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KINGDOM OF ESWATINI

February 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE KINGDOM OF ESWATINI

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 2019 Article IV consultation with the Kingdom of Eswatini, 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 January 31, 2020 consideration of the staff report that concluded the Article IV consultation with the Kingdom of Eswatini.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 31, 2020, following discussions that ended on November 4, 2019, with the officials of Kingdom of Eswatini on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 15, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Kingdom of Eswatini.

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February 11, 2020

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IMF Executive Board Concludes 2019 Article IV Consultation with the Kingdom of Eswatini

On January 31, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Kingdom of Eswatini.

Following the severe fiscal deterioration in 2010, Eswatini experienced a period of macroeconomic stability. Fiscal consolidation, a temporary rebound in Southern African Customs Union (SACU) revenue, and credibility in the peg with the South African rand contributed to improve fiscal and external balances and rebuild buffers. However, declining private investment and weakening external competitiveness have kept growth below the pre-2010 period and are hindering the long-term growth prospects of the economy. With subdued growth, socio-economic challenges have remained entrenched reflected by widespread poverty, high income inequality, and elevated unemployment.

Macroeconomic conditions have recently deteriorated. After a period of subdued growth, real GDP growth picked up somewhat in 2018, as the drought impact faded, and public spending remained elevated. However, over the last three years, expansionary budget policies and low SACU revenue have widened the fiscal deficit to an annual average of 9 percent of GDP. Public debt has risen rapidly, and financing constraints have led to the accumulation of domestic arrears. The current account surplus has narrowed and international reserves have fallen. With a weakening economic environment, credit to the private sector has lately decelerated, and banks' asset quality has deteriorated. The authorities have recently implemented some actions to contain the rise in the fiscal deficit, which remains large.

Economic indicators are expected to remain weak. GDP growth is projected to temporarily pick up in 2020, as the government plans to repay some arrears, but growth would be subdued afterwards as fiscal imbalances persist and the private sector remains hamstrung. The fiscal

[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.

deficit is expected to remain large and budget financing risks to be elevated. The large deficit would raise public debt above 60 percent of GDP over the medium-term and contribute to further reduce international reserves.

Downside risks weigh on this fragile outlook. Risks emanate from possible further fiscal slippages that could undermine confidence in the government's ability to control public finances and in the peg. Other risks arise from further decline in SACU revenue, weak demand for key exports, and rising interest rates. With a highly interconnected financial sector, macro-financial feedback loops could amplify the adverse effects of shocks.

Executive Board Assessment[2]

Executive Directors noted that Eswatini is at a critical juncture, with subdued growth, rising public debt, and depleting international reserves. Moreover, falling private investment and declining competitiveness are hindering growth prospects. Directors welcomed the recent fiscal measures to stabilize the economy and support growth and encouraged more decisive policy action to bring the economy back on a sustainable path. An ambitious structural reform agenda is key to promoting private-sector-led growth and addressing poverty and inequality.

Directors recommended a credible medium-term fiscal adjustment plan to achieve debt sustainability and macroeconomic stability. Building on initial steps to rationalize expenditures, Directors emphasized the need for additional high-quality adjustment measures, while supporting long-term growth and protecting the most vulnerable through better-targeted social programs. Specifically, they encouraged the authorities to contain public wage spending and administrative expenses, rationalize transfers to state-owned entities, prioritize capital projects, and broaden the tax base.

Directors underscored the importance of fiscal reforms to support consolidation efforts. They called for further steps to strengthen budget formulation and public financial management to restore fiscal discipline and contain the build-up in arrears. They also encouraged reforms to revamp the public procurement process, improve the efficiency and governance of public enterprises, and adopt a transparent arrears clearance strategy.

Directors concurred that, given the exchange rate peg to the South African rand, the central bank should maintain the policy rate broadly in line with the South African Reserve Bank's rate and refrain from providing further budget financing. They noted that stable monetary conditions and fiscal consolidation would help strengthen the country's external position and support the rebuilding of reserve buffers.

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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 summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors noted that, while the financial sector is overall stable, vulnerabilities are rising. They highlighted the need to strengthen financial sector oversight and accelerate efforts to improve the regulatory and supervisory frameworks for the large non-bank financial sector, including through legislative changes. They also underlined the importance of establishing a macroprudential structure and developing crisis preparedness and management capacity, as well as addressing non-performing loans and the high concentration risks in the banking sector. Directors also supported enhancing the AML/CFT framework and looked forward to this year's planned assessment.

Directors welcomed the authorities' efforts to promote growth, job creation, and good governance, as articulated in the *National Development Plan 2019-22* and *the Strategic Roadmap*. They stressed the importance of complementary supply-side and governance reforms to support private investment and strengthen competitiveness. Directors agreed that structural reforms should aim to improve business conditions, address weaknesses in product and labor markets, and invest in human capital. Reform of the electricity and telecommunications industries is also key. Determined efforts are needed to reduce vulnerabilities to state-capture and other forms of corruption.

Eswatini: Selected Economic Indicators

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
					(Percentage changes; unless otherwise indicated)					
National account and prices										
GDP at constant prices	2.3	1.3	2.0	2.4	1.2	2.5	1.6	0.9	0.8	0.8
GDP deflator	5.8	7.3	2.9	2.8	5.1	5.6	5.3	6.8	7.0	7.0
GDP at market prices (Emalangeni billions)	52.0	56.5	59.3	62.4	66.3	71.8	76.9	82.9	89.4	96.4
GDP at market prices (US dollar billions)	4.1	3.8	4.5	4.7	4.6	4.9	5.1	5.3	5.6	5.9
Consumer prices (average)	5.0	7.8	6.2	4.8	2.6	4.3	4.8	6.5	7.0	7.0
External sector										
Average exchange rate (local currency per US$)	12.8	14.7	13.3	13.2	…	…	…	…	…	…
Nominal exchange rate change (– = depreciation) [1]										
Real effective exchange rate (– = depreciation) [1]	0.7	2.7	-7.8	-1.3	…	…	…	…	…	…
Terms of trade (deterioration -)	10.2	19.4	-18.3	-11.9	2.9	6.2	2.8	1.4	0.4	0.1
Gross international reserves										
(months of imports)	4.2	3.6	3.1	2.6	2.0	3.0	2.9	2.4	1.6	0.9
(percent of GDP)	16.4	13.7	11.7	9.9	7.9	11.9	11.5	9.4	6.4	3.4
(percent of reserve money)	392	269	244	186	131	168	156	119	81	42
Gross reserves minus reserve money										
(percent of deposits)	50.1	30.3	24.5	16.4	7.1	18.3	16.1	6.1	-6.3	-19.7
Money and credit										
Domestic credit to the private sector	4.2	11.6	3.9	5.1	5.9	4.4	4.4	3.5	2.8	2.6
Reserve money	15.4	32.3	-0.9	16.4	20.9	26.3	11.9	14.7	9.4	9.0
M2	13.6	26.4	3.8	4.1	0.8	8.2	6.2	5.4	6.2	5.6
Interest rate (percent) [2]	5.3	5.8	7.0	7.3	…	…	…	…	…	…
										(Percent of GDP)
National accounts										
Gross capital formation	12.5	12.8	12.7	13.1	10.7	11.1	10.8	10.7	10.7	10.8
Government	6.9	8.3	7.5	5.3	5.5	6.0	5.6	5.5	5.5	5.4
Private	5.5	4.4	5.2	7.7	5.2	5.1	5.1	5.2	5.3	5.3
National savings	25.4	20.6	19.7	15.0	14.4	14.6	13.8	12.8	12.4	12.5
Government	3.8	-0.1	0.3	-3.7	-1.2	1.9	1.0	-0.9	-2.0	-3.2
Private	21.6	20.7	19.3	18.8	15.6	12.7	12.8	13.7	14.4	15.7
External sector [3]										
Current account balance										
(including official transfers)	12.9	7.8	7.0	2.0	3.8	3.5	3.0	2.1	1.7	1.7
(excluding official transfers)	-0.8	-2.1	-4.3	-7.9	-5.6	-7.4	-7.6	-7.8	-8.1	-8.1
Trade balance	4.5	4.7	4.2	0.6	3.7	2.4	2.7	2.4	2.0	2.0
Financial account	5.0	1.4	2.3	-2.7	5.2	-0.7	3.0	3.7	4.2	4.4
of which foreign direct investment	-1.0	-0.7	2.7	-1.0	-0.6	-0.8	-0.8	0.8	0.8	0.8
External debt	13.4	17.7	15.8	17.2	19.0	23.5	25.0	25.0	24.7	24.1
of which: public	8.8	9.1	8.9	9.8	11.9	16.8	18.6	18.8	18.9	18.6
Central government fiscal operations [4]										
Overall balance	-5.5	-8.9	-7.0	-11.2	-7.9	-6.6	-7.2	-9.1	-10.0	-11.3
Total revenue and grants	27.5	25.1	28.0	24.8	25.6	28.0	26.7	25.7	25.7	25.7
of which: SACU receipts	15.3	13.1	9.2	11.8	9.2	9.3	11.4	10.3	9.8	9.8
Total expenditure	33.0	34.0	35.0	35.9	33.5	34.6	33.9	34.8	35.7	37.0
Public debt, gross	17.7	23.1	25.1	33.4	38.1	41.6	45.3	50.3	55.9	62.2
Public debt, net	9.3	15.6	20.1	29.5	34.4	38.2	42.1	47.3	53.1	59.7
Net lending (excl. SACU revenues)	-18.6	-18.2	-18.9	-20.4	-17.2	-18.1	-17.6	-18.9	-19.8	-21.1
Primary net lending (excl. SACU revenues)	-17.9	-17.3	-17.7	-19.1	-15.5	-15.9	-14.7	-15.4	-15.8	-16.2
Memorandum item:										
Population (in million)	1.08	1.09	1.09	1.10	1.11	1.13	1.14	1.15	1.16	1.18

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

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

2 12-month time deposit rate.

3 The series reflect the adoption of the BPM6 methodology and recent data revisions.

4 Public debt includes domestic arrears. Fiscal year runs from April 1 to March 31.

INTERNATIONAL MONETARY FUND

KINGDOM OF ESWATINI

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

January 15, 2020

KEY ISSUES

Context. The authorities have recently taken some policy actions toward stabilizing the economy. However, reflecting expansionary spending policies and declining Southern African Customs Union (SACU) revenue, public debt is still rising, domestic arrears have accumulated, and international reserves have fallen below adequate levels. Decelerating private investment and declining external competitiveness are hindering the country's growth prospects, leaving 40 percent of the population in extreme poverty and unemployment high.

Outlook and Risks. Fiscal policy is unsustainable, weighing on macroeconomic stability and growth. Absent policy actions, growth is expected to decline and international reserve to deplete. Downside risks dominate this fragile outlook and stem from further fiscal slippages that may undermine the capacity to support the peg, further declines in SACU revenue, lower demand for key exports, and increases in risk premia.

Fiscal and Monetary Policy. A credible medium-term fiscal adjustment plan, starting with measures to reduce next year's fiscal deficit, is needed to bring the economy on a sustainable path. Policies should combine expenditure reductions and revenue increases that enhance long-term growth prospects. Expanding and better targeting cash transfers would help protect the poor. Strengthening budget formulation and expenditure controls, revamping the procurement process, and reforming public entities and enterprises are essential to deliver fiscal adjustment. In the context of the peg, the Central Bank should refrain from providing further budget financing and should keep the policy rate broadly in line with the South African Reserve Bank's rate.

Structural Reforms. Supply-side and governance reforms are needed to support private investment and strengthen competitiveness. Reforms should reduce vulnerabilities to state-capture and other forms of corruption, streamline business regulations and regulatory requirements, reduce high electricity and telecommunications costs, contain wage growth, and address shortages of skilled workers.

Financial Stability. The financial system remains sound, although vulnerabilities are rising. Hence, bank supervision should be intensified, the early intervention regime strengthened, and plans to relax single borrower concentration regulations suspended. Legislative changes to address regulatory and oversight gaps for NBFIs should be accelerated. Setting up macro-prudential and crisis preparedness and management frameworks is a critical step to manage macro-financial risks. Efforts to update and improve the AML/CFT framework should be stepped up.

Approved By
David Robinson (AFR) and Ashvin Ahuja (SPR)

Discussions for the 2019 Article IV consultation took place in Mbabane during October 23-November 4, 2019. The team comprised Mr. Palomba (head), Ms. Ganum, Messrs. Habib and Thakoor (all AFR) and Mr. Jeasakul (MCM). Messrs. Mahlinza and Ismail (both OED) participated in the discussions. Ms. Wang and Mr. Alsokhebr provided research and editorial assistance for the preparation of this report.

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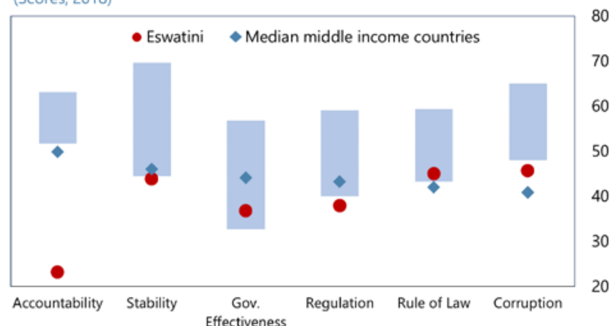
THE PITFALLS OF UNSUSTAINABLE FISCAL EXPANSION

1. **Among Southern African economies, Eswatini stands out for its close links to South Africa that have helped support economic progress, while anchoring policy-making.**[1] In the early 2000s, annual per capita GDP growth averaged 2.9 percent, boosted by South Africa's strong performance following the end of apartheid. The peg with the South African rand anchored the policy framework and helped contain inflation, while financial integration and access to South African markets, and good road infrastructure supported the emergence of a somewhat diversified economy.

2. **Economic links to South Africa have, however, exposed Eswatini to external shocks, amid structural bottlenecks constraining growth and deep social challenges** (Figure 1). In 2010, the global crisis-induced recession in South Africa prompted a sharp reduction in Southern African Customs Union (SACU) revenue and triggered a fiscal liquidity crisis in Eswatini and a decline in international reserves. The government implemented significant fiscal adjustment, and with SACU revenue bouncing back, fiscal and external balances improved. However, since then, SACU revenues have been on a declining trend and growth has been below the pre-crisis period held back by decelerating private investment and stagnant competitiveness, reflecting structural impediments to business and widespread governance and regulatory issues (Figure 2).

Weak Governance and Institutions

(Scores, 2018)



Sources: Worldwide Governance Indicators, D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank) 2017 and IMF staff calculations.
Notes: Shaded areas show the distribution of SACU countries excluding Eswatini (Botswana, Lesotho, Namibia, and South Africa). Scores are rescaled to 0-100 range; higher scores indicate better performance.

Socio-economic developmental challenges have remained deeply entrenched: about 40 percent of the population live in extreme poverty; unemployment is elevated, particularly among the youth; and, the HIV prevalence rate is one of the highest in the world.

3. **Expansionary budget policies and declining SACU revenue have recently resulted in rapidly growing public debt and declining international reserves.** Since 2013, public spending has increased by about 7 percent of GDP as public wage costs, transfers to extrabudgetary entities, and capital outlays increased. With SACU revenue on a declining trend, a substantial fiscal deficit has emerged, resulting in public debt almost doubling over 2015-17 (from a low level), and government accumulating domestic arrears (about 4 percent of GDP in early 2018).[2] With SACU revenue

[1] Eswatini's currency is pegged to the South African rand. With South Africa, Botswana, Lesotho and Namibia, Eswatini is a member of the Southern African Customs Union (SACU) and over the last decade has received annual customs revenues of about 12 percent of GDP. These revenues are critical to support the external balance and the currency peg and to finance the government budget (about 40–45 percent of tax revenue). Moreover, about 70 percent of exports and 70 percent of imports occur with South Africa. South African banks dominate the domestic banking system, and South African financial markets are the main destination of Eswatini's large financial outflows.

[2] In the absence of reliable estimates of the structural fiscal balance, changes in spending levels and in the fiscal balance net of SACU revenue are the most reliable measures of government's fiscal policy stance.

declining, the current account surplus narrowed and international reserves fell to about three months of imports (Table 1).

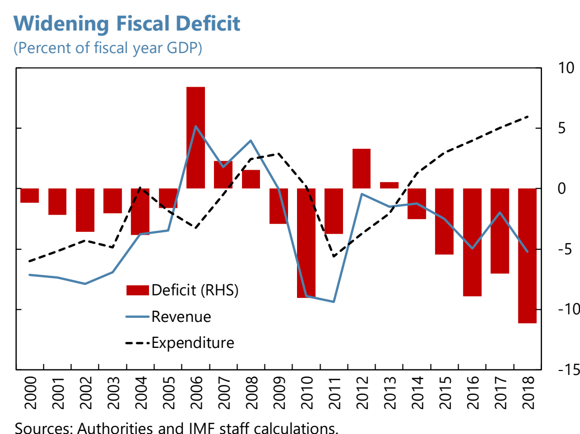
4. In 2018 and early 2019, growth temporarily recovered, as drought impacts lessened, but external buffers thinned further and vulnerabilities deepened. (Figure 3)

- Real GDP in 2018 grew by 2.4 percent, the fastest rate in recent years, supported by high public spending and a temporary pick up in agricultural production, as the impact of the past years' drought dissipated. The strong growth performance continued in the first two quarters of 2019, as public spending remained large, and manufacturing activities picked up; although growth started to decelerate in the third quarter.

- Strong domestic demand, combined with high fuel prices and low SACU revenue, narrowed the current account surplus to 2 percent of GDP in 2018 (7 percent in 2017). International reserves declined to 2.6 months of projected imports (about 185 percent of reserve money), despite increased portfolio inflows by non-bank financial institutions (NBFI). The external position was moderately weaker than implied by macroeconomic fundamentals and desirable policies, with international reserve buffers thinning (Annex I).[3] In 2019, international reserves declined further to 2 months of projected imports (about 130 percent of reserve money), despite the Central Bank of Eswatini (CBE) expanding its program of foreign currency purchases from banks.[4]

5. Expansionary budget policies continued in 2018/19, and the fiscal position weakened further. Despite policies to contain the wage bill and reduce other non-wage spending, the FY18/19 fiscal deficit widened to 11.2 percent of GDP (7 percent in FY17/18) as SACU revenue declined (about 2½ percent of GDP) and, with weak public financial management systems, efforts to contain non-wage spending led to unreported spending commitments (Tables 2–3). Gross financing needs increased to 23½ percent of GDP. With banks' limited appetite to expand sovereign exposures, the government drew on its bank deposits, which reached an all-time low, used additional central bank's advances (2.6 percent of GDP), and increasingly tapped the domestic bond market

Widening Fiscal Deficit
(Percent of fiscal year GDP)



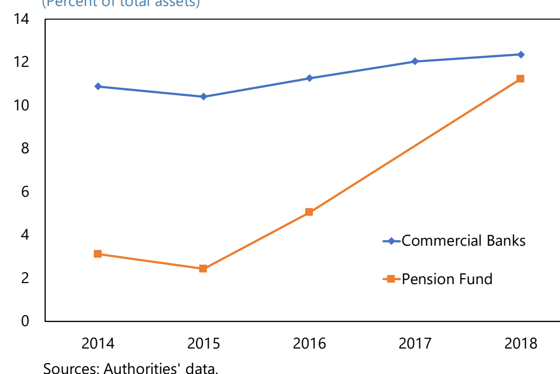
Sources: Authorities and IMF staff calculations.

[3] Large and consistently negative errors and omissions in the balance of payments (about 6–8 percent of GDP) underpin the conclusion of an overvalued exchange rate.

[4] In 2019, a regulation was introduced requiring authorized dealers to offer any foreign currency acquired from export proceeds to the CBE for purchase at market price. This measure is being assessed by the staff using the Institutional View on Liberalization and Management of Capital Flows as it might constitute a capital flow management measure.

dominated by the government-owned pension fund.[5] Notwithstanding these actions, domestic arrears rose to about 6¾ percent of GDP by year-end, and public debt (including domestic arrears) reached 33½ percent of GDP, almost doubling from three years earlier.

6. The weakening macroeconomic environment and rising government's arrears have adversely affected credit and the banking sector. Credit growth to the private sector decelerated to 3.5 percent in 2018 (7.5 percent in 2017).[6] With liquidity easing and relatively low loans-to-deposit ratios, the deceleration was mostly driven by weak demand from highly-leveraged households. Credit to households, particularly consumption credit, declined, though corporate credit remained buoyant (Figure 4). The difficult economic juncture affected banks' asset quality, and NPLs rose to 9⅓ percent of total loans by end-2018. Despite the government's high financing needs, banks' direct exposures to government securities remained stable (around 12 percent of total assets), but NBFIs, particularly the government pension fund, substantially increased their exposures.



7. Headline inflation declined and, in the context of the currency peg, the central bank lowered its policy rate. Average headline inflation declined to 4.8 percent in 2018 (6.2 percent in 2017) as core inflation lowered and food price inflation turned negative. In 2019, average inflation fell to around 3 percent, reflecting the weakening economy and the government's decision to freeze electricity and water tariffs. In July 2019, the CBE followed the South African Reserve Bank (SARB) and lowered the policy rate, citing low inflation and persistent fiscal challenges.

8. Since taking office in late 2018, the new government has taken some actions to control rising fiscal deficits and has developed plans to boost growth. In line with staff's past advice, the authorities began policies to contain the wage bill and restructure some loss-making public entities (Annex X). To support growth, the government has developed a national development plan and a roadmap of priority actions to support private investment. In the short term, it is facilitating the setting-up of selected foreign investment projects.

[5] In March 2019, the central bank's total exposure to the government amounted to 4.7 percent of GDP. This is close to the maximum exposure to the government allowed under the Central Bank Order.

[6] Given the volatility of credit, credit growth refers to 12-month averages.

OUTLOOK AND RISKS

9. Absent additional policy actions to contain the fiscal deficit, the economic outlook is unsustainable. The fiscal deficit is projected at around 8 percent of GDP this year and is expected to remain large thereafter, deepening government's liquidity problems and weighing heavily on the outlook. Growth is projected to decline to around 1.2 percent in 2019 as agricultural activity stabilizes. Plans to pay off some arrears will temporarily boost growth in 2020, but over the medium-term growth would remain subdued as policy uncertainty rises and government's domestic arrears continue accumulating[7]. Even if additional budget financing were available to avoid arrears, the outlook would remain unsustainable. Public debt would exceed 60 percent of GDP by the end of projection period, with government's gross financing needs averaging about 22 percent of GDP. Absent additional external financing, international reserves would rapidly deplete, undermining the CBE's capacity to support the currency peg and eventually leading to some form of abrupt adjustment (Table 4).

Staff Medium-Term Projections (Baseline)[1]
(Percent of GDP, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	(Percent of GDP; unless otherwise indicated)									
Real GDP growth (percent change)	2.3	1.3	2.0	2.4	1.2	2.5	1.6	0.9	0.8	0.8
Real GDP per capita (percent change)	1.6	0.6	1.3	1.3	0.2	1.4	0.6	-0.1	-0.3	-0.3
Credit to the private sector (percent change)	4.2	11.6	3.9	5.1	5.9	4.4	4.4	3.5	2.8	2.6
Fiscal Balance	-5.5	-8.9	-7.0	-11.2	-7.9	-6.6	-7.2	-9.1	-10.0	-11.3
Primary Fiscal Balance	-4.8	-8.1	-5.9	-9.9	-6.1	-4.4	-4.4	-5.5	-5.9	-6.3
Gross Financing Needs	14.8	20.0	17.6	23.4	20.5	21.6	19.5	20.9	22.2	23.9
Public debt, gross	17.7	23.1	25.1	33.4	38.1	41.6	45.3	50.3	55.9	62.2
o/w Stock of Arrears		3.6	4.0	6.7	8.8	6.5	9.5	14.1	20.9	28.8
Current account balance	12.9	7.8	7.0	2.0	3.8	3.5	3.0	2.1	1.7	1.7
Gross international reserves (months of imports)	4.2	3.6	3.1	2.6	2.0	3.0	2.9	2.4	1.6	0.9
Gross international reserves (percent of reserve money)	392	269	244	186	131	168	156	119	81	42

Sources: Staff estimates.

1/ Fiscal year data (April 1 - March 31).

10. Downside risks weigh on an already fragile outlook. The main risk arises from further fiscal slippages that could undermine confidence in the government's ability to control public finances and the central bank to effectively support the peg. Doubts about the sustainability of the peg could result in accelerating inflation, currency mismatches in the private sector's balance sheets, capital outflows and low growth. External shocks could exacerbate these vulnerabilities. If growth in South Africa remains sluggish, SACU revenues would decline, widening the fiscal deficit and accelerating the depletion of international reserves. Rising protectionist pressures and weaker global growth, including in South Africa, could negatively affect exports and GDP growth, and reduce SACU revenue, prompting a deterioration in both external and fiscal accounts. Moreover, increases in risk premia, driven by deteriorating market sentiments, could trigger rising interest rates in South Africa and, in the context of the peg, increase government's financing costs and exacerbate funding

[7] The authorities have recently negotiated a R2 billion commercial loan, repayable within 5 years, to clear domestic arrears, and have requested creditors with claims on the government to come forward.

difficulties (Annex II). Furthermore, Eswatini is exposed to climate events, like droughts, that could adversely affect growth and fiscal accounts.

11. Macro-financial feedback loops could intensify the effect of shocks and policy inaction. External shocks and tightening financial conditions in South Africa, or globally, could tighten domestic funding conditions for both the government and the private sector. With credit decelerating and government arrears rising, the financial position of the private sector would deteriorate further, undermining banks' asset quality, reducing financial intermediation, and adversely affecting growth, with the risk that deteriorating expectations could create negative feedback loops.

Authorities' Views

12. The authorities broadly agreed with staff's outlook and risk assessment but see more upside to medium-term growth and stressed that some fiscal adjustment efforts are underway. They noted that a number of measures to contain FY19/20 budget overruns are being implemented, and that some tax measures (e.g., excises on alcohol, tobacco, fuel) have been introduced that will be fully effective in FY20/21. To restore sustainability and mitigate vulnerabilities, starting with the FY21/22 budget, they intend to develop a medium-term fiscal framework and implement a fiscal adjustment strategy to stabilize public debt. Finally, they expect that the implementation of the recently developed Recovery Roadmap and the 2019 National Development Plan would help increase private investment, reduce vulnerabilities, and deliver stronger growth over time. They concurred that external shocks would pose additional pressure on the already fragile outlook.

POLICY DISCUSSIONS

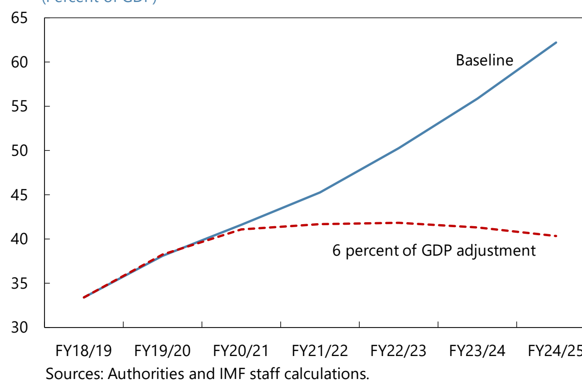
Discussions focused on: (i) designing a fiscal adjustment strategy to restore fiscal sustainability and strengthen external buffers, while supporting long-term development prospects; (ii) implementing reforms to boost private investment and competitiveness to reignite long-term growth, and (iii) advancing financial sector reforms to better manage macro-financial and AML/CFT risks.

A. Restoring Fiscal Sustainability and Supporting Long-term Growth

13. The authorities envisage a small reduction in the fiscal deficit next year, but have yet to develop a medium-term strategy to restore fiscal sustainability. They estimate the FY19/20 fiscal deficit to be around 6⅓ percent of GDP, and have approved budget spending ceilings that would contain the FY20/21 fiscal deficit to 5¾-6 percent of GDP. They intend to leverage a temporary increase in SACU revenue (2 percent of GDP) to finance an increase in capital spending and some wage increases, as well as meet rising interest costs, while continuing to contain new hiring and increases in non-wage expenses. Beyond the FY20/21 budget, the authorities are working on a medium-term fiscal and financing strategy to stabilize public debt.

14. Staff estimate that, without additional actions, the fiscal deficit over the next years would remain large and public debt would rise to unsustainable levels. Following the authorities' recent actions, staff expect the FY19/20 fiscal deficit to be substantially lower than in the past but still large at about 8 percent of GDP because of revenue shortfalls and spending overruns in non-wage recurrent outlays. With limited financing, domestic arrears would increase to about 8¾ percent of GDP. Under the baseline scenario, which includes the authorities' FY20/21 budget plans and no additional measure, the fiscal deficit would remain large, public debt would exceed 60 percent of GDP over the projection period, gross financing needs would average around 22 percent of GDP, deepening financing pressures and prompting further arrears accumulation (Tables 2-3). In addition, this outlook is subject to significant risks, particularly contingent liabilities from public entities as the financial situation of some entities is deteriorating (Annex III).

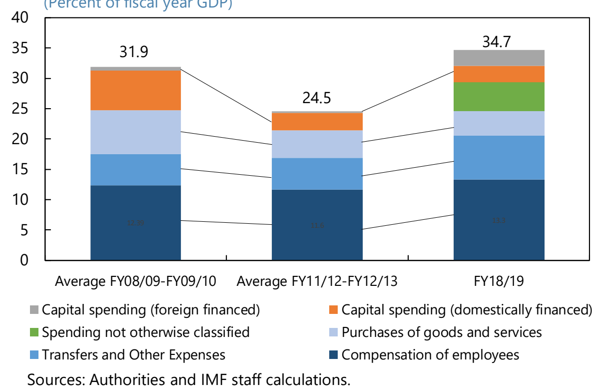
Public Debt Under Alternative Scenarios
(Percent of GDP)



Sources: Authorities and IMF staff calculations.

15. Immediate measures to reduce next year fiscal deficit and a credible medium-term consolidation plan, consistent with available financing, are needed to restore sustainability. Under staff's macroeconomic projections, about 6 percent of GDP in measures is needed over the next three years, starting with FY20/21, to restore fiscal sustainability and bring public debt on a gradually declining path. While the goal is ambitious, the proposed adjustment is smaller than what was delivered in the aftermath of the 2010 fiscal crisis.[8] With the limited financing options currently available, there is no fiscal space to smooth the adjustment over time and some front-loading of consolidation efforts is needed, which puts a premium on the ability to deliver reforms quickly. In the near-term, the fiscal adjustment would, however, have temporary adverse effects on growth.

Changes in Primary Spending
(Percent of fiscal year GDP)



Sources: Authorities and IMF staff calculations.

[8] In 2010, the authorities developed a Fiscal Adjustment Roadmap that envisaged a reduction in fiscal deficit (about 11 percent of GDP in three years) by relying on both expenditure and revenue measures.

Staff Medium-Term Projections (Adjustment Scenario)[1]
(Percent of GDP, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	(Percent of GDP; unless otherwise indicated)									
Real GDP growth (percent change)	2.3	1.3	2.0	2.4	1.2	1.4	0.2	1.2	2.0	2.2
Credit to the private sector (percent change)	4.2	11.6	3.9	5.1	5.9	4.4	8.9	9.4	8.1	8.7
Fiscal Balance	-5.5	-8.9	-7.0	-11.2	-7.9	-4.4	-2.4	-2.0	-2.1	-2.0
Revenue	27.5	25.1	28.0	24.8	25.6	28.1	27.1	26.7	26.7	26.8
Expenditure	33.0	34.0	35.1	36.0	33.6	35.0	34.5	34.7	34.8	34.9
Adjustment measures (cumulative)						2.5	5.0	6.0	6.0	6.0
Primary Fiscal Balance	-4.8	-8.1	-5.9	-9.9	-6.1	-2.2	0.5	0.8	0.6	0.8
Gross Financing Needs	14.8	20.0	17.6	23.4	20.6	19.6	14.9	14.1	14.7	15.0
Public debt, gross	17.7	23.1	25.1	33.4	38.2	41.1	41.7	41.8	41.3	40.3
o/w Stock of Arrears		3.6	4.0	6.7	8.9	5.6	5.3	4.9	4.6	4.3
Current account balance	12.9	7.8	7.0	2.0	3.8	4.5	6.5	6.8	5.9	5.0
Gross international reserves (months of imports)	4.2	3.6	3.1	2.6	2.1	3.5	4.6	5.4	5.8	6.0
Gross international reserves (percent of reserve money)	392	269	244	186	131	178	229	276	302	311

Sources: Staff estimates.
1/ Fiscal year data (April 1 - March 31).

16. The adjustment should be based on policies that can deliver sustained fiscal consolidation and enhance the long-term growth prospects of the economy. Policy measures should include a combination of both spending and revenue measures, while protecting social and core capital spending.

Possible Adjustment Measures, FY20/21-22/23
(Percent of GDP)

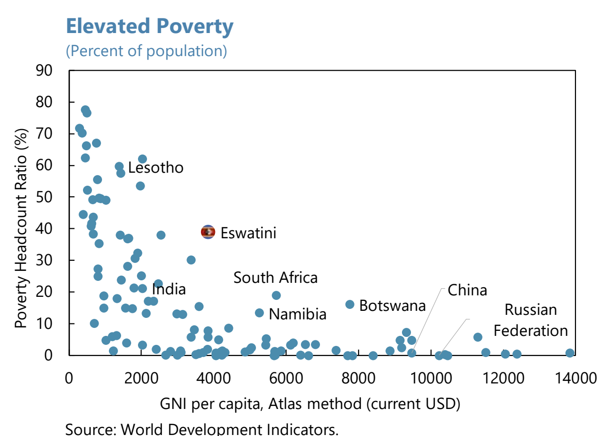
Total measures (up to)	**Up to 11.4**
Expenditure	**6.6-8.5**
Limit wage increases, new hires, and statutory posts	2.1-3.0
(1:1 replacement, COLA only in 2020)	2.1
(5:1 replacement, No COLA)	3.0
Reprioritize capital spending	3.0-3.5
(Reduce to 5 percent of GDP)	3.0
(Reduce to 4.5 percent of GDP)	3.5
Rationalize transport and travel expenses, professional services	0.6-1.0
Restructure public entities and reduce subventions	1.0
(Preserving education, health, cash and other social transfers)	
Revenue	**2.6-2.9**
Increase top tax rate for PAYE	0.2
Broaden CIT base	1.1-1.4
(e.g., capital allowances, loss carry fwd, tax incentives/exemptions, thin capitalization)	
Widen VAT base	0.8
(e.g., fuel, electricity)	
Excises (fuel, other minor items)	0.5

Sources: Authorities and staff estimates.

- With wages and transfers to extrabudgetary entities exceeding 60 percent of public spending, staff discussed a menu of near-term spending rationalization measures, including: (i) continuing policies limiting new hires and containing salary indexation over the next three years, extending these policies to all public entities and enterprises, while containing allowances and costs for special committees and appointments; (ii) rationalizing government administrative expenditures (e.g., travel costs, transfers to support traditional institutional frameworks); and (iii) prioritizing capital outlays to deliver budget savings and improve their impact on growth. Over time, additional savings could be achieved through: (iv) strengthening the efficiency of health and education spending, including through sectoral spending reviews (Figure 5), and (v) reforming public entities to improve their operational efficiency and reduce government transfers (see below). Staff also discussed design options to limit the short-term adverse effects on growth of some policies.

- On the revenue side, measures should aim at creating a level-playing field for private investors and expanding domestic tax bases. Options include to: review the scope of existing discretionary tax reliefs; strictly limit the new special economic zone regime to new investment; broaden the corporate income tax base (e.g., thin capitalization, loss carry forward rules, special capital allowances) and the VAT base (e.g., electricity exemption, zero-rated fuel and other items), eliminate tax loopholes, and introduce a simplified tax regime for small taxpayers to facilitate compliance and revenue administration.

17. It will be important to accompany fiscal adjustment with measures to mitigate the effects on low-income households and to strengthen the distributive capacity of fiscal policy. Despite widespread poverty and high inequality, fiscal policy has only had a limited impact on addressing these challenges (Annex IV). While stronger growth and more equal access to economic opportunities are critical to address these challenges, there is room to adopt well-targeted budget policies and enhance some public programs to strengthen the impact of fiscal policy on poverty and reduce the adverse effect of the needed fiscal adjustment on the most vulnerable. The most effective policy options include: (i) increasing the old age grants, and possibly applying means-testing, and (ii) considering cash transfers targeted towards households with children. Improving the progressivity of the personal income tax would yield some revenue, with some limited improvements on overall inequality. The fiscal cost of these reforms would be limited (Annex IV). [9]



18. Rationalizing extra-budgetary entities and public enterprises (PE) is key to the success of the fiscal consolidation efforts and to support long-term growth potential. Public entities and PEs provide essential services and operate in sectors that are key to the development of the country. However, they offer costly production inputs (e.g., electricity, telecommunications) and, with a few exceptions, represent a significant burden for the budget (about 5.4 percent of GDP) and a source of fiscal risks for the government.[10] Aware of these challenges, the authorities are taking measures to improve the financial performance of a large medical referral scheme and some entities (e.g., University of Eswatini). In addition, they are developing plans to consolidate extra-budgetary entities and reviewing the governance structure of the sector. However, deep reforms are needed to enhance the sector efficiency and governance, while contributing to fiscal adjustment. In the short-term, reforms should focus on: (i) fast-tracking turnaround plans for key loss-making entities (e.g., Central Transport Administration, Eswatini Airways, medical referral scheme); (ii) enforcing

[9] For instance, increasing the old age grant benefits by 50 percent is estimated to cost about 0.3 percent of GDP per year; replacing the old age grant with a universal E200/month child grant would carry a similar cost.

[10] As of March 2019, central government's loan guarantees amounted to about 4 percent of GDP. In June 2019, extra-budgetary public entities and enterprises' overall liabilities were estimated to exceed 16 percent of GDP.

limits on fast-rising wage costs for all entities and PE; (iii) reviewing entities' mandates, rationalizing functions and eliminating unnecessary entities; and (iv) establishing a stronger accountability framework (e.g., board and management appointment procedures, business plans, performance contracts, revenue raising powers). Over time, it is important to establish an overarching governance structure to separate regulatory, policy, and financial monitoring responsibilities for the sector and drive future reform efforts.

19. Implementing fiscal adjustment measures requires accelerating reforms to strengthen public financial management (PFM) and procurement systems. The recent hurdles in containing public spending and arrears accumulation highlight widespread shortcomings in PFM. The authorities have recently introduced an invoice tracking system that has helped identify unpaid bills, however, deep reforms are needed.

- In the near term, accelerating the implementation of the new PFM law is critical to formulate credible budgets, establish a medium-term fiscal framework, and tighten budget execution processes (including through a single treasury account).[11] In this context, centralizing all budgetary functions within the Ministry of Finance would help manage tight budgets and control arrear accumulation.

- Fast tracking the adoption of the 2011 Public Procurement Act regulations and developing a cost-effective and transparent procurement system, including by revamping the tender board's technical capacity, would deliver needed savings and enhance transparency. Procurement rules should focus on delivering value-for-money and not pursue developmental objectives (e.g., supporting local producers) that reduce opportunities for savings and create risks of mismanagement.

- Reviewing the rationale and prioritizing existing investment projects, establishing rigorous selection and appraisal processes for future projects, and centralizing the investment portfolio oversight with the Ministry of Planning would contribute to deliver fiscal adjustment and improve the growth impact of public investment (Annex V).[12]

Under the current circumstances, there is a premium to deliver short-term savings; however, it is important to develop over time a fiscal framework to deal with the volatility of SACU revenue and contain debt levels, possibly through fiscal rules.

20. A transparent strategy to clear existing arrears would support the normalization of the fiscal situation and ease pressure on the private sector. Such a strategy would firstly require to have in place adequate controls to limit the accumulation of new arrears. Moreover, it would entail to perform a comprehensive stock taking exercise and thorough verification of existing claims,

[11] Implementing regulations for the new PFM law have been developed, with Fund technical assistance, and are waiting for submission to the Attorney General as part of the promulgation process.

[12] Recommendations refer to a Public Investment Management Assessment (PIMA) recently completed as part of the Fund's capacity development activities.

define transparent repayment plans and, importantly for fiscal planning, to liquidate arrears through the standard budget process (Annex VI).

21. Over time, fiscal adjustment would restore macroeconomic stability and enhance the long-term growth prospects of the economy. The adjustment would compress domestic demand and help re-build international reserves buffers, thus contributing to restore macroeconomic stability. In addition, fiscal adjustment measures would help reduce the cost of key production inputs such as electricity and telecommunication, better align wage dynamics to productivity trends, and lead to more efficient and growth-enhancing public investment.

