March 2007
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The Kingdom of Swaziland: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director

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 2006 Article IV consultation with the Kingdom of Swaziland, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 27, 2006 with the officials of the Kingdom of Swaziland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 16, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 31, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for the Kingdom of Swaziland.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

THE KINGDOM OF SWAZILAND

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for
the 2006 Consultation with The Kingdom of Swaziland

Approved by David Andrews and Adrienne Cheasty

January 16, 2007

- Streamlined 2006 Article IV consultation discussions were held in Mbabane November 16–27, 2006. The mission team comprised Ms. Soonthornsima (head), Mr. Fontaine, and Ms. Masha (all AFR). Mr. Mamba (Executive Director's office) also participated. Staff met with Finance Minister Sithole, Central Bank Governor Dlamini, and representatives of the private sector, unions, and the donor community. Staff presented key findings to the Cabinet.

- The Executive Board concluded the 2005 Article IV consultation on February 8, 2006. Directors noted that Swaziland's economic performance had deteriorated over the past two years, and considered that the key policy challenges facing the authorities were to restore fiscal sustainability and external competitiveness to reduce poverty. With the exchange rate of the lilangeni pegged at par to the South African rand under the Common Monetary Area arrangement, Directors welcomed Swaziland's efforts to strengthen reserve management, but stressed that strengthening the official foreign position would depend critically on a prudent fiscal policy stance.

- Implementation of Fund advice has been slow, particularly with respect to fiscal adjustment and structural reforms to strengthen the business environment and promote competition in product markets. Swaziland has, however, benefited from Fund technical assistance in financial management and statistics.

- Swaziland has no outstanding use of Fund resources. It is not eligible for debt relief under the HIPC Initiative. It has accepted the obligations of Article VIII, Sections 2–4 and maintains an exchange restriction arising from a 33.33 percent limit on advance payments for imports of capital goods.

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EXECUTIVE SUMMARY

Background: Swaziland's economic performance remains weak. Poverty has escalated in the face of high and rising unemployment, food shortages, and the world's highest HIV/AIDS infection rate. In 2006, growth slowed to around 2 percent; inflation is rising; and the current account surplus is narrowing. Significant windfall revenue from the South Africa Customs Union (SACU) during 2006/07—greater than anticipated during the 2005 Article IV mission—is expected to improve the fiscal balance temporarily despite a lack of fiscal reform and rising expenditure, particularly for wages. It also contributed to an increase in official reserves from 1.2 months of imports in December 2005 to 2.3 months in November 2006. An opportunity exists for the authorities to address overdue fiscal reforms using the windfall revenues, which are projected to stay high through 2007/08 but then sharply decline.

Key Policy Issues: The 2006 streamlined Article IV consultation focused on the following:

- **Fiscal sustainability**: The current fiscal stance will be unsustainable as SACU revenues begin to fall. Deficit financing has relied on drawdowns of government financial assets closely connected with international reserves, a practice which risks undermining the exchange rate parity in the Common Monetary Area (CMA). Staff recommended immediate action to improve budget management, reduce the wage bill, and begin civil service reform and privatization. Over the medium term, this would permit a build-up of international reserves and create fiscal space to fight poverty.

- **Financial sector vulnerability:** Concentration of lending in a few sectors makes Swaziland's financial system vulnerable. Supervision needs strengthening, particularly for deposit-taking nonbank financial institutions, which are expanding rapidly. With the support of MCM, the central bank is intensifying commercial bank supervision and improving reserve management, and is beginning to address weaknesses in nonbank supervision.

- **External competitiveness and structural reforms:** Swaziland is susceptible to a range of potentially permanent shocks, including erosion in the preferential treatment of major exports and the SACU revenue decline. Since Swaziland remains pegged to the rand, structural reforms are key to improving competitiveness—including labor market reforms; simplifying business licensing requirements and procedures; improving transportation, energy, and telecommunication infrastructures; and enhancing land productivity by a strategy for land reform.

I. BACKGROUND

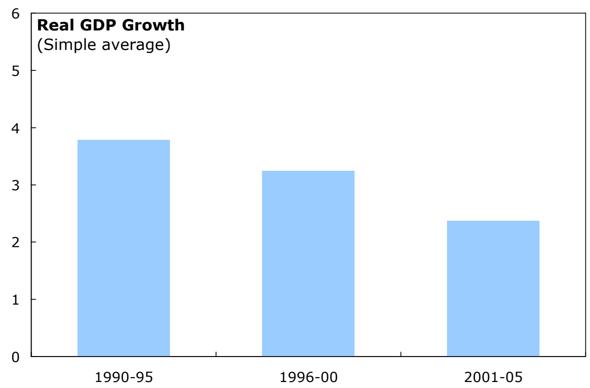
1. **Swaziland's economic performance remains weak.** Because of a substantial real appreciation of the lilangeni during 2002-04, erosion of trade preferences, and recurrent droughts, growth has averaged only 2 percent since 2000.[1] Over that same period, rising government expenditures, especially on the wage bill, undermined fiscal sustainability and reduced foreign reserves to critically low levels. Swaziland has one of the highest income-inequality among low-middle-income countries with a Gini coefficient of 0.61. Poverty has escalated in the face of high and rising unemployment, food shortages, and the world's highest HIV/AIDS infection rate. The World Food Program estimates that about 20 percent of the population required food aid during 2006 (Figure 1).

2. **In 2005/06 fiscal and external imbalances were masked by a temporary rise in revenues from the South Africa Customs Union (SACU).** GDP growth in 2006 is estimated at about 2 percent, close to the average of the last five years. Inflation is expected to reach 5.4 percent at end-year as food prices continued to rise. The surge in SACU revenues (related to South Africa's higher import bill) sharply reduced the fiscal deficit to 1.5 percent of GDP in 2005/06 from 4.6 percent in 2004/05. Despite weak export growth following the elimination of textile quotas, a small external current account surplus is expected in 2006 because of the SACU windfall, and net international reserves increased from 1.2 months of imports in December 2005 to 2.3 months in November 2006. Since December 2005, the real effective exchange rate has depreciated by 8.4 percent, primarily reflecting movements in the rand-U.S. dollar exchange rate (Figure 2). Consistent with the peg to the rand, the Central Bank of Swaziland (CBS) has maintained its interest rates in line with South Africa's; in December, the CBS increased the discount rate by 50 basis points to 9 percent.

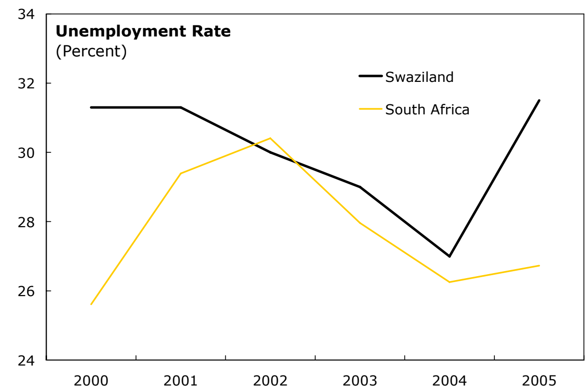
[1] See IMF Staff Country Report No. 03/22, January 2003.

Figure 1. Swaziland: Main Challenges

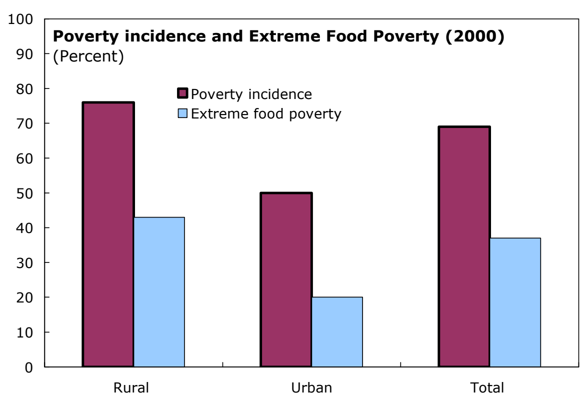
The deterioration in real GDP growth continues...



...and unemployment has risen sharply.



Poverty is rising and food is still scarce.



HIV/AIDS prevalence is the highest in the world.

HIV/AIDS Prevalence in SACU Countries, 2005
(Percentage of adult population, ages 15-49)

Botswana	24.1
Lesotho	23.2
Namibia	19.6
South Africa	18.8
Swaziland	**33.4**
Sub-Saharan Africa	6.1

Although growth lags behind the region...

Real GDP Growth, 2001-2005 (Percent)

	2001	2002	2003	2004	2005	2000-05 Average
SSA average	4.1	3.5	4.0	5.7	5.6	4.6
SACU average	3.0	4.5	3.7	4.4	3.7	3.8
Botswana	4.9	5.6	6.3	6.0	6.2	5.8
Lesotho	3.3	3.6	3.2	2.7	1.3	2.8
Namibia	2.4	6.7	3.5	6.6	4.2	4.7
South Africa	2.7	3.7	3.0	4.5	4.9	3.7
Swaziland	**1.6**	**2.9**	**2.9**	**2.1**	**2.3**	**2.4**

...Swaziland remains a middle- income country—but with extensive income inequality.

GNI per Capita, 2001-04 (PPP, Current dollars)

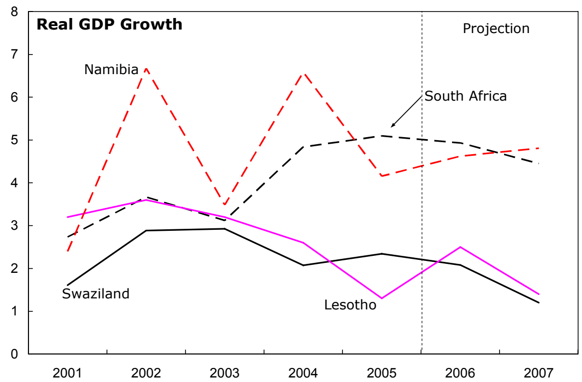
	2001	2002	2003	2004	2000-04 Average
SSA average	1,671	1,713	1,770	1,871	1,756
SACU average	6,192	6,508	6,832	7,310	6,711
Botswana	7,700	8,190	8,900	9,590	8,595
Lesotho	2,800	2,940	3,090	3,270	3,025
Namibia	6,300	6,720	6,990	7,520	6,883
South Africa	9,570	9,970	10,340	11,160	10,260
Swaziland	**4,590**	**4,720**	**4,840**	**5,010**	**4,790**

Source: World Bank, World Development Indicators.

