Republic of Botswana

DRAFT

2024/25 BUDGET STRATEGY PAPER

MINISTRY OF FINANCE

September 2023

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I. INTRODUCTION

1. The 2024/25 Budget Strategy Paper (BSP) is a strategic policy document that outlines the upcoming proposed budget priorities after taking into account the macroeconomic conditions. The aim is to increase awareness and understanding of the broader macro-fiscal stance amongst stakeholders as well as availing an opportunity for input in policy direction for the preparation of the 2024/2025 national budget. In addition the Paper provides an opportunity to evaluate the effectiveness of the Government's existing policies with the intention of bridging the gap between the public expectations and what is fiscally attainable. The Paper highlights the current state of the economy, provides macro-fiscal outlook over the medium term, together with a summary of Government spending plans as a basis for the 2024/2025 budget.

2. Since 2010, the Strategy Paper has facilitated informed policy discussions and decision making for prioritisation of the budget allocations for the coming financial year. It is worth noting that the 2024/2025 BSP is framed against a backdrop of global economic slowdown underpinned by the ongoing geo-political tensions, elevated global inflation, the lingering effects of the COVID-19 pandemic, the persistent supply chain disruptions and the drought effects that have created the urgency on the need to put emphasis on addressing food security and climate change effects. This urgency allows us to refocus investments on mitigation, adaptation and firm-up our resilience as an economy.

3. The Botswana economy continues to recover, recording positive GDP growth rates as the effects of COVID-19 pandemic are beginning to fade away. Despite these challenging times, Botswana's economy remained resilient with an impressive economic performance in 2022. These challenges have reversed efforts made in the previous years, in poverty reduction and inequality, and above all promoted social ills in the society. The need to address these challenges and boost resilience while building on successes realised overtime, forms the basis of the economy's Transformation and RESET Agenda, hence the need to ensure that the strategic priorities identified in the Second Transitional National Development Plan (TNDP) and the ongoing structural reforms, fiscal consolidation plans and sectorial expenditure programmes outlined in the previous year will continue to be implemented.

4. Following these unprecedented macroeconomic shocks, the 2024/2025 budget will supports policies, programmes and projects towards improving livelihoods and strengthening socio-economic resilience. This will ensure that Batswana withstand and recover from current and future economic and social shocks or disruptions. Critical to this endeavour, is the urgent need to address project implementation and service delivery deficiencies. In this context, the 3 Stage Appraisal and Development Manager models will be key in ensuring that projects are implemented within time, scope and

budget. Infrastructure development, human capital, social protection and economic empowerment schemes will continue to play a significant role towards improving lives by reducing poverty and inequality.

5. One of the key result areas/priority areas of the 2024/2025 budget is to address unemployment especially among the Youth. It is envisaged that the identified 2024/2025 budget priorities will accelerate and support positive economic growth trajectory necessary to further reduce unemployment. In addition, one of the key areas of focus by Government will be upskilling and reskilling young people with the skills and knowledge needed to facilitate growth in the economy.

6. As the world irreversibly moves towards combating climate change, one of the country's top priority is how to optimally transition to low carbon energy sources as well as how to find a more optimal energy mix that is friendlier to the environment. It is worth noting that transition from hydrocarbons to renewables is not an easy undertaking, given the high costs involved. Government's obligation is therefore, towards cutting on emissions, spending on new and cleaner energy and most importantly making investments that will help arrest global warming that is now categorised as the immediate challenge facing the world economy.

7. In this regard, the strategic objectives and budget priorities for 2024/2025 which have been identified and are proposed include; **Export Led Value Chain Development, Infrastructure Investment and Development, Innovation Digital Transformation and Development, Socio-Economic Resilience, Knowledge Based Economy Investment and Green Economy.** These will be geared towards economic turnaround and inclusive growth that places special focus on the need to increase employment, especially among the youth and the graduates, ensure equitable distribution of income, ensure social security while also expanding the tax revenue base and increasing our foreign exchange reserves.

II. MACROECONOMIC REVIEW AND OUTLOOK

Global Economic Review and Outlook

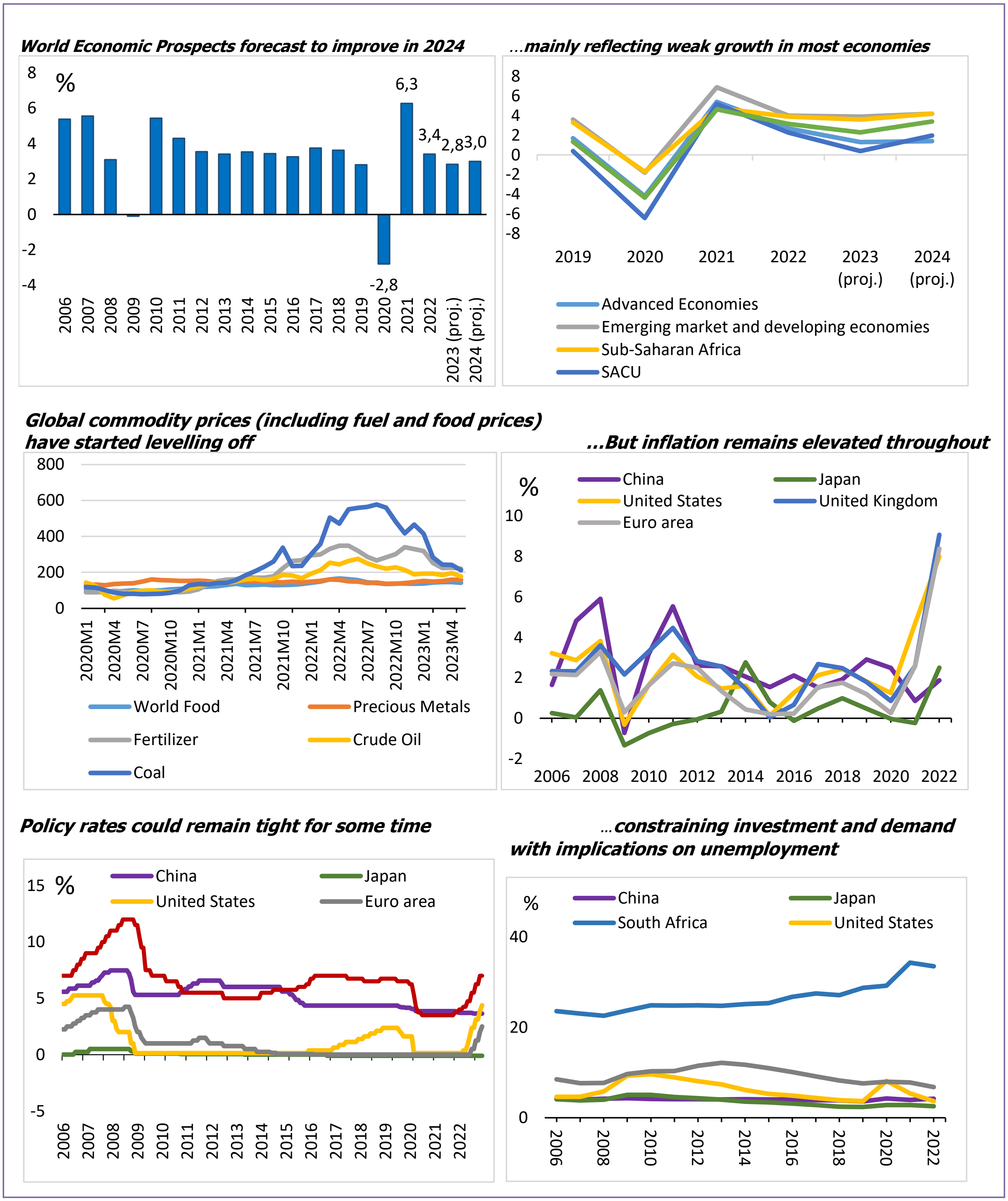
8. World economic prospects continue to weaken on the back of heightened macro-financial uncertainty coupled with the lack of clarity on the ongoing geopolitical tensions. The situation was, earlier in the year made worse by the recent financial sector turmoil in some of the major banks in the US and Europe including a potential US debt default, threatening global financial sector stability, with potential spill overs to other markets although these have since been contained. While risks of a potential debt default have not materialised, issues surrounding the US debt ceiling may prompt a downgrade by rating agencies signalling a possible US recession in the short term.

9. It is against this background among others, that in July 2023, the International Monetary Fund (IMF) revised global prospects downwards in 2023. The world economy is now estimated to slow down to 3.0 percent in 2023 from 3.5 percent in 2022 (Figure 1 panel a). The slowdown, which largely reflects weak demand in major economies in the US, UK and the Euro area. Advanced economies are therefore anticipated to grow by 1.5 percent in 2023 from 2.7 percent in 2022 (panel b). In 2024, global prospects are expected to remain unchanged at 3.0 percent.

10. Among Emerging Market and Developing Economies (EMDEs), the anticipated recovery in China following the end of its zero-COVID policy could falter, after a slower-than expected growth in the second quarter of 2023.This performance could further derail growth prospects for EMDEs which are currently estimated at 4.0 percent in 2023 unchanged from 4.0 percent in 2022. In the sub-Saharan Africa region, growth is expected to fall to 3.5 percent in 2023 from 3.9 percent the previous year. More specifically, the SACU region is projected to decelerate to 0.4 percent in 2023 from 2.3 percent with much of this slowdown attributed to deteriorating growth prospects in the South African economy. The weak economic performance in South Africa reflects ongoing power supply constraints and weak consumer and investment sentiments. Together these factors combined have weakened the South African rand (ZAR) against major currencies, particularly the US dollar with which the pula has also weakened against. Domestically, this means cheaper transit cost elements priced in ZAR but an upward pressure on dollar denominated elements of the domestic fuel price mechanisms.

11. Global prospects are however set to improve, with the global economy projected to rebound to 3.0 percent in 2024 as most economies start to recover. Trends for several global economic indicators in **Figure 1** portray this anticipated path to recovery.

Figure 1: Global Economic Developments



Source: *WEO, July 2023*

Domestic Review and Outlook

Economic Growth

12. According to Statistics Botswana, the latest GDP estimates indicate that the domestic economy grew by 5.8 percent in 2022, compared to 11.9 percent in 2021. Growth was broad-based, with the fastest-growing sectors of the economy being Water & Electricity (48.6 percent growth) and Diamond Traders (17.6 percent) and manufacturing (8.2 percent). Growth in these sectors was attributable to increased local electricity production, increased activity in sales of rough diamonds and strong activity in diamond mainstream industries. The Mining sector (7.5 percent) also contributed to overall growth in the economy on account of strong demand for rough diamonds during the year. A decomposition of the drivers of economic growth in 2022 (Table 1) reveals that the contribution to total growth indicates that almost half of total growth came from the non-diamond private sector, while diamond activities were responsible for just under 40 percent of growth. From a policy perspective, this is a positive development given Government's objective of diversifying the economy.