22. As the government consolidates, the central bank should refrain from providing further budget financing and keep the policy rate broadly in line with the SARB's rate. The peg with the South African rand has provided an effective nominal anchor for monetary policy and allowed some space for the CBE to tailor the policy rate to the cyclical position of the domestic economy. However, the peg and a stable inflation differential with South Africa have entailed some loss of price competitiveness relative to South Africa, its main trade partner (Annex VII). Going forward, the CBE should maintain the policy rate broadly in line with the SARB's rate, with a small positive spread to reflect differential risks and economic uncertainty due to possibly slow fiscal adjustment. To support the peg, the CBE should refrain from providing further budget financing. In addition, the CBE should control base money creation and domestic liquidity, particularly if the financing of government's needs prompts additional foreign borrowing and large repatriations of assets held abroad by NBFI's (Table 5).

Authorities' Views

23. The authorities underscored their commitment to take measures to stabilize public debt and avoid the accumulation of domestic arrears. They agreed that the fiscal outlook is unsustainable and a cumulative adjustment of about 6 percent of GDP is needed over the next few years to stabilize public debt and avoid domestic arrears. They noted that some initial steps have been taken, including freezing new hires, increasing some excise tax rates, and restructuring the medical referral fund. To provide relief to government's suppliers, they have also secured external financing from the African Import-Export Bank to clear part of the domestic arrears stock in 2020. Finally, they agreed on the need to develop medium-term fiscal plans to stabilize public debt dynamics and avoid further arrears accumulation, a process that has already started.

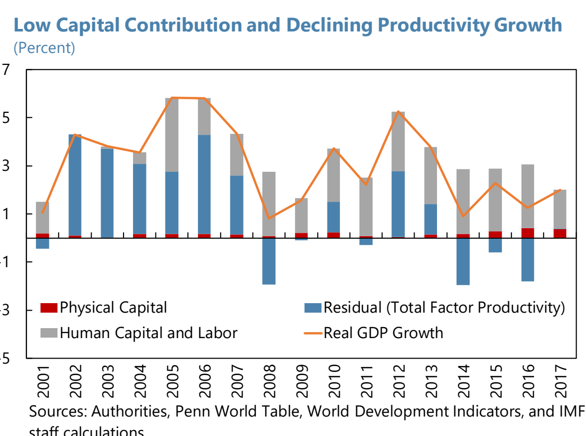
24. The authorities intend to pursue a more gradual consolidation strategy than suggested by staff to account for capacity constraints and concerns with the adverse effects of adjustment on growth. For FY20/21, they plan to continue current policies to contain new hires and restrain increases in non-wage expenses. However, they noted the need to provide some wage increases after years of no inflation adjustment, to increase capital outlays to complete ongoing projects, and observed that the restructuring of PEs will need to be implemented gradually. Accordingly, they plan to start fiscal adjustment with the FY21/22 budget and spread adjustment measures over the following four or five years. To support these plans, they intend to adopt a medium-term fiscal framework starting with the FY21/22 budget. To protect the poor, they have

increased the old age grant and are considering introducing programs to target poor children. On procurement, the authorities reiterated the importance of using procurement rules to support local suppliers, but concurred with the need to improve the effectiveness of the tender system and will seek technical assistance in this respect.

B. Implementing Supply-Side and Governance Reforms to Reignite Growth

25. Structural impediments to business and weak governance are hampering competitiveness and private investment, hindering growth and employment prospects. Since the early 2000s, both the contribution of exports to growth and goods exports have declined as the country's competitiveness has decreased (Figure 6). Deteriorating competitiveness reflects relatively high labor costs, elevated cost of key production inputs (e.g., electricity, telecommunications), and a number of non-tariff barriers in the region (e.g., customs costs, rules of origin) that increase the cost of accessing some of Eswatini's main export markets (e.g. South Africa). At the same time, private investment has sharply decelerated, the contribution of capital to growth has been negligible and productivity growth negative. As a reflection, the country's indicators of ease of business, regulatory environment, and governance have been low, held back, among others, by inefficient government bureaucracy, limited control of corruption, weaknesses in contract enforcement, and shortages of skilled labor force (Figure 7).

Low Capital Contribution and Declining Productivity Growth
(Percent)



Sources: Authorities, Penn World Table, World Development Indicators, and IMF staff calculations.

26. Aware of these challenges, the authorities have made supporting private investment and boosting growth the central tenets of their development strategy. The 2019 National Development Plan focuses on improving governance, facilitating private investment, and enhancing human capital. In addition, the authorities have developed a Strategic Roadmap of priority and high-impact actions in these areas.

27. Supply-side and governance reforms, together with fiscal consolidation, would boost competitiveness and private investment, and support long-term growth and employment. A credible fiscal consolidation would help create a stable macroeconomic environment and remove some of the impediments to private investment. In addition, reforms are needed to (Annexes VII-VIII):

- *Strengthen governance, and improve business conditions.* Reducing vulnerabilities to state-capture and corruption (e.g., strengthening the anti-corruption framework and the public procurement system), and improving regulatory transparency (e.g., *ad hoc* preferential tax treatments, investment procedures) would simplify the investment environment and facilitate the entry of new investors. Streamlining business regulations (e.g., starting businesses, licensing requirements, including trading licenses, lowering regulatory

compliance costs and other fees), and strengthening investors protection (e.g., contracts enforcement, property and investors' rights, including for land, creation of commercial courts, legal labor disputes) would facilitate private investment and boost growth, while increasing the capacity of the economy to create new employment.[13]

- *Address weaknesses in product market regulations.* Removing the causes underlying the high costs of key production inputs (e.g., electricity, communications), including by restructuring PEs operating in these sectors, reviewing regulations hampering competition in domestic markets (e.g., access to electricity and telecommunications networks, preferential treatments in public procurement) [14] would reduce production costs and boost competitiveness.

- *Contain wage dynamics in the public sector and in the economy.* Containing public sector wage growth and facilitating the adoption of more flexible wage policies in the private sector would help reduce the disconnect between wage dynamics and productivity trends and improve competitiveness.

- *Invest in human capital and reduce skill mismatches in the labor market.* Ameliorating the shortage of skills and improving human capital are key to supporting long-term growth, boosting employment, and reducing poverty. In the short-term, this requires facilitating the issuance of work permits for skilled foreign workers. Over time, it is important to improve education attainments and access to education, especially for secondary and higher education and vocational training, which remain below peer countries.

28. The potential gains from supply-side and governance reforms could be significant. Growth could increase by 1⅓-2 percentage points per year if, for example, reforms help close part of the gap with middle-income countries in key product market, governance, and labor market indicators. In this respect, improving the quality of the regulatory environment for product markets appears to have the largest growth payoff.[15]

Authorities' Views

29. The authorities consider supply-side reforms to facilitate private investment and fiscal adjustment policies as critical to preserve economic stability and boost long-term growth. They believe that a number of policies can have immediate impact on the country's growth performance. Specifically, they are facilitating the setting-up of selected large foreign investment projects and have recently established special economic zones with new investment incentives. As part of their Strategic Roadmap, they also intend to create a one-stop shop for business

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[13] For an analysis of policies to increase employment and its elasticity to growth, see IMF Country Reports 17/274-275.

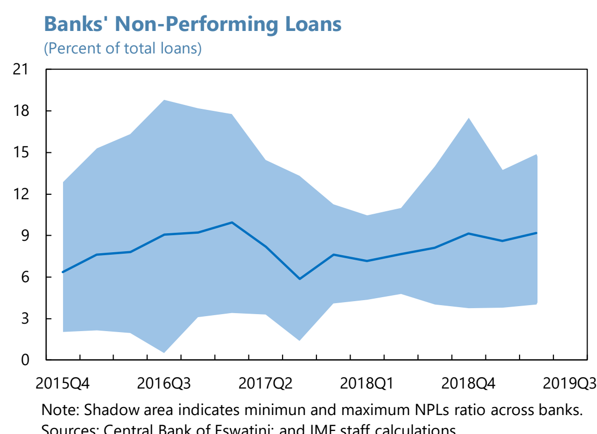
[14] Procurement rule granting preferential regimes to specific supplier inhibit competition and increase collusion risks.

[15] Estimates assume that reforms would close the gap with the middle-income countries median in key governance and structural indicators, and that gains occur over a period of 5 years. The analysis relies on third-party indicators, which should be interpreted with caution due to their perception-based nature, and uncertainty around point estimates and representativeness of survey samples.

registrations, simplify license requirements, gradually reduce corporate taxation, and establish commercial courts to speed the resolution of commercial disputes.

C. Managing Macro-Financial and Financial Stability Risks

30. Rising macroeconomic imbalances and the deteriorating economic environment are affecting the financial sector, although the impact is so far contained. The banking sector (assets about 30 percent of GDP) remains on average well capitalized and profitable, with good liquidity buffers. However, banks' asset quality has weakened (Table 6). Over the last two years, NPLs have increased, and provisioning coverage has declined, with significant disparities across banks in terms of both capitalization and asset quality (Figure 4). The performance of the large NBFI sector, comprising a large state-owned pension fund and insurance companies (gross assets about 110 percent of GDP), remained positive. However, with government's financing needs rising, the financial sector's exposure to central government securities has increased, reaching in 2019 about 12 percent of GDP (about 70 percent of public domestic debt, excluding arrears).



Note: Shadow area indicates minimun and maximum NPLs ratio across banks.
Sources: Central Bank of Eswatini; and IMF staff calculations.

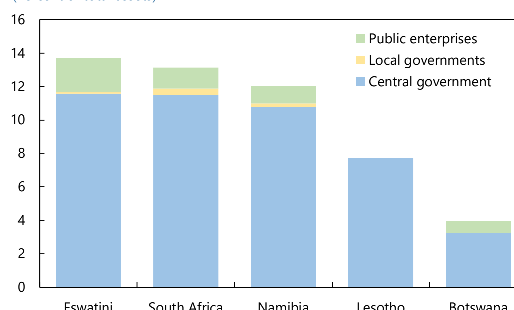
31. The weakening economic environment could compound with existing structural vulnerabilities in the financial sector to amplify macro-financial and financial stability risks. With the economy expected to weaken further, NPLs are likely to remain on a rising path and continue weighing on banks' profitability and capitalization. Tight interconnections within the financial sector could further amplify risks that need to be monitored and managed, including (Figure 8):

- *Banking sector concentration risks.* Banks' highly concentrated loan books and extensive reliance on wholesale deposits point to significant counterparty and asset-class concentration risks, and exposures to liquidity shocks. Stress tests suggest that while the banking sector is on average resilient to a doubling in NPLs, some banks could face difficulties in complying with capital requirements.[16] Liquidity risks are also significant. While banks can on average meet significant deposit outflows, the capacity varies markedly across banks depending on their holdings of liquid assets and exposures to large depositors.

[16] Stress tests assume no use of future profits and a conservative provisioning coverage for existing and new NPLs. If NPLs are adequately provisioned, the banking sector can on average absorb NPLs up to about 27 percent of total loans (the increase in NPLs is similar to the amount of government's domestic arrears expected by March 2020).

- *Sovereign-financial sector nexus*. Over the past few years, the financial sector's exposures to the sovereign have risen substantially. At end-2018, government-issued securities accounted for about 8 percent of NBFIs' gross assets (6.4 percent in 2017) and 12 percent of banks' assets, the largest exposures among SACU countries.

Deposit-taking Institutions' Exposure to Public Sector, 2018
(Percent of total assets)



Sources: IMF, International Financial Statistics; and IMF staff calculations.

- *Interconnections among financial institutions and cross-border linkages*. NBFIs are large and closely linked to banks and foreign markets, posing concerns about financial stability shocks. NBFIs account for 10 percent of banks' deposits (3 percent of GDP) and hold foreign assets of about 40 percent of GDP. Even small portfolio adjustments by institutional investors and other NBFIs (e.g., reflecting concerns with domestic credit risk or spillovers from investments overseas) could trigger significant liquidity pressures on banks. These interconnections create potentially large contagion risk channels that need to be monitored. However, the Financial Services Regulatory Authority (FSRA) has yet to develop adequate regulatory and supervisory tools for the NBFI sector, against a legal framework that needs to be overhauled, and incomplete macroprudential and crisis management frameworks.

- *Household indebtedness*. Compared to other middle-income countries, household leverage in Eswatini is elevated. Combined with banks' large exposure to households (about 45 percent of bank loans), this raises concerns about banks' resilience to households' vulnerabilities, especially with the prospects of depressed real income growth.

32. Progress is needed to enhance the ability to manage vulnerabilities and rising risks, while continuing strengthening the legislative framework of the sector (Annex IX). Specifically, improvements are needed in:

- *Banking sector oversight*. The CBE is progressively implementing Basel II standards and enhancing risk-based supervision. However, at the current economic junction, the CBE should intensify supervision by: requiring the most exposed banks to develop credible action plans to address high NPLs; continuing to ensure proper assets classification, collateral valuation, and provisioning; operationalizing an early intervention regime, including mandatory corrective actions; and by accelerating plans to improve capital quality of selected banks. To help manage concentration risks, it is important to suspend plans to relax single borrower concentration regulations. Moreover, increasing capital regulatory requirements and introducing the option of jointly syndicating large loan exposures could be considered.

- *NBFI oversight framework, regulation and supervision*. The oversight framework of NBFIs needs a significant overhaul. The finalization of legislative changes currently under preparation, including amendments to the FSRA Act and laws regulating specific sectors,

should be prioritized (Annex IX). While completing legislative reforms, the FSRA should continue efforts to scale up its supervisory role and moving beyond simply monitoring regulatory requirements, particularly for systemically large NBFIs and lending entities (e.g., building societies, SACCOs). In this respect, large non-bank deposit-taking institutions (e.g., building societies) should be subject to a regulatory framework similar to that applied to banks.

- *Macroprudential policy framework and toolkit*. Despite the large and interconnected financial system and its specific vulnerabilities, no explicit macroprudential framework exists in Eswatini. The Financial Stability Bill (FSB), still under preparation, assigns an explicit macroprudential mandate to the CBE and creates a financial stability framework and its approval should be prioritized. Meantime, the authorities should strengthen the coordination between the CBE, FSRA and the Ministry of Finance, including through the creation of a planned Macroprudential Forum. In this context, and to help curb risks from highly leveraged households, consideration should be given to introducing debt-to-income (DTI) and debt-service-to-income (DSTI) ratio requirements.[17]

- *Crisis management and financial safety net*. Developing an effective crisis preparedness and management framework is critical to the stability of the financial system. Draft amendments to the Financial Institutions Act and the draft CBE legislation, if appropriately rectified, would strengthen the legal framework underpinning the financial safety net and enhance the independence of the CBE. In advance of the envisaged upgrade of the legal framework, the authorities should start: requiring banks to submit recovery and resolution plans; operationalizing emergency lending assistance; and, strengthening cooperation with the SARB on recovery and resolution planning for South African bank subsidiaries. Over time, a deposit insurance scheme that meets international standards should also be developed.

- *Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT)*. The implementing regulations of the 2011 Money Laundering and Financing of Terrorism Prevention Act have not been enacted yet. However, the authorities are performing a national risk assessment that will inform a review of AML/CFT requirements and the risk-based supervision activities of the CBE, the FSRA and the Financial Intelligence Unit. Additional work is needed to develop a beneficial ownership framework, set up a central register for beneficial ownership information, and enhance the identification of domestic politically exposed persons.

Authorities' Views

33. The authorities agreed that financial stability risks are rising, but noted that banks have large capital buffers, providing a strong assurance of stability. Nonetheless, they are intensifying bank supervision, requiring some banks to develop plans to address high NPLs. They

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[17]Moreover, macroprudential tools should be used to prevent the buildup of systemic risks. Therefore, differently from what envisaged under the current FSB draft, they should be considered before risks materialize.

also intend to introduce mandatory corrective actions to strengthen the early intervention regime. However, they are considering relaxing single borrower limits for specific sectors to support growth. The authorities remain committed to introduce a macroprudential policy framework, but they do not plan to introduce DTI and DSTI limits at this stage. They also noted that a bank resolution framework and provisions for emergency liquidity assistance are part of the amendments to the Financial Institutions Act and the CBE legislation. On AML/CFT regulations, the authorities noted that an assessment of AML/CFT standards will be conducted in 2020. Finally, they recognized the importance of enacting key legislative proposals to overhaul the oversight framework of the financial sector, particularly for NBFIs, and intend to finalize the drafting of key bills in the coming months.

OTHER ISSUES

34. Improving fiscal management capacity and the ability to effectively oversee the financial sector will be important to underpin the authorities' policy efforts going forward. In consultation with the authorities, a medium-term strategy has been developed to closely integrate the Fund's capacity development activities with Eswatini's surveillance priorities. The strategy focuses on: improving PFM and fiscal data quality, developing medium-term macro-fiscal and budget frameworks, and supporting several legislative changes to strengthen the financial sector oversight (Annex XI).

35. Statistical data are broadly adequate for surveillance purposes, but further improvements in fiscal and national accounts data are warranted. Amongst others, the registration of budget spending commitments should be enhanced to avoid further unidentified spending items to arise, coverage of fiscal accounts should be expanded to cover all central government entities and the general government. In addition, more timely and consistent annual and quarterly GDP statistics should be produced, and the compilation of external sector statistics improved to reduce the still large errors and omissions (Informational Appendix).

STAFF APPRAISAL

36. The Eswatini economy is on an unsustainable path, with subdued growth and deep developmental challenges. Years of fiscal expansion and declining SACU revenue have resulted in wide fiscal deficits and rapidly rising public debt. Domestic arrears have accumulated and international reserves have fallen below adequate levels. Despite expansionary policies, decelerating private investment and declining external competitiveness have resulted in subdued growth that has been unable to lift people out of poverty and reduce unemployment.

37. The new government has taken some measures, but additional actions are needed to bring the economy back to a sustainable path. Steps have been recently taken to control personnel expenses and slow arrears accumulation, which would result in a reduction in the FY19/20 fiscal deficit. However, going forward the fiscal deficit is projected to remain large and growth to be negative in per capita terms. Public debt would exceed 60 percent of GDP over the next few years, government's liquidity problems would deepen, and international reserves would deplete. Downside

risks dominate this fragile outlook and stem from potential fiscal slippages that may undermine the CBE's capacity to support the currency peg; lower demand for key exports; and, further declines in SACU revenue. Extensive macro-financial linkages could amplify the negative effects of these shocks. Eswatini's key policy challenges are to reduce the fiscal deficit to restore fiscal sustainability and external buffers, and reignite the country's long-term growth prospects to reduce poverty and unemployment.

38. A credible medium-term fiscal adjustment plan, starting with policies to reduce next year's fiscal deficit, is needed. About 6 percent of GDP in measures over the next three years, starting in FY20/21, would bring public debt on a gradually declining path and restore international reserve buffers. While the proposed adjustment is ambitious, it is smaller than what was delivered in the aftermath of the 2010 fiscal crisis. With limited financing, some frontloading of consolidation efforts is, however, needed, putting a premium on delivering reforms quickly and designing policies to reduce the adverse effects of fiscal adjustment on growth and the most vulnerable.

39. Policies should combine spending reductions and revenue increases that can deliver sustained adjustment and enhance long-term growth prospects, while protecting the poor. Policies should include: continuing current policies limiting new hiring and salary indexation and applying these policies to all public entities; rationalizing government's administrative expenditures and transfers to public entities and enterprises, while reforming the sector; prioritizing capital outlays; and strengthening the efficiency of health and education spending. Additional adjustment would come from limiting discretionary and special tax reliefs and from widening the corporate income and consumption tax bases. Over time, these policies would help better align wage dynamics to productivity trends, and create a level-playing field for investors, with positive effects on private investment and competitiveness. Increasing old age grants, and introducing cash transfers to children would strengthen the distributive impact of fiscal policy and help protect the poor from the proposed adjustment. In this context, the CBE should maintain the policy rate broadly in line with SARB's rate and refrain from providing further budget financing.

40. Fiscal reforms are critical to the success of fiscal consolidation plans. Developing a medium-term fiscal framework, strengthening budget formulation and expenditures controls, reforming extrabudgetary public entities and enterprises, and adopting transparent selection and appraisal systems for capital spending are critical steps to deliver fiscal adjustment. To support fiscal transparency, it is also important to revamp public procurement processes and set up a transparent arrear clearance strategy.

41. Pressing ahead with supply-side and governance reforms would facilitate private investment and strengthen competitiveness, boosting growth prospects and employment. Leveraging fiscal adjustment policies, supply-side and governance reforms should aim to: reduce vulnerability to state-capture and other forms of corruption (e.g., strengthening public procurement); streamline business regulations and regulatory requirements; reduce high electricity and telecommunications costs; better align wage growth to productivity trends; and avoid regulations hampering domestic competition (e.g., *ad hoc* tax incentives, preferential public

procurement rules). Over time, it is important to improve education attainments and access to secondary and higher education to address shortages of well-educated and skilled workers.

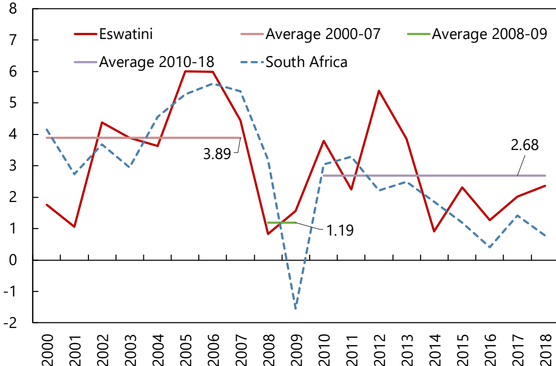
42. The financial sector remains sound although risks are rising, thus progress is needed to enhance the capacity to manage vulnerabilities and strengthen the sector oversight. Despite an increase in NPLs, the banking sector remains well capitalized and profitable. However, with the weakening macroeconomic environment, bank supervision should be intensified, including by addressing high NPLs, operationalizing an early intervention regime, and suspending plans to relax single borrower concentration regulations. With a large non-bank financial industry, completion of the legislative changes underway to improve the oversight, regulatory and supervisory frameworks of the sector ought to be accelerated. While setting up a macroprudential framework, the coordination between the CBE, FSRA and the ministry of finance should be strengthened. Moreover, to help manage risk buildup from highly leveraged households, the introduction of DTI and DSTI limits could also be considered. Finally, efforts to develop the crisis preparedness and management capacity and strengthen the AML/CFT framework should be stepped up.

43. It is proposed that the next Article IV consultation with Eswatini takes place on the standard 12-month cycle.

Figure 1. Eswatini: Macroeconomic Volatility and Elevated Poverty and Inequality

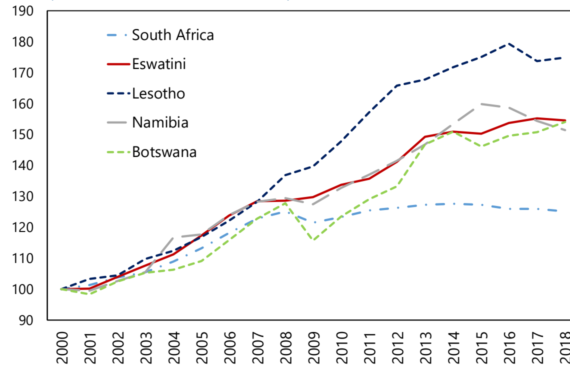
In the early 2000s, close links to the South Africa economy boosted growth, but...

Real GDP growth
(Percent)



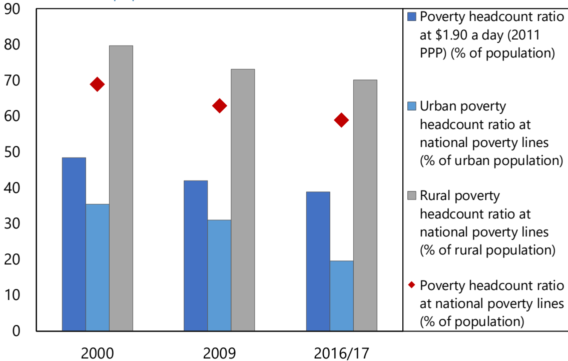
... in recent years, the South Africa economy slowed down, and per capita income growth in Eswatini decelerated,

Real Income Per Capita
(2000=100, PPP international dollar)



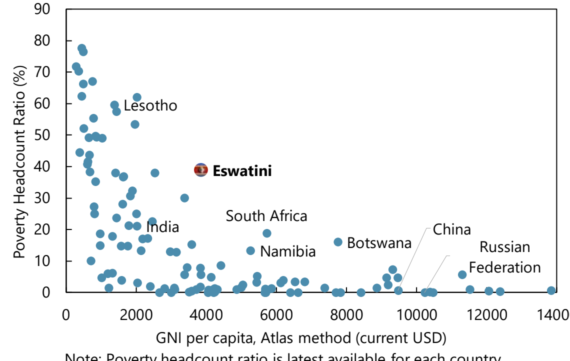
With a weak economy, poverty has remained widespread and persistent...

Poverty Headcount Rates
(Percent of population)



...and higher than in countries with comparable income levels.

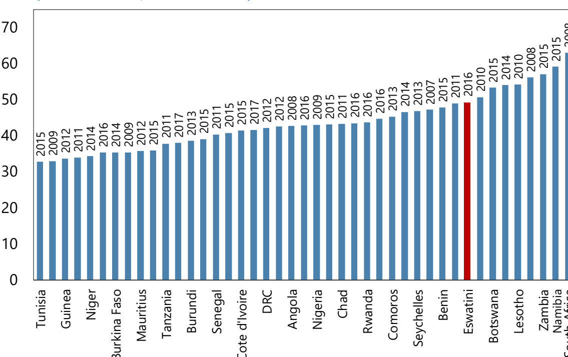
International Poverty Rates
(Percent of population below US$1.9 per day)



Note: Poverty headcount ratio is latest available for each country.

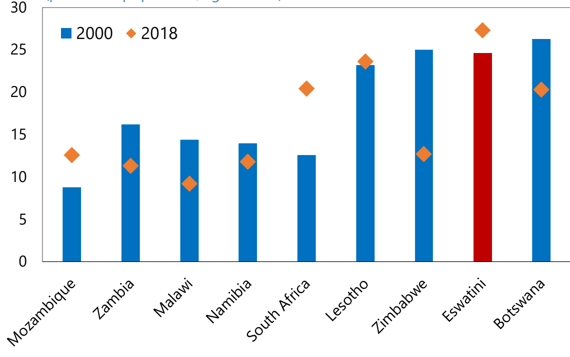
Inequality is also elevated. ....

Countries with Highest Income Inequality
(Gini coefficient, latest available)



... and the HIV prevalence rate is one of the highest in the world.

HIV Prevalence
(percent of population, ages 15-49)

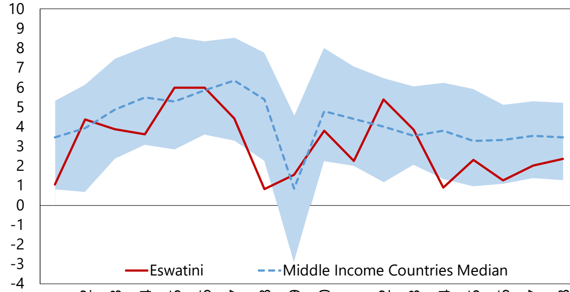


Sources: Eswatini authorities, World Bank World Development Indicators, and staff calculations.

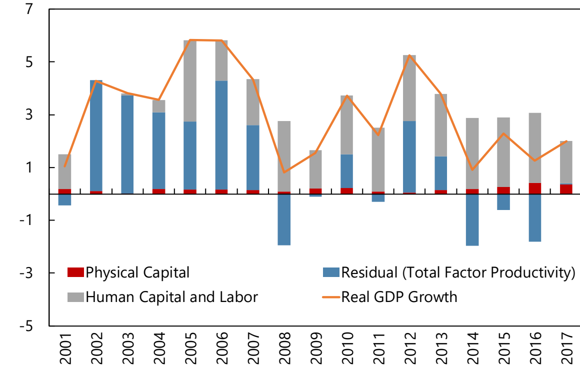
Figure 2. Eswatini: Weak Governance and Regulatory Frameworks Hindering Investment and Growth

Since 2010, GDP growth has decelerated …

… held back by negligible capital accumulation and declining productivity growth.

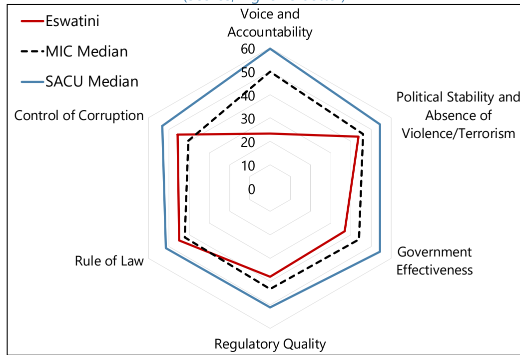


Note: The light blue area represents the three center quintiles for other Lower Middle Income Countries.

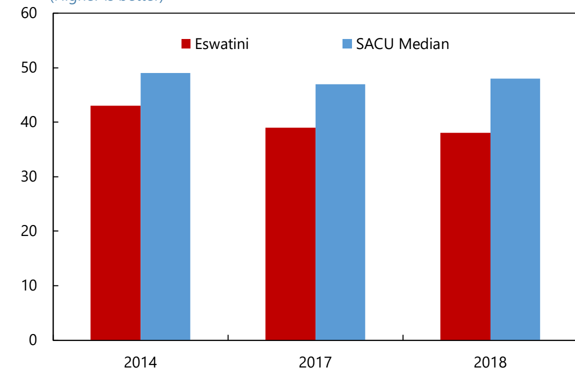


Governance and regulatory frameworks are weaker than in neighboring SACU countries, and …

… perception of corruption is higher,…

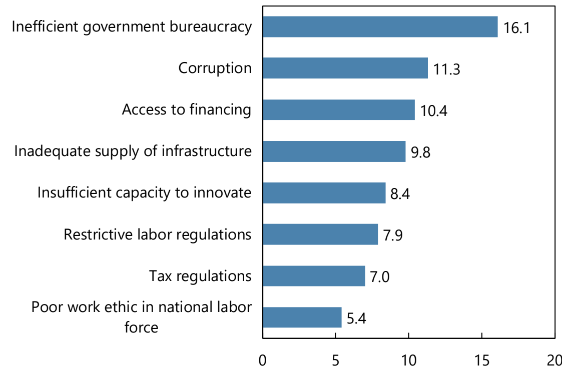


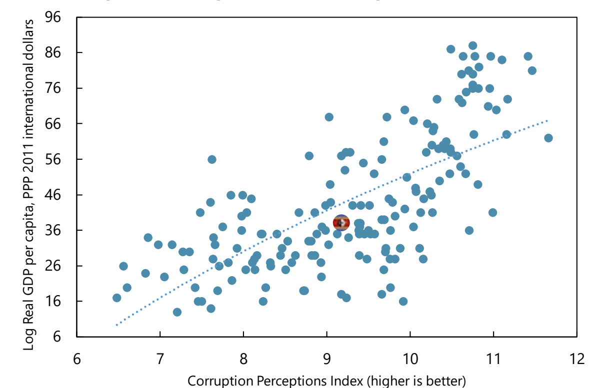
Note: Scores are rescaled to 0-100 range.



… inhibiting firms' investment…

…and limiting growth.



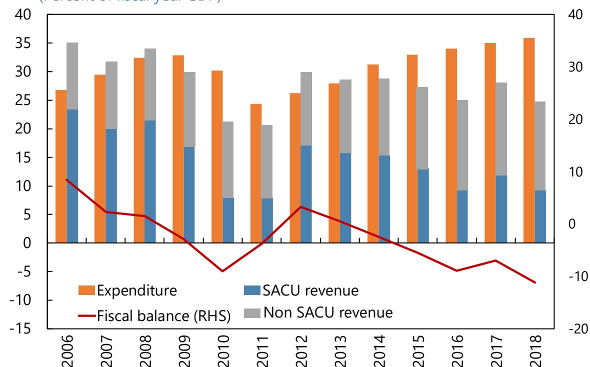


Sources: Eswatini authorities, Worldwide Governance Indicators (WGI), The Global Competitiveness Report (GCR), Transparency International (TI), and staff estimations.

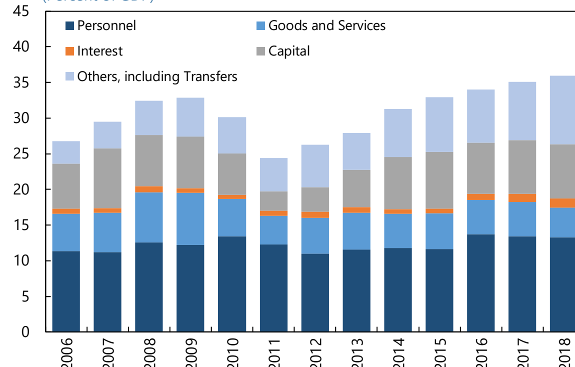
Notes: WGI cover six dimensions of governance. The Corruption Perception Index from TI is a composite indicator measuring corruption. GCR indicators assess economic competitiveness. All these indicators have wide country coverage but rely on surveys of perceptions.

Figure 3. Eswatini: Unsustainable Fiscal Expansion Undermining Macroeconomic Stability

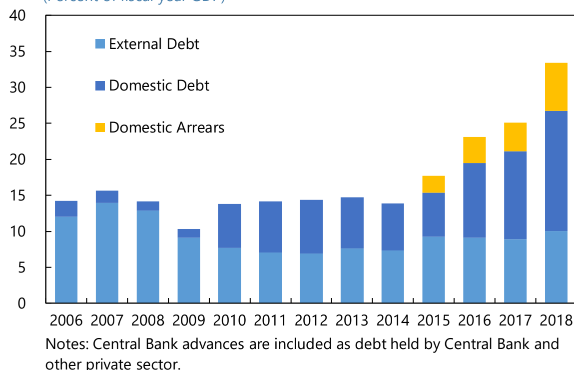
The fiscal deficit has recently widened as SACU revenues declined, and public spending increased.



The rise in public spending was driven by increases in personnel costs, capital outlays and transfers to entities

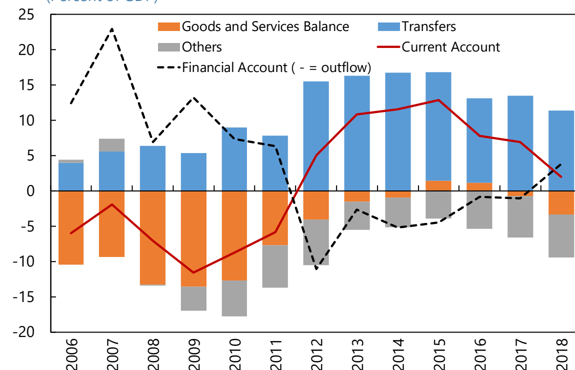


In a few years, public debt has more than doubled and domestic arrears have accumulated.

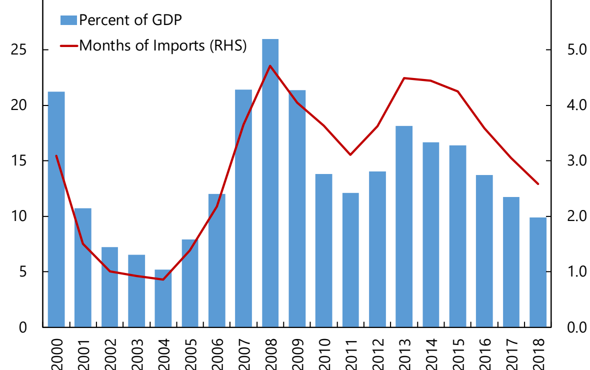


Notes: Central Bank advances are included as debt held by Central Bank and other private sector.

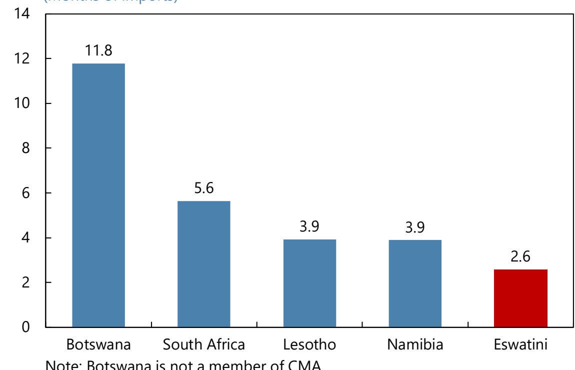
With expansionary policies and low SACU revenue, the current account surplus has narrowed,…



… prompting a decline in international reserves, …



… which have reached the lowest levels among SACU and Common Monetary Area (CMA) member countries.

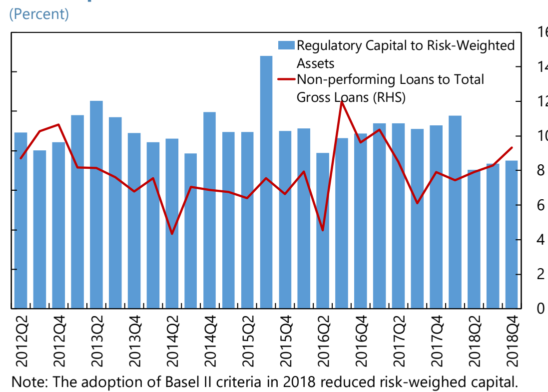


Note: Botswana is not a member of CMA.

Sources: Eswatini authorities and staff calculations.

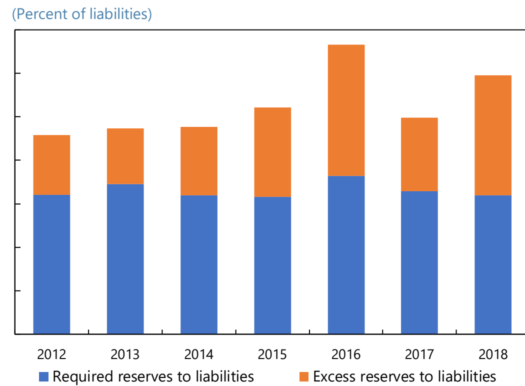
Figure 4. Eswatini: A Resilient Banking Sector Amid a Weak Economy

The weakening economy is weighing on banks' asset quality and NPLs, but banks remain well capitalized…

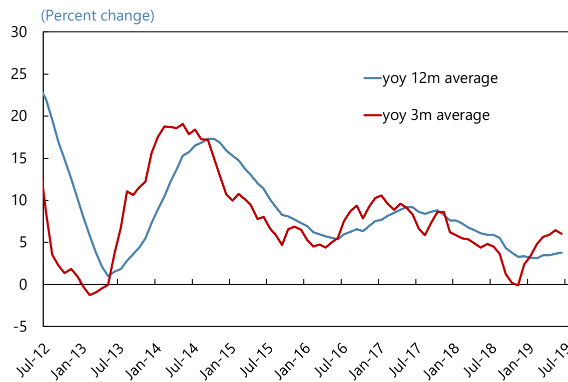


Note: The adoption of Basel II criteria in 2018 reduced risk-weighed capital.

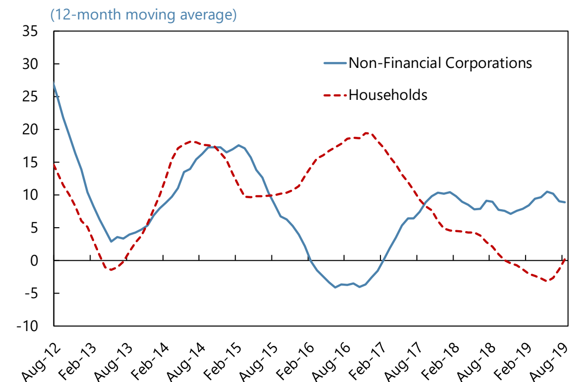
… and their liquidity buffers have improved.



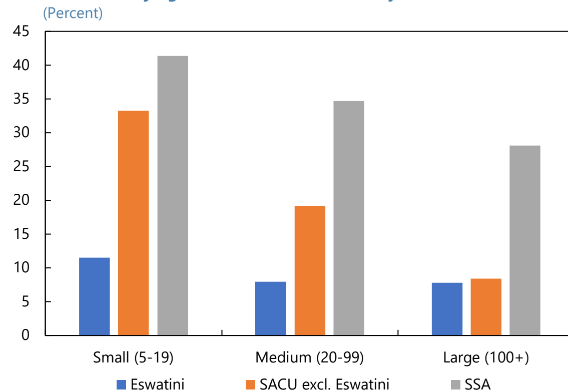
However, private credit growth has been lately decelerating …



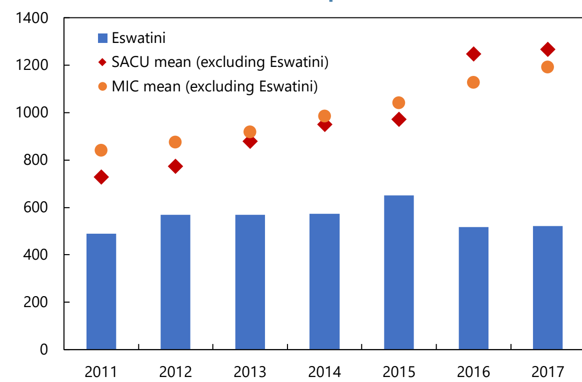
… driven by declining lending to households, while corporate credit is buoyant.



