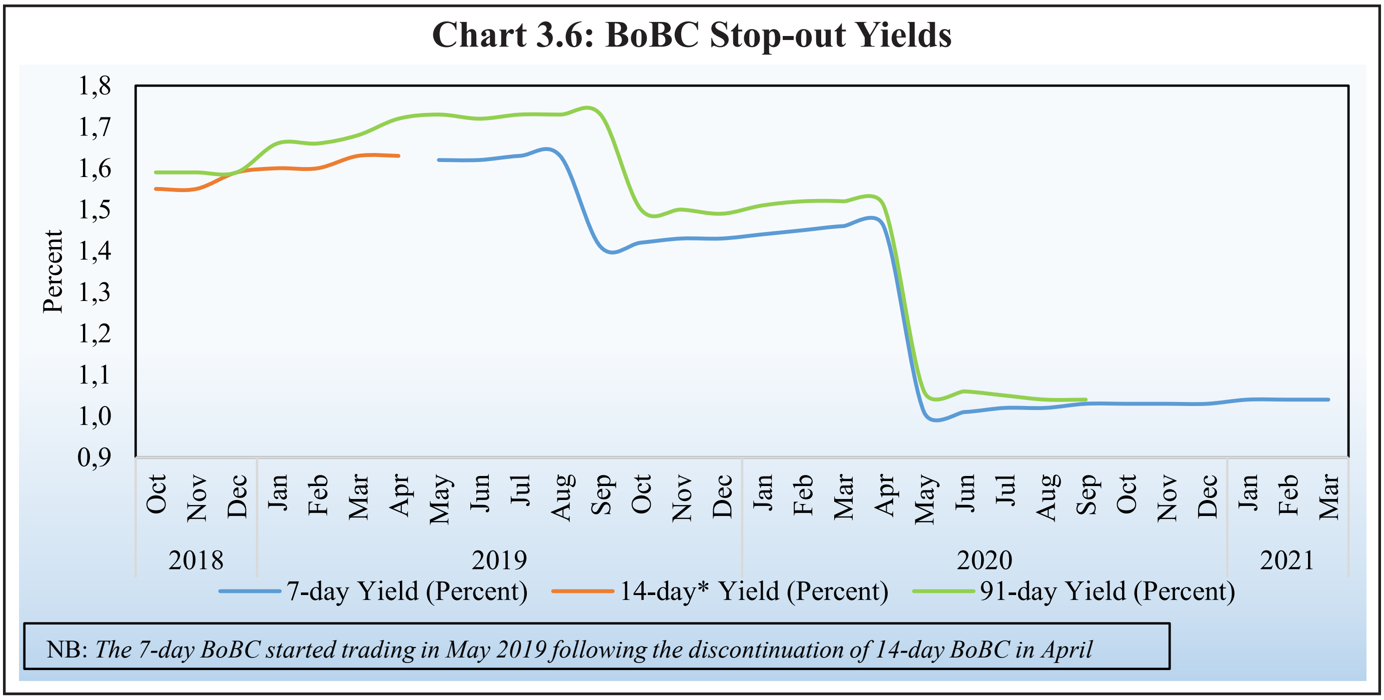
3.35 Money market interest rates remained low in line with the Bank's accommodative monetary policy position. The stop out yield for the 7-day Bank of Botswana Certificates (BoBCs) fell to 1.03 percent in December 2020, from 1.43 percent in December 2019. The stop-out yield on the BoBCs increased to 1.04 percent in March 2021. The yield on the relatively new 3-month Treasury Bill (T-Bill) increased to 1.27 percent in March 2021, from 1.16 percent in the previous auction. The stop out yield for the 6-month T-Bill increased from 1.27 percent in February 2021 to 1.51 percent in March 2021 (Chart 3.6), and demand was satisfactory for 3-month T -Bills relative to other securities in March 2021.

Large banks dominate the interbank lending market

3.36 At the end of March 2021, interbank trades by large banks represented 91.4 percent (December 2020: 95.6 percent) of total interbank borrowing and 44.2 percent (December 2020: 59.3 percent) of interbank lending.[18] In line with the fall in average market liquidity in 2020, banks used the interbank market extensively to finance their operations, with overall interbank activity increasing threefold between November 2020 and December 2020, from P2.4 billion to P7.5 billion. Notably, banks seem to actively monitor risks of insolvency, leading to the limited participation of small banks in the interbank market, with regard to

18 Large banks are those with a share of total banking assets greater than 9 percent.

borrowing activity. The reluctance by large banks to lend to small ones possibly reflects their perceived high counterparty risk. The resulting market rationing, however, limits funding options for small banks, and in turn, pushes them to wholesale funding, which is expensive and volatile.



Source: Bank of Botswana

Foreign Exchange Market

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

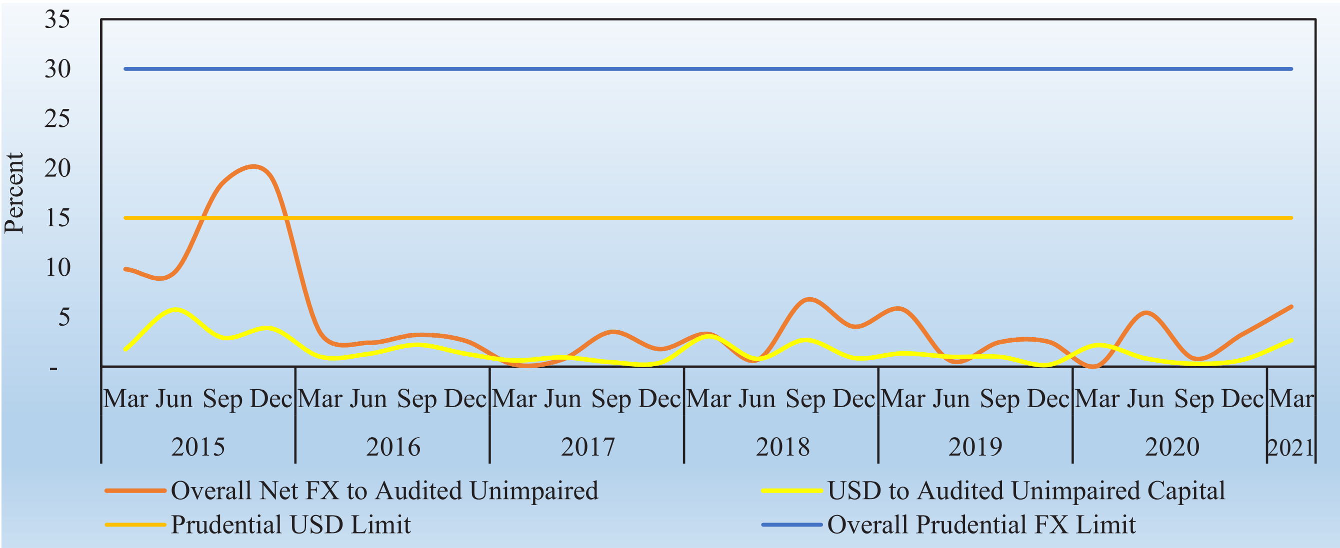
3.37 The exposure to foreign exchange risk of domestic banks increased significantly between December 2020 and March 2021, with the industry's net open foreign exchange position increasing from P97 million to P865 million (from a positive position of P8 million in March 2020). The position in March 2021 translated to 6 percent of the industry's unimpaired capital and, thus, within the 30 percent prudential limit (Chart 3.7). Notably, concerns of vulnerabilities from US dollar funding have increased in the domestic banking with Pula equivalent net exposure to the US dollar deteriorating from a positive net position of P293 million in March 2020 to P380 million in March 2021.

The Pula exchange rate generally stable

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

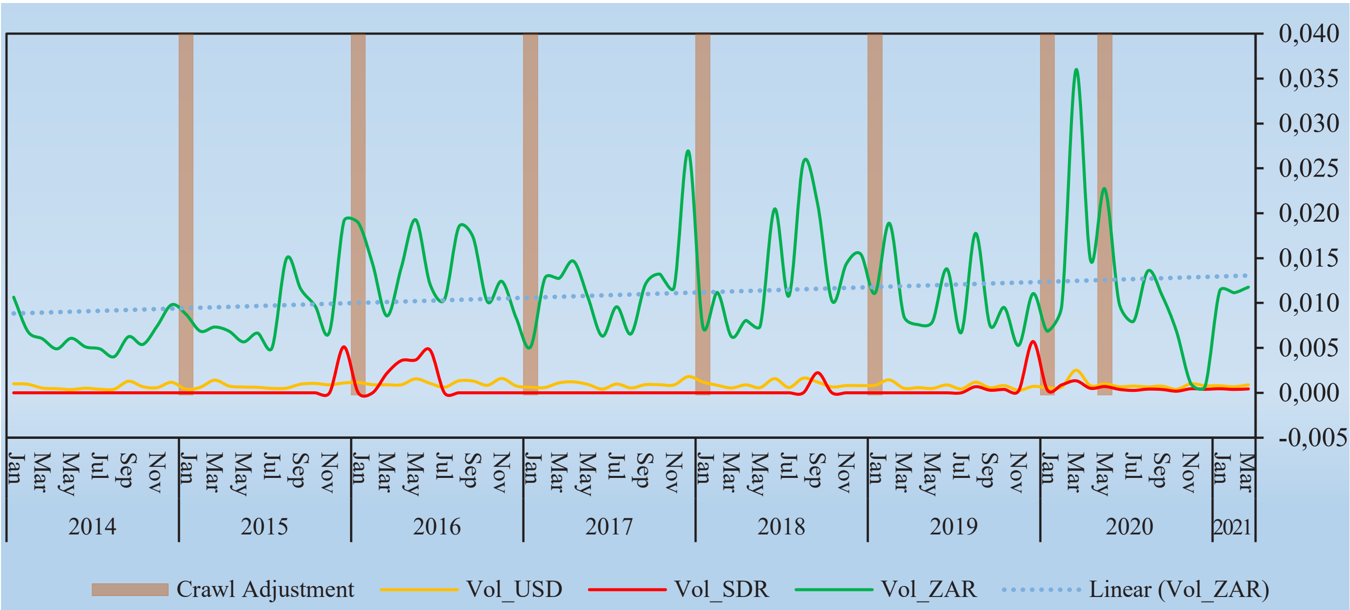
3.39 During the twelve-month period to March 2021, the Pula depreciated against the South African rand and appreciated against the SDR basket. The movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. The South African rand appreciated against all major currencies during this period, buoyed by expectations of faster global economic recovery and an improvement in their trade surplus. Overall, volatility in the Pula exchange rate was muted since May 2020, hence presented limited risks to the domestic financial system and economy (Chart 3.8).