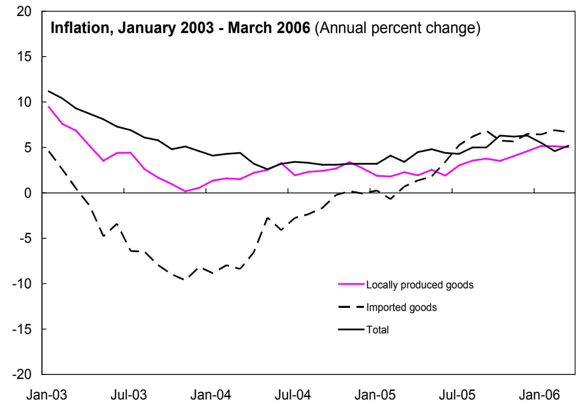
Sources: National authorities, IMF staff estimates, Swaziland Household Income and Expenditure Survey, 2000-2001, World Bank, World Development Indicators, and UNAIDS report, 2006.

Figure 2. Swaziland: Recent Economic Developments

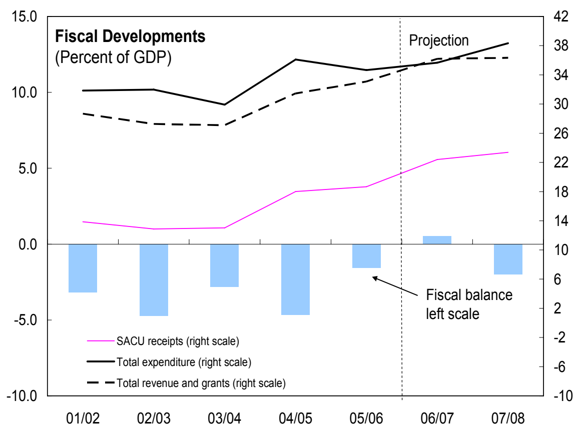
GDP growth is slowing...



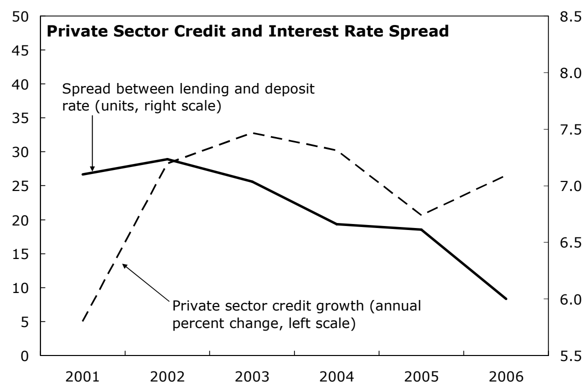
and inflation has been rising since 2005.



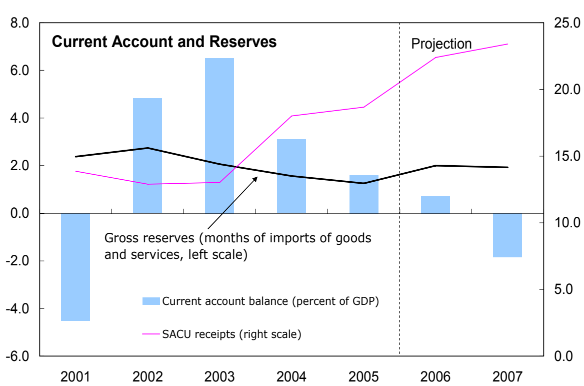
Fiscal operations continue to benefit from SACU receipts.



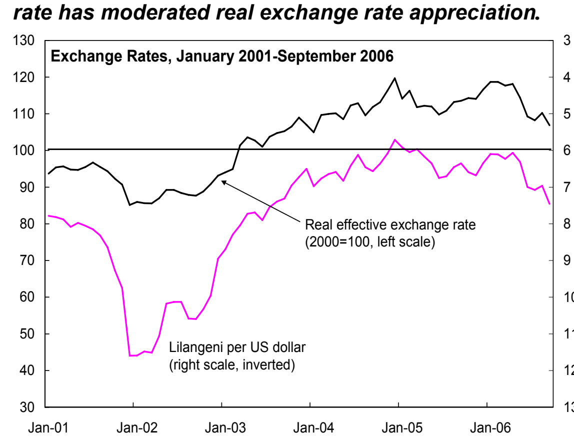
Credit growth is accelerating, and the interest rate spread has narrowed because of more competition in the financial market.



Since 2006 the current account and reserves are strongly influenced by SACU windfalls...



...and recent weakening of the nominal exchange rate has moderated real exchange rate appreciation.



Sources: National authorities and IMF staff projections.

II. Report on the Policy Discussions

A. Outlook, Future Challenges, and Strategy

3. **The authorities and staff agreed that the medium-term outlook remains difficult despite the short-term fiscal and external benefits from the temporary SACU revenues.**[2] Trade preference erosion, especially the anticipated reductions in preferential prices for sugar exports to the EU by 36 percent over the next three years, the forecast decline in SACU tariff revenues as import demand slows in South Africa, and Swaziland's limited diversification are likely to contribute to slowing growth to about 1 percent in the medium term.

4. **Growth is hampered also by institutional factors.** Poor labor productivity, the high cost of doing business, and low governance and transparency indicators deter new investment. The high prevalence of HIV/AIDS seriously undermines human development prospects. The low revenue base, weak public expenditure management, and wage pressures inhibit the effective execution of the government's Poverty Reduction Strategy and Action Plan and the mobilization of much-needed development assistance.

5. **Staff presented two scenarios to illustrate the policy challenges** (see text table). The first assumes no change in current policies, leading to a worsening in fiscal balances, rapid debt accumulation, and subdued real growth. Without structural reforms to improve competitiveness, activity will continue to stagnate, causing the current account deficit to widen and reserves to decline to uncomfortably low levels. Under a reform scenario anchored on fiscal consolidation and a range of structural improvements, the growth rate could gradually rise to around 3 percent. The fiscal and external positions would strengthen and increased external reserve accumulation would bolster confidence in the peg. Key prerequisites are improved business and governance climates, needed to support higher donor participation and private investment, particularly in the export sector.[3]

6. **To address the key challenges, the 2006 streamlined Article IV consultation focused on:** (i) medium-term fiscal sustainability; (ii) financial sector vulnerability; and (iii) structural reforms to strengthen external competitiveness.

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[2] The short-term outlook is significantly better than at the time of the 2005 Article IV consultation, due to the sharp (6 percent of GDP) upward revision of estimated 2006/07 SACU revenue, and to significant data revisions in the external sector—implying a lower fiscal deficit and public debt than in Country Report No. 06/106, March 2006. Moreover, SACU revenue is now projected to remain high in 2007/08 before declining.

[3] In December 2006, the US Congress extended the provision allowing the use of third-country fabrics in textile export manufactures under the African Growth and Opportunity Act (AGOA) from 2007 to 2012. However, the ban on beef exports to the EU remains.

Swaziland: Medium-Term Scenario, 2005-2010
(Percent of GDP, unless noted otherwise)

	2005	2006	2007	2008	2009	2010
Main macroeconomic variables [1]						
Without measures						
Real GDP growth (percent)	2.3	2.1	1.2	1.0	1.0	1.0
Current account balance	1.6	0.7	-1.8	-3.0	-4.1	-4.0
Gross official reserves (millions of US dollars)	231	378	384	353	283	233
Gross official reserves (months of imports of goods and nonfactor services)	1.3	2.0	1.9	1.8	1.4	1.1
Government debt	15.6	14.1	14.4	16.7	19.9	24.0
Total Revenues and grants	32.5	35.5	35.9	33.7	32.2	31.7
of which : Domestic revenues	13.1	13.5	12.3	12.2	12.2	12.2
SACU	18.3	22.0	23.1	21.0	19.5	19.0
Total Expenditure and Net Lending	34.0	33.6	37.9	37.4	37.6	37.8
of which : Wages and salaries	14.4	15.6	15.4	15.4	15.4	15.4
Goods and services	5.9	5.2	6.0	6.0	6.0	6.0
Interest payments	1.1	1.8	1.3	1.0	1.2	1.5
Fiscal balance, including grants	-1.5	1.9	-2.0	-3.7	-5.4	-6.1
Reform policies scenario						
Real GDP growth (percent)	...	2.1	1.8	2.6	3.1	3.1
Current account balance	...	0.7	-0.3	1.5	2.2	2.4
Gross official reserves (millions of US dollars)	...	389	432	468	501	536
Gross official reserves (months of imports of goods and nonfactor services)	...	2.1	2.2	2.3	2.4	2.5
Government debt	...	14.1	9.8	9.0	7.3	5.8
Total Revenues and grants	...	35.5	36.3	35.1	33.7	33.4
of which : Domestic revenues	...	13.5	13.1	13.3	13.5	13.7
SACU	...	22.0	23.1	21.0	19.5	19.0
Total Expenditure and Net Lending	...	32.5	35.8	34.1	32.9	32.6
of which : Wages and salaries	...	15.6	15.0	14.4	13.9	13.4
Goods and services	...	4.5	5.5	5.5	5.5	5.5
Interest payments	...	1.8	1.2	0.7	0.8	1.0
Fiscal balance, including grants	...	3.0	1.3	1.0	0.8	0.8

