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The Kingdom of Swaziland: 2005 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 2005 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 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 9, 2005, 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 23, 2006. 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 February 8, 2006 discussion of the staff report that concluded the Article IV consultation.

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

The document listed below has been or will be separately released.

Statistical Appendix

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INTERNATIONAL MONETARY FUND

THE KINGDOM OF SWAZILAND

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the 2005 Consultation with Swaziland

Approved by David Andrews and Juha Kähkönen

January 23, 2006

Consultation process

- **The 2005 Article IV consultation discussions were held in Mbabane during October 26-November 9, 2005**. The staff team comprised Messrs. Wang (Head), Gons, and Haacker, and Ms. Masha (all AFR). Mr. Mamba (Advisor to the Executive Director) participated in the discussions. Staff worked closely with overlapping technical assistance missions from the Monetary and Financial Systems Department (MFD) and the World Bank.

- **Discussions were held with** Prime Minister A.T. Dlamini, the Cabinet chaired by Deputy Prime Minister Shabangu, Finance Minister Sithole, Central Bank of Swaziland (CBS) Governor Dlamini, other officials, and representatives of the private sector and donor community. The mission conducted outreach activities (seminars) with parliamentarians, CBS and government officials, and donor representatives on fiscal consolidation and monetary and exchange rate policies under the Common Monetary Area (CMA).

- **The discussions focused on the key policy challenges facing Swaziland**: (i) reversing the unsustainable fiscal trends that threaten to deplete official reserves and undermine the exchange rate parity under the CMA; (ii) restoring external competitiveness and creating the conditions for sustainable growth; and (iii) making progress in the fight against HIV/AIDS and poverty.

- **At the conclusion of the 2004 Article IV consultation on February 16, 2005, Directors underscored the importance of addressing the impediments to higher growth and broad-based improvements in living standards**. They emphasized the need for fiscal and wage cost restraint in the face of adverse external developments. Directors identified improvements in governance, restoration of the rule-of-law, and implementation of wide-ranging structural reforms as essential conditions for restoring external competitiveness and stimulating growth.

Exchange system

- Swaziland has accepted the obligations of Article VIII, Sections 2-4, of the Articles of Agreement, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Contents Page

Appendices

Appendix Tables

EXECUTIVE SUMMARY

Economic Background

Economic activity has weakened since 2002, reflecting the impact of the real appreciation of the exchange rate in 2002-04, the removal of textile quotas in January 2005, and a prolonged drought. Poverty is widespread, aggravated by food shortages in parts of the country and a severe HIV/AIDS epidemic.

Fiscal imbalances have widened in the last two fiscal years. The overall fiscal deficit rose to 4.3 percent of GDP in 2004/05, driven primarily by a sharp increase in civil service wages. Spending pressures have continued to rise unabated in 2005/06. The deficits have been financed in large part by drawing down government financial assets and accumulating domestic arrears. As a result, official reserves declined to 1.1 months of imports by end-September 2005.

Swaziland is susceptible to a range of potentially permanent shocks over the medium term: anticipated reductions in the preferential prices for sugar exports to the EU, the expected removal of the AGOA provision allowing the use of third-country fabrics in 2007, and the forecast decline in SACU tariff revenues as a result of trade liberalization.

Policy Discussions

The authorities agreed that the current fiscal stance is not sustainable. In addition to immediate measures to deal with the government's cash flow problem for the remainder of 2005/06, the staff urged a sharp reduction of the deficit in the 2006/07 budget and over the medium term, in view of the lack of access to concessional external financing, little room for domestic borrowing, the need to settle large payment arrears and contingent liabilities, and the need for rebuilding reserves. The staff emphasized the need for providing fiscal space to support poverty reduction.

The staff stressed that key policy reforms needed to be implemented without delay to underpin the fiscal consolidation. The authorities agreed that rightsizing the civil service is crucial for restoring fiscal sustainability but noted difficulties in implementation when the economy is stagnant. They also agreed that reform of the public expenditure system would help strengthen fiscal discipline. The staff urged the authorities to speed up the establishment of a Revenue Authority and the introduction of a broad-based VAT.

The authorities agreed that under the current exchange rate arrangement, Swaziland would have to rely on fiscal adjustment and structural reforms to restore competitiveness. There was broad consensus during the discussions that maintaining the exchange rate peg under the CMA is of vital importance to the economy. To improve the investment climate, the staff stressed the importance of privatizing the large number of public enterprises and improving economic governance. The latter should include enacting the anti-corruption legislation and enforcing internal and financial audits of public entities.

I. Introduction

1. **Swaziland is a small, open economy, with close trade and financial ties with South Africa**. It is a member of the South African Customs Union (SACU) and the Common Monetary Area (CMA).[1] The Swazi lilangeni exchanges at parity with the rand, which is also legal tender in the country. There are no exchange controls between CMA countries. Trade among SACU countries is free of tariffs and duties.[2] About half of fiscal revenues come from Swaziland's share in the SACU joint customs and excise pool. South Africa absorbs about 60 percent of Swazi exports, and provides 80 percent of the country's imported goods and services, including most electricity and all petroleum products. Remittances from migrant workers are an important source of income for Swaziland, amounting to about 5 percent of GDP in recent years.

2. **Economic growth in Swaziland has weakened over the past decade.** Since South Africa democratized in 1994, Swaziland has lost part of its attractiveness to foreign investors. As foreign direct investment inflows declined, real GDP growth fell from 3.6 percent in the 1990s to just over 2 percent since 2000. Swaziland's economy is based mainly on agriculture and agro-processing. In recent years, the garment sector, benefiting from preferences under the US African Growth and Opportunity Act (AGOA), has emerged as one of the largest employers in the country. At its peak, in early 2004, it provided about one quarter of formal sector jobs.

3. **Although Swaziland is a low middle-income country, poverty is widespread, aggravated by food shortages in parts of the country and a severe HIV/AIDS epidemic**.[3] A highly skewed income distribution, persistent drought, and an inefficient internal market for agricultural products have contributed to shortfalls in food production. The World Food Program estimates that about 20 percent of the population are in need of food aid during 2005/06. HIV prevalence is among the highest in the world.[4] As a consequence,

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[1] CMA members include Namibia, Lesotho, Swaziland, and South Africa. SACU members include the CMA countries plus Botswana.

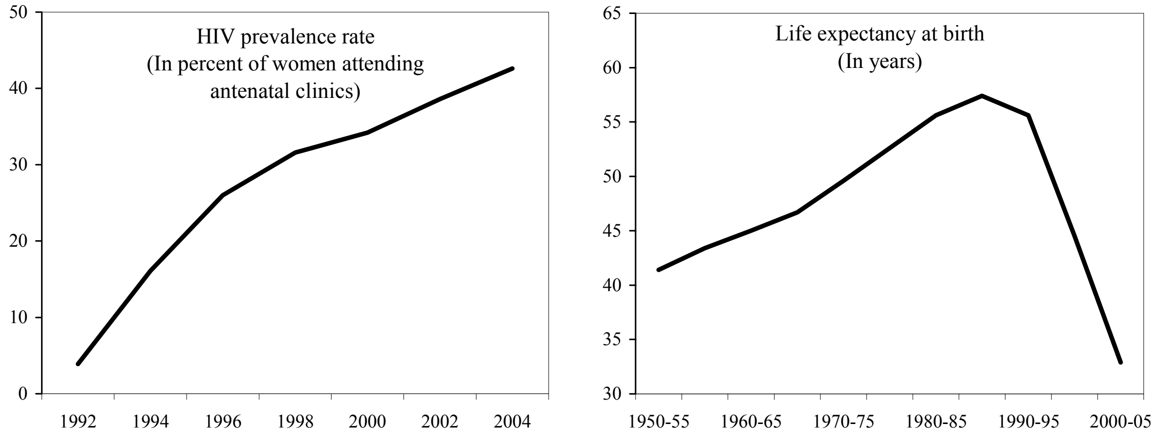
[2] Employment of Swazi workers in South Africa requires a work permit.

[3] A recent Household Income and Expenditure Survey estimates that 69 percent of the population live below the national poverty line (of E 4.1 or about US$0.65 per day). However, these results are difficult to interpret, as the sample average consumption level is only about 20 percent of the national average.

[4] Data from a recent survey among women attending antenatal clinics suggests that HIV prevalence may have risen further in 2004 to 43 percent overall (peaking at 56 percent for the 25-29 age group). The number of AIDS orphans is estimated to have risen to 65,000 by 2003, corresponding to 12 percent of the young population (*2004 Report on the Global AIDS Epidemic* (Geneva: UNAIDS)).

overall mortality has doubled since the 1990s, and life expectancy has dropped from 57 years around 1990 to 33 years.