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



Source: Bank of Botswana, Commercial Banks

Chart 3.8: Exchange Rate Volatility



Source: Bank of Botswana

Capital Markets

Stock market capitalisation falls

3.40 Total equity market value of domestic listed companies decreased by 8 percent, year-on-year, to P35.6 billion in December 2020 (December 2019: P38.7 billion). The market further lost 4.5 percent between April 2021 and December 2020 (Table 3.4). The losses reflect weakening company fundamentals due to the COVID-19 pandemic, particularly banking counters that lost P962 million over the same period. The losses in the banking sector constituted a larger share (49 percent) of the total market losses. In general, the market paints a dim picture on commercial banking profitability, possibly reflecting the effects of the COVID-19 response measures undertaken by the banks to limit the burden of the pandemic on the economy.

3.41 Market liquidity in the domestic bourse remained the same at 1.8 percent between December 2020 and April 2021, compared to a significant decline in the twelve months to December 2020. Prospects for the domestic market remain pessimistic in 2021 due to the COVID-19 pandemic but more shares were traded between January and April 2021 than in the same period in 2020, at 201 million and 99 million, respectively, hence the improvement in market liquidity at the beginning of 2021.

Stock market volatility rising

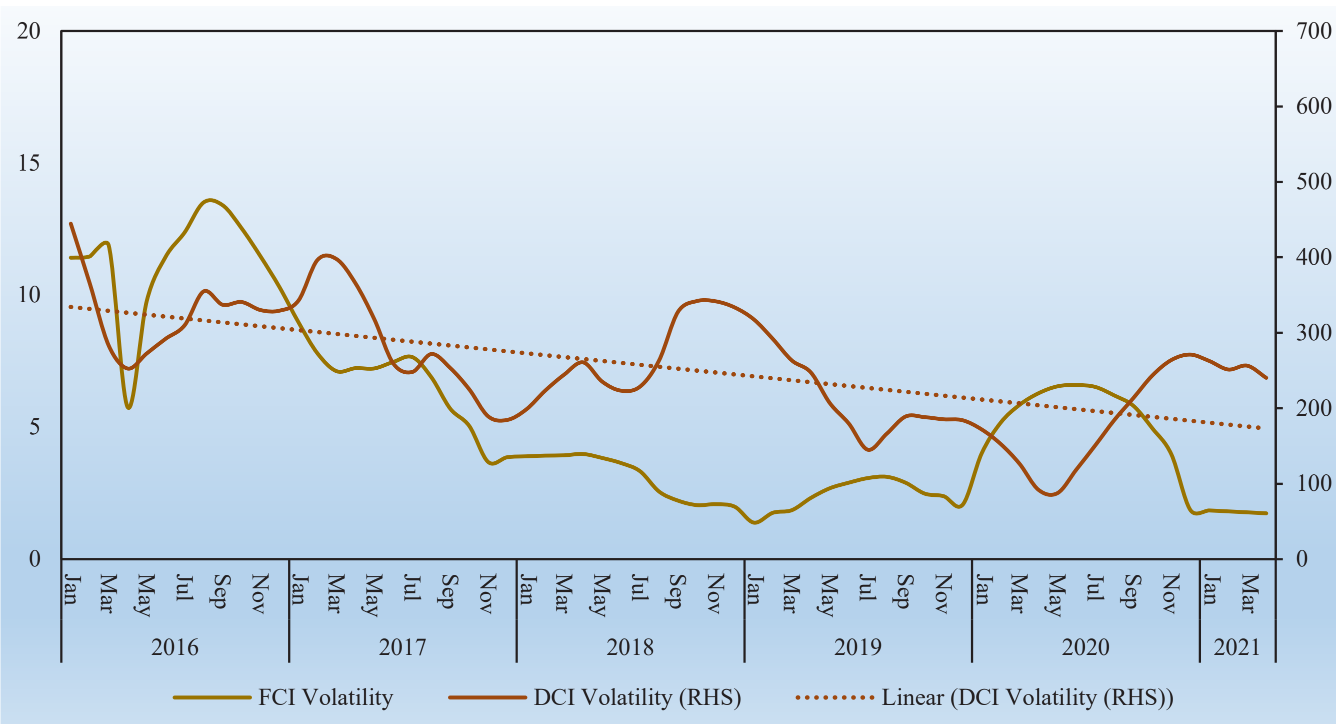
3.42 Developments in market capitalisation translated into a weaker performance of the domestic company index (DCI) in March 2021, which fell by 12.9 percent year-on-year. The DCI fell significantly from 7495 in December 2019 to 6865 in December 2020, and further to 6567 in April 2021. The DCI was highly volatile in the months to December 2020, and into the first four months of 2021 (Chart 3.9). In this respect, investor confidence could be tainted by the economic and financial consequences of COVID-19. Similarly, the rise in volatility could be a reflection of the inherently risky nature of equity markets. Nonetheless, the current low interest rate environment is expected to push investors to high-yielding assets such as equity, in turn, sustaining the equity index value.

Table 3.4: Selected Botswana Stock Exchange Indicators

Period	Shares Traded		Domestic Stock Market Capitalisation (P 'Million)	Liquidity Ratio (Percent)[1]	Equity Indices			
	Volume (Million)	Value (P 'Million)			Domestic Company Index (DCI)	DCI Growth (Percent)	Foreign Company Index (FCI)	FCI Growth (Percent)
2015	834	3 034	49 993	6.2	10 602	11.5	1 572	-0.4
2016	784	2 573	46 304	5.3	9 401	-11.3	1 586	0.8
2017	775	2 477	44 408	5.5	8 860	-5.8	1 575	-0.7
2018	583	1 862	42 406	4.4	7 854	-11.4	1 570	-0.3
2019	628	1 811	38 709	4.5	7 495	-4.6	1 562	-0.5
2020	430	699	35 573	1.8	6 865	-8.2	1 547	-1.0
2021Jan-Apr	201	178	33 988	1.8	6 567	-12.9	1 551	0

Source: Botswana Stock Exchange Limited
Note: 1. Liquidity ratio is calculated as turnover divided by average market capitalisation.

Chart 3.9: Twelve-Month Equity Indices Volatility



Bond market capitalisation rises as Government issues additional tranches

3.43 The Bank auctioned additional tranches on existing Government bonds in February 2021, thereby increasing the nominal market value of Government bonds from P15 billion in December 2020 to P16.1 billion in April 2021 (Table 3.5). The total bond capitalisation also increased as a result, rising to P21.6 billion from P20.3 billion in December 2020. Meanwhile, the number of listed bonds fell from 44 in March 2021 to 43 in April 2021.

3.44 The additional tranches on Government bonds increased the dominance of public bonds in the fixed income market to 75 percent compared to 25 percent for corporate bonds in April 2021. This trend continues to demonstrate Government's efforts to deepen and develop the domestic bond market. Notably, current sovereign borrowing presents minimal fiscal risks given that, relative to GDP, the ratio remains well within the 20 percent statutory threshold for domestic borrowing.

