INTERNATIONAL MONETARY FUND

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KINGDOM OF SWAZILAND

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE KINGDOM OF SWAZILAND

December 2015

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Kingdom of Swaziland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 9, 2015 consideration of the staff report that concluded the Article IV consultation with the Kingdom of Swaziland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's information following discussions that ended September 30, 2015 with the officials of the Kingdom of Swaziland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 24, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Kingdom of Swaziland.
- The documents listed below have been or will be separately released.

  Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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December 10, 2015

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IMF Executive Board Concludes 2015 Article IV Consultation with Swaziland

On December 9, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Swaziland.

Swaziland's growth has been recovering since the 2010–11 fiscal crisis, albeit at a slower pace recently. Growth recovery following the fiscal crisis was broadly supported by the manufacturing and service sectors. In 2015, however, growth is expected to slow, owing to adverse weather conditions and a slowdown in tourism and transport sectors. Swaziland continues to face significant development challenges, with high unemployment and poverty, and prevalence of HIV. Inflation has stayed modest (4.5 percent in September 2015), reflecting low international commodity prices.

Fiscal policy has become expansionary in recent years. Domestic revenue collection improved with stepped-up administration efforts. Expenditures expanded even further since the crisis, owing to increased recurrent spending (with fast growth in public sector wages) and a revival of capital expenditures. Subsequently, after running surplus for two years, the fiscal balance turned into a deficit in 2014/15. The deficit is expected to further increase in 2015/16 to 5 percent of GDP due to lower Southern African Customs Union (SACU) revenues, wage adjustments, and the supplementary budget. As a result, public debt is projected to grow fast in 2015, with heavy reliance on short-term debt creating high rollover risks.

While international reserves have strengthened since the crisis, they have not reached an adequate level. A current account surplus was recorded in 2014, supported by robust SACU revenues and exports (e.g., wood pulp, textile); there were financial account outflows in light of limited domestic investment opportunities. International reserves stayed at 3½ months of imports in September 2015, below the authorities' medium-term target of 5–7 months of imports.

Swaziland's growth outlook is projected to remain subdued over the medium term, while it is clouded with downside risks. Growth is expected to slow in 2016/17, followed by a modest

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

recovery in the following years. SACU revenues are expected to decline markedly in 2016/17, putting pressures on fiscal and external balance. Furthermore, tighter or more volatile global financial conditions and weaker growth in South Africa could have negative spillovers to Swaziland. The recent weakening of the South African economy, together with the expected revision to the revenue sharing formula, point to downside risks for SACU revenues.

Executive Board Assessment[2]

Executive Directors welcomed Swaziland's recovery since the 2010–11 fiscal crisis, but they also stressed that significant challenges remain, including a prospective decline in the revenues from the Southern African Custom Union (SACU), a weakening regional outlook, heavy reliance on short-term financing, and large development needs reflected in high unemployment and poverty and the continued prevalence of HIV. In light of the significant downside risks to fiscal and external sustainability, Directors urged the authorities to substantially improve their policy performance to promote macroeconomic and financial stability, rebuild the economy's resilience to shocks, and boost inclusive growth.

Directors welcomed the authorities' intention to shift toward a tighter fiscal stance. They stressed that enhanced fiscal consolidation is needed over the medium term to ensure fiscal and debt sustainability, while ensuring that spending for critical social and development is safeguarded. Directors encouraged the authorities to contain recurrent expenditure, in particular the wage bill, and strengthen public financial and investment management and domestic revenue collection, while enhancing the international reserves buffer toward the medium-term target of 5–7 months of imports.

Directors called for further efforts to ensure financial sector stability, in light of growing vulnerabilities and risks. They encouraged strengthening financial sector supervision and regulation, with a particular emphasis on the nonbank financial institutions. Directors commended efforts to enhance financial sector development and promote financial inclusion and access to credit.

Directors welcomed the authorities' intention to tackle the substantial social and development challenges, and encouraged stronger efforts to promote more inclusive growth through greater private sector development. Directors urged the authorities to promote export diversification, enhance access to financing, and improve the business climate, while the loss of trade preferences from the United States and prospectively from the European Union underlines the importance of enhancing broader economic diversification and competitiveness.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Swaziland: Selected Economic Indicators, 2013–20

	2013 Prel.	2014 Prel.	2015 Proj.[4]	2016 Proj.[4]	2017 Proj.[4]	2018 Proj.[4]	2019 Proj.[4]	2020 Proj.[4]
	(Percentage changes; unless otherwise indicated)							
National account and prices								
GDP at constant prices	2.9	2.5	1.7	0.8	1.1	1.3	1.2	1.2
GDP deflator	6.1	6.1	5.8	5.0	4.8	4.9	5.1	5.0
GDP at market prices (Emalangeni billions)	44.1	47.9	51.5	54.5	57.8	61.4	65.3	69.4
Consumer prices (average)	5.6	5.7	5.0	6.5	5.8	5.8	5.8	5.8
External sector								
Average exchange rate (local currency per US$)	9.7	10.8	…	…	…	…	…	…
Nominal exchange rate change (– = depreciation) [1]	7.3	5.4	…	…	…	…	…	…
Real effective exchange rate (– = depreciation) [1]	5.1	5.2	…	…	…	…	…	…
Gross international reserves								
(months of imports)	3.7	3.5	3.6	3.3	3.2	3.2	3.2	3.1
(percent of GDP)	18.3	16.7	16.0	14.8	14.4	14.3	14.1	13.6
(percent of reserve money)	423	424	412	384	380	386	389	382
Gross reserves minus reserve money								
(percent of deposits)	57.4	55.0	53.6	48.4	47.4	47.8	47.7	46.0
Money and credit								
Domestic credit to the private sector	20.2	9.8	6.5	5.3	4.7	4.9	4.8	4.8
Reserve money	6.0	-0.8	6.3	4.5	4.2	4.4	4.3	4.2
M2	15.9	3.9	7.1	5.4	5.0	5.5	5.5	5.5
Interest rate (percent) [2]	5.0	5.0	…	…	…	…	…	…
	(Percent of GDP)							
National accounts								
Gross capital formation	7.6	9.2	10.9	7.8	6.4	6.1	6.0	5.7
Government	3.6	5.2	5.6	3.8	3.1	3.0	3.1	3.0
Private	4.0	4.0	5.3	4.0	3.3	3.1	2.9	2.7
National savings	12.7	12.1	11.7	6.6	6.5	7.0	6.8	6.4
Government	6.5	7.4	4.3	-0.2	-0.1	0.6	0.7	0.6
Private	6.2	4.6	7.4	6.8	6.6	6.4	6.1	5.8
External sector								
Current account balance								
(including official transfers)	5.1	2.9	0.7	-1.2	0.1	0.8	0.8	0.6
(excluding official transfers)	-12.8	-13.5	-13.3	-10.8	-9.5	-9.5	-9.5	-9.6
External public debt	7.5	7.3	7.8	8.4	8.6	8.5	8.4	8.3
Central government fiscal operations [3]								
Overall balance	0.7	-1.2	-5.0	-5.9	-4.3	-3.8	-3.9	-3.9
Total revenue and grants	28.7	30.1	27.8	22.9	24.6	25.1	25.0	25.0
Total expenditure	28.0	31.3	32.8	28.9	28.8	28.9	28.9	28.9
Public debt, gross	14.8	13.7	17.4	20.2	21.8	24.0	26.4	28.8
Public debt, net	3.3	2.9	8.2	13.7	17.2	20.0	22.7	25.2
Memorandum item:								
Population (in million)	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.2

Sources: Swazi authorities; and IMF staff estimates and projections.

[1] IMF Information Notice System trade-weighted; end of period.

[2] 12-month time deposits rate.

[3] Fiscal year data (fiscal years run from April 1 to March 31).

[4] Staff estimates based on the baseline scenario.

KINGDOM OF SWAZILAND

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 24, 2015

KEY ISSUES

Context. Swaziland's growth has been recovering since the 2010–11 fiscal crisis, albeit at a slower pace recently, and its significant development challenges continue, with high unemployment and poverty. Over the past three years, Swaziland has shifted toward an expansionary fiscal policy, while revenues from the Southern African Customs Union (SACU) have declined in percentage of GDP since 2013/14. Hence, after running surpluses for two years, fiscal balance turned into a deficit in 2014/15. International reserves stood at 3½ months of imports as of end-September 2015.

Emerging shock and risks. Swaziland's economy faces new challenges. The recent weakening of the regional economic outlook is likely to have adverse impacts on Swaziland through trade and financial channels. The SACU revenues, in particular, are projected to decline significantly in the coming years, raising concerns for fiscal and external sustainability. These challenges, unless properly addressed, could weaken growth and adversely affect financial sector stability.

Strengthening international reserve buffer. Maintaining sufficient international reserves is important to ensure the confidence in the economy. To this end, fiscal consolidation is needed over the medium term, while protecting spending for critical social and development needs. Enhanced fiscal reforms—strengthening public financial (and investment) management and domestic revenue collection—are critical policy agendas.

Safeguarding financial stability. Financial soundness indicators point to generally sound banking system. A dominant size of the nonbank financial sector—which grew fast in recent years—calls for strengthening of supervision and regulation for the sector.

Raising inclusive growth. To address social and economic challenges, it is essential to raise Swaziland's potential for inclusive growth, while the loss of the Africa Growth Opportunity Act (AGOA) eligibility points the importance of enhancing economic diversification and competitiveness. Stepped-up policy efforts in multiple areas are needed: including improving business climate and export diversification.

Past advice. There is broad agreement with the authorities on macroeconomic policies and structural reform priorities, but the implementation of past advice has been uneven. Specifically, although the authorities acknowledge the need to pursue a prudent fiscal policy stance and rein in current spending, there have been no major policy changes since the last consultation. Progress on structural reforms (including improving business climate and accelerating land reforms) has also been modest.

Approved By
Anne Marie Gulde-Wolf and Steven Alan Barnett

Discussions took place in Mbabane September 17–30, 2015, with follow-up discussions through conference call in late October. The team comprised Jiro Honda (head), Yi Wu, Manabu Nose, and Maximilien Kaffo (all AFR). Ms. Dlamini (OED) and Mr. Im (the World Bank) also participated in the meetings.

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CONTEXT: GRADUAL RECOVERY FROM THE CRISIS

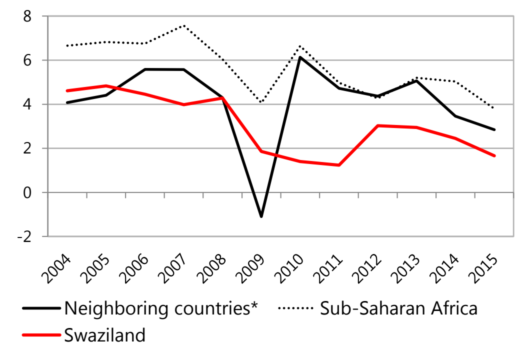
1. **Swaziland is a small middle-income country with close economic linkages to South Africa.** With Lesotho, Namibia, and South Africa, Swaziland is a member of the Common Monetary Area (CMA). Under the CMA, the Swaziland lilangeni is pegged at par to the South African rand, which is also legal tender in the country. CMA members and Botswana constitute the Southern African Customs Union (SACU).

2. **Following parliamentary elections in 2013, the government has formulated a new development strategy, committing to addressing Swaziland's development challenges.**[1] Under the strategy ("Program of Action" for the period through 2018), the government committed to reducing poverty and inequality. To this end, while acknowledging difficult fiscal circumstances, the government's budget strategy for 2015/16 aims at sustaining economic growth, employment and poverty reduction, while implementing measures to improve efficiency and lower the cost of doing business.

3. **Swaziland's growth has been recovering since the 2010–11 fiscal crisis, albeit at a slower pace recently.**[2] Following the fiscal crisis, growth recovered, supported by manufacturing (in particular food and beverages industries), and construction and wholesale and retail sectors (helped by increased government spending). In 2015, however, growth is expected to slow down, owing to adverse weather conditions and slowdown in tourism and transport sectors.[3] While the nominal GDP increased by 20 percent as a result of the recent rebasing and recompilation of GDP, Swaziland continues to face significant development challenges, with high

Swaziland's growth recovered since the crisis, though it lags behind its peers.

Real GDP Growth



* Simple average of Botswana, Namibia, Lesotho, and South

Sources: Country authorities and IMF staff estimates.

[1] Swaziland is an absolute monarchy, where the King holds the executive authority, which may be exercised either directly or through the Cabinet or a Minister. Parliamentary elections are held every five years, following which the King appoints cabinet members, 20 out of 30 senators, and 10 out of 65 members of the lower house.

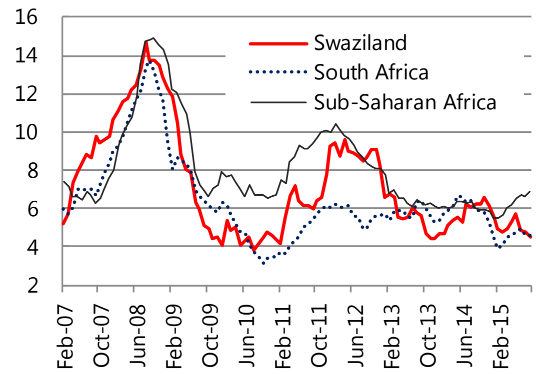
[2] The crisis originated in a sharp shortfall of SACU revenue in 2011/12 (by 9 percent of GDP) that deteriorated fiscal and external balances through significant declines in fiscal revenue and current account transfers. It resulted in a significant drawdown of international reserves and large domestic financing (including domestic payment arrears), which weakened the confidence in the economy.

[3] Changes in the South African visa and immigration rules introduced in June 2015—requiring travelers with children to carry an unabridged birth certificate —appear to have affected the number of tourists coming to Swaziland since mid-2015, as most of them go through South Africa. The South African government has recently relaxed some of the requirements.

unemployment (28 percent in 2013/14) and poverty (poverty head count of 63 percent in 2009/10), and prevalence of HIV (27.7 percent among adult). Inflation has stayed modest (4.5 percent in September 2015), reflecting low international commodity prices.

Inflation stayed modest, broadly in line with that of South Africa.

Consumer Prices (percent, annual changes)



Sources: country authorities and IMF staff estimates.

4. Swaziland's loss of eligibility for trade benefits under the Africa Growth Opportunity Act (AGOA) has adversely affected exports and employment, though its impacts on overall growth and exports have been modest. Swaziland lost its AGOA access in January 2015, after it failed to meet some of the benchmarks set by the US Government (since then, to regain the access, the Swaziland authorities have been making efforts to address the benchmarks related to workers' rights). This has led to a drastic decline in textile exports to the U.S. market, leading to layoffs, though its impacts on overall growth and exports are modest, given the relatively small size of the textile sector, and owing to increased exports to the South African market (as the weakening of South African rand has made Swazi exports more competitive compared with dollar-priced exports from other countries).[4]

5. Fiscal policy became expansionary after the 2010–11 fiscal crisis, supported by the rebound of SACU revenues. Domestic revenue collection continued to improve with stronger performance by corporate and individual income taxes and stepped-up administration efforts (e.g., enhanced efficiency in VAT collection, and strengthened compliance).[5] Expenditures expanded even further since the crisis, owing to increased recurrent expenditure (mainly due to fast growth in public sector wages) and a revival of capital expenditures.[6] Subsequently, after running surplus for two years, fiscal balance turned into a deficit in 2014/15. The deficit is expected to increase in 2015/16 to

Swaziland: Fiscal Balances (in percent of GDP)

	2011/12	2012/13	2013/14	2014/15	2015/16 Budget	2015/16 Staff estimate
Total revenues	20.2	29.5	28.7	30.1	27.9	27.8
Domestic revenues	12.4	12.3	12.4	13.1	14.1	13.9
SACU revenues	7.8	17.1	15.9	15.3	13.3	13.3
Grants	0.0	0.1	0.4	1.6	0.5	0.6
Expenditures	23.9	26.1	28.0	31.3	30.5	32.8
Current expenditures	21.2	22.7	22.7	23.9	24.4	25.3
Capital expenditures	2.7	3.4	5.3	7.4	6.2	7.6
Fiscal balances	-3.7	3.4	0.7	-1.2	-2.6	-5.0
Fiscal balances (excluding SACU)	-11.4	-13.7	-15.2	-16.6	-15.9	-18.2
Public debt	13.9	14.4	14.8	13.7	n.a.	17.4

Sources. Swaziland authorities and IMF staff estimates

[4] Swaziland's textile exports to the U.S. in 2014 are estimated to have reached US$55 million, equivalent to 3 percent of the total exports and 1½ percent of GDP. Following the expiration of the AGOA, more than 2,000 workers (about 10 percent of the total textile employment) are reported to have been laid off.

[5] In April 2015, the Swaziland Revenue Authority (SRA) introduced a new VAT refund scheme at border posts with South Africa. It simplifies declaration process (for goods imported from South Africa) and contributes to mitigating tax evasion. On domestic fronts, the compliance in domestic VAT improved in the sugar industry and the compliance in import VAT also improved following enhanced post audit for imported goods.

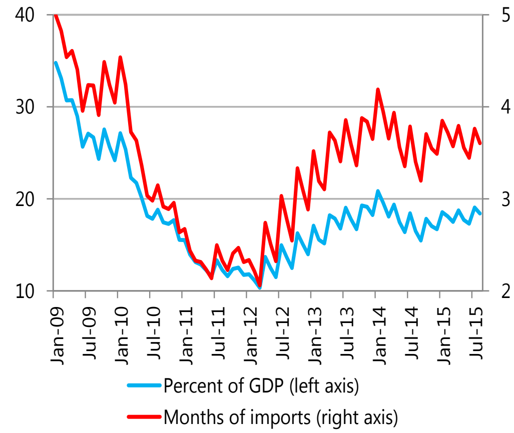
[6] An international convention center and a five star hotel are currently being constructed (at the estimated cost of E1.7 billion, or 3½ of GDP) and expected to be completed for the hosting for the 2020 African Union Summit.

5 percent of GDP due to lower SACU revenues, wage adjustments (Text Figure 1), and increased spending with the supplementary budget.[7] As a result, public debt is projected to grow fast in 2015, with heavy reliance on short-term debt creating high rollover risks.

6. **While international reserves have strengthened since the crisis, they have not reached an adequate level.** A current account surplus was recorded in 2014, supported by robust SACU revenues and exports (e.g., wood pulp, textile), there were financial account outflows in light of limited domestic investment opportunities.[8] International reserves stayed at around 3½ months of imports, below the authorities' medium-term target of 5–7 months of imports.

The pace of increase in international reserves has recently stalled.

International Reserves



Sources: Swazi authorities and IMF staff estimates.

7. **Swaziland's real effective exchange rate (REER) appears moderately overvalued (Annex I).** The REER has depreciated by about 14 percent since end-2010 (2.8 percent since end-2014). The lilangeni recently hit historical lows against the dollar. While different estimation approaches give mixed results, the overall assessment—by properly accounting for the cyclicality of SACU revenues on the current account—points to a moderate overvaluation (by 1–10 percent).[9] The current account, however, might not necessarily improve with the exchange rate depreciation if the expansionary fiscal policy continues.

8. **The implementation of advice from previous Article IV consultations has been uneven**. There was broad agreement with the authorities on macroeconomic policies and structural reform priorities. However, despite the acknowledgement of the need to pursue a prudent fiscal policy stance and rein in current spending, there have been no major policy changes since the last consultation.

[7] The supplementary budget is expected to amount to about E1.6 billion, including the cost of living adjustment for wages (E370 million), an increase in budget appropriations for goods and services mainly related to foreign travels (E265 million), grants for the University of Swaziland (E80 million), and capital projects (E700 million). Most of these appropriations for goods and services and capital projects are made to meet spending needs on one-off basis.

[8] Net FDI flow turned negative in 2014 as a South Africa-based wood pulp company sold its facility in Swaziland following its closure in 2010 (owing to adverse market conditions and fire damage). Other outflows were associated with portfolio and other investments in South Africa.

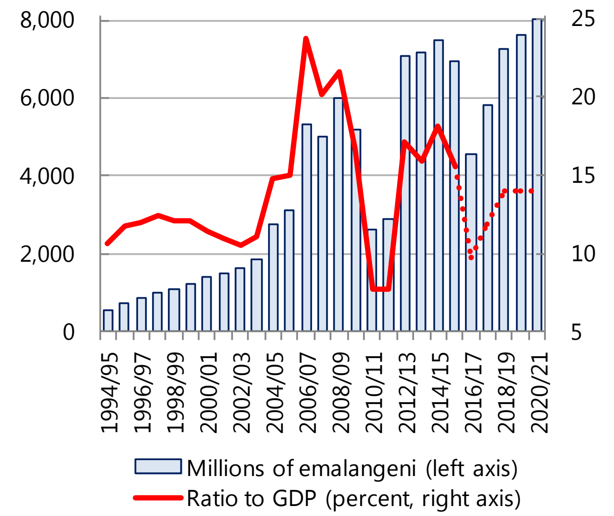
[9] Policy gap essentially accounts for all the current account gap in the current account approach (1 percent of GDP, Annex 1).

OUTLOOK AND RISKS

9. Swaziland's growth outlook is projected to remain subdued over the medium term, in view of a prospective decline in SACU revenues, low private sector activities, and the ongoing impacts of the loss of Swaziland's AGOA access. Growth is projected to slow down in 2016/17, followed by a modest recovery in the following years. SACU revenues are expected to decline markedly in 2016/17 (resulting from adjustments for overpayments in 2014/15 and expected slowdown in South Africa's imports), followed by a modest recovery over the medium term. This SACU revenue shock would put pressure on fiscal and external balances, adversely affecting Swaziland's economy (described later). Increased fiscal imbalances would necessitate large domestic financing (owing to limited external financing sources) and likely crowd out private sector credit, which, together with the expected monetary tightening (following the SARB), would adversely affect the country's growth.

The SACU revenues are expected to decline in the coming years, owing to adjustments for overpayments in 2014/15 and expected slowdown in South Africa's imports.[1]

Swaziland: SACU Revenue Projections



Sources: Swazi authorities and IMF staff estimates.

1. Customs and excise revenue collections within the SACU region are pooled and disbursed to each member state based on revenue projections. An adjustment is made after two years, to correct for discrepancies between the SACU revenues received (based on the projections) and the level corresponding to the actual customs and exercise revenue collection.

10. Furthermore, risks mostly point to the downside. Tighter or more volatile global financial conditions and weaker growth in South Africa could have negative spillovers to Swaziland (specifically through trade and financial channels). The recent weakening of the South African economy, together with the expected revision to the revenue sharing formula, point to downside risks for SACU revenues, beyond what is captured in the baseline forecast. Furthermore, the rand's sharp depreciation may jeopardize price stability, though further declines in oil prices could lower import costs. Structurally weak growth in key advanced and emerging economies and the removal of the E.U. sugar quota in 2017 (which could lead to lower European sugar imports including from Swaziland) may further weaken Swaziland's growth outlook. In view of the policy challenges with the expected decline in the SACU revenues, the government will play a critical role, where a strong policy response could mitigate the impacts, posing an upside risk.