Table 1: Contribution to GDP Growth, 2021-2022

Broad Sector	**Contribution to GDP Growth**	
	2021	2022
Non-diamond private sector	32.0%	47.4%
Diamond mining	46.5%	25.1%
Public administration	7.1%	13.5%
Diamond downstream (trading, cutting & polishing)	14.4%	14.0%
Total	**100.0%**	**100.0%**

Source: *MoF Calculations, 2023*

13. Further to this, other sectors that contributed to the positive growth include Accommodation & Food services (5.4 percent) and Transport & Storage (5.0 percent). However, it is anticipated that performance of the economy will be slower in the second half of the year, as growth in the mining sector moderates. On the back of this, real GDP growth is revised downwards by 2 percentage points to 3.8 percent in 2023 from the 4 percent that was earlier projected in January 2023. This growth profile could be revised down depending on the dynamics of the Russia-Ukraine conflict, regional economic developments, particularly in South Africa among others. Furthermore, recent power outages due to recurring plant shutdowns at both Morupule A and Morupule B could also limit growth prospects especially for other sectors in the economy. The non-mining sector is however anticipated to continue contributing positively underpinned by, among others, Government interventions aimed at accelerating economic transformation and building economic resilience.

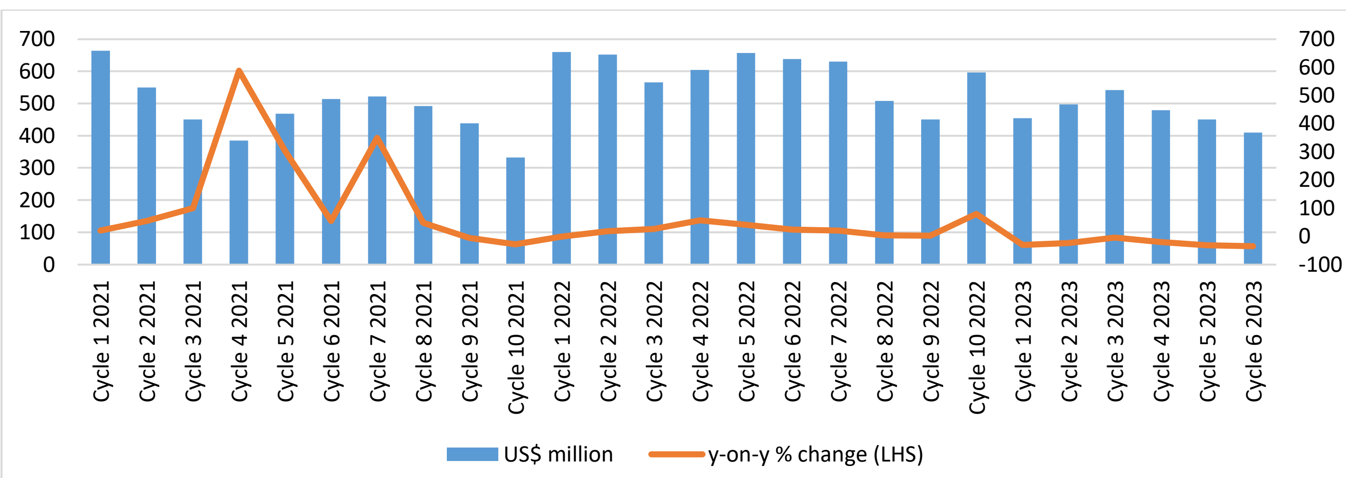
14. On the other hand, demand conditions were mixed during 2022 with private consumption stronger-than-expected albeit a surge in inflation and higher borrowing costs. Private and government consumption grew by 4.7 percent and 3.0 percent in 2022 from 2.3 percent and 4.0 percent, respectively the previous year. The growth in private consumption reflects the increase in salaries of public officers which was effected in April 2022. Investment fell by 12.3 percent, while exports and imports fell by 5.6 percent and 11.8 percent, respectively. The fall in investment was attributed to higher interest rates during the year which affected the cost of investing. On the other hand, the fall in imports in real prices reflects the impact of high import prices particularly of food and fuel, which prevailed for the most part of 2022.

Diamond Market

15. The diamond industry got off to a rough start in 2023 as the ongoing global macroeconomic challenges continued to impact demand and sentiments. In line with expectations, rough diamond sales through De Beers Global Sightholder Sales (DBGSS) totalled USD2, 832 million in the first six cycles of 2023 compared to USD3, 777 million during the same sight sales in 2022, representing a decline of 25.02 percent **(Figure 2).**

16. The likelihood of slowing growth and possible recession in the USA (which accounts for about 50 percent of the diamond jewellery market[1]) and elsewhere – *brought about by persistent high inflation, reduced real incomes and tighter monetary policy* – may adversely affect diamond sales in 2023, with implications for export earnings and Government revenues as well as foreign reserves.

Figure 2: DeBeers Global Sightholder Sales (2021-2023)



Source: *DeBeers, 2023*

[1] Other markets include India, China, Gulf region, Hong Kong and Europe.

17. Meanwhile, diamond prices[2] continued to show a decline in 2023 from 2022 levels. The diamond index fell by 16.9 percent to reach 137.1 in March 2023, from its record high of 165.0 the same month in 2022.Prior to this, prices declined by 2.7 percent in December 2022. The trend continued in 2023 as prices fell by 10.8 percent and 13.8 percent during the first two months of the first quarter of 2023 and are likely to continue with the downward trend owing to the ongoing weak demand for rough diamonds.

Unemployment

18. The strong performance of the economy in the past two years has not generated employment at the pace that would absorb more people into the labour market. Labour force survey data from Q4 2022 shows only a marginal decrease in unemployment to 25.4 percent from 26.0 percent in the fourth quarter of 2021. Prior to this, unemployment had been steadily rising since 2019, in part reflecting the effects of COVID-19 lockdowns in 2020 where it rose to 24.5 percent during the fourth quarter of 2020[3] from 22.2 percent in the fourth quarter of 2019. While the increase is associated with the impact of COVID, the upward trajectory prior to the pandemic suggests that the rising unemployment has been structural in nature. Further, the slight drop in unemployment in 2022 reflects a shrinkage of the estimated labour force rather than jobs being created. Despite this decline in the rate of unemployment, the extended unemployment rate[4] has been increasing throughout the period under review. In 2019 Q4, this was estimated at 27.5 percent and had reached 31.4 percent by 2022 Q4. Gender disparities were notable in 2022 with high rates of unemployment observed amongst females. Female unemployment was estimated at 27.9 percent compared to 24.0 percent of male unemployment.

19. Over the short to medium term, prospects of a reduction in unemployment remain uncertain. This is because the economy remains centred on the capital intensive mining sector while the extent to which the non-mining economy can grow is limited by the nature of the sectors which mainly serve the domestic market, thus creating limited job opportunities. Nonetheless, it is estimated that at the current growth projection of 3.8 percent in 2023, there will only be 7000 fewer people employed by the end of the year.

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[2] Prices are measured by the Antwerp Diamond Index (1982=100) which is based on prices in US dollars, and gives the average price evolution of polished diamonds in the Antwerp markets.

[3] Notwithstanding, public sector employees have fared very well during 2020, compared to their counterparts in the private sector, as there were no salary reductions or loss of jobs thus cushioning public sector employees from the impacts that others have felt such as cuts in wages.

[4] Defined as the combination of people actively seeking work excluding discouraged job seekers (i.e. those who were willing to work but did not take steps to look for jobs).

20. Government however continues to work towards promoting productive, gainful and decent employment for Batswana through the five (5) strategic focus areas of: Strengthening the growth of employment in the private sector; Reforming the education and training system; Improving the flow of information between job seekers and job openings; Strengthening of employment programmes; and developing a framework for coherent and coordinated policies with systematic monitoring and evaluation, as enshrined in the 2021 Employment Policy. Other notable efforts include promoting mineral beneficiation within the diamond industry in order to create employment opportunities through development of value chains in the industry (see policy priorities for further discussions on this).

Inflation and Interest Rates

21. Botswana's monetary policy framework focuses on maintaining price stability by ensuring inflation is kept within Bank of Botswana's objective range of 3-6 percent. In 2023, domestic prices started to moderate as the impact of high commodity prices that prevailed throughout 2022 eased. The annual inflation rate fell to 4.6 percent **(Figure 3)** during the second half of the year (June 2023) as the impact of falling international fuel prices continued to feed through to the domestic economy.

22. Inflation is forecast to remain within Bank of Botswana's objective range during the next few months. This outlook is subject to some upside risks, including the adverse impact of the Russia-Ukraine conflict, cuts in global oil supplies and unanticipated upward adjustments of administered prices as well as pressures from fiscal policy and Government spending. These risks are, however, moderated by the possibility of weak domestic and global economic activity, as well as restrained commodity prices.

23. Consistent with the low price pressures in the domestic economy, the Monetary Policy Committee of Bank of Botswana maintained the Monetary Policy Rate (MoPr)[5] at 2.65 percent in June 2023 following the cumulative 151 basis points increase in 2022. It is anticipated that the MoPr is likely to remain unchanged reflecting the projected stable inflation outlook. However, this expectation may be reversed if any of the upside risks to inflation materialises.

24. On other developments, Bank of Botswana recently added to its 2022 monetary policy framework reforms by liberalising interest rates and allowing commercial banks to set their own prime lending rate effective 1st April 2023. This move is expected to contribute positively to banking sector developments through promoting competition within the banking industry. To this end, the average prime lending rate for the Month of May 2023 and June 2023 has remained unchanged at 6.76 percent (i.e. Monetary Policy Rate plus about 4.11 percent) across all commercial banks.