The HIV/AIDS Epidemic Has Resulted in Dramatic Losses in Life Expectancy



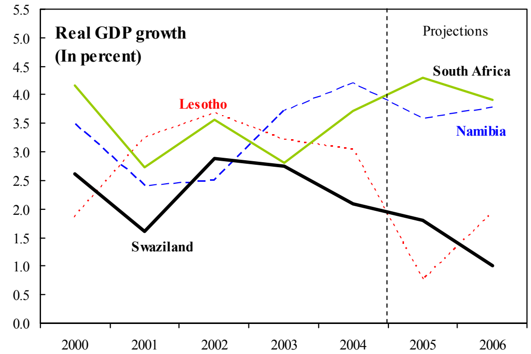
Source: Ministry of Health and Social Welfare, 9th Round of National HIV Serosurveillance.

Source: United Nations, Department of Economic and Social Affairs, Population Division (2005). World Population Prospects: The 2004 Revision.

4. **A constitution, which had been eight years in the making, was signed by the King in July 2005**. The new constitution, expected to become effective in January 2006, represents an improvement to the legal framework. It stipulates various individual rights, including provisions to protect private property, and provides a clearer separation of the executive, legislative, and judicial powers. The rule-of-law crisis that had undermined investor confidence in 2004 has been largely resolved after the government retracted its earlier decision to reject a Court of Appeals ruling regarding a property dispute that triggered the resignation of the judges.

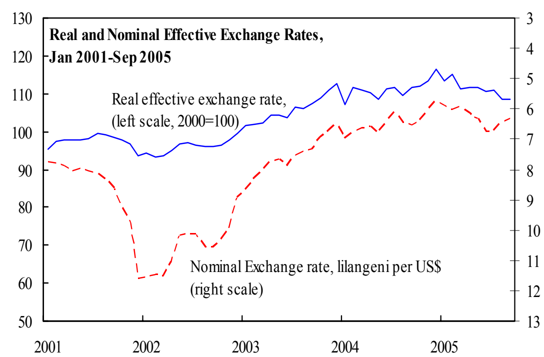
5. **Fund advice in recent years has focused on policies to address the impediments to higher growth and broad-based improvements in living standards**. The Fund has emphasized the need for fiscal consolidation in order to maintain macroeconomic stability and preserve the exchange rate peg, and for structural reforms, most notably in the financial sector and public enterprises. While in broad agreement with the advice, the authorities noted the implementation difficulties they are facing (e.g., downsizing the civil service when unemployment is already high and poverty is worsening). They also stated that Fund policy advice would be more effective if Swaziland's implementation capacity could be further strengthened with external assistance and capacity building support.

II. Recent Economic Developments



Source: IMF staff estimates and projections.

6. **Real GDP growth slowed to 2.1 percent in 2004 and is expected to weaken further to 1.8 percent in 2005** (Table 1). A prolonged drought affected agricultural output, particularly maize, the main staple crop, and cotton.[5] The real appreciation of the lilangeni since 2002 and high oil import prices hurt Swaziland's main exports (sugar, wood pulp, and garments) and manufacturing activities. In addition, the removal of the textile quotas since January 2005 has led to factory closures and significant job losses in the garment sector,[6] further worsening the unemployment rate (estimated at 30 percent). Compared to other small CMA countries that have faced similar or more severe exogenous shocks, Swaziland is lagging behind in adjustment and output recovery (Box 1).



Source: IMF, *International Financial Statistics* and staff estimates.

7. **The lilangeni, which is pegged at par to the South African rand, appreciated by 24 percent in real effective terms between January 2002 and December 2004**. The strength of the rand, while adversely affecting exports, helped to offset the impact of rising world oil prices, contributing to lower inflation through end-2004. In part owing to the lowering of interest rates by the South African Reserve Bank (SARB), the lilangeni depreciated against the US dollar in 2005, partially offsetting the earlier real appreciation. Annual inflation edged up to over 6 percent at end-November 2005, reflecting exchange rate movements and the pass-through of high oil import prices.[7]

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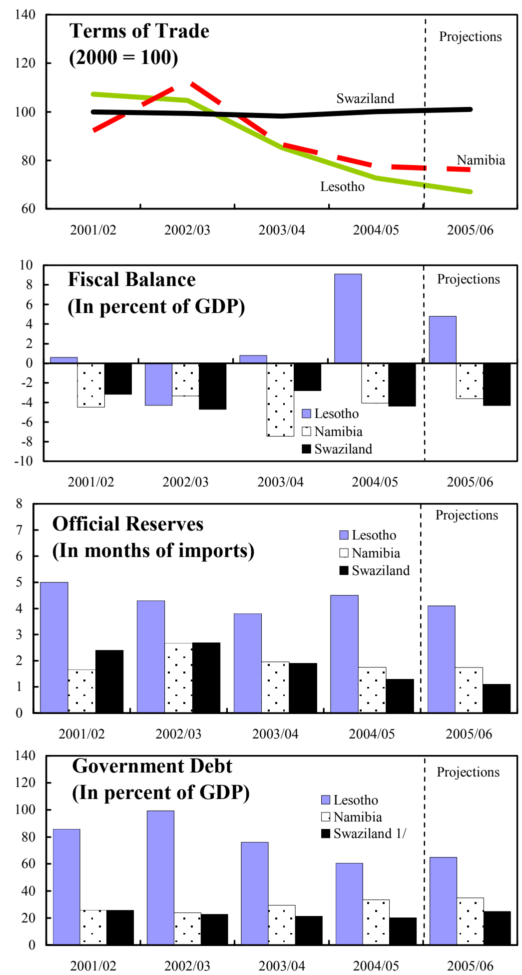
[5] Maize is primarily cultivated by subsistence farmers on nonirrigated Swazi Nation Land (which accounts for 60 percent of land area). In part due to the drought, production levels in Swazi Nation Land in 2004 were only about 60 percent of the 1999 levels. Title Deed Land is held by freehold tenure, has exclusive access rights, is generally well irrigated and used for large scale commercial (e.g., sugar cane) farming.

[6] More than 15,000 jobs (over 50 percent of jobs in the garment sector) were estimated to have been lost in the last two years.

[7] The gasoline price at the pump was about US$2.82 per gallon in Swaziland at end-August 2005, 8 percent higher than the average retail price in the U.S. During 2004 and the first half of 2005, fuel price increases exceeded the changes in the overall Consumer Price Index by 2 percentage points.

Box 1. External Shocks, Policy Responses, and Economic Performance In The Small Countries of the Common Monetary Area

Under the CMA, all three small member countries—Lesotho, Namibia, and Swaziland—peg their currency to the South African rand at par. The rand is legal tender throughout the CMA, circulating side by side with national currencies in the three smaller countries. With the CMA providing a common framework for monetary and exchange rate policies, fiscal policy is the main tool for macroeconomic stabilization in the small CMA countries. During 2004/05-05/06, all three countries have received large one-off SACU revenues.



Source: Country authorities and Fund staff estimates and projections.
1/ From 2003/04 - 2005/06 government debt includes domestic payment arrears.

External shocks: During 2002-2004, the nominal appreciation of the rand against the US dollar was about 40 percent, resulting in a 13-25 percent real effective appreciation in the three countries. However, reflecting the different production and trade structures, terms of trade movements varied. While Lesotho and Namibia have suffered heavy losses since 2002, Swaziland's terms of trade experienced little change, reflecting its more diversified export base and the fact that its main export, sugar, has enjoyed preferential prices in the EU market.

Policy Responses: In response to the severe shocks to its textile sector, Lesotho saved the SACU windfalls (see Footnote 7), ran a budget surplus, and prepaid high interest rate external debt. Namibia managed to sharply reduce its fiscal deficit by 3.5 percentage points of GDP in 2004/05, while targeting further fiscal tightening in 2005/06. In contrast, Swaziland's fiscal deficit has been widening, driven by sharp increases in the wage bill and other spending, and financed by running down external reserves and an accumulation of domestic arrears.

Economic performance: Lesotho has maintained a relatively high level of reserves, and sharply reduced the public debt-to-GDP ratio. Namibia has managed to maintain a higher import cover of official reserves than Swaziland and a good growth performance. Swaziland's official reserves have declined to the lowest level among CMA members. Real GDP growth has continued to weaken, further diverging from that in South Africa, the engine of growth in the region.