11. The authorities fully acknowledged the risks and vulnerabilities. They were specifically concerned of the prospects for SACU revenues and their impacts on fiscal and external sustainability, in light of the experiences of the 2010–11 fiscal crisis. The authorities agreed with the prospect for a suppressed level of SACU revenues for a prolonged period, while pointing to downside risks to the current SACU revenue forecast over the medium term. In light of the risks associated with the weakening of the rand, they also shared the concern on inflation, and pointed out that the recent drought could also add to inflationary pressure.

POLICY DISCUSSIONS

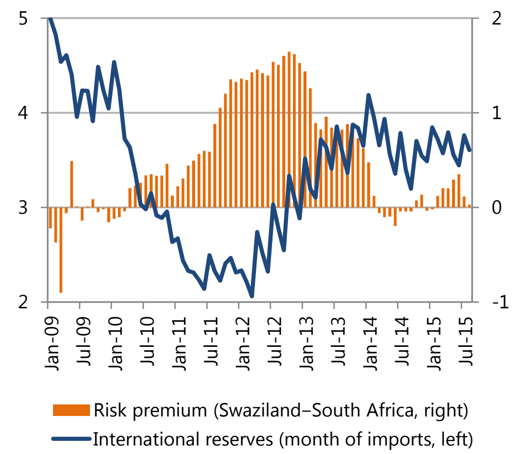
Swaziland's key challenges are therefore: (i) in the near term, to strengthen its resilience to shocks in preparation for the expected SACU revenue fall and (ii) over the medium and long term, to achieve higher and inclusive growth to meet its social and development needs. The 2015 Article IV consultation focused on how Swaziland can address these challenges.

A. Preparing for the Expected SACU Revenue Fall

12. The experience of the 2010–11 fiscal crisis suggests the need to secure the minimum international reserves of three months of imports. Given Swaziland's membership in the CMA, maintaining sufficient international reserves is important to keep the confidence in the arrangement. Looking back on the experiences during the 2010–2011 crisis, the risk premium on Swaziland's T-bill yield started to rise when international reserves fell below three months of imports. This level is viewed as an important benchmark by the authorities, while the medium-term target is set at 5–7 months of imports. This target is deemed adequate, in light of Swaziland's high vulnerability to shocks (Annex II).

The risk spread increased when international reserves fell below three months of imports.

International Reserves and Risk Premium



Sources: Swazi authorities and IMF staff estimates.

The Authorities' Current Policy Line

13. To address the forthcoming SACU revenue shock, the authorities intend to shift to a tighter fiscal policy stance and keep international reserves above three months of imports. Based on the experiences of the last fiscal crisis, the authorities target at keeping international reserves above three months of imports, through stepped-up fiscal consolidation, without compromising Swaziland's growth potential and social needs. In terms of the medium-term reserve target (5–7 months of imports), they argue that it should be achieved over a longer term. Fiscal deficits are targeted at 3–6 percent of GDP, while allowing a larger deficit in 2016/17 when SACU revenues would fall markedly. To achieve this, the authorities plan to implement the following measures:

(i) *contain recurrent expenditures*, by enforcing procurement reforms, postponing non-critical spending, and streamlining transfers to state-owned enterprise,[10] while safeguarding resources to health and education sectors as envisaged under the "Program of Action" for the period between 2013 and 2018,

(ii) *reduce domestically-financed capital spending*, by limiting the implementation of new projects and reprioritizing ongoing projects and donor-funded projects,

(iii) *rationalize the wage bills* by cleaning up unidentified workers[11], removing allocations for permanent vacant positions, and postponing the salary review (while allowing annual cost of living adjustments),

(iv) *enhance domestic revenue collection*, by improving taxpayer compliance rate (in income tax and VAT) and tax collection rate, and enhancing self-assessments,[12] and

(v) *Enhance the availability of financing, by (i) reaching out potential investors* (in particular nonbank financial institutions) for the auctions of government securities, (ii) issuing long-term bonds in floating interest rate, and (iii) exploring to issue long-term bonds linked to specific capital projects. To manage associated risks, a medium-term debt management strategy, together with an annual borrowing plan, will be developed, while improving cash management and forecasting, with technical assistance by the IMF.

Staff Medium-Term Projections (Baseline Scenario)

(Percent of GDP, unless otherwise indicated)

	2011 Prel.	2012 Prel.	2013 Prel.	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
GDP growth (annual change)	1.2	3.0	2.9	2.5	1.7	0.8	1.1	1.3	1.2	1.2
Credits to private sector (annual change)	26.0	-1.7	20.2	9.8	6.5	5.3	4.7	4.9	4.8	4.8
Fiscal balance [1]	-3.7	3.4	0.7	-1.2	-5.0	-5.9	-4.3	-3.8	-3.9	-3.9
Total revenue [1]	20.2	29.5	28.7	30.1	27.8	22.9	24.6	25.1	25.0	25.0
Domestic revenue [1]	12.3	12.3	12.3	13.1	13.9	14.2	14.1	14.1	14.0	14.0
SACU revenues [1]	7.8	17.1	15.9	15.3	13.3	8.2	9.9	10.5	10.5	10.5
Total expenditure [1]	23.9	26.1	28.0	31.3	32.8	28.9	28.8	28.9	28.9	28.9
Recurrent expenditure [1]	21.2	22.7	22.7	23.9	25.3	24.6	24.8	24.8	24.8	24.9
of which wages	12.0	11.0	11.6	11.6	12.1	12.1	12.2	12.3	12.3	12.2
Capital expenditure [1]	2.7	3.4	5.3	7.4	7.6	4.2	4.0	4.0	4.1	4.1
Current account balance (including grants)	-6.8	3.1	5.1	2.9	0.7	-1.2	0.1	0.8	0.8	0.6
Gross international reserves (month of imports)	2.3	2.9	3.7	3.5	3.6	3.3	3.2	3.2	3.2	3.1
Total debt [1]	13.9	14.4	14.8	13.7	17.4	20.2	21.8	24.0	26.4	28.8

[1] Fiscal year data (fiscal years run from April 1 to March 31).

Sources: Swaziland authorities; and IMF staff estimates and projections.

[10] The authorities have been working on procurement reforms. The Public Procurement Act was enacted in 2011, while Swaziland Public Procurement Regulatory Agency commenced operations in late 2013. These reform efforts are expected to effectively address significant overpricing of government procurement.

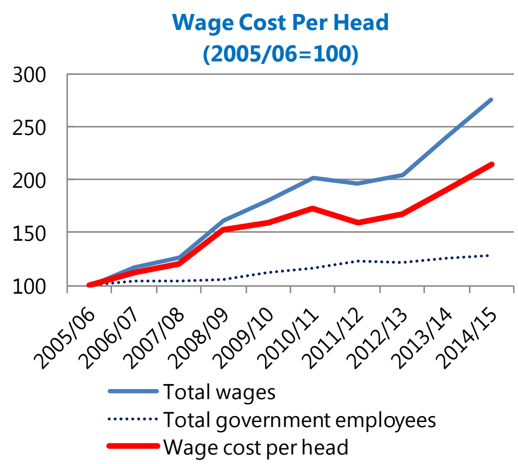
[11] According to the ministry of public services, the recently finalized payroll audit discovered about 800 unidentified workers (out of 41,000 public workers).

[12] The SRA has been stepping up the tax collection efforts by strengthening physical visits and introducing personal identification number to increase taxpayer's registration rate, and by introducing tougher penalties to non-complying taxpayers to improve tax filing compliance rate.

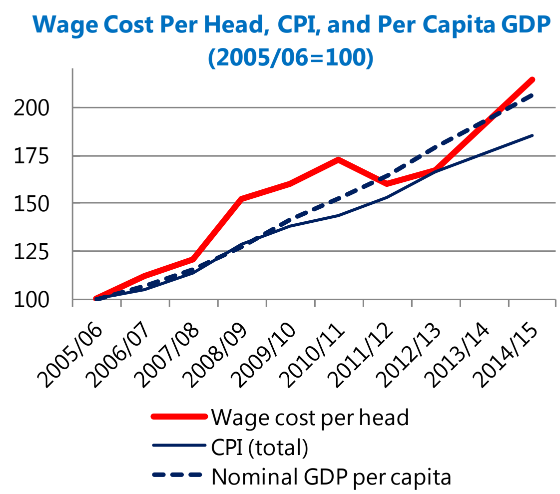
14. These efforts, envisaged under the baseline scenario, would help address the revenue fall to some degree, though vulnerability would remain, with a thin margin of international reserve buffer above the targeted floor (three months of imports). Fiscal deficits—following a marked increase to 6 percent of GDP in 2016/17 (with the SACU revenue fall)—would stabilize between 3¾–4 percent of GDP over the medium term. This would help contain import demand and keep international reserves slightly above three months of imports. With this level of international reserves, however, Swaziland would remain vulnerable to any further exogenous shocks (possibly stemming from downside risks mentioned above). Public debt—though staying below 30 percent of GDP throughout the projected period—would increase steadily. Furthermore, the government's large domestic financing needs could crowd out private sector credit, adversely affecting private sector developments and growth.

Developments of Wages for Government Employees

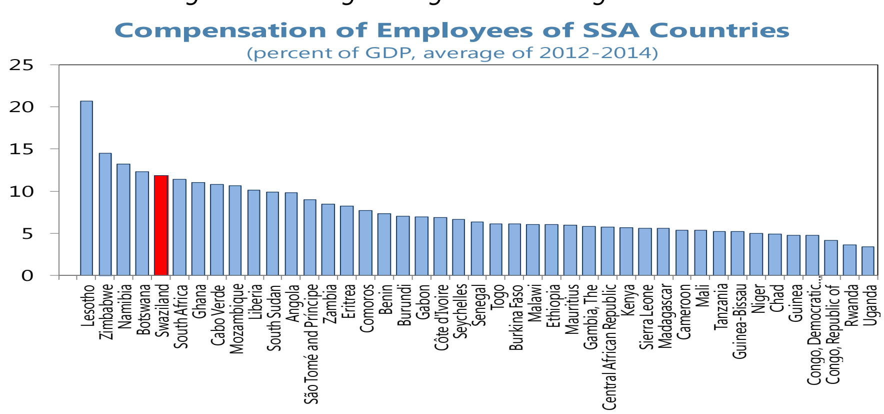
Government wages keep growing fast, driven by increase in per head wage…



…which have grown faster than inflation and nominal GDP per capita.



Swaziland's wages are among the highest in the region.



Sources: Country authorities and IMF staff estimates.

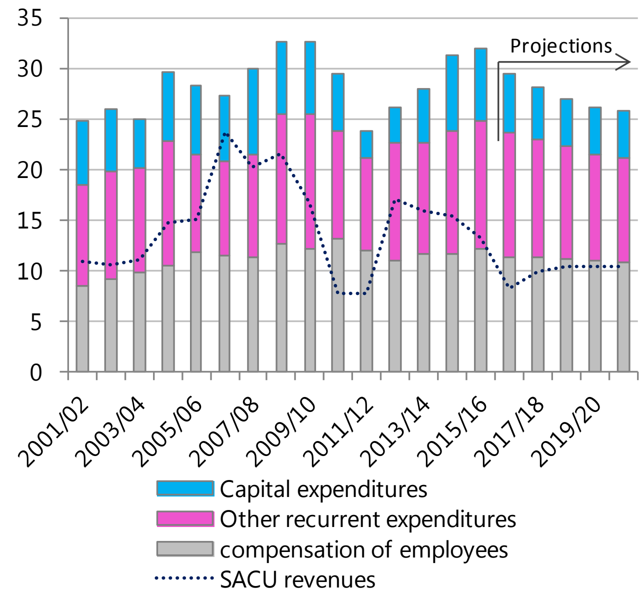
Policies to Strengthen Resilience

15. To strengthen resilience to future shocks and crowding in private sector credit, enhanced fiscal consolidation, through the policy steps below, is called for. Strengthening resilience to shocks would be particularly important in light of the downside risks.

- *Contain expenditures, while mitigating adverse growth impacts.* Specifically it is important to (i) reduce the impact of the 2015/16 supplementary budget on fiscal balances by reducing other spending items under the original budget, (ii) further contain public sector wages, purchases of goods and services, and subsidies and transfer, and (iii) safeguard critical projects with high investment returns and postpone less critical capital projects.[13]

With enhanced fiscal consolidation (the reform scenario), expenditures would return to the levels compatible to the period of low SACU revenues.

Fiscal Expenditures (Percent of GDP)



Sources: Swazi authorities and IMF staff estimates.

- *Enhance the quality and efficiency of fiscal spending,* through strengthening public financial management and public investment management (e.g., strict project appraisals and selection), while reorienting the expenditures towards priority areas (education, health, and essential infrastructure). The enactment of the Public Financial Management Bill is critical to increase the transparency of the budgetary process and to ensure that all expenditures are channeled through the appropriate budgetary procedures, while capital projects should be thoroughly selected based on a well-defined guideline. Key findings laid out in the Auditor General's 2013/14 report should be thoroughly followed up.[14] Other key reform measures include preparing a coherent medium-term fiscal framework and improving cash management and commitment control. Over the medium term, it is also important to revisit the privatization policies and the rationalization of public enterprises and realign spending following a comprehensive public expenditure review.

[13] Wages could be further contained (beyond the authorities' current plan), including through (i) limiting salary and notch increases (to reduce per head cost), (ii) limiting new hiring, while reallocating resources to critical social areas, and (iii) halting salary review (which could lead to sizable wage increases).

[14] The report identified a number of potential irregularities in budget execution.

- *Explore domestic revenue measures*, through (i) prioritizing the collection of outstanding tax arrears[15], and (ii) exploring additional measures (such as ensuring dividend payments by profit-making public enterprises, and increasing fuel tax and excise taxes in tobacco and alcohol to the level comparable to that of South Africa). Given the low revenue performance (in terms of the rebased GDP) relative to other countries in the region, a holistic review of domestic revenue performance is needed (Text Figure 2). In this regard, the authorities are taking steps for a tax-expenditure analysis, a tax-gap analysis, and a review of tax incentives.[16]

- *Prepare for the implementation of a fiscal rule, with adequate PFM system***.** A well-designed fiscal rule could help deal with the large volatility in SACU revenues and improve household welfare. Staff analysis suggests that, once the SACU revenues stabilize, a fiscal rule which targets a non-SACU fiscal deficit and saves windfall SACU revenues (similar to the authorities' plan) could help ensure fiscal and external sustainability.[17]

[15] As of August 2015, total outstanding tax arrears reached E2.1 billion, of which more than 30 percent is expected to be recoverable.

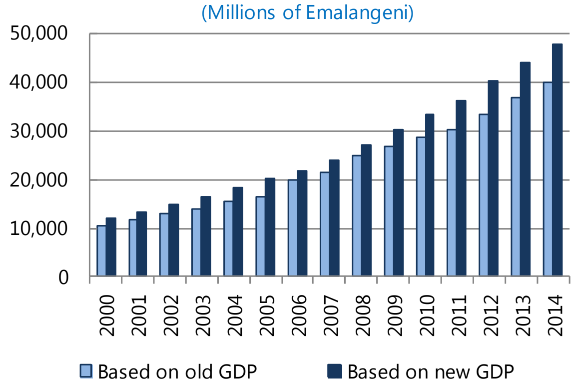
[16] SRA's preliminary tax expenditure analysis suggests that the cost of tax exemptions are sizable, which is estimated to be losses of E2.5 billion on corporate income tax and E0.36 billion on VAT.

[17] IMF Working Paper (forthcoming). "Could Fiscal Rules Help Addressing High Volatility of Revenues from Southern African Customs Union?" (Honda, et al.).

Rebased GDP and Domestic Revenue Performance

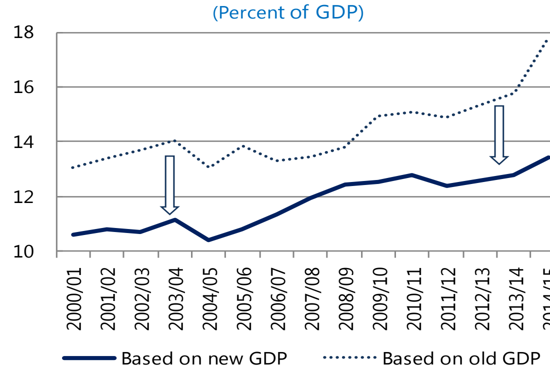
As a result of the national account rebasing and recompiling, nominal GDP revised up by 20 percent…

Nominal GDP under Old and New GDP
(Millions of Emalangeni)



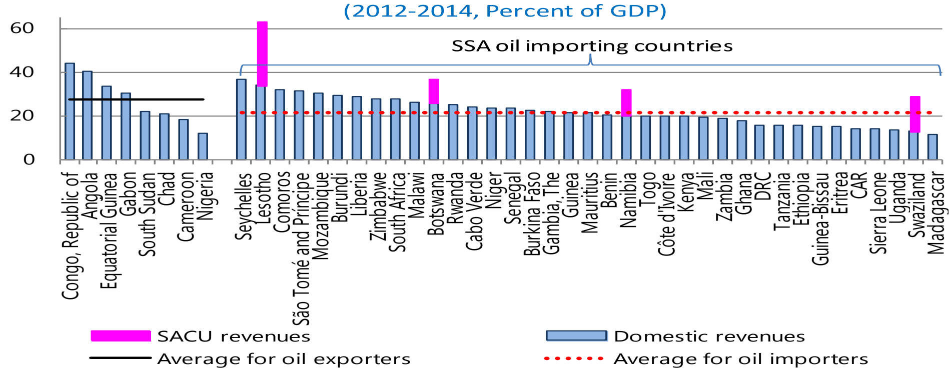
…resulting in the domestic revenue-to-GDP ratio dropping to 13½ percent of GDP.

Domestic Revenues (excl. SACU revenues)
(Percent of GDP)



Swaziland's revenue performance (excl. SACU revenues) is among the lowest in the region, suggesting scope for enhancing domestic revenue collection.

Domestic Revenus of SSA Countries
(2012-2014, Percent of GDP)



Sources: country authorities and IMF staff estimates and projections.

16. **A reform scenario incorporating these measures would strengthen the international reserve buffer, while promoting growth over the medium term.** With enhanced fiscal consolidation, international reserves would stay above 3½ months of imports and reach to 4¼ months of imports by 2020. Fiscal account would be balanced by 2020/21, and government debt would stay around 20 percent of GDP. The larger consolidation in recurrent expenditure, while safeguarding budget allocation for critical capital and social spending, could help crowd in private investment and private sector activities. Growth in the near term would be lower than in the baseline scenario due to larger fiscal consolidation, but would improve over the medium term, supported by structural reforms (described later) and crowding in private sector credit. Any upward revision to the current SACU revenue forecast should be saved to build international reserves, while downward revision may require enhanced consolidation efforts.

17. The authorities recognized the need for enhanced policy efforts, while noting the country's development needs. They expressed the intention to step up efforts for improving the quality of spending and enhancing domestic revenue collection, along the lines envisaged under the reform scenario. They affirmed their intention to improve public financial management (including through strengthening cash management and following up the auditor general's recommendations). In the meantime, the authorities committed to undertaking reprioritization exercise for both recurrent and capital expenditure, while protecting critical social and development needs. Following the finalization of the 2016/17 SACU revenue discussion (by end-2015), the authorities plan to incorporate consolidation measures for the 2016/17 budget and the medium term fiscal framework. Given that the supplementary budget has already been allocated, however, the authorities expressed difficulty in fully offsetting it through reallocation.

B. Supporting Financial Sector Development and Managing Risks

18. Swaziland's banking system stays sound in general, but some vulnerabilities in the financial sector are identified. All commercial banks meet the regulatory capital requirement. Some banks, however, have relatively high nonperforming loans, while the banks have high credit concentration on large borrowers (Box 1, Table 7). Other vulnerabilities include banks' almost unitary business model and the high level of concentration on both sides of banks' balance sheets. Nonbank financial institutions (NBFIs)—dominating the financial system in terms of asset size—are directly or indirectly linked to the banking sector, including through NBFI's deposits at banks, while banks do not appear to lend directly to NBFIs.[18]

Staff Medium-Term Projections (Reform Scenario)
(Percent of GDP, unless otherwise indicated)

	2011 Prel.	2012 Prel.	2013 Prel.	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
GDP growth (annual change)	1.2	3.0	2.9	2.5	1.6	0.8	1.0	1.6	2.1	2.5
Credits to private sector (annual change)	26.0	-1.7	20.2	9.8	6.3	5.5	4.9	6.7	7.4	9.2
Fiscal balance	-3.7	3.4	0.7	-1.2	-4.2	-5.9	-2.7	-1.2	-0.3	0.0
Total revenue	20.2	29.5	28.7	30.1	27.8	23.5	25.4	25.9	25.9	25.9
Domestic revenue	12.3	12.3	12.3	13.1	13.9	14.8	15.0	15.0	14.9	14.9
SACU revenues	7.8	17.1	15.9	15.3	13.3	8.2	10.0	10.5	10.5	10.5
Total expenditure	23.9	26.1	28.0	31.3	32.0	29.4	28.1	27.1	26.2	25.8
Recurrent expenditure	21.2	22.7	22.7	23.9	24.9	23.6	23.0	22.4	21.5	21.2
of which wages	12.0	11.0	11.6	11.6	12.1	11.4	11.4	11.2	11.1	10.8
Capital expenditure	2.7	3.4	5.3	7.4	7.1	5.8	5.1	4.7	4.7	4.7
Current account balance (including grants)	-6.8	3.1	5.1	2.9	0.8	-0.9	0.5	1.8	2.0	1.7
Gross international reserves (month of imports)	2.3	2.9	3.7	3.5	3.6	3.4	3.4	3.7	3.9	4.1
Total public debt	13.9	14.4	14.8	13.7	17.5	20.2	21.5	21.2	20.0	18.4

Sources: Swaziland authorities; and IMF staff estimates and projections.

[18] NBFIs include pension funds, collective investment schemes, insurance companies, a building society, the Savings and Credit Cooperatives and other credit institutions.

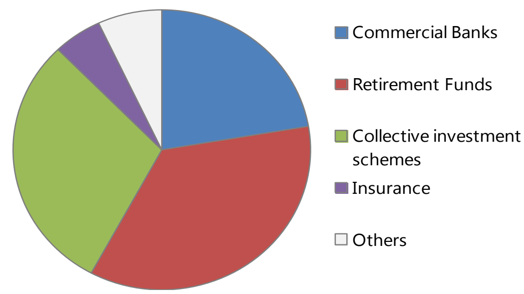
Box 1. Structure of Financial Sector [1]

Performance indicators suggest that Swaziland's banking system is functioning well, but with some structural vulnerabilities.[2] Capital ratios are well above regulatory minima (8 percent of risk-weighted asset) and profitability is high (Table 7). NPLs of the banking system remain moderate on average (6.4 percent of total gross loans), though there is a wide variation among banks, with some banks having substantially higher NPL ratios (20 percent). The system is also subject to several structural vulnerabilities, including the almost unitary business model of three of the banks and the high level of concentration on both sides of banks' balance sheets.

Swaziland's financial sector is exposed to several risks. The main risks are external in origin—a sharp decline in the SACU revenues or a large drop in sugar price. These risks are confirmed by a quantitative impact assessment, which shows that both the solvency and liquidity of banks could come under pressure if either or both of the main risks were to materialize (Annex 2).