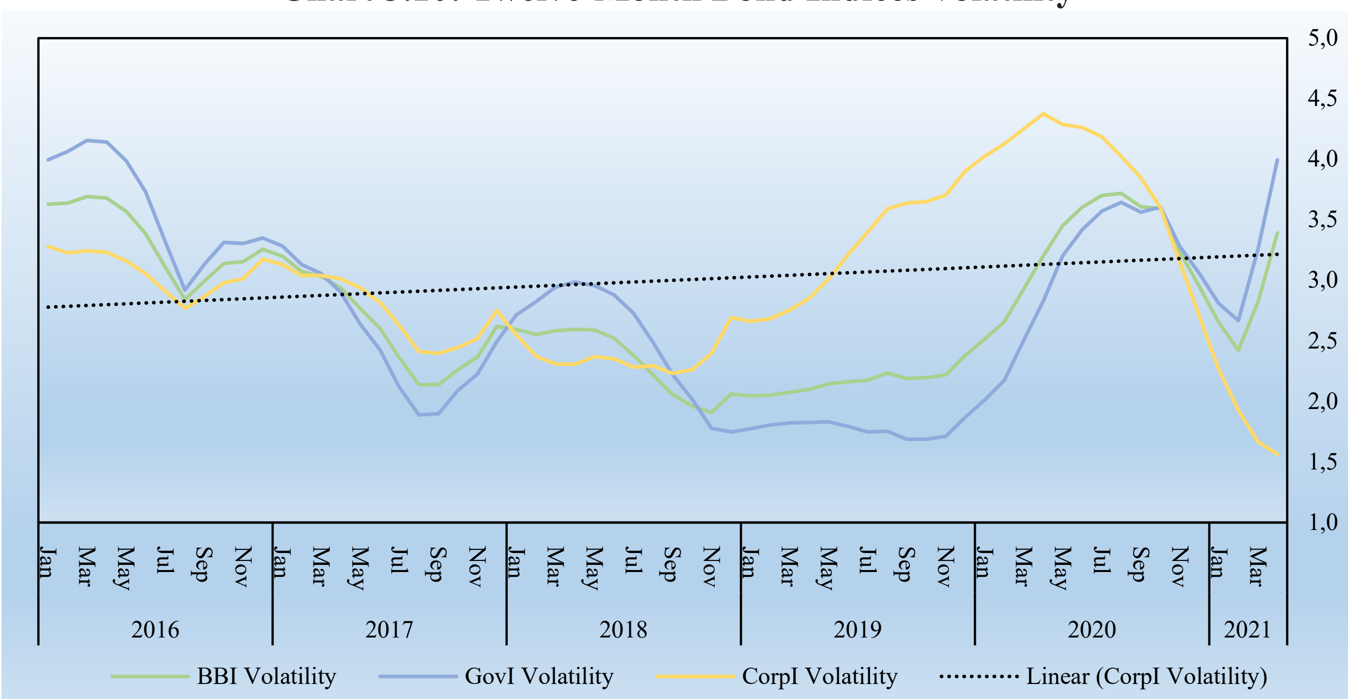
Average bond yields stable

3.45 Average corporate bond yields were stable at 8.1 percent between December 2019 and December 2020 and increased slightly to 8.4 percent in March 2021 and 8.9 percent in April 2021. Meanwhile, the risk in corporate bonds, as reflected in the volatility of the corporate bond index (CorpI), declined marginally in March 2021, and it has been declining since November 2020 (Chart 3.10). The reduction in the volatility of the index is partly explained by the relative stability in the constituents of the index in 2020 as compared to 2019. For example, there were eight changes to the constituents of the index in the 10-months to October 2020 compared to 15 changes in the year ended December 2019. Corporate bonds, however, remain relatively risky and, as such, there is still a potential for tightening of corporate funding in the bond market, although the associated consequences are currently judged to be minimal due to the accommodative monetary conditions. In that sense, funding opportunities in money markets would augment any decline in capital market funding.

Net asset value of exchange traded funds rising

3.46 Developments in international financial markets have a significant bearing on domestic asset valuations. Asset classes that reference on international commodities or indices in other countries have the potential to transmit instability to local asset classes. More specifically, exchange traded funds (ETFs) present a conduit for transmission of shocks into local asset prices. The net asset value (NAV) of ETFs listed on the BSEL declined marginally between December 2019 and December 2020, from P20.3 billion to P19.9 billion and fell further to 19.1 billion in March 2021, after a slight increase to P20 billion in February 2021. In terms of market capitalisation, ETFs valuations represented 4.9 percent of equity market capitalisation in March 2021 (December 2020: 5.3 percent), hence pose little threat to the stability of the capital markets.

Chart 3.10: Twelve-Month Bond Indices Volatility



Source: Botswana Stock Exchange Limited

Table 3.5: Selected Bond Market Indicators

Period	Government			Corporate[1]			Total Number of Bonds	Total Value of Bonds (P'Million)	Government Bonds Value /Total (Percent)	Corporate Bonds Value / Total (Percent)	Bond Indices		
	Number of Bonds	Nominal Value (P'Million)	Average Yield (Percent)	Number of Bonds	Nominal Value (P'Million)	Average Yield[2] (Percent)					Botswana Bond Index	Government Bond Index	Corporate Bond Index
2016	6	8 258	4.5	35	3 888	7.2	41	12 146	68.0	32.0	170.1	169.6	170.6
2017	5	9 083	4.5	38	5 129	7.1	43	14 212	63.9	36.1	179.4	178.1	180.7
2018	7	9 588	4.6	42	5 446	8.8	49	15 034	63.8	36.2	185.1	184.4	186.7
2019	7	11 859	4.7	39	5 429	8.1	46	17 288	68.6	31.4	193.5	191.1	200.1
2020	6	14 957	5.3	38	5 352	8.1	44	20 309	73.6	26.4	195.9	192.9	204.8
2021Mar	6	16 132	5.6	38	5 438	8.4	44	21 570	74.8	25.2	193.9	190.0	206.7
2021Apr	6	16 132	5.9	37	5 370	8.6	43	21 502	75.0	25.0	192.5	188.4	206.7

Source: Botswana Stock Exchange
1. Includes bonds listed by corporate, quasi-government, parastatal and supranational institutions.
2. The average of daily implied yields calculated by the BSEL.

Table 3.6: Selected Exchange Traded Fund Indicators

ETF	EWT40[1]			NewGold			NewPlat			NewFunds[3]		
Underlying Asset	Johannesburg Stock Exchange Top 40 Companies			Gold			Platinum			South African Government Bonds		
Period	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)	Units Traded (Million)	Turnover (P'Million)	Net Asset Value (P'Million)
2016	0.02	0.6	229	1.02	137.6	13 152	0.90	95.7	7 471	–	–	143
2017	3.11	121.6	132	0.08	10.0	12 525	0.14	13.1	7 174	–	–	59
2018	0.01[2]	0.4[2]	124[2]	0.28	33.7	7 906	2.75	246.4	5 742	0.00	0.00	45
2019				0.00	166.2	10 007	0.34	29.9	10 279	0.00	0.02	46
2020				0.00	61.5	13 494	0.00	76.8	6 329	0.00	0.00	73
2021Mar				0.00	14.6	11 865	0.00	10.4	7 416	0.00	0.00	76

Source: Botswana Stock Exchange
1. CoreShares Equally Weighted Top 40 (EWT40) was delisted in August 2018.
2. EWT40 was delisted in August 2018, hence the information used is for the period January to August 2018.
3. NewFunds was listed in 2015 but only started trading in 2018.
(-) represents no trades

Non-Bank Financial Institutions (NBFIs)

Gross insurance premiums decline

3.47 Gross premiums for life insurance declined by 4.9 percent from P4.1 billion in 2018 to 3.9 billion in 2019. All life assurance companies maintained adequate capital levels as at December 31, 2019. The insurance penetration ratios remained low and relatively unchanged at 2.7 percent in 2019 (2018: 2.9 percent) but in line with industry trends across SSA. In contrast, pension penetration ratios averaged 45 percent over the period December 2015 to December 2019. The ratio was 58.2 percent in December 2020 (Table 3.7).

Pension industry safe and sound

3.48 Annual pension contributions increased from P4.3 billion in 2018 to P4.6 billion in 2019. The industry continued to match current assets to current liabilities, recording a liquidity ratio of approximately 97 percent in 2020. As such, the industry was able to meet short-term pension obligations. In addition, the pensions industry held cash of P8.9 billion in January 2020, translating into a prudent liquidity ratio (Cash and near cash-to-assets) of 12.4 percent. Moreover, in January 2021, 88.1 percent of the cash was held in the domestic currency, further enhancing the liquidity profile of the pension industry. In that regard, the pension funds' industry was financially sound and stable as at January 31, 2021.

(d) Macro-Financial Linkages and Contagion Risk

Significant macro financial linkages exist

3.49 Significant interlinkages persist in the financial system, with the banking sector being largely exposed to households. The household sector accounted for 66 percent of total commercial bank credit, while the sector's share of bank deposits was 22 percent in March 2021 (Figure 3.1). In addition, households are highly exposed to NBFIs, with P100 billion of their assets, mostly pension assets, held by the sector. Non-financial corporations accounted for 44.6 percent total commercial bank deposits while their borrowing represented 30.4 percent of commercial bank credit. Meanwhile, deposits from other financial corporations or NBFIs represented a significant portion of bank funding at 21.5 percent of total deposits in March 2021 (Chart 3.11). Thus, the sudden withdrawal of these funds presents potential funding risks to banks. The interlinkages also extend to SOEs that account for 7.1 percent of bank deposits, while loans to the sector account for 2.4 percent of total bank lending. In February 2021, a significant amount of NBFI assets (64.4 percent) are also held abroad, exposing them to external financial and economic shocks, albeit providing some portfolio diversification opportunities for NBFIs. Consequently, there are notable vulnerabilities emanating from the interconnectedness between the banking system, household sector, non-bank financial institutions and the external sector.

Financial sector assets increase

3.50 The size of the financial system, as reflected by the total assets of bank and NBFIs increased to P248.6 billion in December 2020, registering a 7.7 percent growth from the P231.2 billion reported in December 2019 (Table 3.7). The developments were largely driven by a significant increase (9.7 percent) of the NBFI sector that, in turn, was influenced by a 12.9 percent growth in the retirement funds sub-sector. As result, the NBFI sector accounted for 58.5 percent of the system assets in 2020 compared to 41.5 percent of the banking sector.[19]

3.51 The sheer size of the financial system translated into 137.5 percent of GDP in 2020 compared to 117 percent in 2019, demonstrating the significance and importance of the financial system to the economy. The risk of contagion within the financial system, and to the rest of the economy is, therefore, rising in view of the strong interconnectedness and size of the financial system.