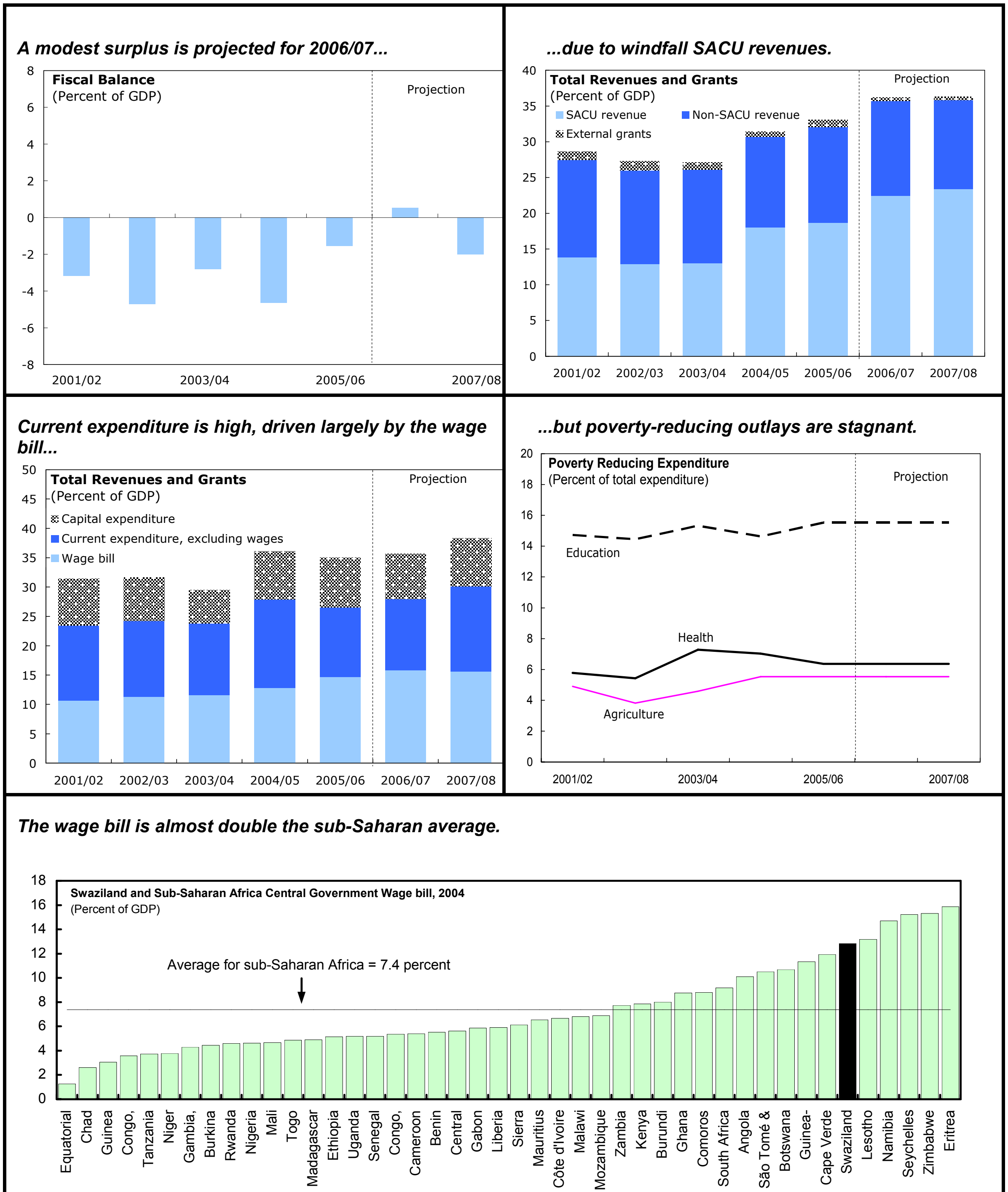
1 Fiscal year runs from April 1 to March 31.

B. Fiscal Sustainability

7. **Reforms to strengthen fiscal sustainability have been limited since the 2005 Article IV consultation.** Additional SACU revenue reduced the 2005/06 fiscal deficit, despite few policy measures. In 2006/07, progress towards reorienting expenditure and rightsizing the civil service by a partial freeze on filling vacancies has been offset by the creation of an additional ministry and new positions (Figure 3). A public expenditure management reform project became operational in 2006 but has yet to be extended to all line ministries. Parliament has, however, approved an anti-corruption act and a strategy for privatizing public enterprises that are a burden on the budget.

8. **Staff and the authorities agreed that current fiscal policies cannot be sustained, since they could jeopardize the credibility of the exchange rate peg.** Staff's baseline estimates for 2006/07 show too small a surplus to be consistent with the build-up of international reserves targeted by the authorities. Moreover, the authorities' medium-term budgetary framework allows for a spending increase of 3 percent of GDP in 2007/08, and is based on overly optimistic domestic revenue forecasts. Staff indicated that this expenditure level was not sustainable in the face of the expected SACU revenue decline. Financing for the implied large fiscal deficits would erode international reserves under the current

Figure 3. Swaziland: Fiscal Developments



Sources: National authorities and IMF staff projections.

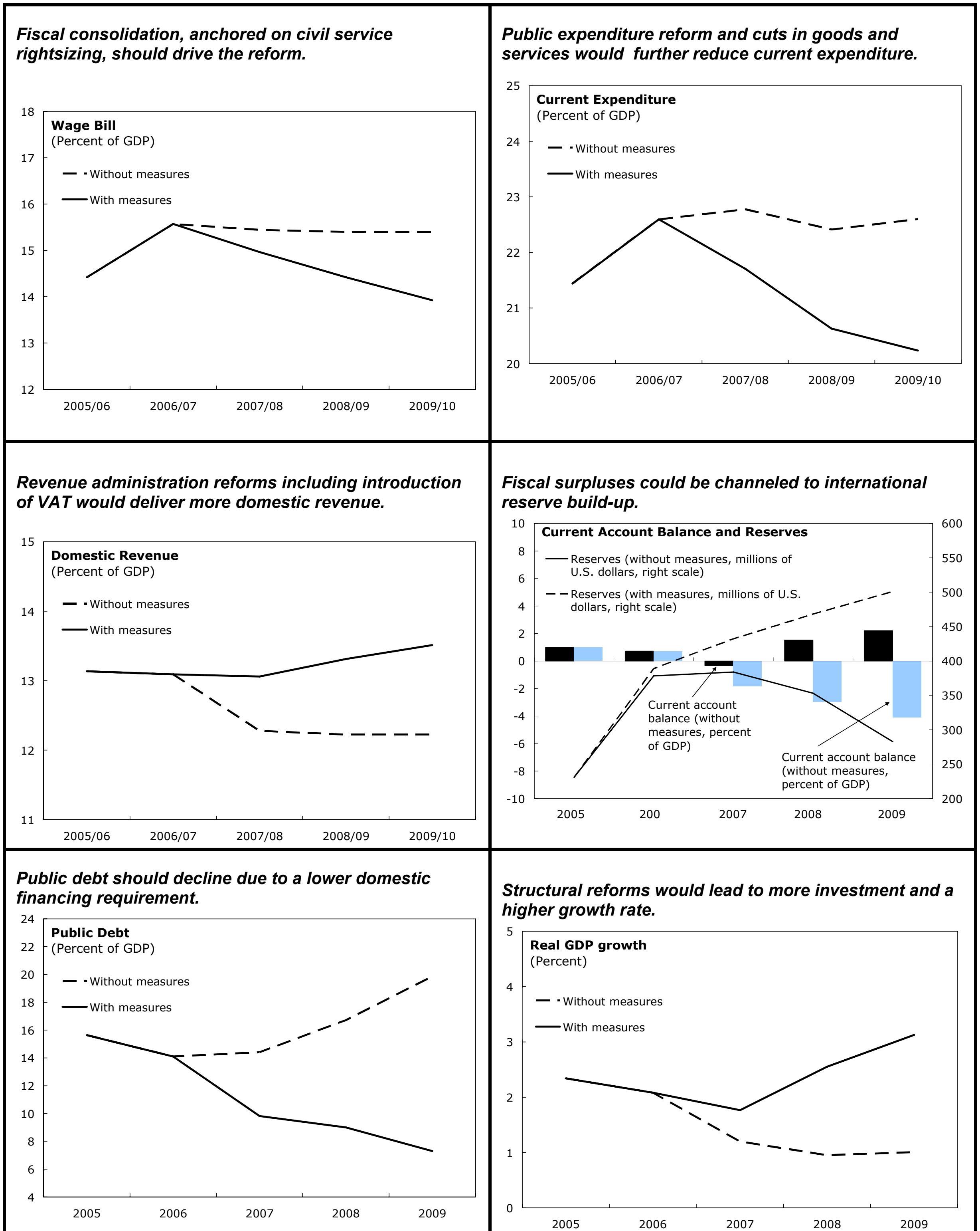
exchange rate arrangement given Swaziland's lack of access to concessional external resources and limited scope for domestic financing without incurring arrears.

9. **The reform scenario discussed with the authorities targets small fiscal surpluses over the medium term to enable a build-up of international reserves** (Figure 4). An initial spending reduction of 1.1 percent of GDP in the rest of 2006/07 would, together with continued high SACU receipts, yield a surplus of 3 percent of GDP. In the medium-term, fiscal consolidation and structural reforms should improve the business climate, promote private sector growth, and contribute to higher real GDP and a stronger current account. Staff urged the authorities to take advantage of the SACU windfall to quickly implement key fiscal measures that would drive the outcome in the reform scenario. These include reform of civil service rightsizing to lower the wage bill, the tax administration and introduction of a VAT to raise domestic revenue, and privatization of public enterprises to reduce subsidies and transfers.

10. **The authorities agreed on the need to safeguard macro-stability by targeting fiscal consolidation through implementation of the required reforms, especially reducing the excessive wage bill.** While reiterating that no supplementary budget would be issued and new wage costs would be allocated within the 2006/07 budget, they stressed the political difficulties of implementing extensive civil service reforms at this time. Nevertheless, they have initiated plans to eliminate vacant positions in 2007/08 and review the appropriate staff size for each ministry, and have introduced a performance management system. The authorities have requested technical assistance from FAD and the African Development Bank to accelerate the establishment of the revenue authority in 2007/08, and then the introduction of a VAT. They also plan to further implement public expenditure management reforms and eliminate arrears. This reform is critical, given the serious cash flow problems and arrears accumulation of the last few years.

11. **The authorities confirmed their commitment to accumulate international reserves in the medium term to at least 3 months of imports of goods** (2.6 months of imports of goods and services). Staff supported this objective. While reserves are now comfortable in relation to the domestic monetary base (reflecting the free circulation of the rand) and external debt (which stands at less than 24 percent of GDP), preventing the projected reserve decline would increase confidence in the peg and cushion against adverse external shocks. More specifically, the authorities committed to increasing reserves by E400 million at end-March 2007, which would raise reserve cover to 2.4 months of imports, and indicated that, by end-November 2006, they had already deposited E300 million at the CBS.

Figure 4. Swaziland: Baseline and Reform Scenario



Source: National authorities and IMF staff projections.

C. Financial Sector Stability and Vulnerability

12. **Swaziland's financial sector is relatively diverse.** Three majority-owned South African commercial banks, the government-owned SwaziBank, and 66 savings and credit cooperatives are the main deposit-taking institutions. The rest of the financial sector comprises the Swaziland Building Society and the Swaziland Industrial Development Company. Contractual savings institutions such as the Swaziland National Provident Fund, the Public Service Pension Fund, and the Royal Swaziland Insurance Corporation are also active. There is a small, relatively inactive, stock exchange and a small bond market which opened in 2002.