Furthermore, increasing links between banks and NBFIs pose risks to financial stability. NBFIs deposits in banks are the most apparent link between NBFIs and banks. NBFIs (mostly pension and insurance companies) place deposits with banks, partly to comply with the local asset requirement and partly for liquidity management purposes. Banks estimate that 10 percent of their deposits are from NBFIs. Banks do not appear to lend directly to NBFIs. Other indirect links are apparently growing but harder to measure.

Swaziland: Financial Sector Structure
(Share of total assets, percent)



Sources: Swaziland authorities and IMF staff estimates.

1/ Largely based on the finding of the IMF TA mission in February 2015.
2/ The banking system includes three subsidiaries of South African banks (which comprise 85 percent of Swazi banking system asset) and a state-owned bank.

19. **The authorities have made progress in enhancing financial sector stability**. The Central Bank of Swaziland (CBS) recently established a Financial Stability Unit (FSU) to strengthen its capacity to undertake financial stability analysis and reporting. The FSU—while it is still not fully staffed—has developed a concrete work program, covering the legal framework for financial stability and institutional arrangements and reporting on financial stability. The CBS has introduced a risk-based supervisory framework for banks and begun the process of introducing the practice of risked-based supervision, and it has also recently finalized a self-assessment against the Basel Core Principles (BCPs). The Financial Services Regulatory Authority (FSRA)—established in 2012—is almost fully staffed, though it will take time to implement a robust examination process to supervise a large number of NBFIs. Most of the Savings and Credit Cooperatives (SACCOs) have been licensed, and on-site examinations for large SACCOs are being conducted, following the IMF TA recommendations.

Box 2. Macro-Financial Linkages in Swaziland

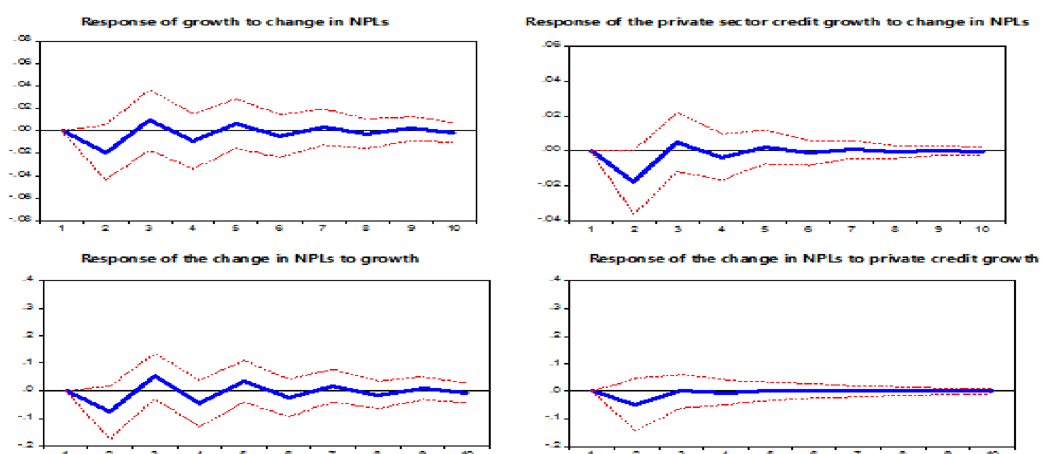
The impact of SACU revenue fall on the economy could be augmented if the shock also threatens the financial sector stability. Staff analysis confirms strong macrofinancial linkages in Swaziland, pointing to adverse macroeconomic consequences of the SACU revenue fall and their impacts on financial sector.

The regression analysis shows that the SACU revenue shock would adversely affect the economy (including through slower growth and higher sovereign risk premium) and worsen financial sector stability.

- A VAR-based analysis reveals that the SACU shock would adversely affects economic growth. Growth is sensitive to a reduction in private credit (with a lag of one quarter), while a fall in SACU revenues could significantly reduce the international reserves, leading to a hike in sovereign spread and a reduction in private credit growth.
- The estimates of the cross-country satellite model—based on a panel data of three SACU countries (Lesotho, Swaziland, and Namibia)—suggest that the consequences of the SACU revenue fall (slower growth, higher sovereign risk premium, and increased likelihood for government arrears for suppliers) would adversely affect the payment capacity of borrowers from commercial banks, and NPL ratios would rise. The analysis using bank-level data also confirms that higher sovereign risk premium and stagnant real economy activities (as proxied by the electricity consumption) would contribute to higher NPL ratios as observed in the past.

The potential impacts of the SACU revenue fall on financial sector could have further feedback effects on growth. The VAR-based analysis suggests that, with an increase in NPLs, the bank would deleverage lending in response to the deterioration in the asset quality, leading to lower growth. The impulse response function in the figures below confirms this feedback channels (from the bank's asset quality to the real economy): an increase in NPLs temporarily reduces private credit and growth (proxied by the electricity consumption growth in the absence of quarterly GDP data).

Response to one standard deviation innovations ±2 standard deviations



Source: IMF staff calculation.

20. Staff's analysis suggests that the SACU revenue shock could threaten financial stability (Box 2, Selected Issues Paper). The analysis reveals that the SACU revenue fall could worsen the commercial banks' asset quality and capital adequacy, mainly through three channels: (i) triggering higher sovereign spread (and interest rate), (ii) crowding out private sector credit and adversely affecting growth, and/or (iii) worsening the payment capacity of borrowers in government-related sector (e.g., construction) and small and medium-sized enterprises, partly due to the government's arrears to suppliers and vendors, as observed during the 2010–11 fiscal crisis. The negative impact on financial sector stability could be significantly augmented should the SACU revenue fall also trigger payment difficulties of large borrowers.

21. In light of these vulnerabilities, a set of supervisory and regulatory measures are called for to enhance financial sector stability, while fiscal consolidation would also help to mitigate the adverse consequences of the SACU revenue fall.

- *Strengthening Banking Supervision,* through eradicating any shortcomings in risk-based supervision and remedying gaps and inconsistencies in the legislative framework. Following the completion of the self-assessment against the BCPs, it is important to make further progress in addressing any shortcomings and facilitating the move to Basel II, with technical assistance by the IMF.

- *Strengthening crisis preparation,* through (i) establishing proper lender-of-last resort functions, (ii) defining cooperation among the CBS, the Ministry of Finance, and FSRA in crisis situation; and (iii) taking further step to manage possible adverse contagion from South Africa through, for example, crisis management arrangements with the SARB in addition to the information sharing MOU.

- *Softening the adverse impact of SACU revenue shock on financial sector stability,* through fiscal consolidation. It would help (i) build sufficient international reserve (which helps containing risk premium), (ii) reduce government's financing needs (allowing crowding in of private sector credit), and (iii) ease the government's liquidity situation (reducing the likelihood of the government arrears).

- Strengthening supervision for NBFIs and ensuring financial sector stability. The FSU should be fully staffed. It is also essential to strengthen the supervision and regulation for NBFIs, fill data gaps, and improve data sharing with the CBS.[19] Systemically important financial institutions should be identified and placed under close oversight.

22. The authorities agreed with the staff's view and shared the importance of further strengthening financial sector supervision and regulation. As the financial sector strategy is expected to be finalized soon (following technical assistance from the IMF and the World Bank), the

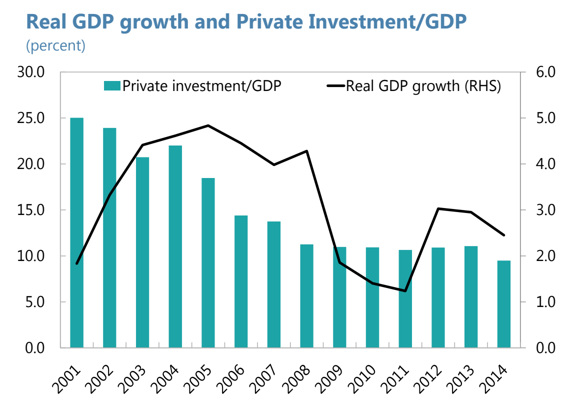
[19] Given that commercial banks do not lend to NBFIs, their possible spillover to banking system would be limited as far as steady flow of deposits to the system are ensured.

authorities intend to take further steps to enhance financial inclusion with proper regulatory oversight. Coordination with the supervisory authorities in the region is being strengthened, through attending supervisory colleges and enhancing information sharing with South African authorities (including through the CMA governors' quarterly meetings). The authorities are also working on modernizing the legal framework, based on technical assistance by the IMF.

C. Structural Reforms to Enhance Inclusive Growth

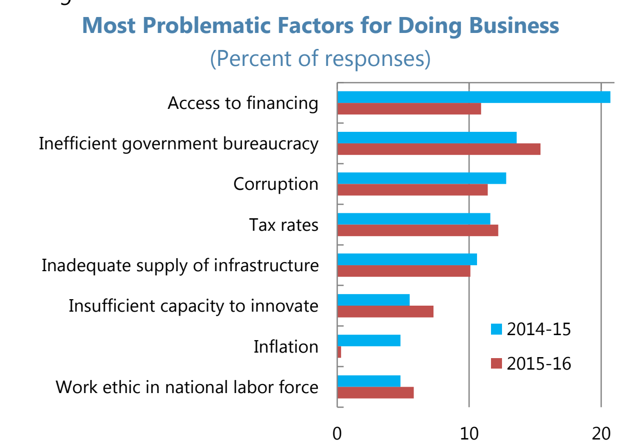
23. Swaziland's significant development challenges—with high unemployment and poverty, call for further increase in the country's potential for inclusive growth, through private sector developments. Swaziland's weak growth performance—observed in the past decades—appears to be associated with its inability to maintain private investment crucial for sustainable economic development.[20] Recent surveys show that investors view access to financing, inefficient government bureaucracy and corruption as major constraints in doing business, which may undermine investment and growth. Swaziland is ranked 105th out of 189 countries on the ease of doing business in the World Bank's 2016 Doing Business Indicators.[21] Despite some improvements in recent years, Swaziland still ranks low on the ease of starting business, getting electricity, and contract enforcement, owing to lengthy procedures. The land tenure system is also seen as a constraint for investment.[22]

Declining private investment underpinned weak growth.



Sources: Country authorities and IMF staff calculations.

Access to financing and governance and institutional quality are among the main constraints to business.



Source: World Economic Forum, Global Competitiveness Report

[20] IMF Country Report No. 14/223.

[21] These indicators should be interpreted with caution owing to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

[22] Swaziland Growth Report, 2015, the World Bank.

World Bank Doing Business Indicators, 2015-16

	Ease of Doing Business	Starting a Business	Dealing with Construction Permits	Getting Electricity	Protecting Investors	Paying Taxes	Enforcing Contracts
Botswana	72	143	97	122	81	71	128
South	73	120	90	168	14	20	119
Namibia	101	164	66	76	66	93	103
Swaziland	**105**	**156**	**80**	**155**	**134**	**79**	**175**
Lesotho	114	112	172	147	99	109	85
Mozambiq	133	124	31	164	99	120	184
Zimbabwe	155	182	184	161	81	145	166

Source: The World Bank: Doing Business Report, 2016

Swaziland: Cost and Procedure of Key Indicators

		2006-07	2009-10	2012-13	2015-16
Starting business	Procedures (number)	12	12	12	12
	Time (days)	60	60	56	30
	Cost (% of income per capita)	41.1	33.9	24.1	23.4
Getting electricity	Procedures (number)	...	6	6	6
	Time (days)	...	137	137	137
	Cost (% of income per capita)	...	1,526.7	1,071.8	1,042.6
Enforcing contracts	Procedures (number)	...	...	...	...
	Time (days)	972	972	956	956
	Cost (% claim)	56.1	56.1	56.1	56.1

Source: The World Bank, Doing Business Indicators

24. Furthermore, the loss of AGOA eligibility raises the importance of enhancing economic diversification and competitiveness, diversification and product quality have declined in recent years. Swaziland's export structure has experienced sizable changes over the past 15 years (Selected Issues Paper). The share of textile exports has halved, and the expiration of Swaziland's AGOA qualification implies that the share of textile exports would decline further. This raises the importance of enhancing economic diversification and competitiveness. Staff analysis suggests that, though Swaziland's export basket is relatively well diversified with reasonably good product quality index compared with its peers, diversification and product quality have declined in recent years.

25. The government sought to address structural weaknesses but with mixed progress. The Economic Recovery Strategy and Private Sector Development Strategy point to the needs to (i) improve regulatory and business environment (including procedural transparency and administrative coordination), (ii) improve innovation, productivity and competitiveness; and (iii) introduce a clear investment policy and transparent incentives. The Draft Land Policy (2009) provides framework for dealing with land management issues and the Draft Land Bill (2013) aims to address these issues. Implementation of these policies, however, has been slow owing to insufficient supports by many key stakeholders.

26. To address Swaziland's development challenges, policy efforts from multiple perspectives are called for, particularly in the following areas:

- *Promote export diversification and quality upgrading, through promoting private sector development*. Specifically, removing the perceived impediments for business (e.g., inefficient government bureaucracy and corruption) and enhancing human capital are important for export diversification and quality upgrading. Building on some progress in recent years, the cost of doing business could be further reduced, including through making it easier to start a business and enforcing contracts. Other export potentials (e.g., exploring Swaziland's mining resources, seeking possibilities to retain AGOA eligibility, diversifying export markets) should also be explored.

- *Enhance access to financing,* including through: (i) establishing a legal framework for comprehensive credit information, (ii) establishing a legal framework for secured transactions and a collateral registry, and (iii) enhancing mobile banking (using simple tools, such as cell phone). These measures would be elaborated in the upcoming financial sector strategy.

- *Other structural reforms*. Improving education outcomes (in particular raising the low secondary school enrollment) and training would help attract new (foreign) investment, and facilitate innovation and inclusive growth. To improve land management, the authorities should enhance efforts to finalize the Draft Land Policy and the Draft Land Bill. Strengthening the anti-corruption and anti-money laundering regimes could also support efforts to improve the business climate.

27. The authorities generally agreed with staff's suggestions. To ensure progress in improving business climate, the government has stepped up its efforts, including through re-launching the Investor Roadmap in 2012 and creating an Investor Roadmap Unit in the Ministry of Commerce, Industry, and Trade. On financial intermediation, the authorities affirmed their intention to enhance financial sector developments and access to credit (particularly for small and medium enterprises), based on the financial sector strategy. They also noted the progress in labor legislation to satisfy the U.S. conditions, and hope that with additional progress it will allow the country to regain the AGOA access. The authorities, however, expressed difficulty in undertaking land reforms pending wider consultations, due to the complexity of the land management issues.

D. Other Surveillance Issues

28. Data provision is broadly adequate for surveillance with some data shortcomings in fiscal sector. Staff welcomed the authorities' recent efforts to rebase and update the national account statistics, based on the new economic survey. On fiscal data, weak cash management is associated with the lack of proper fiscal monitoring, which resulted in large unidentified financing (1½ percent of GDP in 2012/13–2014/15). To this end, it is critical to conduct reconciliation exercises on a regular basis and strengthen cash management. On balance of payments statistics, sizable errors and omissions (1.5 percent of GDP in 2014), reflecting the data and capacity constraints (e.g., compilation knowledge, source data, and the use of data) to comprehensively cover financial transactions. IMF technical assistance is being planned for mid-2016.

STAFF APPRAISAL

29. Though Swaziland continues to gradually recover from the 2010-11 fiscal crisis, its resilience to shocks has not been sufficiently strengthened, exposing the country to future shocks. Its growth performance has improved since the crisis, albeit with some slowdown in recent years. International reserve buffer, however, has not reached the medium-term target, and the government's heavy reliance on short-term financing exposes it to high rollover risks. The government's recent shift to an expansionary fiscal policy stance also contributed to increasing pressures on fiscal and external balances. In the meantime, it continues to face serious social development challenges (with high inequality and unemployment).

30. The recent weakening of the regional economic outlook, likely followed by a decline in SACU revenues, poses significant challenges for Swaziland. A slowdown in the South African economy is likely to have adverse impacts on Swaziland through multiple channels. The expected decline in SACU revenues in the coming years, in particular, is raising serious concerns for fiscal and external sustainability. Based on the experiences of the last fiscal crisis, it is important to maintain international reserves above three months of imports, while keeping the medium-term target of 5–7 months of imports.

31. Swaziland stands at a critical juncture to address significant economic challenges. Specifically, its key challenges are: (i) in the near term, to address the expected SACU revenue fall and manage its impacts on fiscal and external balances and (ii) over the medium and long term, to achieve higher and inclusive growth to meet its social and development needs.

32. In view of the near-term challenge (maintaining international reserves above three months of imports), staff welcomes the authorities' intention to pursue fiscal consolidation in coming years. Though fiscal consolidation efforts may temporarily have adverse impacts on growth, sufficiently strong policy response would strengthen international reserves and help maintain the confidence in the economy. While staff welcomes the authorities' intention to shift toward a tight fiscal policy stance, enhanced consolidation measures would be advisable with safeguarding critical spending for social and development needs. Specifically, it is important to rationalize both recurrent and capital expenditures, enhance domestic revenue collection, and effectively implement PFM and PIM reforms. Enhanced fiscal consolidation—as envisaged under the reform scenario—could help crowd in private sector credit and facilitate private sector developments.

33. Staff calls for further efforts to ensure financial sector stability, in light of vulnerabilities and risks. Specifically, the SACU revenue fall could threaten financial sector stability, which reiterates the needs for fiscal consolidation to mitigate the adverse impacts of the fall. Further progress in risk-based supervision for banks is essential in light of the high credit concentration on large borrowers and external vulnerabilities. In light of the dominant size of NBFIs, strengthened supervision and regulation for NBFIs are also called for.

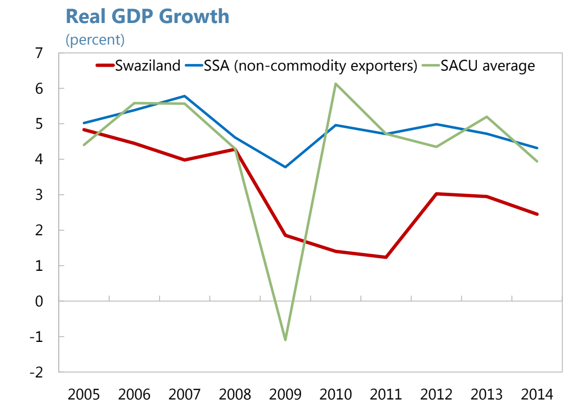
34. To address social and development needs, it is essential to raise the country's potential for inclusive growth, through private sector developments. While the recent loss of AGOA eligibility adversely affected export and employment, Swaziland's textile producers have explored alternative export markets in the region (South Africa in particular). Building on this progress, fast-tracking policy efforts in multiple areas are needed: to promote export diversification, enhance access to financing, and improve the business climate. Staff commends the progress in preparing a financial sector strategy, based on technical assistances by the IMF and the World Bank, and calls for the implementation of reform measures as envisaged under the strategy. Maintaining the soundness of the financial sector is also critical for private sector-led growth.

35. While Swaziland continues to maintain one exchange restriction related to advanced payments for certain imports (subject to Fund approval under Article VIII), the authorities have not requested and staff does not recommend the approval of this restriction.

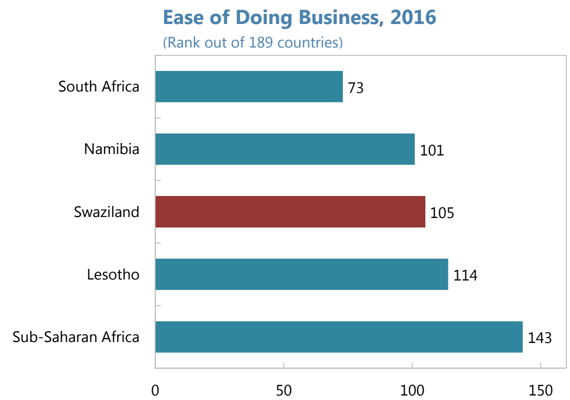
36. Staff recommends that the next Article IV consultation with Swaziland take place on the standard 12-month cycle.

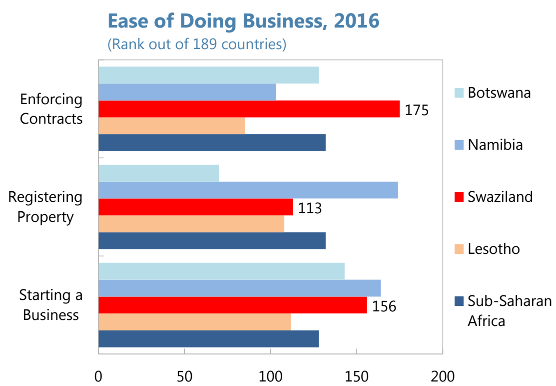
Figure 1. Low Growth Not Sufficient to Address Social Challenges

Swaziland growth has lagged behind peers.

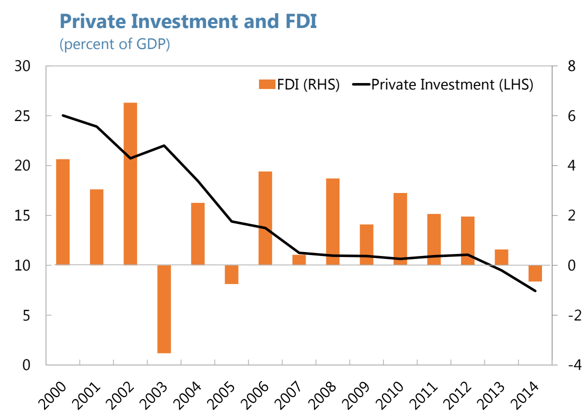


Weak business environment ....

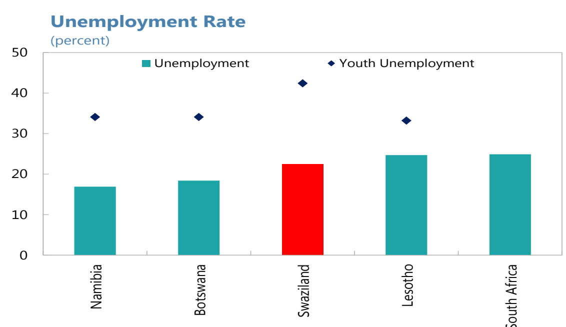




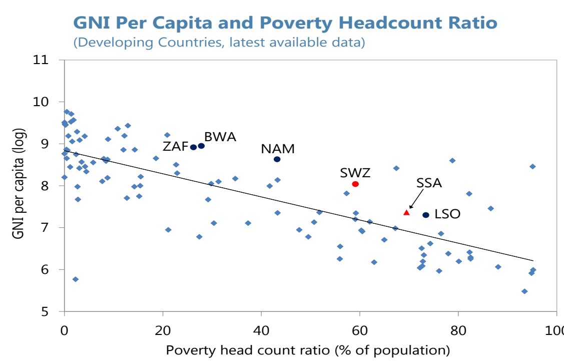
....contributed to low private sector investment and FDI.



Unemployment is high....



....and so is poverty.