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

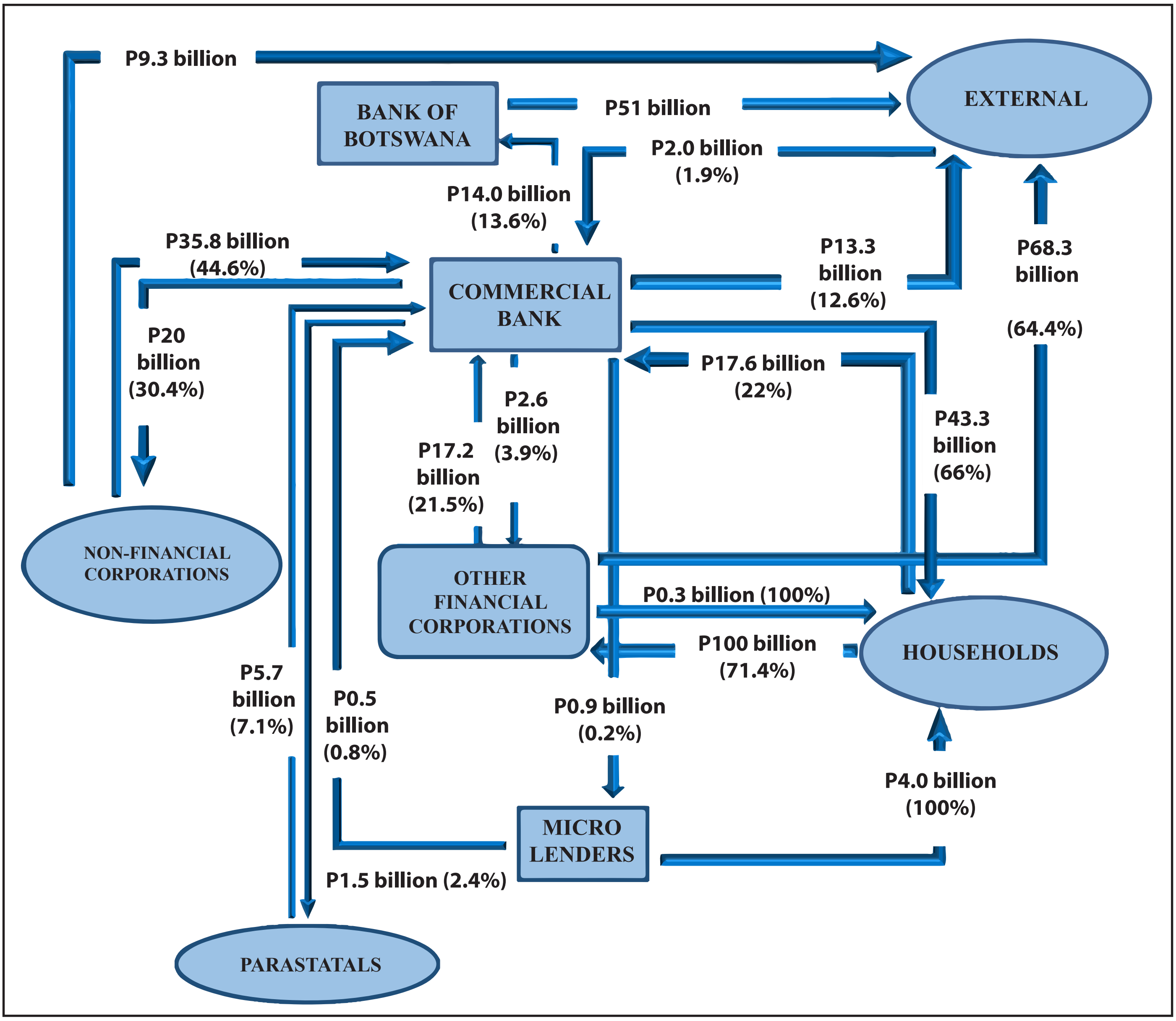
Table 3.7: Structure and Size of the Financial System

Sector/Sub-Sector	2018				2019				2020			
	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP	Assets (P'million)	Percent of Sector Assets	Percent of Financial System Assets	Percent of GDP
NBFIs	**114 560**	**100.0**	**53.7**	**60.3**	**132 472**	**100.0**	**57.3**	**67.2**	**145 384**	**100.0**	**58.5**	**80.4**
Retirement Funds	78 972	68.9	37.0	41.6	93 133	70.3	40.3	47.2	105 175	72.3	42.3	58.2
Insurance	18 596	16.2	8.7	9.8	19 958	15.1	8.6	10.1	20 386	14.0	8.2	11.3
Other*	16 992	14.8	8.0	8.9	19 381	14.6	8.4	9.8	19 823	13.6	8.0	11.0
Banks	98 813	100.0	46.3	52.0	98 685	100.0	42.7	50.0	103 259	100.0	41.5	57.1
Commercial Banks	91 331	92.4	42.8	48.1	98 685	92.4	42.7	50.0	103 259	92.4	41.5	57.1
Statutory Banks	7 482	7.6	3.5	3.9	8 825	7.6	3.8	4.5	8 187	7.6	3.3	4.5
Total Financial System Assets (P'million)	**213 373**			**112.4**	**231 157**			**117**	**248 642**			**137.5**
GDP (P'million)				**189 869**				**197 268**				**180 799**

Source: Bank of Botswana and NBFIRA

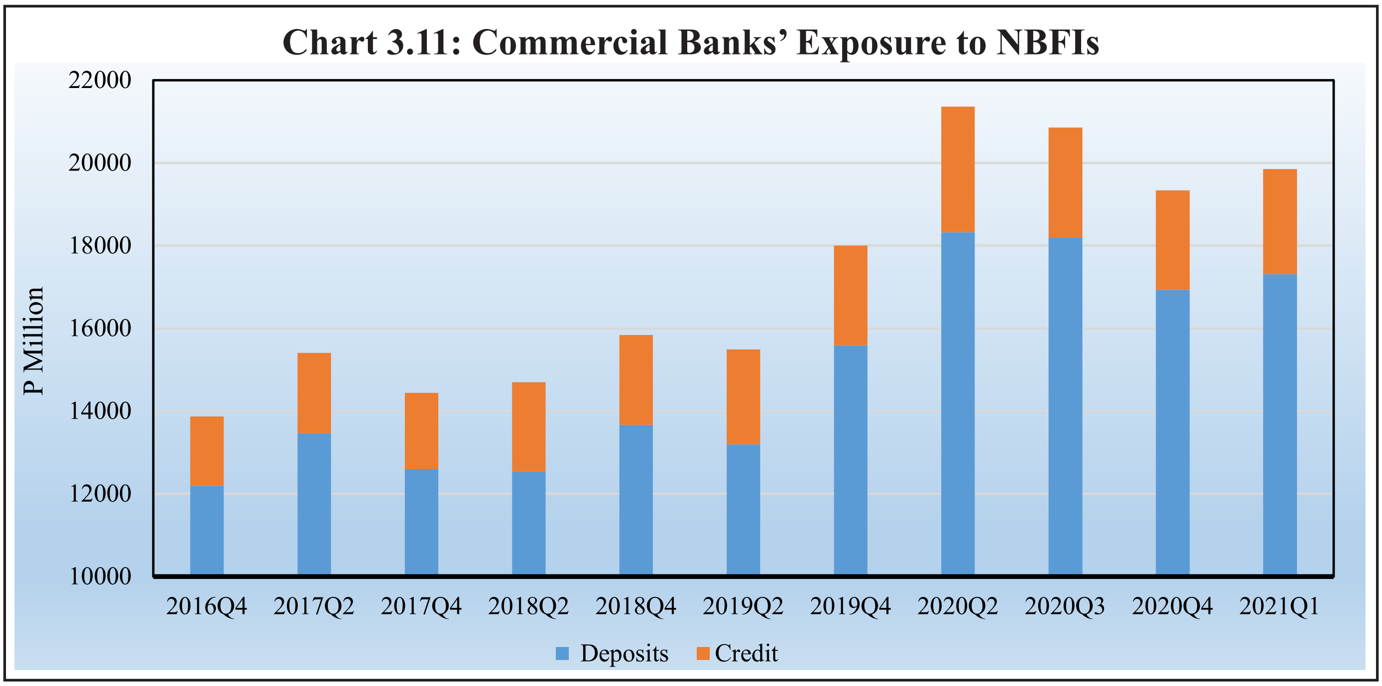
* Other covers Other Financial Corporations, including BBS Limited.

Figure 3.1: Macro-Financial Linkages



Source: Bank of Botswana and NBFIRA

Notes: 1. Percentages indicate shares of loans/deposits for the sector.
2. Balances from the Bank to the external sector represents net foreign assets.
3. Balances from other financial corporations to the external sector are offshore pension assets and are as at February 28, 2021.
4. Balances from commercial banks to the external sector are commercial banks' balances due from foreign banks.