8. **Fiscal imbalances have widened in the last two fiscal years (**Table 2 and Figure 1**).** In 2004/05, despite a large one-time windfall in SACU revenues[8] (4.2 percent of GDP) and efforts to increase domestic revenue by removing some tax exemptions,[9] the deficit (including grants) rose to 4.3 percent of GDP, significantly higher than the originally budgeted deficit of 2.8 percent of GDP, as the wage bill and other current expenditures were sharply increased through three supplementary budgets. Spending pressures have continued to rise unabated in 2005/06, as the wage increase granted in 2004 became fully effective and was extended to all branches of the civil service, increasing the total wage bill to 15 percent of GDP. Moreover, a supplementary budget was adopted in the third quarter of the fiscal year to authorize wage increases for parliamentarians and other politicians, further widening the budget deficit.

9. **The deficits have been financed by external and domestic borrowing, drawing down of government financial assets, including the Capital Investment Fund (CIF), and an accumulation of domestic arrears**. The latter increased from an estimated 0.8 percent of GDP at end-2003/04 to over 2 percent of GDP at end-2004/05. With usable deposits (excluding deposits earmarked for specific projects) virtually exhausted by end-September 2005, the government is facing a serious cash flow problem. Funding for budgeted poverty reduction programs has been adversely affected.

10. **Monetary developments have reflected those in South Africa**. In line with interest rate reductions in South Africa, the CBS reduced its discount rate to 7 percent in April 2005. Market yields on treasury bills have moved downward and interest rate spreads relative to South Africa have remained small, as new issues of treasury bills essentially have been contained to roll over falling due maturities in order to avoid higher borrowing costs on short-term debt, notwithstanding the government's large financing needs. Available data suggest that financial soundness indicators of the banking system remain strong (Table 4).[10]

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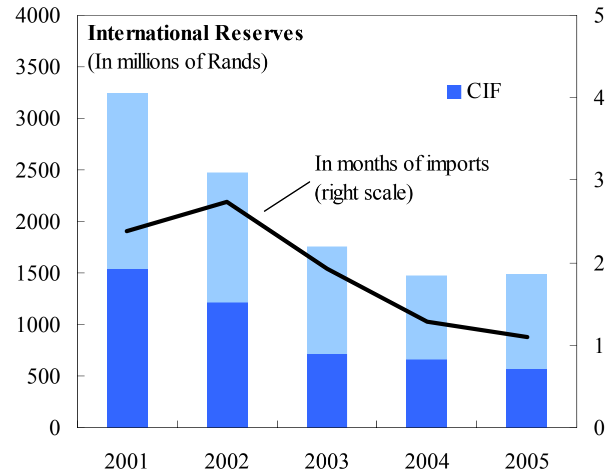
[8] Under the revenue sharing rules agreed in 2002, SACU members receive an additional allocation if, after two years, SACU actual revenue collection turns out to have been higher than the estimates used for the earlier distribution.

[9] Income tax exemptions for parastatals and on benefits in kind were largely removed in 2004/05.

[10] The banking system comprises four commercial banks, three of which South African (accounting for about 80 percent of commercial bank assets). Nonbank financial institutions include a building society, insurance companies, public and private pension funds, and credit cooperatives.

11. **In the face of shocks to exports and strong pressure to finance the fiscal deficit, gross international reserves (which include the CIF) declined from 1.9 months of imports at end-2003 to 1.1 months at end-September 2005, the lowest level among CMA members** (Table 5). Other reserve adequacy indicators such as the ratio to short-term debt or to the monetary base have also deteriorated. In the meantime, public debt, which is mostly on nonconcessional terms, has increased to 22 percent of GDP, including domestic debt excluding outstanding domestic payment arrears.[11]



12. **The authorities issued a "Poverty Reduction Strategy and Action Plan" in October 2004**. The document spells out policies with the overall objective of halving the poverty rate from the level in 1995 by 2015. However, little progress has been made toward this and other Millennium Development Goals (MDGs). There are indications that the share of the population living below the national poverty line has been increasing in the last several years. According to the Ministry of Health, the HIV infection rate among women attending antenatal clinics increased from 39 percent in 2002 to 43 percent in 2004. While there have been modest improvements in the area of education, Swaziland's key social indicators compare unfavorable with those of other countries in the region (Table 7 and Figure 2).

III. Policy Discussions

A. Outlook, Future Challenges, and Strategy

13. **The government's cash flow problems loom large in Swaziland's near-term economic outlook**. Domestic payment arrears adversely affect the private sector's working capital and, ultimately, tax compliance. Uncertainty regarding the government's ability to meet its obligations as budgeted may also have a dampening effect on services and construction activities, which were boosted by increased government expenditures in the last two years. The near-term outlook is also weakened by delayed and likely inadequate

[11] Swaziland, a low middle-income country, is not eligible for credits on IDA terms and has received relatively little official development assistance. It has no outstanding use of Fund resources and is not HIPC-eligible. Domestic government debt amounted to about 3 percent of GDP in 2005, of which over 80 percent were treasury bills (with a maturity less than one year), held mostly by commercial banks.

rainfalls, the ban on beef exports to the EU,[12] the real effective appreciation of the lilangeni, and the erosion of trade preferences for garment exports. Prolonged high oil import prices are also putting pressure on the productive sectors, prices, and the balance of payments. The authorities projected a further slowdown in economic growth and a worsening of the external current account in 2006.

14. **Over the medium term, Swaziland is susceptible to a range of potentially permanent shocks**: anticipated reductions in the preferential prices for sugar exports to the EU by 36 percent over the next four years (Box 2); the eventual elimination of the new restraints on textile imports in the United States and the EU; the expected removal in 2007 of the AGOA provision allowing the use of third-country fabrics; and the forecast decline in SACU tariff revenues as a result of trade liberalization.[13] The HIV/AIDS epidemic is exacting a heavy toll on society, and the high infection rate contributes to higher mortality rates, a loss of productivity and real income, and mounting fiscal pressures.

15. **The authorities agreed that a strategy to achieve more rapid economic growth and broad-based improvements in living standards needs to address three key challenges**: (i) reversing the unsustainable fiscal trends which threaten to deplete official reserves, undermine the exchange rate parity under the CMA, and compromise the government's ability to address development priorities; (ii) restoring external competitiveness; and (iii) addressing the high prevalence of poverty and HIV/AIDS. The staff emphasized that fiscal consolidation would help maintain macroeconomic stability and provide the fiscal space to support poverty reduction.

16. **To illustrate the policy choices the authorities are facing, the staff developed two alternative medium-term scenarios** (Appendix VI). The first one (baseline scenario) assumes that policy implementation continues to be lacking. The fiscal imbalances would worsen further and domestic payment arrears increasingly plague the enterprise sector. Without structural reforms to address the loss of external competitiveness, economic activities will remain depressed. Under such a scenario, official reserves are eventually depleted and the viability of the exchange rate parity arrangement is threatened. In addition to fiscal pressures, a major, unanticipated deterioration of the terms of trade or a sudden loss of the public's confidence in the exchange rate parity could hasten the breakdown of the exchange rate peg.

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[12] Since April 2005, after the country failed to produce the paperwork needed to track the origin of slaughtered cattle.

[13] The potential impact of these shocks could be mitigated by several considerations: Swaziland's sugar industry is relatively competitive in the world market; the adverse effects of the expiry of the AGOA third-country fabric provision might be offset by the SACU-US free trade agreement now under negotiation; and the reduction of SACU tariffs for imports from the EU under a free trade agreement could be gradual and over a long period.

BOX 2. SUGAR SECTOR AND REFORM OF THE EU PRICE REGIME

Swaziland's sugar industry consists of commercial and a large number of small-holder sugar cane farms, sugar processing subsectors, and related trade and service businesses. Sugar also constitutes the basis for the production of soft drink concentrates and other beverages, the largest exports of Swaziland, as well as ethanol and other derivative products. While the sector per se accounts for about 15-20 percent of GDP and exports, it indirectly affects a much larger part of the national economy.

The reform of the European Union (EU) Sugar Regime: Currently, Swaziland exports sugar to the EU under two preferential agreements: the Sugar Protocol (100-130,000 tons per year) and the Special Preference Sugar (SPS, 40,000 tons per year). The anticipated reform would reduce the prices applicable to Swazi exports by 36 percent over four years. It also opens the possibility of a higher export volume from developing countries including Swaziland to the EU, as the reform cuts the quotas for EU producers by 2.8 million tons.