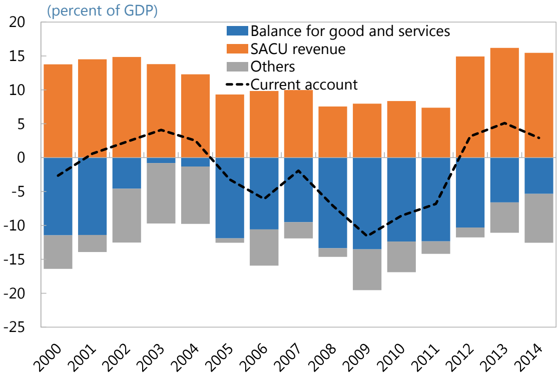


Sources: Country authorities, World bank and IMF staff calculations.

Figure 2. Buffers have been Partially Rebuilt but Vulnerabilities Remain

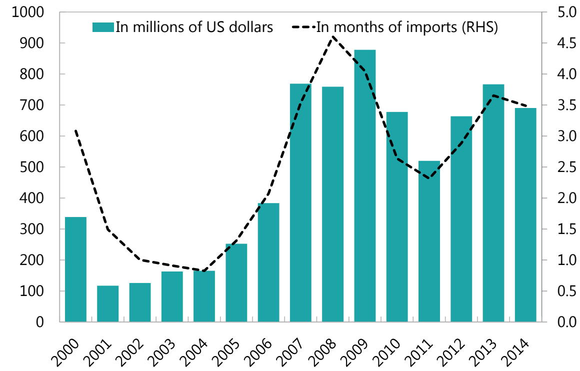
The recovery of SACU revenues has turned the current account deficit into a surplus…

Current Account Balance
(percent of GDP)



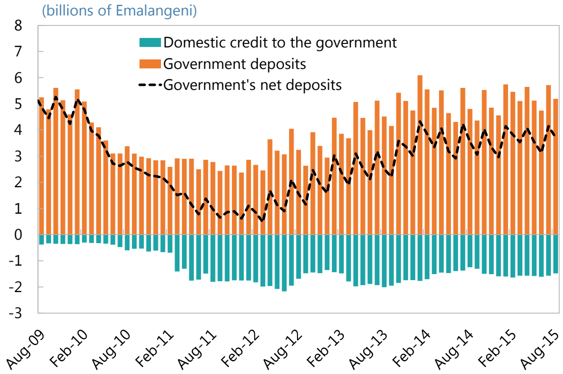
…and raised international reserves…

International Reserves



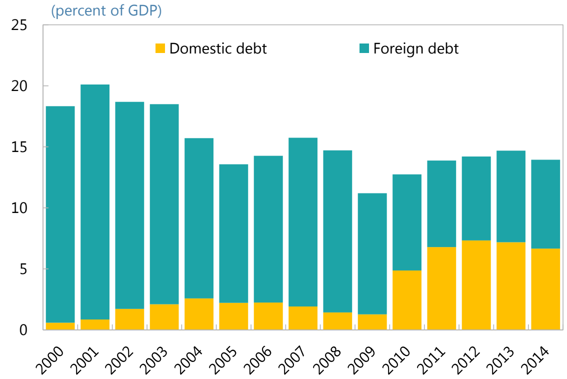
…as well as the government's cash position.

Government's Net Position at Banking System
(billions of Emalangeni)



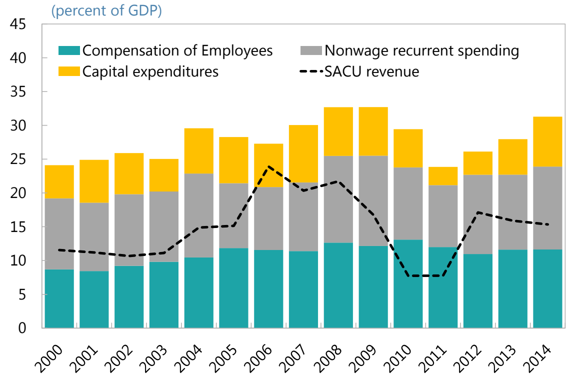
Public debt remains relatively low.

Public Debt
(percent of GDP)



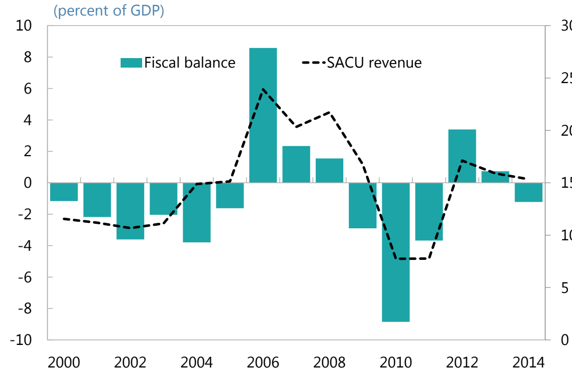
Fiscal spending has recently picked up…

Fiscal Expenditures
(percent of GDP)



…turning fiscal balance into deficit in 2014.

Fiscal Balance and SACU Revenue
(percent of GDP)

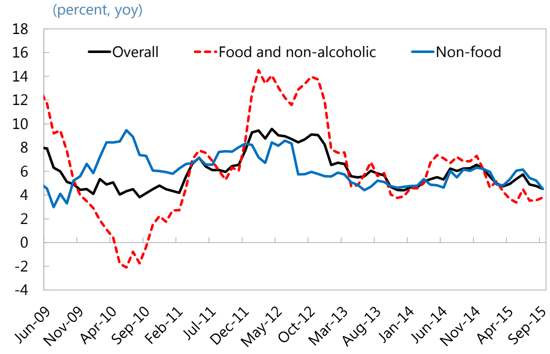


Sources: Country authorities and IMF staff calculations.

Figure 3. Inflation Moderated

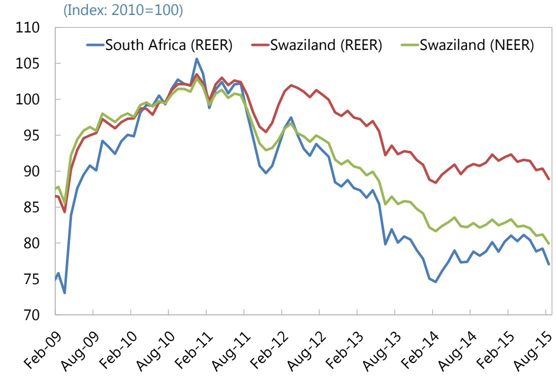
Inflation moderated…

Inflation
(percent, yoy)



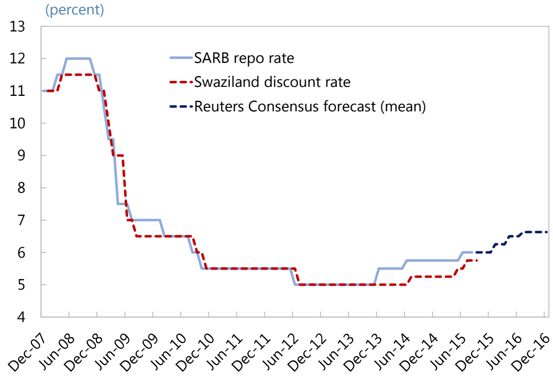
…but the weakening exchange rate poses risks.

REER and NEER
(Index: 2010=100)



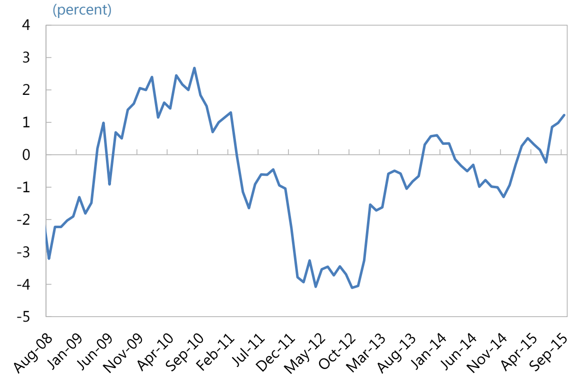
Policy rate was raised in May 2015 and again in July (following the South African Reserve Bank) and is expected to be raised further…

Swaziland: Policy Rate
(percent)



…the real policy rate is also pushed up by moderating inflation.

Swaziland: Real Policy Rate
(percent)

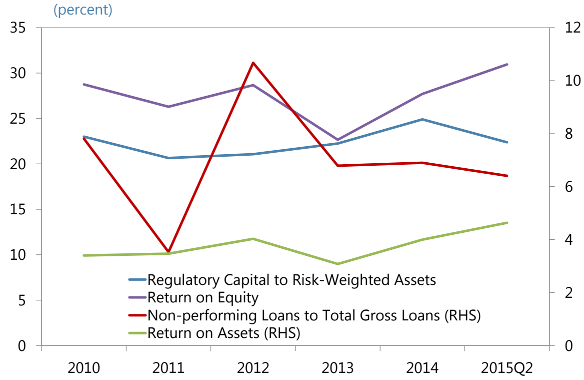


Sources: Country authorities and IMF staff calculations.

Figure 4. Financial Sector Developments

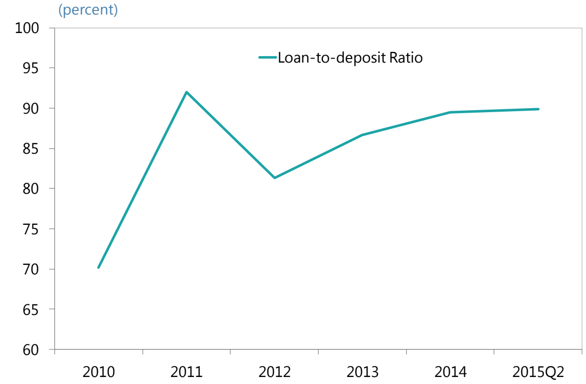
Banks are relatively well capitalized and are profitable…

Financial Soundness Indicators
(percent)



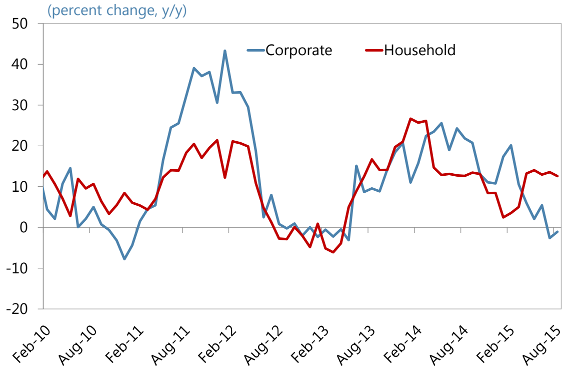
…but liquidity conditions have generally deteriorated in recent years.

Financial Soundness Indicators (cont.)
(percent)



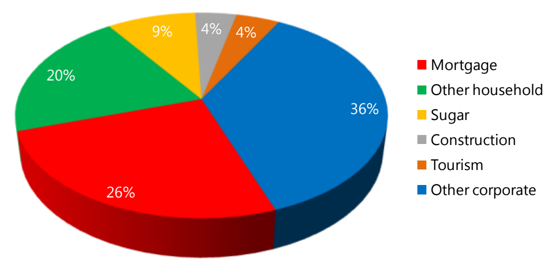
Credit growth has slowed.

Private Sector Credit Growth
(percent change, y/y)



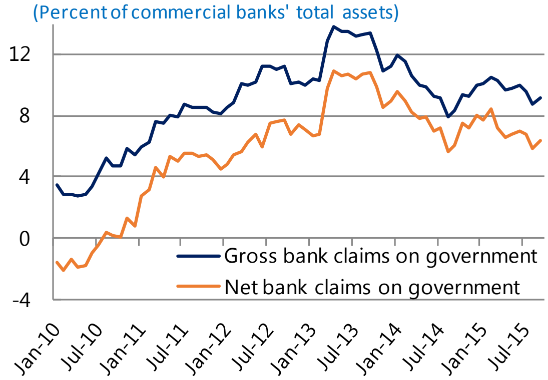
There exists large exposure to the sugar sector.

Composition of Banking System Loans
(percent of total lending, July-2015)



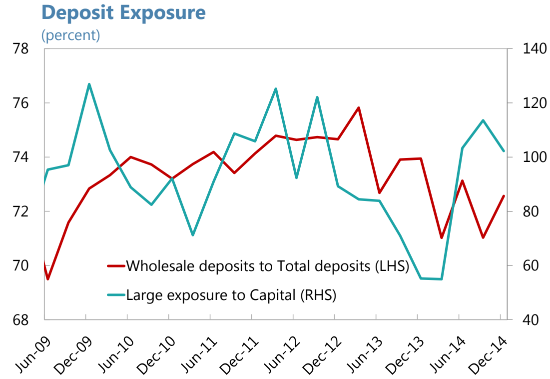
Commercial banks' exposure to the government has somewhat declined in recent years.

Commercial Banks' Claims on Government
(Percent of commercial banks' total assets)



While wholesale funding declined, lending concentration has increased in recent years.

Concentration of Commercial Banks' Credit and Deposit Exposure
(percent)



Sources: Country authorities and IMF staff calculations.

Table 1. Swaziland: Selected Economic Indicators, 2013–20 (Baseline Scenario)

	2013	2014	2015	2016	2017	2018	2019	2020
	Prel.	Prel.	Proj.[4]	Proj.[4]	Proj.[4]	Proj.[4]	Proj.[4]	Proj.[4]
	(Percentage changes; unless otherwise indicated)							
National account and prices								
GDP at constant prices	2.9	2.5	1.7	0.8	1.1	1.3	1.2	1.2
GDP deflator	6.1	6.1	5.8	5.0	4.8	4.9	5.1	5.0
GDP at market prices (Emalangeni billions)	44.1	47.9	51.5	54.5	57.8	61.4	65.3	69.4
Consumer prices (average)	5.6	5.7	5.0	6.5	5.8	5.8	5.8	5.8
External sector								
Average exchange rate (local currency per US$)	9.7	10.8	...	...	...	...	...	...
Nominal exchange rate change (– = depreciation) [1]	7.3	5.4	...	...	...	...	...	...
Real effective exchange rate (– = depreciation) [1]	5.1	5.2	...	...	...	...	...	...
Gross international reserves								
(months of imports)	3.7	3.5	3.6	3.3	3.2	3.2	3.2	3.1
(percent of GDP)	18.3	16.7	16.0	14.8	14.4	14.3	14.1	13.6
(percent of reserve money)	423	424	412	384	380	386	389	382
Gross reserves minus reserve money								
(percent of deposits)	57.4	55.0	53.6	48.4	47.4	47.8	47.7	46.0
Money and credit								
Domestic credit to the private sector	20.2	9.8	6.5	5.3	4.7	4.9	4.8	4.8
Reserve money	6.0	-0.8	6.3	4.5	4.2	4.4	4.3	4.2
M2	15.9	3.9	7.1	5.4	5.0	5.5	5.5	5.5
Interest rate (percent) [2]	5.0	5.0	...	...	...	...	...	...
	(Percent of GDP)							
National accounts								
Gross capital formation	7.6	9.2	10.9	7.8	6.4	6.1	6.0	5.7
Government	3.6	5.2	5.6	3.8	3.1	3.0	3.1	3.0
Private	4.0	4.0	5.3	4.0	3.3	3.1	2.9	2.7
National savings	12.7	12.1	11.7	6.6	6.5	7.0	6.8	6.4
Government	6.5	7.4	4.3	-0.2	-0.1	0.6	0.7	0.6
Private	6.2	4.6	7.4	6.8	6.6	6.4	6.1	5.8
External sector								
Current account balance								
(including official transfers)	5.1	2.9	0.7	-1.2	0.1	0.8	0.8	0.6
(excluding official transfers)	-12.8	-13.5	-13.3	-10.8	-9.5	-9.5	-9.5	-9.6
External public debt	7.5	7.3	7.8	8.4	8.6	8.5	8.4	8.3
Central government fiscal operations [3]								
Overall balance	0.7	-1.2	-5.0	-5.9	-4.3	-3.8	-3.9	-3.9
Total revenue and grants	28.7	30.1	27.8	22.9	24.6	25.1	25.0	25.0
Total expenditure	28.0	31.3	32.8	28.9	28.8	28.9	28.9	28.9
Public debt, gross	14.8	13.7	17.4	20.2	21.8	24.0	26.4	28.8
Public debt, net	3.3	2.9	8.2	13.7	17.2	20.0	22.7	25.2
Memorandum item:								
Population (in million)	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.2

Sources: Swazi authorities; and Fund staff estimates and projections.

[1] IMF Information Notice System trade-weighted; end of period.

[2] 12-month time deposits rate.

[3] Fiscal year data (fiscal years run from April 1 to March 31).

[4] Staff estimates based on the baseline scenario.

Table 2. Swaziland: Fiscal Operations of the Central Government, 2011/12–20/21 1/ (Baseline Scenario)

(Emalangeni millions)

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
			Prel.	Est.	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]
Transactions affecting net worth:										
Total revenue	7,489	12,178	12,911	14,675	14,538	12,684	14,423	15,654	16,624	17,631
Tax revenue	7,054	11,813	12,433	13,749	14,052	12,147	13,867	15,078	15,996	16,964
Taxes on income, profits, and capital gains	2,481	2,274	2,809	3,543	4,074	4,419	4,687	4,982	5,297	5,630
Taxes on property	20	19	17	29	34	36	38	40	43	45
Taxes on international trade and transactions	2,881	7,063	7,154	7,487	6,931	4,549	5,841	6,581	6,997	7,436
of which: SACU receipts	2,881	7,063	7,154	7,487	6,931	4,549	5,841	6,581	6,997	7,436
Domestic taxes on goods and services	1,659	2,446	2,432	2,675	3,001	3,130	3,287	3,460	3,643	3,836
Other taxes	11	12	20	12	13	13	14	15	16	17
Non-tax revenue	417	322	282	148	156	266	282	299	318	338
Grants	18	43	196	778	329	271	274	277	310	329
Budget support	0	0	0	0	0	0	0	0	0	0
Project grants	18	43	196	778	329	271	274	277	310	329
Expense	7,852	9,359	10,218	11,661	13,198	13,646	14,562	15,505	16,489	17,537
Compensation of employees	4,447	4,524	5,231	5,675	6,337	6,717	7,170	7,655	8,131	8,637
Purchases or use of goods & services	1,456	2,070	2,357	2,774	2,918	2,795	2,884	3,020	3,164	3,314
Interest	265	350	344	452	634	963	1,186	1,351	1,551	1,769
Other expense	1,684	2,415	2,285	2,760	3,310	3,171	3,322	3,479	3,644	3,817
Gross operating balance	-363	2,818	2,693	3,014	1,340	-962	-139	149	135	95
Transactions in nonfinancial assets:										
Net acquisition of nonfinancial assets	1,002	1,418	2,364	3,610	3,946	2,329	2,365	2,514	2,715	2,857
Foreign financed	79	98	426	1,194	1,269	1,211	991	1,066	1,149	1,221
Domestically financed	923	1,320	1,938	2,416	2,677	1,118	1,374	1,448	1,566	1,636
Total expenditure	8,854	10,778	12,582	15,271	17,145	15,975	16,927	18,019	19,204	20,393
Primary net lending / borrowing	-1,101	1,750	674	-144	-1,973	-2,329	-1,318	-1,014	-1,029	-993
Net lending/borrowing	-1,365	1,400	329	-596	-2,607	-3,291	-2,504	-2,365	-2,580	-2,762
Transactions in financial assets and liabilities:										
Net acquisition of financial assets	507	-1,216	-1,165	-111	462	1,238	850	212	0	0
of which: Policy lending	48	14	0	0	0	0	0	0	0	0
Net incurrence of liabilities	540	-789	148	22	2,144	2,053	1,654	2,153	2,580	2,762
Domestic	676	-643	110	-11	1,472	1,465	1,377	1,872	2,330	2,531
Foreign	-136	-146	38	33	673	588	277	280	250	231
Unidentified financing [3]	*318*	*605*	*687*	*685*	*0*	*0*	*0*	*0*	*0*	*0*
Memorandum item:										
Gross public debt	5,140	5,924	6,651	6,683	9,107	11,161	12,815	14,968	17,547	20,309

Sources: Swazi authorities; and Fund staff estimates and projections.

[1] The fiscal year runs from April 1 to March 31.

[2] Staff estimates based on the baseline scenario.

[3] Financing gap (positive number means underfinancing).

Table 3. Swaziland: Fiscal Operation of the Central Government, 2011/12–20/21 1/ (Baseline Scenario)

(Percent of GDP)

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
			Prel.	Est.	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]	Proj.[2]
Transactions affecting net worth:										
Total revenue	20.2	29.5	28.7	30.1	27.8	22.9	24.6	25.1	25.0	25.0
Tax revenue	19.0	28.6	27.6	28.2	26.9	21.9	23.6	24.2	24.1	24.1
Taxes on income, profits, and capital gains	6.7	5.5	6.2	7.3	7.8	8.0	8.0	8.0	8.0	8.0
Taxes on property	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on international trade and transactions	7.8	17.1	15.9	15.3	13.3	8.2	9.9	10.5	10.5	10.5
of which: SACU receipts	7.8	17.1	15.9	15.3	13.3	8.2	9.9	10.5	10.5	10.5
Domestic taxes on goods and services	4.5	5.9	5.4	5.5	5.7	5.7	5.6	5.5	5.5	5.4
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-tax revenue	1.1	0.8	0.6	0.3	0.3	0.5	0.5	0.5	0.5	0.5
Grants	0.0	0.1	0.4	1.6	0.6	0.5	0.5	0.4	0.5	0.5
Budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	0.0	0.1	0.4	1.6	0.6	0.5	0.5	0.4	0.5	0.5
Expense	21.2	22.7	22.7	23.9	25.3	24.6	24.8	24.8	24.8	24.9
Compensation of employees	12.0	11.0	11.6	11.6	12.1	12.1	12.2	12.3	12.3	12.2
Purchases or use of goods & services	3.9	5.0	5.2	5.7	5.6	5.0	4.9	4.8	4.8	4.7
Interest	0.7	0.8	0.8	0.9	1.2	1.7	2.0	2.2	2.3	2.5
Other expense	4.5	5.9	5.1	5.7	6.3	5.7	5.7	5.6	5.5	5.4
Gross operating balance	-1.0	6.8	6.0	6.2	2.6	-1.7	-0.2	0.2	0.2	0.1
Transactions in nonfinancial assets:										
Net acquisition of nonfinancial assets	2.7	3.4	5.3	7.4	7.6	4.2	4.0	4.0	4.1	4.1
Foreign financed	0.2	0.2	0.9	2.4	2.4	2.2	1.7	1.7	1.7	1.7
Domestically financed	2.5	3.2	4.3	5.0	5.1	2.0	2.3	2.3	2.4	2.3
Total expenditure	23.9	26.1	28.0	31.3	32.8	28.9	28.8	28.9	28.9	28.9
Primary net lending / borrowing	-3.0	4.2	1.5	-0.3	-3.8	-4.2	-2.2	-1.6	-1.6	-1.4
Net lending / borrowing	-3.7	3.4	0.7	-1.2	-5.0	-5.9	-4.3	-3.8	-3.9	-3.9
Transactions in financial assets and liabilities:										
Net acquisition of financial assets	1.4	-2.9	-2.6	-0.2	0.9	2.2	1.4	0.3	0.0	0.0
of which: Policy lending	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.5	-1.9	0.3	0.0	4.1	3.7	2.8	3.4	3.9	3.9
Domestic	1.8	-1.6	0.2	0.0	2.8	2.6	2.3	3.0	3.5	3.6
Foreign	-0.4	-0.4	0.1	0.1	1.3	1.1	0.5	0.4	0.4	0.3
Unidentified financing [3]	*0.9*	*1.5*	*1.5*	*1.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum item:										
Gross public debt	13.9	14.4	14.8	13.7	17.4	20.2	21.8	24.0	26.4	28.8

Sources: Swazi authorities; and Fund staff estimates and projections.