13. **The authorities have made progress in strengthening commercial bank supervision but vulnerabilities remain.** The authorities and staff concurred that the CBS should move towards a prudential and regulatory framework consistent with international norms and best practices. The authorities indicated that they have recently intensified onsite supervision and that, if necessary, external auditors could be called in.

14. **Additional vulnerability could arise from the high concentration of credit in the tradable sector, especially sugar** (Figure 5). Staff noted that, considering the structure of the economy, the acceleration of credit growth and its concentration may stretch banks' capacity to assess and manage credit risk. The authorities responded that banking system credit is now subjected to a single obligor limit, thereby mitigating risks.

15. **Staff raised concerns about the rapid growth and poor supervision of deposit-taking nonbank financial institutions,** which currently account for about 11 percent of banking system deposits. Credit has expanded especially among rural dwellers with little or no access to the formal banking system. The Ministry of Agriculture and Cooperatives exercises only moderate oversight. As the nonbank financial sector has expanded, two credit cooperatives requested government guarantees; if approved they would create a contingent liability of E 60 million (1 percent of government expenditure). The authorities concurred with the mission that government should not act as guarantor to these institutions. They also agreed that the inadequate supervision could be risky for depositors and expressed keen interest in working with the Fund to improve supervision.

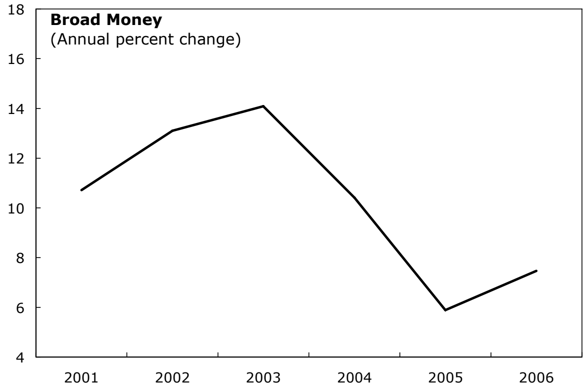
Swaziland: Deposit-taking Cooperative Societies

	2003	2004	2005
Registered societies	59	51	66
Membership, thousands	40.5	35.5	39.9
Savings			
Millions of emalangeni	251.2	270.6	352.1
Percent of banking system deposits	9.1	8.9	10.9
Percent of GDP	1.7	1.8	2.1
Loans			
Millions of emalangeni	167.9	189.6	258.3
Percent of private sector domestic credit	7.5	6.5	7.3
Percent of GDP	1.2	1.2	1.6

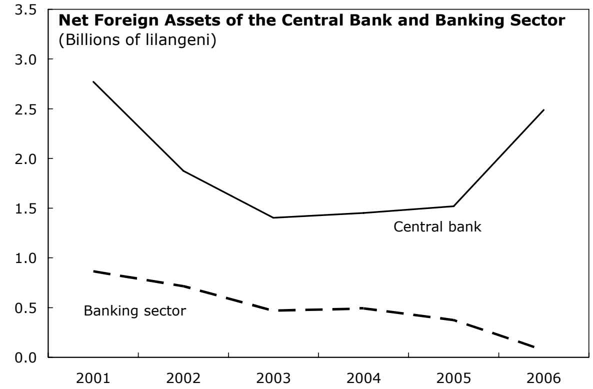
Source: Swaziland Ministry of Agriculture and Cooperatives

Figure 5. Swaziland: Monetary and Financial Developments [1]

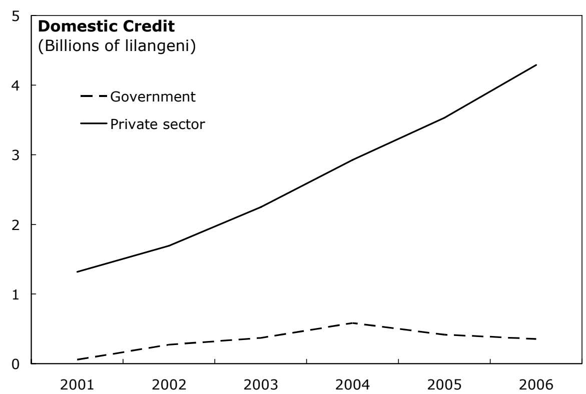
Since 2005 money growth has rebounded...



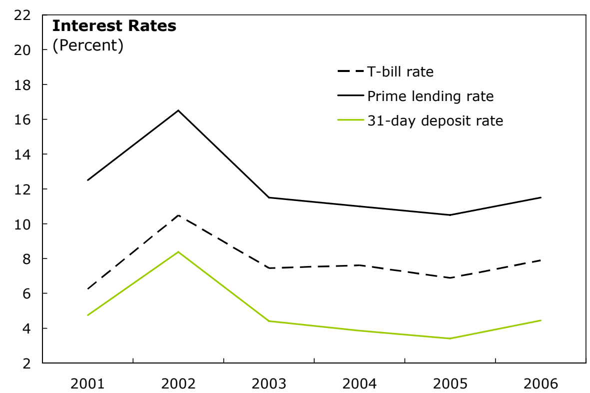
...and net foreign assets of the Central Bank increased.



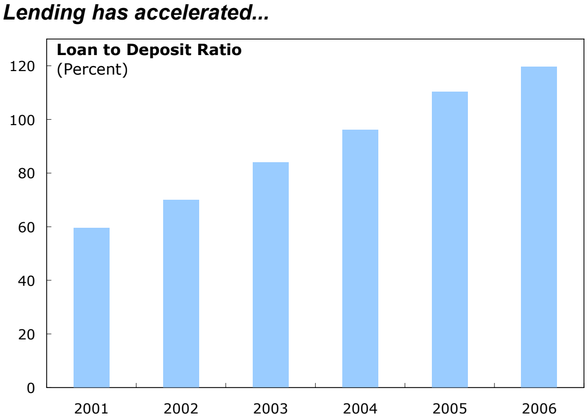
Though government borrowing has recently declined, credit to the private sector has expanded ...



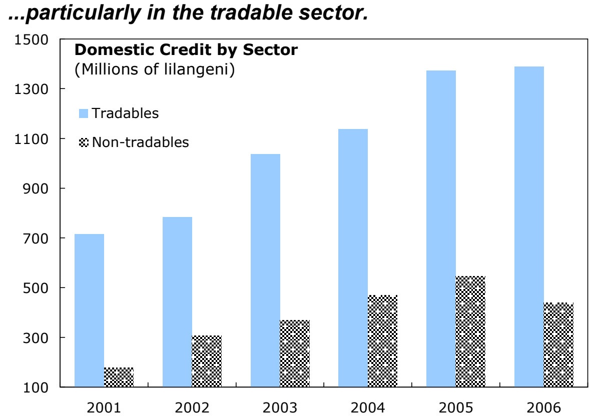
... despite rising interest rates, as in South Africa.



Lending has accelerated...



...particularly in the tradable sector.



Sources: National authorities and IMF staff projections.

[1] For 2006, data are as of July, except for the loan-to-deposit ratio and domestic credit by sector, which are as of June, and interest rates, which are as of August.

D. External Competitiveness and Structural Reforms

16. **Staff supports the authorities' view that maintaining the peg to the rand is appropriate, given Swaziland's close economic integration with Southern Africa.** However, this creates challenges for competitiveness. The recent depreciation of the rand has also resulted in a moderate depreciation of the lilangeni in real effective terms. However, further inflationary pressures could arise given the ongoing depreciation of the rand. If such effects are not contained (for example, by controlling wage and fiscal pressures), competitiveness vis-à-vis South Africa and other trading partners may be further eroded.[4] More fundamentally, poor governance indicators and low labor productivity threaten future competitiveness (Figure 6).

17. **The authorities and staff concurred that competitiveness-enhancing reforms to increase productivity, reduce the cost of doing business, and improve governance are needed to complement macro-policies**. Key elements should include skills-training combined with policies to alleviate the productivity-eroding impact of skill mismatches, labor-market rigidities, and HIV/AIDS. To attract investment the authorities should: (i) simplify business licensing requirements and procedures; (ii) improve transportation, energy, and telecommunication infrastructures; and (iii) increase land productivity, partly by a land reform strategy. The authorities noted their efforts to improve competitiveness through parliamentary passage of an anti-corruption bill; establishment of a Business Economic Advisory Panel to improve Swaziland's image; and approval of a national export strategy. The World Bank is assisting with an Investment Climate Assessment Survey. While welcoming these initiatives, staff stressed the importance of prompt implementation of recent USAID recommendations ("The Swaziland Investor Roadmap 2005"), which confront complications caused by government regulations; and of making the anticorruption commission operational.

E. Other Issues

18. **The authorities and staff share the view that data improvements are needed.** These are particularly important for the national accounts and balance of payments, which are subject to large and frequent revisions. Staff encouraged the authorities to facilitate public participation in policy development, by improving statistics and the dissemination of information. This year for the first time, government reported to parliament on the quarterly budget execution.

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[4] An overwhelming majority of Swaziland's trade flows are accounted for by South Africa, which therefore plays a crucial role in determining the real effective exchange rate.

Figure 6. Swaziland: Competitiveness Indicators

High labor cost is hurting competitiveness...

Garment Sector Wages for Selected Countries, 2002

	Wages per hour (US dollars)
Swaziland [1]	0.86
SACU	
South Africa	1.38
Lesotho [2]	0.45
AGOA	
Kenya	0.38
Mauritius	1.25
Madagascar [3]	0.33
Asia	
China [4]	0.78
India	0.38
Sri Lanka	0.48

Source: USITC (2004); Cadot and Nasir (2001), USAID (2004).

[1] Estimate based on a US$155 monthly wage reported in USAID and a 45hr work week.

[2] Midrange of monthly wages as reported in USITC (US$80-100) and a 50hr work week.

[3] Data for 2001 computed in Cadot and Nasir (2001).

[4] Midrange between US$0.68-0.88 as reported in USITC.

...as is the inefficient business environment.