Access to credit for firms compares well to the region,…



… but financial inclusion for households is behind SACU and other middle-income countries …

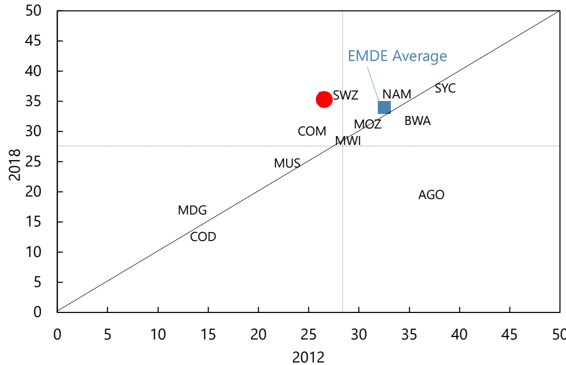


Sources: Eswatini authorities, FinStats 2019, Global Findex database, and staff calculations.

Figure 5. Eswatini: Public Spending Inefficiencies

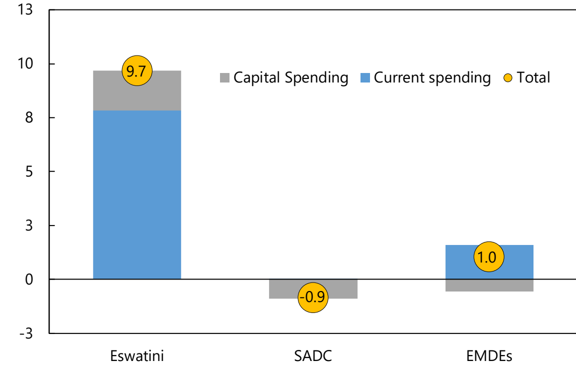
Public spending has been increasing fast and is higher than in most peers,...

General Government Spending
(Percent of GDP, SADC countries)



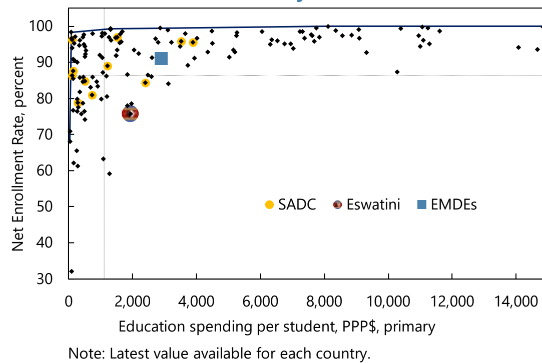
...as current expenses have increased significantly over the last few years, amid sustained capital outlays.

Change in Total Spending, 2012-2018
(Percent of GDP)



Despite high social spending, spending inefficiencies lead to poor education outcomes both at primary,...

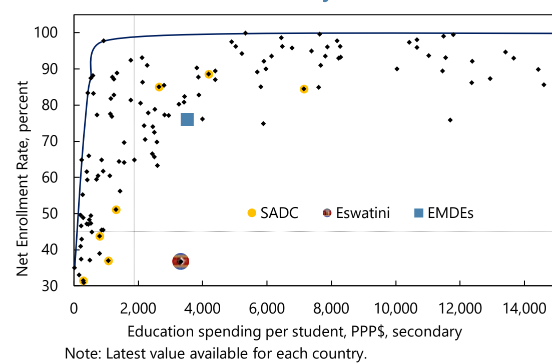
Government Education Spending and Net Enrollment Rate, Primary Education



Note: Latest value available for each country.

...and especially at higher education levels..

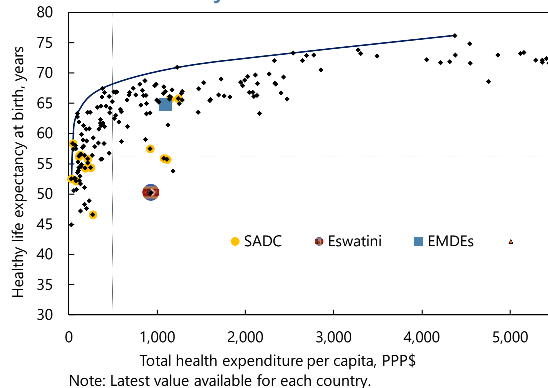
Government Education Spending and and Net Enrollment Rate, Secondary Education



Note: Latest value available for each country.

...and health outcomes are below peers in the region.

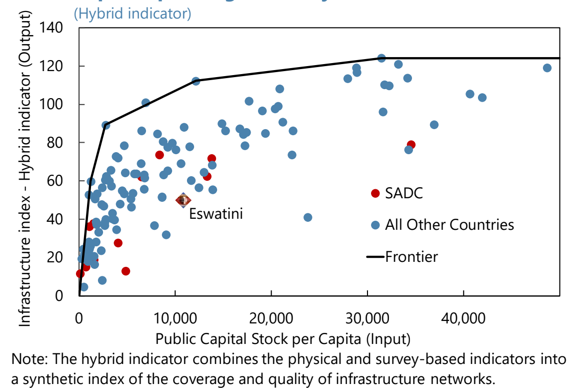
Health Efficiency Frontier



Note: Latest value available for each country.

The quality and efficiency of public investment lag behind other comparable countries.

Capital Spending Efficiency Frontier
(Hybrid indicator)

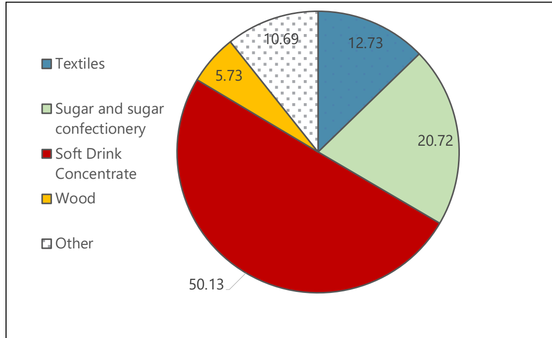


Note: The hybrid indicator combines the physical and survey-based indicators into a synthetic index of the coverage and quality of infrastructure networks.

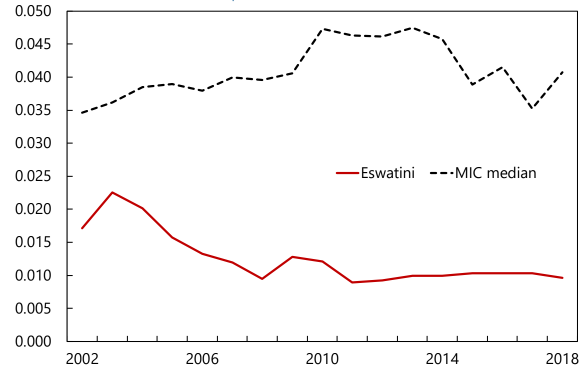
Sources: IMF WEO, FAD Government Wage Bill and Employment Dataset, and World Bank ASPIRE.

Figure 6. Eswatini: Weakening Export Competitiveness

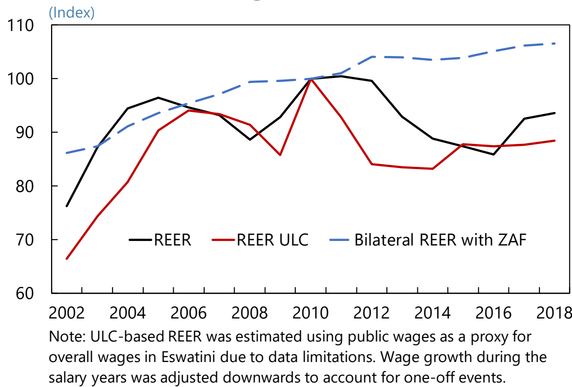
Eswatini's exports remain dependent on a few traditional products…



…and the country's global market export shares have declined ….

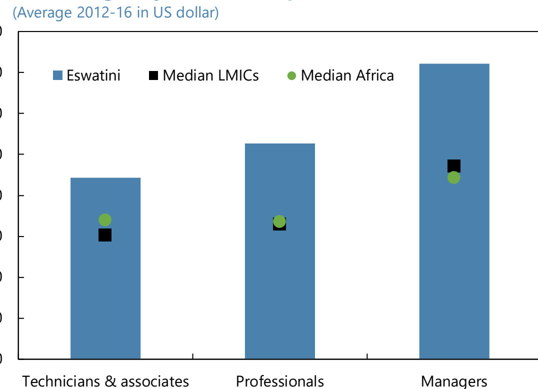


…in part reflecting an appreciation of the exchange rate vis-à-vis South Africa and rising unit labor costs.

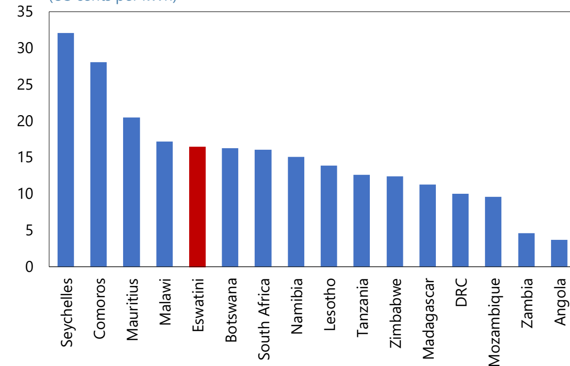


Note: ULC-based REER was estimated using public wages as a proxy for overall wages in Eswatini due to data limitations. Wage growth during the salary years was adjusted downwards to account for one-off events.

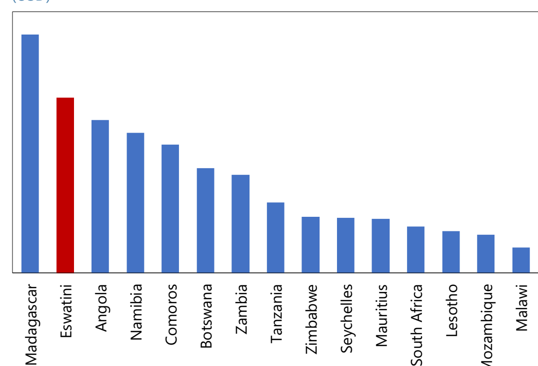
Export competitiveness is held back by high labor costs, particularly for skilled workers, compared to peers…



…costly production inputs such as electricity, and …



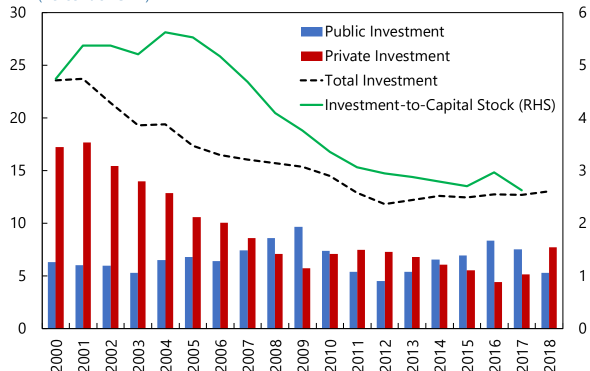
…and telecommunications costs.



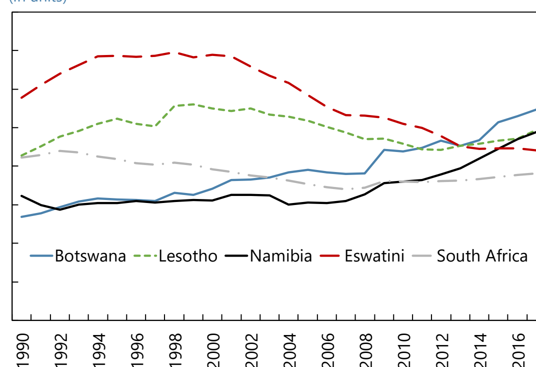
Sources: CBE, MoF, World Bank Doing Business, IFS, ILO, and IMF staff calculations.

Figure 7. Eswatini: Supply-Side and Governance Constraints Limiting Private Investment

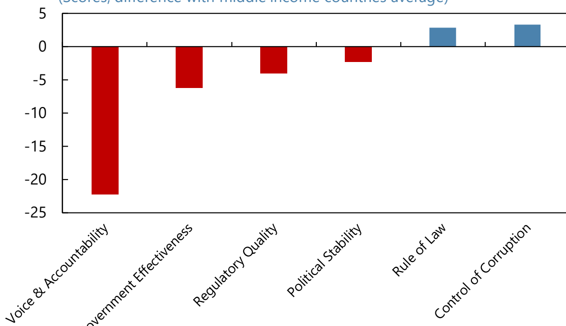
Over the past two decades, private investment has been on a trend decline ...



...resulting in lower capital intensity.

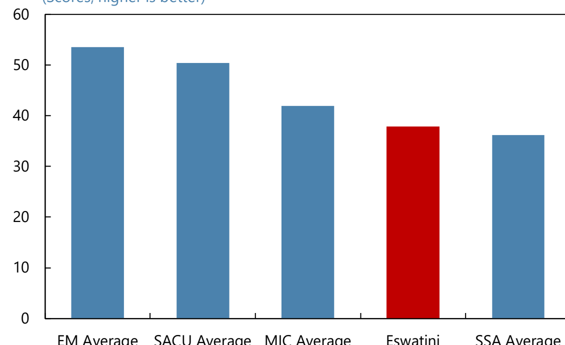


Lower private investment reflects weaknesses in governance, ...



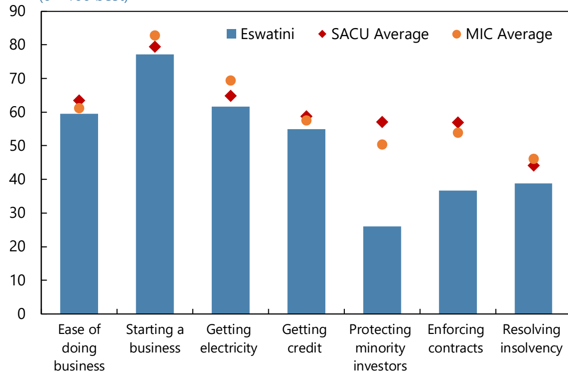
Sources: Scores are rescaled to 0-100 range; Positive numbers imply that Eswatini outperforms MIC average.

...particularly in the regulatory quality, ...

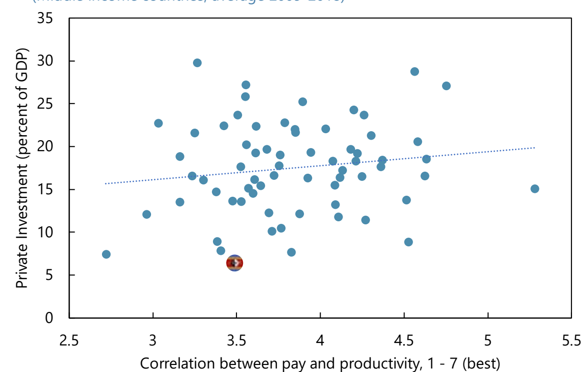


Note: Scores are rescaled to 0-100 range.

...relatively weak business conditions, ...



...and decoupling between wages and productivity.

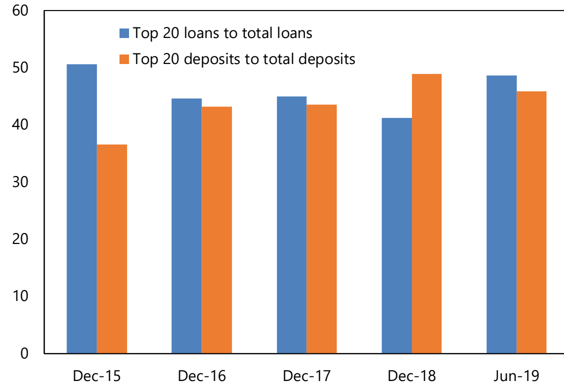


Sources: Eswatini authorities, Penn World Tables, World Bank Doing Business, Worldwide Governance Indicators (WGI), Global Competitiveness Indicators (GCI), and staff calculations.

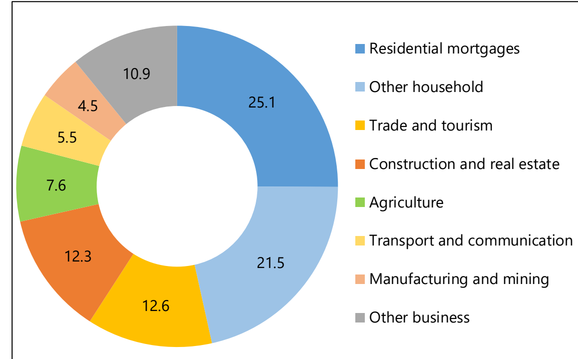
Notes: WGI and GCI are perception-based measures with wide country coverage. Doing Business indicators are based on a survey of experts using hard data. Country coverage is wide but refers to businesses in largest cities.

Figure 8. Eswatini: Persistent Macro Financial Vulnerabilities

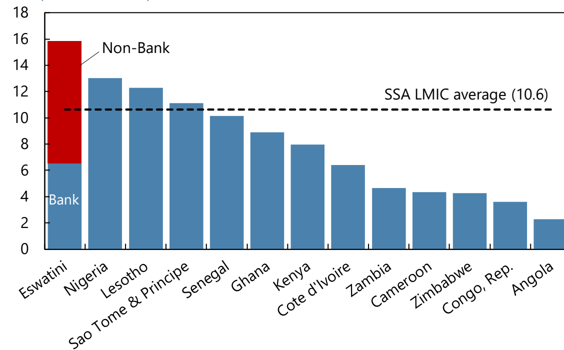
Banks' funding and loan books are highly concentrated…



… with exposures concentrated in the trade and construction sectors, residential mortgages and other household lending…

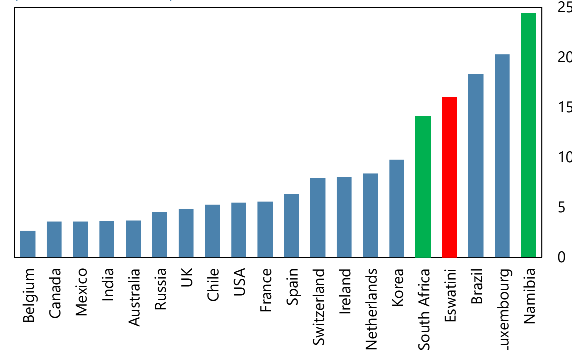


,… against highly leveraged household.



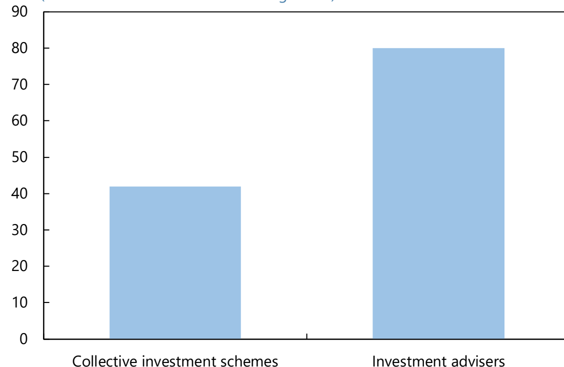
Note: For Nigeria, credit data is for 2017.

Banks and NBFIs are closely interconnected through funding links …

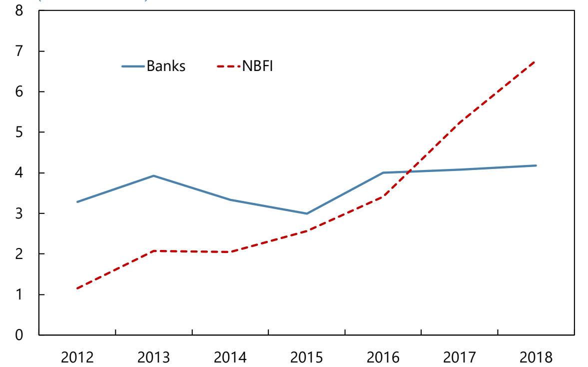


Note: Data for Eswatini is for 2018.

…and, NBFIs are highly exposed to overseas market volatility, particularly South Africa.



Moreover, NBFIs exposure to the public sector has been increasing fast, tightening the links to a weak sovereign.



Sources: Central Bank of Eswatini, FSRA, and IMF staff estimates

Table 1. Eswatini: Selected Economic Indicators, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percentage changes; unless otherwise indicated)									
National account and prices										
GDP at constant prices	2.3	1.3	2.0	2.4	1.2	2.5	1.6	0.9	0.8	0.8
GDP deflator	5.8	7.3	2.9	2.8	5.1	5.6	5.3	6.8	7.0	7.0
GDP at market prices (Emalangeni billions)	52.0	56.5	59.3	62.4	66.3	71.8	76.9	82.9	89.4	96.4
GDP at market prices (US dollar billions)	4.1	3.8	4.5	4.7	4.6	4.9	5.1	5.3	5.6	5.9
Consumer prices (average)	5.0	7.8	6.2	4.8	2.6	4.3	4.8	6.5	7.0	7.0
External sector										
Average exchange rate (local currency per US$)	12.8	14.7	13.3	13.2	…	…	…	…	…	…
Nominal exchange rate change (– = depreciation)	2.7	6.2	-5.0	0.0	…	…	…	…	…	…
Real effective exchange rate (– = depreciation) [1]	0.7	2.7	-7.8	-1.3	…	…	…	…	…	…
Terms of trade (deterioration -)	10.2	19.4	-18.3	-11.9	2.9	6.2	2.8	1.4	0.4	0.1
Gross international reserves										
(months of imports)	4.2	3.6	3.1	2.6	2.0	3.0	2.9	2.4	1.6	0.9
(percent of GDP)	16.4	13.7	11.7	9.9	7.9	11.9	11.5	9.4	6.4	3.4
(percent of reserve money)	392	269	244	186	131	168	156	119	81	42
Gross reserves minus reserve money										
(percent of deposits)	50.1	30.3	24.5	16.4	7.1	18.3	16.1	6.1	-6.3	-19.7
Money and credit										
Domestic credit to the private sector	4.2	11.6	3.9	5.1	5.9	4.4	4.4	3.5	2.8	2.6
Reserve money	15.4	32.3	-0.9	16.4	20.9	26.3	11.9	14.7	9.4	9.0
M2	13.6	26.4	3.8	4.1	0.8	8.2	6.2	5.4	6.2	5.6
Interest rate (percent) [2]	5.3	5.8	7.0	7.3	…	…	…	…	…	…
	(Percent of GDP)									
National accounts										
Gross capital formation	12.5	12.8	12.7	13.1	10.7	11.1	10.8	10.7	10.7	10.8
Government	6.9	8.3	7.5	5.3	5.5	6.0	5.6	5.5	5.5	5.4
Private	5.5	4.4	5.2	7.7	5.2	5.1	5.1	5.2	5.3	5.3
National savings	25.4	20.6	19.7	15.0	14.4	14.6	13.8	12.8	12.4	12.5
Government	3.8	-0.1	0.3	-3.7	-1.2	1.9	1.0	-0.9	-2.0	-3.2
Private	21.6	20.7	19.3	18.8	15.6	12.7	12.8	13.7	14.4	15.7
External sector [3]										
Current account balance										
(including official transfers)	12.9	7.8	7.0	2.0	3.8	3.5	3.0	2.1	1.7	1.7
(excluding official transfers)	-0.8	-2.1	-4.3	-7.9	-5.6	-7.4	-7.6	-7.8	-8.1	-8.1
Trade balance	4.5	4.7	4.2	0.6	3.7	2.4	2.7	2.4	2.0	2.0
Financial account	5.0	1.4	2.3	-2.7	5.2	-0.7	3.0	3.7	4.2	4.4
of which foreign direct investment	-1.0	-0.7	2.7	-1.0	-0.6	-0.8	-0.8	0.8	0.8	0.8
External debt	13.4	17.7	15.8	17.2	19.0	23.5	25.0	25.0	24.7	24.1
of which: public	8.8	9.1	8.9	9.8	11.9	16.8	18.6	18.8	18.9	18.6
Central government fiscal operations [4]										
Overall balance	-5.5	-8.9	-7.0	-11.2	-7.9	-6.6	-7.2	-9.1	-10.0	-11.3
Total revenue and grants	27.5	25.1	28.0	24.8	25.6	28.0	26.7	25.7	25.7	25.7
of which: SACU receipts	15.3	13.1	9.2	11.8	9.2	9.3	11.4	10.3	9.8	9.8
Total expenditure	33.0	34.0	35.0	35.9	33.5	34.6	33.9	34.8	35.7	37.0
Public debt, gross	17.7	23.1	25.1	33.4	38.1	41.6	45.3	50.3	55.9	62.2
Public debt, net	9.3	15.6	20.1	29.5	34.4	38.2	42.1	47.3	53.1	59.7
Net lending (excl. SACU revenues)	-18.6	-18.2	-18.9	-20.4	-17.2	-18.1	-17.6	-18.9	-19.8	-21.1
Primary net lending (excl. SACU revenues)	-17.9	-17.3	-17.7	-19.1	-15.5	-15.9	-14.7	-15.4	-15.8	-16.2
Memorandum item:										
Population (in million)	1.08	1.09	1.09	1.10	1.11	1.13	1.14	1.15	1.16	1.18

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

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

[2] 12-month time deposit rate.

[3] The series reflect the adoption of the BPM6 methodology and recent data revisions.

[4] Public debt includes domestic arrears. Fiscal year runs from April 1 to March 31.

Table 2. Eswatini: Fiscal Operations of the Central Government, 2015/16–24/25[1]
(Emalangeni millions)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue	14,595	14,334	16,837	15,710	17,344	20,437	20,894	21,715	23,429	25,266
Tax revenue	13,664	13,092	15,669	14,959	16,211	19,230	19,600	20,320	21,924	23,643
Taxes on income, profits, and capital ga	3,825	4,547	4,860	5,213	5,571	6,014	6,449	6,760	7,290	7,863
of which: Corporate income tax	1,372	1,499	1,374	1,458	1,558	1,682	1,803	1,750	1,887	2,036
of which: Personal income tax	2,176	2,662	3,045	3,261	3,484	3,761	4,034	4,350	4,691	5,059
Taxes on property	34	43	43	47	53	58	62	67	72	78
Taxes on international trade and transac	6,949	5,277	7,138	5,870	6,346	8,378	8,116	8,306	8,972	9,675
of which: SACU receipts	6,939	5,264	7,109	5,844	6,318	8,348	8,083	8,271	8,934	9,635
Domestic taxes on goods and services	2,850	3,216	3,608	3,802	4,215	4,752	4,943	5,155	5,554	5,989
Other taxes	5	6	21	23	25	27	29	31	34	36
Non-tax revenue	602	743	631	297	581	554	595	641	691	746
Grants	329	500	536	455	552	652	700	754	814	877
Project grants	329	500	536	455	552	652	700	754	814	877
Expense	13,310	15,471	16,911	19,435	17,832	19,292	21,180	23,595	26,269	29,596
Compensation of employees	6,169	7,841	8,080	8,429	8,464	9,021	9,864	10,828	12,085	13,489
Purchases or use of goods & services	2,679	2,736	2,860	2,626	2,983	3,123	3,282	3,508	3,750	4,008
Interest	360	498	691	822	1,203	1,615	2,242	3,014	3,699	4,835
of which: Domestic	214	358	549	626	948	1,039	1,600	2,349	3,013	4,133
Other expense	4,102	4,146	4,472	4,578	5,181	5,534	5,792	6,245	6,735	7,264
of which: Subsidies	45	34	39	47	50	54	58	63	68	73
of which: Grants (transfers)	3,136	3,191	3,258	3,398	3,632	3,920	4,204	4,534	4,889	5,273
Unidentified spending	0	250	807	2,980	0	0	0	0	0	0
Gross operating balance	1,285	-1,136	-74	-3,725	-487	1,145	-285	-1,880	-2,841	-4,330
Transactions in nonfinancial assets:										
Net acquisition of nonfinancial assets	4,194	3,976	4,149	3,344	4,840	5,994	5,402	5,816	6,264	6,747
Foreign financed	1,664	1,425	1,587	1,655	3,039	3,840	3,099	3,341	3,604	3,886
Domestically financed	2,456	2,419	2,452	1,684	1,691	2,045	2,193	2,364	2,550	2,750
Regional Development Fund		131	110	5	110	110	110	110	110	110
Total expenditure	17,504	19,441	21,060	22,780	22,671	25,286	26,581	29,411	32,533	36,342
Primary net lending / borrowing	-2,549	-4,608	-3,532	-6,248	-4,123	-3,234	-3,444	-4,682	-5,406	-6,241
Net lending/borrowing	-2,909	-5,106	-4,223	-7,069	-5,327	-4,849	-5,687	-7,696	-9,104	-11,076
Transactions in financial assets and liabilities:	1,830	2,469	3,893	4,588	2,901	3,368	2,213	2,349	1,955	1,817
Net acquisition of financial assets	614	1,451	1,546	975	80	320	304	400	278	189
of which: Policy lending	-130	1,120	179	380	0	246	232	329	278	189
Net incurrence of liabilities	1,217	1,018	2,347	3,613	2,821	3,049	1,909	1,949	1,677	1,628
Domestic	180	1,790	1,690	2,823	873	771	759	880	700	754
Foreign	1,037	487	657	790	1,948	4,277	1,150	1,069	977	874
Payments of pending bills		-1,259	0	0	0	-2,000	0	0	0	0
Unidentified financing	*1,079*	*2,638*	*330*	*2,482*	*2,426*	*1,481*	*3,474*	*5,347*	*7,150*	*9,259*
Memorandum item:										
Gross public debt 2/	9,425	13,214	15,083	21,177	25,797	30,429	35,475	42,493	50,943	61,158
Domestic	4,503	7,998	9,747	14,797	17,416	17,180	20,858	26,564	33,780	42,999
External	4,922	5,216	5,336	6,380	8,381	13,249	14,617	15,928	17,163	18,159
Unpaid invoices (Stock of arrears)	1,263	2,069	2,389	4,235	5,981	4,727	7,414	11,911	19,061	28,320
Net lending (excl. external financing)	-1,245	-3,681	-2,636	-5,414	-2,288	-1,009	-2,588	-4,354	-5,501	-7,190
Net lending (excl. SACU revenues)	-9,858	-10,383	-11,362	-12,940	-11,673	-13,228	-13,802	-16,002	-18,076	-20,752
Primary net lending (excl. SACU revenues)	-9,498	-9,885	-10,670	-12,118	-10,469	-11,613	-11,560	-12,988	-14,377	-15,916
GDP at market prices (Emalangeni billions)	53,103	57,194	60,057	63,365	67,715	73,096	78,391	84,529	91,163	98,316

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

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

[2] Gross public debt includes domestic arrears.

Table 3. Eswatini: Fiscal Operations of the Central Government, 2015/16–24/25[1]
(Percent of GDP)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue	27.5	25.1	28.0	24.8	25.6	28.0	26.7	25.7	25.7	25.7
Tax revenue	25.7	22.9	26.1	23.6	23.9	26.3	25.0	24.0	24.0	24.0
Taxes on income, profits, and capital gains	7.2	7.9	8.1	8.2	8.2	8.2	8.2	8.0	8.0	8.0
of which: Corporate income tax	2.6	2.6	2.3	2.3	2.3	2.3	2.3	2.1	2.1	2.1
of which: Personal income tax	4.1	4.7	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on international trade and transactions	13.1	9.2	11.9	9.3	9.4	11.5	10.4	9.8	9.8	9.8
of which: SACU receipts	13.1	9.2	11.8	9.2	9.3	11.4	10.3	9.8	9.8	9.8
Domestic taxes on goods and services	5.4	5.6	6.0	6.0	6.2	6.5	6.3	6.1	6.1	6.1
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	1.3	1.1	0.5	0.9	0.8	0.8	0.8	0.8	0.8
Grants	0.6	0.9	0.9	0.7	0.8	0.9	0.9	0.9	0.9	0.9
Project grants	0.6	0.9	0.9	0.7	0.8	0.9	0.9	0.9	0.9	0.9
Expense	25.1	27.0	28.2	30.7	26.3	26.4	27.0	27.9	28.8	30.1
Compensation of employees	11.6	13.7	13.5	13.3	12.5	12.3	12.6	12.8	13.3	13.7
Purchases or use of goods & services	5.0	4.8	4.8	4.1	4.4	4.3	4.2	4.2	4.1	4.1
Interest	0.7	0.9	1.2	1.3	1.8	2.2	2.9	3.6	4.1	4.9
of which: Domestic	0.4	0.6	0.9	1.0	1.4	1.4	2.0	2.8	3.3	4.2
Other expense	7.7	7.2	7.4	7.2	7.7	7.6	7.4	7.4	7.4	7.4
of which: Subsidies	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
of which: Grants (transfers)	5.9	5.6	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Unidentified spending	0.0	0.4	1.3	4.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating balance	2.4	-2.0	-0.1	-5.9	-0.7	1.6	-0.4	-2.2	-3.1	-4.4
Transactions in nonfinancial assets:										
Net acquisition of nonfinancial assets	7.9	6.9	6.9	5.3	7.1	8.2	6.9	6.9	6.9	6.9
Foreign financed	3.1	2.5	2.6	2.6	4.5	5.3	4.0	4.0	4.0	4.0
Domestically financed	4.6	4.2	4.1	2.7	2.5	2.8	2.8	2.8	2.8	2.8
Regional Development Fund		0.2	0.2	0.0	0.2	0.2	0.1	0.1	0.1	0.1
Total expenditure	33.0	34.0	35.1	35.9	33.5	34.6	33.9	34.8	35.7	37.0
Primary net lending / borrowing	-4.8	-8.1	-5.9	-9.9	-6.1	-4.4	-4.4	-5.5	-5.9	-6.3
Net lending / borrowing	-5.5	-8.9	-7.0	-11.2	-7.9	-6.6	-7.3	-9.1	-10.0	-11.3
Transactions in financial assets and liabilities:	3.4	4.3	6.5	7.2	4.3	4.6	2.8	2.8	2.1	1.8
Net acquisition of financial assets	1.2	2.5	2.6	1.5	0.1	0.4	0.4	0.5	0.3	0.2
of which: Policy lending	-0.2	2.0	0.3	0.6	0.0	0.3	0.3	0.4	0.3	0.2
Net incurrence of liabilities	2.3	1.8	3.9	5.7	4.2	4.2	2.4	2.3	1.8	1.7
Domestic	0.3	3.1	2.8	4.5	1.3	1.1	1.0	1.0	0.8	0.8
Foreign	2.0	0.9	1.1	1.2	2.9	5.9	1.5	1.3	1.1	0.9
Payments of pending bills		-2.2	0.0	0.0	0.0	-2.7	0.0	0.0	0.0	0.0
Unidentified financing	*2.0*	*4.6*	*0.5*	*3.9*	*3.6*	*2.0*	*4.4*	*6.3*	*7.8*	*9.4*
Memorandum item:										
Gross public debt[2]	17.7	23.1	25.1	33.4	38.1	41.6	45.3	50.3	55.9	62.2
Domestic	8.5	14.0	16.2	23.4	25.7	23.5	26.6	31.4	37.1	43.7
External	9.3	9.1	8.9	10.1	12.4	18.1	18.6	18.8	18.8	18.5
Unpaid invoices (arrears)		3.6	4.0	6.7	8.8	6.5	9.5	14.1	20.9	28.8
Net lending (excl. external financing)	-2.3	-6.4	-4.4	-8.5	-3.4	-1.4	-3.3	-5.1	-6.0	-7.3
Net lending (excl. SACU revenues)	-18.6	-18.2	-18.9	-20.4	-17.2	-18.1	-17.6	-18.9	-19.8	-21.1
Primary net lending (excl. SACU revenues)	-17.9	-17.3	-17.7	-19.1	-15.5	-15.9	-14.7	-15.4	-15.8	-16.2
GDP at market prices (Emalangeni billions)	53,103	57,194	60,057	63,365	67,715	73,096	78,391	84,529	91,163	98,316

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

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

[2] Gross public debt includes domestic arrears.

Table 4. Eswatini: Balance of Payments, 2015–24
(Emalangeni millions, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	526.6	300.4	309.4	93.9	175.0	170.9	154.1	112.3	92.9	99.1
Trade balance	181.8	182.3	186.8	29.2	171.1	114.7	136.8	126.8	109.2	116.7
Exports, f.o.b.	1,676.3	1,621.6	1,795.7	1,838.7	1,914.4	1,967.7	2,058.4	2,147.4	2,232.3	2,347.6
Imports, f.o.b	1,494.5	1,439.4	1,608.9	1,809.5	1,743.3	1,852.9	1,921.6	2,020.6	2,123.2	2,230.9
Services (net)	-123.3	-138.2	-217.6	-185.5	-201.5	-232.5	-254.0	-259.0	-264.1	-263.3
Income (net)	-159.4	-204.6	-261.2	-288.5	-323.0	-344.9	-374.1	-398.0	-421.7	-459.9
Of which: interest on public debt	-11.2	-9.6	-10.7	-13.8	-16.8	-33.6	-41.3	-42.3	-42.4	-42.4
Transfers	627.6	460.9	601.4	538.7	528.4	633.5	645.5	642.5	669.6	705.5
Official transfers	558.5	382.9	498.8	464.9	434.0	532.3	537.6	527.1	546.3	573.7
Other transfers	69.1	78.0	102.6	73.8	94.3	101.2	107.9	115.4	123.3	131.8
Capital and financial account 1/	-204.2	-55.0	-95.6	122.7	-244.1	32.9	-152.2	-199.8	-234.3	-258.5
Capital account	-1.9	0.4	6.8	-2.3	-2.2	-2.1	-2.1	-2.0	-1.9	-1.9
Financial account 2/	202.4	55.4	102.4	-125.0	242.0	-35.0	150.2	197.9	232.4	256.7
Foreign direct investment	-42.2	-28.5	121.6	-47.1	-26.0	-37.0	-38.5	40.4	45.4	49.7
Portfolio investment	97.1	-3.4	82.8	-85.6	93.0	97.6	101.5	106.4	111.5	117.1
Financial derivatives	27.7	14.8	13.4	6.7	10.5	10.2	9.9	9.6	9.4	9.1
Other investment	119.8	72.5	-115.3	0.9	164.5	-105.8	77.3	41.5	66.1	80.7
Medium and long-term	-62.2	-7.5	-12.7	-22.9	58.4	-163.0	47.6	9.9	32.4	44.9
Of which:										
Public sector (net)	-62.7	-42.5	-46.1	-57.1	-116.2	-285.0	-94.5	-69.9	-62.4	-54.6
Disbursements	83.9	69.8	76.6	87.8	151.7	340.6	171.4	162.9	170.8	179.3
Amortization	-21.2	-27.4	-30.4	-30.7	-35.6	-55.5	-76.9	-93.1	-108.5	-124.7
Short-term	182.0	80.0	-102.6	23.8	106.1	57.3	29.6	31.6	33.7	35.9
Errors and omissions	-345.1	-269.6	-268.9	-273.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-22.7	-24.2	-55.1	-56.4	-69.2	203.8	1.9	-87.6	-141.4	-159.5
Financing										
Net international reserves of the monetary authorities (+ = increase)	-22.7	-24.2	-55.1	-56.4	-69.2	203.8	1.9	-87.6	-141.4	-159.5
			(percent of GDP)							
Current account	12.9	7.8	7.0	2.0	3.8	3.5	3.0	2.1	1.7	1.7
Trade balance	4.5	4.7	4.2	0.6	3.7	2.4	2.7	2.4	2.0	2.0
Exports, f.o.b.	41.1	42.2	40.3	39.0	41.2	40.3	40.5	40.4	40.0	40.1
Imports, f.o.b	36.7	37.5	36.1	38.4	37.5	38.0	37.9	38.0	38.1	38.1
Services (net)	-3.0	-3.6	-4.9	-3.9	-4.3	-4.8	-5.0	-4.9	-4.7	-4.5
Income (net)	-3.9	-5.3	-5.9	-6.1	-6.9	-7.1	-7.4	-7.5	-7.6	-7.9
Of which: interest on public debt	-0.3	-0.3	-0.2	-0.3	-0.4	-0.7	-0.8	-0.8	-0.8	-0.7
Transfers	15.4	12.0	13.5	11.4	11.4	13.0	12.7	12.1	12.0	12.1
Capital and financial account 1/	-5.0	-1.4	-2.1	2.6	-5.3	0.7	-3.0	-3.8	-4.2	-4.4
Capital account	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account 2/	5.0	1.4	2.3	-2.7	5.2	-0.7	3.0	3.7	4.2	4.4
Of which foreign direct investment	-1.0	-0.7	2.7	-1.0	-0.6	-0.8	-0.8	0.8	0.8	0.8
Errors and omissions	-8.5	-7.0	-6.0	-5.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.6	-0.6	-1.2	-1.2	-1.5	4.2	0.0	-1.6	-2.5	-2.7
Memorandum items:										
Official transfers	13.7	10.0	11.2	9.9	9.3	10.9	10.6	9.9	9.8	9.8
Gross International Reserves 3/	547	567	565	430	363	570	576	492	354	196
(months of imports)	4.2	3.6	3.1	2.6	2.0	3.0	2.9	2.4	1.6	0.9
National currency per US$ (average)	12.8	14.7	13.3	13.2	…	…	…	…	…	…
National currency per US$ (eop)	15.6	13.7	12.3	14.4	…	…	…	…	…	…
GDP at market prices (US dollar millions)	4075	3840	4452	4711	4649	4880	5076	5318	5575	5853

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

Data reflects BPM6 classification.