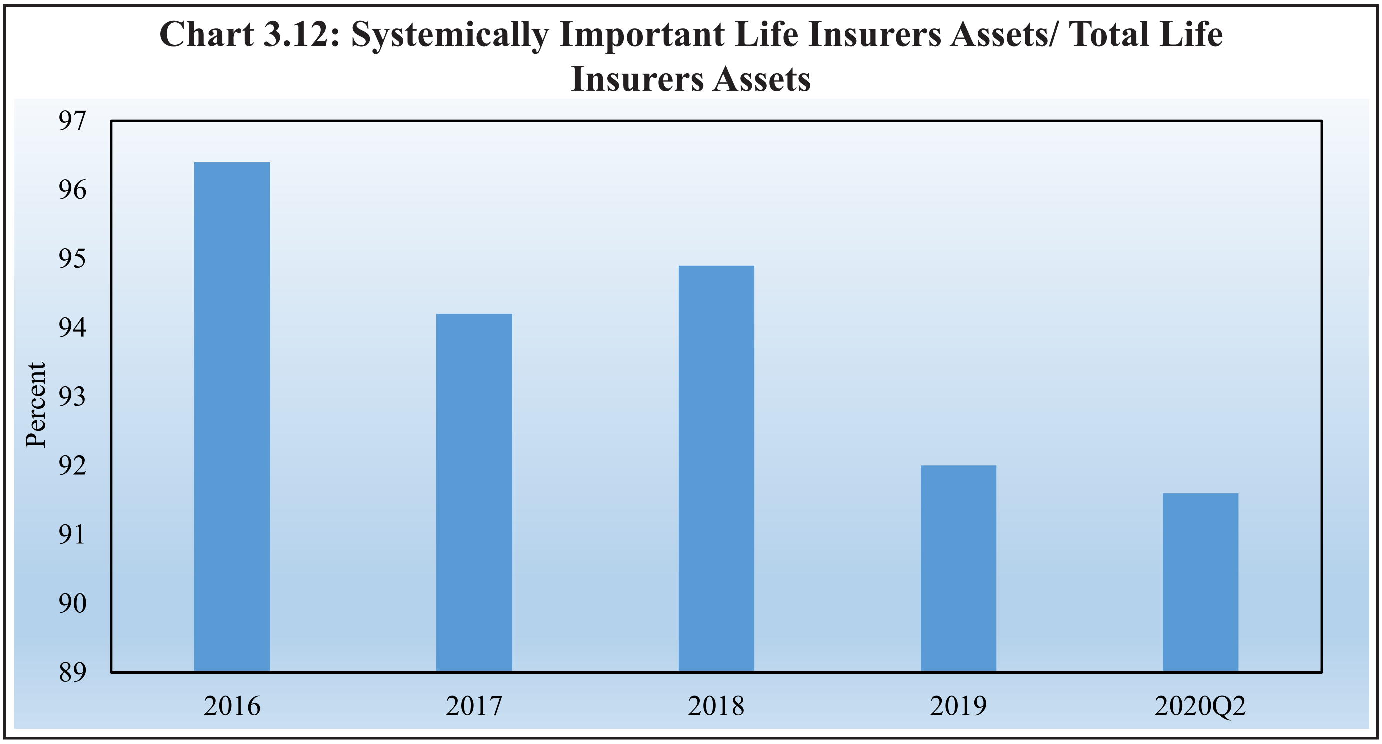


Source: Commercial banks

Risk Concentrations

Insurance and pensions sectors highly concentrated

3.52 Insurance companies could affect financial stability and contribute to systemic risk through three potential transmission channels, namely, failure to provide critical services; inability to mitigate risk and compensate for loss with respect to systemically important counterparties; and with regard to risk to systemically important financial institutions.[20] In a highly concentrated market such as the domestic market, failure by a dominant insurance company may leave a significant gap in the provision of critical risk mitigation services to the economy as remaining companies may not have the capacity to fill the void. Lack of alternative service providers could amplify the effect of an insurance company's distress on the real economy. The dominance of Botswana Insurance Holdings Limited (BIHL) in the local insurance sector exacerbates these risks and warrants enhanced supervision. The largest life insurance companies have a market share of over 90 percent of the assets of the life insurance sector and consequently dominate in gross premiums written (Chart 3.12).



Source: NBFIRA

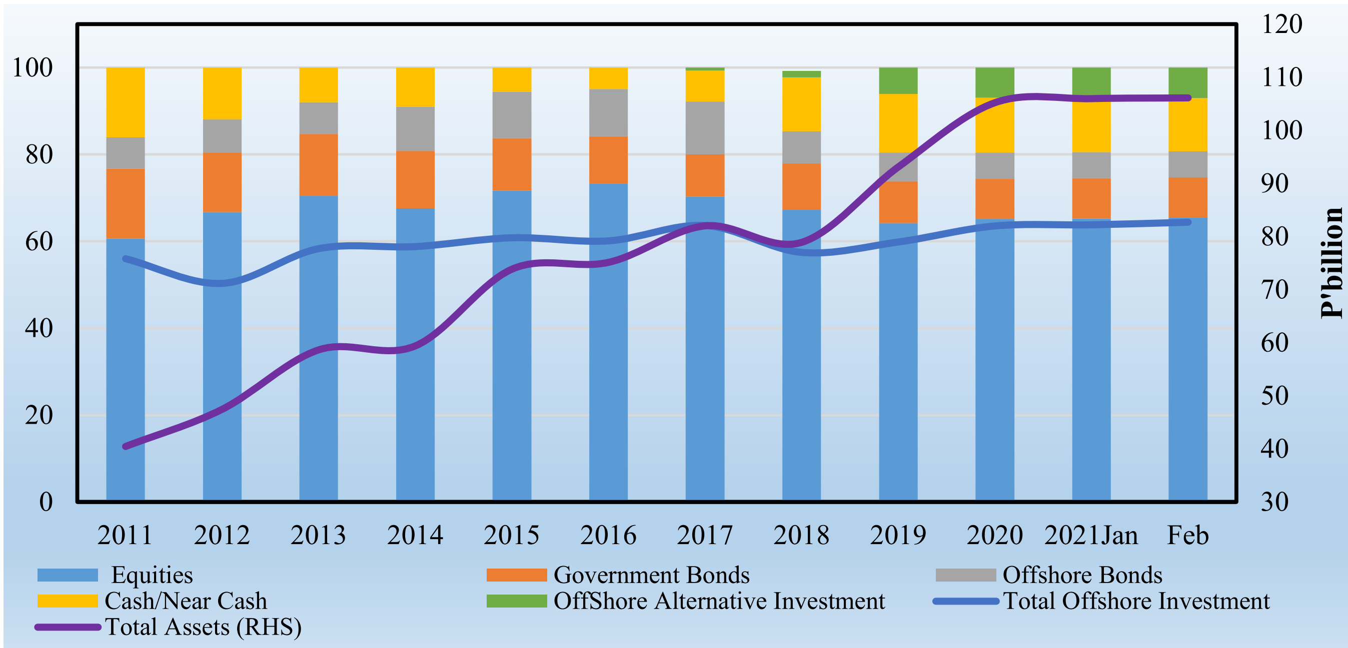
20 French et al., (2015). Insurance and Financial Stability, Bank of England Quarterly Bulletin.

Pension fund assets increased amid COVID-19

3.53 Over the last year, pension funds' assets grew by 12.9 percent from P93.1 billion in the last quarter of 2019 to P105.2 billion in the last quarter of 2020 (P106.1 billion in February 2021). Investment in equities increased from P59.8 billion in the last quarter of 2019 to P68.7 billion in the last quarter of 2020 (P69.5 billion in February 2021) and accounted for the biggest share (66 percent) in the portfolio investment allocation of pension funds (Chart 3.13). Furthermore, 63.5 percent of the funds were invested offshore in December 2020, compared to 59.8 percent in December 2019 (64.4 percent in February 2021). Generally, the investment allocation of pension funds remained broadly unchanged with an average of 60 percent invested offshore since 2009. This is in line with the retirement funds prudential regulations that require that at least 30 percent of assets should be invested locally. The regulations also require that annuities must be purchased exclusively from insurance providers operating in Botswana; potentially restricting consumer choices due to limited competition and shortage of annuity-related products.

3.54 Noteworthy is that more than 80 percent of total industry pension funds are accounted for by or attributed to the Botswana Public Officers Pensions Fund (BPOPF). Measured in relation to the size of the domestic economy (GDP), total assets of pension funds were 58.6 percent of GDP in the 2020 compared to 47.2 percent in December 2019.

Chart 3.13: Investment Allocation of Pension Funds



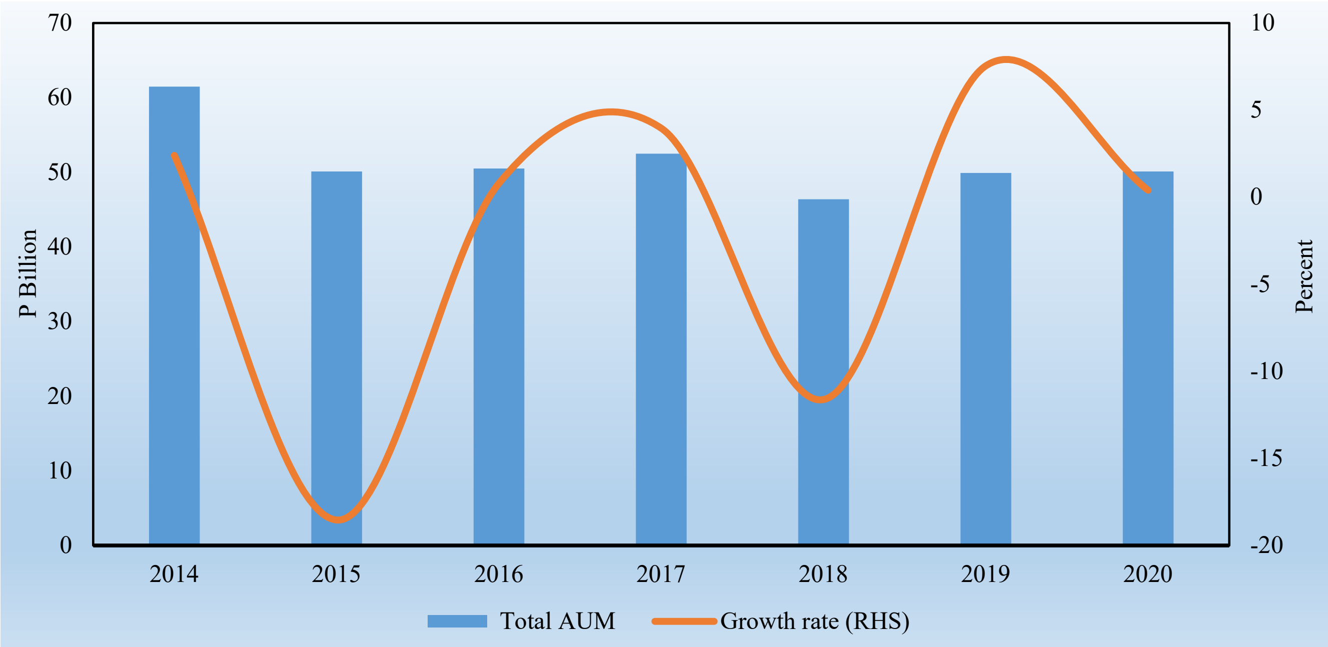
Source: NBFIRA

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

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

3.56 At the end of 2020, there were 29 asset managers and management companies (Mancos). Total Assets Under Management (AUM) increased to P51.1 billion in 2020 from P49.9 billion in 2019 (Chart 3.14). In December 2020, 80.7 percent of the AUM were for pension funds. Other AUM belonged to retail investors, insurance companies and other professional investors. As such, the asset management sub-sector is highly interconnected with other parts of the financial system through ownership linkages, common asset exposures and the provision of wholesale funding to banks. Therefore, the sub-sector poses some level of systemic risk, although mitigated by profitability and adequate capitalisation of asset management companies. As such, the sector presents limited risk to financial stability.