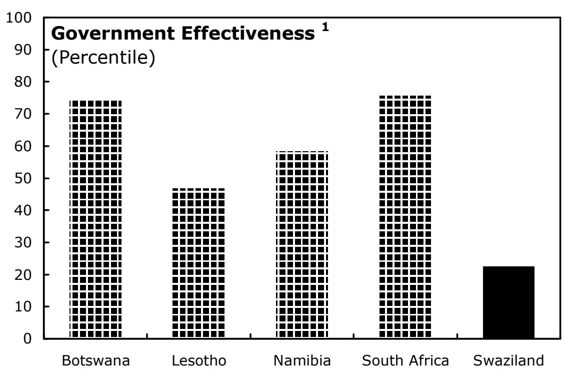
Doing Business [1]

	2006 rank	2005 rank	Change
Doing business	76	67	-9
Starting a business	112	94	-18
Dealing with licenses	16	20	4
Registering property	140	134	-6
Getting credit	21	19	-2
Protecting investors	168	168	0
Trading across borders	133	130	-3
Enforcing contracts	132	130	-2

Source: World Bank.

[1] Ranking based on the 175 countries surveyed.

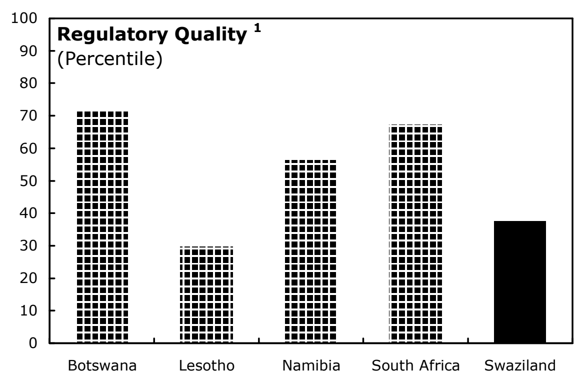
The quality of public service is the lowest in the region.



Source: Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Governance Matters V: Governance Indicators for 1996-2005."

[1] Government effectiveness measures the quality of public services, civil service, policy formulation and implementation.

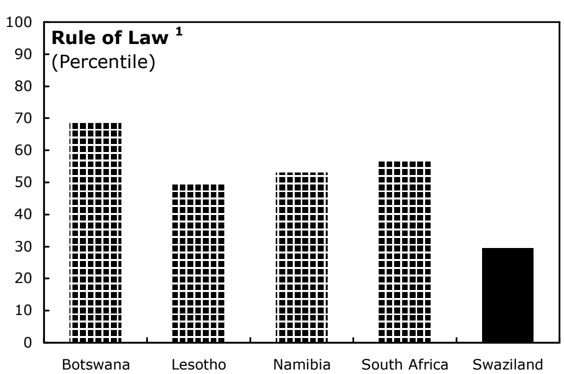
Poor regulation impedes private sector development.



Source: Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Governance Matters V: Governance Indicators for 1996-2005."

[1] Regulatory quality measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

The inadequate rule of law lowers foreign investor confidence...



Source: Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Governance Matters V: Governance Indicators for 1996-2005."

[1] Rule of law measures the extent to which agents have confidence in and abide by the rules of society, in particular the quality of contract enforcement, the police, and the courts.

...as do negative perceptions of corruption.

Corruption Perception Index, 2004-2006

	2004	2005	2006
Botswana	31	32	37
Lesotho	...	70	79
Namibia	54	47	55
South Africa	44	46	37
Swaziland	**...**	**103**	**121**

Source: Transparency International.

III. Staff Appraisal

19. **Swaziland's economic performance remains weak.** Growth has slowed, exacerbating widespread poverty. The medium-term outlook is difficult because of a continued erosion of preferential treatment for Swaziland's main export industries, poor competitiveness, and an expected decline in SACU revenue. The key policy challenge is, therefore, to address impediments to higher growth and improved living standards, while adjusting to declining SACU revenues over the medium term.

20. **Fiscal reforms are essential to safeguard macroeconomic stability and the credibility of the exchange rate peg**. Recent fiscal improvement has been due largely to SACU revenue windfalls rather than implementation of the authorities' reform programs. Expenditure continues to escalate and, as a share of GDP, the wage bill is among the highest in the sub-Saharan region. Given the expected SACU revenue decline, staff urges the authorities to exercise a conservative fiscal stance. As well as allowing for international reserve accumulation to bolster confidence in the peg and provide a cushion against external shocks, fiscal policy should aim to reorient spending to poverty reduction priorities. In this connection, the planned 2007/08 budget, which accommodates an expenditure increase of 3 percent of GDP, is a step in the wrong direction. Staff urges the authorities to use the opportunity provided by the 2007/08 SACU windfalls to immediately implement pending fiscal reforms, including right-sizing the civil service, improving revenue administration and introducing the VAT, tightening expenditure control, and implementing the privatization strategy. Staff welcomes the authorities' commitment to refrain from issuing a supplementary budget and to introduce a computerized expenditure control system.

21. **Maintenance of the exchange rate peg to the rand is appropriate, given Swaziland's close integration with the region.** Confidence in the peg will be bolstered by the authorities' planned build-up of international reserves. However, success in this area will depend on progress with fiscal consolidation and the entrenchment of fiscal sustainability.

22. **Staff welcomes recent efforts by the CBS to strengthen the supervisory framework, reduce the concentration of sectoral lending, and improve the management of international reserves.** It supports the plan to extend financial supervision to nonbank deposit-taking institutions with MCM assistance, and urges enactment of the pending bills to help regulate the sector.

23. **Acceleration of structural reforms is essential to enhance competitiveness and improve investors' perception of Swaziland as an investment destination.** Staff recommends immediately operationalizing the anti-corruption commission, eliminating cumbersome and inconsistent administrative requirements for investors, accelerating land reform, enhancing labor productivity, and combating HIV/AIDS. The privatization of key utilities would also help improve the economy's competitiveness through lower costs of services.

24. **Greater efforts are urgently needed to improve the quality and timeliness of data to facilitate policy decision-making and monitoring.** Data shortcomings continue to hamper surveillance. Review and revision of GDP data should be given high priority and

there should be a greater effort at data dissemination as a means of demonstrating the government's commitment to transparency.

25. Staff recommends that the next Article IV consultation with Swaziland be held on the standard 12-month cycle.

Table 1. Swaziland: Basic Economic and Financial Indicators, 2003-2010

	2003	2004	2005	2006	2007	2008	2009	2010
		Est.	Est.	Projections				
	(Annual percentage change, unless stated otherwise)							
National income and prices								
GDP at constant prices	2.9	2.1	2.3	2.1	1.2	1.0	1.0	1.0
GDP per capita at constant prices	0.5	-0.1	0.4	0.3	-0.3	-0.4	-0.3	-0.4
GDP deflator	11.6	3.4	4.8	5.1	5.8	4.6	4.6	4.6
CPI (period average)	7.4	3.4	4.8	5.1	5.8	4.6	4.6	4.6
CPI (end of period)	4.6	3.2	5.0	5.4	5.2	4.6	4.6	4.6
External sector								
Current account balance (millions of U.S. dollars)	124.3	74.0	41.6	18.9	-49.9	-82.9	-118.6	-120.1
Export volume, f.o.b.	-3.1	4.2	2.3	2.7	-7.0	3.6	1.8	1.6
Import volume, f.o.b.	-19.1	3.8	-2.4	-3.4	-0.5	1.6	1.4	-0.9
Real effective exchange rate [1]	13.0	3.0	1.7	-5.2	...	...	...	...
Terms of Trade	0.6	-1.2	3.6	-3.0	...	...	...	...
Money and credit								
Broad money	14.1	10.4	5.9	15.3	...	...	...	...
Prime lending rate (percent; end of period)	11.5	11.0	10.5	10.5	...	...	...	...
Interest rate on 12-month time deposits (percent; end of period)	4.2	4.1	3.5	7.4	...	...	...	...
Discount rate (end of period)	8.0	7.5	7.5	8.0	...	...	...	
	(Percent of GDP)							
Gross national savings	24.5	21.5	19.5	14.7	13.8	12.1	10.5	10.1
Of which: government	3.3	3.6	6.5	8.2	6.2	4.4	2.7	1.9
Gross domestic investment	18.0	18.4	18.0	14.0	15.6	15.0	14.6	14.1
Of which: government	5.7	8.2	8.5	4.6	6.6	7.0	6.6	6.1
Central government finances (fiscal year) [2]								
Total revenue and grants	26.7	30.8	32.5	35.6	35.9	33.7	32.2	31.7
Of which: South African Customs Union (SACU) receipts	12.8	17.7	18.3	22.0	23.1	21.0	19.5	19.0
Total expenditure and net lending	29.4	35.4	34.0	35.1	37.9	37.4	37.6	37.8
Current expenditure and net lending	23.4	27.4	26.1	27.5	29.8	29.4	29.6	29.8
Central government balance (including grants)	-2.8	-4.6	-1.5	0.5	-2.0	-3.7	-5.4	-6.1
Primary balance (including grants)	-1.6	-3.5	-0.4	2.4	-0.6	-2.7	-4.2	-4.7
Government debt	19.4	18.0	15.6	14.1	14.4	16.7	19.9	24.0
External sector								
Current account balance	6.5	3.1	1.6	0.7	-1.8	-3.0	-4.1	-4.0
Trade balance (merchandise goods)	5.4	5.9	2.8	2.5	-0.8	-3.0	-2.9	-1.5
Capital and financial account balance	-3.7	-8.9	-7.3	4.3	2.1	2.0	1.9	1.8
Overall balance	-2.3	-0.8	-4.5	5.1	0.3	-0.9	-2.2	-2.2
External debt	21.7	23.9	18.2	17.4	17.6	18.5	18.9	19.3
Memorandum items:								
GDP in current prices (millions of emalangeni) [3]	14,422	15,390	16,616	17,931	19,084	20,073	21,083	22,157
Balance of payments (millions of U.S. dollars)	67	46	-30	142	8	-26	-63	-66
Gross official reserves (millions of U.S. dollars)	265	262	231	378	384	353	283	233
(months of imports of goods and nonfactor services)	2.1	1.6	1.3	2.0	1.9	1.8	1.4	1.1
(months of imports of goods)	2.5	2.0	1.6	2.5	2.4	2.1	1.6	1.3
Net official international reserves (millions of U.S. dollars)	212	257	228	374	381	351	280	231
(months of imports of goods and nonfactor services)	1.6	1.5	1.2	2.0	1.9	1.8	1.4	1.1
(months of imports of goods)	2.0	1.9	1.6	2.5	2.4	2.1	1.6	1.3
Total external debt (millions of U.S. dollars)	413	571	474	458	481	515	545	582

Sources: Swazi authorities; and IMF staff projections.

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

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

[3] Under review by the CSO; data on indirect taxes used for estimation of GDP may contain errors and are subject to downward revision.