1/ Capital account minus financial account balance.

2/ Positive sign indicates outflows.

3/ In 2018 and 2019, gross international reserves exclude unmatured forward contracts.

Table 5. Eswatini: Monetary Accounts, 2015–24[1]
(Emalangeni millions, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Emalangeni millions)									
Depository Corporation Survey										
Net foreign assets	8,898	8,949	7,955	7,029	5,390	8,548	8,793	7,633	5,512	2,949
Net domestic assets	4,321	7,759	9,388	11,019	12,806	11,132	12,100	14,386	17,863	21,744
Claims on central government (net)	-2,738	-833	-63	2,430	2,616	3,082	3,513	4,027	4,318	4,529
Claims on other sectors	11,426	13,044	14,225	14,877	15,618	15,948	16,546	16,814	17,751	18,627
Of which: Claims on private sector	10,590	11,816	12,275	12,905	13,663	14,270	14,902	15,425	15,859	16,272
Other items (net)	-4,367	-4,451	-4,774	-6,288	-5,428	-7,898	-7,959	-6,456	-4,206	-1,412
Broad money	13,219	16,708	17,343	18,048	18,196	19,680	20,893	22,019	23,375	24,693
Currency in circulation [2]	555	609	608	598	619	877	1,150	1,361	1,684	1,917
Deposits	12,664	16,099	16,735	17,450	17,577	18,803	19,743	20,658	21,691	22,776
Central Bank										
Net foreign assets	7,361	6,552	5,928	5,212	4,084	7,284	7,569	6,448	4,366	1,840
Gross reserves	8,523	7,751	6,959	6,183	5,267	8,514	8,849	7,779	5,750	3,279
Net domestic assets	-5,184	-3,672	-3,073	-1,888	-68	-2,212	-1,892	66	2,760	5,924
Reserve money	2,177	2,880	2,854	3,323	4,016	5,072	5,677	6,514	7,126	7,764
	(percent of GDP)									
Depository Corporation Survey										
Net foreign assets	17.1	15.8	13.4	11.3	8.1	11.9	11.4	9.2	6.2	3.1
Net domestic assets	8.3	13.7	15.8	17.7	19.3	15.5	15.7	17.4	20.0	22.6
Claims on central government (net)	-5.3	-1.5	-0.1	3.9	3.9	4.3	4.6	4.9	4.8	4.7
Claims on other sectors	22.0	23.1	24.0	23.9	23.5	22.2	21.5	20.3	19.9	19.3
Of which: Claims on private sector	20.4	20.9	20.7	20.7	20.6	19.9	19.4	18.6	17.7	16.9
Broad money	25.4	29.6	29.3	28.9	27.4	27.4	27.2	26.6	26.1	25.6
Currency in circulation [2]	1.1	1.1	1.0	1.0	0.9	1.2	1.5	1.6	1.9	2.0
Deposits	24.4	28.5	28.2	28.0	26.5	26.2	25.7	24.9	24.3	23.6
Central Bank										
Net foreign assets	14.2	11.6	10.0	8.4	6.2	10.1	9.8	7.8	4.9	1.9
Net domestic assets	-10.0	-6.5	-5.2	-3.0	-0.1	-3.1	-2.5	0.1	3.1	6.1
Reserve money	4.2	5.1	4.8	5.3	6.1	7.1	7.4	7.9	8.0	8.1
Memorandum items:	month percentage change; unless otherwise indica									
Reserve money	15.4	32.3	-0.9	16.4	20.9	26.3	11.9	14.7	9.4	9.0
M2	13.6	26.4	3.8	4.1	0.8	8.2	6.2	5.4	6.2	5.6
Credit to the private sector	4.2	11.6	3.9	5.1	5.9	4.4	4.4	3.5	2.8	2.6
Money multiplier (broad money/reserve money)	6.1	5.8	6.1	5.4	4.5	3.9	3.7	3.4	3.3	3.2
Velocity (GDP/broad money)	3.9	3.4	3.4	3.5	3.6	3.7	3.7	3.8	3.8	3.9

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

[1] End of period.

[2] Excludes rands in circulation.

Table 6. Eswatini: Financial Sector Indicators, 2011–2018

(Percent, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018
Banking indicators								
Capital adequacy								
Capital to assets	12.2	12.5	11.9	12.6	12.9	13.0	13.4	13.1
Regulatory capital to risk-weighted assets	20.6	21.1	22.2	24.9	22.5	22.2	23.2	18.8
Regulatory tier 1 capital to risk-weighted assets	17.8	18.2	19.3	21.3	20.0	20.0	20.8	16.0
Nonperforming loans net of provisions to capital	5.9	35.3	20.9	18.1	19.6	28.7	21.6	27.2
Asset quality								
Large exposure to capital	105.8	89.2	55.2	102.2	107.1	68.0	105.1	...
Nonperforming loans to total gross loans	3.5	10.7	6.8	6.9	6.6	9.6	7.9	9.3
Sectoral distribution of loans to total loans								
Agriculture	18.1	12.9	18.2	14.6	11.5	11.9	11.2	10.8
Mining and quarrying	1.8	2.0	2.2	1.9	1.3	1.1	1.8	1.3
Manufacturing	21.6	20.1	19.1	21.5	14.9	7.9	4.2	4.9
Construction	7.6	7.0	8.7	10.9	9.6	6.5	6.0	5.6
Distribution and Tourism	10.6	11.9	9.5	12.1	16.5	19.1	30.1	27.9
Transport and Communication	6.8	9.6	8.8	8.9	8.6	8.4	10.1	9.5
Community, Socialand Personal services	4.8	5.5	5.8	6.8	8.7	12.7	14.1	10.5
Other	28.7	31.1	27.7	23.3	28.8	32.4	22.4	29.5
Earnings and profitability								
Trading income to total income	0.9	1.4	1.7	1.7	1.1	0.5	0.5	...
Return on assets	3.5	3.5	3.1	3.5	10.3	4.0	5.5	2.5
Return on equity	26.3	24.8	22.7	27.7	50.1	25.6	36.2	7.0
Interest margin to gross income	51.0	49.2	46.9	47.3	49.7	54.2	57.6	56.9
Noninterest expenses to gross income	60.0	61.1	59.9	54.3	53.9	58.3	63.5	67.9
Personnel expenses to noninterest expenses	54.8	50.1	50.7	48.3	54.0	47.0	47.8	...
Liquidity								
Liquid assets to total assets	9.8	9.0	8.0	9.7	10.5	11.2	9.9	11.9
Liquid assets to short-term liabilities	15.5	12.7	12.1	14.2	15.3	16.4	14.7	17.5
Customer deposits to total (non-interbank) loans	108.6	122.9	115.4	111.7	125.4	141.0	139.5	...
Exposure to foreign exchange risk								
Foreign currency liabilities to total liabilities	6.0	4.2	0.1	6.0	4.9	12.4	8.6	...
Financial system structure								
Banks	4	4	4	4	4	4	4	4
Private commercial	0	0	0	0	0	0	0	0
State-owned	1	1	1	1	1	1	1	1
Foreign-owned subsidiaries	3	3	3	3	3	3	3	3
Branches of foreign banks	28	38	39	39	39	39	39	39
Deposits								
Banks	7,451	8,119	9,448	10,050	11,649	14,458	15,039	16,015
Private commercial	...	...	...	...	...	...	...	...
State-owned	989	1,011	1,126	1,210	1,168	1,389	...	...
Foreign-owned subsidiaries	6,492	7,108	8,322	8,840	8,446	13,069	...	...

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

Note. Starting in 2012, statistics exclude Building Society. Last available year for branches of foreign banks is 2014. Data for 2018Q1 are preliminary.

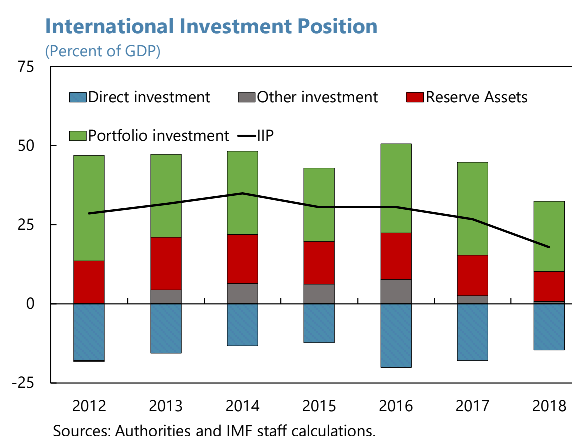
Annex I. External Sector Assessment

In 2018, the external position of Eswatini was moderately weaker than implied by macroeconomic fundamentals and desirable policies. The current account surplus narrowed on the back of declining SACU receipts and a shrinking trade balance. Despite a net inflow in the financial account, particularly portfolio investments, international reserves declined, reflecting the deterioration in the current account. After a temporary improvement in 2019, the current account balance is expected to return close to the 2018 level. Since 2013, international reserves have been declining and in 2018 they were below the lower bound of the IMF's reserve adequacy metric.

A. External Sector Assessment

Net International Investment Position

1. In 2018, the Net International Investment Position (NIIP) remained positive but declined somewhat. Eswatini remained a net creditor to the world, with an NIIP of 17.9 percent of GDP in 2018 (26.6 percent of GDP in 2017). Albeit the positive value, the NIIP has been deteriorating over the last four years on the back of declining international reserves, portfolio assets and other investment. Most of the external assets are in the form of portfolio investment and other investment assets (together accounting for 77 percent of assets abroad) mainly owned by the non-bank financial and corporate sectors.



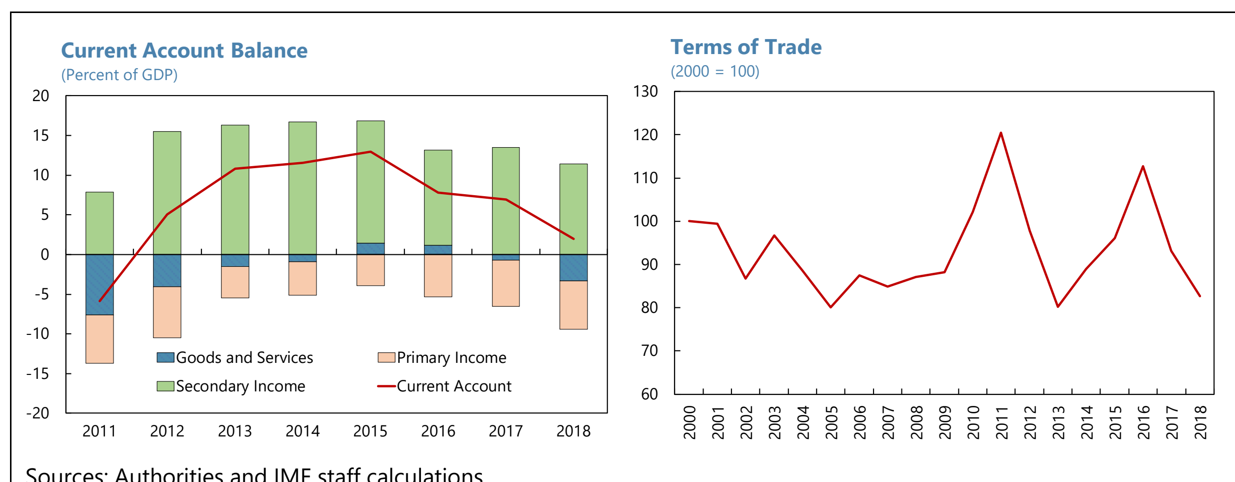
2. Despite ample assets abroad, in the absence of fiscal adjustment, the NIIP is expected to continue declining. Under staff's baseline scenario, the current account surplus is projected to be limited compared to capital outflows, hence prompting the NIIP to deteriorate further, including reserve assets.

Current Account

3. The current account surplus narrowed in 2018 and reached the lowest level since 2011. In the last five years, Eswatini has experienced large current account (CA) surpluses (10 percent of GDP on average) on the back of substantial, although declining, Southern African Customs Union (SACU)'s receipts and trade surpluses.[1] In 2018, the CA deteriorated to 2 percent of GDP as the trade surplus narrowed, largely because of high fuel prices, and SACU revenues declined by 2 percentage

[1] The external sector statistics in Eswatini reflect adoption of BPM6 methodology in 2018 and subsequent data revisions. However, large and consistently negative errors and omissions suggest significant room to improve the reliability of external statistics.

points of GDP. The primary income balance has remained broadly in line with past trends, reflecting the accumulation of dividends abroad by some large non-financial corporations.



Sources: Authorities and IMF staff calculations.

4. In 2018, the external position was moderately weaker than implied by macroeconomic fundamentals and desirable policies. Using the revised EBA-lite CA methodology, the current account gap is estimated at about 0.7 percent of GDP and the real exchange rate gap at -2.4 percent. The 2018 cyclically adjusted CA (3.8 percent of GDP) was broadly in line with the model's CA norm, estimated at 3.1 percent of GDP.[2] While small, the current account gap is composed of a large policy gap of -9.4 percent of GDP, reflecting a loose fiscal policy, and a large residual. The residual may reflect productivity differentials (measured by output per worker) with the rest of the world and data issues that result in large errors and omissions. The presence of large and consistently negative errors and omissions points to the possibility of a weaker current account balance than reported. In addition, considering the inadequacy of international reserves (see below), the external position in 2018 was assessed as moderately weaker than implied by macroeconomic fundamentals and desirable policies.[3] Preliminary and still incomplete data indicate that the overall position in 2019 is likely to remain moderately weaker than implied by macroeconomic fundamentals and desirable policies as, despite the current account position is estimated to temporarily improve, international reserves have declined further. Staff's proposed fiscal adjustment, together with structural reforms to improve external competitiveness, would contribute to improve the current account and bring the external position broadly in line with macroeconomic fundamentals, and build adequate international reserves buffers.

[2] The cyclically adjusted CA is larger than the actual CA because of a decline in the terms of trade during the year.

[3] The large errors and omissions are likely to be in part due to data limitations in recording trade in services. External position assessment based on IMF, "The Revised EBA-lite Methodology", Policy paper No. 19/026, July 2019.

Table A1.1. Eswatini: Current Account and Real Exchange rate Assessment Results

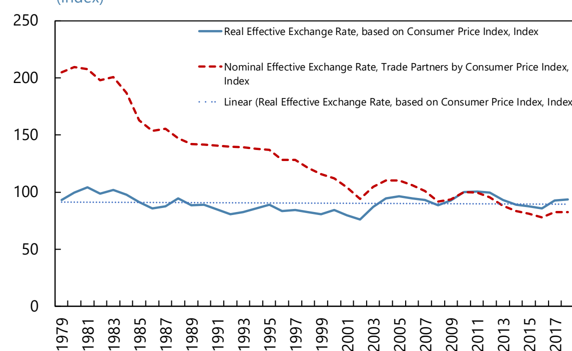
	Current Account Regressions	Equilibrium REER Regressions
CA/REER reference[1]	3.8	4.5
CA/REER norm[2]	3.1	4.8
CA gap	0.7	--
o/w: Policy gap	-9.4	4.1
Real exchange rate gap[3]	-2.4	-23.6

Source: IMF staff estimates.
[1] For CA regression, 2018 cyclically adjusted CA value. For REER regression, 2018 REER value in log.
[2] For CA regression, this is the multilaterally consistent adjusted CA norm. For REER regression, REER norm in log.
[3] Negative numbers indicate undervaluation. Elasticity of current account to real exchange rate gap is -0.30.

Real Effective Exchange Rate

5. Background. The lilangeni is pegged at par to the South African rand, and the nominal exchange rate depreciation has followed the rand. The REER has remained broadly constant since the 80s despite a nominal depreciation, largely reflecting rising price differentials with trading partners. However, there are signs of weakening competitiveness (Annex VII) since both the bilateral REER vis-à-vis South Africa as well as the REER deflated by unit labor costs have been appreciating since the 2000s.

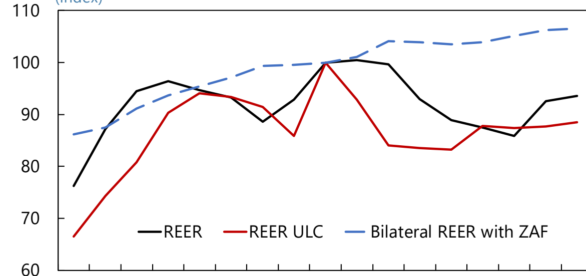
Nominal and Real Effective Exchange Rate
(Index)



Sources: International Financial Statistics.

6. Assessment. The REER approach suggests an undervaluation of 23.6 percent. This is driven mainly by demographic factors (e.g. life expectancy, dependency ratio), which would suggest that Eswatini's lower life expectancy should translate into low savings and a more appreciated exchange rate. However, this implication contrasts with Eswatini's high savings (15–25 percent of GDP over the last five years). Given the uncertainty surrounding how well the REER model lends itself to examine the characteristics of Eswatini and the decline in external competitiveness, the CA methodology used above appears the preferable approach to assess the adequacy of the Eswatini external position.

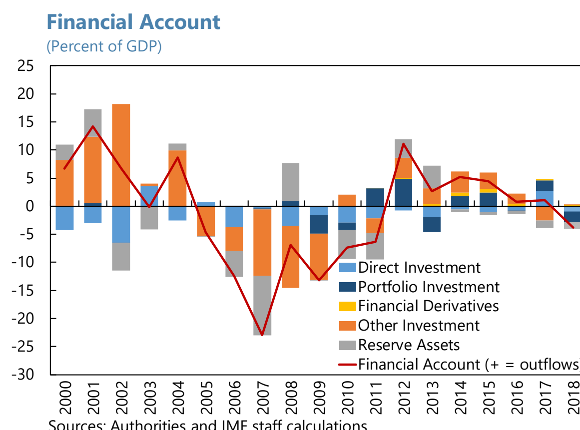
Real Effective Exchange Rate based on CPI and ULC
(Index)



Note: ULC-based REER was estimated using public wages as a proxy for overall wages in Eswatini due to data limitations. Wage growth during the salary years was adjusted downwards to account for one-off events.
Sources: Authorities, OECD, IMF Information Notice System and staff calculations.

Capital and Financial Account

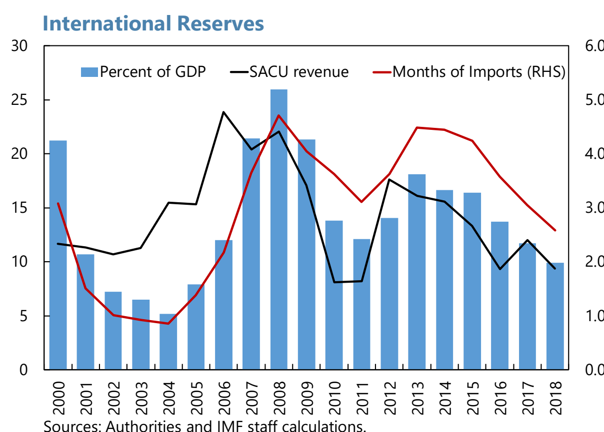
7. Differently from past trends, the financial account in 2018 was marked by large inflows, mostly in the form of portfolio investment. Following unusual FDI outflows in 2017, in 2018 FDI inflows returned to more normal levels, but portfolio investment registered significant inflows, largely driven by reversals of equity investments abroad by non-bank financial entities. This was likely driven by the expectation that the domestic asset requirements for institutional investors would increase, which prompted a temporary repatriation of assets. The reversal of flows of other investment was driven by lower accumulation of deposits abroad by corporates in light of stagnant exports over the year. Since most of the flow reversals observed in 2018 were linked to one-off events, the financial account is likely to return to the trends prevailing in past years. Over the last five years, Eswatini has experienced financial account outflows (about 3 percent of GDP on average) mainly driven by portfolio investments of the large non-bank financial sector (gross assets about 110 percent of GDP), including a fully-funded pension fund, and other investment reflecting significant savings by large exporters.



Sources: Authorities and IMF staff calculations.

B. International Reserve Adequacy

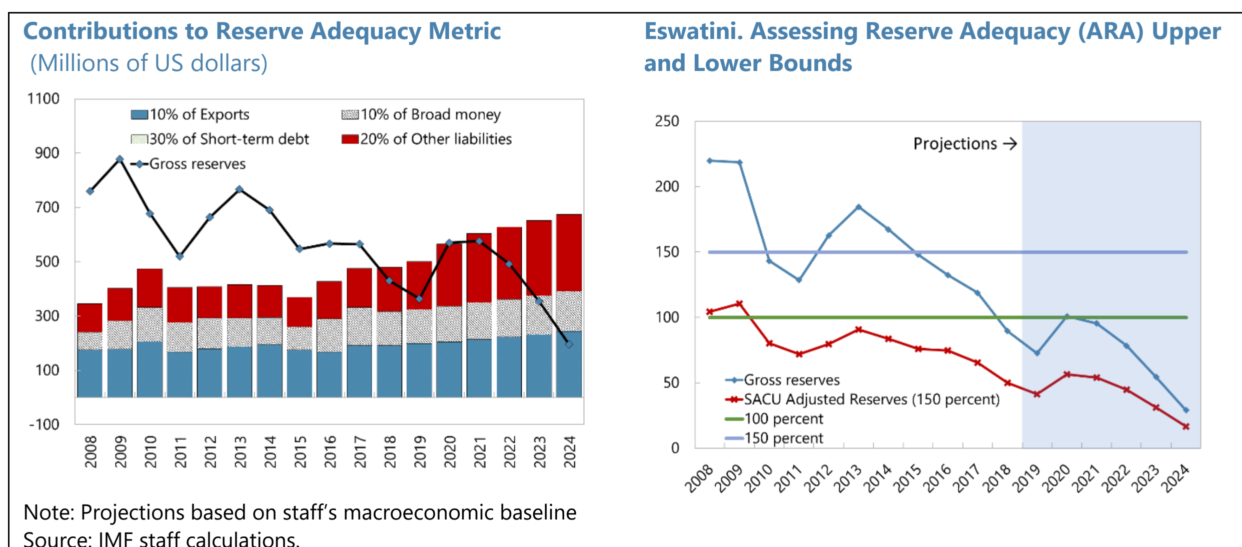
8. Eswatini's international reserves have been on a steadily declining trend since 2013. In 2010, a sharp decline in SACU revenue prompted a drop in international reserves. In the following years, SACU revenue bounced back and helped restore healthy levels of international reserves well above the IMF metric, reaching about 4.5 months of import coverage. However, since 2013, international reserves have been on a declining trend. International reserves have dropped from a peak of US$767 million, equivalent to 4.5 month of prospective imports (about 18 percent of GDP) at end 2013 to US$430.1 million at end-2018, below 3 months of imports or 9.9 percent of GDP. This decline is mainly driven by a deteriorating trade balance and lower SACU revenue, in addition to large and negative errors and omissions that signal a lower current account balance than reported.



Sources: Authorities and IMF staff calculations.

Reserve Adequacy

9. Eswatini's international reserves are below adequate levels. They are below traditional adequacy metrics, e.g., imports coverage (2.6 months of imports in 2018) and below the lower bound of the IMF's composite metric (ARA) to assess reserve adequacy for countries with market access. According to the ARA, which captures vulnerabilities from multiple sources, reserves in the range of 100–150 percent of the composite metric are in general considered adequate. Using 2018 data, this would correspond to international reserves between 2.9 and 4.3 months of projected imports (10.2 and 15.3 percent of GDP). In 2018, gross international reserves ($430.1 million) fell to about 90 percent of the lower bound of the IMF's reserve adequacy metric. By end-2019, international reserves declined further to about 72½ percent of the metric and, in the absence of fiscal adjustment, they are expected to continue declining as the current account would remain weak and economic uncertainty weighs on capital flows[4].



Contributions to Reserve Adequacy Metric (Millions of US dollars)

Eswatini. Assessing Reserve Adequacy (ARA) Upper and Lower Bounds

Note: Projections based on staff's macroeconomic baseline
Source: IMF staff calculations.

10. The high dependence of the CA on structurally volatile SACU's revenue would suggest for Eswatini a cautionary approach in assessing the adequacy of reserves. Reflecting the high volatility of SACU revenue and their role in the CA, potential reserve losses from volatile SACU revenue would call for higher reserve levels. For example, were 20 percent of SACU revenue a measure of plausible reduced inflow risk, the adequate reserve level would increase by around 80 percent to about 5 months of imports, or 18.2 percent of GDP in 2018. [5]

[4] International reserves have been adjusted to exclude FX forward purchase contracts between the Central Bank of Eswatini and commercial banks as these foreign assets would only be available to the central bank as international reserves upon reaching maturity.

[5] The risk weight was chosen based on the 10th percentile of observed reduced SACU inflow over recent years.

Annex II. Risk Assessment Matrix[1]

Source of main risks	Relative Likelihood and Time Horizon	Expected impact on the economy	Recommended Policy Response
Rising protectionism and retreat from multilateralism, with negative consequences for growth directly and through adverse confidence effects and financial market volatility.	**High** **ST, MT**	**Medium/High.** Deterioration in the external current account and fiscal balances due to lower SACU revenue and stagnant demand for exports as South Africa growth deteriorates; pressures on public debt and international reserves.	Accelerate structural reforms to promote investment and improve competitiveness through better governance and business environment. Implement fiscal consolidation and consider additional adjustment, depending on persistence of shocks, size of buffers and budget financing constraints.
Weaker than expected global growth, due to idiosyncratic factors in the US, China, Europe, and emerging markets feeding off each other and resulting in a prolonged global growth slowdown, with negative effects in South Africa.	**Medium /High** **ST, MT**		
Sharp rise in risk premia, caused by abrupt deterioration in market sentiments triggered by risk-off events (e.g., disorderly Brexit, renewed stresses in large emerging markets).	**High** **ST**	**Medium/High.** Capital flow reversal, rand depreciation and inflationary pressures would prompt higher interest rates and growth deceleration in South Africa. Higher debt service and re-financing risks for the government; pressures on households' and banks' balance sheets. Additional strains on external and fiscal accounts through lower SACU revenue.	Maintain the policy rate broadly in line with the South African Reserve Bank's rate. Strengthen the monitor of risks in the banking sector and accelerate the building up of the crisis preparedness framework. Consider fiscal consolidation to reduce financing costs. If possible, seek external financing, including project loans to smooth adjustment and release pressures on international reserves.
Slippages in implementing fiscal policies (e.g., triggered by political and capacity constraints, social pressures) that undermines confidence in the government's capacity to control public finances and contain arrears accumulation, and in the CBE's ability to support the peg	**Medium/ High** **ST**	**High.** Rising public debt and arrear accumulation; tighter financing conditions; accelerated decline in international reserves. Possible disorderly fiscal adjustment and loss of confidence in the ability to support the peg; accelerated inflation and currency mismatches in private sector's balance sheets; recession.	Identify spending reduction measures to support long-term adjustment. Lock in policies restraining the wage bill, accelerate reforms of extra-budgetary entities and procurement procedures. Implement mitigating measures for the most vulnerable. Strengthen the monitoring of the banking sector and accelerate the building up of the crisis preparedness framework. Introduce reforms to improve governance, and PFM systems.
Higher frequency and severity of climate event like droughts in Southern Africa, that causes water shortages and lower production.	**Medium** **MT**	**Medium.** Higher food prices and depletion of animal stocks; lower electricity production; higher unemployment. Fiscal costs to cater population's needs.	Strengthen and activate contingency plans for drought and natural disasters. Accelerate the structural transformation of the economy.

[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 under current policies). 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; ST and MT are meant to indicate that the risks could materialize within 1 year and 3 years, respectively). The RAM reflects staff's views on the sources of risk and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex III. Debt Sustainability Analysis

Since 2015, Eswatini' s central government debt has doubled, although from low levels, due to elevated fiscal deficits, largely financed through domestic debt and accumulation of domestic arrears. Under the staff baseline, which includes the authorities' budget plans for FY20/21 and no additional measures going forward, debt would continue to increase, but remain below the stress threshold. Gross financing needs would however be large and exceed the stress threshold, emphasizing short-term financing risks and the urgency for fiscal adjustment. These trends leave Eswatini' public debt outlook exposed to significant rollover risks, as well as vulnerable to growth shocks and potential fiscal slippages, as well as macroeconomic and contingent liabilities shocks. The external debt profile indicates vulnerabilities to current account shocks.

A. Public Debt[1]

Background

1. Eswatini's public debt has doubled since 2015 driven by large primary deficits (Figure A3.3). Between FY15/16 and FY18/19, the public debt to GDP ratio doubled from 17.7 to 33.4 percent of GDP, owing to a large and growing primary deficit averaging about 8 percent of GDP.[2]

2. With high and rising gross financing needs (GFN), the authorities have steadily increased their reliance on domestic financial markets. After reaching 14.8 percent of GDP in FY15/16, GFN further increased to 23.4 percent of GDP in FY18/19. With no access to external financial markets,[3] the share of domestic debt rose from about 48 percent of total public debt in FY15/16 to about 70 percent in FY18/19, including central bank advances and domestic arrears.

3. The maturity and composition of public debt bear significant rollover and liquidity risks, as well as exchange rate vulnerabilities. At end-March 2019, short-term treasury bills and other short-term debt (i.e., central bank advances, domestic arrears) accounted for about 57 percent of government's domestic debt, largely in the form of short-term treasury bills and pending invoices (80 percent of short-term domestic debt). As a result, 90 percent of government's estimated gross financing needs going forward are related to short-term domestic liabilities, exposing the country to rollover risks. Moreover, absent fiscal adjustment, the fiscal financing gap would widen, and gross financing needs would rise further, pointing at significant liquidity risks. While public debt denominated in foreign currencies has recently declined relative to overall debt (because of fast rising domestic debt), it has reached about 10 percent of GDP (about one third of central government public debt), reducing debt sensitivity to exchange rate fluctuations.

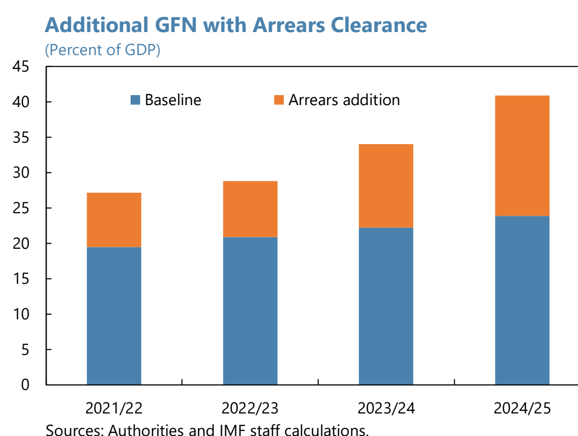
[1] Analysis based on fiscal year and on central government debt, as general government debt data are not available.

[2] As of March 2019, reported debt guaranteed by the central government amounted to 4 percent of GDP.

[3] External public debt is primarily in the form of project loans.

Outlook and Risks

4. Under Staff's baseline, which includes the government's budget plans for FY20/21 and no additional measure, public debt would be rising and financing needs would be elevated (Figure A3.3).[4] Under the baseline, the debt-to-GDP ratio would rise to 62 percent of GDP by the end of the projection period and GFN average around 22 percent of GDP and exceed the risk threshold level. In the absence of a deep domestic financial market, the increase in public debt would be driven largely by the continued accumulation of domestic arrears.[5] The GFN could be significantly higher if the government clears the stock of domestic arrears and finance new arrears. For instance, in a scenario where arrears from FY20/21 and new arrears going forward were financed through one-year T-Bills and 2-year bonds, the GFN would markedly increase, exceeding 40 percent of GDP by FY24/25. In such a scenario, the GFN average would increase from 22 percent to 32 percent of GDP over the projection period, pointing at elevated financing and rollover risks.



Sources: Authorities and IMF staff calculations.

5. Alternative scenarios and stress tests highlight the critical importance of fiscal adjustment to ensure debt sustainability and resilience to shocks. At the current level of the primary balance and no further adjustment, even a relatively small shock would accelerate the build-up in public debt and increase the GFN (Figure A3.5). Stress analysis suggests that debt levels and GFN are particularly sensitive to GDP growth shocks (Figure A3.5).[6] Combing GDP and primary balance shocks with macroeconomic shocks would bring public debt to reach nearly 90 percent of GDP and breach the debt level stress threshold.

B. External Debt[7]

6. Eswatini's external debt and gross financing needs have been increasing recently, but remain low (Table A3.1). In 2018, the stock of external debt increased by about 1.4 percent of GDP to reach 17.2 percent of GDP and is expected to increase further in 2019. Public debt accounts for

[4] Gross financing needs do not include obligations from financing of any fiscal operations financing gap.

[5] The DSA framework uses risk thresholds of 70 percent of GDP for public debt and 15 percent of GDP for gross financing needs. Exceeding these benchmarks is reported with yellow color in the heat map if the benchmarks are passed in a stress scenario and a red color if they exceeded in the baseline. The benchmarks are based on a cross-country early-warning exercise of EMs that have experienced episodes of debt distress. Debt distress events are defined as default to commercial or official creditors, restructuring and rescheduling events, or IMF financing.

[6] Primary balance is assumed to return to the FY18/19 level, about 10 percent of GDP.

[7] Analysis based on calendar year.

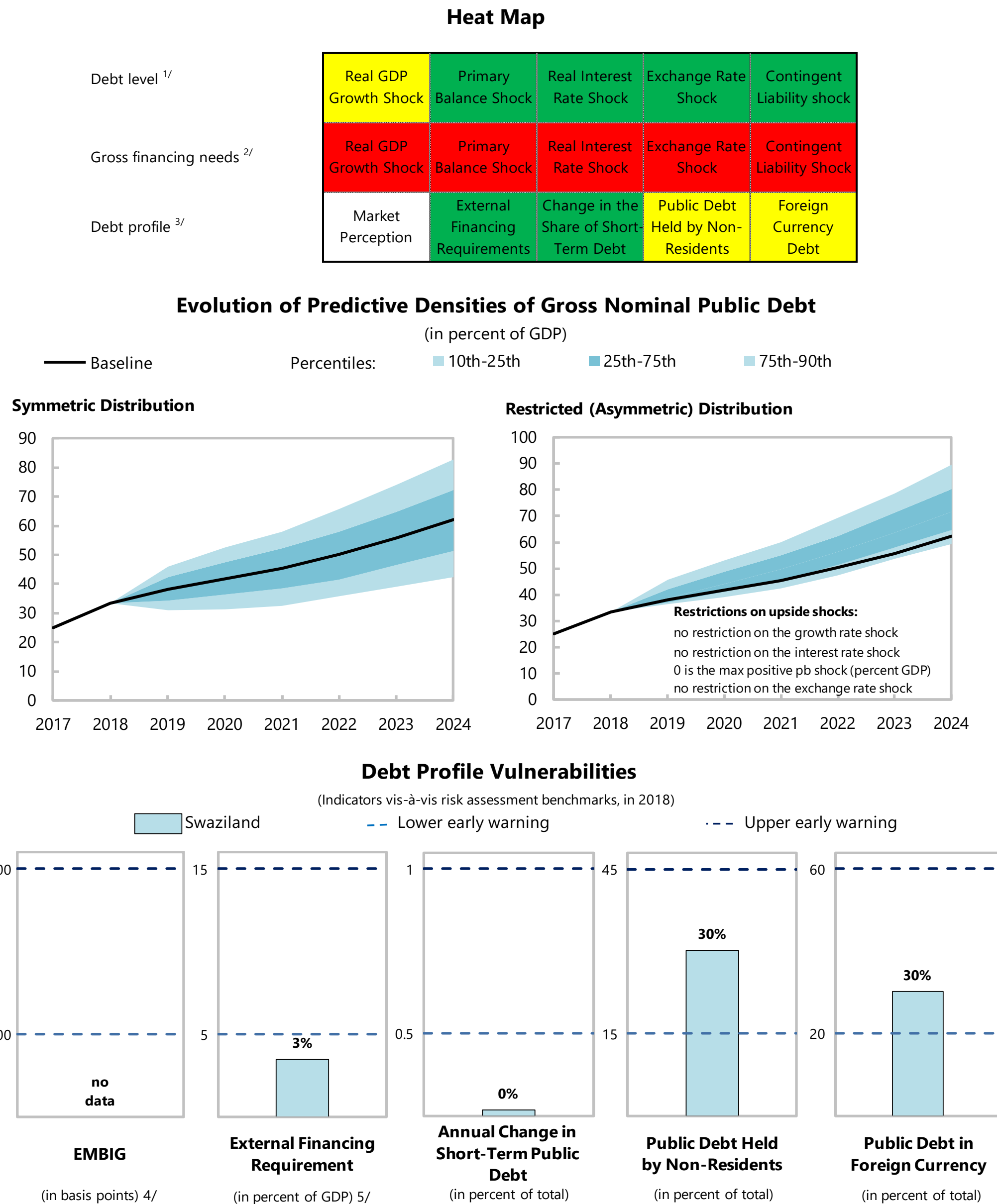
about 60 percent of total external debt[8]. Gross external financing needs increased to 3.5 percent of GDP in 2018.

7. Under the Staff's baseline, external debt will gradually increase and then stabilize over the projection period with contained gross financing needs. The external debt ratio is projected to stabilize at around 24.1 percent of GDP as the current account surplus, above the debt stabilizing level, offsets exchange rate depreciation pressures. Gross external financing needs are expected to stabilize at around 4 percent of GDP over the medium term (Table A3.1).

8. Sensitivity tests suggest that Eswatini' s external debt is particularly sensitive to current account shocks (Figure A3.6). A shock to the non-interest current account would place the external debt-to-GDP ratio on a sharp upward path, reaching 46 percent of GDP over the medium term. This result is driven by the high historical volatility of Eswatini's current account balance, largely due to fluctuations in SACU transfers. However, higher interest rates or a slowdown in economic growth would, by themselves, have very limited effects on debt dynamics. A combined (interest rate, growth, current account) shock has, therefore, an impact on debt similar to the current account shock. A one-time real depreciation of 30 percent would raise the debt level, but it would not place debt on an upward path.

[8] However, given data limitations, there is uncertainty around the stock of private external debt.

Figure A3.1. Eswatini: Public DSA Risk Assessment



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.

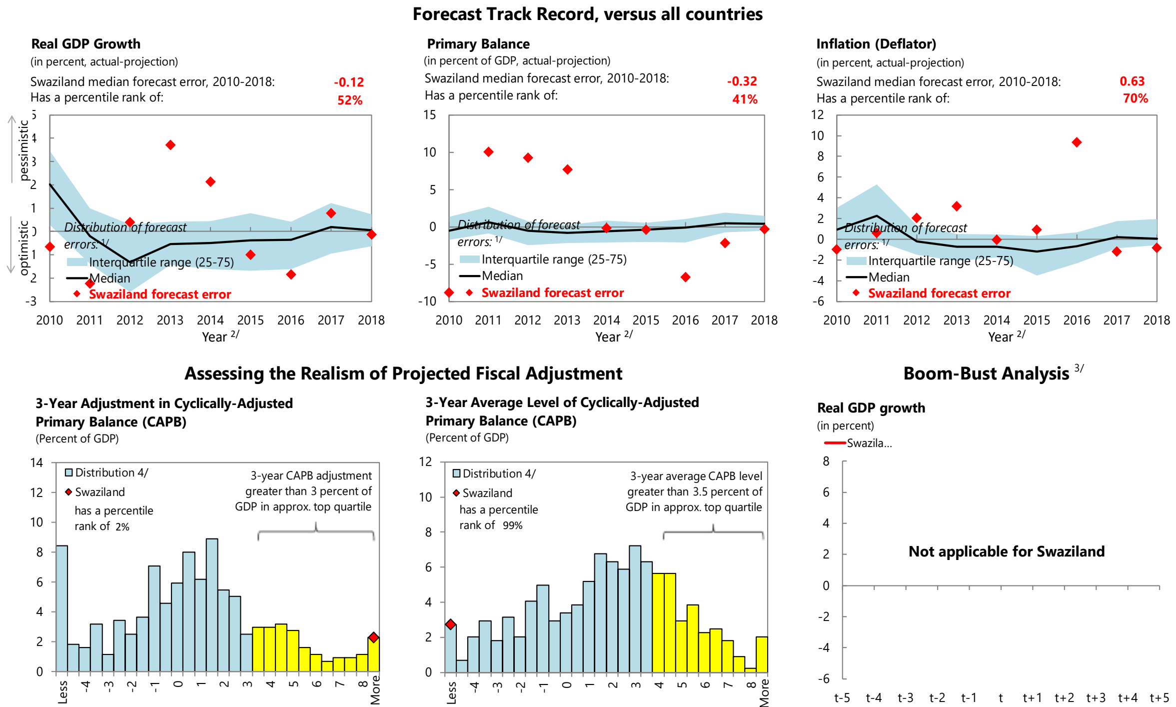
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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/ EMBIG, an average over the last 3 months, 06-Aug-19 through 04-Nov-19.