Swaziland: The Impact of the Reduction in the EU Sugar Price

	Current	2006/07	2007/08	2008/09	2009/10
	Sugar Price (In Euro/ton)				
Prevailing within EU[1/]	632	506	458	411	404
Applicable to Swazi exports:					
Sugar Protocol	524	498	498	434	335
Special Preference Sugar [2/]	497	472	472	412	318
Cumulative reduction, in percent	0	5	5	17	36
	Impact on Swaziland (In millions of Euro)				
Total Exports	87	83	83	72	56
Under Sugar Protocol	67	64	64	56	43
Under Special Preference Sugar	20	19	19	16	13
Total Losses (in millions of Euro)	0	4	4	15	31

Source: Swaziland Sugar Association and EU

1/ So called institutional price. 2/ Assumes the continuation of SPS beyond 2006.

Possible impact on Swaziland: The loss of export earnings from the EU reform are estimated at €50 million over the 4-year period, but could be much more substantial and more imminent if the SPS access expires in 2006. In addition, tax revenue would be adversely affected; small-holder farmers and millers may face financial difficulties, aggravating rural poverty.

The authorities' response: Key elements of the strategy are: to further reduce costs by providing training and financing for small-holder farmers; to seek higher access to the EU market for Swazi sugar; to address specific adverse consequences of the reform process, especially on small-holder growers and the environment; to move to higher value-added products and diversify export markets. Public investment in sugar-related projects would help. For instance, the Lower Usuthu Small-holder Irrigation Project could substantially increase annual net income of some 640 small-holder farms in the newly developed Komati and Usuthu river basins by reducing their vulnerability to drought.

Swaziland: Medium-Term Scenario, 2005-2009
(In percent of GDP, unless noted otherwise)

	2005	2006	2007	2008	2009
Without Measures					
Real GDP growth	1.8	1	1	0.9	0.9
Fiscal balance, including grants (fiscal year)	-4.3	-5.4	-6.2	-6.6	-7
Current account balance	-1.6	-2.4	-3	-3.1	-3.7
Gross official reserves (millions of US dollars)	230	205	162	111	38
Public debt	21.9	25.2	29.5	35	40.1
Reform Policies Scenario 1/					
Real GDP growth	1.8	2.2	2.6	3.2	3.3
Fiscal balance, including grants (fiscal year)	-4.3	-1.1	-0.2	0	0
Current account balance	-1.6	-0.9	-0.6	-0.5	-1.1
Gross official reserves (millions of US dollars)	230	242	261	313	382
Public debt	21.9	21.5	20.2	19.1	17.6

Sources: Fund sources and staff simulation.

1/ Assuming that strong policy reforms will help attract private investment, both domestic and foreign, particularly to tourism and related services and construction activities.

17. **Fiscal consolidation and improvement in economic governance play a central role in the second, "reform policy," scenario**. Under the assumption of decisive actions to implement the civil service reform and improve public expenditure management, the bulk of the fiscal adjustment would initially come from the spending side. In subsequent years, measures to broaden the tax base and strengthen revenue collection would go into effect. The public savings-investment balance would reverse the recent deteriorating trend, contributing to improvements in the gross national savings-investment balance. Implementation of the necessary structural reforms will help improve the business climate, attract donor financing, and enable Swaziland to benefit from strong growth in South Africa. GDP growth could rise to 3-4 percent over the medium term, benefiting from higher investment, including foreign direct investment, and higher efficiency of public investment.[14] Official reserves would be rebuilt gradually along with improvements in the balance of payments.

B. Fiscal Policy

18. **The authorities agreed that the current fiscal policy stance is not sustainable and measures are urgently needed to ensure that the government meet its payment obligations on a timely basis for the remainder of 2005/06**. The staff pointed out that resorting to short-term borrowing and deposit withdrawals provided some breathing space in the recent past, but it has become increasingly difficult to do so without incurring significantly higher borrowing costs or further reducing the country's official international reserves. It is therefore imperative for the authorities to undertake immediate measures that

[14] The recessionary effect of fiscal retrenchment on domestic output is likely to be limited because of the very high import propensity of spending. A fall in government expenditure would be offset in large part by an increase in net exports resulting from a reduction in imports.

would help contain expenditures and prepare the ground for a more fundamental adjustment in the context of the 2006/07 budget (Box 3). In this context, the staff emphasized the importance of starting to "rightsize" the civil service, noting that the Voluntary Retirement Program had been envisaged earlier and the associated costs have already been included in the 2005/06 budget. The authorities were receptive to the staff's recommendations, particularly on prioritizing expenditures, including investment projects, and tightening control of non-wage current expenditure.

19. **The staff urged a sharp reduction of the deficit in the 2006/07 budget**. It argued that with virtually no access to international capital markets on acceptable terms, little room for domestic financing, substantial contingent liabilities, in particular from the seriously under-funded Swaziland Public Pension Fund (PSFP),[15] and low economic growth, maintaining fiscal and debt sustainability will require a substantial reduction of the fiscal deficit, below the government's earlier medium-term target of 2 percent of GDP.[16] Indeed, under the current exchange rate arrangement, any fiscal deficits in excess of available external financing will carry the risk of worsening the international reserve position. This is because domestic money demand may not be adequate to accommodate increased government borrowing, and also because Swaziland's import propensity is high. In view of the need to clear payment arrears and to rebuild the country's international reserves, and in the absence of concessional external financing, the staff supported the Ministry of Finance's intention to aim for a balanced budget in the next several years. For 2006/07, fiscal adjustment of at least 3 percentage points of GDP will have to be made to limit the deficit to available external financing and the adjustment will have to rely heavily on expenditure measures.[17] The authorities agreed with the need for a sharp adjustment but noted that their efforts may encounter substantial resistance given the rigidity of many expenditure programs and the need to finance the implementation of the new constitution. Subsequent to the mission, in their Medium-Term Budget Policy Statement issued in December 2005, the authorities announced that they aim to cut down the fiscal deficit to 2 percent of GDP in the next two years and achieve a balanced budget in 2008/09.

[15] Total assets at end-June 2005 amounted to E 4.1 billion (about 24 percent of GDP), of which 67 percent were invested in equities. According to the latest actuarial evaluation, the pension fund's assets covered 52 percent of its liabilities at end-March 2004. According to PSPF representatives, the funding level has since increased modestly, reflecting higher contributions due to the recent salary increases.

[16] An updated fiscal and external debt sustainability analysis is contained in Appendix V.

[17] See Box 3 for the key measures to achieve the adjustment objectives. Projected external financing includes disbursements from the African Development Bank for the Komati Downstream Development and other projects.

BOX 3. KEY POLICY MEASURES TO RESTORE FISCAL SUSTAINABILITY

Based on discussions with various ministries and the CBS, the staff team made the following recommendations:

Immediate Measures: (i) prioritize budgeted expenditures, giving priority to wages and salaries, debt service, and utilities; (ii) start rightsizing the civil service by implementing the Voluntary Retirement Program aiming to retire about 1,300 public employees aged 55 and above, adopting a Cabinet decision to eliminate 1,000 vacant positions resulting from natural attrition, and continuing the policy of zero growth for budgetary positions; (iii) tighten control of foreign travel and use of government cars; (iv) halt funds for capital projects that have not yet started or are not directly productive and are not funded by donors, in line with a priority list prepared by the Ministry of Economic Planning and Development; (v) strengthen control of expenditure commitments by setting monthly spending ceilings for all line ministries and issuing expenditure warrants accordingly, based on availability of funds; (vi) refrain from approving new supplementary budgets and meet justifiable additional spending needs, for example, for scholarships, within the existing resource envelope; (vii) transfer all foreign assets of the CIF to the CBS balance sheet to strengthen reserve management.

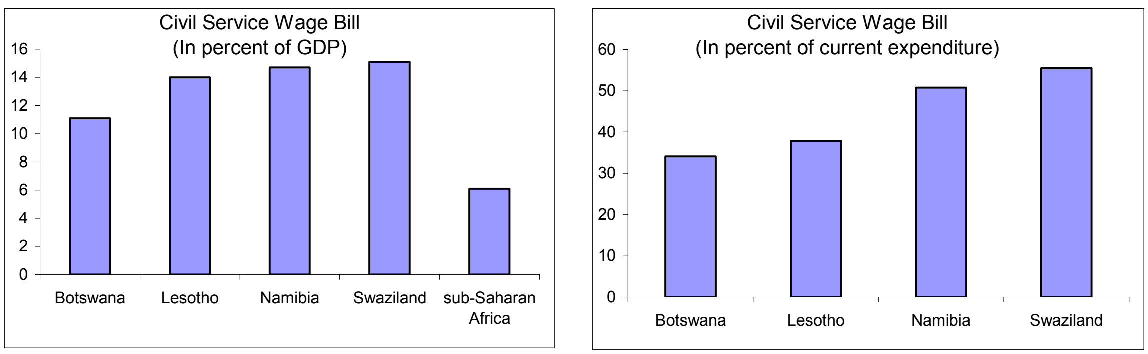
Medium-term Measures: (i) aim for a balanced budget, in the absence of concessional external financing. Budgets over the medium term should aim to support rebuilding of official foreign reserves to cover at least three months of imports; (ii) establish the Revenue Authority and introduce a broad-based VAT; (iii) rightsize the civil service to a sustainable level and reduce the number of ministries from 17 to 14 or less, in line with an earlier study commissioned by the government. Introduce a performance-based pay system; (iv) privatize state-owned companies that can be privatized to increase efficiency and service delivery; (v) improve the public procurement system by requiring competitive bidding, undertake periodic internal audits and financial audits of all spending entities.

