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Research Update:

Botswana 'A-/A-2' Ratings Affirmed On Continued Stabilization Of Public Finances; Outlook Stable

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Overview

- Botswana has a well-managed minerals economy with a long track record of political stability, and prudent economic policies.
- We are affirming our sovereign ratings on Botswana at 'A-/A-2'.
- The stable outlook reflects our opinion that Botswana will continue to record fiscal and current account surpluses, with intermittent and generally brief exceptions when diamond prices and custom union revenues are low.

Rating Action

On July 23, 2012, Standard & Poor's Ratings Services affirmed its 'A-' long-term and 'A-2' short-term sovereign credit ratings on the Republic of Botswana. The outlook is stable. Our transfer and convertibility (T&C) assessment for Botswana remains 'A+'.

Rationale

The ratings are supported by Botswana's strong government balance sheet, well-managed minerals-based economy, and long record of political stability.

The ratings are constrained by the country's narrow economic base, which relies heavily on the diamond sector and is vulnerable to shocks, despite efforts to diversify. Fiscal and inflation challenges and still-significant development needs are further rating constraints.

Botswana's stable politics, track record of prudent economic policies, and high transparency are strong by emerging market standards. However, the country's narrow economy, incomes that are among the lowest in the 'A' category, high unemployment, and a high incidence of HIV/AIDS are key credit constraints.

Botswana is one of the world's largest diamond producers, and the diamond industry remains the country's economic locomotive. It is the biggest generators of foreign exchange earnings and government revenues. Abundant, well-managed diamond resources and a social-democratic-style welfare state have helped Botswana become a middle-income country with GDP per capita of about $8,800 in 2011 from one of the world's poorest countries in the 1960s.

The global downturn in 2008-2009 hit Botswana hard, as declining external demand caused the country's key commodity industries, in particular diamonds, to contract sharply. The diamond market rebounded in 2010 before slowing once more in late 2011. The economy has recovered from its 2009 contraction, and we expect real GDP per capita growth to expand at about 3% per year in 2012-2014--just under its predownturn rate--provided that demand for diamonds grows at least modestly.

After large fiscal deficits of 11.5% and 6.1% in the years ending March 31, 2010 and 2011, rising revenues and real expenditure cuts resulted in a smaller fiscal deficit of about 3.1% of GDP in 2011-2012. We forecast that Botswana will run a surplus of 0.9% in the year ending March 31, 2013, thanks to high customs revenues from the Southern African Customs Union, which are already known but are accounted for with a lag, as well as strong growth in other revenues and prudent expenditure management. We anticipate that, if diamond demand is close to prior trends and spending moderates, Botswana will record small fiscal surpluses averaging about 1.8% of GDP in 2012-2015.

Fiscal deficits over the past three years reduced the government's net asset position to just 1% of GDP in 2010, but it has begun to rise with the stronger fiscal performance, and we expect it to reach 7% of GDP by 2014. The country's net external asset position has weakened, but remains substantial at about 90% of current account receipts and compares favorably with peers.

The current account has moved back into surplus after a deficit of 5.7% of current account receipts in 2009, and we are forecasting small surpluses from 2012 to 2015. This assumes that the recovery in exports will continue, but also that Botswana will see strong growth in imports. Small current account surpluses should allow Botswana to preserve a comfortable net external creditor position of about 80% of current account receipts (CARs) until 2015. We do not expect gross external financing needs to exceed 60% of CARs and usable reserves during the forecast period, which implies a favorable external liquidity position.

Outlook

The stable outlook balances the economic challenges that the government of Botswana faces against still strong government and external balance sheets. We think these balance sheets will be maintained as Botswana continues to record fiscal and current account surpluses, with only intermittent and generally brief exceptions when diamond prices and customs union revenues are low.

We could lower the long-term rating if fiscal or external slippage significantly diminishes asset buffers. A collapse in global diamond prices or demand would likely be the cause.

We could raise the long-term rating if Botswana's creditworthiness improved, which would likely follow if structural reforms are implemented more quickly, inflation is brought into line with that of peers, dependence on mining declines, and private sector development broadens. However, we do not expect sufficient progress on these factors to result in an upgrade over the next few years.

Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Ratings List

Ratings Affirmed

Botswana (Republic of)	
Sovereign Credit Rating	A-/Stable/A-2
Transfer & Convertibility Assessment	
Local Currency	A+
Senior Unsecured	A-
Bank of Botswana	
Sovereign Credit Rating	A-/Stable/A-2
Short-Term Debt	A-2

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