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 A3.2. Eswatini: Public DSA — Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all 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 A3.3. Eswatini: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

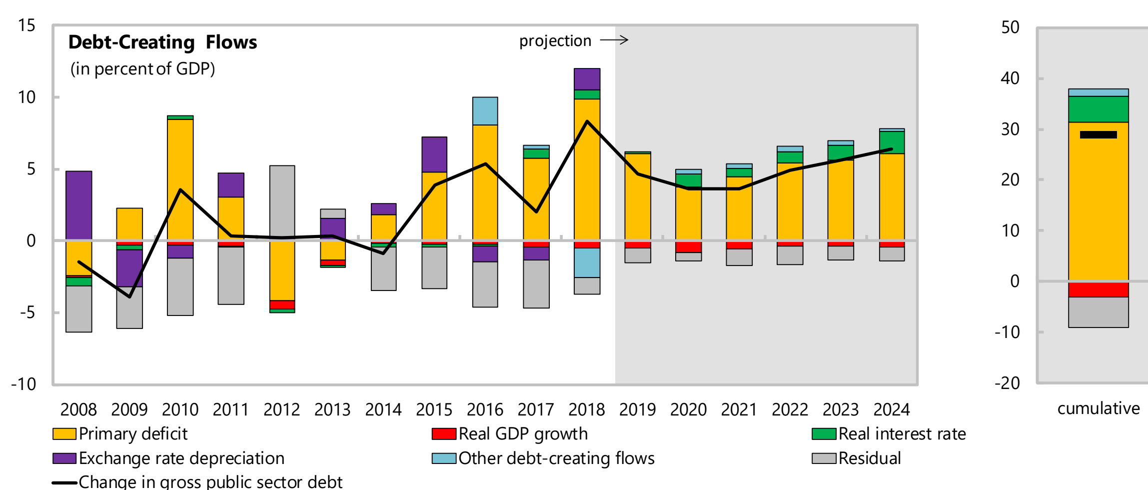
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of November 04, 2019		
	2008-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	15.1	25.1	33.4	38.1	41.7	45.3	50.2	55.9	62.2	EMBIG (bp) 3/		n.a.
Public gross financing needs	10.7	10.2	21.8	20.5	21.0	21.1	22.5	23.8	25.8	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	2.5	2.1	2.1	1.5	2.3	1.5	0.9	0.8	0.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	6.9	2.8	3.4	5.3	5.5	5.7	6.9	7.0	7.0	Moody's	B2	B2
Nominal GDP growth (in percent)	9.6	5.0	5.5	6.9	7.9	7.2	7.8	7.8	7.8	S&Ps	n.a.	n.a.
Effective interest rate (in percent) [4]	5.8	6.8	6.7	7.0	8.3	7.3	8.8	9.4	10.0	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	0.8	2.0	8.3	4.6	3.6	3.6	4.9	5.6	6.4	28.8	
Identified debt-creating flows	2.8	5.3	9.5	5.7	4.2	4.8	6.2	6.6	7.4	34.9	
Primary deficit	2.3	5.8	9.9	6.1	3.7	4.5	5.4	5.6	6.0	31.3	1.3
Primary (noninterest) revenue and grants	27.2	28.0	24.8	25.6	28.0	26.7	25.7	25.7	25.7	157.3	
Primary (noninterest) expenditure	29.5	33.8	34.6	31.7	31.7	31.1	31.1	31.3	31.7	188.7	
Automatic debt dynamics [5]	0.3	-0.7	1.7	-0.4	0.1	0.0	0.4	0.7	1.1	2.0	
Interest rate/growth differential [6]	-0.5	0.2	0.2	-0.4	0.1	0.0	0.4	0.7	1.1	2.0	
Of which: real interest rate	-0.2	0.6	0.7	0.1	0.9	0.6	0.8	1.1	1.5	5.0	
Of which: real GDP growth	-0.3	-0.5	-0.5	-0.5	-0.8	-0.6	-0.4	-0.4	-0.4	-3.0	
Exchange rate depreciation [7]	0.8	-0.9	1.5	…	…	…	…	…	… …	…	
Other identified debt-creating flows	0.2	0.3	-2.0	0.0	0.3	0.3	0.4	0.3	0.2	1.5	
Change in Domestic Arrears (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	
Central bank borrowing	0.2	0.3	-2.0	0.0	0.3	0.3	0.4	0.3	0.2	1.5	
Residual, including asset changes [8]	-2.0	-3.3	-1.2	-1.1	-0.6	-1.1	-1.3	-1.0	-1.0	-6.1	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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.

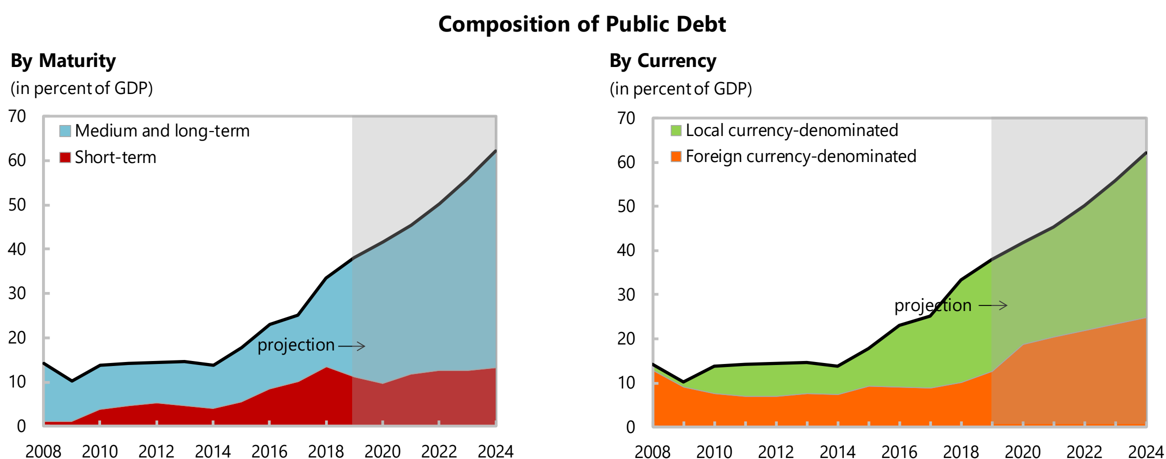
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

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

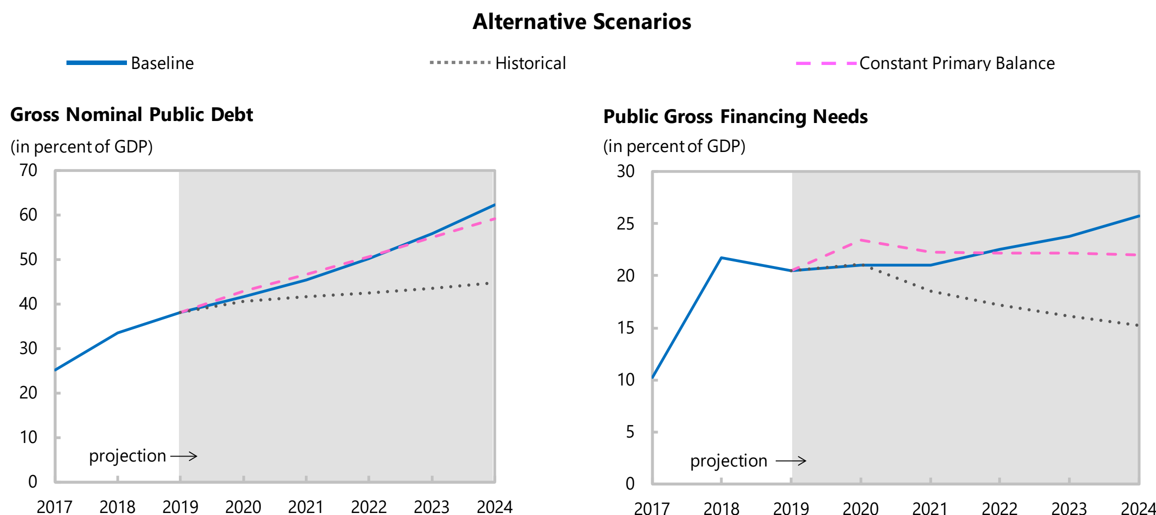
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A3.4. Eswatini: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios

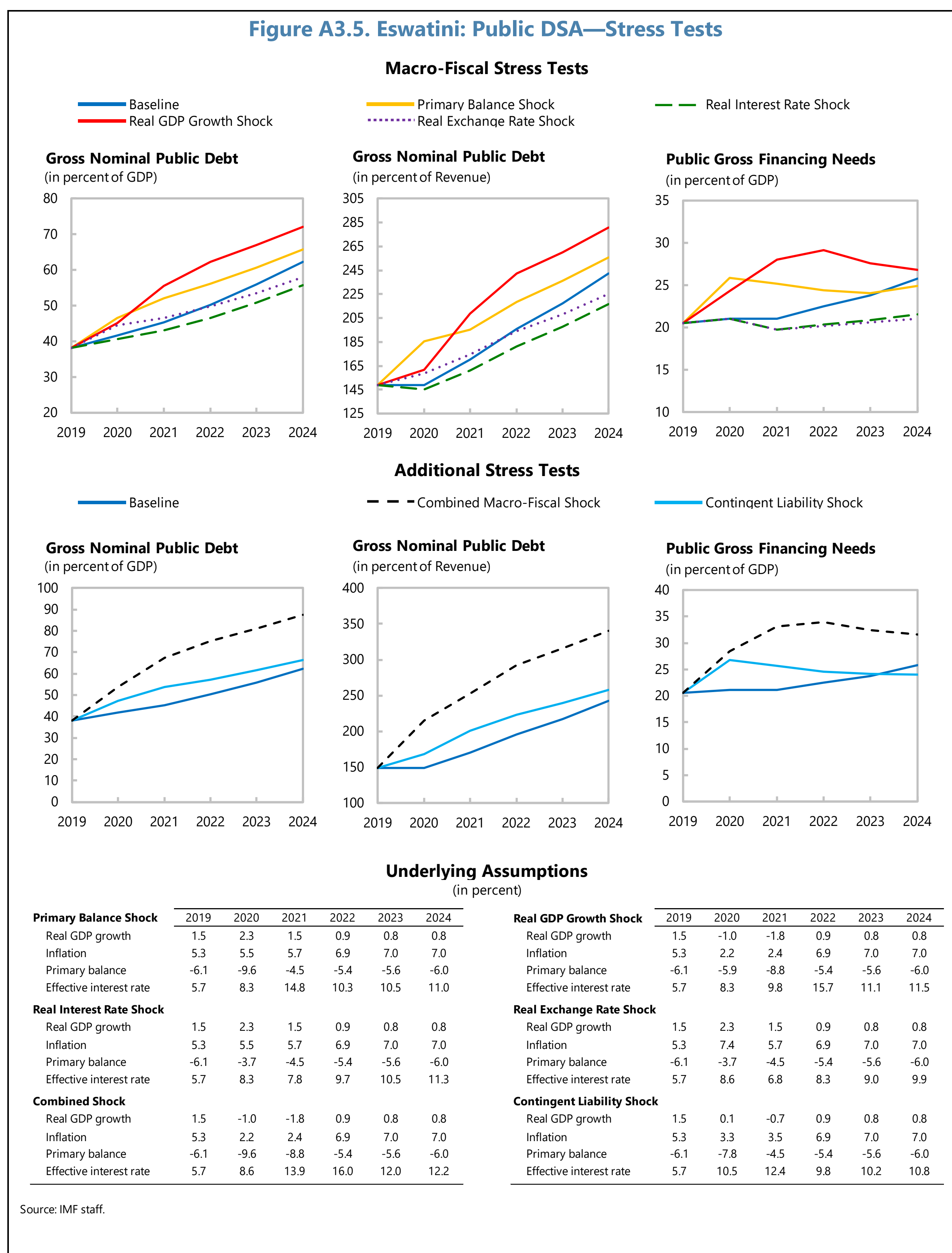


Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.5	2.3	1.5	0.9	0.8	0.8
Inflation	5.3	5.5	5.7	6.9	7.0	7.0
Primary Balance	-6.1	-3.7	-4.5	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.3	7.3	8.8	9.4	10.0
Constant Primary Balance Scenario						
Real GDP growth	1.5	2.3	1.5	0.9	0.8	0.8
Inflation	5.3	5.5	5.7	6.9	7.0	7.0
Primary Balance	-6.1	-6.1	-6.1	-6.1	-6.1	-6.1
Effective interest rate	5.7	8.3	7.1	8.6	9.2	9.9

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.5	2.6	2.6	2.6	2.6	2.6
Inflation	5.3	5.5	5.7	6.9	7.0	7.0
Primary Balance	-6.1	-3.9	-3.9	-3.9	-3.9	-3.9
Effective interest rate	5.7	8.3	6.6	8.1	8.8	9.9

Source: IMF staff.



Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	1.5	2.3	1.5	0.9	0.8	0.8
Inflation	5.3	5.5	5.7	6.9	7.0	7.0
Primary balance	-6.1	-9.6	-4.5	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.3	14.8	10.3	10.5	11.0
Real Interest Rate Shock						
Real GDP growth	1.5	2.3	1.5	0.9	0.8	0.8
Inflation	5.3	5.5	5.7	6.9	7.0	7.0
Primary balance	-6.1	-3.7	-4.5	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.3	7.8	9.7	10.5	11.3
Combined Shock						
Real GDP growth	1.5	-1.0	-1.8	0.9	0.8	0.8
Inflation	5.3	2.2	2.4	6.9	7.0	7.0
Primary balance	-6.1	-9.6	-8.8	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.6	13.9	16.0	12.0	12.2

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	1.5	-1.0	-1.8	0.9	0.8	0.8
Inflation	5.3	2.2	2.4	6.9	7.0	7.0
Primary balance	-6.1	-5.9	-8.8	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.3	9.8	15.7	11.1	11.5
Real Exchange Rate Shock						
Real GDP growth	1.5	2.3	1.5	0.9	0.8	0.8
Inflation	5.3	7.4	5.7	6.9	7.0	7.0
Primary balance	-6.1	-3.7	-4.5	-5.4	-5.6	-6.0
Effective interest rate	5.7	8.6	6.8	8.3	9.0	9.9
Contingent Liability Shock						
Real GDP growth	1.5	0.1	-0.7	0.9	0.8	0.8
Inflation	5.3	3.3	3.5	6.9	7.0	7.0
Primary balance	-6.1	-7.8	-4.5	-5.4	-5.6	-6.0
Effective interest rate	5.7	10.5	12.4	9.8	10.2	10.8

Source: IMF staff.

Table A3.1. Eswatini: External Debt Sustainability Framework, 2014–2024

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018	10-Year Historical Average	10-Year Standard Deviation	2019	2020	2021	2022	2023	2024	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	13.3	13.4	17.7	15.8	17.2			**19.0**	**23.5**	**25.0**	**25.0**	**24.7**	**24.1**	**0.7**
Change in external debt	0.1	0.1	4.3	-2.0	1.4			1.8	4.5	1.5	-0.1	-0.3	-0.6	
Identified external debt-creating flows (4+8+9)	-11.6	-12.8	-7.7	-6.7	-3.9			-4.5	-4.2	-3.5	-1.6	-1.5	-1.5	
Current account deficit, excluding interest payments	-12.0	-13.4	-8.4	-7.6	-2.6			-4.5	-4.0	-3.5	-3.3	-3.2	-3.2	
Deficit in balance of goods and services	0.9	-1.4	-1.1	0.7	3.3			0.7	2.4	2.4	2.5	2.5	2.3	
Exports	43.9	43.0	43.8	43.1	40.5			42.7	41.8	41.8	41.8	41.8	41.8	
Imports	44.8	41.5	42.6	43.8	43.9			43.3	44.2	44.2	44.3	44.3	44.1	
Net non-debt creating capital inflows (negative)	-0.6	-1.0	-0.7	2.7	-1.0			-0.6	-0.8	-0.8	0.8	0.8	0.8	
Automatic debt dynamics 1/	0.9	1.6	1.4	-1.8	-0.2			0.5	0.6	0.8	0.9	0.9	0.8	
Contribution from nominal interest rate	0.4	0.5	0.6	0.6	0.6			0.7	1.0	1.1	1.1	1.0	1.0	
Contribution from real GDP growth	-0.1	-0.3	-0.2	-0.3	-0.4			-0.2	-0.5	-0.4	-0.2	-0.2	-0.2	
Contribution from price and exchange rate changes 2/	0.6	1.5	1.0	-2.1	-0.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	11.7	12.9	12.1	4.7	5.2			6.3	8.7	5.0	1.6	1.3	0.9	
External debt-to-exports ratio (in percent)	30.4	31.2	40.5	36.6	42.3			44.4	56.1	59.8	59.7	59.0	57.7	
Gross external financing need (in billions of US dollars) 4/	-0.3	-0.3	-0.2	0.0	0.2			0.1	0.1	0.2	0.2	0.2	0.2	
in percent of GDP	-6.4	-8.5	-4.0	-0.1	3.5			2.2	3.0	3.9	4.1	4.1	4.0	
Scenario with key variables at their historical averages 5/								**19.0**	**23.6**	**24.5**	**22.4**	**20.0**	**17.3**	**-1.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	0.9	2.3	1.3	2.0	2.4	2.6	1.4	1.2	2.5	1.6	0.9	0.8	0.8	
GDP deflator in US dollars (change in percent)	-4.7	-10.0	-7.0	13.6	3.4	1.5	10.0	-2.5	2.4	2.3	3.8	4.0	4.1	
Nominal external interest rate (in percent)	3.0	3.3	4.0	4.0	4.3	4.4	1.0	4.1	5.7	5.0	4.6	4.4	4.2	
Growth of exports (US dollar terms, in percent)	4.1	-9.8	-4.0	14.1	-0.4	1.4	10.3	3.9	2.9	3.9	4.9	4.8	5.0	
Growth of imports (US dollar terms, in percent)	2.5	-14.6	-3.3	19.1	6.0	0.2	12.4	-2.5	7.2	4.0	4.9	4.9	4.5	
Current account balance, excluding interest payments	12.0	13.4	8.4	7.6	2.6	3.7	8.7	4.5	4.0	3.5	3.3	3.2	3.2	
Net non-debt creating capital inflows	0.6	1.0	0.7	-2.7	1.0	1.0	1.5	0.6	0.8	0.8	-0.8	-0.8	-0.8	

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.

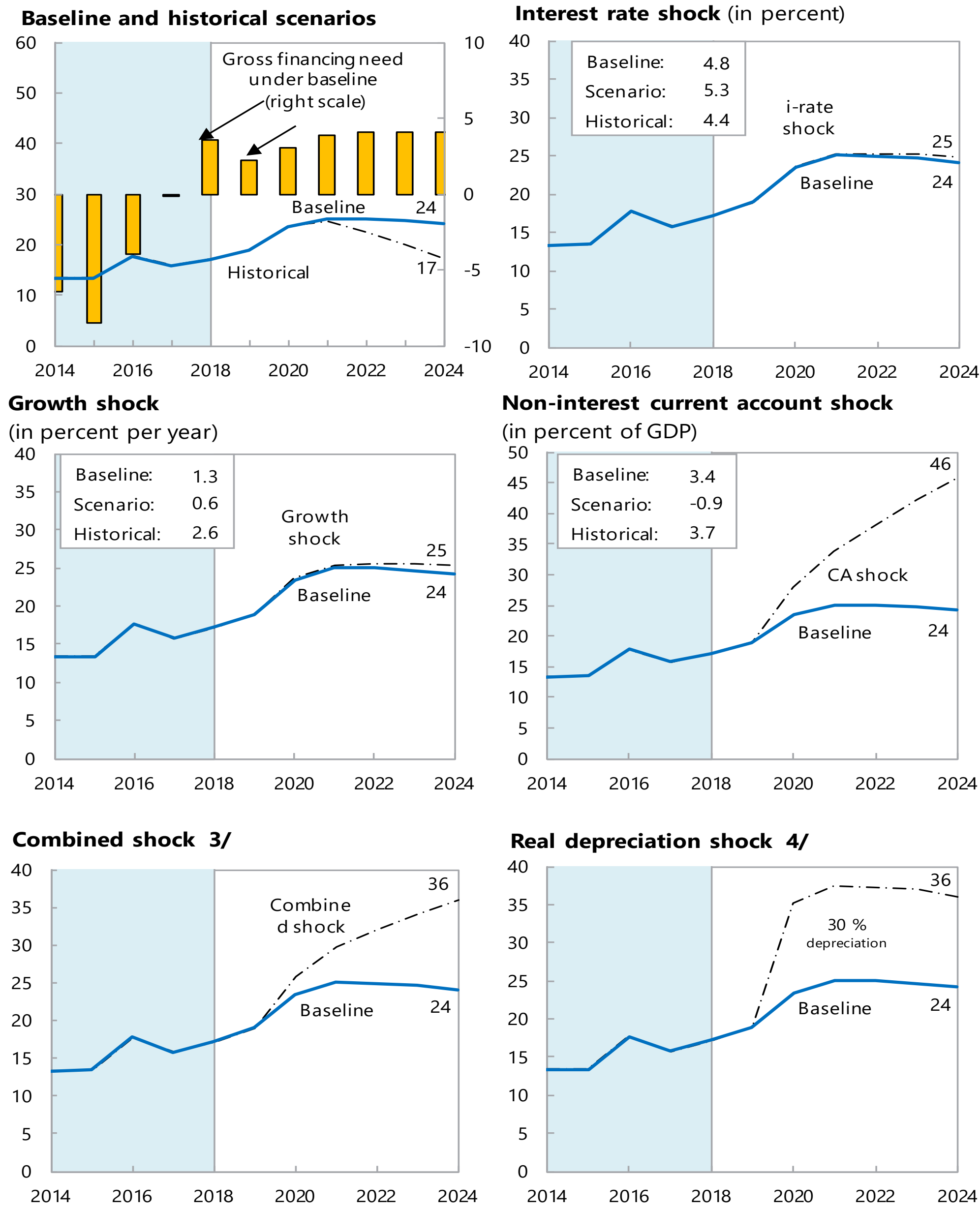
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Figure A3.6. Eswatini: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)

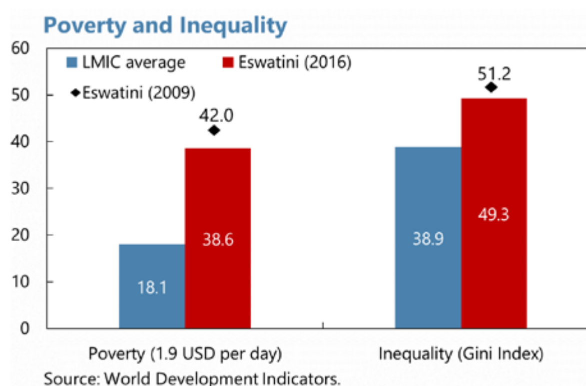


Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. 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 2020.

Annex IV. Poverty and Inequality Trends in Eswatini: Harnessing Fiscal Policy[1]

Over the past decade, poverty and inequality in Eswatini have fallen very little, and remain much higher than in peer countries. Poverty comes with limited access to basic housing services, health care, and education. Child poverty is also very high, and having a job in the private sector does not always guarantee exiting poverty, especially for low-educated workers. While creating more and better jobs will be critical to make inroads on these issues, there is room to enhance the redistributive and poverty-alleviating role of budget policies, including scaling up existing programs and targeting benefits towards children, and over time improving access to higher education.

1. Poverty and inequality in Eswatini have improved little in recent years and are widespread by international standards, amid limited distributional impact of budget policies.[2] According the 2016/17 Household Income and Expenditure Survey, since the early 2000s, poor people's income has grown fast, yet 38.6 percent of the population in Eswatini lives in extreme poverty measured by the $1.9 per day poverty line (42 percent in 2009), one of the highest poverty rate among middle-income countries.[3] Widespread poverty combines with one of the highest income inequality in the world, with the Gini coefficient stable at around 50 percent. Against this background, Eswatini's spending on the social safety net is low compared to other countries in the region and has limited impact. Cash transfers in Eswatini amount to less than 1 percent of GDP and reduce poverty by 1.2 percentage points only (from a poverty headcount of 39.8 percent to 38.6 percent) and the Gini coefficient by 1.5 points (from a Gini coefficient of 50.8 to 49.3). This annex used the recently published household income and expenditure survey to assess the main features of poverty and inequality in Eswatini, and how to strengthen the impact of fiscal policy.

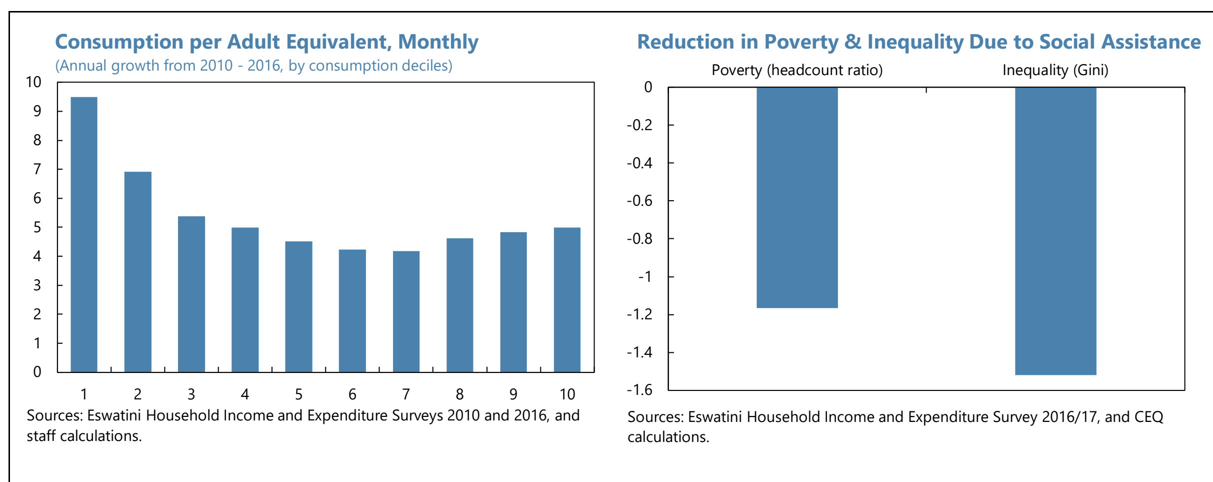


Source: World Development Indicators.

[1] Prepared by A. Habib and Z. Wang, in collaboration with M. Goldman and H. Renda from the Commitment to Equity Institute (http://commitmentoequity.org/).

[2] Unless otherwise specified, the analysis utilizes the recently released 2016/17 Household Income and Expenditure Survey data, available from the Eswatini Central Statistical Office (CSO), Ministry of Economic Planning.

[3] As in many developing countries, consumption expenditure is used as a measure of income and to calculate all poverty statistics to overcome shortcomings of income data.



Consumption per Adult Equivalent, Monthly
(Annual growth from 2010 - 2016, by consumption deciles)

Sources: Eswatini Household Income and Expenditure Surveys 2010 and 2016, and staff calculations.

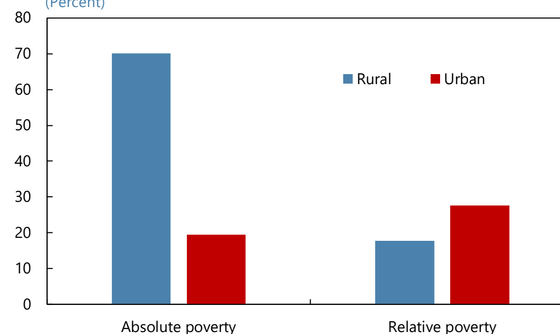
Reduction in Poverty & Inequality Due to Social Assistance

Sources: Eswatini Household Income and Expenditure Survey 2016/17, and CEQ calculations.

A. Being Poor in Eswatini: Poverty Dimensions

2. Poverty is particularly high amongst children, the elderly, and in rural areas. Using the national moderate poverty line (E975.3 per adult equivalent in 2017), 59 percent of the population is poor, and poverty is much higher amongst the elderly (74 percent) and children (69 percent). In rural areas, poverty is both more pervasive (70 percent) and intense, with the poverty gap index in rural areas at around 30 percent compared to 6 percent in urban areas.[4]

Poverty Rates in Urban and Rural Areas
(Percent)



Sources: Eswatini Household Income and Expenditure Survey 2016/17, and staff calculations.

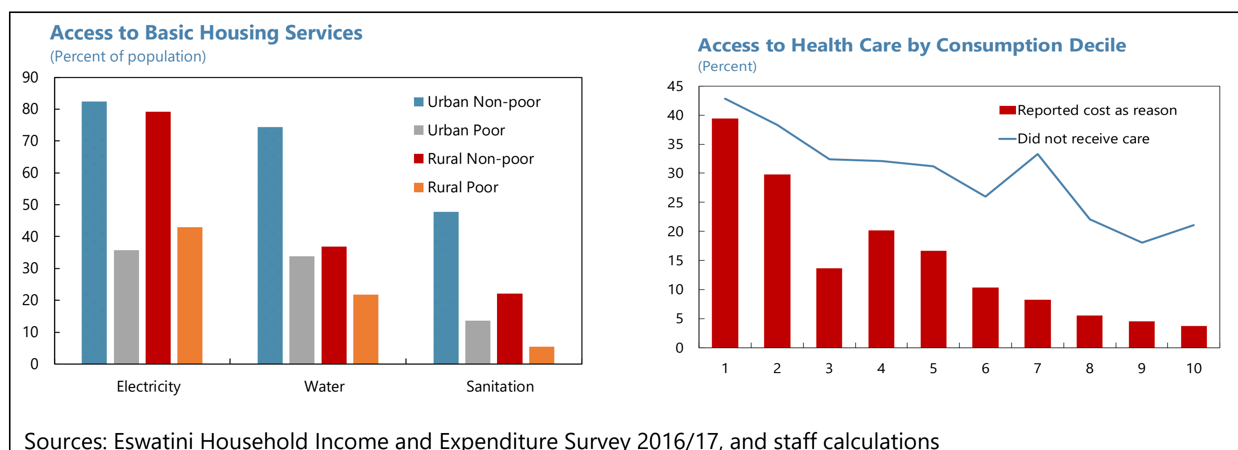
3. Relative poverty is widespread in urban areas too. Once differences in consumption patterns are accounted for, and relative poverty lines are used. poverty in urban areas is somewhat higher than in rural areas (28 percent and 18 percent respectively).[5]

4. Both the rural and urban poor and, more in general, people living in rural areas have lower access to services. Both poor rural and urban households have limited access to services such as sanitation and piped water. With the exception of electricity access, people living in rural areas, both poor and non-poor, have limited access to housing services, suggesting both lack of infrastructure in rural areas and low income are obstacles to access. Similar patterns hold for services such as education and health. Poor households, both in rural and urban areas, have less access to education and health care. For health care, members of households in the bottom decile are about twice as likely to report not getting care than members of households in the top decile. The cost of

[4] Eswatini has seen little urbanization over the past two decades, as the share of the rural population has remained stable at three-quarters of the population. Poverty gap is defined as the average shortfall of income relative to the poverty line.

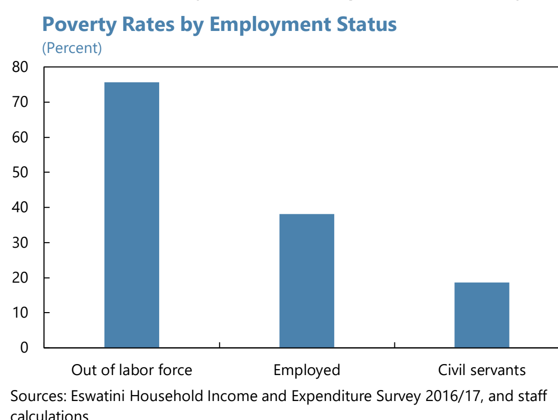
[5] The relative rural and urban poverty lines are calculated as 60 percent of the median consumption per adult equivalent in the area.

care is a major hindrance, as about 40 percent in the bottom decile reported high cost as the reason for not getting care.



Sources: Eswatini Household Income and Expenditure Survey 2016/17, and staff calculations

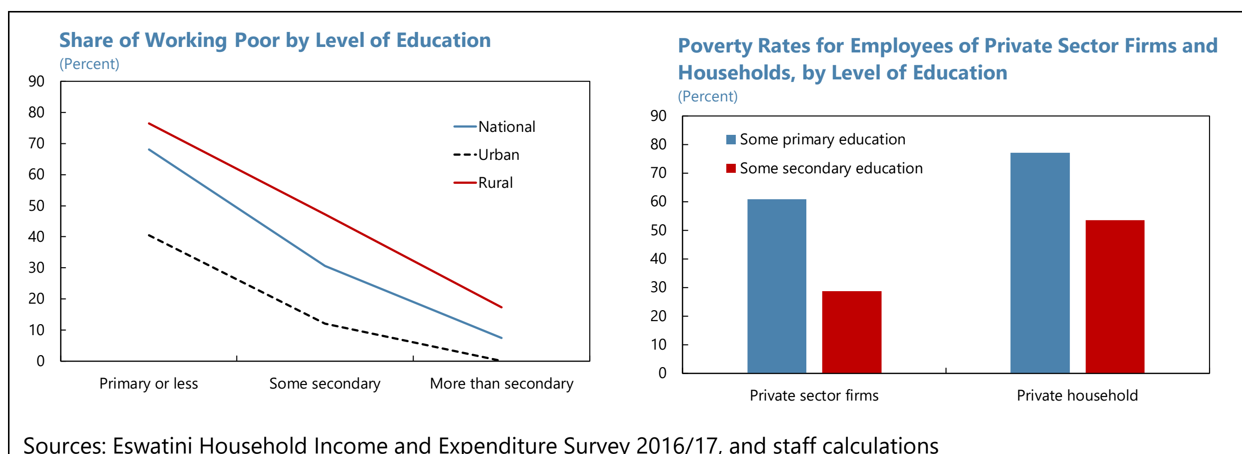
5. While employment helps to escape poverty, many working people remain poor. Having a job reduces poverty by about 40 percentage points, but the poverty rate amongst the employed remains substantial at 38 percent.[6] Furthermore, the overall poverty rate amongst the employed hides substantial differences by type of employer: the poverty rate amongst civil servants is about 18 percent, while it is over 70 percent for the nearly 40 percent of household heads who report working for a private household. The working poor are mainly employed by private sector firms or private households, and are about half as likely as the non-poor to have a permanent contract.



Sources: Eswatini Household Income and Expenditure Survey 2016/17, and staff calculations.

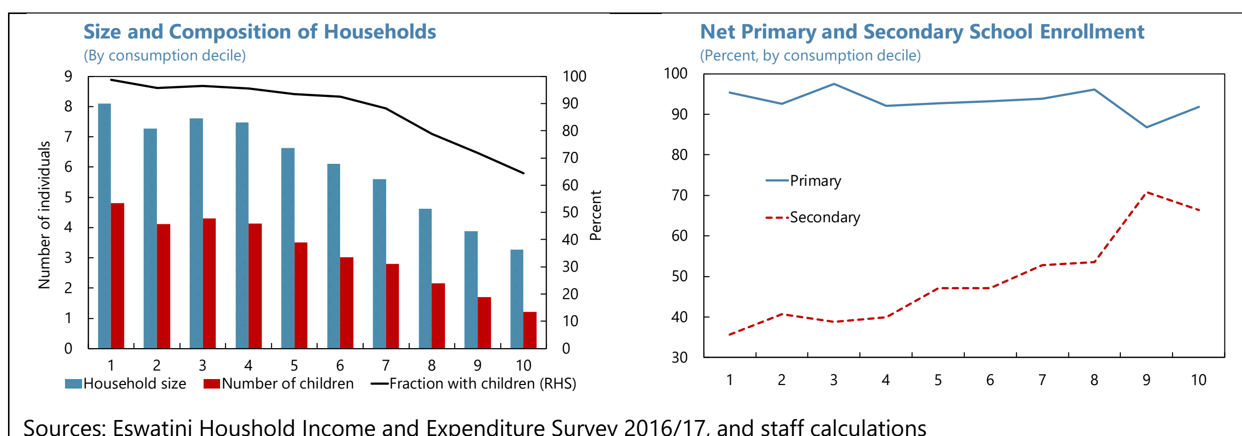
6. Education is strongly associated with lower poverty rates amongst workers. In both urban and rural areas, people with at least some secondary or higher education face poverty rates about 30 percent lower than people with primary education or less. While both groups report working for different types of employers at similar rates, those with primary education are somewhat more likely to work for private households, which is associated with higher poverty rates. More educated workers are likelier to have permanent contracts and have much lower rates of poverty for nearly all types of employers.

[6] Based on the 2016 Labor Force Survey, about 50 percent of the working age population are in the labor force, 67 percent of whom are employed.



Sources: Eswatini Household Income and Expenditure Survey 2016/17, and staff calculations

7. Children experience very high rates of poverty and limited access to education. Poverty amongst children is about 70 percent (compared to 59 percent for the entire population). Poor children tend to live in rural areas and in large families, and nearly all poor households contain children. Except for primary education, which is free, poorer children have much lower access to education than children from richer households. For example, children in the top decile are twice as likely to be enrolled in secondary school than children in the bottom decile. Given the strong correlation between education and poverty rates, lack of access for poor children is likely to transmit poverty across generations.



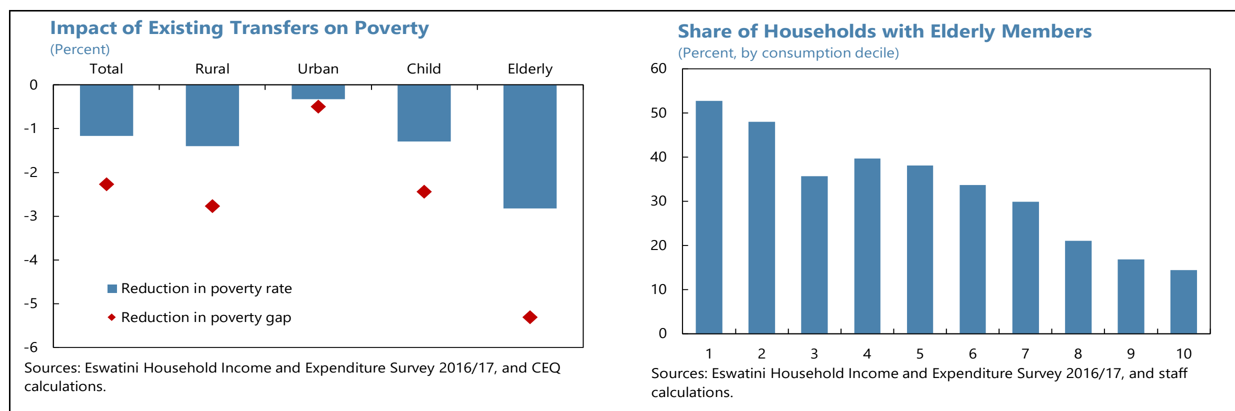
Sources: Eswatini Houshold Income and Expenditure Survey 2016/17, and staff calculations

B. The Role of Fiscal Policy

8. Despite widespread poverty, Eswatini's spending on social cash transfers is low relative to other SACU countries, and it has limited impact on poverty rates. In FY2016/17, Eswatini spent about 0.6 percent of GDP on cash transfers, much less than in Namibia (2 percent of GDP) and Lesotho (4.5 percent GDP). Two programs accounted for about 90 percent of these transfers: The old age grant (OAG) and the Orphans and Vulnerable Children (OVC) Education Grant. The old age grant is a near-universal program, which in FY 2016/17 gave E240 per month to citizens above the age of sixty.[7] The OVC Education Grant contributes towards the cost of secondary education for

[7] In FY 2017/18, the old age grant was raised to E400/month.