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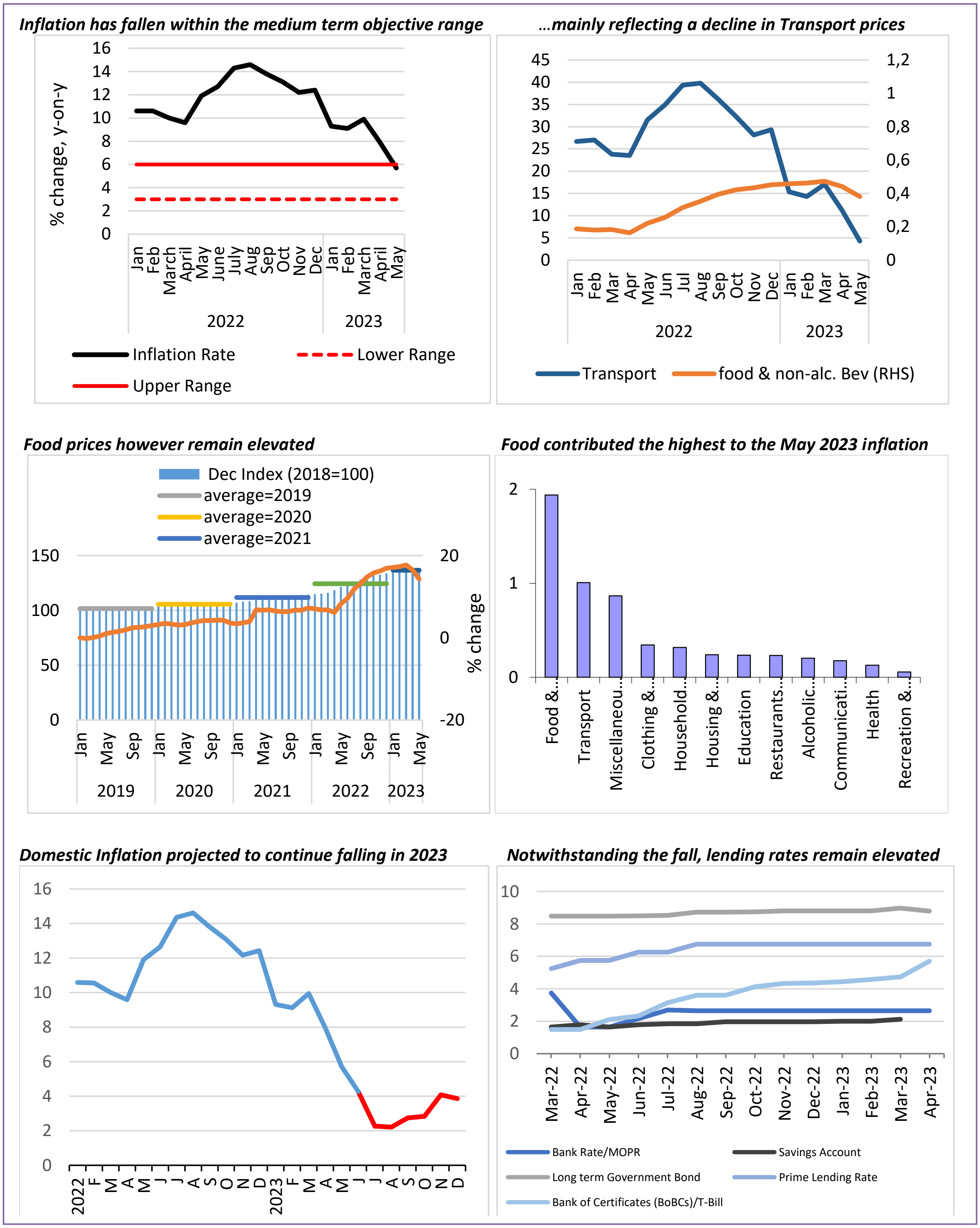
[5] This is the new monetary policy rate corresponding to the yield on the seven-day BoB certificate, adopted in April 28, 2022 as the main instrument of monetary policy following the discontinuation of the Bank Rate.

Figure 3: Inflation Developments



***Source:** Statistics Botswana, 2023*

Monetary and Financial Sector

Exchange Rates

25. Consistent with the objective of maintaining a stable inflation-adjusted trade-weighted exchange rate of the Pula, Bank of Botswana continued to use the flexibility afforded by the exchange rate framework to contribute to the tightening of real monetary conditions amid the high inflationary pressures that prevailed in 2022. The positive inflation differential between Botswana and trading partner countries was higher than the downward rate of crawl, suggesting a loss of international competitiveness of domestic firms. The Bank therefore adopted a downward rate of crawl of 1.51 percent effective on 1st January, 2023 from -2.87 percent in 2022. This was meant to support domestic industry competitiveness, given the unfavourable inflation differential and to ensure that the economy benefits from a measured depreciation of the Pula against trading partner currencies. Nevertheless, in 2022 the real effective exchange rate (REER) appreciated by 2.1 percent **(Figure 4).** Bilaterally, the Pula real exchange rate appreciated by 2.8 and 1.4 percent against the South African rand and the Special Drawing Rights respectively in 2022 but depreciated by 3.0 percent against the US dollar.

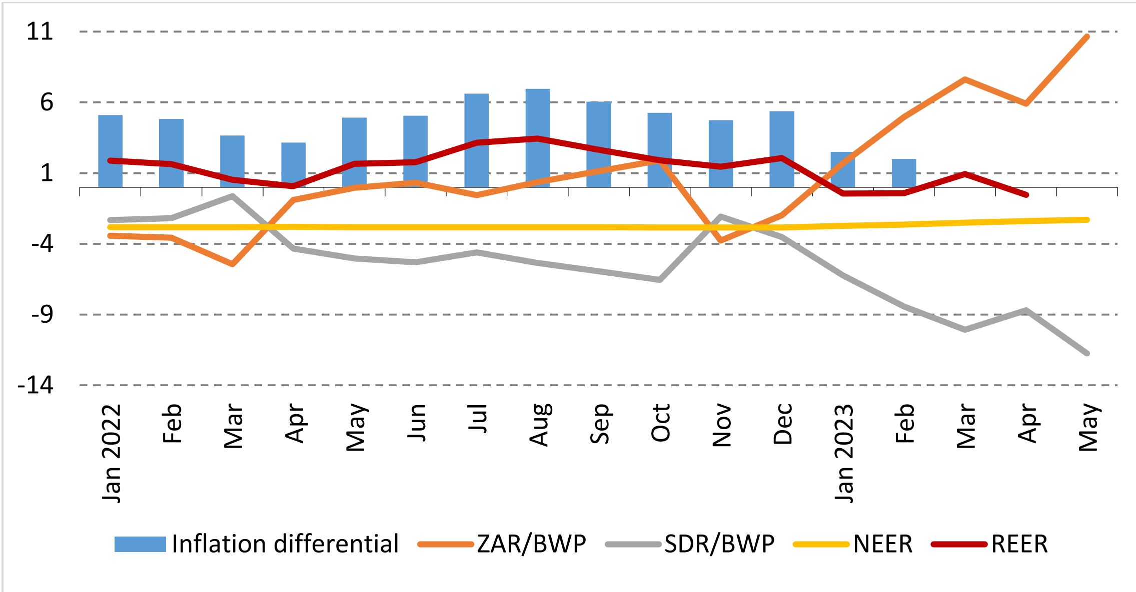
26. The nominal Pula bilateral exchange rate appreciated by 5.0 percent against the ZAR and depreciated by 8.4 percent against the Special Drawing Rights (SDR)[6] in May 2023, compared to the same period last year. The movement of the Pula against the SDR constituent currencies primarily reflects the performance of the ZAR against these currencies, particularly US dollar. For instance, the ZAR weakened against US dollar during 2023 reaching about 19 to the US dollar, while the Pula depreciated against the SDR currencies. Meanwhile, the Pula appreciated against the ZAR reaching about 1.43 by the end of May 2023. Generally, the nominal effective exchange rate (NEER) of the pula depreciated by 2.3 percent during the period under review consistent with the annual downward rate of crawl. On the other hand, the real effective exchange rate (REER) depreciated by 0.5 percent year-on-year during the month of April 2023 because of a lower positive inflation differential between Botswana and trading partner countries which was lower than the downward rate of crawl, suggesting a gain in international competitiveness of domestic firms.

27. Over the short to medium term, the dynamics of the NEER and REER will reflect the interplay between the nominal exchange rate movements and inflation differentials between Botswana and its trading partners. The Pula is expected to appreciate against the ZAR in the short term due to the country's weak economic fundamentals and growth outlook. On the other hand, the Pula is anticipated to depreciate against the SDR constituent currencies. Overall, the projected appreciation of the Pula against the

[6] Comprising the US dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling

South African rand is expected to exert downward pressure on the domestic inflation outlook.

Figure 4: REER, Rand/Pula and SDR/Pula Exchange rates



Source: *Bank of Botswana, 2023*

Balance of Payments and Foreign Exchange Reserves

28. The current account balance recorded a surplus of P7.4 billion in 2022 **(Figure 5),** following periods of deficits in the last three (3) years. This increase was primarily underpinned by a surge in diamond exports, which rose by 20.4 percent owing to the recovery in demand in major rough diamond markets, particularly the US, and most recently due to spill-over effects from the Russian invasion of Ukraine.

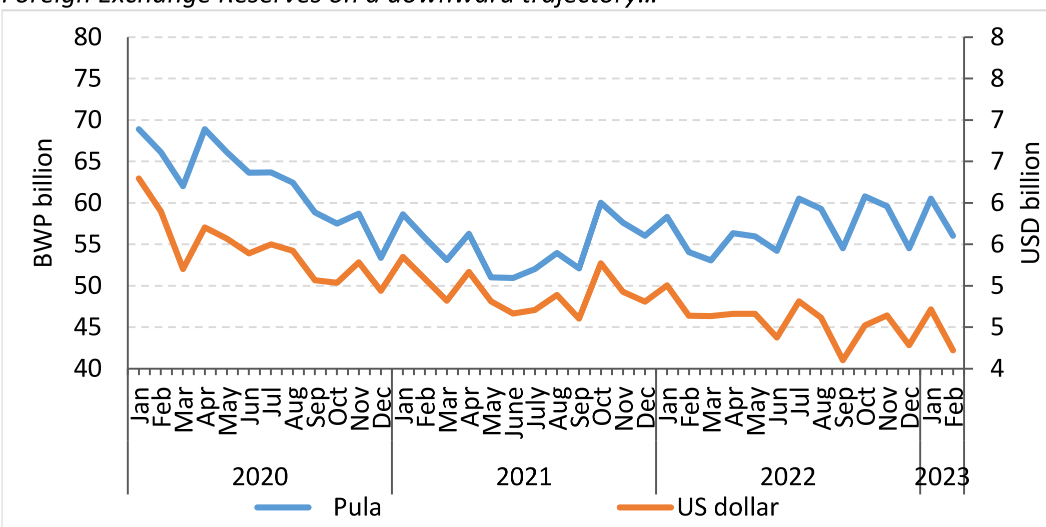
29. Notwithstanding the increase in the current account balance, the level of foreign exchange reserves showed a decline to P54.5 billion in December 2022 from P56.0 billion in December 2021. This reflected to a large extent asset price valuation losses related to the impact of higher interest rates in global financial markets during this period. Measured in terms of foreign currency, the reserves amounted to USD4 281 million which is a fall of USD525 million (10.9 percent). More recently, reserves showed an increase of 17.7 percent to P65.9 billion in May 2023 from May the previous year. The increase was attributed to increased mineral inflow receipts and exchange rate gains due to the depreciation of the pula against the US dollar over this period.

30. At the current level, reserves are equivalent to 9.9 months of non-diamond import cover, which is low by historical standards. With the current macroeconomic landscape, prospects for 2023 are less favourable, with risks that the ongoing weak global demand for diamonds could put additional pressure on the inflow of mineral receipts.