[1] The fiscal year runs from April 1 to March 31.

[2] Staff estimates based on the baseline scenario.

[3] Financing gap (positive number means underfinancing).

Table 4. Swaziland: Monetary Accounts, 2012–20 (Baseline Scenario)1/

(Emalangeni millions, unless otherwise indicated)

	2012	2013	2014	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
					(Emalangeni millions)				
Depository Corporation Survey									
Net foreign assets	6,269	7,867	7,714	8,896	8,404	8,506	8,930	9,306	9,454
Net domestic assets	3,388	3,330	3,925	3,575	4,738	5,293	5,631	6,061	6,754
Claims on central government (net)	-1,589	-3,008	-2,965	-2,398	-870	328	927	1,224	1,472
Claims on other sectors	8,062	9,759	10,872	11,334	11,798	12,355	12,958	13,586	14,243
Of which: Claims on private sector	7,698	9,254	10,159	10,817	11,387	11,924	12,503	13,106	13,737
Other items (net)	-3,084	-3,421	-3,983	-5,361	-6,189	-7,390	-8,255	-8,748	-8,960
Broad money	9,658	11,197	11,639	12,470	13,143	13,799	14,561	15,367	16,208
Currency in circulation [2]	409	499	530	798	841	883	932	983	1,037
Deposits	9,248	10,698	11,109	11,672	12,302	12,916	13,629	14,383	15,171
Central Bank									
Net foreign assets	4,935	7,158	7,078	7,294	7,043	7,254	7,706	8,106	8,272
Net domestic assets	-3,140	-5,256	-5,192	-5,289	-4,947	-5,070	-5,427	-5,728	-5,796
Reserve money	1,794	1,901	1,886	2,005	2,096	2,184	2,279	2,377	2,477
					(percent of GDP)				
Depository Corporation Survey									
Net foreign assets	15.5	17.9	16.1	17.3	15.4	14.7	14.5	14.2	13.6
Net domestic assets	8.4	7.6	8.2	6.9	8.7	9.2	9.2	9.3	9.7
Claims on central government (net)	-3.9	-6.8	-6.2	-4.7	-1.6	0.6	1.5	1.9	2.1
Claims on other sectors	20.0	22.2	22.7	22.0	21.6	21.4	21.1	20.8	20.5
Of which: Claims on private sector	19.1	21.0	21.2	21.0	20.9	20.6	20.3	20.1	19.8
Broad money	23.9	25.4	24.3	24.2	24.1	23.9	23.7	23.5	23.3
Currency in circulation [2]	1.0	1.1	1.1	1.5	1.5	1.5	1.5	1.5	1.5
Deposits	22.9	24.3	23.2	22.7	22.6	22.3	22.2	22.0	21.8
Central Bank									
Net foreign assets	12.2	16.2	14.8	14.2	12.9	12.5	12.5	12.4	11.9
Net domestic assets	-7.8	-11.9	-10.8	-10.3	-9.1	-8.8	-8.8	-8.8	-8.3
Reserve money	4.4	4.3	3.9	3.9	3.8	3.8	3.7	3.6	3.6
Memorandum items:					(12–month percentage change; unless otherwise indicated)				
Reserve money	0.7	6.0	-0.8	6.3	4.5	4.2	4.4	4.3	4.2
M2	10.0	15.9	3.9	7.1	5.4	5.0	5.5	5.5	5.5
Credit to the private sector	-1.7	20.2	9.8	6.5	5.3	4.7	4.9	4.8	4.8
Money multiplier (broad money/reserve money)	5.4	5.9	6.2	6.2	6.3	6.3	6.4	6.5	6.5
Velocity (GDP/broad money)	4.2	3.9	4.1	4.1	4.1	4.2	4.2	4.3	4.3

Sources: Swazi authorities; and Fund staff estimates and projections.

[1] End of period.

[2] Excludes rand in circulation.

Table 5. Swaziland: Balance of Payments, 2012–20 (Baseline Scenario)
(US$ millions, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
		Prel.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	154.7	233.0	128.5	29.8	-47.6	5.6	36.9	37.4	28.7
Trade balance	77.9	202.2	212.7	123.2	235.2	298.7	305.5	298.1	291.1
Exports, f.o.b.	1,926.1	1,895.7	1,903.9	1,626.3	1,628.1	1,696.3	1,742.7	1,769.0	1,795.2
Imports, f.o.b	-1,848.3	-1,693.6	-1,691.2	-1,503.1	-1,392.9	-1,397.6	-1,437.2	-1,471.0	-1,504.1
Services (net)	-584.5	-503.4	-448.8	-406.0	-417.1	-429.7	-442.7	-454.8	-469.5
Income (net)	-313.8	-367.2	-433.7	-322.2	-332.0	-342.2	-352.9	-363.5	-375.4
Of which: interest on public debt	-19.0	-18.2	-18.1	-16.9	-19.5	-22.5	-24.1	-25.3	-26.1
Transfers	975.1	901.4	798.3	634.8	466.2	478.8	527.0	557.6	582.5
Official transfers	931.6	815.6	725.5	568.7	396.0	405.2	449.3	463.6	474.2
Other transfers	43.5	85.9	72.8	66.1	70.2	73.6	77.6	94.1	108.3
Capital and financial account	33.7	-143.6	-83.6	-60.7	20.4	2.0	-13.0	-18.4	-23.5
Capital account	113.3	25.8	77.9	30.9	29.7	28.7	27.8	26.9	26.2
Financial account	-79.7	-169.4	-161.5	-91.7	-9.3	-26.7	-40.8	-45.3	-49.6
Foreign direct investment	96.1	29.1	-28.6	31.0	26.8	27.4	28.2	29.0	30.0
Portfolio investment	-13.1	-236.9	-27.1	-70.7	-45.3	-46.4	-47.7	-49.1	-50.8
Other investment	-162.6	38.4	-105.8	-52.0	9.2	-7.8	-21.3	-25.2	-28.9
Medium and long-term	-142.7	100.7	-96.3	14.1	47.7	16.8	3.9	0.7	-2.4
Of which:									
Public sector (net)	-17.1	5.5	3.2	40.3	46.0	25.9	19.7	17.6	15.7
Disbursements	7.3	22.4	34.1	63.6	70.9	56.3	54.5	56.5	58.4
Amortization	-24.4	-16.9	-30.9	-23.3	-24.9	-30.5	-34.7	-38.9	-42.8
Short-term	-20.0	-62.3	-12.8	-66.1	-38.5	-24.6	-25.3	-25.9	-26.5
Errors and omissions	-29.6	99.9	-68.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	223.7	258.4	39.9	-17.4	-27.3	7.5	23.8	19.1	5.2
Financing									
Net international reserves of the monetary authorities (– = increase)	-158.7	-189.3	23.3	30.9	27.3	-7.5	-23.8	-19.1	-5.2
				(percent of GDP)					
Current account	3.1	5.1	2.9	0.7	-1.2	0.1	0.8	0.8	0.6
Trade balance	1.6	4.4	4.8	3.0	5.7	7.1	7.0	6.7	6.3
Exports, f.o.b.	39.2	41.5	43.1	40.2	39.6	40.2	40.2	39.6	38.9
Imports, f.o.b	-37.6	-37.1	-38.3	-37.1	-33.8	-33.2	-33.1	-32.9	-32.6
Services (net)	-11.9	-11.0	-10.2	-10.0	-10.1	-10.2	-10.2	-10.2	-10.2
Income (net)	-6.4	-8.0	-9.8	-8.0	-8.1	-8.1	-8.1	-8.1	-8.1
Of which: interest on public debt	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.6	-0.6	-0.6
Transfers	19.8	19.7	18.1	15.7	11.3	11.4	12.1	12.5	12.6
Capital and financial account	0.7	-3.1	-1.9	-1.5	0.5	0.0	-0.3	-0.4	-0.5
Capital account	2.3	0.6	1.8	0.8	0.7	0.7	0.6	0.6	0.6
Financial account	-1.6	-3.7	-3.7	-2.3	-0.2	-0.6	-0.9	-1.0	-1.1
Of which foreign direct investment	2.0	0.6	-0.6	0.8	0.7	0.6	0.7	0.6	0.7
Errors and omissions	-0.6	2.2	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	4.6	5.7	0.9	-0.4	-0.7	0.2	0.5	0.4	0.1
Memorandum items:									
Official transfers	19.0	17.9	16.4	14.0	9.6	9.6	10.4	10.4	10.3
Gross International Reserves	664	767	690	609	569	567	582	592	589
(months of imports)	2.9	3.7	3.5	3.6	3.3	3.2	3.2	3.2	3.1
National currency per US$	8.2	9.7	10.8	…	…	…	…	…	…

Sources: Swazi authorities; and Fund staff estimates and projections.

Table 6. Swaziland: Financial Sector Indicators, 2010–2015[1]

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015Q2
Banking indicators						
Capital adequacy						
Capital to assets	12.3	12.2	12.5	11.9	12.6	13.2
Regulatory capital to risk-weighted assets	23.0	20.6	21.1	22.2	24.9	22.4
Regulatory tier 1 capital to risk-weighted assets	20.4	17.8	18.2	19.3	21.3	19.3
Nonperforming loans net of provisions to capital	18.9	5.9	35.3	20.9	18.1	15.9
Asset quality						
Large exposure to capital	92.1	105.8	89.2	55.2	102.2	94.9
Nonperforming loans to total gross loans	7.8	3.5	10.7	6.8	6.9	6.4
Sectoral distribution of loans to total loans						
Agriculture	17	18	13	17	15	...
Mining and quarrying	0	2	2	2	2	...
manufacturing	15	22	20	20	22	...
Construction	11	8	7	9	9	...
Distribution and Tourism	12	11	12	9	12	...
Transport and Communication	9	7	10	9	9	...
Community, Socialand Personal services	4	5	6	6	7	...
Other	32	29	31	28	24	...
Earnings and profitability						
Trading income to total income	0.9	0.9	1.2	2.9	1.7	0.8
Return on assets	3.4	3.5	4.0	3.1	3.5	4.6
Return on equity	28.7	26.3	28.7	22.7	27.7	30.9
Interest margin to gross income	49.7	50.6	47.5	47.9	47.3	50.7
Noninterest expenses to gross income	57.1	63.4	60.1	60.0	54.3	57.8
Personnel expenses to noninterest expenses	53.7	58.1	52.3	55.4	48.3	52.3
Liquidity						
Liquid assets to total assets	12.0	9.8	9.0	8.0	9.7	7.8
Liquid assets to short-term liabilities	18.0	15.5	12.7	12.1	14.2	12.4
Customer deposits to total (non-interbank) loans	142.5	108.6	122.9	115.4	111.7	111.2
Exposure to foreign exchange risk						
Net open position in foreign exchange to capital	34.9	44.0	30.6	34.7	36.0	43.6
Foreign currency liabilities to total liabilities	2.5	6.0	4.2	0.1	6.0	5.3
Financial system structure						
Banks	4	4	4	4	4	4
Private commercial	0	0	0	0	0	0
State-owned	1	1	1	1	1	1
Foreign-owned subsidiaries	3	3	3	3	3	3
Branches of foreign banks	28	28	38	39	39	...
Deposits						
Banks	7506	7451	8119	9448	10050	10184
Private commercial	...	...	...	...	...	...
State-owned	972	989	1,011	1,126	1,210	...
Foreign-owned subsidiaries	6,534	6,492	7,108	8,322	8,840	...

Sources: Central Bank of Swaziland; and IMF staff estimates.

[1] As recommended by a recent IMF TA, starting in 2012 the statistics exclude the Building Society as it is not a bank.

Table 7. Swaziland: Millennium Development Goals, 1995–2014

	1995	2000	2005	2008	2009	2010	2011	2012	2013	2014
Goal 1: Eradicate Extreme Poverty and Hunger										
Employment to population ratio, 15+, total (%)	44.3	43.5	43.3	43.4	43.5	43.7	44.0	44.3	44.5	...
Employment to population ratio, ages 15-24, total (%)	26.9	26.1	25.8	25.8	25.8	25.8	25.8	25.9	25.7	...
Income share held by lowest 20%	2.7	...	...	...	...	4.1	...	...	...	...
Malnutrition prevalence, weight for age (% of children under 5)	...	9.1	...	7.3	...	5.8	...	...	...	...
Poverty headcount ratio at national poverty line (% of population)	...	...	...	...	63.0	...	...	...	...	...
Prevalence of undernourishment (% of population)	22.6	17.7	18.7	27.3	29.7	30.1	27.0	26.1	26.5	26.8
Vulnerable employment, total (% of total employment)	...	...	...	...	...	...	...	...	...	
Goal 2: Achieve universal primary education										
Literacy rate, youth female (% of females ages 15-24)	...	92.9	...	...	...	...	95.3	...	...	...
Literacy rate, youth male (% of males ages 15-24)	...	90.7	...	...	...	...	92.2	...	...	...
Persistence to last grade of primary, total (% of cohort)	55.3	58.5	83.0	...	83.9	67.3	...	...	...	...
Primary completion rate, total (% of relevant age group)	63.4	60.9	65.6	...	72.2	76.7	76.8	...	...	...
Total enrollment, primary (% net)	74.5	72.3	76.5	...	...	...	...	...	...	...
										...
Goal 3: Promote gender equality and empower women										
Proportion of seats held by women in national parliaments (%)	...	3.1	10.8	13.8	13.6	13.6	13.6	13.6	6.2	6.2
Ratio of female to male tertiary enrollment (%)	...	90.0	106.8	...	...	...	104.2	...	...	...
Ratio of female to male primary enrollment (%)	97.3	95.2	94.0	...	92.1	91.8	89.8	...	...	...
Ratio of female to male secondary enrollment (%)	...	100.9	102.0	...	101.1	99.9	97.2	...	...	...
Share of women employed in the nonagricultural sector										...
(% of total nonagricultural employment)	33.2	...	...	...	...	...	...	...	...	...
Goal 4: Reduce child mortality										
Immunization, measles (% of children ages 12-23 months)	94.0	92.0	93.0	94.0	94.0	94.0	98.0	88.0	85.0	...
Mortality rate, infant (per 1,000 live births)	63.9	79.5	80.1	73.2	67.2	61.2	57.0	55.7	55.9	...
Mortality rate, under-5 (per 1,000)	88.4	121.4	127.2	113.6	106.1	91.9	84.9	79.7	80.0	...
Goal 5: Improve maternal health										
Adolescent fertility rate (births per 1,000 women ages 15-19)	115.5	105.2	93.8	84.8	81.6	78.4	75.2	...	...	...
Births attended by skilled health staff (% of total)	...	70.0	...	...	...	82.0	...	...	...	...
Contraceptive prevalence (% of women ages 15-49)	...	27.7	...	...	...	65.2	...	...	...	...
Maternal mortality ratio (modeled estimate, per 100,000 live births	290.0	360.0	420.0	...	...	320.0	...	...	310.0	...
Pregnant women receiving prenatal care (%)	...	86.6	...	...	...	96.8	...	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases										
Children with fever receiving antimalarial drugs (% of children										
under age 5 with fever)	...	25.5	...	...	...	...	...	...	...	...
Condom use, female (% ages 15-24)	...	...	44.0	44.0	...	...	...	...	...	...
Condom use, male (% ages 15-24)	...	...	66.0	66.0	...	...	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	337.0	803.0	1147.0	1227.0	1257.0	1287.0	1317.0	1349.0	1380.0	...
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	...	...	...	20.0	1380.0	...
Prevalence of HIV, total (% of population ages 15-49)	13.7	24.3	25.6	25.9	26.1	26.2	26.5	26.5	12.4	...
Tuberculosis case detection rate (all forms)	63.0	69.0	69.0	61.0	68.0	66.0	52.0	43.0	27.4	...
Goal 7: Ensure environmental sustainability										
CO2 emissions (kg per PPP $ of GDP)	0.1	0.3	0.2	0.2	0.2	0.2	...	...	...	...
CO2 emissions (metric tons per capita)	0.5	1.1	0.9	0.9	0.9	0.9	...	...	...	...
Forest area (% of land area)	28.8	30.1	31.5	32.2	32.5	32.7	33.0	...	...	...
Improved sanitation facilities (% of population with access)	49.5	51.8	54.1	55.5	56.0	56.5	57.0	...	...	...
Improved water source (% of population with access)	42.7	51.9	61.0	66.6	68.4	70.3	72.2	74.0	74.0	74.0
Marine protected areas (% of total surface area)	...	7.3	...	...	...	10.2	...	10.2	...	...
Goal 8: Develop a global parternership for development										
Net ODA received per capita (current US$)	59.9	12.3	42.2	60.6	47.7	76.6	103.0	...	...	...
Debt service (PPG and IMF only, % of exports, excluding workers'										...
remittances)	1.5	2.1	1.4	2.5	2.1	...	...	...	...	...
Daily newspapers (per 1,000 people)	...	...	...	...	...	...	...	...	...	...
Mobile cellular subscriptions (per 100 people)	0.0	3.1	18.1	46.2	56.1	61.2	63.7	66.0	71.5	...
Telephone lines (per 100 people)	2.2	3.0	4.0	3.9	3.9	4.5	6.3	4.0	3.7	...
Other										
Fertility rate, total (births per woman)	4.9	4.2	3.9	3.7	3.4	3.6	3.5	...	...	...
GNI per capita, Atlas method (current US$)	1,740	1,580	2,300	2,600	2,380	2,630	2,630	2,630	2,630	...
GNI, Atlas method (US$ million, current)	1,685	1,613	2,644	3,194	2,785	3,119	3,119	3,119	3,119	...
Gross capital formation (% of GDP)	16.0	18.1	15.0	11.0	10.3	16.6	16.6	16.6	16.6	...
Life expectancy at birth, total (years)	56.4	48.7	45.9	47.3	47.9	48.3	48.7	...	...	...
Literacy rate, adult total (% of people ages 15 and above)	...	81.7	...	...	...	...	87.8	...	...	...
Population, total (million)	1.0	1.1	1.1	1.2	1.2	1.1	1.1	1.1	1.1	...
Trade (% of GDP)	133.8	162.3	178.3	128.0	137.1	135.0	135.0	135.0	115.0	...
Unemployment, total (% of total labor force)	21.7	...	...	...	...	...	...	...	22.5	...

Source: World Bank; and Swailand authorities.

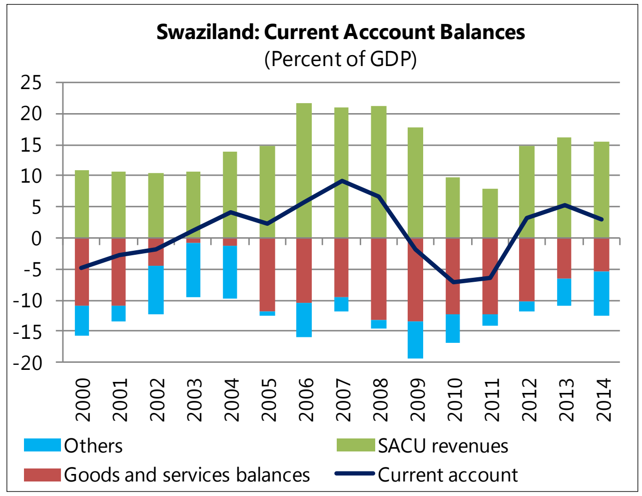
Table 8. Swaziland: Risk Assessment Matrix[1]

Nature/source of main risks	Likelihood of realization in the next three years	Expected impact on economy if risk is realized	Possible Policy Response
Tighter or more volatile global financial conditions: • **Sharp asset price adjustment and decompression of credit spreads** as investors respond to unanticipated changes in growth prospects, Fed policy rate path, and increases in U.S. term premia, with poor market liquidity amplifying the effect on volatility. • **Persistent dollar strength.** Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors.	*HIGH*	*MEDIUM/SMALL* • Capital flow reversals in South Africa could weaken rand and push up sovereign borrowing cost, which would push up borrowing cost in Swaziland as well. • Weakness of rand could add to inflationary pressures.	• May need to tighten fiscal policy if financing becomes problematic.
Structurally weak growth in key advanced and emerging economies (the "new mediocre"): • **Euro area and Japan.** Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and accumulation of financial imbalances. • **Emerging markets, including China.** Maturing of the cycle, misallocation of investment and excess corporate leverage (including in FX) fueled by a prolonged period of easy global financial conditions, and insufficient progress with reforms leads to a significant medium-term growth slowdown.	*HIGH (Euro area and Japan)* *MEDIUM (Emerging markets)* • Slower growth in Europe would adversely affect sugar exports (one of Swaziland's key export items) to Europe. • Slower growth in South Africa would reduce Swaziland's exports to South Africa.	*MEDIUM* • Current account would deteriorate with weaker exports. Economic growth would also be affected.	• Expedite structural reforms to improve business environment and promote private sector development.
A larger-than-forecasted decline in SACU revenues in 2016/17 and beyond and/or delayed policy adjustment to a prospective decline in SACU revenue fall	*MEDIUM (2016/17)* *HIGH (2017/18 and beyond)* • The recent weakening of the South African economy, together with the expected revision to the revenue sharing formula, point to downside risks for SACU revenues, beyond what is captured in the baseline forecast.	*MEDIUM/LARGE* • Further decline in SACU revenue would worsen the fiscal and external balance, threaten financial stability, and adversely affect growth.	• Enhance fiscal consolidation by containing spending and enhancing revenue mobilization.
Risks to energy prices: • **Increased volatility** due to uncertainty about the persistence of the oil supply shock and the underlying drivers of the price decline.	*MEDIUM*	• Higher fuel prices would add to pressures on prices and external balances.	• May need to tighten fiscal policy if the pressures become problematic.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views at the end of the Article IV consultation mission.

Annex I. Exchange Rate Assessment [1]

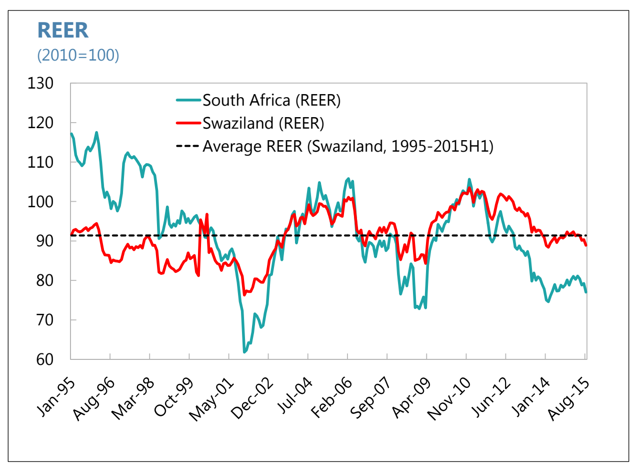
Staff analysis suggests that Swaziland's real effective exchange rate (REER) is moderately overvalued compared to the level that would be consistent with fundamentals. The estimated results are mixed using different approaches, but overall points to moderate overvaluation.