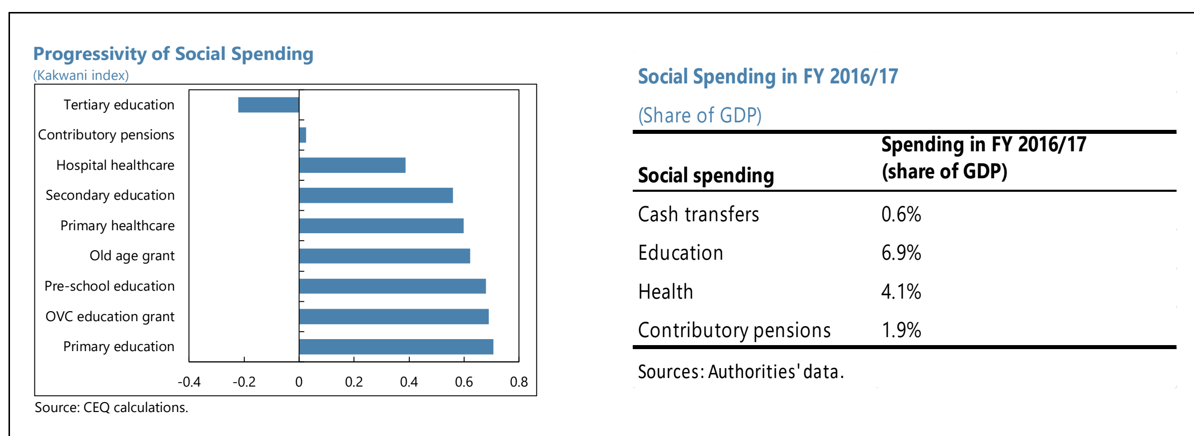
eligible children. These transfers reduce poverty only by about one percentage point (with the old age grant having the biggest impact), and even their effects on the targeted groups are relatively small. For example, these transfers reduce elderly poverty rate and poverty gap by 2.8 percentage points (to 74 percent) and by 5.3 percentage points (to 33 percent) respectively. The existing programs give benefits to many non-poor households, and at the same time miss most of the poor households. For example, about one-third of the households receiving the old age grant are not poor. At the same time, about sixty percent of poor households do not benefit from the grant as they do not contain elderly members.



Sources: Eswatini Household Income and Expenditure Survey 2016/17, and CEQ calculations.

Sources: Eswatini Household Income and Expenditure Survey 2016/17, and staff calculations.

9. Social spending, including education and health, is large and broadly progressive. In FY 2016/17, Eswatini spent over 13 percent of GDP on education, health, pensions and cash transfers. As measured by the Kakwani index, spending on education, health, pensions and transfers were progressive, with only tertiary education spending being regressive. However, the effectiveness of the spending is likely reduced by the large share taken up by the wage bill.



Source: CEQ calculations.

Social Spending in FY 2016/17

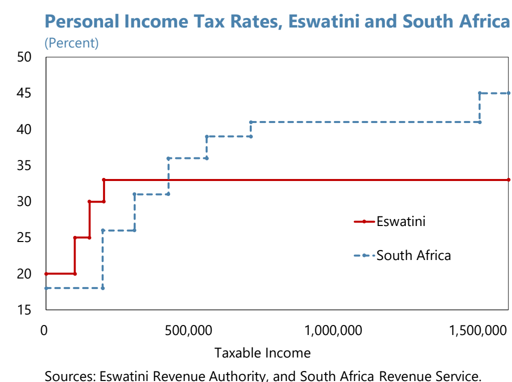
(Share of GDP)

Social spending	**Spending in FY 2016/17 (share of GDP)**
Cash transfers	0.6%
Education	6.9%
Health	4.1%
Contributory pensions	1.9%

Sources: Authorities' data.

10. The personal income tax provides some progressivity to the tax side, although less so than in neighboring South Africa. The top tax rate is 33 percent and applies to incomes above E200,000. Although South Africa imposes a lower rate of 26 percent for incomes of 200,000 Rands, it has several additional brackets and the maximum rate is 45 percent.[8] Marginal rates on income earners with taxable income above E500,000, who are responsible for about one-third of the revenue collected by the tax, are lower in Eswatini than in South Africa.

Personal Income Tax Rates, Eswatini and South Africa
(Percent)



Sources: Eswatini Revenue Authority, and South Africa Revenue Service.

C. Strengthening the Impact of Fiscal Policy on Poverty and Inequality

11. Scaling up the old age grant and, over time, improving its targeting, are likely the most effective ways of increasing the poverty impact of the existing transfer system.[9] In FY 2017/18, the old age grant was increased from E240/month to E400/month, which raised the cost of the program by about 0.2 percent of GDP and is estimated to have reduced overall poverty rate to 58.1 percent (from 58.9 percent) and the elderly poverty rate to 71.7 percent (from 74.3 percent). Further increasing the old age grant to E600/month could reduce overall poverty to 57.1 percent, and the elderly poverty rate to 68.6 percent, at the additional cost of about 0.3 percent of GDP (raising total spending on cash transfers to 1.1 percent of GDP). Targeting the old age transfers to poor pensioners would improve its impact and reduce poverty to 56 percent, but doing so will require developing new administrative capacity and may take time.

12. A cash grant to households with children would cover most of the poor households and better address the issue of childhood poverty and possibly education access. Simulations suggest that, for example, rather than increasing the old age grant, replacing it with a universal cash grant to households with children (E200/month per child) would cover more poor households, and reduce childhood poverty rates, while yielding similar overall poverty rates and the same fiscal cost as the old age grant. Under the new grant, even though the OAG is eliminated, the impact on elderly poverty would be mitigated, since many elderly poor live with children and would indirectly benefit from the child grant. Targeting the child grant would amplify its benefits. In this respect, targeting poor households with children may be easier to implement as the authorities have recently performed a pilot study using proxy means testing to target poor children.[10]

13. A mixed system, combining targeted old age and child cash grant could substantially reduce poverty and inequality, but targeting will be necessary to control costs. A targeted mixed system that gives E400/month to the elderly and E200/month to children, living below

[8] The Emalangeni is pegged at parity to the South African Rand.

[9] The OVC Education Grant is estimated to have a limited impact on current poverty rates. However, scaling up that program could help reduce the gap in secondary enrollment rates between children from poor and rich households, and reduce poverty in the long term.

[10] Eswatini recently concluded a cash grant pilot for OVCs, but have yet to decide whether to introduce a permanent program.

110 percent of the poverty line, would leave both groups substantially better off. This program is estimated to reduce overall poverty to 55.9 percent, childhood poverty to 64.5 percent, and elderly poverty to 70.9 percent. Although the cost of such a system would be about 1.4 percent of GDP, Eswatini would still be spending significantly less than its neighbors.

Table A4.1. Eswatini: Fiscal Cost, and Impact on Poverty and Inequality of Policy Reforms

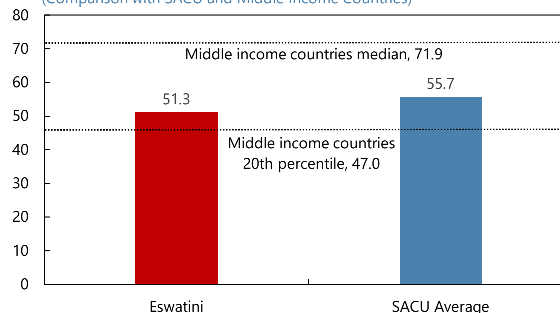
	Total cost of cash transfers (share of GDP)	Gini coefficient	Overall poverty rate	Childhood poverty rate	Elderly poverty rate
System as of FY 2016/17	*0.6*	*49.3*	*58.9*	*68.9*	*74.3*
Increase universal old age grants to E400/month (implemented)	*0.8*	*48.8*	*58.1*	*67.9*	*71.7*
Increase universal old age grants to E600/month	1.1	48.4	57.0	67.2	68.6
Replace old age grants with an universal child cash grant of E200/month	1.1	48.3	57.1	65.7	74.5
Targeted transfers to the poor: old age grant of E400/month and child cash grant of E200/month	1.2	46.7	55.9	64.5	70.9

Sources: Authorities' data, and CEQ simulations.

14. There is room to increasing the progressivity of the personal income tax to yield additional revenue, while marginally reducing inequality. The personal income tax could be made more progressive by raising the rate on incomes above E200,000 from the current rate of 33 percent. As an example, raising the marginal rate for incomes between E200,000 – E400,000 to 38 percent, and raising the marginal rate for incomes above E400,000 to 43 percent could raise about 0.4 percent of GDP in additional revenue while slightly reducing the Gini coefficient (by about 0.1 point).

15. In the long term, improving access to secondary education will be critical to reducing poverty. Eswatini has achieved near-universal primary school enrollment through offering free access. However, while the government spend about 7 percent of GDP on education (FY 2016/17), its net secondary school enrollment rate is only 51 percent, placing the country at the 20th percentile of middle-income countries, below the SACU average of 56 percent and substantially lower than the middle-income median of 72 percent. Furthermore, the much lower enrollment rates for children from poorer households is likely to transmit poverty across generations. In the medium term, facilitating access to secondary education would help close the gap between Eswatini and its peers.

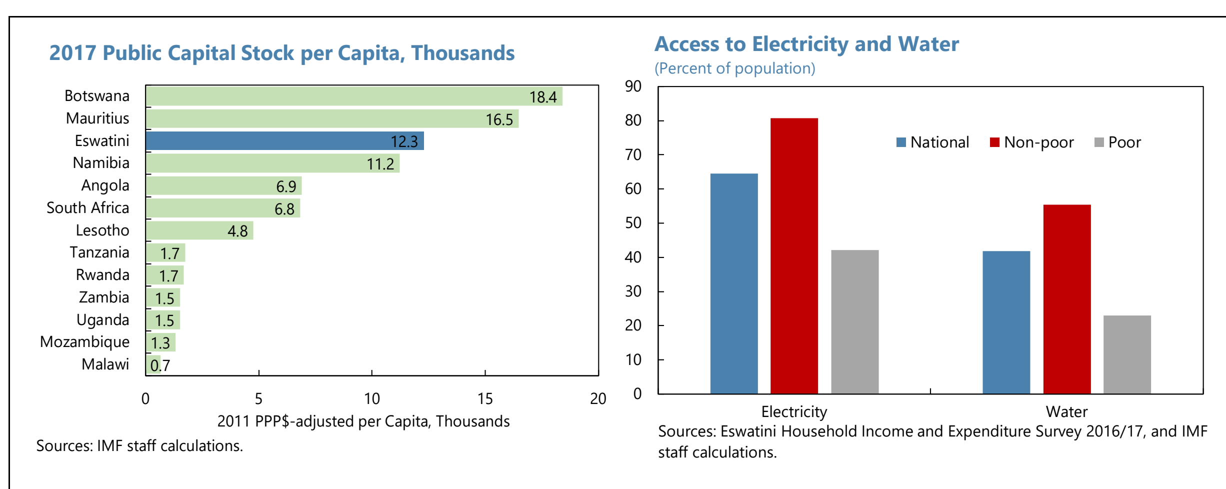
Net Secondary School Enrollment
(Comparison with SACU and Middle Income Countries)



Note: Latest available data for each country.
Sources: Eswatini Household Income and Expenditure Survey 2016/17, World Development Indicators.

Annex V. Strengthening Public Investment[1,2]

1. **Eswatini has one of the highest levels of per capita public capital relative to peer countries, although access to some key service remain low.** This reflects sizable public investment over the years. The 2019 National Development Plan has an ambitious agenda to further scale-up public investment. Nevertheless, Eswatini performs modestly relative to its neighbors in terms of access and the perceived quality of infrastructure in key sectors such as electricity and water. Only 65 percent of the population has access to electricity, with only 42 percent of poor households having access to power. Moreover, Eswatini has one of the highest prices for electricity in the SACU. Access to water averages 42 percent nationally, with only 22 percent of poor households having access. Moreover, overall service delivery is weak, particularly in sectors such as healthcare and education.



Sources: IMF staff calculations.

Sources: Eswatini Household Income and Expenditure Survey 2016/17, and IMF staff calculations.

2. **The quality of public investment management (PIM) suffers from various weaknesses across the investment cycle**. On the IMF's overall indicator of public investment efficiency, Eswatini's estimated efficiency gap is 35 percent, broadly in line with the SSA average but slightly worse than the rest of SACU. Weakness across the spectrum of the public investment process contribute to the relatively low efficiency:

- ***Weak governance undermines investment planning and selection***. There is an absence of rigorous formal appraisal of projects prior to their inclusion in the budget. This also applies to some of the largest projects being implemented and creates uncertainty about their viability. Moreover, there are no explicit and transparent criteria for project prioritization, including some of the costliest projects currently ongoing.

- ***Financial and technical constraints hinder resource allocation***. Public spending has been consistently under-executed, reflecting both technical capacity challenges and fiscal

[1] Prepared by V. Thakoor.

[2] The annex reflects findings from a recently conducted Public Investment Management Assessment (PIMA).

constraints. The absence of multi-year budgets creates cash constraints, frequently disrupting project implementation. Various stalled projects saddle the budget and no resources have been identified to enable their completion. The diversion of resources across projects also slows down project implementation.

- ***Poor project management leads to implementation hurdles.*** No single entity is tasked with responsibility for overseeing the entire portfolio of projects, with project management and supervision fragmented across different line ministries. Procurement, contracting, and contract management arrangements appear not to offer adequate protection from project scope revisions and project cost escalations. Projects suffer from steep but unexplained escalation in their total cost, resource unavailability, and lack of clarity on the optimal path with which to proceed.

3. With no fiscal space and low investment efficiency, emphasis needs to be placed on improving efficiency of investment to secure value for money and better service delivery. Comprehensive institutional reforms are thus needed with a view to:

- ***Strengthen project appraisal and selection***. There is a need to develop dedicated PIM regulation, on project appraisal, prioritization and selection, and roles and responsibilities of key stakeholders. PPP projects should await the implementation of a PPP framework, while implementation capacities need to be strengthened. A unit must be established within the Ministry of Economic Planning and Development (MEPD) for administering the PIM regulations and guidelines, overseeing implementation, performing the screening function, and overseeing the projects portfolio.

- ***Improve public procurement and contracting, and project oversight***. Government procurement and contract arrangements need to be reviewed to offer greater protection from, and to disincentivize, project cost adjustment and ensure timely completion of projects. The role of the Ministry of Economic Planning and Development (MEPD) as an implementer of projects should be discontinued with the Public Works and Transport (MPWT) and other ministries, departments, or agencies carrying implementation duties.

- ***Improve budget financing framework and review resource allocation to current projects***. Address weaknesses in the budget framework by credibly allocating resource to capital projects over time would allow the budget to credibly allocate resources to priority capital spending. A comprehensive review and reprioritization of the current investment portfolio is needed to identify projects for postponement or cancellation, to allow more resources to be assigned to priority projects that can be efficiently implemented, and completed.

Annex VI. Designing an Effective and Transparent Arrears Clearance Strategy[1]

1. Since 2016, Eswatini central government has been experiencing a significant build-up in unpaid invoices and the accumulation of domestic arrears that should be cleared. The central government's stock of arrears had mothballed to around 7 percent of GDP in March 2019. Arrears accumulation reflected the combined effects of expansionary budget policies which were not fully financed, and weaknesses in the budgetary process and expenditure controls, which contributed to widening financing shortfalls. With budget financing issues deepening over time, the arrears problem has extended beyond the central government, including public entities and enterprises and local governments (with a stock of arrears estimated at 2 percent of GDP), including arrears across government entities. As part of the government's fiscal adjustment plans to restore fiscal sustainability, a transparent strategy to clear existing arrears should be developed.

2. A pre-condition to embark on an arrear clearance strategy is to put in place actions that control and prevent the accumulation of new arrears. Avoiding the accumulation of new arrears is essential to prevent that the clearance becomes a rolling over process. In Eswatini, this requires improving both the budget formulation and execution processes, as well as addressing arrears accumulation outside the central government (i.e., public entities and enterprises). On budget formulation, annual budgets should provide realistic spending estimates, cover special funds and trading accounts, and be fully financed. Introducing the need for the ministry of finance to authorize the signature of high value contracts can also strengthen the budget. On budget execution, commitment controls within the standard spending execution have to be strengthened, eliminating expenditures processed outside the standard PFM channels, and individual and institution sanctions for violators should be enforced. Accounting and institutional oversight needs to be enhanced to ensure rules are observed. Finally, tighter controls on budget execution of extrabudgetary entities and public enterprises and effective penalties for violations need to be set up to prevent arrears outside the central government.

3. Based on cross-country experience, once arrear accumulation is under control, an effective arrears clearance strategy needs to follow a sequence of steps and principles:

- ***Comprehensive stock-taking.*** The first step of a clearance strategy is taking stock of the existing unpaid invoices and commitments and define the size of the problem to be addressed. Line ministries should be held responsible for the completeness of arrears data for both the ministry and its subordinate extrabudgetary public entities and enterprises. The stock-taking process should be timebound with cut-off dates for reporting, and sanctions for non-reporting or incomplete reporting should be announced and enforced. Status of limitation for claims not reported on time could be introduced as needed. The recently

[1] For details on how to design arrears clearance strategies, see IMF, Prevention and Management of Government Expenditure Arrears, 2014 (https://www.imf.org/external/pubs/ft/tnm/2014/tnm1403.pdf). For Eswatini, see recent IMF TA report, Chaponda et. al. (April 2017), Y. Koshima et. al. (September 2017), and F. Rahim et. al. (August 2018).

introduced Invoice Tracking System (ITS) can help identify unpaid bills from Ministries, Departments, and Agencies (MDAs), if the ITS is comprehensively populated. A process to identify arrears from public enterprises, other public entities, special funds, trading accounts (e.g. CTA), and local authorities needs to be separately defined.

- ***Claim verification.*** Claims should be verified and legally endorsed to contain risks of fraud and duplication of payments. In Eswatini, central government's unpaid bills pending before the Treasury Department (processed through the Treasury Accounting System) have an established verification process. However, in case of uncertainty, external audits of ministries generating significant arrears could be undertaken to verify the completeness of reported liabilities. A verification process needs to be established for entities outside the central government, such as trading accounts, local authorities, and claims not processed via the treasury department.

- ***Transparent repayment plans with clear prioritization.*** The repayment process needs to be transparent, with a clear prioritization in the order of payments to guarantee stakeholders that the clearance process is robust and fair and without undue interferences. Various prioritization criteria for repayment could be adopted, including: age profile, risks of penalties or possible legal actions, socio-economic risks, and disruption of critical ongoing projects.

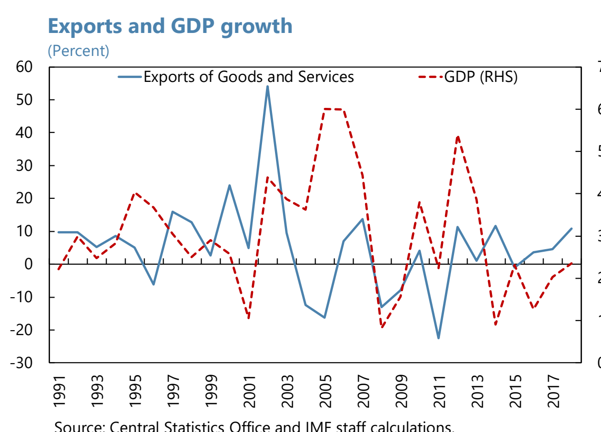
- ***Liquidation through the budget.*** Financing the clearance of arrears should be part of the standard budget process and arrears should be paid out of budget financing. Securitization options to pay existing arrears should be considered carefully as they create interest costs and increase financing needs in the future as securities mature, complicating debt management.

4. Finally, Cabinet approval of any strategy is a key step to ensure the comprehensiveness, transparency, and credibility of the arrear's clearance process.

Annex VII. Trade, Export Competitiveness and Growth[1]

Over the last two decades, export performance in Eswatini has been deteriorating, and diversification of the export base and trading partners has narrowed. These trends reflect declining competitiveness. Underpinning the decline in external competitiveness are a rising price differential with South Africa, fast-rising and higher wage costs than peers, particularly for skilled workers, high inputs costs in network industries (i.e., electricity, telecommunications), weaknesses in business conditions and high border costs for exports to Eswatini's main trade partners.

1. Growth in Eswatini is closely associated with exports performance, and the recent ratification of the AfCFTA is an occasion to assess the country's competitiveness and its support to growth. Exports are usually among the major drivers of growth in small and open economies and Eswatini has been no exception. Since the early nineties, changes in GDP growth in Eswatini have been largely accompanied by changes in export growth.[2] In recent years, the growth rate of exports has halved compared to the early 2000s (10 percent between 2000-2006) and has been associated with weaker GDP growth which has also halved over the same period (3.8 percent between 2000-2006). The recently ratified African Free Trade Area (AfCFTA) is a major step towards trade integration in the continent and may offer to the country an opportunity to strengthen exports and reignite growth. Specifically, the AfCFTA envisages eliminating tariffs on traded goods, liberalizing trade services, and addressing non-tariff barriers. In this respect, it may support a return for Eswatini to the higher GDP growth rates experienced in the past.



A. Declining External Competitiveness

2. Over the last two decades, exports performance in Eswatini have been declining, reflecting negatively on GDP growth. Exports of goods and services have halved from about 78 percent of GDP in the early 2000s, a time when global trade was booming and commodity prices were high, to 40 percent of GDP in 2018. As a result, unlike peer middle income countries, Eswatini's trade volumes have not kept up with global trends, resulting in a loss of share in global markets. Exports of services have similarly experienced a loss of market share and a trend decline, representing 1.5 percent of GDP in 2018 (about 10 percent of GDP in the early 2000s). The contribution of exports to growth is much lower from an average 3.2 percent during the 1990s and 2000s to 0.35 percent contribution during 2010-2017.

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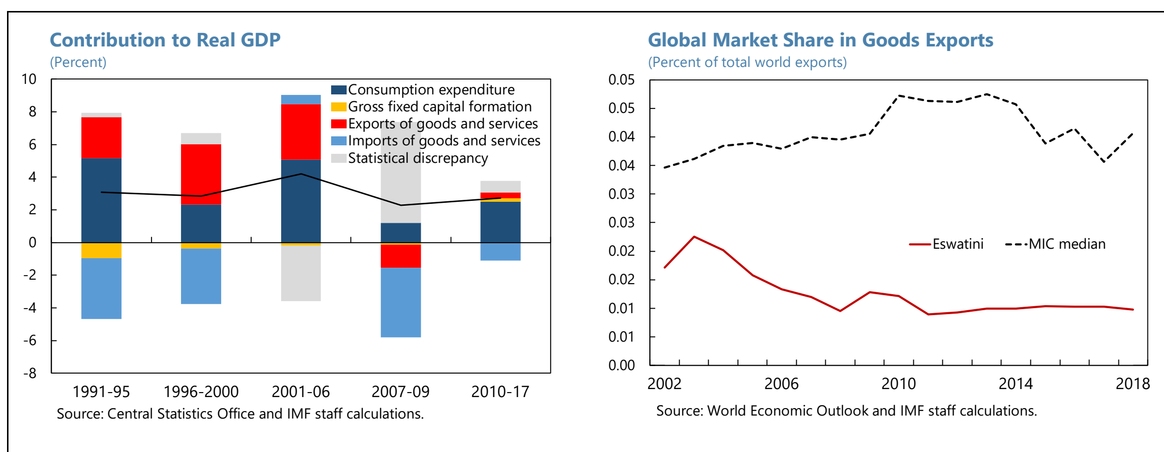
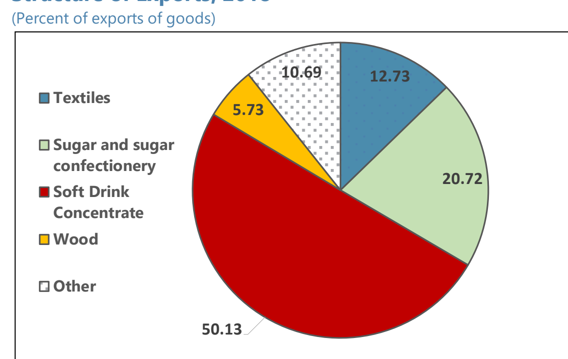
[1] Prepared by P. Ganum.

[2] Growth accelerations/decelerations are defined as structural breaks in the growth pattern.



3. Eswatini's export base has also narrowed and become less diversified, increasingly dominated by exports from a few traditional sectors. Up to 2008, exports were relatively diversified and of good quality and Eswatini was among the more diversified product exporters in Sub-Saharan Africa (measured by a Theil diversification index) and the quality level (measured by the unit value of exports) was higher than the average of African countries (see SM/15/354 report for details). In recent years, export diversification has, however, declined. Exports have increasingly been dominated by few items and there has been little increase in new products. Today, about 90 percent of exports are concentrated in four manufactured goods from traditional sectors: soft drink concentrate, sugar, textiles, and wood manufacturing. In particular, soft-drink concentrate accounts for half of goods exports in 2018 (compared to 33 percent in 2000).

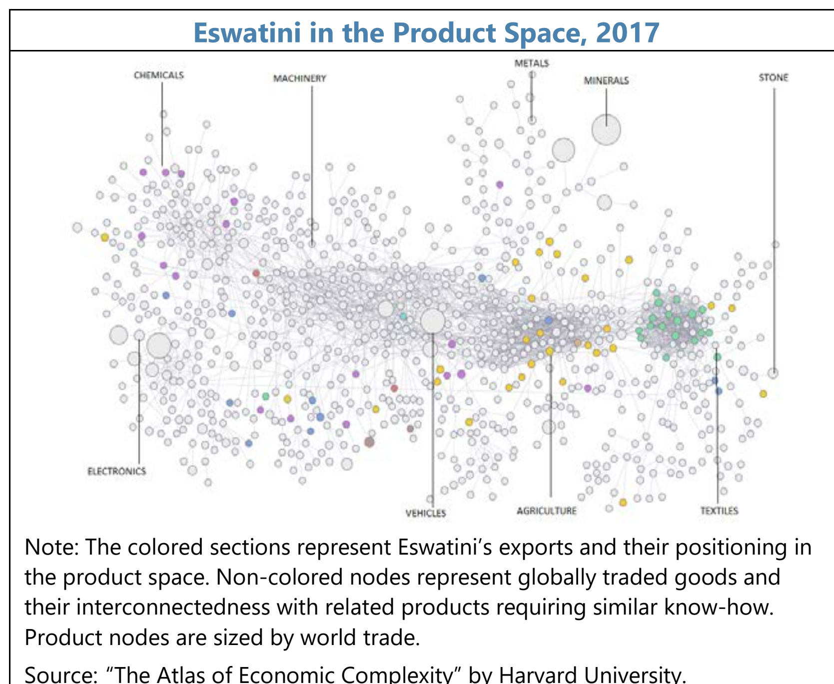


Sources: Central Bank of Eswatini and IMF staff estimations.

4. As a reflection, Eswatini's exports positioning in the product space carry limited opportunities for product development and diversification.[3] Eswatini's exports (represented by the colored sections in the graph) are mainly positioned at the periphery of the product space (agricultural, textile, and soft-drink concentrate), indicating that, based on the connectedness between existing products and related products requiring similar know-how, there are limited opportunities for further product development leveraging current know-how. Further diversification based on know-how would require positioning in the dense middle as this offers opportunities to export other products with similar production processes.

[3] The product space network analysis represents the relatedness of over 800 traded goods based on the connectedness between existing products and related products requiring similar know-how, and its shape helps define paths to diversify exports. For more details see "The Atlas of Economic Complexity" by Harvard University: http://atlas.cid.harvard.edu/

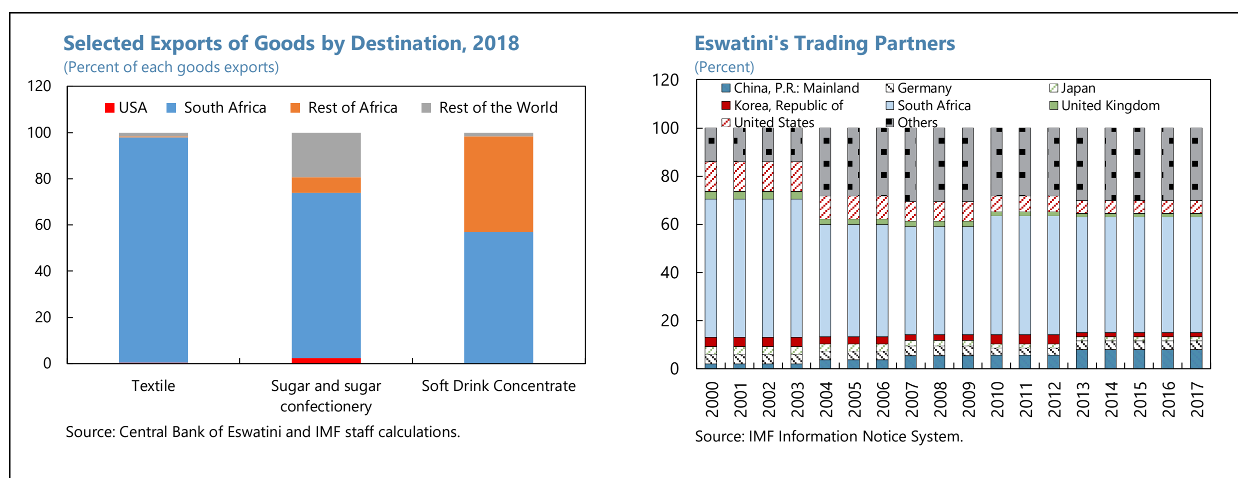
Eswatini in the Product Space, 2017



Note: The colored sections represent Eswatini's exports and their positioning in the product space. Non-colored nodes represent globally traded goods and their interconnectedness with related products requiring similar know-how. Product nodes are sized by world trade.

Source: "The Atlas of Economic Complexity" by Harvard University.

5. Export concentration, compounded with a concentration in trading partners, suggests that the country has been unable to take advantage of its various trade agreements. Despite numerous trade agreements, including the Southern Africa Customs Union (SACU), the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and with the European Union (EPA) and the United States (AGOA), among other regional bodies, about half of total trade is conducted with South Africa. Major commodities, such as sugar, textiles, and soft-drink concentrate are destined to South Africa. This increases the trade sector's dependence on its neighbor's performance. Other trade agreements such as the African Growth and Opportunities Act (AGOA), which gives Eswatini preferential access to US markets are not being exploited beyond textiles[4].

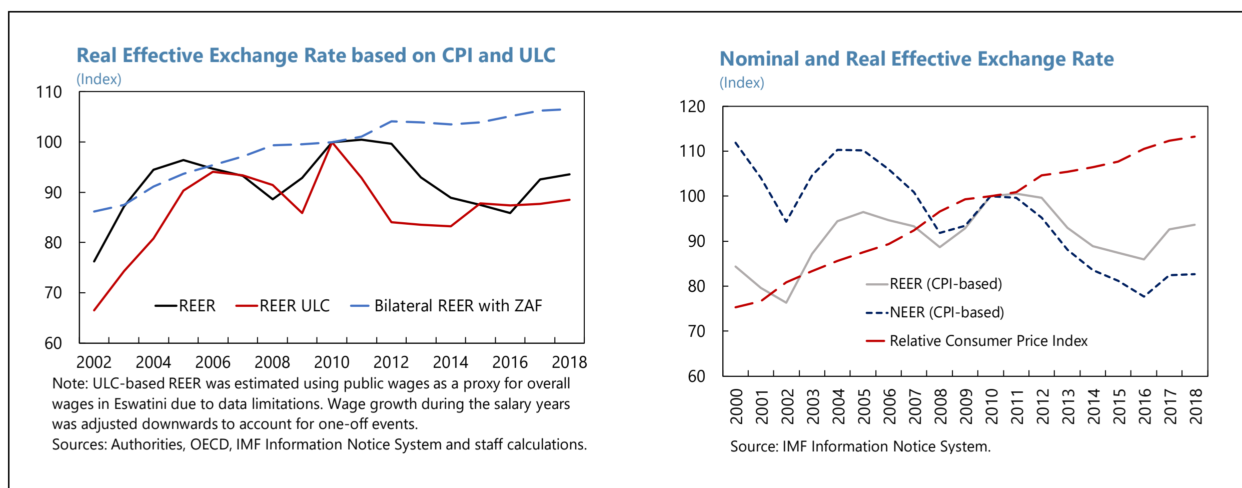


[4] Although, Eswatini lost AGOA eligibility in 2014 leading to a replacement of the US market as a destination for textile products with South Africa.

B. Factors Hindering Export Competitiveness

Appreciating Real Effective Exchange Rates (REER)

6. Despite the nominal exchange rate has been depreciating over the last two decades, the country has been losing price competitiveness vis-a-vis its trade partners. The standard CPI-based REER has remained broadly constant over the last two decades, signaling that the nominal depreciation of the exchange rate has not translated in competitiveness gains because of a rising price differential in Eswatini compared to its trading partners. Given the large share of trade with South Africa, an important indicator of price competitiveness for Eswatini is the bilateral REER with South Africa. Unlike the general REER, the REER with respect to South Africa has been appreciating by 22 percent since the 2000s, reflecting an adverse inflation differential (since there is no exchange rate effect). Price competitiveness has been declining compared to other trade partners too because of a differential in wage growth. Indeed, Eswatini's REER deflated using unit-labor costs has been appreciating by 33 percent since 2002.[5]



Higher Labor Costs

7. Labor costs for skilled workers have been rising fast and their wages are now higher than in peer countries, together with a widening wage-productivity gap (Figure A7.1). According to the 2016 Labor Force Survey, over the period 2013-16, nominal salaries increased well above the inflation rate, rising on average 11 percent each year across all occupations. Following the fast increases in public sector wages, which almost doubled in three years, nominal wages increased significantly in several industries including trade (19 percent), manufacturing (8 percent), and agriculture (9 percent). Fast-growing salaries have resulted in Eswatini having relatively higher wages compared to other African and lower-middle income countries (LMICs) for high skilled

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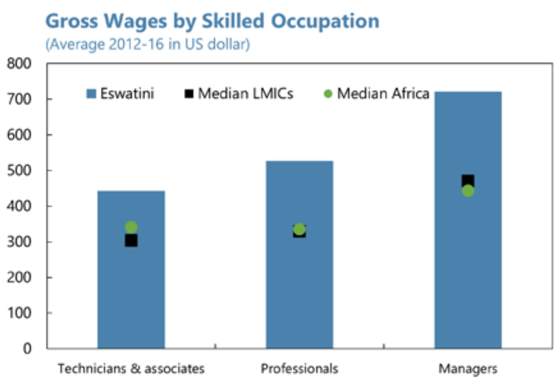
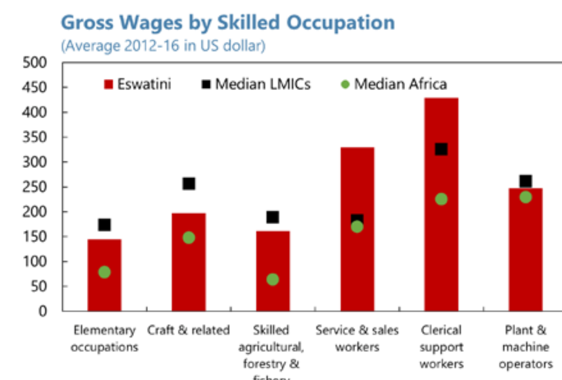
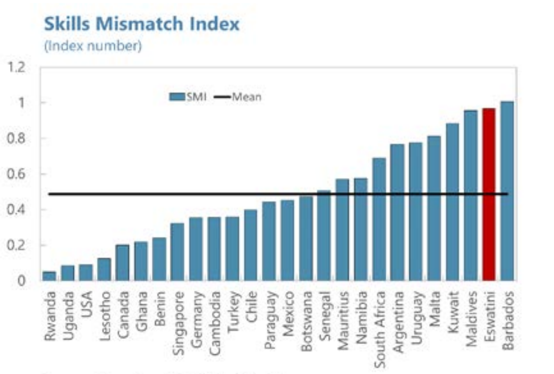
[5] Typically, REER deflated by labor costs is estimated using economy-wide measures of the unit labor cost (labor compensation and output). However, due to data limitations, public wages are used to proxy for overall wage level and have been adjusted downwards accounting for one-off increases during salary review years. In the context of a small economy like Eswatini, the government is a large employer and public employment constitutes about 46 of formal employment.

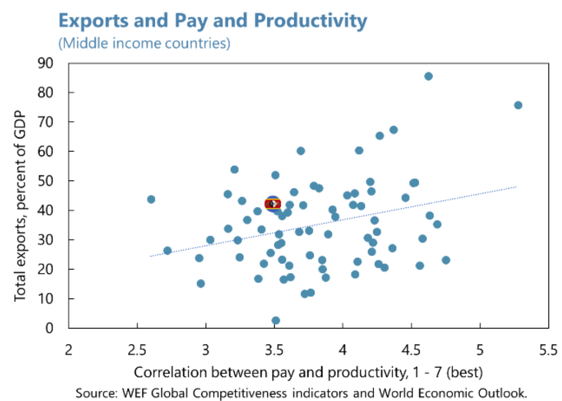
(e.g. professionals, managers, and technicians) and mid-skilled labor (e.g. sale workers and clerical workers). In this context, the gap between wage and productivity dynamics has widened and contributed to erode further Eswatini's competitiveness edge.

Figure A7.1. Eswatini: Wages by Occupation and Industry, and Skills Mismatch





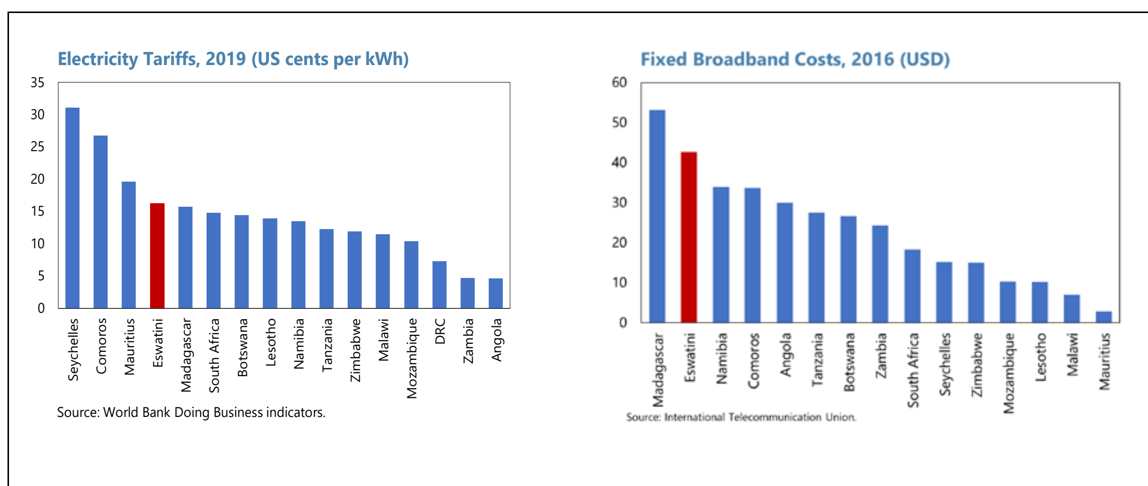




8. Apart from fast rising public sector wages, the high wage premium for skilled workers reflects, among others, skills mismatches in the labor market. Eswatini has very high skill mismatches in the labor market.[6] These mismatches contribute to the high unemployment rates for the lower skilled workers (e.g. elementary occupations, crafts, skilled agriculture, and plant operators), who also have more competitive wages compared to LMICs. [7] However, the relatively lower supply of skilled workers contributes to higher wage costs for skilled workers, particularly for high skilled occupations in the public sector, followed by professionals, education sector and financial sector workers. Thus, shortages of skills in the labor market and recent increases in public sector wages may explain pressures on overall wages and contributes to rising unit labor costs.