Chart 3.14: Trend in Assets Under Management



Source: NBFIRA

(e) Banking Sector Stress Test Results

COVID-19 poses a significant threat to the banking system

3.57 The Bank continues to monitor and assess the potential impact of the COVID-19 pandemic on the banking sector and the economy as a whole. In this regard, the Bank conducts periodic stress tests on the liquidity and profitability of the domestic banking system, to determine the industry's resilience to the consequences of the pandemic (COVID Event). The analysis relied on statutory returns as at December 31, 2020 and subjected banks to a moderate and severe COVID-19 shocks to reflect the daunting effects of the pandemic. The financial soundness indicators as at December 31, 2020 were used as the baseline scenario.

3.58 The liquidity stress test assesses the ability of a bank to survive unexpected liquidity drain without recourse to any outside liquidity support, such as the central bank or inter-bank market, while the interest rate stress test establishes the impact of policy rate reductions on bank profitability.

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

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

Banks generally resilient but extreme credit shocks could deplete their capital

3.61 Commercial banks were generally resilient to stress, save for credit shocks that resulted 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 11.5 percent, thus breaching the prudential capital adequacy requirement of 12.5 percent. The industry capital position worsens to 2.1 percent in the severe scenario, where 20 percent of performing loans are assumed to become NPLs. Resultantly, asset quality declines under the COVID Event, with the ratio of NPLs to total loans rising from a baseline of 4.2 percent to 13.6 percent and 23.2 percent under moderate and severe scenarios, respectively.

3.62 Sector specific tests were also conducted to capture the impact of COVID-19 on sectors whose economic activity has been significantly affected by the pandemic and related disease containment measures. Termed the 'red sectors', these sectors include mining, which contracted by 26.2 percent in the twelve months to December 2020; trade, hotels and restaurants (-14.8 percent); construction (-11 percent); manufacturing (-8.7 percent) and transport and communications (-7.7 percent). Under the moderate scenario, where 15 percent of performing loans in the 'red sectors' are assumed to become non-performing (10 percent for the other sectors), banks' capital adequacy ratio falls to 9.0 percent while the NPL ratio increases to 16.3 percent. The capital adequacy ratio falls further to 4.4 percent under the severe COVID-19 scenario, where 20 percent of performing loans in the 'red sectors' become non-performing, and the NPLs ratio increases to 21 percent.

3.63 Regarding credit concentration shocks, banks breach the capital adequacy requirement at 7.7 percent under the assumption that the largest borrower defaults for each bank (moderate scenario). The capital adequacy ratio further drops to 3.7 percent under the severe COVID-19 scenario, which assumes that the largest two borrowers would default. The assumed borrower defaults would increase the NPL ratio to 15.8 percent and 20.5 percent in the moderate and severe scenarios, respectively. Overall, credit risk tests show that the severe COVID-19 NPL shock has more prominence in the capital and asset quality position of banks than the non-performing loan shock. Nevertheless, the credit concentration stress tests do not take into account credit mitigation measures such as underlying collateral.

Large banks are more resilient to liquidity shocks

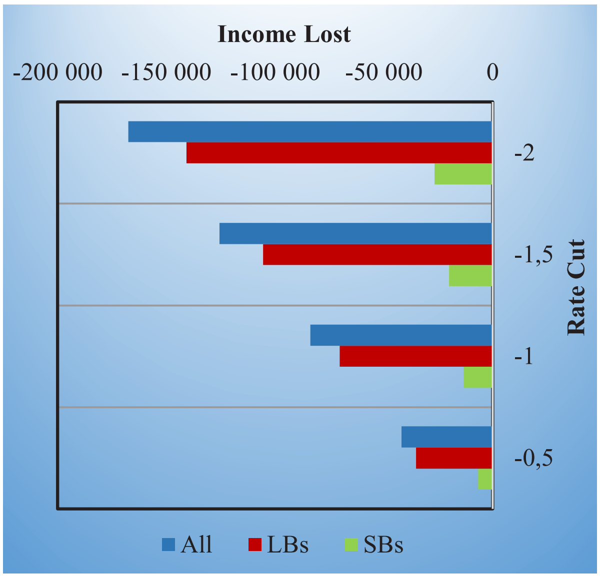
3.64 In the liquidity risk test, banks show resilience to a liability run in the moderate COVID Event, particularly the large banks, which survive for 23 days (September 2020: 25 days). Small banks experience some liquidity squeeze and would only survive for 15 days (September 2020: 18 days) as shown under Table 3.9. Under the severe COVID-19 stress conditions, large banks survive for 10 days (September 2020: 11 days), while small ones survive for a much shorter 7 days (September 2020: 8 days). Shorter survival horizons for small banks reflect the large proportion of illiquid assets in their portfolios, being loans and advances, relative to a highly liquid deposit base that is dominated by wholesale deposits.

3.65 Notably, these scenarios do not consider the availability of liquidity support provided by the Bank through the Credit Facility. Accordingly, the stress results should not be interpreted to mean that the banks would default under these scenarios.

Banks are resilient to interest rate shocks

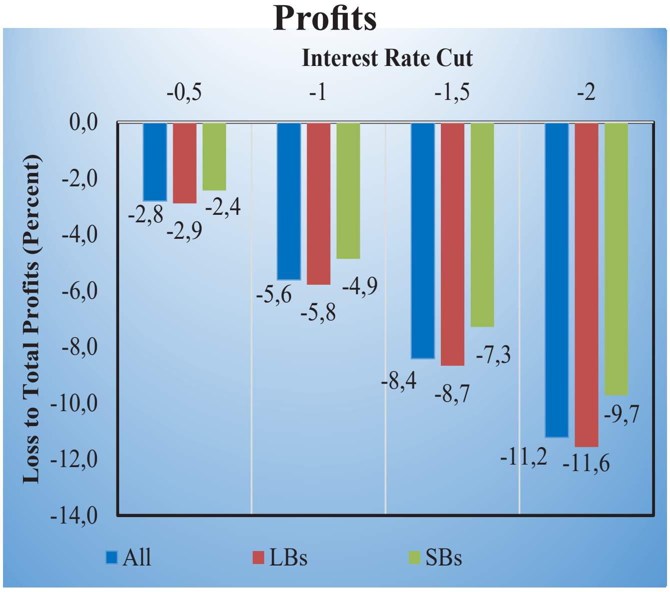
3.66 Interest rate shocks indicate that the industry will experience revenue losses ranging from P41 million to P167 million as a result of assumed Bank Rate reductions ranging from 50 to 200 basis points (Chart 3.15). Large banks are generally more susceptible to interest rate shocks than small banks (SBs) given their dominance over interest-earning assets, including loans and advances. The fraction of large banks' losses to total profits ranges from 2.9 percent at the least policy rate cut to 11.6 percent at the most, compared to 2.8 percent to 9.7 percent for SBs (Chart 3.16).

Chart 3.15: Impact on Profits (P'000)



Source: Bank of Botswana

Chart 3.16: Income Lost as Percent of Profits



Source: Bank of Botswana

Table 3.8: Banking Sector Financial Soundness Indicators

Capital Adequacy (Percent)	Dec 2019	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021
Core Capital to Unimpaired Capital	67.9	66.3	65.5	68.0	68.0	70.9
Tier 1 Capital to Risk-Weighted Assets1	13.3	12.9	13.3	13.5	13.5	14.1
Capital Adequacy Ratio2	18.4	18.2	18.5	19.8	19.7	20.2
Asset Quality (Percent)						
NPLs to Gross Loans	4.8	4.4	4.4	4.1	4.2	4.4
NPLs Net of Specific Provisions to Unimpaired Capital	9.4	8.5	8.8	7.4	7.4	9.1
Specific Provisions to NPLs	59.0	62.3	58.9	62.7	62.8	54.7
Liquidity (Percent)						
Liquid Assets to Deposits (Liquidity Ratio)3	18.3	16.3	21.2	20.8	21.4	20.4
Advances to Deposits (Intermediation Ratio)	82.9	89.3	85.1	84.3	81.4	82.2
Profitability/Efficiency (Percent)						
Return on Average Assets (ROAA)	2.3	8.9	1.8	2.1	1.6	2.3
Return on Equity (ROE)	19.4	7.7	15.4	19.2	15.1	21.0
Cost to Income	58.1	32.1	69.3	65.5	64.9	59.7

Notes:

1 The prudential lower limit is 7.5 percent - Basel II/III.
2 The prudential lower limit is 15 percent.
3 The minimum statutory requirement is 10 percent.