1. **Buyoed by increased SACU revenues after the 2010-11 fiscal crisis, Swaziland's current account has improved since 2010.** The recent improvement of the current account can be mostly attributed to a rebound in SACU revenues (after 2010-11) and improved sugar exports (2013-14). In 2015, however, the closure of the Ngwenya iron ore mine and the expiration of access to the African Growth and Opportunity Act (AGOA) are expected to weigh on export earnings, leading to a slight decline in the current account surplus.

2. **Swaziland's REER has depreciated since its peak at end-2010 and recently moved close to its historical average**. Since the lilangeni is pegged to the South African rand, the depreciation has mostly followed the rand, although the pace of the recent depreciation was less pronounced for Swaziland. On average, the REER has depreciated by about 12 percent between end-2010 and end-2014, reversing the bulk of the appreciation of 2009-10, and currently stands at 2.7 percent below its historical average over 1995–2015.

3. **Staff assessed the 2014 REER based on the IMF's EBA-lite methodology.** The EBA-lite methodology extends the EBA approach to a much broader group of countries (147 including EBA countries). The EBA-lite methodology comprises three methods, each based on its corresponding CGER predecessor. Two methods are panel regression-based analyses of the current account and real exchange rate (we give more weight to these two approaches), while the third method is model-free and focused on sustainability analysis. EBA and EBA-lite however bring important differences relative to CGER in the two regression-based methods. One crucial difference is that EBA-lite takes into account a much broader set of factors—including policies, cyclical conditions, and global capital market conditions—that may influence the current account and real exchange rate.



[1] Prepared by Maximilien Kaffo Melou (AFR).

4. Based on the original IMF's CA EBA-lite model, Swaziland's REER is estimated to be moderately undervalued (12.8 percent), though this result requires caution. The results of the current account approach should be cautiously interpreted because the CA-gap is mostly explained by the regression residuals, while Swaziland has a unique current account structure with significant SACU revenues. Since the actual current account in 2014 is a surplus of 2.9 percent of GDP and the CA-norm is -1.5 percent, the CA-gap is estimated to be 4.4 percent of GDP, of which -1.7 percent is due to policy gaps. The estimated elasticity of the trade balance to changes in the REER is -0.30. Thus, the REER would need to appreciate by 15.2 percent to close the gap between the CA and the CA-norm.

5. Taking into account the characteristics of the SACU revenues, the assessment now points to a slight overvaluation (3.5 percent). Though the SACU revenues (about 16 percent of GDP on average over the last ten years) —which tend to be highly volatile depending on South African economy and the needs for adjustments for previous SACU disbursements—are crucial determinants of Swaziland's current account, they are not captured by the fundamentals covered in the EBA-lite model. Thus, an ad-hoc adjustment is made to better account for these revenues. Staff estimates the impact of these revenues on the cyclically adjusted CA-norm to be 5.6 percent of GDP[2], and therefore, the cyclically adjusted CA-Norm is now estimated at 4.1 percent of GDP (-1.5 plus 5.6). With this adjustment, the new CA-gap is -1 percent of GDP, suggesting a slight overvaluation of 3.5 percent. The contribution of policy gaps to the CA misalignment is estimated at -1.7 percent of GDP and is mostly due to a deviation of fiscal policy from its desirable position. Indeed, the cyclically adjusted fiscal balance in 2014 (-3.6 percent) is judged to be below a level that would be recommended for the future (2 percent)[3] and thus, eliminating this gap would have help to reduce CA and REER misalignments.

Summary Table: EBA-lite CA approach		
	No adjustment	**With adjustments**
CA-Actual	**2.9%**	**2.9%**
Cyclically adjusted CA	3.1%	3.1%
CA-Norm	-1.5%	-1.5%
Cyclically adjusted CA-Norm	-1.3%	4.1%
CA-Gap	**4.4%**	**-1.0%**
o/w Policy gap	-1.7%	-1.7%
Elasticity	-0.30	-0.30
Real Exchange Rate Gap	**-14.9%**	**3.5%**

[2] The SACU revenues—categorized as part of current transfer in the balance of payment statistics—are different from other current transfers as the revenues are recognized as customs and excise revenues collected and distributed by the SACU member states (Botswana, Lesotho, Namibia, South Africa, and Swaziland). Nevertheless, the revenues have the economic characteristic similar to those of aid: (i) the revenues are paid in non-local currency (South African rand); (ii) they are disbursed to the government account and used to finance fiscal spending; and (iii) they tend to be volatile and are not under the government's control. Thus, for the purpose of this exercise, aid is adjusted to reflect SACU revenues.

[3] We used the average cyclically adjusted fiscal balance over 2018/2020 in the reform scenario.

6. **Similarly, the IMF's index REER EBA-lite model—while pointing some undervaluation of the REER (14 percent) in its original version—indicates a REER broadly in line with fundamentals (an overvaluation of 1 percent) on a SACU revenue-adjusted basis.** Based on this assessment, the actual REER is 4.49 in 2014, compared with its norm of 4.63 (all expressed in logs). Given that the model does not also capture the impact of SACU revenues, the REER-norm is adjusted down to 4.48.[4] With this result, the adjusted model implies that Swaziland's REER is broadly in line with fundamentals (an overvaluation of 1%).

Summary Table: EBA-lite Index REER approach

	No adjustment	With adjustments
ln(REER)-Actual	**4.49**	**4.49**
ln(REER)-Norm	4.63	4.63
Adjusted ln(REER)-Norm	**-**	**4.48**
REER-Gap	**-14%**	**1%**
o/w Policy gap	0.00	0.00

7. **The EBA-lite External Sustainability (ES) approach points to a moderate overvaluation of the REER in the scenario stabilizing the net IIP at its 2014 level (15.8 percent of GDP).** In this scenario, the underlying CA and the CA-norm are -3.3 and -0.3, respectively. Therefore, the CA-gap is -3 percent of GDP and the REER should depreciate by 10.1 percent to close this gap since the Swaziland's specific elasticity of the current account to the REER is -0.30.

8. **In summary, staff analysis points to a moderate overvaluation (by 1-10 percent) at end-2014.** This is to put in perspective with a further depreciation of 2.8 percent since end-2014.

References

IMF, 2013, "The External Balance Assessment (EBA) Methodology," *IMF Working Paper* No. 13/272.

IMF, 2015, "Background note on the EBA-lite Index REER model," *Unpublished manuscript.*

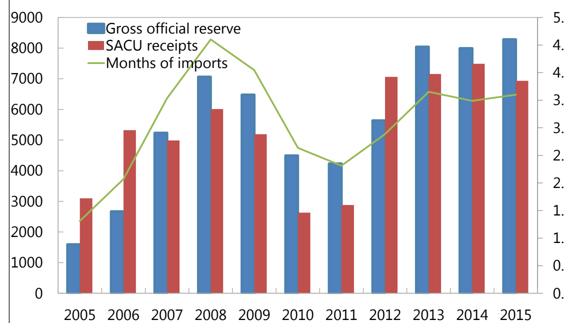
[4] We applied a procedure similar to the one we used in adjusting the EBA-lite CA approach.

Annex II. Adequate International Reserves [1]

Revised and updated analysis confirms a desirable level of reserve coverage of 5–7 months of imports, as discussed with the authorities during the 2014 Article IV consultation.

1. After a strong rebound from the 2010–11 crisis, Swaziland's reserve coverage has marginally declined over the past year. Gross official reserves currently stand at 3½ months of projected 2016 imports of goods and services.

Gross official reserve and SACU receipts
(In millions Emalangeni)



Source: Central Bank of Swaziland. August data for 2015.

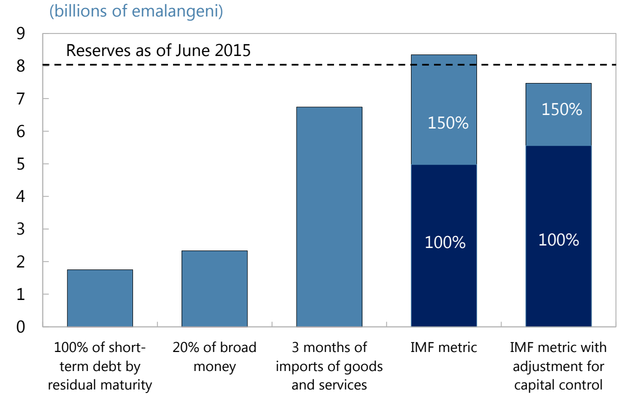
2. Swaziland's international reserves are adequate based on traditional simple adequacy metrics. Reserves are well above traditional metrics based on import coverage, short-term debt by residual maturity,[2] and broad money (used to capital flight risks, given that many recent capital account crises have been accompanied by outflows of residents' deposits). These metrics are simple and intuitive, but narrowly focus on a specific aspect and could lead to an underestimate of vulnerability.

3. Reserve adequacy is also assessed using the composite IMF metric. The IMF metric (IMF 2015, 2013, 2011) is designed to measure the vulnerabilities that might arise in a country's balance of payments during an exchange market pressure event. It captures vulnerabilities from four possible sources: (i) lower exports (X); (ii) lower rollover rates of short term debt (at remaining maturity) (STD); (iii) non-resident capital outflows proxied by longer-term debt and equity liabilities (OL), where OL is defined as the sum of portfolio liabilities and other investment liabilities minus short-term debt (at remaining maturity);[3] and (iv) resident capital flight proxied by broad money (M2). Specifically, the metric for countries with fixed exchange rate regime is computed as:

30% of STD+ 20% of OPL + 10% of M2 + 10% of X.

The relative risk weights for each component are based on the 10th percentile of observed outflows from emerging market countries during exchange market pressure episodes. The metric is found to better predict exchange market pressure and other crisis events than traditional simple metrics (IMF 2015). This metric is designed for countries with market access. Although Swaziland's sovereign

Reserve Adequacy
(billions of emalangeni)



Sources: Central Bank of Swaziland, IMF staff estimates, Lane and Milesi-Ferretti (2007).

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[1] Prepared by Yi Wu (AFR).

[2] One third of long-term private external debt is assumed to be due next year.

[3] Equity liabilities data are from the (updated) External Wealth of Nation database (Lane and Milesi -Ferretti, 2007), where the latest observation is for 2011 (US$68 million).

securities are all domestically owned,[4] this metric still provides a useful benchmark.

4. Reserve coverage is barely sufficient using the IMF metric. Reserves in the range of 100–150 percent of the metric are considered broadly adequate for precautionary purposes. Swaziland's reserve currently stands at 145 percent of the IMF metric. Reserve coverage at 150 percent of the metric would be equivalent to 3.7 months of imports or 16 percent of (2015) GDP. IMF (2015) also makes the argument that in countries with capital flow management measures (capital controls), there are fewer outflows during exchange market pressure events. For these countries a smaller weight of 5 percent could be applied to broad money, to reflect the lower risk of resident flight. Swaziland has a capital flow management measure in place which requires non-bank financial institutions to invest 30 percent of their assets domestically. If the adjustment for capital control is made, current reserve coverage would rise to 161 percent of the metric.

5. However, the standard IMF metric does not take into account risks associated with the volatile SACU revenue receipts. As shown during 2010–11, a large decline in SACU revenues quickly drained Swaziland's international reserves, from 4.0 months of imports at end-2009 to 2.3 months of imports at end-2011, with the country falling into a fiscal crisis. With another major SACU revenue shock looming next year, it is important to take into account of the SACU revenue shock into reserve adequacy analysis.

6. A modified IMF metric incorporating the risk of SACU revenue shock calls higher reserve coverage. Accumulated decline of SACU revenue during 2010–11 amounted to 94 percent of the level of pre-crisis SACU revenue. Applying the same concept in the construction of the standard IMF metric leads to the following revised metric for Swaziland:

30% of STD+ 20% of OPL + 10% of M2 + 10% of X + 80% of SACU revenue,

where a more conservative 80 percent weight[5] is used for the SACU revenue shock. Maintaining a 100 percent coverage of the metrics would require international reserve coverage of 5.1 months of imports, or 22 percent of GDP.

7. Swaziland's reserve adequacy is further examined using a cost-benefit analysis approach. The analysis is based on Dabla-Norris et al. (2011, also see IMF 2013, 2015), which is intended for low-income countries and quantifies the optimal level of reserves to prevent and mitigate shocks. Countries choose reserve level R to maximize the net benefit of holding reserves (NBR):

$\max_{\mathrm{R}} \mathrm{NBR} = -\, q * P(R, W) * C(R, Z)$ – r*R, where

- q refers to the unconditional probability of a large shock event, which is set to be 0.4 based on the sample average.[6]

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[4] Government external debt (loan) is mainly to official creditors.

[5] It is the average of the decline in 2010–11 and the expected decline in 2016–17.

[6] Large shock events are identified if the annual percentage change of the following variables falls below the 10th percentile in the left-tail of the country-specific distribution: external demand, terms-of-trade, FDI, aid flows (program grants), remittances, and large natural disasters.

➢ *P* represents the conditional probability of a crisis given a large shock event, where crisis is defined as a sharp drop in absorption. *P* depends on reserve level *R* and other variables (*W*) including fiscal balance and policy and institutional framework (using the World Bank's CPIA index), where higher values are associated with less crisis. Estimated fiscal balance for 2014/15 is used. The CPIA index is not available for Swaziland, and the value for Lesotho is used as a proxy.

➢ *C* represents the utility cost of a crisis. It depends on reserve level *R* and other variables (*Z*) including external demand,[7] terms of trade, FDI, and aid to GDP ratio. For these variables, the 10th percentile value over the past 20 years is used.

➢ Finally, *r* represents the opportunity cost of holding reserves.

8. The analysis points to higher optimal reserve level for Swaziland than the other methods. The optimal level of reserves critically depends on the opportunity cost of holding reserves which is however difficult to quantify. Following IMF (2015), the cost is calculated as the difference between the real yield on local government securities (weighed average of 3-year and 3-month securities) and the average real interests on 3-month U.S. T-bill and 2-year U.S. treasury bond. This implies a cost of holding reserves at 2.0 percent (after correcting for average annual real exchange rate depreciation over the past 10 years), which corresponds to an optimal level of reserves equivalent to 7.0 months of imports. The desirable reserve level would be even higher if medium term fiscal balance (a higher deficit) is used (instead of the 2014/15 value as we did).

Optimal reserve level (in months of imports)	
Standard IMF metrics (150%)	3.7
Modified IMF metrics A (100%)	5.1
Cost-benefit analysis	7.0

9. In summary, Swaziland needs to further increase its reserve coverage from the current level to prepare for exogenous shocks. While there are uncertainties to the exact optimal level of reserves, the analyses using various methodologies suggest that Swaziland should aim to increase its international reserve to 5-7 months of imports.

References

Dabla-Norris, Era, Jun Il Kim, and Kazuko Shirono, 2011, "Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis," IMF working paper 11/249.

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Lane, Philip R. and Gian Maria Milesi-Ferretti, 2007, "The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970–2004", Journal of International Economics 73, November, 223–250.

[7] The external demand is compiled as the weighted average of real GDP growth of South Africa, the Euro area, and the U.S. using 2005 export share as the weights.

Annex III. Debt Sustainability Analysis [1]

Though Swaziland's current public debt level is low, large gross financing needs raise concerns. The debt sustainability analysis (DSA) indicates that, under the baseline scenario, most of the public debt indicators remain below their relevant indicative thresholds over the medium term, although high gross financing needs raises concerns for a continuous accumulation of public debt and rollover risks. Should the SACU revenue fall significantly (as experienced in 2010–11), the debt level could rise sharply, leaving little scope for absorbing shocks.

Recent developments

1. **Swaziland's public debt remains low, although it has risen since the last fiscal crisis.** The debt increased in nominal terms from 11 percent of GDP in 2009 to nearly 14 percent of GDP in 2014, owing to a large increase in primary deficit (during the fiscal crisis in 2010–2011). Meanwhile, gross financing needs remain high, at about 11 percent of GDP. Improved SACU revenue after the fiscal crisis relieved pressure on the fiscal front, leading to a fiscal surplus recorded for 2012 and 2013, though it turned deficit in 2014.

2. **The central government has steadily increased their reliance on domestic debt for its borrowing needs.** In terms of the composition of public debt, the proportion of debt denominated in domestic currency increased over time, reducing exposure to exchange rate risk. The share of domestic debt rose from 12 percent of total public debt in 2009 to about 50 percent in 2014. By the end of 2014, treasury bills account for around 61 percent of the government's domestic debt.

3. **The country's external public debt—primarily in the form of project loans from bilateral and multilateral sources as well as private creditors—is relatively high (53 percent of the total debt), albeit on a declining trend.** While its importance—relative to domestic public debt—has declined, the composition of external public debt has been quite stable over the past few years.

Medium term public DSA

4. **A heat map suggests that, while the public debt level is not subject to imminent risks, the country faces risks relating to its gross financing needs and debt profile (Figure 1)**. Under the baseline scenario, the gross financing needs would increase continuously and exceed 15 percent of GDP benchmark level by 2016. All standard macro-fiscal shocks would push the gross financing needs even higher. In particular, the primary balance shock would significantly raise the gross financing needs compared with the baseline. The large share of debt held by non-residents—albeit on a downward trend—also highlights vulnerabilities in the debt profile.

Baseline scenario

5. **The baseline macroeconomic scenario for the DSA is based on the status-quo policies, consistent with the macroeconomic framework underlying the 2015 Article IV Staff Report**. Specifically, growth is expected to decline below 1 percent per annum in 2016 and remain sluggish (slightly

[1] Prepared by Manabu Nose (AFR).

above 1 percent per annum). With a prospective decline in the SACU revenue, the total revenues (including grants) would decline to about 24.1 percent of GDP in 2016 which would gradually recover to around 25 percent of GDP by 2019. Primary fiscal expenditure would slightly decline but is assumed to remain expansionary as envisaged under the baseline scenario. Interest payment would increase over time due to an accumulation of public debt and higher interest rate. As a result, primary fiscal balance would remain negative and be around 4 percent of GDP in 2016 which is expected to be mainly financed by short-term borrowing and the withdrawal of government deposits. The realism of this scenario is assessed in Figure 2. The forecast errors for Swaziland on real GDP growth and inflation have been mostly in line with other countries, while the forecast track record shows relatively larger forecast errors for the primary balance which largely reflects the high uncertainty associated with prospective SACU revenues. [2]

6. **The DSA under the baseline scenario indicates that the level of public debt would continue to rise over the medium term, although it remains below the indicative threshold of 60 percent.** Under the baseline scenario, the expected increase in fiscal deficits and an increase in interest payment would lead to fast accumulation of public debt (Figure 3). Gross public debt would approach 30 percent of GDP by 2020. As it is expected to be financed mainly domestically by short- and medium-term treasury bills/bond (Figure 4), gross financing needs are projected to grow continuously, from about 11 percent of GDP in 2014 to about 20 percent of GDP in 2020.

7. **The results under the alternative scenarios highlight the importance of fiscal consolidation to avoid a continuous increase in public debt and gross financing needs (Figure 4).** Gross public debt and public gross financing needs would be brought down to lower level when (i) the primary deficit is set to be constant from 2015 onwards ("Constant Primary Balance" scenario) and (ii) when real GDP, the primary deficit, and real interest rates are set at their historical average ("Historical" scenario).

8. **The customized stress test, which simulates a SACU revenue shock, results in an accumulation of public debt-to-GDP ratio (which approaches the threshold level) and a sharper increase in gross financing needs.** The results of the standardized macro-fiscal stress tests (especially the primary balance shock) similarly demonstrate an increase in gross public debt and public gross financing needs. The customized stress tests on a further fall in the SACU revenue (by 5 percent of GDP in 2016-17) and on contingent liability shock are also conducted. Under the SACU revenue shock scenario, gross public debt would be estimated to rise up to about 40 percent of GDP, and the gross financing needs would approach 30 percent of GDP by 2020. The rapid increase in gross financing needs would potentially crowd out the private sector credit, as well as posing risks related to the maturity structure and debt roll-over.

9. **The tighter fiscal policy scenario (reform scenario) would help to avoid a constant increase in public debt and help to revert the gross financing needs to sustainable level (Figure 5).** To strengthen the country's resilience to exogenous shocks, the reform scenario assumes enhanced fiscal consolidation. As a result, the primary balance is assumed to turn positive by 2018, leading to the reduction in gross financing needs (to around 10 percent of GDP by 2020) and public debt stock would be stabilized around 14 percent

[2] The medium-term projection of the SACU revenue is revised to reflect latest budget projection by South African treasury on the total SACU transfer to the revenue pool. The SACU revenue for Swaziland is computed based on the Swaziland's latest share of SACU revenue from the total pool.

of GDP. A similar result would be achieved under the historical scenario where the real GDP growth, the primary balance, and the real interest rate are set at their historical averages. Under such scenarios, public debt and gross financing needs are projected to be sustainable over the medium term.

Medium Term External DSA

10. **Swaziland's gross external debt has remained low and recently declined slightly from nearly 16 percent of GDP in 2010 to 11.5 percent of GDP in 2014.** Under the baseline assumptions, gross external debt is projected to only slightly increase to 12.3 percent of GDP in 2020.

11. **Stress tests, while pointing no imminent concerns for external debt trajectory, indicates vulnerability to shocks to the non-interest current account and large exchange rate depreciations.** Standardized sensitivity analysis suggests that Swaziland's external debt is resilient to interest rate and growth shocks, but a 30 percent real depreciation would raise the external debt-to-GDP ratio to around 17 percent in 2020. A large current account deficit—with 2.8 percentage points of GDP (one-half standard deviations) larger than projected in the baseline—would likely put the country on an unsustainable path, as the external debt-to-GDP ratio would increase to 27 percent by 2020. Thus, moderating the non-interest part of the external current account balance is important for external debt sustainability.

Conclusion

12. **Overall, the DSA indicates that, though the debt level is not posed to imminent risks, high gross financing needs and projected pace of debt accumulation raise concerns**. Both public debt and external debt are on sustainable trajectories below the debt stock thresholds under the baseline scenario. Furthermore, should the expected pace of debt accumulation continue over the longer period, Swaziland would eventually face higher debt distress. In addition, the analysis found that the public debt outlook is particularly vulnerable to a shock of SACU revenue. Finally, increasing gross financing needs projections—with excessive reliance on short-term financing—raise concerns for risks associated with distorted maturity structure and debt roll-over.

13. **Given the difficulty to secure stable external financing sources, shifting toward more prudent fiscal policy, along the lines envisaged under the reform scenario, is critical for macroeconomic stability and debt sustainability over the medium term.** As presented in the analysis under the reform scenario, it is important to tighten the fiscal policy stance over the medium term with a view to maintaining fiscal and debt sustainability over a longer term.