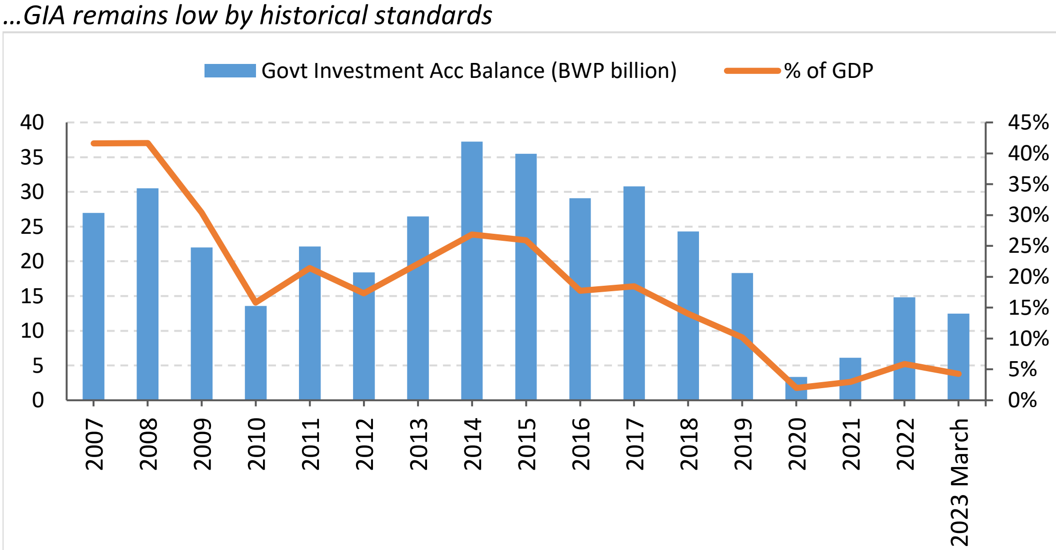
31. While the GIA has shown some recovery over the past years, reaching P14.8 billion in December 2022 (and more recently P18.6 billion in May 2023) compared to P14.9 billion a year earlier, it is important to note that the GIA remains low. Low GIA levels limit the extent to which Government can draw on its reserves to finance future budget deficits, leaving borrowing as the main financing option. Caution is therefore required, to replenish the country's buffers as much as possible, with the knowledge that the opportunity to do so may be short-lived and that these may be required to support the economy in the event of a sharp slowdown in global growth.

Figure 5: External Sector Developments

Foreign Exchange Reserves on a downward trajectory…



Government Investment Account recovering, but at a slow rate…
…GIA remains low by historical standards



Source: *Bank of Botswana, 2023*

Financial Sector

32. Botswana's financial system has remained sound with substantial capital buffers in the banking sector to withstand a deterioration in asset quality. For instance, there has been a significant decrease in the percentage of Nonperforming Loans (NPLs) to Total Loans[7]. NPLs reduced by 1.4 percent to 4.3 in 2021 and by 12.4 percent to 3.8 in 2022. Much of the reductions in NPLs in 2021 could be attributed to the COVID-19 economic support measures (6-month loan repayment moratorium, loans restructuring, and guaranteed loans to affected sectors). In addition, commercial banks remain adequately capitalized[8] and maintain satisfactory levels of profitability[9].

33. Annual bank credit growth rose, reaching 6.0 percent by the end of December 2022 from 5.1 percent the same period in 2021. Over this period, changes in growth in credit to firms have accelerated faster than credit to households, with business credit averaging 6.8 percent while household credit averaged 5.4 percent. Despite this, the concentration of loans in the household sector (over 60 percent of the total) remains a source of risk, with much of this attributed to unsecured lending[10] at around 70 percent of household credit. Nevertheless, overall rate of growth of credit slowed in the second quarter of 2023 after sharply rising by 11 percent earlier in the year.

34. Despite the sound financial sector, there are downside risks associated with the declining trend in household deposits against an increase in loans to the same **(Panel c of Annex 1)**. This poses risks to the ability of the banking sector to maintain adequate liquidity to extend credit in the future. There are also risks of sovereign debt risks resulting from direct and/or indirect influences of government operations on household income.[11]. On the upside, positive inflation outlook may moderate risks in the financial sector, reducing pressure for interest rate hikes. However, the situation is contingent upon the Russia-Ukraine war, which, if prolonged and intensified, could impact conditions and have implications for prices and monetary policy.

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[7] NPLs/Loans thresholds indicate that the risk of bank failure is very low if the ratio is less than 5 percent

8 Ample capital buffers were recorded as capital adequacy ratios were well above the minimum requirements. Basel Committee on Banking Supervision (BCBS) has prescribed minimum regulatory capital of 8 percent of RWA for all internationally active banks. Basel III (a global regulatory framework for more resilient banks and banking systems) effectively raises this minimum to 10.5 percent through the introduction of the 2.5 percent capital conservation buffer.

9 The return on equity (ROE) ratio increased from 17.3 in 2020 to 21.34 percent in 2021 and 30.9 percent in 2022. ROE thresholds indicate that the risk of bank failure is very low if the ratio is more than 20 percent.

10 This is personal advances and credit card loans.

11 Monitoring fiscal developments closely is crucial to assess any potential correlation with bank balance sheets. This correlation serves as a valuable indicator for obtaining a comprehensive understanding of the financial sector developments.

Domestic Capital Market

35. The capital market serves as a mechanism for transforming savings into financing opportunities and is a potential vehicle for raising capital to finance various development projects. The Botswana Stock Exchange Domestic Company Index (DCI) continued to show improvements post the COVID-19 recovery, on the back of strong economic activity throughout 2021 to 2022. The DCI, which was affected by the impact of COVID-19 has since recovered due to improved trading conditions and increased corporate earnings. Figure 9 shows that DCI increased by 10.2 percent in pula terms during 2022 from 1.9 percent a year earlier.

36. On the other hand, the (debt) securities market, which primarily deals with the trading of bonds and treasury bills showed an increase in yields of some Government securities in line with the high interest rate environment that prevailed throughout 2022. More specifically, yields on bonds maturing between two years and five years increased moderately from 5.5 percent to 6.6 percent between January and December 2022. Meanwhile, yields of longer-term maturity[12] have to some extent remained flat on the longer end of the yield curve, indicating the lesser impact of monetary policy tightening on these securities. On the other hand, monetary policy has had a larger impact on yields of short term securities, which increased significantly from 1.96 percent in January 2022, to 5.1 percent in December 2022.

37. Over the short to medium term, the outlook for the domestic capital market remains uncertain. First, on the equity side, the anticipated slowdown in economic activity in 2023, could a reduce gains in the equities market, while higher interest rates are anticipated to continue supporting interest income among financial service providers. On the other hand, yields on debt instruments could potentially remain unchanged or fall reflecting low pressure to hike interest rates as a result of the moderate inflation outlook. Beyond this, Government's initiatives aimed at developing the domestic capital market are anticipated to continue supporting growth of the bond market.

38. Further to this, Government recently launched the 2023/2024 Government Borrowing Strategy and a revamped Issuance Calendar. It is anticipated that this will help contribute towards improved diversity of market participants as well as expansion in terms of quantum of issuance and trading activity in the bond market.

[12] BW0013 - 2 year; BW007 - 5 year; BW014 and BW011– 10 year; BOTSGB0635, BW012 and BW015 – very long maturity. T- Bills ≤1 year, where securities bonds generally account for the highest share (91 percent) compared to only 9 percent of securities with short term maturity (T-Bills). The BOTSGB0635 was recently issued in June 2023, replacing the BW0013 which matured on 7th June 2023.

III. FISCAL POLICY DEVELOPMENTS

Budget Outturn for 2022/2023

39. 2022/23 data shows total revenue and grants improved by P5.65 billion or 8.25 percent from P68.57 billion in the financial year 2021/2022 to P74.10 in the current financial year. The improved performance is largely due to increase in mineral revenues. The high performance of mineral revenue is mainly due to an improvement in the demand for rough diamonds. Specifically mineral revenue grew significantly by 45 percent to register P33.8 billion in 2022/23, compared to P23.2 billion in 2021/22. Non mineral income tax also showed an increase over the same period registering P14.3 billion in 2022/23, compared to P12.5 billion in 2021/22. This increase was is accounted for by, among other things, the effects of a 5 percent upward adjustment of public officers' salaries effected in FY2022/23. VAT recorded a decrease of 14 percent to P9.4 billion, the underperformance of VAT was due to the reduction of VAT rate from 14 percent to 12 percent for the last eight months of the financial year. This reduction was to cushion households against the high inflation. Meanwhile SACU receipts fell from P14.1 billion in 2021/22 to P13.8 billion in 2022/23, due to downward adjustments following weaker performance during FY2020/21.

40. On the expenditure side, budget outturn indicated that total expenditure and net lending was P74.09 billion and increase from 68.5 billion in 2021/22. This increase was mainly due to higher recurrent spending, particularly personal emoluments which rose by 8 percent from 30 billion in 2021/22, compared to 32 billion in 2022/23. Other charges recorded a slight increase of 3 percent to 10.8 billion in 2022/23 from 10.4 billion in 2021/22. Meanwhile, Grants and Subventions decreased by 1.2 percent to 15.6 billion in 2021/22 from 15.7 billion 2022/23. Development spending stood at P14.3 billion in 2022/23, representing an increase of 20.3 percent from P11.8 billion in 2021/22. Despite this increase, development expenditure remained lower when compared with the revised budget of P21.4 billion.

Overall Balance

41. Overall, the 2022/23 budget balance pointed a surplus of P10 million (0.0 percent of GDP), compared to a deficit of 104 million that was recorded in the previous financial year.

IV. STRATEGIC OBJECTIVES AND BUDGET PRIORITIES FOR 2024/2025

42. The 2024/2025 budget marks the end of the second TNDP which will pave way for the National Development Plan 12 (NDP 12). The 2024/2025 financial year will set a strategic tone and foundation of sound fiscal and monetary policies required to provide a stable macroeconomic environment which will be necessary for the implementation and performance of NDP 12.

43. It is therefore important to accelerate a development agenda that coincides with; achieving a growth rate in line with the nation's aspiration to become a High Income Country by 2036, job creation, achieving fiscal sustainability, economic diversification as well as improve livelihoods. Due to prevailing uncertainties in the global space and associated risks posed by these developments, the stability of the macroeconomic environment remains under threat. For 2023, the domestic economy is anticipated to grow at an average growth rate of 4 percent, unemployment also expected to remain in double digit figures slightly over 20 percent while inflation is expected to remain low.

44. Strategic objectives and budget priorities set for the 2024/2025 financial year are in line with the nation's guiding policy frameworks as outlined in the TNDP, Reset & Reclaim Agenda, and Vision 2036 as well as the global agenda of achieving Sustainable Development Goals (SDGs). These priorities are consistent with the aspiration to attain an annual average growth rate of real GDP of 6 percent and an unemployment rate of 5 percent as espoused in Vision 2036.

45. Following the overarching vision of Government to attain High Income status, the 2024/2025 budget priorities will focus on *Supporting Export-led growth and attracting inward FDI, Supporting the private sector through business environment reform and value-chain development, Innovation and digital transformation, Financial sector reform, Infrastructure development and spatial planning, Green transition, Fiscal sustainability and Education and human capital development*

46. Central to these priorities is building socio-economic resilience for the most vulnerable population of our society. Government remains devoted to initiating programmes to support social welfare of Batswana and find ways to advance efficacy across the social welfare system to ensure that even the most vulnerable are cushioned against the extremities of unforeseeable shocks. The Old Age Pension Scheme, Destitute Allowance, Disability Allowance, Orphan Care programme, Ipelegeng programme are some of the initiatives that Government continuously implements in order to support and uplift the most vulnerable groups.