Possible Impact in 2006/07: Implementation of civil service reform and consolidation of ministries could help reduce wages and other expenditures by about 1 percent of GDP. Restructuring of public enterprises, including the Central Transport Administration by reducing its car fleet and other costs, could lower spending on goods and services and subsidies by nearly 1 percent of GDP. Rationalization of the public investment program could help reduce capital expenditures by up to 1.5 percent of GDP. These estimates are in line with the assessment of the World Bank staff team assisting expenditure management and control.

20. **The authorities indicated their intention to strengthen revenue mobilization**. They have planned since 2003 to combine the Department of Customs and Excise and the Income Tax Commission into a unified Revenue Authority and then to introduce a broad-based VAT. However, these reforms have been postponed, with the introduction of VAT slipping from 2006/07 to 2007/08. The staff urged the authorities to speed up the reforms and implement other measures as envisaged, including the removal of tax exemptions on rental income, a sales tax amendment to close loopholes, and the enforcement of tax collections from non-compliant entities.

21. **On the expenditure side, the authorities agreed that containing the wage bill through implementation of the civil service reform is crucial for restoring fiscal sustainability**. They explained, however, that the recent wage increases to levels competitive with those of the private sector were needed to retain qualified public sector workers and were meant to be implemented in conjunction with rightsizing the civil service. They acknowledged that rightsizing the civil service to a sustainable level (of about 20,000, from the current 28,000) will require persistent efforts and would be difficult to implement if the economy remains stagnant. The staff urged the authorities to press ahead with this important reform because further delay would only make the eventual correction more costly.

The Civil Service Wage Bill in a Regional Context



Source: IMF staff estimates.

22. **As an integral part of fiscal consolidation and to effectively address poverty, the staff encouraged the authorities to reorient expenditures in favor of HIV/AIDS and other pro-poor programs**, including by increasing the share of capital expenditure for poverty reduction. The latter will require curtailing capital expenditures on projects that do not make a direct contribution to productive activities and are currently beyond the domestic financing capacity (e.g., a new international airport and a theme park). The authorities responded by stating that on the basis of a cost-benefit analysis, public investment projects yielding no positive economic return should not be undertaken.

23. **The authorities recognized that weak expenditure controls, especially the lack of effective control of expenditure commitments on the level of line ministries, have resulted in budget overruns and accumulation of domestic arrears**. They informed the staff that the Integrated Financial Information System, which was expected to become operational by end-2005, would provide the information base for improving expenditure management. They also concurred with the staff's recommendation to undertake a review to identify all outstanding payment arrears by each spending unit, as an initial step in a comprehensive reform aimed at preventing the reoccurrence of arrears. The staff stressed the importance of overhauling the public expenditure system with technical assistance. It further pointed out that enhanced fiscal transparency and quality of the budgeting process for ministries and departments would help prioritize expenditure, increase accountability and strengthen fiscal discipline.

C. External Sector and Monetary Policies

24. **The authorities were of the view that the exchange rate peg with the South African rand provides a framework for monetary policy, helps maintain price stability, and facilitates trade and investment within the CMA**. However, as the exchange rate is beyond the control of Swaziland, the consequences of the real appreciation of the exchange rate and reduction of trade preferences needed to be addressed by other means. The authorities agreed that under these circumstances, Swaziland will have to rely on fiscal adjustment and structural reforms to restore competitiveness. In the latter context, the staff pointed out that labor costs in Swaziland are higher than in many competing African and Asian countries. Swaziland's competitiveness has also been weakened by low investor confidence (see paragraph 28), cumbersome business regulations especially concerning trade licensing and entry permits, unreliable power supply and expensive telecommunications. Although Swaziland's corporate tax (30 percent) is comparable to that of South Africa and lower than the rates in neighboring Lesotho, Namibia and Mozambique, Swaziland has too many taxes, some of which are difficult to collect, and the general sales tax is costly to payer and the government.[18] Efforts therefore will have to be made to boost labor productivity, reduce domestic costs, and improve the investment climate. The authorities noted their adjustment strategy in the important sugar sector (Box 2) and informed the staff that they have allocated additional resources (E 30 million), notwithstanding their fiscal difficulties, for workers' training and other skill-enhancing programs following the Job Creation Summit in July 2005.

25. **The authorities made it clear that they would continue to maintain an open trade and exchange system**. As a member of SACU, Swaziland has free-trade relations with regional partners while sharing common external trade policies. In the context of SACU, Swaziland is actively pursuing free trade arrangements and trade partnerships, including with the European Union and the United States. SADC (excluding South Africa) is also negotiating a free-trade agreement with the European Union, based on and extending the Cotonou Agreement.[19] The staff encouraged the authorities to work with SACU partners to lower SACU's external tariffs, focusing on tariff "peaks" on manufactured products.

26. **On monetary policy, staff stressed the importance of prudently managing the CBS's net domestic assets**. Under the CMA, Swaziland does not have an independent monetary policy. Demand for the lilangeni depends importantly on the public's confidence in

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[18] Swaziland is the only country in SACU that does not have a VAT. Tax reform is discussed in paragraph 20. For an analysis of Swaziland's investment environment, see *The Swaziland Investor Roadmap* (USAID, 2005).

[19] South Africa is a SADC member, although, as a non-ACP country, it is not a party to the Economic Partnership Agreement negotiations with the EU. South Africa already has a free trade agreement with the EU.

the exchange rate parity arrangement. Containing the CBS's net domestic assets by limiting the government's net position at the CBS is essential to ensure that domestic currency issued by the central bank is adequately backed by foreign reserves. The authorities shared the staff's view that the level of official reserves at present is inadequate; their objective is to increase the reserves to cover at least three months of imports. They noted that such a policy objective cannot be achieved without a prudent fiscal policy. The authorities informed staff that, with MFD technical assistance, the CBS has initiated the process of bringing their reserve management in line with international best practice, including improving the liquidity and security of the reserves.

D. Structural Reforms

27. **The authorities agreed that the efficiency of the Swazi economy could be enhanced by restructuring and privatizing the large number of public enterprises**.[20] The government approved a Privatization Policy for Swaziland in 2004 and has submitted the Swaziland Railway Privatization Bill to Parliament. However, no public enterprises have been privatized so far. The staff pointed out that to speed up the public enterprise reform, progress needed to be made in identifying enterprises which could be privatized, developing the necessary regulatory frameworks, and establishing a concrete timetable for this process. The staff team noted that the privatization of key utilities could enhance private sector development, help improving the competitiveness of the Swazi economy through lower costs of key services, and contribute to fiscal consolidation by lowering expenditures for goods and services supplied by these enterprises, as well as subsidies.

28. **The authorities expressed determination to fight corruption and improve economic governance**. They recognized that misuse of public resources and corruption not only increase the costs of public services but also worsen the investment climate, deterring potential investors.[21] They indicated that decisive actions would be taken soon on some major cases. The staff team noted that the authorities' efforts would be greatly enhanced by strengthening the relevant institutions. It advised that the Anti-Corruption Unit be empowered, through the draft Anti-Corruption legislation, to investigate and charge suspects, including senior officials. It also recommended that the anti-corruption bill, which has been submitted to Cabinet, be enacted as soon as possible. To increase transparency and accountability, the staff strongly recommended periodic internal financial audits for all entities that are part of the consolidated government budget.

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[20] Swaziland currently has 45 public enterprises covering a broad range of activities, including transportation, telecommunication, utilities, agriculture, services, and trade. Some of these enterprises are de facto monopolies in their sectors and key suppliers of goods and services to the government.

[21] The "Corruption Perception Index" by Transparency International, an NGO, ranks Swaziland (103 of out of 153 countries) much lower than the other SACU countries (between rank 32 and 70), and somewhat lower than neighboring Mozambique (rank 97).