Table 2. Swaziland: Summary of Central Government Operations, 2004/05-2010/11 [1/]

	2004/05	2005/06	2005/06	2006/07	2006/07	2007/08	2008/09	2009/10	2010/11
	Actual	Budget	Actual	Budget	Est.	Projections			
	(In millions of emalangeni)								
Total revenue and grants	4,842	5,049	5,499	6,490	6,470	6,936	6,855	6,881	7,135
Tax revenue	4,628	4,861	5,190	6,288	6,266	6,724	6,632	6,647	6,889
SACU receipts	2,773	2,796	3,101	4,017	4,017	4,465	4,268	4,164	4,273
Non-SACU revenue	1,855	2,065	2,088	2,271	2,249	2,258	2,364	2,483	2,616
Nontax revenue	98	113	137	114	114	115	121	127	134
Total expenditure and net lending	5,557	5,943	5,758	6,396	6,117	7,318	7,600	8,023	8,508
Current expenditure	4,295	4,496	4,416	5,011	5,011	5,752	5,974	6,315	6,709
Wages and salaries	1,964	2,642	2,443	2,836	2,836	2,985	3,130	3,288	3,463
Goods and services	1,421	867	996	946	946	1,160	1,220	1,281	1,349
Interest payments	168	254	194	334	334	258	206	256	326
Subsidies and transfers	742	733	783	894	894	1,349	1,418	1,490	1,569
Capital expenditure	1,259	1,452	1,410	1,392	1,114	1,566	1,626	1,708	1,799
Net lending	3	-5	-68	-7	-7	0	0	0	0
Primary balance	-547	-640	-64	428	686	-124	-539	-886	-1,046
Overall balance (including grants)	-715	-894	-259	94	352	-382	-745	-1,143	-1,372
Overall balance (excluding grants)	-831	-969	-431	6	262	-479	-847	-1,250	-1,485
Financing	715	894	259	-94	-352	382	745	1,143	1,372
Foreign (net)	255	100	212	-54	-54	209	226	250	277
Domestic (net) 2/	460	794	47	-40	-298	173	518	892	1,095
Increase in financial assets (reserves, CBS)	...	...	...	...	-228	...	...	...	...
Central Bank recapitalization	...	...	...	...	-20	...	...	...	...
Settlement of arrears	...	...	...	...	-50	...	...	...	...
Government debt	2,507	2,972	2,735	2,641	2,568	3,022	3,767	4,910	6,282
Foreign	2,096	2,392	2,308	2,254	2,151	2,504	2,754	3,004	3,254
Domestic	411	580	427	387	417	519	1,013	1,906	2,128
	(In percent of GDP, unless otherwise specified)								
Total revenue and grants	30.8	29.8	32.5	35.6	35.5	35.9	33.7	32.2	31.7
Tax revenue	29.5	28.7	30.6	34.5	34.4	34.8	32.6	31.1	30.6
SACU receipts	17.7	16.5	18.3	22.0	22.0	23.1	21.0	19.5	19.0
Non-SACU revenue	11.8	12.2	12.3	12.5	12.3	11.7	11.6	11.6	11.6
Nontax revenue	0.6	0.7	0.8	0.6	0.6	0.6	0.6	0.6	0.6
Grants	0.7	0.4	1.0	0.5	0.5	0.5	0.5	0.5	0.5
Total expenditure and net lending	35.4	35.1	34.0	35.1	33.6	37.9	37.4	37.6	37.8
Current expenditure	27.4	26.5	26.1	27.5	27.5	29.8	29.4	29.6	29.8
Of which:									
Wages and salaries	12.5	15.6	14.4	15.6	15.6	15.4	15.4	15.4	15.4
Goods and services	9.1	5.1	5.9	5.2	5.2	6.0	6.0	6.0	6.0
Interest payments	1.1	1.5	1.1	1.8	1.8	1.3	1.0	1.2	1.5
Subsidies and transfers	4.7	4.3	4.6	4.9	4.9	7.0	7.0	7.0	7.0
Capital expenditure	8.0	8.6	8.3	7.6	6.1	8.1	8.0	8.0	8.0
Primary balance	-3.5	-3.8	-0.4	2.4	3.8	-0.6	-2.7	-4.2	-4.7
Overall balance (including grants)	-4.6	-5.3	-1.5	0.5	1.9	-2.0	-3.7	-5.4	-6.1
Overall balance (excluding grants)	-5.3	-5.7	-2.5	0.0	1.4	-2.5	-4.2	-5.9	-6.6
Financing	4.6	5.3	1.5	-0.5	-1.9	2.0	3.7	5.4	6.1
Foreign (net)	1.6	0.6	1.2	-0.3	-0.3	1.1	1.1	1.2	1.2
Domestic (net)	2.9	4.7	0.3	-0.2	-1.6	0.9	2.6	4.2	4.9
Government debt	16.0	17.5	16.1	14.5	14.1	15.6	18.5	23.0	24.0
Foreign	13.4	14.1	13.6	12.4	11.8	13.0	13.5	14.1	14.5
Domestic	2.6	3.4	2.5	2.1	2.3	2.7	5.0	8.9	9.5
Memorandum items:									
Payment arrears	2.0	...	...	...	0.3	...	...	...	...
GDP at current prices (in millions of emalangeni)	15,697	16,945	16,945	18,219	18,219	19,331	20,325	21,352	22,490

Sources: Ministry of Finance; and Fund staff projections.

[1] Without corrective policy measures. The fiscal year runs from April 1 to March 31.

[2] Including domestic payment arrears estimated at 2 percent of GDP for 2004/05. For 2005/06 onwards, including financing gaps.

Table 3. Swaziland: Monetary Survey, 2002- Sep. 2006 1/
(in millions of emalangeni)

	2002	2003	2004	2005	2006 Sep.
Monetary authorities					
Net foreign assets	1,873	1,405	1,450	1,518	2,370
Central Bank of Swaziland (CBS)	1,863	1,378	1,243	1,518	2,264
Of which : Capital Investment Fund (CIF), managed by CBS.	1,220	713	667	0	0
Government	10	27	207	0	106
Net domestic assets	-1,544	-974	-973	-1,029	-1,611
Central government (net)	-1,300	-1,031	-933	-1,082	-1,526
CBS claims on government	57	83	252	101	179
Government deposits with CBS	-1,357	-1,113	-1,185	-1,183	-1,705
Domestic	-127	-374	-311	-1,183	-1,705
Foreign 2/	-1,230	-739	-874	0	0
Private sector	-77	-80	-86	1	8
Commercial banks (net)	0	0	0	2	0
Other items (net)	-167	136	46	50	-92
Reserve money	329	430	477	490	550
Commercial banks					
Net foreign assets	715	469	490	374	72
Reserves	209	236	256	211	276
Domestic credit	1,985	2,614	3,344	3,832	4,609
Central government (net)	215	286	331	302	327
Claims on Government	215	287	332	315	344
Government deposits	0	0	2	13	17
Private sector	1,770	2,328	3,013	3,531	4,282
Other items (net)	-552	-655	-1,110	-1,196	1,328
Private sector deposits	2,357	2,664	2,946	3,221	3,657
Monetary survey					
Net foreign assets	2,588	1,874	1,941	1,893	2,442
Domestic credit	609	1,504	2,325	2,751	3,090
Central government (net)	-1,084	-744	-602	-781	-1,200
Private sector	1,693	2,248	2,927	3,532	4,290
Other items (net)	-595	-409	-987	-1,173	-1,530
Broad money	2,602	2,969	3,278	3,471	4,002
Currency in circulation 3/	155	213	236	242	268
Deposits	2,447	2,756	3,042	3,229	3,734
	(Annual change in percent of beginning-of-period broad money) 4/				
Broad money	13.1	14.1	10.4	5.9	15.3
Net foreign assets	-45.5	-27.5	2.2	-1.5	15.8
Domestic credit	58.3	34.4	27.7	13.0	9.8
Central government (net)	42.1	13.1	4.8	-5.4	-12.1
Private sector	16.2	21.3	22.9	18.4	21.8
Other items (net)	0.3	7.1	-19.5	-5.7	-10.3
Memorandum items:					
Currency/broad money (percent)	6.0	7.2	7.2	7.0	6.7
Reserve money/deposits (percent)	13.5	15.6	15.7	15.2	14.7
Money multiplier (broad money/reserve money)	7.9	6.9	6.9	7.1	7.3

Sources: Central Bank of Swaziland (CBS); and Fund staff estimates.

[1] End-of-year data.

[2] Counterpart of government external assets in rand and in CIF.

[3] Excludes rand in circulation.

[4] For July 2006, change from Dec. 2005.

Table 4. Swaziland: Commercial Banks' Performance Ratios, Dec. 2003 - Sep. 2006

	2003 Dec.	2004 Dec.	2005 Dec.	2006 Sep.
	(in percent)			
Performance Ratios				
Basle capital ratio (Tier 1)	14	14	15	19
Basle capital ratio (Tier 2)	20	16	17	21
Asset Quality				
Loans to deposit ratio [1]	75	73	83	101
Earning assets to total assets	90	87	92	92
Nonperforming loans to total loans [1]	2	3	2	2
Reserve for losses to total loans	9	8	7	7
Liquidity Ratios				
Liquid assets to total deposits	19	18	17	14
Available reserves to total deposits	18	19	20	20
Liquid assets to total assets	14	14	13	14
Profitability Ratios				
Net income to average total assets (return on assets)	4	3	3	4
Net income to average total equity (return on equity)	29	20	20	20
Total expenses to total income	60	64	68	64

Source: Central Bank of Swaziland.

[1] Excluding the Swaziland Development and Savings Bank, which is owned by the government and offers both development finance and commercial banking services since its relaunch by government in 2001 and its recapitalization in 2003.