Costly Production Inputs: Electricity and Telecommunications

9. The cost of electricity in Eswatini is among the highest in the SADC region, hindering firms' profitability and competitiveness. In Eswatini, electricity tariffs are cost-reflective and in recent years they have been rising fast. Electricity tariffs are now among the highest in the SADC at 16.2 US cents per kWh (Table A7.1). Underpinning the high electricity costs are high generation costs, contributing to 60 percent of total tariffs (ESERA cost of supply study, 2018) coupled with a monopoly market structure that prevents competitive price setting. Electricity supply is mainly covered by imports (about 70 percent), mostly from South Africa and Mozambique. The state-owned enterprise Eswatini Electricity Company (EEC) owns the monopoly on the transmission and distribution of electricity and has a dominant position in the local electricity production. Cognizant of these challenges, the authorities have started to deregulate the generation segment of the electricity sector, and the construction of an independent power producers (IPP) solar generation plant has recently started.



Source: World Bank Doing Business indicators.

Source: International Telecommunication Union.

[6] For more details on skills mismatches in Eswatini's labor market see IMF Country Paper SM/17/221 "Investment, employment, and inclusive growth in Swaziland".

[7] The 2016 Labor Force Survey showed that about 90 percent of the unemployed have up to secondary education or a lower education level. While those that have completed tertiary education represent only 7.6 percent of the unemployed.

10. Relatively high telecommunications costs also contribute to hamper the country's competitiveness. Following efforts by the regulator (ESCCOM) to reduce prices in the ICT sector and the licensing of a new mobile operator, mobile phone per minute tariffs have recently declined, but they are still 50 percent higher than in neighboring South Africa. Similarly, internet data charges are the second highest in SSA (ESCCOM report, 2016), while internet service provision stands at only 32 percent of the population.[8] Moreover, the number of households' fixed broadband connections is very low, and data costs are among the highest in the SADC (Table A7.1 and figure).[9]

11. High communications costs reflect a still weak market regulatory framework. While there are no regulations restricting access to the market, by national mandate, the EPTC, which owns the network infrastructure, sets the price for its use to both internet service providers and mobile operators. In addition, Eswatini has no immediate access to an international gateway and internet service providers must purchase capacity in neighbor countries, which partly contributes to high costs. Cognizant of these challenges, the authorities are considering liberalizing the sector by unbundling the EPTC into three separate and independent entities, separating the management of the network and encouraging competition in the fixed and mobile markets. However, progress on these plans has so far been slow and the regulator's efforts to address the issues regarding accessing infrastructure need to be accelerated and its powers strengthened to ensure the cost and ease of sharing the facilities do not discourage competition and pose barriers of entry.

Table A7.1. Eswatini: Cost of Local Inputs and Trade

	Electricity Tariff (US cents per kWh, 2019)		Fixed Broadband (USD, 2016)		Customs Compliance (Export, USD, 2018)		Customs Compliance (Import, USD, 2018)	
Eswatini	16.2	4	42.62	2	210		210	
Angola	4.6		29.92		1065		1490	3
Botswana	14.4		26.61		496		165	
Comoros	26.8	2	33.73		775		858	
Congo, Dem. Rep	7.3		N/A		2723	1	3804	1
Lesotho	13.9		10.20		240		240	
Madagascar	15.7		53.20	1	985		745	
Malawi	11.5		7.00		585		305	
Mauritius	19.6	3	2.81		431		538	
Mozambique	10.4		10.31		762		459	
Namibia	13.5		33.92	3	1093		208	
Seychelles	31.1	1	15.11		447		434	
South Africa	14.8		18.29		1312	3	749	
Tanzania	12.3		27.56		1435	2	1725	2
Zambia	4.7		24.24		570		555	
Zimbabwe	11.9		15.00		455		712	

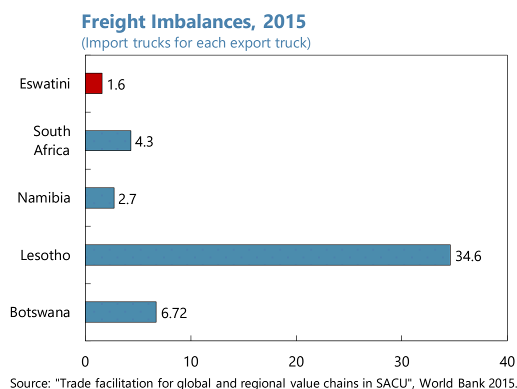
Source: World Bank Doing Business Indicators, International Telecommunication Union.

[8] See 2018 Annual Report, Eswatini Communications Commission (ESCCOM).

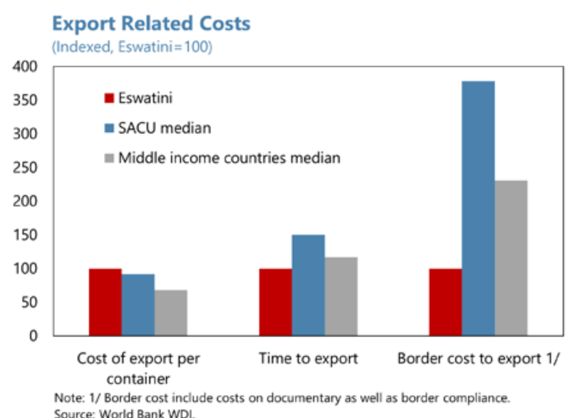
[9] For importance of the ICT sector in lower information and transaction costs for firms see "Digital Dividends", World Bank 2016.

Non-tariff Trade Costs and Business Environment

12. Eswatini has good quality road infrastructure and freight imbalances do not seem to be an issue. In a landlocked country like Eswatini, transport infrastructure is key to improve trade integration. The country has overall good quality road infrastructure, which is the preferred mode of transportation for regional trade. In addition, given Eswatini's large trade with South Africa (both imports and exports), the country seems to have more efficient trucking use compared to other SACU countries. Typically, transporters in peer SACU countries may need to charge the client for the full return trip to cover the empty return leg of the trip, given the large imbalances in trade with South Africa. However, limited data availability on transport costs in Eswatini prevent analyzing whether transport costs could be improved.



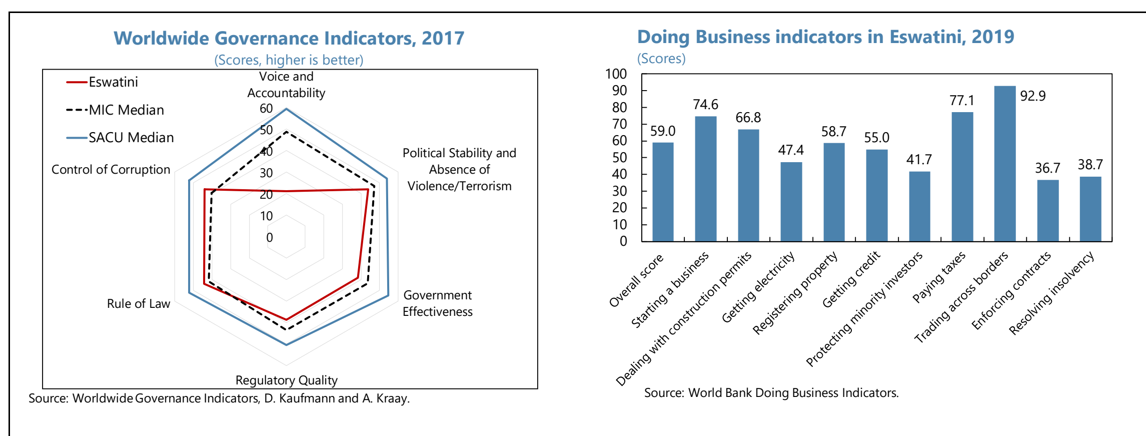
13. Eswatini ranks well in trading across borders, but customs compliance costs across the border and lack of harmonization in procedures are not negligible. While border cost to export (measured by documentary and border compliance costs) are lower than other SACU countries, South Africa's higher border costs weigh on the total cost exporters face when trading goods with its neighbor. In addition, the cost to export per container in Eswatini is higher than the SACU median and middle-income countries and remains high in global terms. Border clearance time is efficient and time to export is lower than peers, but lack of harmonization in standard procedures, particularly between the SACU and the SADC, represents a concern for firms[10].



14. The business environment has become increasingly costlier to navigate, and governance weaknesses have risen. Excessive regulation and levies, weaknesses in government effectiveness, a slow process to start a business, and weaknesses and delays in enforcing contracts are harming Eswatini firms and the country competitiveness. In 2019, Eswatini ranked 117 of 190 countries in the World Bank Doing Business indicators with weaker performance in getting electricity, enforcement of contracts, starting a business and registering property. Regulatory challenges related to excessive regulation and fees are the biggest challenge reported by companies in surveys. These are challenges affecting the country's competitiveness for new and existing businesses. In addition, the country's governance indicators have been structurally low and worse than peer SACU countries hindered by limited control of corruption, which contributes to the cost of

[10] See "Trade Facilitation for Global and Regional Value Chains in SACU", World Bank, 2015.

doing business. Cognizant of these weaknesses, authorities have placed strengthening governance and improving the business climate as key priorities in the Strategic Roadmap.



C. Conclusions and Policy Recommendations

15. Several indicators point to eroding competitiveness. Exports as a percent of GDP have halved during the last two decades, and the export base and trading partners have become more concentrated. In addition, appreciating exchanges rate vis-à-vis South Africa and as measured by ULC have made Eswatini's exports less competitive. Relatively higher labor costs and production costs, and a costly business environment hinder competitiveness.

16. Boosting export competitiveness and the role that exports may play in the Eswatini development require reforms focused on:

- *Reducing the cost of electricity and communications services.* Addressing the causes underlying high electricity and communications costs, including by promoting private sector participation, access to infrastructure, and private sector investment in new technologies would contribute to reduce the cost of key production inputs, secure better electricity supply and higher speed on internet service, with positive effects on the country's competitiveness.

- *Improving the availability of skilled workers and containing public and private sector wage dynamics.* Alleviating shortages of skills in the short-term, by easing restrictions on work permits, and over time, by strengthening high education outcomes and training, would contribute to release pressure in the labor market for skilled workers. Containing growth in public sector wages and facilitating the adoption of more flexible wage policies in the private sector would contribute to more competitive labor costs dynamics and reduce the disconnect between wages and productivity and improve competitiveness.

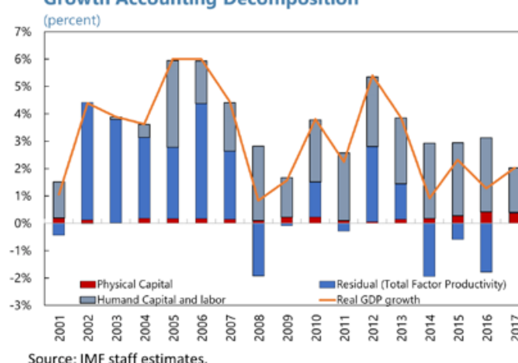
- *Taking advantage of regional trade integration and harmonizing documents and border procedures.* The authorities should work on leveraging the new AfCFTA area, and take advantage of Eswatini's vast trading agreements and preferential access to the EU and the US, to diversify exports destinations and widen products export bases.

- *Strengthening governance and improving the business environment.* Reforms to reduce vulnerabilities to corruption (e.g. strengthening the anti-corruption framework) and streamlining business regulations (e.g. ease of starting businesses, lowering compliance costs, and trading license requirements) would contribute to improve business conditions and lower costs of doing business in the country.

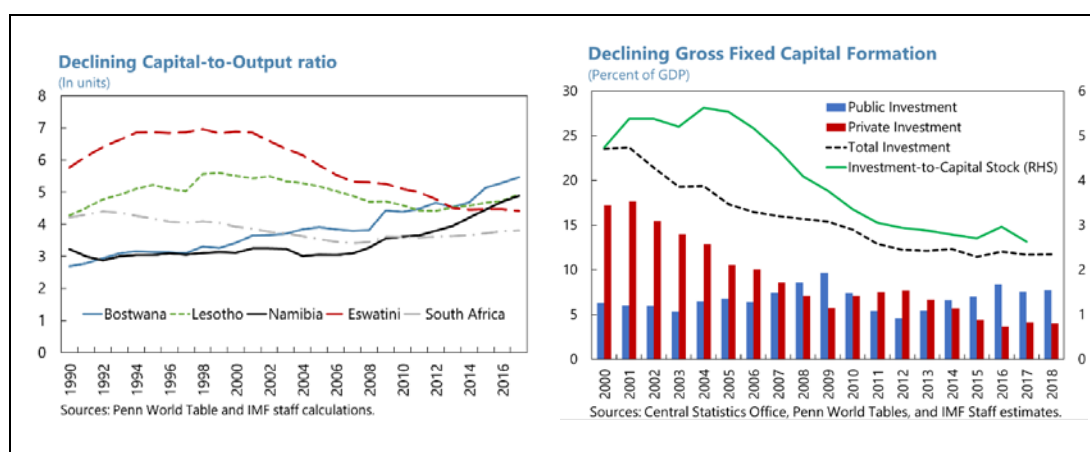
Annex VIII. Supply-Side and Governance Reforms to Reignite Growth[1]

Over the past decade, Eswatini has experienced weak growth hindered by a steady decline in private investment and declining productivity growth. Factors underlying the decline in private investment are governance weaknesses, inefficiencies in the regulatory framework for product markets, and weaknesses in the labor market, and a challenging business environment. Structural reforms that aim to relax these constraints could contribute to reignite growth by about 1⅓-2 percent.

1. Over the past decade, growth in Eswatini has been subdued due to decelerating private investment and declining productivity growth. During 2000-2007, GDP growth averaged about 4 percent supported by strong growth in the region. Since the global financial crisis and Eswatini's 2010 fiscal crisis, growth in Eswatini has averaged about 2.5 percent, despite significant fiscal stimulus since 2015. The deceleration in growth reflects longstanding adverse trends in the growth engines of the economy. Investment has been on a declining trend, with private investment decelerating from about 17 percent of GDP in the early 2000s to 4 percent in 2018. Hence, capital-to-output ratios have been declining and the contribution of capital formation to growth has been negligible. Moreover, the deceleration in investment has been compounded by declining total factor productivity (TFP) contribution to growth, from about 2.3 percentage points in the early 2000s to 0.3 percent after the global crisis. With no fiscal space to support domestic demand, decelerating private investment and TFP will continue to hold back Eswatini's growth potential. Reviving private investment is therefore central to reignite growth and address widespread poverty and elevated unemployment in the country. This annex identifies the key factors holding back private investment and examines supply-side reforms that can reverse the trend.



Source: IMF staff estimates.



Sources: Penn World Table and IMF staff calculations.

Sources: Central Statistics Office, Penn World Tables, and IMF Staff estimates.

[1] Prepared by P. Ganum and V. Thakoor.

A. What Explains Eswatini's Decelerating Private Investment?

2. Empirical evidence suggests that structural factors underpinning labor markets, the business environment, governance, and market regulations matter for private investment. Staff's econometric analysis shows that for middle-income countries the gap between wage dynamics and productivity trends, skills mismatches in the labor market, flexibility of wages, and protection of property rights are associated with firms' investment decisions.[2] Extending the existing analysis to include indicators of governance and product markets regulation suggests that also these factors are relevant for private investment (Table A8.1).[3] Specifically,

- In specification (1) of our extended model, regulatory quality is the most important factor for investment among the Worldwide Governance Indicators (WGI).
- Results in specifications (2)-(4) highlight the importance of efficient product markets as measured by the regulatory environment, reduced government's presence in the economy and government spending efficiency. [4]
- Specification (5) confirms the importance of efficiency in labor markets in combination with the above factors. All cyclical factors have the expected sign, with growth and capital inflows having positive effects on investment and real lending rates have the opposite effect.

Moreover, recent analyses suggest that governance and regulatory indicators matter for TFP (IMF, 2019a)[5]. Additionally, reforms aiming to deregulate product markets, ease job protection legislation, and improve governance have considerable effects on investment and, with varying degrees, on productivity (IMF, 2019b)[6]. Eswatini exhibits significant weaknesses in most of these areas.

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[2] See IMF country Report 17/219 "Investment, Employment, and Inclusive Growth in Swaziland" for further details.

[3] The analysis relies on third-party indicators, which should be interpreted with caution due to their perception-based nature, and uncertainty around point estimates and the representativeness of survey samples.

[4] Size of government (by Fraser Institute) gauges the degree to which a country relies on personal choice and markets rather than government budgets, whereby countries with lower government size receive higher scores in this area. It captures five components: government consumption spending as a share of total consumption, transfers and subsidies as a share of GDP, top marginal income and payroll tax rates, government enterprises and investment as a share of total investment, and a ratings variable capturing the state ownership of assets.

[5] See IMF country Report 19/295 "Annex V. Unleashing Growth Through Supply-Side Reforms" and IMF (2015) "Structural Reforms and Macroeconomic Performance: Initial Considerations for the Fund".

[6] IMF (2019), World Economic Outlook, Chapter 3, "Reigniting Growth in Emerging Market and Low-Income Economies: What Role for Structural Reforms?".

Table A8.1. Eswatini: Factors Associated with Private Investment Across Middle-Income Countries, 2005–2017

DV: Private Investment to Capital Stock	(1)	(2)	(3)	(4)	(5)
L.Real GDP growth-to-Capital Stock	0.1147***	0.0387**	0.1079***	0.0728***	0.0700***
	(0.0147)	(0.0154)	(0.0159)	(0.0170)	(0.0168)
Real lending rate	-0.0028***	0.0058	-0.0475***	-0.0412***	-0.0400***
	(0.0004)	(0.0087)	(0.0114)	(0.0119)	(0.0117)
Capital inflows	0.0507***	0.0580***	0.0458***	0.0501***	0.0508***
	(0.0060)	(0.0068)	(0.0067)	(0.0069)	(0.0068)
Terms of trade (percent change)	-0.0006	0.0070	0.0060	0.0058	0.0054
	(0.0047)	(0.0047)	(0.0046)	(0.0048)	(0.0047)
Voice and accountability	0.4835*				
	(0.2875)				
Political stability	-0.1879				
	(0.1516)				
Government Effectiveness 1/	-0.1512				
	(0.3542)				
Regulatory Quality 2/	1.1961***	0.6764***	1.0064***	0.2811	0.1942
	(0.2880)	(0.2526)	(0.3590)	(0.4062)	(0.4002)
Rule of Law	-0.4239				
	(0.3712)				
Control of Corruption	0.5185				
	(0.3390)				
Government Size 3/		0.1522*		0.4293***	0.3906***
		(0.0792)		(0.0997)	(0.0986)
Efficiency of government spending 4/			0.2350*	0.3100**	0.2036
			(0.1228)	(0.1333)	(0.1416)
Flexibility of wage determination (score)					0.4784***
					(0.1611)
Connection between pay and productivity (score)					0.3406*
					(0.1762)
Constant	5.2519***	4.2493***	4.3876***	1.2508	-1.8821*
	(0.1493)	(0.5654)	(0.4064)	(0.8311)	(1.1284)
Observations	986	764	597	494	494
Country FE	YES	YES	YES	YES	YES
Adjusted R2	0.121	0.0465	0.113	0.125	0.153
No. countries	56	56	56	56	56

Note: * denotes significance at the 10% level, ** at the 5% level, and *** at the 1% level.

1/ Index reflects perceptions of the quality of public services and the degree of independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

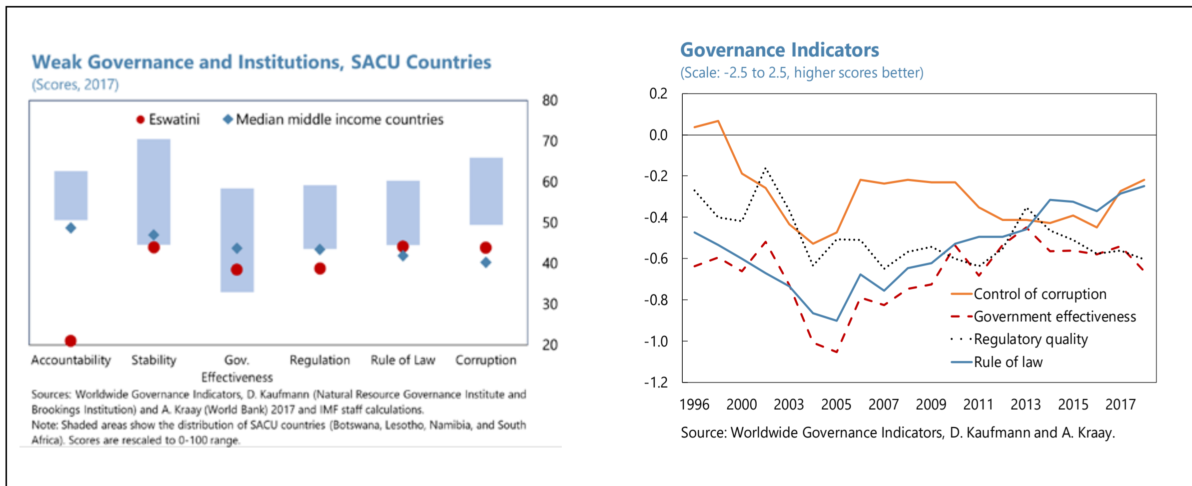
2/ Regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

3/ Countries with lower levels of government spending, lower marginal tax rates, and less state ownership of assets earn the highest score in this area.

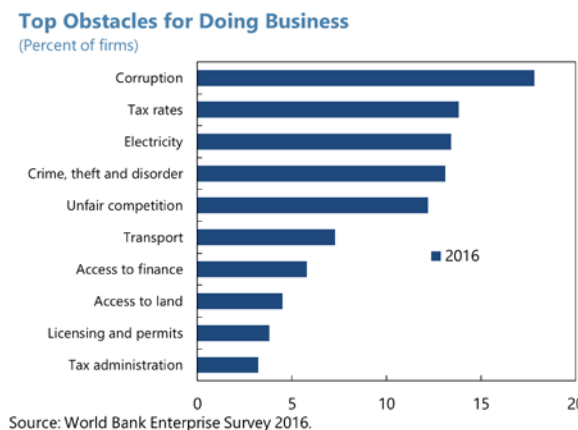
4/ GCI indicator addressing the question: "In your country, how efficient is the government in spending public revenue? (1 = extremely inefficient ; 7 = extremely efficient)"

Governance Weaknesses

3. Eswatini lags SACU and middle-income countries (MICs) in most governance indicators, and the perception of corruption has been deteriorating over time. Among the WGI, control of corruption—which captures the "*perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests*"—has been declining. Similarly, regulatory quality has also been deteriorating. On the other hand, there have been improvements in government effectiveness and the rule of law, albeit from a low base and the overall scores continue to remain weak.



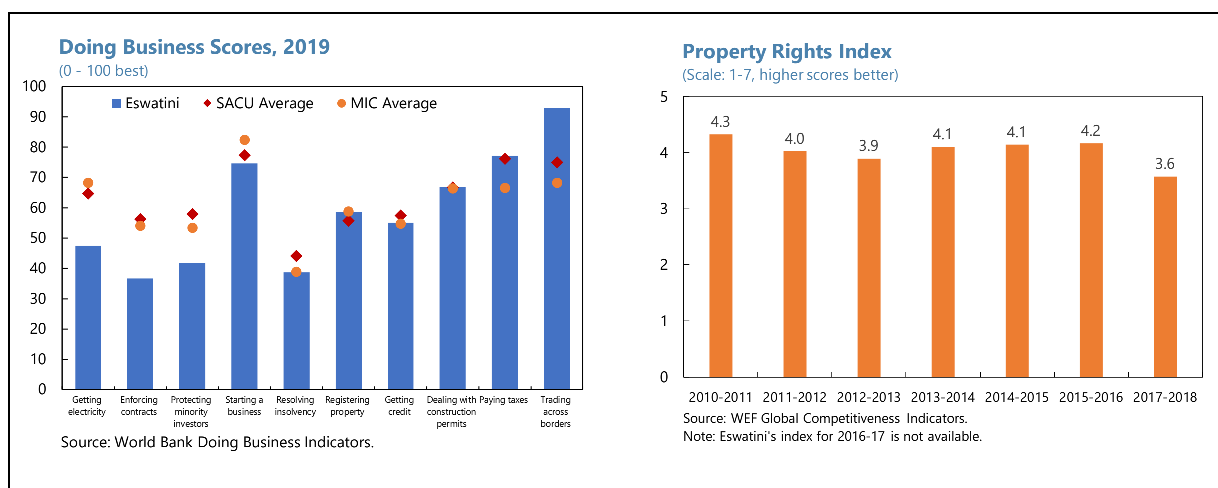
4. Reflecting these weaknesses, firms report corruption as the main obstacle for doing business in Eswatini. In the 2016 World Bank Enterprise Survey, 17.8 percent of businesses highlighted corruption as the main obstacle for doing business—compared to 5.2 percent in 2006 and 7.7 percent for Sub-Saharan Africa (SSA). Survey data suggest that instances and scope of bribery are relatively low in Eswatini, with the exception of government contracts (Box A8.1). However, about half (48.4 percent) of surveyed firms cited that gifts were expected to be offered to secure government contracts, and 17 percent of firms declared that gifts were expected "to get things done". Overall, the 2017 National Corruption Perception Survey by the Ministry of Justice and Constitutional Affairs, found that 93 percent of respondents—unchanged from the 2010 survey—perceived corruption to be a major issue in Eswatini. The survey further illustrated an increase in tolerance for corruption compared to 2010, signaling this longstanding issue remains.



5. Corruption is a tax on capital and corruption perception indicators are associated with lower private investment. Payments of gifts and bribes to secure contracts, permits, or licenses, raises the cost of doing businesses, and lowers the returns on investment. Small middle-income countries in the region, with better perception of corruption have achieved higher levels of investment, including high-performers like Botswana and Cabo Verde.

Difficult Business Environment

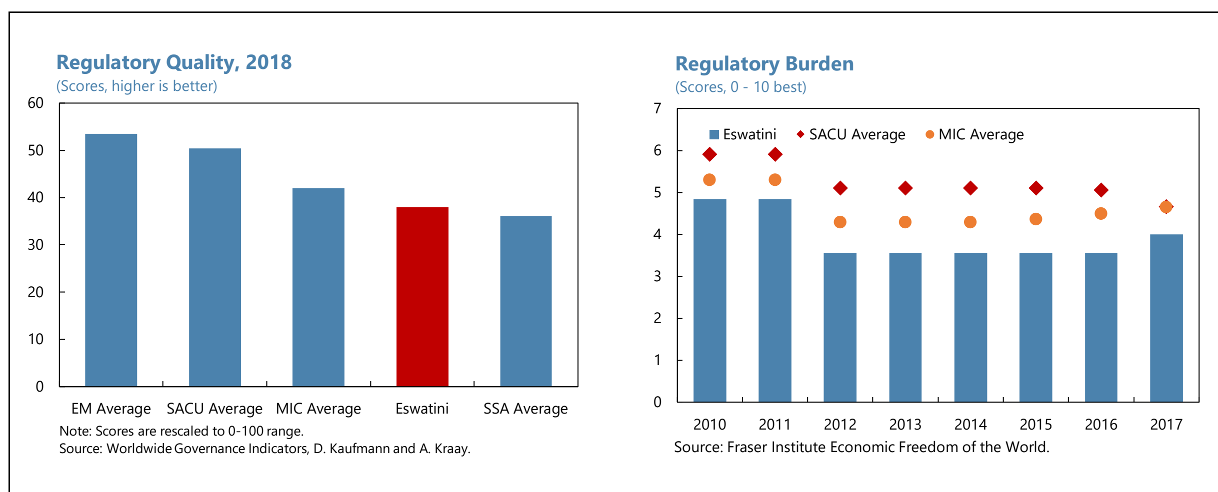
6. The business environment in Eswatini has become more difficult to navigate. In 2019, Eswatini ranked 117th out of 190 economies in the World Bank Doing Business Indicators, with the ranking dropping in recent years. The main weaknesses relate to getting electricity, enforcing contracts, protecting minority investors and starting a business. In particular, enforcing contracts, defined as "*the time and cost for resolving a commercial dispute through a local first-instance court, and the quality of the judicial process index*", takes longer and is costlier than in other SACU and Sub-Saharan African countries (956 days compared to 655 days in SSA). Reflecting these costs, the indicator of property rights protection has been declining, signaling shortcomings in how effectively and reliably the legal system enforces property and contract rights, despite the constitutional protection of property and the absence of expropriation events[7].



7. Weaknesses in the regulatory environment are a major obstacle to private investment. According to the 2019 National Development Plan, the single largest challenge firms face in doing business is the regulatory framework. Regulatory quality, as measured by the WGI, reflects "*perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development*". The regulatory quality has been deteriorating and is lower than other SACU, EMs, and MICs. Similarly, the regulatory burden indicator, as defined by the Fraser Institute, reflecting "the risk that normal business operations become more costly due to the regulatory environment, including regulatory compliance and bureaucratic inefficiency and/or opacity", has been deteriorating and remains below peers. These

[7] It is worth noticing that this indicator may be capturing the traditional country structure in which two-thirds of land surface is Swazi Nation Land, governed by different rules and procedures than Title Deed Land.

trends may reflect, among others, increased red tape and inefficient bureaucracy, which are in part linked to higher perception of corruption.



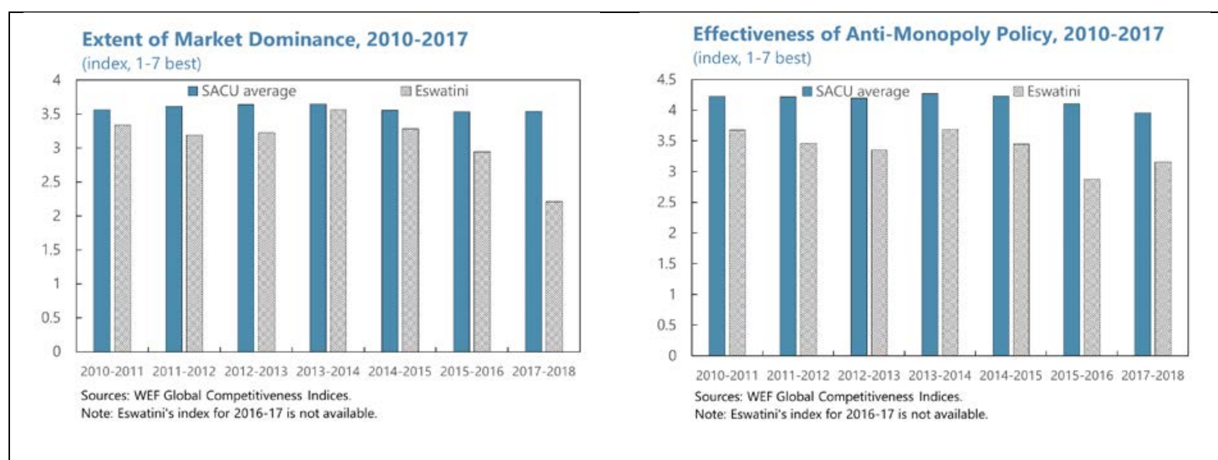
8. Lack of clarity on rules and procedures, particularly 'Employing' and 'Reporting' procedures, are among the top constraints for investors. Recent evidence suggests that results from the Swaziland Investor Roadmap (2005) about lack of transparency on investment procedures are still valid.[8] Lack of general information, forms, and legislation; poor policy and administrative coordination among government agencies; and lack of transparency on investment incentives were among the main findings. Specifically, the most problematic procedures for 'Employing' are the approval timeframe for work permits, and 'Reporting' weaknesses include annual trading licenses required to all firms and each activity they operate in, the mining license policy and process, and lack of transparency in the decision of applications for tax breaks offered under the Development Approval Orders (DAO). While 'Locating' and 'Operating' procedures were identified as less binding, among the 'Locating' procedures, access to land remains challenging. Overall, the ease of navigating the system depends very much on the door through which investors came to the country and the availability of a local partner.

Ineffective Regulations in Key Product Markets

9. While market dominance is prevalent, the effectiveness of the regulatory framework of key product markets is limited, constraining private investment and growth. The small market in Eswatini naturally reduces the number of prospective players, resulting in market concentration and the dominance of few firms, including public enterprises. The Global Competitiveness Indicators, capturing the extent of market dominance and effectiveness of anti-monopoly policy at ensuring fair competition, have deteriorated consistently since 2010. In this context, some large public enterprises operate in key sectors of the economy, often providing inputs that are costly, in turn undermining the competitiveness of domestic firms and hindering their ability to compete in the regional market. Specifically, the cost of electricity and communications provided

[8] The "Swaziland Investor Roadmap" (2005) is an assessment of the administrative regime governing investment in Eswatini,

by public enterprises are among the highest in the SADC region. Moreover, the strong presence of subvented public enterprises in sectors such as agriculture distorts the playing field and likely crowds out the private investment in the sector.



Box A8.1. The Governance-Investment Nexus

There are various channels through which a weak governance framework can contribute to a worsening of the business environment, making it more difficult and costlier for investors to operate. In Eswatini, three channels appear to be at work, and sometimes they overlap and can be difficult to disentangle:

- *Perception of corruption* comes across as the main obstacle to investment in firm surveys in Eswatini and this perception has worsened over time. Corruption can take various forms, such as petty bribery, exchange of favors using public positions or even broader capture of the organs of the state. Corruption is most likely in public procurement, which is rather weak in Eswatini. Anecdotical evidence suggests that some firms in Eswatini have stopped participating in public procurement processes out of corruption and late payment concerns.

- *An unlevel playing field* can deter investors. Eswatini is characterized by strong insider-outsider dynamics, where insiders have preferential access to investment opportunities. In a regulatory framework difficult to navigate, outsiders can find it difficult to access investment opportunities, including serviced land, ad hoc tax breaks, licensing requirements. Such a state of affairs reinforces the dominance of a few players and inhibits competition.

- *An unbalanced public spending composition and rising inefficiencies in public investment translate in limited improvements in the infrastructure.* Government spending has been skewed towards largely non-productive recurrent spending. Additionally, government capital spending, while increasing in recent years, suffers from both planning and governance weaknesses. Recent capital spending has been allocated towards low-impact projects, which over time would contribute little to close infrastructure gaps (e.g., in energy), and may deepen infrastructure weaknesses, thus inflating the cost of doing business.

Several policies, with synergies, could be used to promote better governance and support private investment. Such policies include:

- *Greater adherence to existing laws and regulations.* The anti-corruption framework (prevention and enforcement) needs to be technically capacitated to deal with the backlog of cases currently under investigation and reverse the perceived culture of impunity. The AML/CFT framework must be bolstered to allow for stronger assessment relating to customer due diligence, beneficial ownership, asset declarations, and politically exposed persons. The proposed setting-up of the commercial court to deal

Box A8.1. The Governance-Investment Nexus (concluded)

with corruption cases needs to be expedited. All the entities involved in fighting corruption must be independent. Adherence to high standards also involves the public sector. It is important to enforce strict adherence to the Public Procurement Act (PPA) and ensure procurement complies with all regulations and requirements at all stages.

- *Levelling the playing field and reducing opportunities for corruption.* Given the strong insider-outsider dynamics, the role of the Investment Promotion Agency must be strengthened so that it can operate as a proper one-stop-shop for investors. The role must extend from that of promotion to one where the agency is able to credibly address entry and regulatory barriers that outsiders face. Such measures must include efforts to accelerate access to land and utilities. Moreover, regulatory constraints that prevent new players from coming in, including due to domestic shareholding requirements, must be alleviated to increase competition.
- *Strengthening centralized procurement to promote cost savings and transparency, while tackling conflicts of interest and abuse.* In this respect, it is important to adopt the 2011 procurement Act regulations, revamping the tender's board technical capacity, and better capacitate the Public Procurement and Regulatory Agency to deliver on its mandate. Integrating SOE and local government procurement with that of the central government would allow for greater economies of scale and oversight. Improving the transparency of the procurement process is also critical. Several steps can be taken in this respect, including: creating a database of eligible suppliers (based on compliance and previous record criteria), publishing all tenders online to allow for equal opportunities and competition, including for SMEs, making public the winning bids as well as prices. Moreover, enforcement is of paramount importance. In this respect, payments in cases of non-compliant procurement payments should be delayed pending proper investigation, irregular contracts should be voided and prosecuted, and centralized procurement could be used to gather information—such as state employees, tax payer IDs and status, and the ultimate owners of companies—that can support law enforcement agencies in ethical violation and corruption investigations.
- *Improving public investment management.* This includes cost-benefit analysis and budgeting to ensure they have economic merit and are prioritized in line with available financing. Strong safeguards must be put in place to stop projects that are initiated outside of the budget process. MOF authorization must be required for the signature of high value contracts to strengthen budget execution.

B. Potential Dividends from Structural and Governance Reforms

10. Structural reforms can have significant positive effect on growth. Following Prati et al (2011)[9], the impact of structural reforms on GDP per capita growth was estimated using panel data regressions over a sample of MICs during 1998-2017 (the availability of structural indicators varies across indicators and countries). The following growth equation was estimated:

$$\boldsymbol{ln\,GDP_{i,t} - ln\,GDP_{i,t-1} = a_0 + a_1 lnGDP_{i,t-1} + a_2 Reform_{i,t} + \mu_i + \delta_t + \varepsilon_{it}}$$

Where *GDP* is real GDP per capita in country *i* and period *t*, and *Reform* reflects a group of structural reform indicators. Four different specifications were run (Table A8.2), with a set of country and year fixed effects and covering a set of labor market, product market, and governance indicators. In most of these indicators Eswatini ranks below the median of the sample. To estimate the gains in GDP from improving each set of indicators, we assume that Eswatini's indicators in each reform group

[9] A. Prati, M. Onorato, and C. Papageorgiou, (2011), "Which Reforms Work and under What Institutional Environment: Evidence for a New Dataset on Structural Reforms".

increase gradually to the MIC median. Subsequently, we estimate the path for GDP per capita assuming reforms are undertaken and have the above estimated gains. Next, we obtain the dividends from reforms in overall growth rate terms by comparing the baseline real GDP path (after adding population growth) with the reform path over a 5-year horizon and we take the average growth rate.

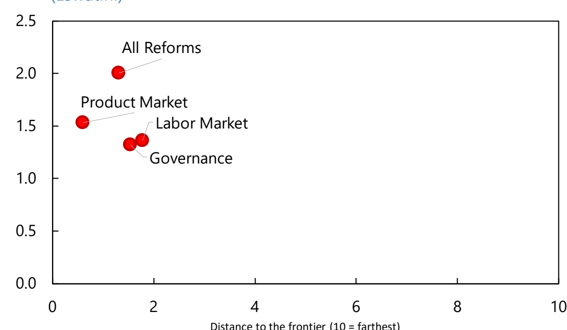
Table A8.2. Eswatini: Impact of Structural Reforms on GDP per Capita Growth in MICs, 1998–2017

	(1)	(2)	(3)	(4)
	All Reforms	Product Market	Labor Market	Governance
L.GDP per capita (log)	-0.2060***	-0.1933***	-0.1210***	-0.1266***
	(0.0393)	(0.0381)	(0.0262)	(0.0374)
Flexibility of wage determination	0.0004		0.0022	
	(0.0049)		(0.0049)	
Pay and Productivity	-0.0017		0.0059	
	(0.0053)		(0.0047)	
Size of Government	0.0041	0.0043		
	(0.0031)	(0.0033)		
Efficiency of government spending	0.0140***	0.0120***		
	(0.0049)	(0.0041)		
Regulatory Quality	0.0452**	0.0486***		
	(0.0191)	(0.0154)		
Control of Corruption	0.0028			0.0088
	(0.0117)			(0.0107)
Government effectiveness	-0.0018			0.0190*
	(0.0136)			(0.0106)
Voice and accountability	0.0214*			-0.0127
	(0.0119)			(0.0124)
Rule of Law	-0.0214			-0.0049
	(0.0170)			(0.0131)
Political Stability	0.0163**			0.0277***
	(0.0071)			(0.0093)
Constant	1.6886***	1.5838***	1.0150***	1.0319***
	(0.3219)	(0.3084)	(0.2211)	(0.2996)
Observations	598	598	671	1,706
Country FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Adjusted R2	0.425	0.415	0.335	0.178
No. countries	74	74	75	97

11. Structural reforms to bring Eswatini's labor and product markets, and governance indicators to the level of other MICs can substantially increase growth. Reducing distortions in product markets and reforms to improve labor markets and governance would lift annual growth by

1.5 and 1.3 percent, respectively. Undertaking a comprehensive set of reforms across product markets, labor markets, and governance reforms, and accounting for overlapping effects, could be associated with an increase in GDP growth above the baseline of about 2 percent over a 5-year period. These findings are consistent with recent estimates of the impact of structural reforms in EMs. A recent study (IMF, 2019b) for a broad sample of EMs and developing economies finds that deregulation in product markets would lead to an increase in output of about 1 percent three years after the reform. The same study finds that improvements in governance would increase output by 2 percent after six years.

Real GDP Growth Gains and Distance to the Frontier
(Eswatini)



Sources: IMF Staff estimates.
Note: The chart shows the distance from the frontier and the estimated increase in annual growth rate of real GDP if the gap is closed in five years. The frontier is the median value for each indicator in a sample of MIC countries.