Export-Led Growth and Attracting Inward FDI

47. It is government agenda to diversify exports and promote the growth of non-diamond goods and services to ensure sustained growth and diversification. Government will continue to accelerate the agenda to reach high-income status by supporting measures and initiatives towards an export-led growth. This growth path is expected to ensure the attainment of necessary economic transformation which will create sustainable jobs, reduce poverty and inequality. In addition to policies or enablers of export-led growth, government will invest in and mobilise more resources towards

infrastructure development, prioritise value chain development, continue to introduce the necessary business reforms and remove unnecessary regulations which impedes the operations of businesses.

48. The conducive business enabling environment that will be created will attract the associated foreign direct investment (FDI), which will in turn promote competition in the domestic market, skills transfer, technological advancement, productivity, capital inflows as well as strengthen access to global markets and integration into global value chains. The continuous provision targeted interventions to build the capacity of potential and current exporters, enhancing their competitiveness, linking them to new clients, and to improve the business environment for exporters will be supported by the Botswana Exporter Development Programme (2020 – 2024). There is need to build the capacity of local private sector to produce products that are competitive in the international markets.

49. Further to this, the Special Economic Zones will continue to be utilised to attract medium and large firms involved in producing for export. The priority sectors that government will concentrate on for export led include but not limited to leather and leather Products, meat and meat products, horticulture, jewellery and semi-precious stones and manufacturing.

Supporting the private sector through Business Environment Reform and Value-Chain Development

50. In 2024/2025 financial year, Government will continue to promote and explore value chain development opportunities in key strategic sectors covering tourism, minerals, manufacturing, energy, and agriculture. As the country intensifies regional and global economic integration, attention should be placed on the development of value chains. These strategic value chains sectors are expected to unlock various benefits and opportunities including but not limited to jobs creation, foreign direct investment, improving livelihoods, industrialization, private sector competitiveness, skills transfer and most importantly broaden the export portfolio. In addition, Government will in continue to recognise Special Economic Zones (SEZs) as a pivotal approach of attracting FDI, boosting domestic investment and promoting export-led value chains. This is mainly due to SEZs model of an attractive taxation regime and other incentives such as tax exemption on property transfers.

51. In an effort to accelerate the impact of export-led value chains on the economy, Government will prioritises necessary policies and enablers to support this mission which will include business environment reform, investing in productive infrastructure and removal of any regulations which serves as impediments.

52. Promotion of mineral beneficiation within the diamond industry will be highly emphasised as a deliberate approach to develop value chains that will significantly create sustainable employment opportunities and reduce poverty and inequality. Value Chain opportunities such as sorting, cutting, polishing and jewellery manufacturing will be explored as beneficiation by the private sector. The agreement in principle between the Government of Botswana and the De Beers Group for a new 10-year Sales Agreement and a 25-year extension of the Debswana mining licenses solidify the Government's aspiration of exploring opportunities and creating jobs in the diamond value chain.

53. Government will also explore opportunities in the Non-diamond mining sector by mobilising the private sector to invest in other mining activities as well as beneficiation of base metals such as copper, nickel, iron ore. Other priority sectors includes manufacturing, horticulture, livestock and dairy.

54. The private sector requires a supportive environment, including laws, regulations, public institutions and a competitive environment necessary to support the growth of the sector. Appropriate business environment reforms will be put in place as part of government's commitment towards recognising the importance of and role of private sector in the economy.

Innovation and Digital Transformation

55. Fostering digital inclusion is of paramount importance hence Government in the 2023/2024 financial year committed to a budget of two billion, six hundred and twenty million Pula (P2.62 billon) for projects under this priority area. The Government continues to accelerate the implementation of the digital transformation strategy for Botswana (SmartBots) through a whole-of-government approach. Leading projects that continue to be deployed include: setting-up a vaccine manufacturing plant, effectively monitoring and evaluating programmes and projects through a digital dashboard to ensure the attainment of the national visions and improved citizen satisfaction.

56. SmartBots projects and initiatives that have since commissioned and gained momentum include: a reference framework for building the public sector and citizens' digital competencies with a clear scope of digital competency components; establishing a National Research and Education Network that connects research and academic institutions to high-speed internet, and interlink to regional and global network to collaborate and share resources; accelerated development of Open Science and Open Data policies for improved quality of research, development and innovation, and efficiency of intellectual output to support the transition towards a knowledge-based economy; a tailored digital entrepreneurship package for women in the informal

sector and for SMMEs aimed at building their capacities to compete and flourish in the digital space; development of an integrated prisons security solution to ensure the safe and secure custody of offenders, and public safety; and the Maun Science Park, a state-of-the-art project for resilient and sustainable living, stimulating global knowledge and 4IR technology with local tribal wisdom and culture in Botswana.

57. Phase 1 of the Village Connectivity project that connects 144 villages is expected to be completed by end of August, 2023 while phases 2 and 3 targeting 61 villages will be completed by the end of financial year, 2023/2024. Government's plan to further connect more villages will continue in 2024/2025 financial year with phase 4 targeting 301 villages.

58. In line with strategic priority of digital transition, as entrenched in TNDP, Government concentrated digitisation efforts on putting online services offered by Government to both citizens and businesses. Over 140 online services covering import and export permits; tourism permits; licenses and permits application; tertiary student financing, eHealth among others have been successfully launched. More than 400 online services are expected to be covered over the next two financial years. For the next budget, Government is looking into digitizing services that promote Government to Government (G2G) and Government to Employee (G2E) interactions.

Financial Sector Reform

59. For the fiscal year 2024/25, the government will continue to prioritize the advancement of our financial sector, building upon our longstanding commitment to reform and development. The government will continue to enhance access to financial services for both businesses and households while fostering a competitive and diverse range of financial products and services that drive economic growth. Additionally as part of the ongoing effort, the government will further streamline regulations and modernize our banking infrastructure, facilitating smoother and more accessible online banking experiences for all citizens.

60. In the same vein, during the 2024/25 financial year, the government is committed to embrace technological advancement. A pivotal undertaking entails the establishment of a cutting-edge national payment switch, fostering seamless, real-time, and cost-effective digital connectivity across a spectrum of financial services. This landmark initiative aims to catalyze the adoption of digital payments, reducing reliance on cash transactions and stimulating a modernized economic system. As we navigate the ever-evolving fintech landscape, the government will diligently assess and adapt to emerging trends, ensuring that digital currencies and novel financial service providers are harnessed for the collective benefit.

Infrastructure Development and Spatial Planning

61. Infrastructure development continues to be a national priority as Botswana aspires to become a high-income country. Economic development and growth rely on infrastructure as it facilitates the smooth running of other sectors of the economy, including, value chains and services. Efficient utilisation of other infrastructure delivery methods such as Manager Development Model and Public Private Partnerships (PPPs) can bring about desirable outcomes. It is also expected that the overseeing of the planning and monitoring functions by the National Planning Commission will yield much results in infrastructure projects delivery. In order to avoid mismatches and for efficiency, it is necessary that infrastructure planning be in sync with the National Spatial Plan. Development of sustainable and resilient infrastructure is key to achieving Sustainable Development Goal (SDG) 9.

62. During the 2024/2025 financial year, investment in productive infrastructure such as road refurbishment/improvement; urban/major village infrastructure; cross-border connectivity, including one-stop border posts and new railway links; water infrastructure; electricity grid strengthening, especially to accommodate variable renewable energy and electricity exports; well-targeted rural infrastructure to support agriculture will entail continuation and completion of projects which commenced in 2023/2024 as well as new projects. Maintenance of existing infrastructure will be critical towards improving the infrastructural outlook required to attract investors and contribute significantly to economic development and job creation.

63. The National Spatial Plan (NSP) will support the necessary transformation of the economic development trajectory by ensuring optimum use of land resources in order to promote relevant uses and provision of infrastructure in appropriate places. The synergy between economic planning and physical planning will be emphasised to avoid misalignment and implementation problems.

Green Transition

64. In terms of the environment, society, and economy, climate change has over time had imminent implications on GDP drivers both nationally and globally. The primary concerns are the worsening energy and water shortages brought on by rising temperatures and shifting rainfall patterns, as well as the productivity losses in rangelands and decreased agricultural yields, which are seriously endangering food security, the tourism industry, the ecosystem, and biodiversity because these sectors are dependent on the climate. If proper adaptation and mitigation measures are not put into place, the susceptibility of these economic elements will continue to rise, which will have a severe effect on the ecosystem, human health, and accelerate the

development of diseases linked to climate change. This therefore calls for government to strengthen efforts geared towards access to climate financing.

65. The Botswana National Climate Strategy, which supports the nation's objective of creating a society that is suitable, climate-resilient, and those whose development follows a low carbon emission pathway, is one of the government's response measures. The goal of the Strategy is to give Botswana the necessary direction so that it can reduce its carbon footprint and become more resilient to the effects of climate change. Additionally, it commits to establishing guiding principles that help monitor economic activities that support climate change resilience, comprehensiveness that lessens Botswana's vulnerability, adaptation and mitigating measures that provide guidance on how to adapt to climate change with specific dedicated measures that reduce the potential carbon footprint and sustainably achieve desired emission reductions, as well as educational and research developments that inform on the risks, adaptation, and mitigation of climate change.

66. Furthermore, Botswana has agreed to a number of obligations to the international world through its updated Nationally Determined Contribution (NDC), which has been submitted to the United Nations Framework Convention on Climate Change Secretariat. Through such agreements, the nation agrees to support international efforts to reduce greenhouse gas emissions until they reach net zero. By switching from carbon-intensive to low carbon activities, this entails altering the character of economic activity and development.

67. The TNDP's Public Investment Program (PIP) for climate change resilience projects comprises both new and continuing initiatives, such as community rangelands restoration and the management of pesticides and containers that have reached the end of their useful lives. In order to reduce greenhouse gas emissions and ultimately advance the green livestock value chain, the program intends to address land degradation through bolstering institutions, support systems, ecosystem services, biodiversity, and regenerative grazing. Additionally, it will manage land pollution to help fulfil national priorities like food and water security, while also assuring long-term sustainability and preserving livelihoods, food and water security while ensuring long-term sustainability and safeguarding livelihoods.

Fiscal Sustainability

68. In the pursuit of a resilient and prosperous future, Botswana places fiscal sustainability at the forefront of its strategic priorities for the 2024/25 financial year. Recognizing the profound impact of sound fiscal management on economic stability, enhancing public service delivery, and global competitiveness, the government is steadfastly

committed to charting a path that ensures responsible financial practices and secures the nation's enduring success. For the fiscal year 2024/25, Botswana's government is unwavering in its pursuit of fiscal sustainability, undertaking a multifaceted approach to ensure long-term economic resilience. The government is dedicated focus on controlled expenditure growth aligned with revenue trends, the government is poised to gradually reduce spending relative to GDP, fostering a stable fiscal foundation.