Table 3.9: December 2020 Commercial Banks' Stress Test Results

SCENARIOS	CREDIT RISK		
	Concentration Risk	**Sectoral Shocks***	**Overall NPL Shock**
BASELINE SCENARIO: **(BANKING CONDITIONS AS AT DECEMBER 31, 2020)**	Capital Adequacy Ratio (CAR) of 20.0 percent. 4.2 percent NPLs/Total loans.	Capital Adequacy Ratio (CAR) of 20.0 percent. 4.2 percent NPLs/Total loans.	Capital Adequacy Ratio (CAR) of 20.0 percent. 4.2 percent NPLs/Total loans.
MODERATE COVID-19 SCENARIO			
DESCRIPTION OF SHOCK	One Largest Exposure defaults or becomes non-performing.	15 percent of 'red sector' performing loans become non-performing and 10 percent of other sectors' performing loans become non-performing.	10 percent of performing loans become non-performing.
RESULTS	Banking system breaches the prudential limit with CAR of 7.7 percent. NPLs/Total Loans ratio increases to 15.8 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 9.0 percent. NPLs/Total Loans ratio increases to 16.3 percent, a sign of increasing vulnerability.	Banking system slightly breaches the prudential limit with CAR of 11.5 percent. NPLs/Total Loans ratio increases to 13.6 percent, a sign of increasing vulnerability.
SEVERE COVID-19 SCENARIO			
DESCRIPTION OF SHOCK	Two Largest Exposures default or become non-performing.	20 percent of 'red sectors' performing loans become non-performing and 15 percent of other sectors' performing loans become non-performing.	20 percent of performing loans become non-performing.
RESULTS	Banking system breaches the prudential limit with CAR of 3.7 percent. NPLs/Total Loans ratio increases to 20.5 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 4.4 percent. NPLs/Total Loans ratio increases to 21.0 percent, a sign of increasing vulnerability.	Banking system breaches the prudential limit with CAR of 2.1 percent. NPLs/Total Loans ratio increases to 23.2 percent, a sign of increasing vulnerability.

* Sectoral shocks have been applied to sectors that have been significantly affected by the COVID-19 pandemic and related disease containment measures. Termed the 'red sectors', these sectors include mining, trade, hotels and restaurants, construction, manufacturing and transport and communications.

SCENARIOS	RISK CATEGORY	
	LIQUDIITY	**INTEREST RATE**
BASELINE SCENARIO: **(BANKING CONDITIONS AS AT DECEMBER 31, 2020)**	Perfect asset liability match, leading to 30 days survival.	Banks start off with a CAR of 20.0 percent.
MODERATE COVID-19 SCENARIO		
DESCRIPTION OF SHOCK	Bank run simulation based on Assets' Haircuts and Liabilities' Run-off Rates.	150 basis point cut in Policy Rate.
RESULTS	On average banks survive for 21 days Large banks survive 23 days. Small banks survive 15 days.	19.7 percent CAR (change in CAR not significant at -0.3 percentage points). Loss of P127 million in interest income.
SEVERE COVID-19 SCENARIO		
DESCRIPTION OF SHOCK	Bank run simulation based on higher Assets' Haircuts and Liabilities' Run-off Rates than in moderate scenario.	350 basis points cut in policy rate.
RESULTS	On average banks survive for 10 days Large banks survive 10 days. Small banks survive 7 days	19.4 percent CAR (change is -0.6 percentage points). Loss of P293 million in interest income.

Source: Bank of Botswana

4. FINANCIAL MARKET INFRASTRUCTURE (FMI) AND REGULATORY DEVELOPMENTS

(a) Payments and Settlements Systems

FMIs largely resilient

4.1 Clearing systems were largely resilient in handling large volumes of transactions without any major disruption during 2020. The value and volume of cheque transactions continue to show a declining trend between 2016 and 2020 (Table 4.1).

4.2 Table 4.1 shows the Botswana Interbank Settlement System (BISS) transactions by value and volume for the years 2016 to 2020 and for the first four months of 2021. Developments and trends in the payments and settlement platforms point to an economy that is increasingly becoming digitalised, with growing usage of electronic funds transfers (EFTs) as compared to cheque clearances.

4.3 While payment and settlement platforms are becoming more reliable and efficient in terms of timeliness and finality, increased digitisation could generate different types of risks such as cybercrimes. To that end, a National Cyber-Security Strategy was approved in October 2020 to pave way for policy development in the area. A Computer Incident Response Team (CIRT), which is responsible for responding to Cyber-Security breaches, viruses and other potentially catastrophic incidents, was also established in September 2020.

4.4 Overall, FMIs (i.e. payment systems, central securities depository and securities settlement systems) remain stable and resilient, thus strengthening and preserving domestic financial stability.

Table 4.1: Selected Payment and Settlement Systems Indicators

Period	BISS Transactions		Cheques		EFTs	
	Volume ('000)	Value (P' billion)	Volume ('000)	Value (P' billion)	Volume ('000)	Value (P' billion)
2016	183	1 690	1 204	26	7 507	166
2017	178	1 273	1 038	22	8 135	165
2018	175	1 414	929	20	8 513	180
2019	183	1 899	810	19	9 161	209
2020	155	2 110	495	12	9 770	211
2021Jan- Feb	24	30	60	1	1 535	24

Source: Bank of Botswana

(b) Regulatory Developments

Bank rate maintained

4.5 The Monetary Policy Committee (MPC) held its first meeting on April 29, 2021. The MPC noted that the short-term adverse developments in the domestic economy occur against a growth-enhancing environment including accommodative monetary conditions; improvements in water and electricity supply, reforms to further improve the business environment and Government interventions against COVID-19, including vaccine rollouts, and the implementation of ERTP and ISF. It is projected that the economy will operate below full capacity in both the short and medium term and, therefore, not creating any inflationary pressures, going forward. The projected increase in inflation in the short-term is primarily due to transitory administered price changes and supply side factors that, except for second round effects, would not normally attract monetary policy response. It is against this backdrop that the MPC decided to continue with the accommodative monetary policy stance and maintain the Bank Rate at 3.75 percent.

Botswana continues to address AML/CFT deficiencies

4.6 Botswana remains on the Financial Action Task Force list of jurisdictions with strategic AML/CFT deficiencies and accordingly that the authorities continue to implement the required action plans. Progress made has been compelling so far as reflected in the recent upgrading on some FATF recommendations. Therefore, the likelihood of elevated risk to financial stability due to ongoing strategic AML/CFT deficiencies is expected to recede going forward.

RPC holds the first meeting of the year

4.7 The Regulatory Policy Committee (RPC) met in March 2021 to deliberate on regulatory and policy matters affecting the financial system. The

Committee discussed and approved the Guidelines on Identification, Monitoring and Reporting of Suspicious Transactions. The purpose of the guidelines is to provide guidance on the reporting of suspicious transactions to the Financial Intelligence Agency (FIA).

4.8 At the same meeting the RPC discussed The Draft Guidelines on Identification of Beneficial Ownership Information for Legal Entities and Legal Arrangements. These guidelines lay down procedures that banks must follow in order to establish and verify the identity of beneficial owners when establishing a business relationship or concluding a transaction with a customer. Subsequently, the RPC met on April 8. 2021 to discuss the proposal to discontinue use of cheques in Botswana. The proposal was noted and would further be explored following consultation with relevant stakeholders.

Bank SBI Botswana Limited surrenders its banking licence.

4.9 Pursuant to Section 11(2) of the Banking Act (Cap. 46:04), Bank SBI Botswana Limited (Bank SBI) will surrender its licence to transact banking business in the domestic market effective June 30, 2021. This follows the bank's decision to voluntarily close operations effective June 30, 2021, in Botswana.

Access Bank PLC undertakes to acquire majority stake in BancABC

4.10 In April 2021, the Bank received and conditionally approved an application for the purchase and acquisition of the entire ordinary shares held by African Banking Corporation Holdings Limited (ABCH) in African Banking Corporation of Botswana (BancABC), by Access Bank PLC (Access Bank), a pan-African bank headquartered in Nigeria, with operations and representation in a number of jurisdictions in Africa, Asia, Europe and the Middle East. The transaction is subject to satisfactory completion of the procedural regulatory conditions and would result in effective transfer of the strategic ownership and controlling interest of BancABC to Access Bank, with the 78.15 percent singular majority shareholding. The remaining 21.85 percent of shares are publicly held, having been issued and traded on the Botswana Stock Exchange Limited in 2018.

BBS Limited implored to exercise good corporate governance and sound management practices.

4.11 The Bank has noted with concern corporate governance issues surrounding BBS Limited (BBSL) during April 2021. Based on the current delegated supervisory arrangements for institutions such as BBSL and statutory banks, as provided under Section 53(2) of the Banking Act (Cap 46:04), the Bank is conducting a targeted on-site examination of BBSL to determine the effectiveness of corporate governance practices at the company. BBSL board was implored to continue exercising duty of care in a diligent and prudent manner, and to maintain safe and sound banking practices.

The implementation of the D-SIBs framework expected to enhance financial stability

4.12 The Domestic Systemically Important Banks (D-SIBs) framework, which was approved by the RPC in July 2020 is expected to be implemented during 2021. An impact assessment survey with key stakeholders commenced in February 2021. The framework is anticipated to enhance financial stability in Botswana as discussed in detail under Box 4.1.

The Minister approves the establishment of Deposit Protection Fund (DPF).

4.13 Meanwhile, in March 2021, the Minister of Finance and Economic Development approved the establishment of a DPF, paving way for the development of legislative and institutional structures to operationalise the fund. Other notable legislative developments in the financial sector include: the ongoing revision of the NBFIRA Act and the Financial Intelligence Act; and the drafting of the Credit Information Bill and the Secured Transaction on Movable Property Bill (which provides for the establishment of the Collateral Registry). These regulatory developments would have a positive bearing on the efficient functioning of the financial services sector.

FSC meets to discuss the stability and resilience of the domestic financial system.

4.14 The FSC met on April 27 and May 10, 2021 to deliberate on recent developments in the financial sector, as well as address regulatory and public interest issues relating to the stability, performance and prospects for the domestic financial system. It identified and discussed recent global, regional and domestic developments that impacted on the performance and resilience of the financial sector amid the devastating impact of the COVID-19 pandemic on the lives and livelihoods of Batswana. The FSC acknowledged the pre-existing financial stability vulnerabilities for Botswana but concluded that overall, vulnerabilities that could elevate risks to financial stability have, thus far, been generally contained.