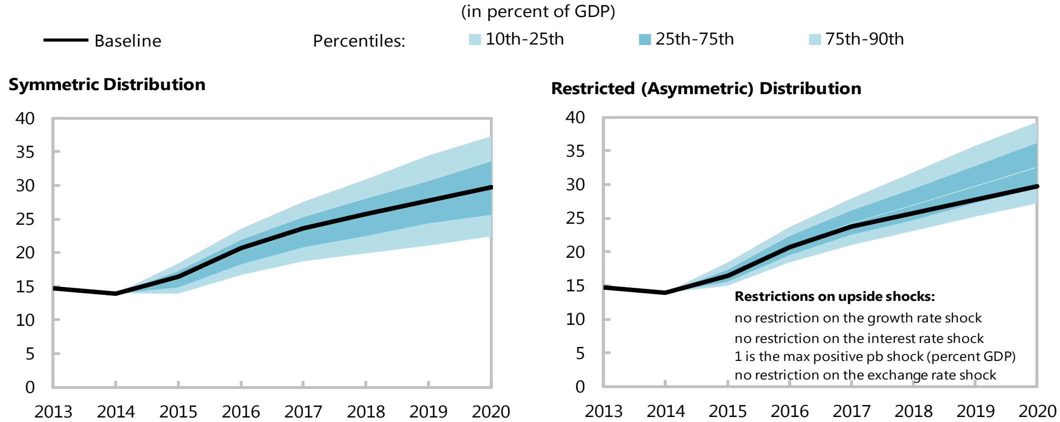
Figure 1. Swaziland Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

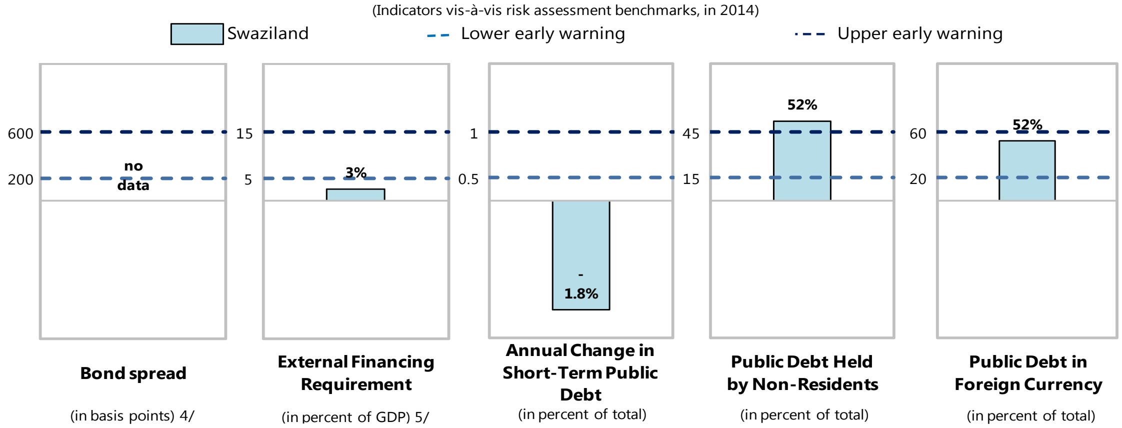
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

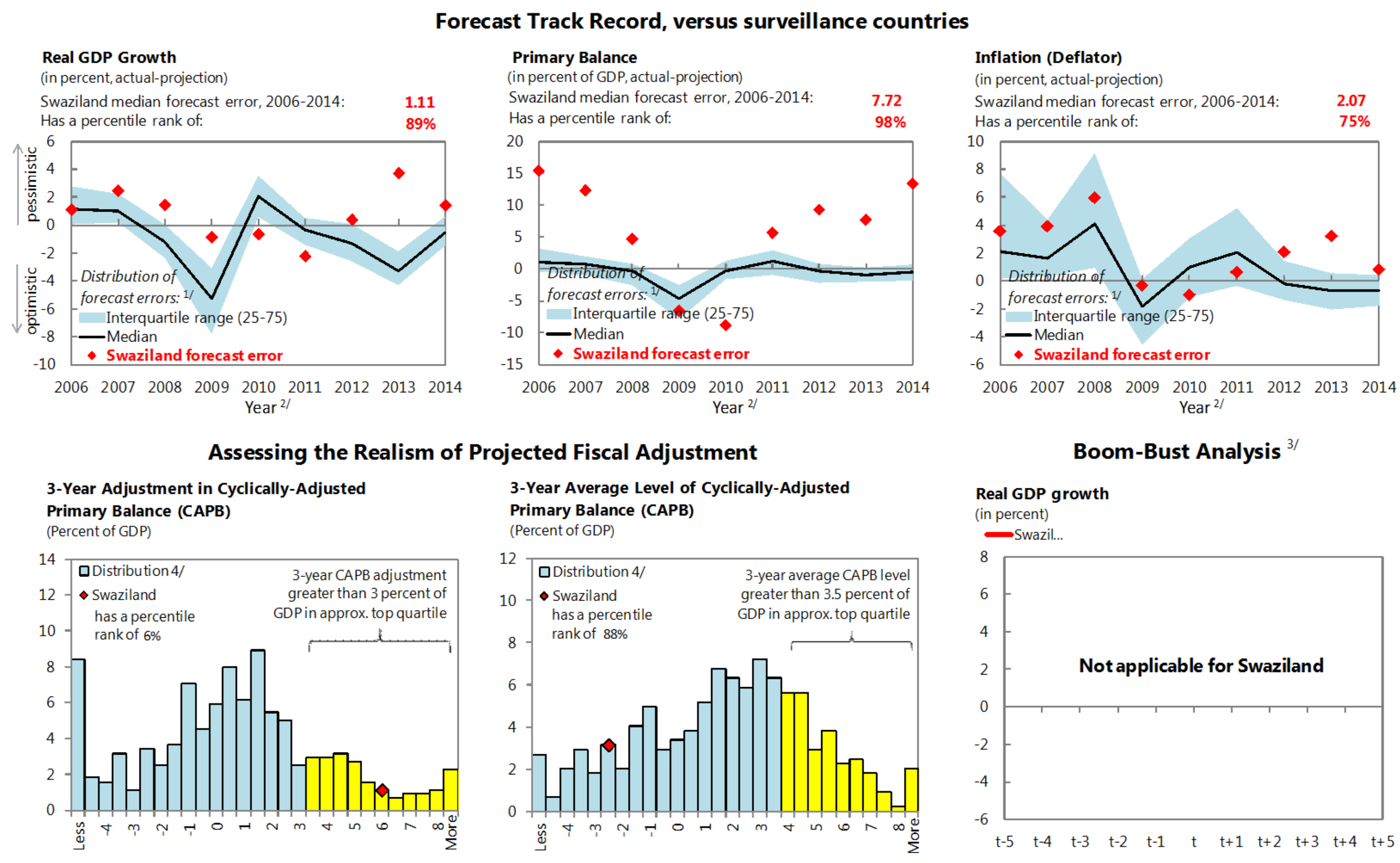
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 24-Mar-15 through 22-Jun-15.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Swaziland Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Swaziland, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

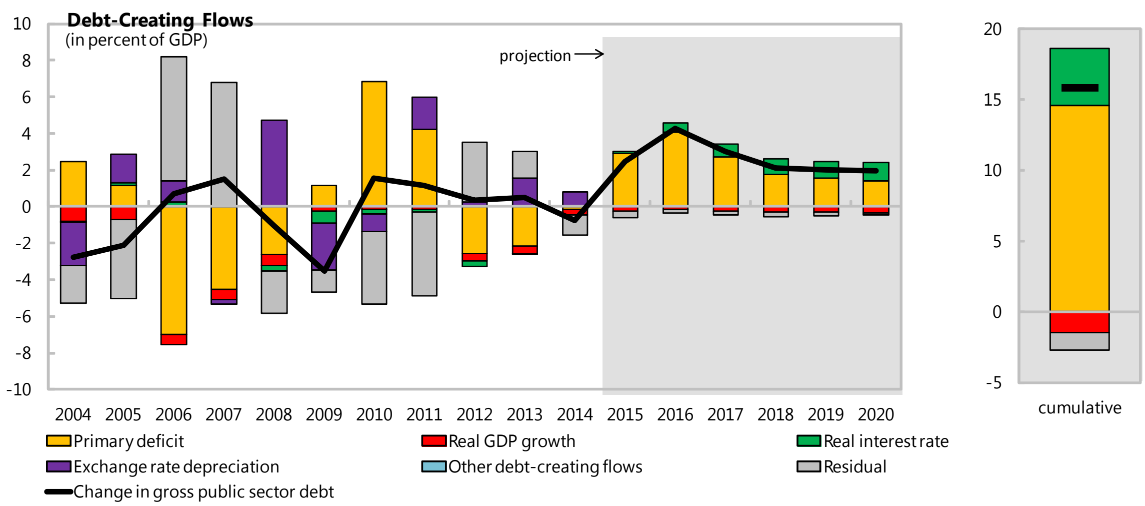
Figure 3. Swaziland Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections							As of June 22, 2015	
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020		Sovereign Spreads	
Nominal gross public debt	14.0	14.7	13.9	16.4	20.7	23.7	25.8	27.8	29.8		10Y Bond (bp) 3/	702
Public gross financing needs	5.1	8.3	10.9	13.7	17.8	18.6	18.7	19.0	20.4		5Y CDS (bp)	n.a.
Real GDP growth (in percent)	3.3	2.9	2.5	1.7	0.8	1.1	1.3	1.2	1.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	6.9	6.1	6.1	5.8	5.0	4.8	4.9	5.1	5.0	Moody's	n.a.	n.a.
Nominal GDP growth (in percent)	10.4	9.2	8.7	7.5	5.9	6.0	6.3	6.3	6.3	S&Ps	n.a.	n.a.
Effective interest rate (in percent) [4/]	6.0	6.0	6.6	6.4	8.3	8.6	8.9	8.8	8.8	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing
Change in gross public sector debt	-0.5	0.5	-0.7	2.4	4.3	3.0	2.1	2.0	2.0	15.8	primary
Identified debt-creating flows	-0.3	-1.0	0.3	2.8	4.5	3.2	2.4	2.2	2.1	17.1	balance [9/]
Primary deficit	-0.1	-2.1	-0.1	2.9	4.1	2.7	1.8	1.6	1.4	14.6	0.6
Primary (noninterest) revenue and grants	28.2	28.9	29.7	28.3	24.1	24.2	25.0	25.1	25.0	151.7	
Primary (noninterest) expenditure	28.1	26.8	29.6	31.2	28.2	26.9	26.7	26.6	26.5	166.2	
Automatic debt dynamics [5/]	-0.2	1.2	0.5	-0.1	0.4	0.5	0.6	0.6	0.6	2.6	
Interest rate/growth differential [6/]	-0.6	-0.4	-0.3	-0.1	0.4	0.5	0.6	0.6	0.6	2.6	
Of which: real interest rate	-0.1	0.0	0.0	0.1	0.5	0.7	0.9	0.9	1.0	4.0	
Of which: real GDP growth	-0.4	-0.4	-0.3	-0.2	-0.1	-0.2	-0.3	-0.3	-0.3	-1.5	
Exchange rate depreciation [7/]	0.4	1.6	0.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.2	1.5	-1.1	-0.3	-0.2	-0.2	-0.2	-0.2	-0.1	-1.3	



Source: IMF staff.

1/ Public sector is defined as central government. All figures are in calendar year basis.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

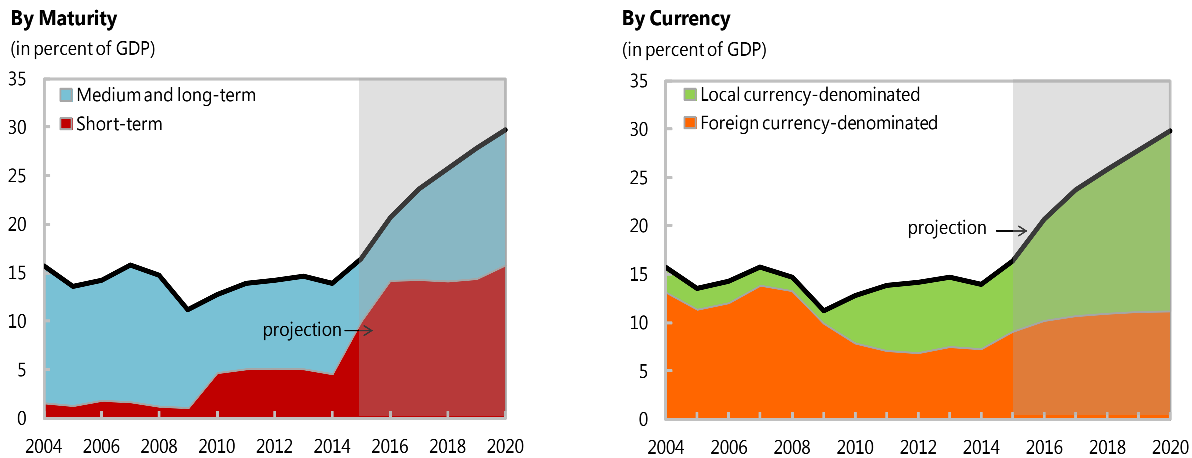
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

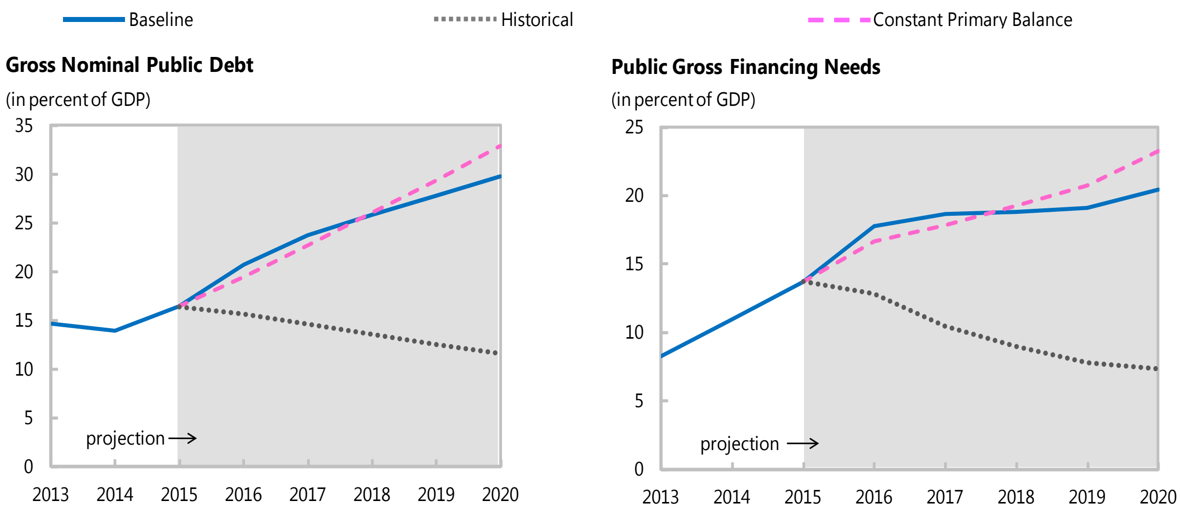
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Swaziland Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

(in percent)

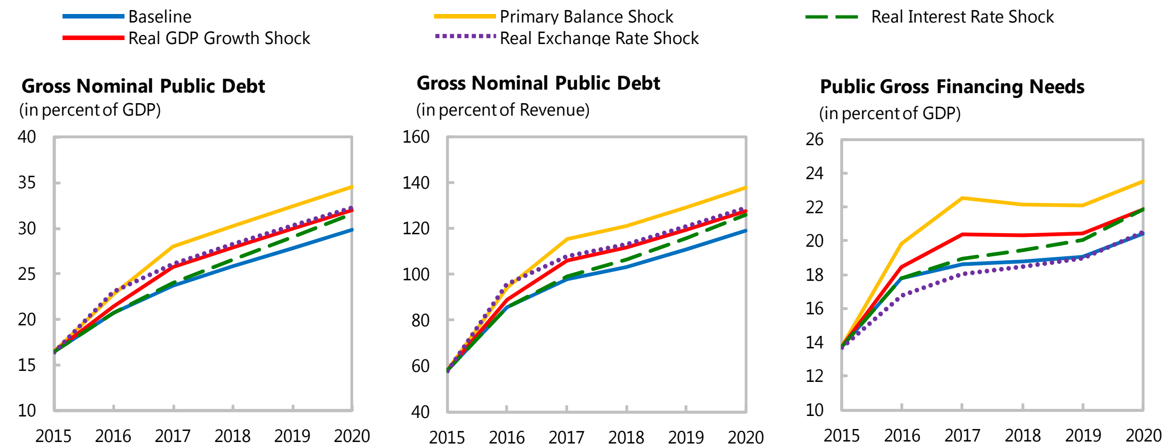
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.7	0.8	1.1	1.3	1.2	1.2
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary Balance	-2.9	-4.1	-2.7	-1.8	-1.6	-1.4
Effective interest rate	6.4	8.3	8.6	8.9	8.8	8.8
Constant Primary Balance Scenario						
Real GDP growth	1.7	0.8	1.1	1.3	1.2	1.2
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary Balance	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Effective interest rate	6.4	8.3	8.7	8.9	8.8	8.7

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.7	3.0	3.0	3.0	3.0	3.0
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary Balance	-2.9	0.6	0.6	0.6	0.6	0.6
Effective interest rate	6.4	8.3	6.3	6.7	6.4	6.3

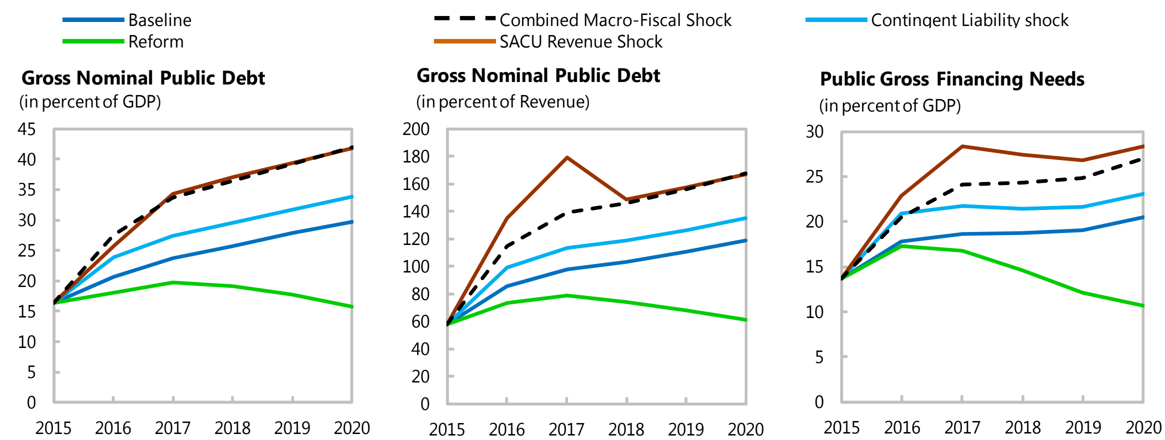
Source: IMF staff.

Figure 5. Swaziland Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

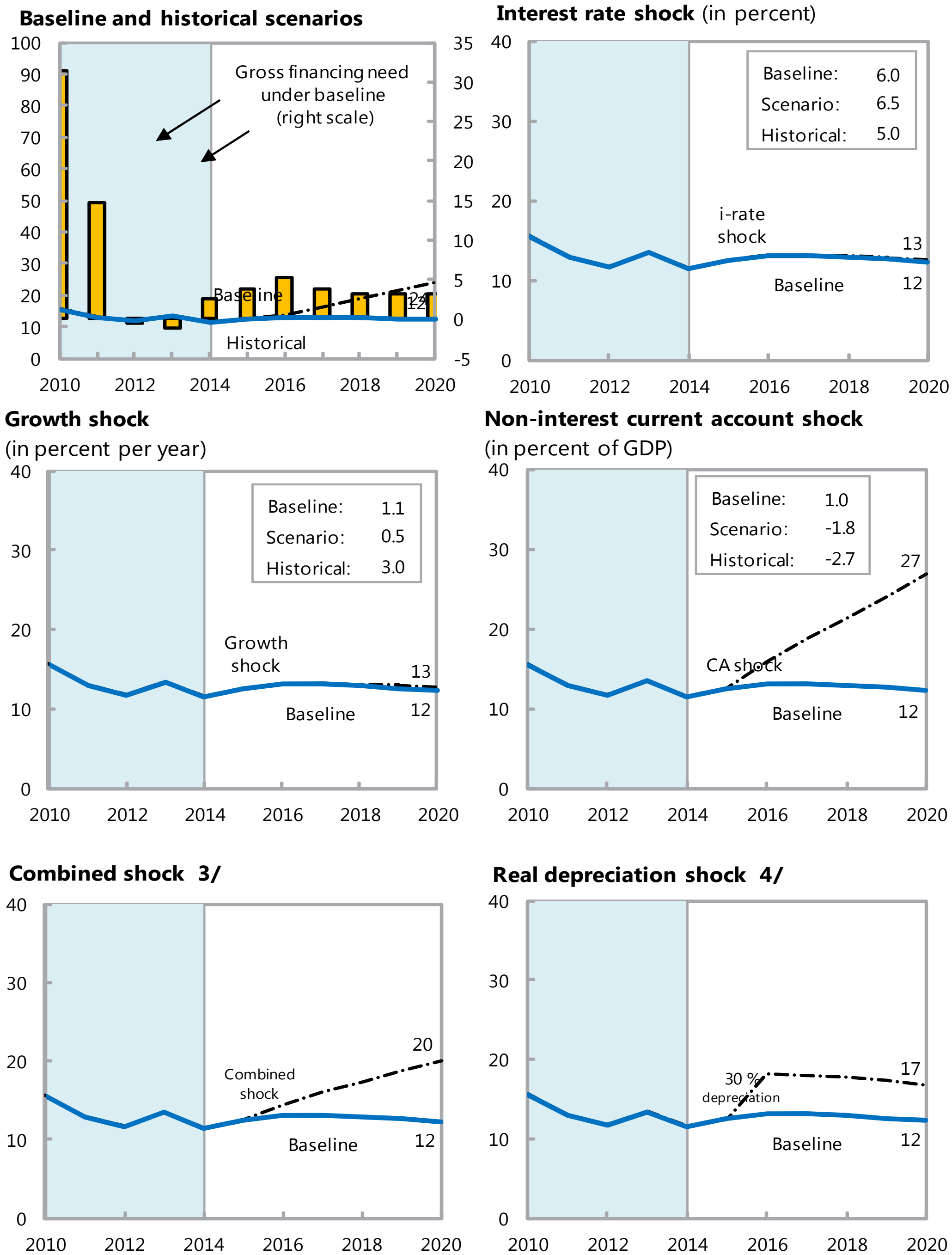
(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.7	0.8	1.1	1.3	1.2	1.2
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary balance	-2.9	-6.2	-4.8	-1.8	-1.6	-1.4
Effective interest rate	6.4	8.3	8.9	9.1	8.8	8.7
Real Interest Rate Shock						
Real GDP growth	1.7	0.8	1.1	1.3	1.2	1.2
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary balance	-2.9	-4.1	-2.7	-1.8	-1.6	-1.4
Effective interest rate	6.4	8.3	10.3	10.6	10.6	10.6
Combined Shock						
Real GDP growth	1.7	-0.5	-0.2	1.3	1.2	1.2
Inflation	5.8	4.7	4.5	4.9	5.1	5.0
Primary balance	-2.9	-6.2	-4.8	-1.8	-1.6	-1.4
Effective interest rate	6.4	9.6	9.3	9.7	9.9	10.0
Reform						
Real GDP growth	1.7	0.8	1.0	1.6	2.1	2.5
Inflation	5.8	4.9	4.9	5.3	5.4	5.6
Primary balance	-2.9	-3.8	-1.5	0.6	1.6	1.9
Effective interest rate	6.4	7.7	9.3	9.6	9.7	9.8

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.7	-0.5	-0.2	1.3	1.2	1.2
Inflation	5.8	4.7	4.5	4.9	5.1	5.0
Primary balance	-2.9	-4.6	-3.6	-1.8	-1.6	-1.4
Effective interest rate	6.4	8.3	8.7	9.0	8.8	8.8
Real Exchange Rate Shock						
Real GDP growth	1.7	0.8	1.1	1.3	1.2	1.2
Inflation	5.8	17.2	4.8	4.9	5.1	5.0
Primary balance	-2.9	-4.1	-2.7	-1.8	-1.6	-1.4
Effective interest rate	6.4	9.6	7.9	8.2	8.3	8.2
Contingent Liability Shock						
Real GDP growth	1.7	-0.5	-0.2	1.3	1.2	1.2
Inflation	5.8	4.7	4.5	4.9	5.1	5.0
Primary balance	-2.9	-6.6	-2.7	-1.8	-1.6	-1.4
Effective interest rate	6.4	10.9	8.9	8.8	8.8	8.7
SACU Revenue Shock						
Real GDP growth	1.7	0.4	0.6	1.3	1.2	1.2
Inflation	5.8	5.0	4.8	4.9	5.1	5.0
Primary balance	-2.9	-9.1	-7.7	-1.8	-1.6	-1.4
Effective interest rate	6.4	8.3	9.6	9.8	8.8	8.8

Source: IMF staff.