69. The government is committed to achieving fiscal sustainability through a series of strategic actions. These include managing the growth of the public sector wage bill to ensure it rises more slowly than GDP and overall government spending. Additionally, the government will prioritize development projects based on agreed criteria to maximize returns and impact within available fiscal resources.

70. To enhance financial transparency, the government will modernize its accounting system, transitioning to accrual accounting for a more accurate financial overview, and expanding transparency to cover Special Funds and off-budget items. Efforts will be made to replenish and build up the Government Investment Account (GIA) and Pula Fund to create a buffer against economic shocks and secure future income as mineral revenues decline.

71. Diversifying revenue sources is another crucial step, addressing under-taxed activities, improving revenue collection efficiency, and addressing gaps. The government will also focus on bolstering local authority finances, promoting self-sufficiency and proper revenue management. Lastly, to ensure long-term fiscal sustainability, the government will establish a robust Fiscal Rule, curbing expenditure growth and restoring the accumulation of financial savings.

Education and Human Capital Development

72. Botswana recognizes the transformative potential of investing in a knowledge-based economy where knowledge, innovation and technology drive sustainable economic growth and development. Knowledge creation and the application of knowledge has become central to economic growth. However, there is a noticeable mismatch between the available human capital and the requirements of employers and the overall economy. While some gaps can be attributed to a lack of skills training, the widespread issue of graduate unemployment implies that it is not the only factor at play. It is possible that tertiary education is producing an excess of graduates in fields with limited demand in the job market, while there is a shortage of graduates with STEM skills and vocational expertise.

73. For the 2024/2025 financial year, there will be a continued commitment to identifying areas for reforms in order to enhance the delivery of education and training in the

country with the aim of exploring alternatives and make improvements. One of the in progress initiative planned under Education is the review of General Education Curriculum to support outcome-based education in line with Education and Training Sector Strategies Plan (ETSSP). ETSSP is intended to enhance the alignment between educational qualifications and the evolving demands of the labour market. This alignment aims to ensure that educational outputs are better suited to meet future employment needs. Additionally, ETSSP seeks to enhance overall outcomes for learners by addressing concerns regarding quality, relevance, access, equity, and accountability across the entire education sector, spanning from Pre-Primary schooling to the Tertiary level.

74. During the 2024/2025 financial year, the government will continue execution of various infrastructure projects as a means of moving the Country to a knowledge based economy. One of the projects is the Development of Primary Education Services. The Programme aims to tackle certain aspects of the Revised National Policy on Education, which promotes a classroom ratio of 30 pupils to one teacher **(30:1)** in all public schools. This objective aligns with the government's focus on education and human capital development as a key priority.

75. In addition, the Government will finance New Rapid Skills Centres with the aim of providing accelerated and focused training programs to develop essential skills. These centres are designed to equip individuals with the necessary competencies to meet the demands of the rapidly evolving job market.

V. STRATEGIES TO ADDRESS PROJECT IMPLEMENTATION CHALLENGES

76. Botswana faces project implementation challenges. Most of the implementation challenges are experienced in the infrastructure sector, and this has often led to cost overruns, implementation delays, adoption of projects with low returns and a failure to prioritise. The most common challenges are the ones relating to: inadequate project planning, inclusion of projects in the National Development Plans impulsively without having done proper costing and thorough project appraisal; inadequate skills in project management in both government and private sector; delays in commencement and progress in delivery of projects and limited capacity to implement large scale projects.

77. In an endeavour to address the above challenges, government has adopted the new procurement method being the Development Manager (DM) model to assist in improving the delivery of infrastructure projects. In addition, government has adopted the three (3) Stage Project Appraisal concept and this will be applied in the next NDPs. Government will commit resources towards capacity building on this new project appraisal process. These are relatively new ways of ensuring improved

efficiency in projects delivery, in line with the government's transformation and reset agenda.

Development Manager Model

78. Under this method, the DM is expected to produce a comprehensive scope of the project and come up with designs, and then run with the procurement process, construction and provide management services associated with facilities and infrastructure projects from inception to close out. The advantage of using this method is the efficiency gains associated with it and also cushioning of the Government from the different risks associated with delays in project implementation and delivery (design, construction and financial risks).

Three (3) Stage Appraisal Concept

79. Major development projects will be subjected to a three-stage assessment process before inclusion in the Public Investment Programme (PIP) of the National Development Plan. The appraisal process will include both pre-feasibility for an initial screening, and, in due course, a full feasibility study. This new three-stage process will achieve two main objectives being: higher quality project preparation, with more information required to pass through the assessment process; and a clear basis for project prioritization, based on an objective assessment of project returns and achievement of national development priorities.

VI. MEDIUM-TERM PROJECTIONS

Medium Term Fiscal Forecasts

80. The three-year medium term fiscal framework points to a widening of the fiscal deficit in the 2023/24 fiscal year, before narrowing towards a small surplus by 2025/26. The higher deficit in FY2023/24 reflects mostly higher budgeted capital expenditure as part of the TNDP and lower revenue due to lower mineral receipts in line with anticipated weak global prospects. The lower revenues also reflect lower SACU transfers due to a projected fall in Botswana's share as a result of exchange rate valuation losses, due to a stronger pula against the South African rand. This is partially offset by relatively higher diamond revenue due to a projected depreciation of the pula against the US dollar, large increase in non-mineral income tax due to salary increment and VAT receipts on account of the reinstatement of the VAT rate. Thereafter, in **FY2024/25** and FY2025/26, the fiscal deficits are expected to reduce significantly by about 2.7 percent of GDP, moving to almost a balanced budget and

surpluses consistent with Government's fiscal consolidation plan and main objective of rebuilding buffers.

81. For the 2023/2024 financial year, Total Revenues and Grants are projected to reach P81.7 billion, while Total Expenditure and Net Lending is expected to register P87.4 billion, resulting in a budget deficit of P5.7 billion, or -2.0 percent of GDP (table 2). This compares to a small surplus of P10 million in FY2022/2023. For the **2024/25 financial year,** Total Revenue and Grants are projected at **P83.7 billion,** while Total expenditure and Net Lending is expected to record **P88.8 billion.** Meanwhile, total revenue and grants are projected at P93.2 billion in FY2025/26, while expenditure is estimated at P90.9 billion. The fiscal balance is projected to slightly narrow to a deficit of **P5.1 billion or -1.6 percent of GDP in FY2024/25** before reaching a surplus of P2.3 billion (equivalent to 0.7 percent of GDP) in FY2025/26. The non-resource primary balance for FY2024/25 is however projected at **P30.9 billion, which is equivalent to -10.0 percent of GDP.**

82. The **Gross Financing Requirement** for financial year 2023/24 and 2024/25 is forecast to be P10.8 billion (budget deficit). It is anticipated that this shortfall will be financed through a combination of three financing options: net issuance of domestic Government securities, in the form of bonds and Treasury Bills, which is anticipated to provide P5.9 billion; net external financing, from official multilateral and bilateral lenders, which is projected at P3.5 billion (should all the envisaged budget support loans be disbursed in the year); and P1.6 billion expected to be drawn from the Government Investment Account over these two years.

Table 2: Medium Term Fiscal Forecasts (P' million), 2020/21-2025/26

	2022/23 Preliminary	2023/24 Original Budget	2023/24 Revised Budget	2024/25	2025/26	2026/27
Total Revenue and Grants	**74,098**	**79,788**	**81,669**	**83,688**	**93,193**	**101,571**
Mineral Revenue	33,815	23,339	26,457	28,431	35,730	39,975
Customs & Excise Revenue	13,845	24,934	23,930	21,378	21,337	22,609
Non-mineral Income Tax	14,319	14,767	15,910	17,389	18,634	20,165
VAT	9,372	13,301	12,003	13,119	14,058	15,213
BOB Revenue	425	829	829	700	700	700
Other Revenue & Grants	2,322	2,618	2,540	2,672	2,734	2,910
Total Expenditures and Net Lending	**74,088**	**87,378**	**87,378**	**88,775**	**90,884**	**94,664**
Recurrent Expenditure	**59,714**	**66,511**	**66,511**	**67,457**	**68,602**	**71,374**
Personal emoluments & pensions	31,777	34,438	34,438	35,127	35,654	37,307
Other Charges	10,769	13,104	13,104	13,389	14,933	16,724
Grants & Subventions	15,553	16,600	16,600	16,403	15,774	15,592
Interest payments	1,615	2,369	2,369	2,538	2,241	1,750
Development Expenditure	**14,270**	**21,008**	**21,008**	**21,412**	**22,375**	**23,382**
Net Lending	**104**	**-141**	**-141**	**-94**	**-93**	**-92**
Overall Balance	**10**	**-7,590**	**-5,709**	**-5,087**	**2,309**	**6,908**
Overall Balance as % of GDP	*0.0%*	*-2.8%*	*-2.0%*	*-1.6%*	*0.7%*	*2.0%*
Non-Resource Primary Balance	**-32,190**	**-28,560**	**-29,797**	**-30,980**	**-31,179**	**-31,317**
as % of GDP	*-12.4%*	*-10.6%*	*-10.5%*	*-10.0%*	*-9.6%*	*-8.9%*
GDP at current prices	***259,748***	***268,198***	***284,709***	***308,308***	***325,544***	***351,504***
FINANCING	***-10***	***7,590***	***5,709***	***5,087***	***-2,309***	***-6,908***
External Loans	697	4,444	6,971	173	173	0
Internal Loans	13,464	15,584	15,584	16,750	10,000	7,450
Less Amortisation (External)	-1,712	-1,778	-1,778	-1,817	-2,291	-2,004
Less Amortisation (Internal)	-9,836	-12,585	-12,585	-13,765	-7,013	-7,000
IMF Transactions	-108	-250	-250	-80	-80	-80
Other Financing	-1,688	-10	-10	-10	-10	-10
Change in Cash Balances	-826	2,185	-2,223	3,836	-3,088	-5,263

Source: *MoF, July 2023*

83. Looking ahead, risks remain elevated and skewed to the downside, owing to uncertainty around the Russia-Ukraine conflict. The worsening of the war implications on demand could worsen the outlook for diamond revenues. Further, any associated supply disruptions from the war pose risks to potential rebound in inflation, and tighter financial conditions which could hamper monetary-fiscal coordination. The long term decline in Government balances at Bank of Botswana, is putting downward pressure on borrowing requirements through limiting the extent to which Government can draw on its savings to finance the budget with a recourse to foreign savings. Slower implementation of the planned fiscal consolidation could further erode fiscal and external buffers, increasing Botswana's vulnerability to external shocks, with negative effects on growth and fiscal sustainability.