C. Supply-side and Governance Reforms

12. Several reforms can help reduce bottlenecks to investment by improving governance, and labor and product market functioning, thus reigniting growth and employment:

- *Strengthening governance and government effectiveness.* Reducing vulnerabilities to corruption, for example, by strengthening the anti-corruption framework, reforming the government procurement process, and improving public investment management would contribute to strengthen the governance framework.

- *Streamlining regulations to improve the investment climate and business conditions.* Enhancing the transparency of procedures, availability of information, forms, and legislation online, greater clarity on the qualification for investment incentives, strengthening the role of the investment promotion agency to credibly address entry and regulatory barriers investors may face, and easing procedures to start and operate a business would make the business and regulatory environment easier to navigate and contribute to attract investment. In addition, accelerating the setting up of the commercial court, appointment of commercial judges, and adoption of electronic case management would enable the expediting of pending cases and improve contract enforcement.

- *Improving the functioning of key network industries and competition.* Inefficient functioning of network industries, such as electricity and communications, inflate the cost structure of the economy and undermine competitiveness. Improving the regulatory framework in these sectors would help reduce costs and create a playing field to allow market entry by new investors.

- *Investing in human capital and addressing shortages of skills.* Closing the skills-gap in the labor market by better aligning higher education and vocational training to industry needs, improving education attainments and access to education, especially for secondary and

tertiary education, and reducing timeframe for work permits would have positive spillovers to growth and employment.

- *Aligning wage and productivity dynamics.* Establishing a well-structured salary policy in the public sector and facilitating the adoption of a more flexible wage policy in the private sector would help better align wage growth with productivity.

Annex IX. Strengthening the Financial Stability Architecture[1]

1. Eswatini has a large financial sector with some structural vulnerabilities that are sources of macro-financial and stability risks.

- The financial sector is dominated by non-bank financial institutions (gross assets about 110 percent of GDP), including a large government retirement funds (assets about 35 percent of GDP), with a relatively small banking sector (assets about 30 percent of GDP). (Figure A9.1; Table A9.1)
- The sector is highly concentrated and characterized by considerable structural vulnerabilities: banks extensively rely on wholesale deposits as a funding tool and their loan books are highly concentrated; financial institutions are closely interconnected and have large foreign exposures, with NBFIs providing a sizable share of banks' deposits while holding about half of their assets abroad (about 40 percent of GDP), exposing the system to external shocks; households are highly leveraged compared to neighboring and other middle-income countries; and the sovereign-financial linkages have been strengthening, exposing the sector to the government's weak fiscal position (Table A9.2).
- Despite structural vulnerabilities, the sector oversight framework has several weaknesses. A macroprudential and crisis management frameworks need yet to be fully developed, the independence and operational capacity of the central bank ought to be strengthened, and the legislative framework underpinning the regulatory and supervisory ability of the CBE and the FSRA should be updated and completed.

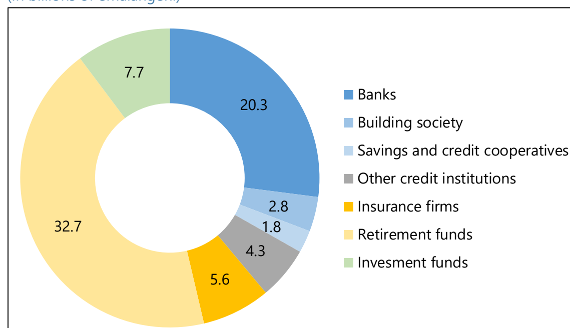
2. In light of the financial sector vulnerabilities, there is a strong case for strengthening the financial stability architecture and the authorities have embarked on extensive legislative reforms. The planned legal reforms include: enacting the CBE bill (currently, there is a Central Bank Order), amending the Financial Services Regulatory Authority (FSRA) Act, and introducing the Financial Stability bill (Table A9.3), together with upgrading sectoral laws (e.g., Financial Institutions, Insurance, Retirement Funds, Securities, Building Societies, and consumer Credit Acts). These legal reforms would establish the legal underpinnings to develop effective macroprudential and crisis management frameworks (e.g., Financial Stability Bill), bolster the financial safety net, including by strengthening the bank resolution regime and the liquidity provision framework (e.g., CBE bill, amendments to the Financial institutions Act), and upgrade the legal frameworks for NBFIs (which are outdated or non-existent) (Table A9.3). These legislative reforms should be completed as a priority. In addition, the creation of a deposit insurance scheme would strengthen the financial safety net, and in the context of a macroprudential framework, macroprudential tools to prevent systemic risks should be developed.

[1] Prepared by P. Jeasakul.

Figure A9.1. Eswatini: A large and Developed Financial Sector

The financial system is dominated by retirement funds and banks.

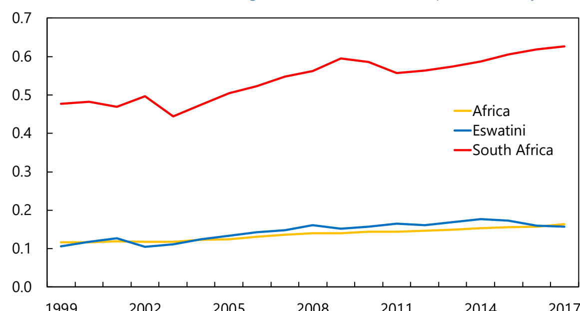
Composition of Financial Institutions' Total Assets, 2019Q2
(In billions of emalangeni)



Sources: Eswatini authorities; and IMF staff estimates.

The level of financial development in Eswatini is broadly with most African countries.

Financial Development Index, 1999-2017
(Value between 0 and 1, with the higher value, the more developed financial system)



Sources: IMF, Financial Development Index database; and IMF staff calculations.
Note: For more details about the index, see IMF SDN/15/08 and IMF WP/16/05.

Table A9.1. Eswatini: Financial System Structure[1]

	In billions of emalangeni					In percent of GDP					In percent of total assets				
	2015	2016	2017	2018	2019Q2	2015	2016	2017	2018	2019Q2	2015	2016	2017	2018	2019Q2
Financial institutions	55.9	61.8	67.8	72.1	75.2	108	109	114	116	113	100	100	100	100	100
Deposit-taking institutions	18.7	21.9	23.4	24.8	25.0	36	39	40	40	38	33	35	35	34	33
Banks	15.4	18.3	19.5	20.4	20.3	30	32	33	33	31	27	30	29	28	27
Building society	2.1	2.2	2.4	2.7	2.8	4	4	4	4	4	4	4	4	4	4
Savings and credit cooperatives	1.2	1.3	1.5	1.7	1.8	2	2	3	3	3	2	2	2	2	2
Other credit institutions	2.6	3.0	2.2	4.1	4.3	5	5	4	7	6	5	5	3	6	6
Insurance firms	3.3	3.9	4.7	4.8	5.6	6	7	8	8	8	6	6	7	7	7
Long-term	2.7	3.3	3.7	3.9	4.4	5	6	6	6	7	5	5	5	5	6
Short-term	0.6	0.6	1.0	0.9	1.2	1	1	2	1	2	1	1	1	1	2
Retirement funds	25.0	26.4	30.4	31.3	32.7	48	47	51	50	49	45	43	45	43	43
Invesment funds	6.3	6.6	7.0	7.2	7.7	12	12	12	12	12	11	11	10	10	10
Memo:															
Assets managed by investment advisers	16.5	17.3	18.8	18.7	19.1	32	31	32	30	29	30	28	28	26	25
Financial markets															
Outstanding debt securities	3.6	5.1	6.8	9.6	11.0	7	9	11	15	17	…	…	…	…	…
Government	3.1	4.4	5.8	8.4	9.7	6	8	10	13	15	…	…	…	…	…
Financial institutions	0.4	0.7	0.8	1.0	1.1	1	1	1	2	2	…	…	…	…	…
Other issuers	0.1	0.1	0.2	0.2	0.2	0	0	0	0	0	…	…	…	…	…
Stock market capitalization	2.8	3.3	3.5	3.6	3.7	5	6	6	6	6	…	…	…	…	…

1/ Assets managers' assets not included in financial institutions' total assets (see memo item).

Sources: Eswatini authorities; and IMF staff estimates.

Table A9.2. Eswatini: Financial Soundness Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Banking sector								
Capital adequacy and leverage								
Total capital to risk-weighted assets	20.6	21.1	22.2	24.9	22.5	22.2	23.2	18.8
Tier-1 capital to risk-weighted assets	17.8	18.2	19.3	21.3	20.0	20.0	20.8	16.0
Total capital to total assets	12.2	12.5	11.9	12.6	12.9	13.0	13.4	13.1
Asset quality								
Nonperforming loans to total loans	3.5	10.7	6.8	6.9	6.6	9.6	7.9	9.3
Provisions to nonperforming loans	63.2	18.8	32.9	41.5	28.4	22.6	25.0	19.1
Profitability and earnings								
Return on assets	3.5	3.5	3.1	3.5	10.3	4.0	5.5	2.5
Return on equity	26.3	24.8	22.7	27.7	50.1	25.6	36.2	7.0
Net interest income to total asets	5.0	4.6	4.3	1.4	5.7	5.9	5.8	5.0
Other income to total assets	4.8	4.8	4.8	1.6	5.7	5.0	4.3	3.8
Operating expense to total assets	-5.9	-5.7	-5.5	-1.7	-6.1	-6.4	-6.4	-6.0
Liquidity and funding								
Liquid assets to short-term liabilities	15.5	12.7	12.1	14.2	15.3	16.4	14.7	17.5
Loans to deposits	92.0	81.3	86.7	89.5	79.8	70.9	71.7	...
Liquid assets to total assets	9.8	9.0	8.0	9.7	10.5	11.2	9.9	11.9
Foreign-currency liabilities to total liabilities	6.0	4.2	0.1	6.0	4.9	12.4	8.6	...
Other risks								
Large exposures to capital	105.8	89.2	55.2	102.2	107.1	68.0	105.1	...
Net open position in equities to capital	1.1	1.7	1.2	6.0	29.2	22.0	35.1	...
Long-term insurance sector 1/								
Profitability and earnings								
Return on equity	...	...	...	25.0	10.6	24.4	14.4	19.4
Net claims to net premiums	...	...	116.0	108.0	107.8	95.0	76.7	92.0
Expenses to net premiums	...	...	27.8	15.3	27.7	18.5	29.2	36.6
Investment income to investment assets	...	...	...	11.7	8.1	6.6	2.5	6.9
Short-term insurance sector 1/								
Profitability and earnings								
Return on equity	...	...	...	45.4	56.2	63.3	56.1	51.7
Net claims to net premiums	...	...	41.1	32.7	33.8	31.8	31.9	32.7
Expenses to net premiums	...	...	34.4	36.9	30.4	26.1	31.6	36.2
Reinsurance								
Net premiums to gross premiums	...	...	65.8	60.6	61.0	63.0	62.9	63.1
Retirement fund sector 1/								
Earnings								
Investment return	...	...	...	14.7	8.8	9.4	6.4	6.1

1/ Reporting financial year, starting from April of the year to March of the subsequent year.

Sources: Eswatini authorities, IMF, Financial Soundness Indicators database; and IMF staff estimates.

Table A9.3. Eswatini: Status of Financial Sector Legislative Reforms			
Law	Main objectives of the amendment/enactment	Key changes	Status
Central Bank of Eswatini bill	To modernize the central bank's functions	• Clarify the central bank's primary objective (maintaining price stability) and secondary objective (fostering a stable financial system) • Assign the responsibility of banking oversight and resolution, and oversight of payment, clearing and settlement systems to the central bank • Provide the basis for the central bank's provision of emergency liquidity assistance	Under review by the Ministry of Finance
Financial Stability bill	To establish the financial stability framework—both macroprudential policy and crisis management	• Give the central bank the power to designate systemically important financial sector participants and determine systemic events • Give the central bank the power to employ macroprudential tools—for systemically important financial sector participants at any time; for other entities during systemic events • Create the inter-agency Macroprudential Forum, with the power to make recommendations to other agencies • Create the inter-agency Financial Stability Panel as a coordination body for crisis management	Under review by the Board of the Central Bank
Financial Institutions Act (2005)	To strengthen the legal, regulatory and supervisory frameworks in line with the Basel Core Principles for Effective Banking Supervision	• Give the central bank the power to set different capital requirements based on banks' risk profiles and tougher requirements for systemically important banks • Strengthen the governance framework, including risk management, internal control, and compliance function • Strengthen the early intervention framework and resolution regime for banks (including recovery and resolution planning) • Strengthen the market conduct and consumer protection frameworks	Under review by the Board of the Central Bank
Financial Services Regulatory Authority Act (2010)	To strengthen the legal, regulatory and supervisory frameworks for nonbank financial institutions in line with international standards To enable the FSRA to become a signatory of the IOSCO multilateral MOU	• Address inconsistencies between the FSRA Act and sectoral laws • Improve powers to gather information • Strengthen the licensing regime, particularly related to beneficial ownership, significant ownership and controlling interest • Enable the declaration of new categories of nonbank financial service products without the need to amend the FSRA Act • Give the FSRA the power to investigate and take action against unauthorized financial service providers • Raise the penalty on offenses	Under preparation by the FSRA

Table A9.3. Eswatini: Status of Financial Sector Legislative Reforms (concluded)

Law	Main objectives of the amendment/enactment	Key changes	Status
Insurance Act (2005)	To enhance the safety and soundness of insurance firms To promote access to insurance products	• Introduce a micro insurance framework (micro insurance firms subject to lower capital requirements and simplified prudential rules) • Introduce a risk-based solvency regime for insurance firms, a framework for group supervision, and a framework for reinsurance • Enhance consumer protection provisions • Address regulatory and supervisory gaps to be aligned with the Insurance Core Principles • Address inconsistencies with the FSRA Act	Under preparation by the FSRA
Retirement Funds Act (2005)	To strengthen the legal, regulatory and supervisory frameworks for retirement funds	• Introduce regulatory and supervisory frameworks for umbrella funds and beneficiary funds • Introduce capital requirements for retirement funds administrators • Strengthen requirements for trustees • Address inconsistencies with the FSRA Act	Under preparation by the FSRA
Securities Act (2010)	To upgrade the legal, regulatory and supervisory frameworks for securities markets	• Introduce a risk-based supervision and intervention framework • Strengthen the requirement on record safekeeping • Improve powers to gather information, particularly related to bank transactions that links with securities activities • Widen the list of securities that can be offered • Address inconsistencies with the FSRA Act	Under review by the Ministry of Finance and the Attorney General
Building Societies Act (1962)	To facilitate building societies to obtain banking license	• Enable demutualization of a building society so that they can set up as a joint-stock entity	Completed
	To strengthen the legal, regulatory and supervisory frameworks for building societies	• Strengthen the prudential and market conduct requirements, more in line with international best practice • Establish the corporate governance and risk management framework • Enhance the solvency framework for building societies	Under preparation by the FSRA
Savings and Credit Cooperatives bill	To establish the legal, regulatory and supervisory frameworks as there is no sectoral law at the moment	• Establish the legal, regulatory and supervisory frameworks for the savings and credit cooperatives sector • Establish the insolvency framework and set up the deposit guarantee fund for the credit cooperatives sector	Under preparation by the FSRA

Annex X. Implementation of Past IMF Advice

	Recommendations	Status
Fiscal policy and SOEs	- Implement significant fiscal adjustment over three years to restore debt sustainability and macroeconomic stability. Frontload efforts if needed to bring deficit in line with available financing. - Improve the public financial management framework. - Reform extra-budgetary entities and public enterprises to improve their financial performance, and strengthen the sector's governance.	- Authorities have granted no salary indexation and reduced hiring; a decline in SACU revenues and political gridlock ahead of the 2018 election constrained further consolidation efforts. - The authorities plan to stabilize the fiscal deficit in FY20/21 and undertake fiscal adjustment starting in FY21/22, but have yet to develop a medium-term strategy to restore fiscal sustainability. - Authorities passed a new PFM law in 2017 and are finalizing the implementing regulations. - No reform strategy for extra-budgetary entities and public enterprises has been developed and their economic performance has been worsening. A study on restructuring key entities and enterprises has been recently commissioned.
Monetary policy	- Support the peg by maintaining the policy rate at a positive spread with the South African Reserve Bank (SARB)'s rate, and refrain from budget financing.	- The CBE has provided advances to the government for budget financing, and total exposure to the government has reached the legal limit (about 5 percent of GDP). - The CBE has maintained the policy rate broadly in line with the SARB's rate and has eliminated the initial positive spread.
Financial sector	- Improve banking supervision and regulation. - Strengthen supervision and regulation of NBFIs. - Monitor and manage risks from interlinkages between NBFIs and the sovereign, and set up a macro-prudential framework. - Strengthen crisis preparedness by developing crisis management and contingency planning capacities, and by expanding CBE's liquidity facilities.	- The CBE implemented Basel II pillar I in 2018. - The authorities drafted amendments to the Central Bank Order and Financial Institutions Act to strengthen the CBE independence and supervisory capacity, while a draft Financial Stability Bill is intended to establish the macroprudential and crisis management frameworks. - The authorities are revising legislations governing NBFIs, and updating the regulatory framework to strengthen supervisory and regulatory capacity. - NBFIs, particularly the public sector pension fund, have increased exposure to government securities.
Structural reforms for stronger and inclusive growth	- Reduce skills mismatches by improving education attainments. - Realign wages and productivity dynamics by improving labor market flexibility and containing growth in public sector wages. - Simplify business regulations and strengthen the institutional environment to increase investment and job creation. - Scale up cash assistance programs to reduce extreme poverty.	- Access beyond primary education remains limited, with about half of eligible students enrolling in secondary schools. - The authorities' agenda includes as key actions the review of the employment legislation to improve labor market flexibility and the development of a Labor Market Information System. - No inflation adjustment has been granted for three years to public employees, and public wages have declined in real terms. - The government has made improving governance and ease of doing business key pillars of their development strategy, though specific actions are lacking. - Grants to the elderly were increased in 2017. A two-year pilot cash grant program for orphans and vulnerable children concluded in 2018.

Annex XI. Capacity Development Strategy: Summary[1]

CD Strategy

Eswatini's key policy challenges are to: (i) deliver substantial fiscal adjustment to restore macroeconomic stability, amid declining SACU revenue; (ii) reignite long-term growth prospects to reduce poverty and unemployment; and, (iii) manage macro-financial risks and vulnerabilities.

Eswatini's medium-term capacity development (CD) strategy, developed in coordination with the authorities, aims at supporting the authorities' fiscal adjustment efforts, strengthen their capacity to manage macro-financial risks, and improve macroeconomic data quality to better support surveillance activities. In this context, the most urgent capacity development needs are to: establish a credible annual and medium-term budget framework; strengthen budget execution and commitment controls; mobilize domestic revenue; strengthen financial sector supervision and regulation; and improve quality and timeliness of macroeconomic statistics. These strategic priorities do not constitute a significant departure from the previous capacity development strategy note.

Key Overall CD Priorities Going Forward

Priorities	Objectives
Public Financial Management: budget preparation, execution and controls	Develop a credible annual budget and medium-term budget framework; strengthen budget execution and commitment control systems to deliver budget objectives and prevent the accumulation of domestic arrears.
Domestic revenue mobilization: revenue administration and tax policy	Enhance tax collections through strengthening tax administration and introduce tax reforms to broaden the tax bases to reduce dependence on volatile SACU revenue.
Financial sector oversight framework	Improve and expand compliance with the Basel core principles, enhance regulation and supervision of nonbank financial institutions, develop macroprudential and crisis preparedness frameworks.
Fiscal, external, and national accounts statistics	Strengthen quality, consistency, timeliness and dissemination of core macroeconomic statistics, including fiscal, external and national accounts data, to better support policy decision-making and surveillance activities.

Main Risks and Mitigation

Eswatini is a high intensity technical assistance (TA) recipient, and past implementation of Fund TA has been mixed. The authorities have implemented: policies to contain the wage bill (after a TA on expenditure rationalization), a new system for invoice tracking (supported by a resident advisor);

[1] Preliminary version reflecting a draft CD strategy.

improved tax administration functions (supported by intense TA), and advanced in the drafting of key financial sector legislation (with TA support). However, they have strived to develop credible and comprehensive budget and reliable medium-term budget plans, implement effective cash management systems, effectively control spending commitments, largely due to insufficient implementation capacity, staffing constraints, and, in some cases, lack of political support. To mitigate capacity issues, recent experience in revenue administration, PFM, and national accounts compilation shows that better progress can be achieved by hands-on training, presence of a resident advisor and/or close and continuous TA engagement.

Authorities' Views

The authorities consider IMF TA of great value and regularly seek the Fund's advice to structure the reform strategy in areas such as PFM, revenue administration, expenditure management, financial sector supervision and regulation, and statistics.

The authorities have also suggested that our CD activities could achieve greater results by relying more on hands-on support, resident advisors, peer learning and comparisons with international best practices to complement written recommendations from TA reports.

INTERNATIONAL MONETARY FUND

KINGDOM OF ESWATINI

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 15, 2020

Prepared By

International Monetary Fund Staff in collaboration with the World Bank.

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FUND RELATIONS

As of October 30, 2019

Membership Status

Joined: September 22, 1969; Article VIII.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	78.50	100.00
Fund holdings of currency	71.94	91.65
Reserve position	6.56	8.36

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	48.28	100.00
Holdings	48.84	101.16

Outstanding Purchases and Loans: None

Financial Arrangements None

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

	2019	2020	2021	2022	2023
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
Total		0.00	0.00	0.00	0.00

Implementation of HIPC Initiative None

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 Lilangeni vis-à-vis the U.S. dollar are based on the exchange rate of the South African rand against the U.S. dollar. Eswatini has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. Eswatini is on a standard 12-month consultation cycle. The last Article IV Consultation was concluded by the Executive Board on September 1, 2017.

Technical Assistance, 2015-2019

Department	Date of Delivery	Purpose	Beneficiary Agency
Fiscal Affairs Department (FAD)			
	February, April, September, October 2015	PFM Act and Regulations, Cash Management and Accounting	MOF
	February 2015	Tax Administration: Further Developments of a Comprehensive Compliance Framework (Module 5 and 6) [Visit 1 of 2]	SRA
	June 2015	Customs Administration Mission	SRA
	August, November 2015	Expenditure Management	MOF
	January, March 2016	Tax Administration	SRA
	September, November 2016	Tax Administration: Implementing a Comprehensive Compliance Framework	SRA
	January 2017	Strengthening Treasury Functions and Installation of New Resident Advisor	MOF
	January 2017	Review of the Tax System	SRA
	April 2017	Cash Management and Accounting	MOF
	July 2017	Medium-Term Budgetary Framework and Expenditure Control	MOF
	December 2017	Stronger PFM Laws and Institutions [AFRITAC]	MOF
	February 2018	Strengthening Management and Governance Arrangements	SRA
	March, September, 2018	Strengthening Core Tax Business Functions and Procedures	SRA
	June 2018	Developing the New Government Public Financial Management Regulations [AFRITAC]	MOF
	July 2018	Strengthening Budget Preparation and Managing Arrears	MOF
	September 2018	Developing the New Government Public Financial Management Regulations [AFRITAC]	MOF
	October 2018	Expenditure Rationalization	MOF
	November 2018	Revenue Administration	SRA
	April 2019	Developing the New Government Public Financial Management Regulations [AFRITAC]	MOF
	June 2019	Excise Administration and Controls [AFRITAC]	SRA
	July 2019	Public Investment Management Assessment	MOF, MEPD
Monetary and Capital Markets (MCM)			
	February 2015	Financial Stability Analysis	CBE
	May 2015	Debt Management and Institutional Arrangements	MOF, CBE
	May 2015	Stress Testing [AFRITAC]	CBE
	February 2016	Risk Based Supervision [AFRITAC], Strengthening Stress Testing	CBE
	April 2016	Financial Stability Analysis	CBE
	August 2016	Implementation of Basel II [AFRITAC]	CBE
	April 2017	Financial Stability Issues	CBE
	February 2018	Strengthening NBFI Supervision	FSRA
	February 2018	Basel II Implementation [AFRITAC]	CBE

	April 2018	Strengthening Compliance with the CPSS-IOSCO Principles for Financial Market Infrastructures [AFRITAC]	CBE
	May, June 2018	Strengthening the Supervision of the NBFIs, Capital Markets, Credit and Saving Institutions	FSRA
	August, September, 2018	Strengthening the Supervision of the NBFIs, Insurance and Retirement Funds, Credit and Saving Institutions, Capital Markets	FSRA
	November, December 2018	Credit and Savings Institutions, Insurance and Retirement Funds	FSRA
	February 2019	Insurance and Retirement Funds, Capital Markets	FSRA
	June 2019	Capital Markets Intermediaries, Credit and Savings Institutions, Basel II/III Implementation	FSRA
	July, August, 2019	Insurance, Retirement Funds	FSRA
	October, November 2019	Insurance Retirement Funds, capital markets intermediaries, Credit and Savings Institutions	FSRA
Statistical Department (STA)			
	June 2015	National Accounts [AFRITAC]	CSO
	April 2016	National Accounts [AFRITAC]	CSO
	July 2016	Balance of Payments Statistics	CBE
	January, April, August, 2017	National Accounts [AFRITAC]	CSO
	February 2017	Balance of Payments Statistics	CBE
	July 2017	Producer Price Index [AFRITAC]	CSO
	March, May, October 2018	National Accounts [AFRITAC]	CSO
	April 2018	Monetary and Financial statistics	CBE
	May 2018	Government Finance Statistics	MOF
	July 2018	Price Statistics [AFRITAC]	CSO
	August 2018	External Sector Statistics	CBE
	April, July, October, 2019	National Accounts [AFRITAC]	CSO
	July 2019	Government Finance Statistics	MOF
	July, November 2019	Price Statistics [AFRITAC]	CSO
Legal Department (LEG)			
	September 2016	Central Banking and Bank Supervision	CBE
	March 2017	National Payment System	CBE
	March 2017	Bank Resolution and Institutional Setup for Crisis Management and Prevention	CBE
	December 2017	Financial Stability Law	CBE

JOINT WORLD BANK AND FUND WORK PLAN

Table 1. Eswatini: World Bank and IMF Planned Activities, Next 12 months
(As of November 2019)

Title	Products	Mission Date[1]	Delivery Date
A. Mutual Information on Relevant Work Programs			
World Bank work program (next 12 months)	Lending Operations:		
	• Water supply and sanitation access project	February	TBD
	• Network Reinforcement and access project	February	TBD
	• Health systems strengthening project	January	TBD
	Analytical Services and Advisory		
	• Systematic Country Diagnostic	January	March
	• Trade Facilitation and Doing Business	January	Ongoing
	• Rapid Education sector analysis	Feb, April	December
	• Social Protection analysis	March	December
Fund work program (next 12 months)	• 2019 Article IV Consultation	October 2019	January 2020
	• PFM (Commitment and cash management, PFM regulatory framework, IFMIS)	Long-term advisor	On-going
	• Revenue administration	Early 2020	2020
	• National Accounts and Prices	2020	
	• Balance of Payments (DFID EDDI2)	April 2020	
	• Government Finance Statistics	2020	
	• Financial Sector Statistics	2020	
	• Risk-based Supervision (AFS)	2020	
	• Basel II/Basel III compliance (AFS)	2020	
	• Systemic Risk and Financial Stability	2020	
	• Regulatory and Prudential Framework	2020	
B. Requests for Work Program Inputs			
Fund's requests to Bank	Periodic updates on work and progress related to structural reform agenda, including in the context of the authorities' Strategic Roadmap; business climate; social protection reforms; sectoral spending reviews, particularly health and education; poverty and inequality assessment, following the latest household survey; financial sector strategy; and fiscal structural reforms.		
Bank's request to the Fund	Periodic updates on macroeconomic/fiscal developments and policies and Fund's analytical and technical assistance reports provided to the authorities		

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance (Category B). The most important shortcomings concern timely and reliability of national accounts statistics, coverage and reliability of fiscal operations, and compilation of external sector data.
National Accounts: The Central Statistical Office (CSO) has revised past annual national accounts data from 2011 to reflect revisions in the balance of payments statistics and is planning to rebase GDP. With TA from the Fund and donors, the CSO has integrated tax data in the GDP compilation framework, improved the consistency with balance of payments series and is developing quarterly GDP estimates. Shortcomings remain with frequent GDP data revisions, large statistical discrepancies for the demand-side of GDP series, quality of quarterly GDP series, delays in finalizing GDP series with about a year lag, and absence of formal dissemination system.
Price Statistics: The CSO is working on updating the weights for the CPI and plans to rebase the index using the latest 2016/17 household survey. Monthly consumer price data are disseminated by the CSO with a one-month lag. With Fund assistance, the CSO is also developing a producer price index. The CSO has conducted the 2016/17 Household Income and Expenditure Survey, the 2017 population census, and the 2016 Labor Force Survey.
Government Finance Statistics: Annual budgetary central government data by fiscal year are reported on an invoice-registered basis by spending entity and only to the Fund in the GFSM 2014 format. With Fund support, implementation of GFS classification standards has been recently improved. Large discrepancies are common in the fiscal operations of the Central Government, no fiscal statistics are disseminated for extra budgetary funds and institutions, and consolidated general government. These issues point at several shortcomings and needs for improvements, including: coverage of central government statistics, timely registration of invoices, development of consolidated general government fiscal data; data collection of potential fiscal risks from extrabudgetary funds.
Monetary and Financial Statistics: The Central Bank of Eswatini (CBE) reports monthly monetary statistics on standardized report forms for the CBE balance sheet and other depository corporations (banks, and the Eswatini Building Society since January 2006). Credit and savings cooperatives remain outside the deposit corporations' survey. The CBE reports Financial Soundness Indicators (FSIs) to the Fund for three commercial banks and a Savings and Development Bank on a quarterly basis and, at times, require revisions. The CBE reports data on several indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals.

Balance of Payments and International Investment Position Statistics: The coverage and classification of balance of payments (BOP) and international investment position (IIP) data reported by the CBE are largely in line with the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). The CBE reports BOP and IIP data annually and quarterly. However, frequent and large data revisions and large errors and omissions point at the need for further actions to improve the accuracy and reliability of the BOP data. Recent TA (July 2018) found the current account surplus to be overestimated and provided guidance to improve the coverage. The exchange control data collection system used to compile balance of payments data needs further improvements and validation.
II. Data Standards and Quality
No data ROSC is available for Eswatini. Eswatini implemented the Enhanced General Data Dissemination System (e-GDDS) in January 2017, but needs to improve the timeliness of data posted on its National Summary Data Page. Most metadata have not been updated since 2005.
III. Reporting to STA
The CBE 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. For the first time, in 2019 Eswatini submitted fiscal data in GFSM format to STA for publication in the Government Finance Statistics Yearbook.

Eswatini: Table of Common Indicators Required for Surveillance

(As of December 2, 2019)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Dec 19	Dec 19	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec 19	Dec 19	W	W	M
Reserve/Base Money	Oct 19	Dec 19	M	M	M
Broad Money	Oct 19	Dec 19	M	M	M
Central Bank Balance Sheet	Oct 19	Dec 19	M	M	M
Consolidated Balance Sheet of the Banking System	Oct 19	Dec 19	M	M	M
Interest Rates[2]	Dec 19	Dec 19	M	M	D
Consumer Price Index	Oct 19	Nov 19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Mar 19	Oct 19	M	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[4]	Sep 19	Nov 19	Q	Q	Q
External Current Account Balance	Jun 19	Nov 19	Q	Q	Q
Exports and Imports of Goods and Services	Jun 19	Nov 19	M	Q	Q
GDP/GNP	2018	Sep 19	A	A	A
Gross External Debt	Sep 19	Nov 19	Q	Q	Q
International Investment Position[5]	Jun 19	Nov 19	Q	Q	Q

[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).

Statement by Mr. Dumisani Mahlinza Executive Director,
and Mr. Muayad Ismail, Advisor on Kingdom of Eswatini
January 31, 2020

I. INTRODUCTION

1. Our authorities appreciate the constructive Fund engagement during the recent Article IV Consultation mission to the Kingdom of Eswatini. They broadly concur with the staff's analysis and policy recommendations.

2. The economy of Eswatini continues to face severe macroeconomic challenges characterized by high fiscal deficits, rising debt, accumulation of domestic arrears, and a decline in foreign exchange reserves. At the same time, volatility in Southern African Custom Union (SACU) revenues, recurring droughts, and a recent terms of trade shock have weighed on economic performance. Recognizing these challenges, the new government, which came into power in October 2018 launched the National Development Plan 2019-2022 (NDP), which aims to restore macroeconomic stability by fostering fiscal discipline, ensuring prudent debt management, adherence to good governance practices, and promoting private sector led growth. In addition, the new government launched a Strategic Roadmap, focused on improving the business climate and boosting private investment.

II. RECENT ECONOMIC DEVELOPMENTS AND THE OUTLOOK

3. Real GDP growth declined from 2.4 percent in 2018 to 1.2 percent in 2019 owing to a decline in private sector activity emanating from an escalation of fiscal challenges that culminated in the accumulation of government arrears. Going forward, the authorities anticipate a modest recovery in medium term growth supported by increased private investment in response to the implementation of policies articulated in the recently developed recovery roadmap and relief for the private sector as government clears some of its arrears.

4. Inflation declined from 4.8 percent in 2018 to 2.6 percent in 2019 due to depressed aggregate demand that accompanied the economic slowdown, and a sustained freeze on water and electricity tariffs. Against the backdrop of subdued inflation and low growth, the Central Bank of Eswatini (CBE) cut the discount rate by 25 basis points in July 2019 to 6.5 percent to support private sector credit and stimulate economic activity.

5. The current account surplus increased from 2.0 percent of GDP in 2018 to 3.8 percent of GDP in 2019 underpinned by improvements in the trade balance as exports recovered somewhat and imports declined slightly. Over the medium term, the current account is expected to slightly weaken due to slow export growth. Meanwhile the fiscal deficit is expected to narrow from 11.2 percent of GDP in 2018 to 6.3 percent of GDP in 2019 supported by several expenditure and tax measures implemented as part of the 2019/20 budget. Going forward, the deficit is expected to further decrease as the authorities implement consolidation measures.

III. Fiscal Policy

6. The authorities recognize the extent of the fiscal challenges and broadly concur that a fiscal adjustment of about 6 percent of GDP would be needed over the next few years to restore fiscal sustainability and place public debt on a downward trajectory. They however, note that a more gradual consolidation path would be more appropriate to smoothen the adverse effects of adjustment on growth and vulnerable households.

7. Since taking office in late 2018, the new government has taken steps to control the rising fiscal deficit, including implementing policies to contain the wage bill and restructure some loss-making public entities. As a result, they estimate the FY 19/20 deficit to be lower than the previous year. Given the magnitude of the adjustment required to restore fiscal sustainability, the authorities intend to use FY20/21 to build consensus towards a comprehensive consolidation plan, while keeping the fiscal deficit low. Starting in FY21/22, the authorities plan to continue a gradual fiscal adjustment spread over four or five years. Importantly, they plan to develop a medium-term fiscal framework to stabilize public debt levels going forward.

8. As part of an effort to place public finances on a sustainable path, the authorities have implemented a combination of expenditure and revenue measures. Going forward, they plan to continue controlling the wage and non-wage expenditures over the medium term through a sustained freeze on new hiring while accounting for capacity constraints. They also plan to leverage a temporary increase in SACU revenue to finance a wage increase in FY2020/21 to cushion civil servants following three years of a wage freeze. Further, they plan to optimize capital expenditures in line with the new NDP to focus on high impact and high return projects, while strengthening the project selection criteria and tendering process, and improving project implementation and management, in line with the recent PIMA recommendations. While they see limited scope to reduce capital outlays in FY2020/21 given the respective legal and financial agreements associated with ongoing projects, the authorities will prioritize spending thereafter as part of their medium-term plan.

9. On the revenue side, measures already introduced by the authorities include increases in excise taxes for alcohol, tobacco and fuel that are expected to be fully effective in FY20/21. The authorities also have plans to improve revenue collection, review tax exemptions, and sell off some government assets to generate additional revenue.

10. The authorities concur with the need to develop an effective and transparent arrears clearance strategy, going forward. To this end, they recently introduced an invoice tracking

system to help identify unpaid bills from ministries and government departments and improve the management of government arrears. To clear part of the existing stock of arrears and provide relief to the private sector, they have issued domestic securities and secured external financing.

11. To address weaknesses in public financial management, the authorities are planning to accelerate operationalization of the Public Financial Management Act, implement an Integrated Financial Management Information Systems and introduce a Treasury Single Account. They also plan to undertake a comprehensive review of public enterprises to reduce relevant subventions and increase dividends through potential mergers, where appropriate. The authorities also concur with the need to develop a cost-effective and transparent procurement system, including revamping the tender board and would require Fund technical assistance in this area.

IV. MONETARY AND FINANCIAL POLICIES

12. The authorities reiterate that the exchange rate peg has served the economy well, providing an effective policy anchor and helping to contain inflation. Recognizing deterioration in the level of reserves, the CBE launched a program to purchase FX from banks at market price to support the exchange rate peg. In addition, they intend to secure a large FX swap to further bolster the reserves' position. In parallel, the CBE will continue to employ effective monetary policy instruments to mop up resultant excess liquidity. Further, the authorities plan to maintain the policy rate broadly in line with the South African Reserve Bank's rate, taking into account differential risks and other key economic factors.

13. Despite the challenging macroeconomic environment, the financial sector has remained broadly stable, well capitalized, and profitable, with ample liquidity buffers. Nonetheless, vulnerabilities in the banking sector have continued to grow with a weakening in bank's asset quality, rising exposure to the sovereign.

14. To improve financial sector oversight, the authorities are progressively implementing Basel II standards, strengthening risk-based supervision and requiring exposed banks to develop plans to address high NPLs. While an early intervention regime is in place, the authorities have identified gaps and plan to introduce mandatory corrective actions to strengthen the regime. They recognize the importance of introducing a macro-prudential policy framework to address financial stability risks and will continue to monitor risks emanating from high household debt.

15. The authorities are presently reviewing the Financial Services Regulatory Authority (FSRA) Act and laws regulating specific sectors to strengthen the non-bank financial institutions' oversight framework. At the same time, the FSRA has continued to expand its coverage of non-banks under its purview and continues to build its regulatory and supervisory capacity with Fund TA. Further, the authorities plan to conduct a national risk assessment in 2020, which will inform a review of AML/CFT requirements and risk-based activities of the CBE, FSRA, and the Financial Intelligence Unit. They also intend to expedite enactment of the Financial Institutions Act and the CBE law, to strengthen the oversight of the financial sector and the bank resolution framework.

V. STRUCTURAL REFORMS

16. The authorities recognize that implementing structural reforms is critical to facilitate private sector growth, bolster long-term inclusive growth, and reduce poverty. To this end, the Strategic Roadmap identified priority high impact actions to facilitate private investment. In this connection, the authorities recently established special economic zones with investment incentives and launched a National Financial Inclusion Strategy to enhance access to finance, stimulate SME growth, and support small-holder farmers. In addition, they are facilitating the set-up of selected large foreign investment projects.

17. As part of an effort to improve the business environment, the authorities plan to establish a one-stop shop for business registrations, simplify licensing requirements, and enhance the use of e-government and digital processes. They also plan to reduce the costs and time associated with commercial court cases and resolution of commercial disputes as well as improve the governance and strengthen the anti-corruption framework.

18. To help increase competition in the ICT sector and reduce communication costs, the authorities intend to accelerate liberalization of the ICT sector by unbundling the Eswatini Posts and Telecommunications Corporation (EPTC) into three separate and independent entities as well as encouraging competition in the fixed and mobile telephone market. They also plan to restructure the electricity sector by supplementing electricity supply with renewable energy sources while adjusting electricity cross-subsidies to ensure cost-effective pricing, in line with the objectives of the NDP.

19. The authorities continue to allocate substantial budgetary resources towards social spending, including education, health, and cash transfers. They have also decentralized social services to increase access at more affordable costs. Going forward, the authorities plan to strengthen social safety nets, increase the old age grant, and introduce programs to target poor children to further protect the vulnerable segments of the population.

20. Finally, the authorities are working on improving access to quality, relevant, and inclusive education, reducing the skills gap in the economy, enhancing research and development and innovation, and removing wage rigidities with a view to enhancing social and human capital deployment.

VI. CONCLUSION

21. The authorities are committed to implementing a comprehensive fiscal consolidation plan and structural reforms needed to restore fiscal stability, stop accumulation of government arrears, stabilize the public debt, and support inclusive growth. They appreciate Fund's advice and technical support and look forward to continued collaboration in implementing their reform agenda.