29. **Regarding financial sector reform, the authorities have focused on measures to modernize the financial legal framework, strengthen the supervision of financial institutions, and improve the efficiency of the payment system**. They have made progress in advancing their legislative agenda. The recently enacted Insurance Bill has opened up the insurance sector for competition. Parliament approved the Financial Institutions Bill, which, once signed into law, will help strengthen corporate governance in banks. Additional legislative items pending parliamentary approval include the Financial Services Regulatory Authority Bill and the Securities Bill. A Real Time Gross Settlement system is being implemented to modernize the national payment system. Based on a mutual evaluation in the Eastern and Southern Africa Anti-Money Laundering (AML/CFT) Group, the authorities are working to strengthen their AML/CFT regime, including the relevant legal framework.

30. **To reduce poverty, the authorities have concentrated their efforts in improving food security, extending the reach of anti-HIV/AIDS programs, and improving access to primary education**. They informed staff that they have made some progress in improving the domestic food market by restructuring the National Maize Corporation and the new constitution will open the possibility to lease Swazi Nation Land for 99 years, which would facilitate access to credit by small-holder farmers. The National Emergency Response Council reported that Swaziland will meet the target under the WHO's "3 by 5" initiative (providing at least 13,000 AIDS patients with antiretroviral treatment by end-2005). It also recently launched a program to provide food and social support to orphans. The latest data show for the first time a decline in HIV prevalence for the 15-19 age group (from 32.5 percent in 2002 to 29.3 percent in 2004), suggesting that prevention efforts are beginning to take effect.[22] On education, the right to free primary education was included in the new constitution,[23] and the government has been funding scholarships for orphans. To make further progress, the staff encouraged the authorities to prepare concrete anti-poverty projects (including their costing) in line with their Action Program for the Reduction of Poverty, so that these projects can be incorporated in the national budget or used to attract external funding. In addition, the authorities need to strengthen their implementation capacity to ensure efficient use of the $20 million grant awarded by the Global Fund for the period of July 2005-June 2008.

E. Capacity Building and Technical Assistance Issues

31. **Although Swaziland participates in the Fund's General Data Dissemination System (GDSS) and posted its metadata on the GDDS bulletin board in February 2003,**

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[22] Ministry of Health and Social Welfare, 2005, *9th Round of National HIV Seroprevalence Among Women Attending Antenatal Care Services and Health Facilities in Swaziland 2004* (Mbabane, Swaziland).

[23] The right would be effective three years after the adoption of the new constitution, and would be subject to resource availability.

deficiencies in the quality of economic data have remained pervasive and hamper effective surveillance (Appendix III). The staff noted severe inconsistencies in the national accounts, particularly the data on indirect taxes used for the estimation of GDP. In response, the Central Statistical Office indicated its intention to correct the discrepancies and, with technical assistance, to revise the GDP figures in early 2006.[24]

32. **The authorities confirmed that Swaziland's economic adjustment and reform need technical assistance**. Areas that are particularly in need of external support include civil service reform, public expenditure management reform, including developing a strategy for the resolution and prevention of payment arrears, national accounts and balance of payments statistics, as well as central bank operations.

IV. Staff Appraisal

33. **Swaziland's economic performance has deteriorated over the last two years**. Economic growth has slowed, reflecting a substantial real appreciation of the exchange rate that has weakened external competitiveness, the elimination of textile quotas, and a persistent drought. The fiscal deficit has widened, despite large windfalls in SACU receipts, and has been increasingly financed by the accumulation of domestic payment arrears. The fiscal imbalances have led to losses of foreign reserves, which have declined to a critically low level. At the same time, the very high HIV/AIDS prevalence rate is exacting a heavy toll on society, food shortages persist in part of the country, and poverty remains widespread.

34. **The key policy challenges facing the authorities are to restore fiscal sustainability and external competitiveness so that progress can be made in reducing poverty**. There is an urgent need to promptly embark on an adjustment and reform strategy centered on fiscal consolidation and improvements in economic governance. As such a strategy has already been discussed within the country and with development partners in the past, the critical issue now is implementation. Further delays will make the eventual correction more costly and enlarge the growth gap between Swaziland and South Africa and other countries in the region.

35. **The cash flow problem in the implementation of the 2005/06 budget is not merely a temporary liquidity problem; it reflects structural fiscal imbalances accumulated over the last few years**. While fundamental reforms are required to reduce the deficit, the authorities need to forcefully implement immediate measures to ensure that the government meet its payment obligations on a timely basis for the remainder of the fiscal year. Initiating the steps as envisaged earlier to start rightsizing the civil service would lay the ground for fiscal adjustment in the context of 2006/07 budget. The staff regrets that a new supplementary budget was adopted, which will further increase the wage bill.

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[24] Swaziland's GDP data since 1994 are likely to be revised downward but the country is expected to remain a low middle-income country.

36. **The 2006/07 budget will be critical in restoring public finances to a sustainable path.** With little room for domestic financing, large payment arrears and contingent liabilities, and low economic growth, in the absence of concessional external financing, the authorities will have to sharply reduce the budget deficit, below the government's earlier medium-term target of 2 percent of GDP. To restore fiscal sustainability and rebuild official reserves, the authorities should aim for a balanced budget in the next few years. The staff shares the authorities' concern about the currently low level of official reserves and supports the authorities' objective to rebuild reserves to at least three months of imports over the medium term.

37. **To achieve the fiscal adjustment, the authorities need to undertake the necessary revenue reforms, rightsize the civil service to a sustainable level, and strengthen the growth orientation of public investment**. As SACU revenues are projected to decline, strong efforts are needed to increase domestic revenues. Key measures should include establishment of the Revenue Authority and the introduction of a broad-based VAT. On the expenditure side, it is important that the authorities follow through with measures to rightsize the civil service and rationalize the government structure, in line with their civil service reform programs. Revamping the public investment program by reducing expenditures on projects that are not expected to contribute directly to productive activities and reorienting expenditures in favor of pro-poor programs will make the budget more growth-enhancing.

38. **The staff strongly support the authorities' intention to reform the public expenditure management system**. Weak expenditure controls, including at the line ministry levels, have contributed to the rising fiscal deficits and payment arrears. While the introduction of the Integrated Financial Information System would help, improving fiscal discipline will also require institutional reforms to strengthen various components of the public expenditure management and control system. The staff encourages the authorities to seek technical assistance in order to make progress in this important area.

39. **With the exchange rate of the lilangeni pegged at par to the rand under the CMA, the authorities will have to rely on fiscal adjustment and structural reforms to restore external competitiveness**. Regarding the latter, efforts to increase labor productivity, reduce domestic costs for the export sector, and improve the investment climate will be crucial. The authorities' recent initiatives to support workers' training and skill enhancing are encouraging. While Swaziland's sugar industry is relatively competitive in the world market, there is scope for further cost reduction, particularly in small-holder farms, and diversification of products and markets.

40. **To improve the investment climate and support fiscal consolidation, the authorities need to press ahead with restructuring and privatization of the large number of public enterprises and reforms to strengthen governance**. The privatization of key utilities could enhance private sector development, help improve the competitiveness of the Swazi economy through lower costs of key services, including those provided to the government. Staff encourages the authorities to enact the anti-corruption legislation as soon