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Public Sector Debt Dynamics and Outlook

85. The IMF Debt Dynamics Toolkit and the latest macro-fiscal profile are used to analyse the medium-term risk of debt distress. This analysis, as presented in Table 3 is centred on Government's debt-burden and its repayment capacity (i.e., Debt - GDP ratio). The data suggest that, in the recent past, even though the debt to GDP ratio is within the statutory debt ceiling of 40 percent of GDP, it slightly trended upwards due to among others, structural deficits experienced over the years. For example, the debt-to-GDP ratio averaged 22.2 percent between FY2014/15 and FY2020/21 and is estimated to have slightly decreased by 1.6 percentage point to 20.6 percent in 2022/23. The recent drop in public debt is attributed to improved primary budget deficit and a strong recovery in economy growth. Preliminary data indicates that total Government Debt stock (including sovereign guarantees) as at 31 March, 2023, stood at P50.41 billion. This was constituted by P21.93 billion in external debt, and P28.48 billion owed to domestic lenders.

86. Looking ahead, the debt to GDP ratio is projected to reduce gradually over the medium-term. The ratio of public debt and guarantees is expected to reach 18.2 percent of GDP in FY2026/27 from 21.3 percent of GDP estimated in FY2023/24. This suggests a cumulative decline in the debt ratio of 2.4 percentage points of GDP. The bulk of this decrease is expected to be driven by an improved economic performance in years ahead and better fiscal policy execution in the medium term and as highlighted in Section 2 and Section 4, respectively.

87. Despite this positive outlook, downside risks to growth prospects due to the uncertainties around Russia-Ukraine conflict, looming USA recession and unanticipated public spending which might put more pressure on the primary deficit. These risks may undermine Government's short to medium term fiscal strategy of running surpluses and **re-building of financial buffers** and in the process increase

the likelihood of debt distress. Such agility in the management of the policy framework can strengthen fiscal and debt sustainability.

Table 3: Debt and Economic Indicators

	Actual		Est.	Projections			
	2014-15 - 2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Nominal gross public debt	22.2	22.1	20.6	21.3	21.6	20.0	18.2
Of which: guarantees (uncalled)	5.3	3.4	2.8	2.5	2.1	1.9	1.8
Real GDP growth (in percent)	1.5	11.9	5.8	3.8	4.4	4.5	4.1
Inflation (GDP deflator, in percent)	3.1	6.7	12.2	5.8	4.8	4.8	4.5
Nominal GDP growth (in percent)	4.6	19.4	18.7	9.8	9.4	9.5	8.8
Effective interest rate (in percent)	2.8	3.4	3.1	4.0	4.1	4.1	4.1

Source: *MoF Calculations, 2023*

VII. RISKS TO MACROECONOMIC OUTLOOK

88. Despite a moderation of risk factors that prevailed throughout 2022, the domestic economy is not yet out of the woods. Emerging and prevailing risks, particularly those that pose future challenges to the current growth projections are discussed below. These include (i) global developments and growth; (ii) economic diversification; (iii) private sector development; (iv) revenue risks; (v) expenditure risks; (vi) exchange rate; (vii) accumulation of buffers; (viii) commodity price instability/inflation and monetary policy; (ix) capacity constraints; and other risks.

89. While global growth prospects remain subdued, downside risks could escalate with a worsening of the geo-political tensions in Ukraine. This could further weaken demand especially in major advanced economies with implications on demand for rough diamonds whose production is set in line with developments in global market conditions. The first quarter of 2023 realised an expansion in diamond production of 10.8 percent relative to 23 million carats that were produced over the same period in 2022. However, prospects for the remainder of the year remain uncertain and could be revised lower than is currently projected if the situation worsens in line with the prevailing weaker global demand prospects. The impact of falling diamond prices could further lower supply amid increasing production costs. Overall, this shortfall in supply could potentially reduce production much lower than 24.1 million carats that is anticipated at the end of 2023, which could have an adverse impact in the growth in mining and quarrying.

90. Related to the uncertainty in the global market is risks associated with the slow pace of economic diversification. The undiversified nature of the domestic economy continues to limit shock-absorption capacity. While there exists some level of diversification towards sectors serving the domestic market, this has squeezed growth of the tradable sectors of agriculture and manufacturing. The slow implementation of

diversification towards growth of these sectors continues to subject the domestic economy to significant volatility of fluctuations in global demand and supply. In addition, the dominance of the public sector, which accounts for almost a third of formal employment, is creating labour market distortions at the same time crowding out private-sector participation. This, to some extent is worsened by the dominance of parastatals in the energy, transport and telecommunications sectors. This dominance of the public sector limits the scope for private sector-led growth and in the process minimizes the prospects for export diversification. As such, there is need to accelerate efforts towards private sector development, with a proper balance of sectors serving both the domestic and external markets.

91. Capacity constraints in the utilities sectors pose risks to production of other sectors in the economy. The current equipment defects and ongoing remedial works at Morupule B power station, which accounts for the highest share of domestically produced electricity could continue to weaken generation capacity, leading to an increase in energy imports and increased intermediate costs. Similarly, continued power challenges in South Africa's Eskom where Botswana imports 18.5 percent of electricity could expose the economy to Eskom's load-shedding, making electricity imports from South Africa increasingly costly. Meanwhile, a persistence of water supply disruptions due to maintenance works and delays in completion of water projects could slow distribution of water especially in the Southern part of the country. The situation may be complicated by extreme weather events unreliable rainfall, and even frequent drought episodes, amplifying current supply water disruptions in the economy.

92. The demand side of the economy also faces some level of risk. While consumption has remained strong throughout 2022 despite higher borrowing costs and depressed real disposable incomes, the relatively high spending was due to drawdowns in available savings to cushion consumers against reductions in incomes. However, there is a limit to the frequency and how much savings can be withdrawn in order to sustain the same level of spending. Despite first quarter growth increase, investment prospects remain uncertain, reflecting to a large extent a slowdown in business credit during the same period and tight monetary conditions which remain elevated albeit subdued cost pressures from lower inflation. On the other hand, the long term secular decline in the contribution of external demand due to plateauing exports is expected to weaken aggregate demand unless this is offset by a much faster decline in imports.

93. The combination of the above factors continues to limit the extent to which the domestic economy can generate sufficient revenues in order to achieve fiscal surpluses and accumulate depleted buffers. The proportion of domestic revenue to external revenue continues to remain low following a decline to 0.54 in 2022/23 from 0.60 the previous year. Projections indicate that the proportion is estimated to average 0.62 over the medium term. Despite this increase, the level of domestic revenues

remain insufficient to cushion the economy against any potential shortfall in external revenues and as such continues to subject the economy to long term fiscal risks which could compromise fiscal sustainability amid an uncertain diamond outlook.

94. On the inflation front, while fuel prices have receded from their war induced peaks, food inflation and core inflation (excluding administered prices) however remain elevated, suggesting there are still signs of underlying price pressures due to second round effects of inflation. Food accounts for the largest component in the consumer price index after fuel (transport index). Hence, the higher food prices are expected to be key to inflation persistence over the short term, weighing on households and as such may limit the start of any monetary policy easing decisions until there are clear signs of sustained low food inflationary pressures in the economy. These therefore suggests that monetary policy stance could remain in a contractionary territory for some time. This is expected to continue putting pressure on household incomes through increased debt servicing costs. In the short term, these combined factors could generate tensions between fiscal and monetary policy objectives.

95. Over and above these, the economy continues to be exposed to exchange rate risks related to the movement of the pula against major trading partner countries' currencies, particularly the South African rand and Special Drawing Rights (SDR) more specifically the US dollar. While these account for a small fraction of revenue risks, this can, in some cases have a sizeable impact on the budget. This is because SACU revenues are typically denominated in ZAR while diamond revenues are denominated in US dollars. Meanwhile, the current exchange rate mechanism of the Pula is such that the movement of the Pula against the US dollar primarily reflects the performance of the South African rand against the dollar. In this respect a worsening of economic fundamentals and growth outlook in South Africa could potentially lead to further depreciation of the rand than is currently anticipated. This could reduce Botswana's share of the Pula denominated SACU receipts. On the other hand, there could be a dampening effect on mineral revenue arising from the associated depreciation of the pula against the dollar. The net effect on the budget depends on the magnitude of the two.

96. Expenditure risks which are largely related to delayed implementation of the fiscal consolidation plan, coupled with the higher budget allocation to development spending over the next two years. The former is critical for fiscal sustainability given the large depletion of fiscal buffers. There are however risks of a delay in fiscal consolidation post the implementation of the Transitional National Development Plan as NDP 12 and implementation of related projects takes off. All else equal, this could prolong fiscal deficits and further erode fiscal buffers, with negative effects on the budget unless this is complemented by accelerated revenue generation opportunities

to support increased spending levels. On the other hand, low execution of the development budget could delay job creating opportunities with implications on growth. While prospects for inflationary pressures remain benign, any upside risks could trigger potential wage-price spirals and put pressure on prices of goods that are closely linked to inflation, especially inputs for some infrastructure projects.

VIII. FISCAL STRATEGY

Public Expenditure Reforms

97. Unprecedented and prolonged macroeconomic instability in the global space have triggered an urgent need to strengthen Government's efforts of achieving fiscal consolidation. In an effort to prepare the economy against future shocks and the risk of unsustainable public debt levels, Government will prioritize measures towards boosting domestic revenue mobilisation and cutting down on expenditure. This implies that for Government to adopt a fiscal policy objective that coincide with attaining the desired economic transformation, rebuilding buffers and implementation of the necessary expenditure rule will be core to this agenda. Historically, the Country's debt-to-GDP ratios have been within the statutory debt ceiling of 40 percent of GDP and it remains a fiscal objective to maintain this trend. This implies that potential or future fiscal deficit can be managed by rebuilding the fiscal space but without posing the risk of stretching beyond the ceiling.

98. On another note, the Zero-Based Budgeting (ZBB) and Budget Option (BO) approaches will be used to guide the 2024/2025 Budgeting to control expenditure. These approaches will continue to be embedded in the budgeting system to improve the National Budgeting process in the medium to long term and in the National Development Plan (NDP) 12.

99. To further improve efficiencies and ultimately eliminate redundancies and wastage in the public sector, the Government wide rationalization of Ministerial portfolio responsibilities, which started in the financial year 2022/23, will be monitored. Similarly, Government is closely monitoring the performance of State – Owned Enterprises (SOEs) to ensure maximum revenue mobilization with low expenditures.

Tax Reforms

100. An important aspect of fiscal consolidation is to mobilize revenue by broadening the tax base and improving efficiency of the tax system. In light of this, Government is currently undertaking a comprehensive review of taxations laws for purposes of consolidation, efficiency and modernization. The review, which is expected to be completed in the 2023/2024 financial year, includes making technical corrections in

provisions that do not capture the true intention of the Income Tax Act and Value Added Tax Act and the relocation of procedural and administrative provisions of both the Income Tax and VAT Acts into a separate Tax Administration Act (TAA). The implementation of these reforms, which are expected to commence during the fourth quarter of 2023/2024 and spill over to 2024/2025, will contribute significantly to the broadening the tax base.