Table 5. Swaziland: Balance of Payments, 2004-2010 [1]
(Millions of U.S. dollars, unless otherwise specified)

	2004	2005	2006	2007	2008	2009	2010
		Est.			Projections		
Current account balance	74.0	41.6	18.9	-49.9	-82.9	-118.6	-120.1
Trade balance	140.0	72.9	67.2	-21.9	-83.9	-83.7	-46.1
Exports, f.o.b.	1,741.1	1,824.7	1,876.9	1,913.8	1,904.2	1,973.2	2,056.2
Imports, f.o.b.	-1,601.1	-1,751.8	-1,809.7	-1,935.7	-1,988.1	-2,056.9	-2,102.3
Services (net)	-177.8	-194.7	-224.8	-220.0	-173.3	-175.2	-188.6
Exports of services	232.1	266.3	236.3	231.3	243.2	252.3	264.4
Imports of services	-409.9	-461.0	-461.1	-451.3	-416.5	-427.5	-453.0
Goods and services balance	-37.8	-121.8	-157.6	-241.9	-257.2	-258.9	-234.7
Income (net)	19.3	19.6	14.6	6.8	11.6	5.4	-6.6
Income (credits)	144.3	132.2	152.6	149.5	157.5	156.1	156.6
Income (debits)	-124.9	-112.6	-138.0	-142.7	-145.9	-150.8	-163.2
Of which : interest	-24.9	-23.5	-22.4	-23.3	-24.7	-26.4	-28.4
Transfers (net)	92.4	128.1	161.8	185.2	162.8	134.9	121.2
Official sector (mainly SACU receipts) [2]	213.0	193.9	300.3	335.2	323.2	308.5	311.3
Private sector	-120.6	-65.8	-138.4	-150.0	-160.4	-173.6	-190.1
Capital and financial account balance	-193.8	-73.6	123.2	57.7	56.9	56.1	53.9
Capital account balance	-0.6	1.1	8.6	0.0	0.0	0.0	0.0
Financial account balance (excluding reserve assets)	-193.2	-74.7	114.6	57.7	56.9	56.1	53.9
Direct investment	72.2	8.8	52.1	50.4	48.7	47.1	45.4
Portfolio investment	-11.3	0.9	-2.6	-2.7	-2.8	-2.9	-3.0
Other investment	-254.2	-84.4	65.1	10.0	11.0	11.9	11.5
Errors and omissions	165.6	2.2	0.0	0.0	0.0	0.0	0.0
Overall balance	45.8	-29.8	142.1	7.8	-25.9	-62.5	-66.2
Memorandum items:							
Current account/GDP (percent)	3.1	1.6	0.7	-1.8	-3.0	-4.1	-4.0
Goods and services balance/GDP (percent)	-1.6	-4.7	-6.0	-8.9	-9.2	-9.0	-7.8
Net official reserves (end of period)	257.4	228.1	374.0	381.4	350.7	280.3	230.9
In months of imports of goods and services	1.5	1.2	2.0	1.9	1.8	1.4	1.1
Gross official reserves (end of period)	261.8	230.9	378.2	383.9	353.0	282.6	233.2
In months of imports of goods and services	1.6	1.3	2.0	1.9	1.8	1.4	1.1
Total external debt	571.1	473.7	457.6	481.1	514.6	545.0	581.5
Total external debt/GDP (percent)	23.9	18.2	17.4	17.6	18.5	18.9	19.3

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

[1] Without corrective policy measures.

[2] SACU: Southern African Customs Union.

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IMF Executive Board Concludes 2006 Article IV Consultation with the Kingdom of Swaziland

On January 31, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of Swaziland.[1]

Background

Swaziland's economic performance has remained weak with growth averaging only 2 percent since 2000, owing to a substantial real appreciation of the lilangeni during 2002-04, erosion of trade preferences, recurrent drought, and stagnant investment. Over that same period, rising government expenditures, especially on the wage bill, undermined fiscal sustainability and reduced foreign reserves to critically low levels. Poverty has escalated in the face of high and rising unemployment, food shortages, and the world's highest HIV/AIDS infection rate.

In 2005/06 fiscal and external imbalances were masked by a temporary rise in revenues from the South Africa Customs Union (SACU). GDP growth in 2006 is estimated at about 2 percent and inflation at year-end was 5.4 percent as food prices continued to rise. The surge in SACU revenues sharply reduced the fiscal deficit to 1.5 percent of GDP in 2005/06 from 4.6 percent in 2004/05. Significant windfall SACU revenue continues during 2006/07 and is expected to help improve the fiscal balance temporarily despite a lack of fiscal reform and rising expenditure, particularly for wages. Despite weak export growth following the elimination of textile quotas, a small external current account surplus is expected in 2006 because of the SACU windfall. Net

[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. 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.

international reserves increased from 1.2 months of imports in December 2005 to 2.3 months in November 2006.

Monetary developments have reflected those in South Africa. Since December 2005, the real effective exchange rate has depreciated by 8.4 percent, primarily reflecting movements in the rand-U.S. dollar exchange rate. Consistent with the peg to the rand, the Central Bank of Swaziland (CBS) has maintained its interest rates in line with South Africa's, increasing the discount rate by 50 basis points to 9 percent in December 2006.

Swaziland faces significant economic challenges over the medium-term. Economic growth is likely to be adversely affected by continued erosion of trade preferences and SACU tariff revenues are projected to decline.

Executive Board Assessment

Executive Directors expressed concern about Swaziland's continued weak economic performance. In the wake of a substantial real appreciation of the lilangeni during 2002-04, the erosion of trade preferences, and recurrent droughts, growth has averaged only 2 percent since 2000. Moreover, poverty has escalated in the face of high and rising unemployment, food shortages, and the world's highest HIV/AIDS prevalence rate. Windfall revenues from SACU are masking underlying pressures on the fiscal deficit and official reserves.

Directors considered that the key policy priority for the authorities is to tackle the impediments to higher growth and improved living standards, while adjusting to an expected decline in SACU revenues over the medium term. This will also involve addressing the challenges arising from the erosion of trade preferences and limited economic diversification. In light of this, Directors emphasized the need for fiscal consolidation and structural reforms to improve the business climate, promote higher private sector-led growth, and contribute to a stronger current account. While the authorities' intention to address these issues is encouraging, decisive action and implementation are now urgently needed. This will also be key to mobilizing stronger assistance from the international community.

Directors stressed the need for fiscal reforms to safeguard macroeconomic stability and to help preserve the credibility of the exchange rate peg to the South African rand, which continues to be appropriate given Swaziland's close integration with the region. Directors urged the authorities to use the opportunity provided by temporarily higher SACU revenues to move ahead expeditiously with pending fiscal reforms, including right-sizing the civil service to lower the wage bill, improving revenue administration, introducing the VAT, and tightening expenditure control.

Directors welcomed the recent efforts to strengthen commercial bank supervision, reduce lending concentration, and improve reserve management. However, the weak supervision of the rapidly growing deposit-taking nonbank financial institutions entails risks for depositors. Directors therefore welcomed the authorities' intention to work with Fund assistance on strengthening financial supervision, and urged enactment of pending bills to help regulate the sector.

Structural reforms will be key to enhancing competitiveness and improve investor confidence. Although the recent depreciation of the lilangeni will improve competitiveness in the short run, reforms are urgently needed to enhance labor and land productivity and improve the business climate. This will involve sustained efforts to improve skills training, strengthen governance, and promote land reform, while the privatization of utility companies should lower costs of key services. Against this background, Directors welcomed the recent enactment of an anti-corruption act and the establishment of a Business Economic Advisory Panel, and urged the authorities to build on these initiatives.

Directors called for improvements in the quality and timeliness of data to facilitate policy decision making and monitoring.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Swaziland: Selected Economic and Financial Indicators, 2002-2006

	2002	2003	2004	2005	2006 Est.
Domestic economy					
Real GDP	2.9	2.9	2.1	2.3	2.1
Consumer price inflation (period average)	11.7	7.4	3.4	4.8	5.1
	(In millions of U.S. dollars, unless otherwise indicated)				
External economy					
Exports, f.o.b.	1,032	1,387	1,741	1,825	1,877
Imports, f.o.b.	-941	-1,283	-1,601	-1,752	-1,810
Current account balance [1]	58	124	74	42	19
(In percent of GDP)	4.8	6.5	3.1	1.6	0.7
Gross official international reserves	260	265	262	231	378
(In months of imports of goods and nonfactor services)	2.7	2.1	1.6	1.3	2.0
Debt service (in percent of exports of goods and nonfactor services)	1.4	1.1	1.3	1.1	1.1
Financial variables	(In percent of GDP, unless otherwise indicated)				
Total government revenue and grants [2]	26.3	26.7	30.8	32.5	35.6
Total government expenditure and net lending [2]	30.8	29.4	35.4	34.0	35.1
Overall government balance (incl. grants) [2]	-4.5	-2.8	-4.6	-1.5	0.5
Change in broad money (in percent)	13.1	14.1	10.4	5.9	15.3
Interest rates (in percent) [3]	9.5	4.2	4.1	3.5	7.4

Sources: Swazi authorities; and IMF staff estimates.
1 Including transfers.
2 Fiscal years (April 1-March 31).
3 For 12-month time deposits.

Statement by Peter Gakunu, Executive Director for the Kingdom of Swaziland and Bhadala T. Mamba, Advisor to Executive Director
January 31, 2007

Introduction

Swaziland's economic performance has been lackluster in recent years as a result of a confluence of exogenous shocks and other challenges that include: high international oil prices; recurring droughts; the decline in international price of sugar, a key export; and the end of the multi-fiber arrangement and loss of preferential trade access for textiles, another key export. There is the ongoing appreciation of the Rand/Lilangeni exchange rate for which Swaziland has little control and the consequential diversion of foreign direct investments to more competitive destinations within the region. These developments and the stagnating economic growth, which has averaged only 2 percent since 2000, aggravated youth unemployment and poverty. The incidence of HIV/AIDS has been rising and is now rated the highest in the world. With these daunting challenges, the classification of Swaziland as a middle income country adds another layer of complication, depriving the country of concessional resources to fight HIV/AIDS and reduce poverty thereby making the already challenging fiscal situation even more difficult.

Facing these problems, the authorities have embarked on a reform process aimed at resuscitating economic growth to the robust levels being experienced by other countries in the region. They are fully aware that there is no room for complacency and the process of reform implementation requires resoluteness on their part. The 2006/07 budget is cast with a view to addressing the main priorities, which include poverty alleviation, fight against HIV/AIDS, employment creation, tackling the food security problem, ensuring sound public expenditure management and revenue diversification. In this regard, the authorities appreciate the continued Fund engagement and thank the staff mission for the constructive dialogue during the last streamlined Article IV discussion. They thank the IMF Executive Board and management for the advice proffered over the years and their continued support in the many challenges they face.