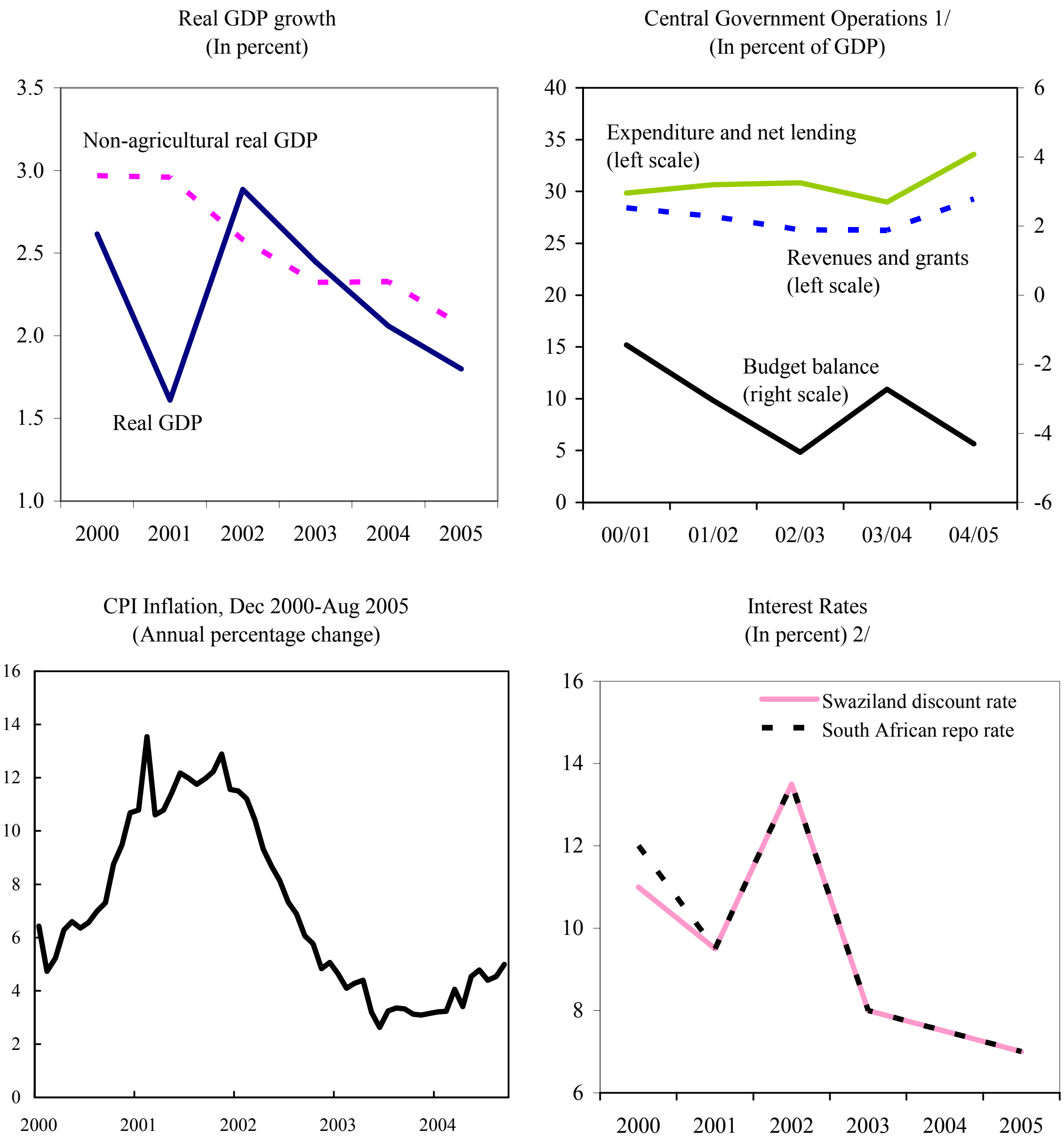
as possible and institute periodic internal and financial audits for all entities benefiting from the consolidated government budget.

41. **The staff welcomes the recent steps by the CBS to strengthen its operations, including reserve management, and to develop Swaziland's financial system.** It supports the authorities' intention to strengthen official foreign reserve position but such a task will have to be supported by a prudent fiscal policy. The agreement to transfer the government's Capital Investment Fund to the central bank to strengthen the management of official reserves is welcome. To further promote development of Swaziland's financial sector, staff encourages the authorities to finalize and enact key pieces of financial legislation, including the Financial Service Regulatory Authority Bill, the Securities Bill, the National Clearing and Settlements Bill, and the AML/CFT Bill.

42. **The staff welcomes the authorities' commitment to improving the national accounts statistics**. The review and revision of the GDP data should be given high priority, as the shortcomings in economic data, most notably in the national accounts and the balance of payments, are compromising economic policy decision making and monitoring.

43. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle**.

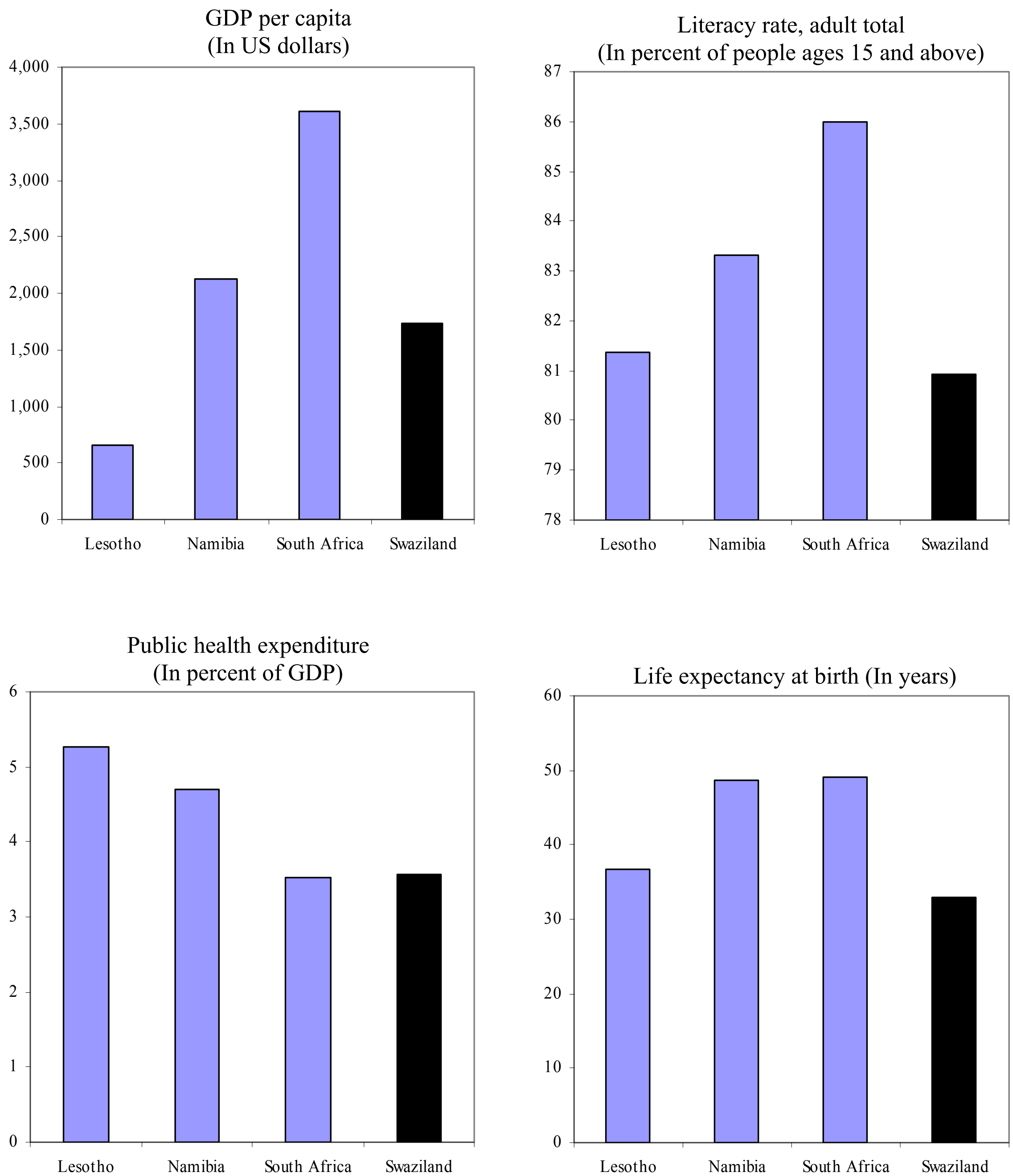
Figure 1. Swaziland: Main Economic Indicators



Sources: Central Bank of Swaziland; and South African Reserve Bankl

1/ Fiscal year beginning April 1.
2/ End of period 2000-2004, through September, 2005.

Figure 2. CMA Countries: Social Indicators, 2003



Source: World Bank, *World Development Indicators 2005*; United Nations Population Division.