BOX 4.1: D-SIBS METHODOLOGY FOR BOTSWANA - AN OVERVIEW

Introduction

D-SIBs are banks which dominate the financial system and have the potential to significantly affect the stability of the domestic financial system and the economy at large should they become non-viable. The D-SIBs framework is necessary to address adverse side effects (i.e. negative externalities) that could be created by D-SIBs, which existing regulatory policies do not adequately address. In addition, the identification of D-SIBs is part of the broader macroprudential framework in which authorities wish to control structural vulnerabilities within the financial system.

Objectives of the D-SIBs Framework

(a) identify and designate systemically important banks using an agreed methodology;

(b) reduce the probability of failure by introducing higher loss absorbency requirements and implementing enhanced supervisory measures for D-SIBs; and

(c) reduce the impact of failure by improving resolvability. This is achieved by fully implementing the Financial Stability Board *key attributes of effective resolution regimes for financial institutions.*

Methodology

In order to address the systemic risks presented by D-SIBs, the Bank has adopted the Basel Committee on Banking Supervision (BCBS) D-SIBs methodology for the banking system of Botswana. The BCBS D-SIBs methodology is an indicator-based approach consisting of selected indicators with different weights (Table 1). These indicators include the size of the bank, interconnectedness within the financial system, substitutability, domestic sentiment and complexity of operations (Table 1). However, the approach allows for discretion in the choice of indicators and weights in line with the characteristics of the domestic financial system. For example, size (i.e. balance sheet total assets) was assigned the highest weight because it is considered the key measure of systemic importance. In addition, the banking system of Botswana is highly concentrated, therefore, failure of a large bank would cause significant damage to the domestic economy.

Table 1: Indicators for the Identification of D-SIBs in Botswana

INDICATOR	WEIGHT (Percent)	SUB-INDICATORS
Size	40	Resident assets
Interconnectedness	20	Loans to financial institutions Deposits from financial institutions
Substitutability	20	Bank branches Domestic loans Household loans
Complexity	10	Securities outstanding Market risk weighted assets Cross-jurisdictional activity
Domestic sentiment	10	Households deposits

Sources: Bank of Botswana and Bank for International Settlements

Size: The size of a bank is a key measure of systemic risk given that activities of a large bank comprise a large share of banking sector activity therefore, the greater the likelihood that its failure would cause disruption to the whole financial system. Moreover, the collapse of a large bank is more likely to negatively impact confidence in the domestic financial system and performance of the real economy.

Interconnectedness: Interconnectedness relates to the degree to which banks are linked with other financial institutions. A high level of interconnectedness increases the risk that financial distress in one bank spills over to other financial institutions. Therefore, the systemic impact of a bank greatly depends on its degree of interconnection with banks and other financial institutions.

Substitutability: The default of a financial institution can have negative externalities on the financial system and the performance of the real economy if certain critical services provided by the bank cannot be easily replaced by other banks in a timely manner in the event of a bank failure. If an institution plays a dominant role in a specific business segment or as a provider of market infrastructure such as the payment system, the substitution by alternative suppliers may be considered impossible. Lack of substitutability largely reflects a bank's relevance to non-financial institutions customers who have no direct access to capital markets and has the potential to cause great financial instability.

BOX 4.1: D-SIBS METHODOLOGY FOR BOTSWANA - AN OVERVIEW (Continued)

Complexity: The systemic risk following a bank's failure increases with the complexity of its business in terms of structure, operations and business model. This means that the larger a troubled bank's portfolio of trading and investment securities is, for example, the tougher it becomes to resolve the failure, and the resultant disruption to the financial sector could be more severe.

Domestic Sentiment: This indicator expresses the public's perception of the impact of a bank failure, which is regarded as a depiction of the domestic relevance of a financial institution. The share of household deposits is used to capture public perception. The more household deposits the bank has, the higher the chances of widespread anxiety across the country, leading to a general reduction in national savings or even bank runs. This event has the potential to destabilise the financial system through weakened confidence in the domestic financial system.

Identifying and Designating D-SIBs

The output of the D-SIBs methodology for the period December 2017, 2018 and 2019, identifies First National Bank of Botswana Limited (FNBB), ABSA Bank of Botswana Limited (ABSA) and Standard Chartered Bank Botswana Limited (Stanchart) as D-SIBs for all the periods. Accordingly, FNBB, ABSA and Stanchart were recommended to be designated as D-SIBs for 2020. There will be annual reviews of the D-SIBs list or as and when there are important structural changes to the domestic banking system.

Reducing the Probability of Failure and Impact of Failure

A D-SIBs framework was approved by the Bank's RPC in July 2020 and noted by the FSC at its August 2020 meeting. The D-SIBS framework will be implemented during 2021 following consultations with the banking sector. In addition to existing requirements, the following enhanced supervisory approach for D-SIBs will be adopted:

a) increased high-quality liquid assets requirements. This requirement shall be met by a combination of common equity Tier 1 capital and Tier 11 capital;
b) development of recovery and resolution plans by D-SIBs and annual submission of these plans to the Bank;
c) intensive supervision of D-SIBs, such as annual targeted on-site examinations; and
d) any additional requirements or policy measures that are considered appropriate to mitigate risks posed by D-SIBs.

Conclusion

The identification of D-SIBs is part of the broader macroprudential framework in which authorities wish to control structural vulnerabilities within the financial system that arise through interlinkages, direct and indirect exposure concentrations with a view to maintaining financial stability. The Bank will undertake regular assessment of the systemic importance of banks in Botswana, to ensure that the assessment reflects the current state of the financial system. The methodology will be reviewed regularly to ensure that it remains relevant to the evolving domestic financial system.

5. CONCLUSION AND OUTLOOK

The financial sector continues to be resilient but uncertainties due to COVID-19 present vulnerabilities and elevated risks

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

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

5.3 Vulnerabilities to the financial system are exacerbated by the COVID-19 pandemic and the necessary disease containment measures that continue to have an adverse effect on economic performance in the short to medium term. Specifically, the potential increase in bank loan defaults and insurance premiums payments or contributions to pension funds, as well as early pension withdrawals emanating from loss of employment and, constrained liquidity, profits and investment returns for some institutions could further elevate risks to financial stability.

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

5.5 While Botswana remains on the Financial Action Task Force list of jurisdictions with strategic AML/CFT deficiencies, the country continues to implement the required action plans. Efforts in this regard have so far yielded upgrades on some FATF recommendations and, as such, the likelihood of elevated risk to financial stability due to ongoing strategic AML/CFT deficiencies is expected to recede going forward.

APPENDIX

Table A1: Macroeconomic and Financial Stability Indicators

Financial Sector (Percent)	Jun 2019	Sep 2019	Dec 2019	Mar 2020	Jun 2020	Sep 2020	Dec 2020
Relative Size of Financial Sector (percent of GDP)[1]	100.2	102.8	117.6	111.4	122.2	111.3	127.2
Pension Funds' Assets (percent of GDP)	45.1	45.5	47.2	44.1	49.7	54.7	58.2
Pension Funds Offshore Investments (percent of GDP)	27.2	27.5	28.3	25.7	31.2	34.8	37.0
Corporate Sector (Percent)							
Corporate Sector Debt to GDP	11.9	11.5	11.6	12.0	12.6	12.3	12.5
Debt to Equity	…	…	46.3	…	45.7	44.3	
Household (Percent)							
Household Debt to GDP	18.9	18.9	21.7	20.5	21.7	22.7	23.7
Household Debt to Income	48	42.2	45.0	47.3	47.0*	47.0*	…
NPL (household)	3.3	3.2	3.2	3.6	3.9	3.2	3.4
Real Estate (Percent)							
Mortgage Loans to Total Loans	21	20.8	20.4	20.0	20.1	20.2	19.6
NPL (mortgages)/Total mortgage loans	6.2	6.2	6.1	6.5	7.2	6.0	6.1
Total Mortgage Loans/GDP	7.1	7.1	7.1	7.1	7.5	7.7	5.6
General Economic Indicators							
Economic growth	3.9	3.6	3.0	2.6	-4.2	6.4	-7.9
Inflation	2.8	3.0	2.2	2.2	0.9	1.8	2.2
Foreign Exchange Reserves (percent of GDP)	36.0	35.9	32.3	30.3	34.1	32.4	29.5
Current Account Balance (P' Million)	-219	-6 499	-6 581	-3 791	-6 575	-3 848	-18 251
Months of Import Cover	14.7	14.8	12.1	11.5	11.8	10.9	9.9
Exports (percent of GDP)	40.8	27.0	38.2	32.2	26.2	31.5	29.7
Imports (percent of GDP)	38.2	35	35	40.3	40.5	46.9	46.4
Government							
Government Debt to GDP	13.4	13.6	13.9	19.2	19.8	20.0	9.5
Government Debt to Revenue	49.4	47.5	50.1	53.9	61.0	63.1	74.4
Government Guaranteed Debt/GDP	…	…	…	4.5	4.6	4.8	4.8
Government Net Financial Position to GDP	-4,3	10.2	8.7	5.6	8.0	9.8	-10.7
Government Interest Payments to Revenue	0.8	3.6	0.9	4.1	1.0	4.6	2.11
Government Interest Payments to GDP	0.3	1.0	0.2	0.9	0.4	1.1	0.04
Government Lending to State-Owned Enterprises (P'Million)	2 209.6	2 209.6	2 209.6	…	…	…	…
General Government to GDP	14.7	14.7	14.7	15.3	20.2	17.6	16.6
Government Deposits to GDP	16.7	16.3	16.3	15.0	15.8	15.7	1.4
Government Expenditure to GDP	30.3	36.2	32.2	…	33.2	35.5	36.9
Government Employment to Total Employment	45.0*	33.3	32.3	32.3	40.3	40.3*	40.3*

Source: Bank of Botswana, Statistics Botswana, MFED, NBFIRA, Botswana Stock Exchange Limited and Commercial Banks.

Note: … denotes data not available

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

* are estimated figures.

Chart 17: Financial Systems Vulnerabilities' Heat Map