IX. SUMMARY AND CONCLUSION

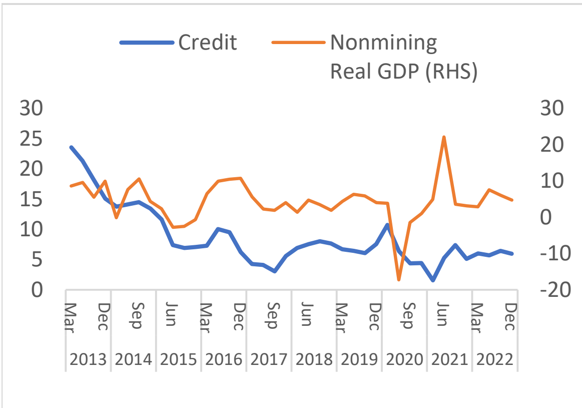
101. The Botswana economy continues to recover, with positive GDP growth rates as the effects of COVID19 pandemic recede. This financial year's Budget Strategy Paper is set against a backdrop of global economic slowdown, high global inflation, and prolonged supply chain challenges emanating from the ongoing Russia-Ukraine conflict. Botswana's medium term economic prognosis is clouded by concerns about a probable recession and falling global demand, particularly in advanced markets.

102. The identified national strategic priorities sought by Government continue to guide the preparation of this paper which is focused on giving the reform and transformation agenda more momentum by entrenching macro-economic stability which is essential for socioeconomic development, while sustaining livelihoods. In addition, the government will continue to implement measures to attain fiscal sustainability and avoid successive fiscal deficits in order to maintain macroeconomic stability necessary for economic growth and employment creation. Job creation, poverty and inequality remain central to the 2024/2025 development agenda.

Annex I: Botswana Macro-Financial Linkages

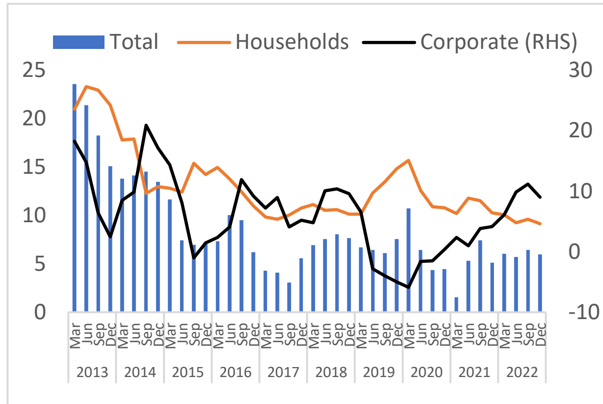
The recent slowdown in credit as a result of policy tightening has impacted the non-mining sector…

Credit and Non-mining GDP Growth
(Year-on-year percent change)



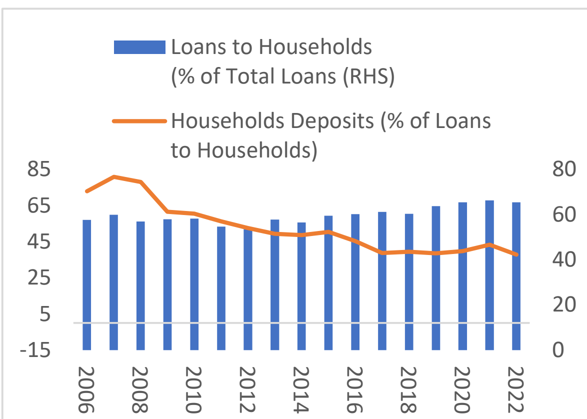
… this was due to a slowdown in credit to households while there has been faster growth of business credit. However, more recently credit growth decelerated both for households and businesses…

Credit Growth
(Year-on-year percent change)



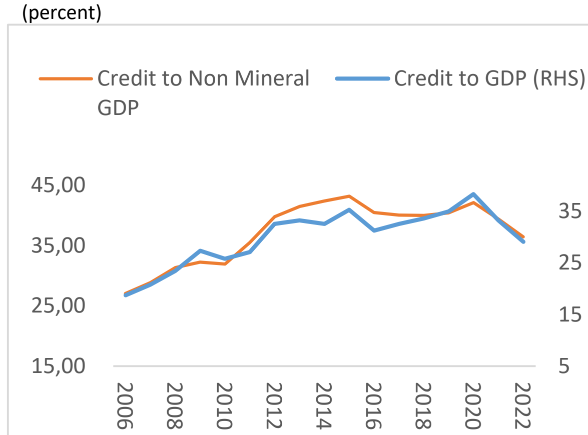
Moreover, a slight decline in household deposits was observed

Household Credit and Deposits
(Percent of total loans)



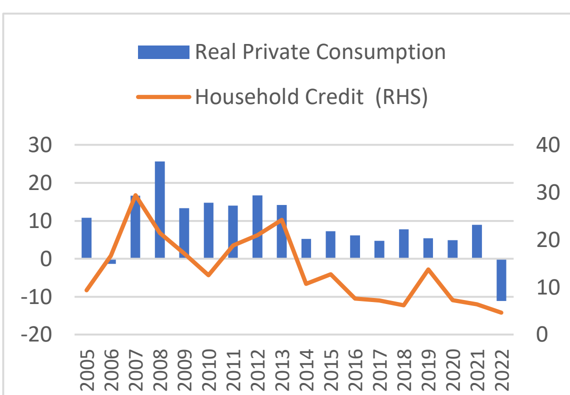
…as a result, there has been a levelling off in the credit-to-GDP trend.

Credit To GDP
(percent)



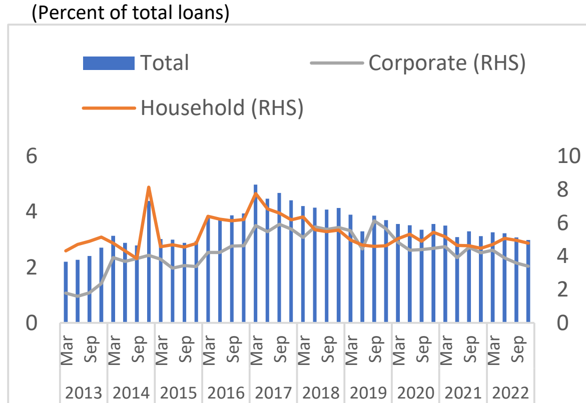
…. And more specifically household credit, constraining growth of private consumption

Household Credit and Consumption
(Percent change)



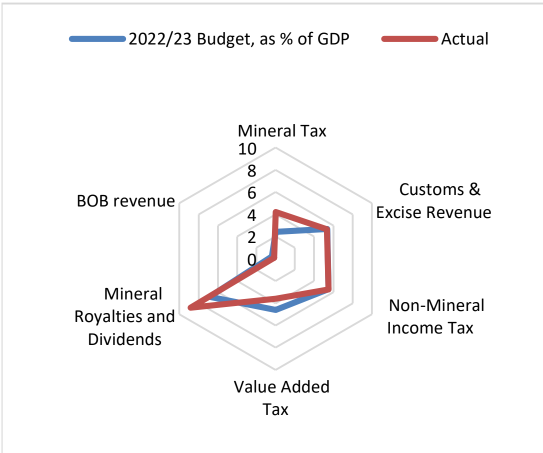
Meanwhile, NPLs have been declining, a positive development for the stability of the financial sector

Non-Performing Loans
(Percent of total loans)

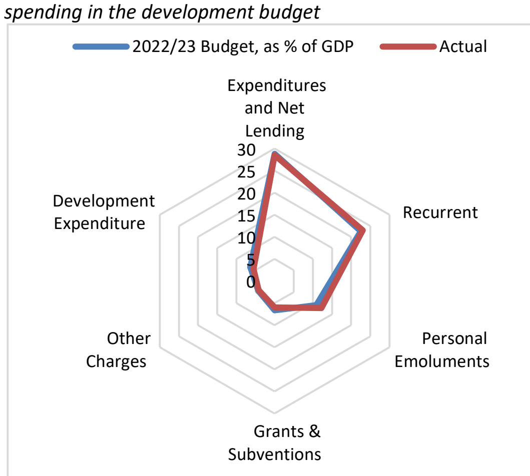


Annex II Medium Term Projections

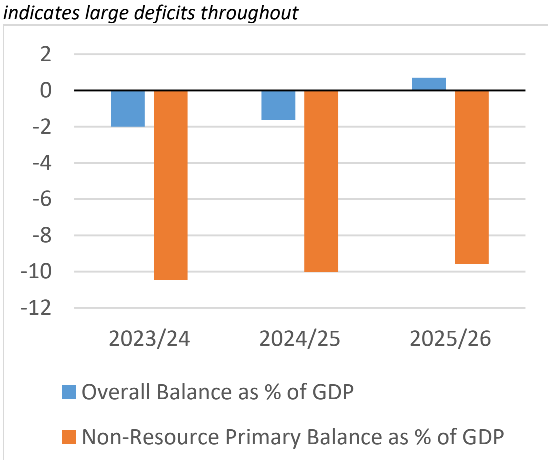
Despite higher receipts in FY2022/23, Government budget continued to be exposed to volatility in revenue sources



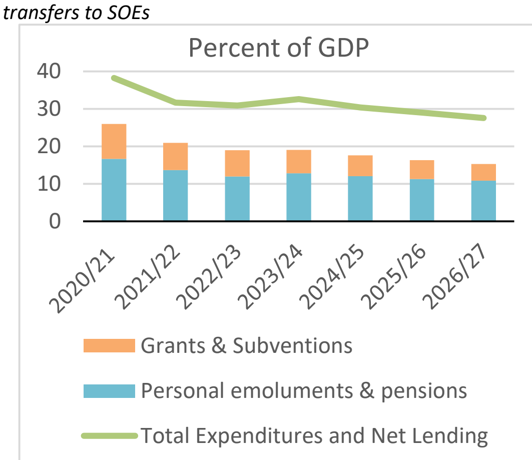
...while expenditure remained broadly stable, except for under-spending in the development budget



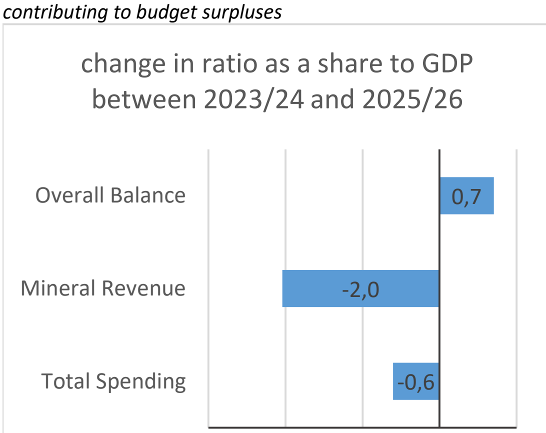
Narrowing deficits and surpluses are projected over the medium term, but non-resource primary balance indicates large deficits throughout



...there is therefore need to accelerate fiscal consolidation plan especially through reducing the ratio of wages to GDP and transfers to SOEs



As indicated, containing expenditure growth can help offset against falling mineral revenue, contributing to budget surpluses



Expanding growth of other revenue sources, which are generally flat can also provide a cushion against falling mineral receipts