Recent Economic Developments

The slowdown in economic activity has been aggravated by the coming to an end of preferential access to markets for Swazi exports, especially the all important sugar exports. This situation has also been worsened by the expiry of the multi-fiber agreement in the textile sector and the subsequent decline in the international price of sugar, which has had far reaching implications beyond the sugar industry. The sugar industry directly and indirectly supports a bulk of the social services in communities surrounding the sugar estates, covering a substantial part of the eastern part of the country. Furthermore, during the review period, the country's exchange rate strengthened, further undermining manufacturing sector exports, which also include the textile, forestry and the sugar industries, resulting in the loss of over 10,000 jobs. This has called upon the government to devise an effective strategy to counteract the effect of the reduction of prices, including developing mitigating measures for the job losses and seeking diversification of exports and markets.

Swaziland's investment climate has been largely undermined by perceptions of governance in the last few years and the 2007 World Bank, Doing Business report, shows that though the country may have slipped in rankings, there were more positive reforms than being perceived. These include the restoration of the rule of law and adoption of a constitution, the commitment to fight corruption by passing a new anti-corruption bill, and strengthening the Anti-Corruption Commission. To demonstrate its commitment towards getting rid of the scourge, the Government is taking action to deal with individuals and institutions that have been associated with any corrupt practices. To improve the investment climate, the Swaziland Investment Promotion Agency (SIPA) has been strengthened as a one shop center and an eminent group of advisors called the Business Advisory Panel (BEAP) has been formed, comprising of locals and foreigners to advise government on how to improve the country's attractiveness as an investment destination.

Fiscal Developments

Swaziland has limited scope for influencing the economy through monetary policy given its membership to the CMA. The authorities, therefore, recognize the importance of pursuing a prudent fiscal policy and structural reforms as the only avenues at their disposal to restore macroeconomic stability and engender sustained economic growth. The 2006/07 budget has been anchored on fiscal sustainability, which is key to macroeconomic stability requiring strict measures in the allocation of limited financial resources. During the 2006/07 fiscal year, there has been increased outlays towards social sectors, but this has not been enough to address the scale of the challenges facing the economy. The government of Swaziland has no access to concessional resources to deal with these challenges despite the rising incidence of HIV/AIDS pandemic, worsening social indicators and deepening poverty. Nonetheless, the budget has re-established expenditure controls and fiscal sustainability through the introduction of a computerized commitment system, improvement of the procurement system and support to the reform of public enterprises. These reforms are not expected to yield immediate results and their adoption and implementation will only show results in the years to come.

Meanwhile, the country has very limited fiscal space to deal with institutional reforms aimed at reducing expenditure in certain areas while at the same time increasing expenditures in the social sectors like health and education aimed at increasing investments in human capital. In this respect the introduction of universal primary education will be gradually phased-in. The authorities, faced with the limited resource envelope, have also had to prioritize between the on-going development program and related recurrent requirements. The budget was crafted taking into consideration the recommendations of the country's cooperating partners. It targeted a fiscal deficit of around 2% of GDP and ensures a balanced budget in the medium term. This situation was made possible by the improved but still unpredictable revenue inflows from the SACU pool. The authorities are looking at various avenues of broadening the tax base and reducing the over-reliance on SACU receipts. They are seeking technical assistance from the Fund and the international community to introduce the VAT and establish the Revenue authority by 2007/08 to improve revenue collection. They have committed themselves to replenish the country's international reserves using the higher than expected SACU receipts.

Civil service reform

The authorities are committed to implementing public expenditure management systems aimed at bringing down the wage bill, starting with the voluntary retirement program, elimination of arrears and reduction of overall recurrent expenditure. They acknowledge the constraints relating to implementation of the proposed civil service reforms, and have continued to engage all stakeholders and cooperating partners on the best way forward with minimal disruptions in an already difficult economic and social environment. The authorities face a dilemma of right-sizing the civil service in a shrinking economic environment with unemployment already at high levels. The authorities had initially offered a voluntary separation package for civil servants who were over 55 years of age but the response has been very disappointing. This has forced the Government to go back to the drawing board and devise a new strategy. Of particular concern however, is developing the appropriate safety nets to mitigate against the effects of the envisaged civil service rightsizing. They remain committed to civil service reform while seeking social safety nets to cushion and accommodate the very vulnerable groups.

Fighting the HIV/AIDS pandemic

The results of the recent 2006 10th HIV Sentinel Surveillance survey that establishes trends of the epidemic among pregnant women, estimate incidence of HIV prevalence in the adult population to have significantly decreased to 39.2% from 42.6 percent as a result of a wide range of intervention strategies by the National Emergency Response Council on HIV/AIDS (NERCHA). Though this may indicate some measure of success, the authorities believe the figure remains at an alarmingly high level and more still needs to be done and seek support of the international community to fight the pandemic. The government, working with NERCHA, is also developing complementary policies and measures in the fight against the HIV/AIDS pandemic, such as the National Multi-Sectoral HIV and AIDS Policy, National Policy on Children, including OVCs, Gender Policy and Land Policy.

The authorities recognize the increasing challenges in the medium to long term, towards meeting the health needs of its youthful population. In an effort to revitalize the health sector, the authorities have embarked on a comprehensive review of the health sector budget to incorporate these new challenges and begin a process of zero-based budgeting. This effort is supported by the World Health Organization (WHO), and includes developing a strategic plan for the whole health sector, undertaking a service mapping exercise for the sector, strengthening the sector's legislative framework, addressing the brain drain issue, strengthening health management systems and designing a human resource development policy. The authorities seek international support to implement this ambitious health sector reform program to train, build and equip health institutions and practitioners to effectively deal with the emergence of new diseases and challenges in an already disease-burdened country.

Monetary and Exchange Rate Developments

The overall financial sector continued to grow as more institutions broadened their services and products. The authorities in their efforts to revamp the sector, embarked on a process to reform the Financial Services Regulatory Authority through a Bill which seeks to modernize financial sector, creating new structures and institutions and instilling competition and efficiency in the sector. The Central Bank has initiated a process to implement a Real Time Gross Settlement (RTGS) System for the monitoring of payments and settlements. The authorities remain committed to strengthening and maintaining a healthy financial sector as indicated in previous Article IV reports and the staff's concluding statement. Their efforts to modernize the financial system are supported by the Fund in a number of areas including improving reserve management, dealing with anti-money laundering and supervision of all financial institutions amongst other areas. Several pieces of legislation have been tabled to parliament in the review period to support these efforts. The authorities acknowledge the challenges facing the sector and have been reviewing the legal and structural reforms aimed at deepening the financial sector and enhancing its stability so as to further conform to regional and international norms and standards. In this vein they have requested further assistance from the International Financial Institutions to continue with these reforms and dealing with other challenges like the supervision of the non-bank financial institutions.

The authorities continue to foster cooperation and monetary integration at the regional level. They remain fully committed to the ideals of the Common Monetary Area as a means to anchor price stability and promote economic growth in the country. They recognize the need to strengthen their obligation to the exchange rate peg through steady accumulation of international reserves. The Central Bank, supported by the government, has continued to focus on promoting financial sector soundness and exchange rate stability by increasing the country's international reserve position. The government has continued to recapitalize the Central Bank by committing to inject E400 million during the 2006/07 fiscal year. This will improve the Bank's balance sheet and boost the country's international reserves, which have since risen to cover 2.4 months of imports by November 2006 compared to only a month of import coverage at the beginning of 2006.

Structural Issues

The authorities acknowledge the need to dramatically review the investment climate and efforts are underway to implement the recommendations of studies already undertaken. They will commission more studies about Swaziland's unique challenges with a view to improve the country's competitiveness and reclaim some markets lost to the more competitive producers. The expiry of the multi-fiber agreement and its replacement with the agreement on textile and clothing, has undermined smaller and less competitive economies like Swaziland, thereby reducing their market share. This development has resulted in a massive restructuring exercise by most firms leading to lay offs and other firms closing shop. They believe the continued harmonious industrial climate, the country's good infrastructure, preferential access and proximity to markets, and a relatively well-educated labor force, augurs well for future investment inflows, though more work needs to be done.

The process to transform the economy will be anchored on implementation of a number of structural reforms, sound macroeconomic management, improve competitiveness and develop and implement a new set of investment incentives that are budget neutral. This effort will be bolstered by the attraction of foreign investors while developing an indigenous entrepreneurial class of Small and Medium Sized Entrepreneurs (SMEs). The government is committed to supporting this effort through clearing domestic arrears and expediting payment to private sector suppliers of goods and services.

The authorities recognize the challenges facing the economy arising from the constraints to economies of scale and geographic location, and have embraced regional economic integration efforts as the main driving force for growth and development. The country, together with its SACU counterparts, continue to pursue an aggressive bilateral trade negotiations agenda to achieve this goal. The authorities are watching the WTO multilateral trade negotiations with anxiety and are cognizant of the impact of the outcome of the Doha Development Agenda on a small export dependant developing country like Swaziland.

The authorities are committed to the fight against poverty and are in the process of devising a comprehensive strategy to deal with this issue. This is particularly so, given the threat posed by the HIV/AIDS pandemic, which is now a major obstacle to economic and social progress. The authorities have since developed a Poverty Reduction Strategy and Action Plan (PRSAP), which will be the country's development framework for poverty reduction. The PRSAP guides government and all stakeholders on the programs and projects to be implemented in order to effectively reduce poverty by half by 2015 and eradicate it by 2022, in line with the Millennium Development Goals (MDGs). As mentioned above, the 2006/07 budget has increased outlays towards achieving this goal through significant increases in the education and health sectors.

The revitalization of the economy to create jobs and deal with the rising incidence of poverty remains an important aspect of the authorities. The agricultural sector, which harbors the bulk of the population remains crucial in this strategy. In this respect the authorities have developed a Comprehensive Agricultural Sector Policy (CASP) to address the food insecurity situation by diversifying into new areas of intervention and promote drought resistant varieties of crops. This process will also address the recurring problem of food security to feed a rapidly growing population through increasing land area under cultivation and productivity. Tourism is also seen as a sector that has huge potential.

Conclusion

The Swazi authorities face difficult challenges and have embarked on a strong reform effort to revive economic growth. They count on the international community and their cooperating partners to assist them deal with the multiplicity of problems that seek to undermine the country's achievement of MDGs. However, the continued classification of the country as a middle-income country, based only on GDP per capita and ignoring the poor social indicators facing the majority of the population, has continued to undermine their efforts to solicit concessional resources to finance the social reforms. The country has all the social indicators of a poor developing country with the rising number of more than two thirds of the population living below the poverty line. HIV/AIDS continues to ravage the country and this, aggravated by the worsening incidence of poverty, is causing untold harm to future economic growth prospects of the country. The international community is urged to act now to avert a calamity in a country where more than 50 percent of the population is under the age of 15 years.