Figure 6. Swaziland External debt Sustainability: bound Test 1/2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

Table 1. Swaziland External Debt Sustainability Framework, 2010-20
(in percent of GDP; unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	15.6	12.9	11.7	13.4	11.5			**12.5**	**13.0**	**13.0**	**12.8**	**12.6**	**12.3**	**-0.4**
2 Change in external debt	-0.9	-2.7	-1.2	1.7	-1.9			1.0	0.5	0.0	-0.2	-0.3	-0.3	
3 Identified external debt-creating flows (4+8+9)	2.2	3.4	-5.0	-4.8	-1.8			-1.7	0.4	-0.9	-1.7	-1.6	-1.4	
4 Current account deficit, excluding interest payments	7.7	6.1	-3.8	-5.6	-3.4			-1.3	0.5	-0.9	-1.6	-1.6	-1.4	
5 Deficit in balance of goods and services	12.4	12.3	10.3	6.6	5.3			7.0	4.4	3.1	3.2	3.5	3.9	
6 Exports	45.4	44.4	44.1	46.6	49.8			46.9	46.3	47.1	47.1	46.6	46.0	
7 Imports	57.8	56.8	54.4	53.2	55.2			53.9	50.7	50.2	50.2	50.1	49.8	
8 Net non-debt creating capital inflows (negative)	-2.9	-2.1	-2.0	-0.6	0.6			-0.8	-0.7	-0.6	-0.6	-0.6	-0.6	
9 Automatic debt dynamics 1/	-2.6	-0.6	0.8	1.4	1.0			0.4	0.6	0.6	0.6	0.6	0.6	
10 Contribution from nominal interest rate	0.8	0.8	0.6	0.5	0.5			0.6	0.7	0.8	0.8	0.8	0.8	
11 Contribution from real GDP growth	-0.2	-0.2	-0.4	-0.4	-0.3			-0.2	-0.1	-0.1	-0.2	-0.2	-0.1	
12 Contribution from price and exchange rate changes 2/	-3.2	-1.2	0.5	1.3	0.8			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-3.1	-6.1	3.7	6.5	-0.1			2.7	0.1	0.9	1.5	1.4	1.1	
External debt-to-exports ratio (in percent)	34.3	29.1	26.5	28.7	23.0			26.7	28.2	27.7	27.3	27.0	26.7	
Gross external financing need (in billions of US dollars) 4/	1429.3	731.0	-28.5	-56.1	112.4			152.0	210.8	161.9	134.1	136.8	149.2	
in percent of GDP	31.5	14.7	-0.6	-1.2	2.5	10-Year	10-Year	3.8	5.1	3.8	3.1	3.1	3.2	
Scenario with key variables at their historical averages 5/								**12.5**	**13.9**	**16.1**	**18.8**	**21.4**	**23.8**	**-1.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.4	1.2	3.0	2.9	2.5	3.0	1.3	1.7	0.8	1.1	1.3	1.2	1.2	
GDP deflator in US dollars (change in percent)	24.6	8.1	-4.0	-9.7	-5.6	1.9	10.3	-9.8	0.8	1.3	1.6	1.7	2.1	
Nominal external interest rate (in percent)	6.5	5.4	4.9	3.7	3.8	5.0	0.9	4.7	5.7	5.9	6.1	6.2	6.3	
Growth of exports (US dollar terms, in percent)	10.4	7.0	-1.8	-1.8	3.4	1.1	9.0	-13.8	0.4	4.1	2.9	1.9	2.0	
Growth of imports (US dollar terms, in percent)	11.5	7.5	-5.2	-9.2	0.3	1.8	8.3	-10.5	-4.3	1.3	3.1	2.7	2.8	
Current account balance, excluding interest payments	-7.7	-6.1	3.8	5.6	3.4	-2.7	5.5	1.3	-0.5	0.9	1.6	1.6	1.4	
Net non-debt creating capital inflows	2.9	2.1	2.0	0.6	-0.6	1.5	1.6	0.8	0.7	0.6	0.6	0.6	0.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

KINGDOM OF SWAZILAND

November 24, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Staff of the International Monetary Fund in Consultation with the World Bank.

CONTENTS

RELATIONS WITH THE FUND

As of September 30, 2015

Membership Status

Joined: September 22, 1969; Article VIII.

General Resources Account:	**SDR Million**	**%Quota**
Quota	50.70	100.00
Fund holdings of currency	44.15	87.07
Reserve position	6.56	12.94

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	48.28	100.00
Holdings	48.74	100.94

Outstanding Purchases and Loans:	None

Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs):

Forthcoming

	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

Implementation of HIPC Initiative:

Not Applicable

Exchange Rate Arrangements

The lilangeni (plural: emalangeni) is pegged at parity to the South African rand, which is also legal tender. Exchange rates for the U.S. dollar are based on the floating middle rate of the South African rand against the U.S. dollar. The average rate in September 2015 was E1 = US$0.073. Swaziland maintains an exchange restriction subject to Fund approval under Article VIII arising from a 50 percent limit on the provision for advance payments for the import of capital goods in excess of 10 million emalangeni.

Article IV Consultation

The last Article IV Consultation was concluded on July 15, 2014. Swaziland is on the standard 12 month Article IV Consultation cycle.

Technical assistance (2012-present)

Department	Purpose	Date of Delivery	Beneficiary Agency
FAD	PFM Act and Regulations	January 2012 May 2012 August 2012 October 2012 January 2014 September 2015 October 2015	MOF
	MTFF/Budget/Expenditure Management	March 2013 May 2013 July 2013 August 2013 December 2013 January 2014 August 2015 October 2015	MOF
	Cash management and accounting	June 2014 December 2014 February 2015 April 2015 October 2015	MOF
	TPA TTF	December 2011 April 2012 May 2013 February 2014	MOF
	Chart of accounts	July 2012 December 2012 January 2013 February 2013 March 2013 August 2013 January 2014 August 2014	MOF
	Customs revenue administration	October 2012 June 2015	SRA
	Tax Administration	July 2012 October 2012 August 2013 December 2013 December 2014 November 2015	SRA

Department	Purpose	Date of Delivery	Beneficiary Agency
MCM	Insurance supervision	January 2011	FSRA[3]
		March 2011	
		November 2011	
		August 2012	
		August 2013	
		October 2013	
		May 2014	
	Risk based supervision	November 2013	CBS
	Capital market supervision	June 2013	FSRA
		August 2013	
		December 2013	
		April 2014	
	SACCOs[1] Supervision	May 2012	FSRA
		August 2013	
		January 2014	
		May 2014	
	Supervision non-banks	November 2011	CBS
		March 2012	
	Compliance with Basel	April 2013	CBS
		May 2013	
	Financial stability	February 2015	CBS
	Public debt management	May 2015	MOF, CBS
STA	Monetary and Financial statistics	September 2013	CBS
	Financial Soundness Indicators	March 2014	CBS
	National Accounts Statistics	January 2012	CSO
		August 2012	
		October 2012	
		December 2013	
		April 2014	

[1] Savings and credit cooperatives

BANK-FUND JOINT MANAGEMENT ACTION PLAN

Title	Products	Mission Date [1]	Delivery Date [1]
A. Mutual Information on Relevant Work Program			
The World Bank work program for the next 12 months	Private Sector Competitiveness Financial Sector Development HIV/AIDS and TB PFM Reform Public Sector Modernization Internal Audit Public Service Payroll Audit	January, February July, October 2016 TBD 2016 TBD TBD TBD TBD	March 2021 TBD June 2018 TBD TBD TBD TBD

The Fund work program for the next 12 months	2015 Article IV Consultation
	
	Technical Assistance
	- PFM (Commitment and cash management, PFM regulatory framework, MTEF, IFMIS)
	- Fiscal reporting
	- Revenue policy and administration
	  - Tax compliance
	  - Custom administration
	- Financial sector
	  - Financial stability
	  - Risk-based supervision
		September 2015
		
		October 2015
		
		February-March 2016
		February-March 2016
		
		Early 2016
			December 2015
			
			On-going
			
			On-going
			
			On-going
			
			Ongoing

B. Requests for Work Program Inputs			
Fund request to Bank	Periodic updates on the work related to business climate; financial sector development; and fiscal developments and reforms.		Ongoing
Bank request to Fund	Periodic macro updates		Ongoing
C. Agreements on Joint Products and Missions			
Joint products in next 12 months	Technical assistances for a financial sector strategy		

[1] Dates are tentative. Years are calendar years

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance	
General: Swaziland is assessed as "Category B" with regards to data adequacy for surveillance Purposes (data provision has some shortcomings, but is broadly adequate for surveillance). Staff's analysis is mainly affected by shortcomings in the national accounts and fiscal sector.	
Real sector statistics: Swaziland's **GDP** is broadly adequate for surveillance. The Central Statistical Office (CSO) has been working to compile a new benchmark for 2011 based on contemporary data from household and business surveys. This data has been used for the 2015 Article IV consultation and is expected to be published by the end of 2015. Shortcomings remain with regards to the treatment of Southern African Customs Union (SACU) revenue. Although the SACU group meeting at end-2012 resulted in a common understanding among technicians from the statistical offices, the treatment of SACU revenue in national accounts has yet to be agreed by member commissions. CSO publishes labor market statistics with long delays. The most recent **unemployment** data is for 2010 and the 2013 numbers are only expected to be released by end–2015. For 2016, the authorities are planning to conduct the third labor force survey (the first was conducted in 2007). The **consumer price index** was significantly revised in May 2007 in the context of the GDDS initiative, incorporating improvements in compilation methodology, market basket coverage, flexibility for introducing new pricing outlets and new varieties of products, and enhanced processing capabilities. Four new geographical indices, as well as a national index, with updated market basket weights, are now available. Monthly consumer price data are published by CSO with a one-month lag.	
Monetary and financial statistics: Although some progress was achieved in the reporting of data on the other depository corporations (ODCs), quality problems remained, particularly in the areas of coverage, classification, and sectorization. The CBS started to include the Swaziland Building Society into the monetary data backdated to December 2006. However, the credit and savings cooperatives, representing about 8 percent of assets of the commercial banks, remain outside the deposit corporations' survey.	
External sector statistics: Quarterly balance of payments statistics are compiled by the CBS according to a methodology consistent with the fifth edition of the *Balance of Payments Manual (BPM5)*. However, shortcomings in the timeliness and availability of trade data impart a certain degree of uncertainty to external sector statistics and surveillance. The errors and omissions term is sizable and further actions are required to improve the accuracy and reliability of external sector data.	
II. Data Standards and Quality	
Participant in the General Data Dissemination System (GDDS) since February 11, 2003.	No data ROSC is available.
III. Reporting to STA	
The CBS reports monetary and financial statistics to STA regularly, although the timeliness of data could be improved. Balance of payments data are published in *International Financial Statistics (IFS)* and in the *Balance of Payments Yearbook*.	

Swaziland: Table of Common Indicators Required for Surveillance

(As of November 1, 2015)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Oct 15	Oct 15	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep 15	Oct 15	W	M	M
Reserve/Base Money	Aug 15	Oct 15	M	M	M
Broad Money	Aug 15	Oct 15	M	M	M
Central Bank Balance Sheet	Aug 15	Oct 15	M	M	M
Consolidated Balance Sheet of the Banking System	Aug 15	Oct 15	M	M	M
Interest Rates[2]	Oct 15	Oct 15	M	M	D
Consumer Price Index	Sep 15	Oct 15	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Aug 15	Sep 15	M	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2014	Sep 14	A	A	A
External Current Account Balance	2014	Oct 15	Q	A	A
Exports and Imports of Goods and Services	2014	Oct 15	Q	A	A
GDP/GNP	2009	Sep 10	A	A 2/ 3/	A
Gross External Debt	2014	Sep 15	A	A	A
International Investment Position[5]	2014	Sep 15	A	A	A

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means, as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] Including currency and maturity composition.

[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

SOCIAL AND DEMOGRAPHIC INDICATORS

Area (sq. km.)	17,364	**Population Density** (per sq)	74
Population		**Health**	
Total population (million)	1.2		
Population growth rate (percent)	1.5	Physicians per thousand people (2009)	0.2
Life expectancy at birth (2013, years)	49	Public health expenditure (2013, percent of GDP)	6.3
Infant mortality rate per thousand (2014)	46		
Urban Population (2014, percent of total)	21	HIV prevalence rate (2014, ages 15–49)	28
Population younger than 15	38		
(percent of total population, 2014)			
GDP per capita (US$) (2014)	2,679	**Education**	
Access to safe water (2014)		Adult literacy rate (2011,	83
Percent of total population	74	Primary school enrollment	
Urban	94	(2007, percent)	85
Rural	69		
		Poverty Indicators	
Labor Statistics (thousands)			
Labor Force (2013)	446	Share of income, lowest 20 percent	4.1
		GINI Index (2010)	51.5
Formal Employment (2006)	92		
Private Sector	65		
Public Sector	28		

Statement by Ms. Kapwepwe, Executive Director for the Kingdom of Swaziland, and Ms. Dlamini-Kunene, Alternate Executive Director
December 9, 2015

We thank Staff for the candid and productive engagement during the Article IV mission in Mbabane. My authorities value Fund engagement and are in broad agreement with the assessment and conclusions of the Staff report. They share similar concerns on the challenges facing the country given the volatility of revenues from the Southern African Customs Union (SACU) and the need to strengthen the country's resilience to shocks.

Despite recent challenges, the Kingdom of Swaziland has made significant socio-economic achievements over the recent years. The authorities have enhanced agricultural production by increasing area under irrigation especially on Swazi Nation Land for small holders by constructing large and medium-sized dams including, the development of the Maguga dam and the Lubovane dams under the KOBWA LUSIP Projects respectively. The quality of road infrastructure has improved connectivity of the major towns, main border gates and rural settlements. In addition, access to electricity has improved in all parts of the country and more that 75 percent of the population has access to clean water. The authorities have also rolled out universal primary school education to grade 7 and access to free Anti-Retroviral Therapy has more than doubled.

Going forward, the challenge for the authorities will be consolidating these achievements and ensuring that the pace of growth is commensurate with the desired social and economic transformation of the Kingdom. Therefore, the focus of the authorities is to build a strong and resilient economy. In this regard, they concur with staff that the need to pursue a reform path that anchors fiscal and debt sustainability while supporting growth in the medium to long term.

Recent economic developments and outlook

Economic activity is estimated to have slowed, with GDP growth rate decreasing from 2.9 percent in 2013 to 2.4 percent in 2014, mainly due to poor performance in the primary sector and loss of momentum in the tertiary sector. The primary sector is estimated to have contracted by 3.2 percent in 2014 due to poor crop production, especially citrus, and poor performance in the livestock sector.

The current account continued to improve in the third quarter of 2015 mainly due to higher current transfers inflows of which SACU accounted for about 63 percent. Gross official reserves increased markedly in October by 11.8 percent to E9 billion compared to the E8 billion recorded in September 2015 and were enough to cover an estimated 3.9 months of imports.

The authorities have been exercising prudent borrowing principles. In this regard, while public debt has edged up slightly in recent months, Swaziland's public debt remains low around 18 percent of GDP and significantly lower than the authorities' 35 percent limit. To further strengthen debt management the authorities have established a Public Debt Management Unit (operational since April 2015) to guide Government Ministries and Agencies on contracting and managing public debt.

Growth in 2015 is expected to slow down to 1.7 percent, mainly due to slower growth in the secondary and tertiary sectors while the primary sector is projected to grow by 6.5 percent, benefitting from positive growth in commercial agriculture and forestry. However, subsistence and livestock farming are expected to be affected by the drought conditions. The outlook will be compromised by the continued slowdown of the South African economy, the country's major trading partner and drought in the region. For Swaziland, the drought will affect the agriculture and construction sectors. In addition, the projected contraction in SACU revenue will exert pressure on the fiscal revenues and negatively affect the economy.

Fiscal policy and reforms

After experiencing a fiscal crisis in 2010/11 mainly due to a significant decline of almost 25% in revenues from SACU, the government has undertaken various fiscal reforms and Swaziland's budgetary outturn has since improved. At the same time, domestic revenue mobilization has improved significantly following the establishment of the Swaziland Revenue Authority (SRA). Domestic revenues have performed better than targets driven by higher than expected income tax and VAT collections.

The authorities pursued fiscal consolidation for two consecutive fiscal years following the crisis and adopted an expansionary fiscal stance for 2015/16 to support the implementation of their development agenda articulated in the Vision 2022. Their main focus was to implement priority development programs over the medium term, with emphasis on education, health, agriculture, infrastructure and improving the conditions for private sector investment. The anticipated decrease in SACU revenue presents additional risks to government revenues. The authorities are cognizant of these developments and having experienced a similar crisis in 2010/11, are aware of the need to take early precautionary steps and practice fiscal prudence to safeguard confidence. This would be achieved through measures including by reviewing spending priorities, containing recurrent spending, rationalize the wage bill, enhance domestic revenue collection and enhance available financing.

Among the main challenges, the wage bill remains a major concern. The authorities are exploring all possible measures, including a wage and hiring freeze across all sectors for the remainder of 2015. In the near-term, deferring and/or closing unused positions. They also intend to minimize expenditure on goods and services to only essential items that substantially improve government objectives and maximize savings. On the revenue side, the authorities intend to amend the Income Tax regulations and introduce a levy on alcohol and tobacco. In addition, an amendment to the Tax Law to reduce tax exemptions has been submitted to Parliament.

Public finance management

The Public Finance Management (PFM) Bill has been finalized and resubmitted to Parliament. The Bill is expected to establish a comprehensive and stronger legal framework for managing public resources, and to empower spending agencies to take full responsibility and accountability of their budgets. In addition, implementation of a new financial management IT and accounting system, with the support of the IMF, World Bank and European Union, will support the implementation and improve transparency and accountability in the use of public resources. At the same time, the authorities remain committed to improving efficiencies in the procurement and cash management process.

Monetary and exchange rate policies

As a member of the Common Monetary Area, Swaziland does not have an independent monetary policy. The Central Bank of Swaziland (CBS) continued to pursue a monetary policy in line with the monetary stance of the South African Reserve Bank. For the first nine months of 2015, the CBS tightened monetary policy increasing rates twice by a cumulative 50 basis points. On the exchange rate policy, the authorities view the exchange rate peg to the South African rand as an appropriate monetary policy anchor. In this regard, they will continue to maintain official international reserves at above 3 months of imports with the intention to increase the reserves to 6-7 months of imports in the medium to long term. They intend to continue to protect the peg by undertaking the necessary fiscal measures that will strengthen the economy's resilience against potential external shocks and to further strengthen policy buffers.

Financial sector developments and policies

The banking sector is liquid, well capitalized, highly profitable and compliant with regulatory requirements. The quality of banking sector assets has been improving since the 2010/11 fiscal crisis and non performing loans (NPLs) have declined from 10.7 percent during the crisis to 6.9 percent. Credit extension to the private sector is reflective of the structure of the economy which is driven by the sugar sector in agriculture manufacturing and services. The banking system though sound is susceptible to developments in the price of sugar, SACU revenues which influence the consumer confidence and implications on reserves.

The authorities recognize that given the rapid growth and size, the non-bank financial institutions (NBFIs) are becoming systemically important and that the strong linkages between the NBFIs and banks warrant closer supervision. Therefore, to safeguard financial sector stability the regulatory authorities, the CBS and the Financial Services Regulatory Authority (FSRA) have strengthened their collaboration. The central bank has established a financial stability unit which liaises with FSRA on stability related issues. The CBS has also adopted a risk based supervisory framework for banks and has commenced risked based supervision. In addition FSRA is in the process of strengthening the regulatory framework of the NBFIs.

Building a strong and resilient economy

In light of Swaziland's protracted periods of slow economic growth and vulnerability to external shocks, the authorities acknowledge that the focus should be more on facilitating and nurturing the private sector to thrive in a stable fiscal environment. They recognize the need for an attractive investment climate, based on sound macroeconomic policies and fiscal discipline, leading to accelerated economic growth. They are committed to implementing structural reforms that will transform the private and public sectors to promote private investment and an expansion of the tradable goods sector. At the same, they will seek to enhance the development of the human resources, to create greater labor market flexibility, and to place a new emphasis on industrial and infrastructural development.

Structural reforms undertaken in the past aimed at improving competitiveness, especially on trade facilitation have yielded results, as Swaziland's ranking for the World Bank Ease of Doing Business improved by 24 places. However, the authorities realize that more still needs to be done. To harness private sector investment, in particular unlocking private finance for infrastructure development they have developed a Public Private Partnerships (PPPs) Policy. In addition, given the prevailing electricity crisis in South Africa, the authorities are exploring the possibility of increasing energy co-generation by sugar mills, timber producers and others to supply the national grid. In this context, the authorities are reviewing the legal framework to provide an enabling environment and incentivize participation both at strategic generation and distribution levels.

Conclusion

Though Swaziland seems to have recovered from the 2010/11 fiscal crisis, the challenge now is how to respond to the looming shortfall in SACU revenues, especially when the fiscal buffers have not been sufficiently restored. The authorities remain committed to supporting and ensuring a more inclusive and sustainable economic growth. In this regard, my authorities realize the need to pursue sound macroeconomic policies and undertake structural reforms that will reduce the country's susceptibility to external shocks and reduce dependency on the volatile SACU revenues. They appreciate the ongoing Fund advice and Technical Assistance.