Table 1. Swaziland: Basic Economic and Financial Indicators, 2002-2009

	2002	2003 Est.	2004 Est.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.
	(Annual percentage change, unless stated otherwise)							
National Income and Prices								
GDP at constant prices	2.9	2.4	2.1	1.8	1.0	1.0	0.9	0.9
GDP per capita at constant prices	0.3	0.1	-0.1	0.1	-0.7	-0.5	-0.4	-0.5
GDP deflator	12.6	12.1	3.4	4.5	5.8	5.5	5.0	4.5
CPI (period average)	11.7	7.4	3.4	4.5	5.8	5.5	5.0	4.5
CPI (end of period)	11.5	4.6	3.2	5.1	5.7	5.3	4.7	4.5
External sector								
Current account balance (in millions of U.S. dollars)	57.6	36.3	40.0	-43.5	-65.8	-84.2	-91.5	-112.7
Export volume, f.o.b.	16.0	3.3	2.8	2.7	2.0	-3.5	2.9	1.0
Import volume, f.o.b.	-9.2	-9.8	-2.4	-3.7	0.1	-5.3	2.1	1.2
Real effective exchange rate 1/	6.0	13.0	3.0	...	...	...	...	...
Money and credit								
Broad money	13.1	14.1	10.4	10.5	...	...	...	...
Prime lending rate (in percent; end of period)	16.5	11.5	11.0	10.5	...	...	...	...
Interest rates on 12-month time deposits (in percent; end of period)	9.5	4.2	4.1	3.5	...	...	...	...
Discount Rate (end of period)	13.5	8.0	7.5	7.0	...	...	...	...
	(In percent of GDP)							
Gross national savings	24.6	19.9	19.0	16.8	15.0	14.0	12.8	12.2
Of which: government	3.0	3.3	3.4	3.6	2.5	1.6	1.2	0.8
Gross domestic investment	19.8	18.0	17.4	18.5	17.3	16.9	15.9	15.9
Of which: government	7.4	5.7	7.7	8.0	7.9	7.9	7.9	7.9
Central government finances (fiscal year) 2/								
Total revenue and grants	26.3	26.3	29.3	30.7	29.0	28.2	28.1	28.0
Of which: South African Customs Union (SACU) receipts	12.4	12.6	16.8	17.8	16.0	15.3	15.2	15.1
Total expenditure and net lending	30.8	29.0	33.6	35.0	34.3	34.5	34.7	35.1
Current expenditure and net lending	23.4	23.1	26.0	27.1	26.5	26.7	26.9	27.2
Central government balance (including grants)	-4.5	-2.7	-4.3	-4.3	-5.4	-6.2	-6.6	-7.0
Primary balance (including grants)	-3.3	-1.6	-3.3	-2.7	-3.9	-4.6	-4.7	-4.8
Government debt 3/	21.9	19.9	18.0	21.9	25.2	29.5	35.0	40.1
External sector								
Current account balance	4.8	1.9	1.6	-1.6	-2.4	-3.0	-3.1	-3.7
Trade balance (merchandise goods)	7.6	2.2	-1.3	-3.9	-4.0	-3.8	-3.6	-3.7
Capital and financial account balance	-6.6	-3.7	0.4	0.1	1.7	1.5	1.4	1.3
Overall balance	-2.2	-2.3	-0.7	-0.7	-0.7	-1.5	-1.7	-2.4
External debt	29.4	21.7	22.6	21.6	23.5	25.8	27.9	30.1
Memorandum items:								
GDP in current prices (in millions of emalangeni) 4/	12,560	14,422	16,262	17,363	18,467	19,536	20,531	21,467
Overall balance of payments (in millions of U.S. dollars)	-25	-21	45	-32	-20	-41	-50	-72
Gross official reserves (in millions of U.S. dollars)	260	265	262	230	205	162	111	38
(in months of imports of goods and nonfactor services)	2.7	1.9	1.3	1.1	0.9	0.7	0.5	0.2
Net official international reserves (in millions of U.S. dollars)	217	212	258	226	200	158	107	33
(in months of imports of goods and nonfactor services)	2.3	1.5	1.3	1.1	0.9	0.7	0.5	0.1
Total external debt (in millions of U.S. dollars)	351	413	571	589	650	735	822	908

Sources: Swazi authorities; and staff projections.

1/ IMF Information Notice System trade-weighted; end of period.
2/ The fiscal year runs from April 1 to March 31.
3/ Reflecting the effects of several factors including exchange rate movements.
4/ Under review by the CSO; data on indirect taxes used for estimation of GDP may contain errors and are subject to downward revisions based on the review.

Table 2. Swaziland: Summary of Central Government Operations, 2003/04-2009/10 [1/]

	2003/04	2004/05	2005/06	2005/06	2006/07	2007/08	2008/09	2009/10
		Est.	Budget	Proj.				
	(In millions of emalangeni)							
Total revenue and grants	3,908	4,842	5,050	5,417	5,440	5,605	5,862	6,109
Tax revenue	3,661	4,628	4,861	5,202	5,212	5,364	5,609	5,844
SACU receipts	1,878	2,773	2,796	3,137	3,018	3,047	3,177	3,301
Non-SACU revenue	1,782	1,855	2,065	2,065	2,194	2,317	2,432	2,543
Nontax revenue	110	98	114	114	121	128	134	140
Total expenditure and net lending	4,314	5,554	5,943	6,168	6,433	6,824	7,215	7,612
Current expenditure	3,437	4,295	4,561	4,786	4,965	5,274	5,589	5,910
Wages and salaries	1,669	1,964	2,642	2,642	2,806	2,963	3,110	3,253
Goods and services	1,003	1,421	916	1,016	973	1,027	1,078	1,128
Interest payments	174	168	254	279	284	331	401	485
Subsidies and transfers	592	742	749	849	902	952	999	1,045
Capital expenditure	818	1,259	1,382	1,382	1,468	1,550	1,627	1,701
Net lending	59	3	0	0	0	0	0	0
Primary balance	-232	-544	-639	-472	-708	-888	-953	-1,018
Overall balance (including grants)	-406	-712	-893	-751	-992	-1,218	-1,353	-1,503
Overall balance (excluding grants)	-543	-828	-968	-852	-1,100	-1,332	-1,472	-1,627
Financing	406	712	893	751	992	1,218	1,353	1,503
Foreign (net)	77	255	100	150	200	250	250	250
Domestic (net) 2/	329	457	793	601	792	968	1,103	1,253
Government debt	2,955	3,102	4,005	3,857	4,716	5,815	7,235	8,653
Foreign	2,455	2,462	2,887	2,887	3,460	4,059	4,815	5,469
Domestic	500	640	1,118	970	1,256	1,756	2,419	3,184
	(In percent of GDP, unless otherwise specified)							
Total revenue and grants	26.3	29.3	28.6	30.7	29.0	28.3	28.2	28.1
Tax revenue	24.6	28.0	27.6	29.5	27.8	27.1	27.0	26.9
SACU receipts	12.6	16.8	15.8	17.8	16.1	15.4	15.3	15.2
Non-SACU revenue	12.0	11.2	11.7	11.7	11.7	11.7	11.7	11.7
Nontax revenue	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Grants	0.9	0.7	0.4	0.6	0.6	0.6	0.6	0.6
Total expenditure and net lending	29.0	33.6	33.7	35.0	34.3	34.5	34.7	35.1
Current expenditure	23.1	26.0	25.9	27.1	26.5	26.7	26.9	27.2
Of which:								
Wages and salaries	11.2	11.9	15.0	15.0	15.0	15.0	15.0	15.0
Goods and services	6.7	8.6	5.2	5.8	5.2	5.2	5.2	5.2
Interest payments	1.2	1.0	1.4	1.6	1.5	1.7	1.9	2.2
Subsidies and transfers	4.0	4.5	4.2	4.8	4.8	4.8	4.8	4.8
Capital expenditure	5.5	7.6	7.8	7.8	7.8	7.8	7.8	7.8
Primary balance	-1.6	-3.3	-3.6	-2.7	-3.8	-4.5	-4.6	-4.7
Overall balance (including grants)	-2.7	-4.3	-5.1	-4.3	-5.3	-6.2	-6.5	-6.9
Overall balance (excluding grants)	-3.7	-5.0	-5.5	-4.8	-5.9	-6.7	-7.1	-7.5
Financing	2.7	4.3	5.1	4.3	5.3	6.2	6.5	6.9
Foreign (net)	0.5	1.5	0.6	0.9	1.1	1.3	1.2	1.2
Domestic (net)	2.2	2.8	4.5	3.4	4.2	4.9	5.3	5.8
Government debt	19.9	18.8	22.7	21.9	25.2	29.4	34.8	39.8
Foreign	16.5	14.9	16.4	16.4	18.5	20.5	23.2	25.2
Domestic	3.4	3.9	6.3	5.5	6.7	8.9	11.7	14.7
Memorandum items:								
Payment arrears	0.8	2.0	...	...	...	...	...	...
GDP at current prices (in millions of emalangeni)	14,882	16,538	17,639	17,639	18,734	19,785	20,765	21,716
Wages and salaries (in percent of current expenditure)	48.6	45.7	57.9	55.2	56.5	56.2	55.7	55.0

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, 2001-2005 1/

	2001	2002	2003	2004	2005 Sept.
	(In millions of Emalangeni)				
Monetary authorities					
Net foreign assets	2,771	1,873	1,405	1,450	1,461
Central Bank of Swaziland (CBS)	2,389	1,863	1,378	1,243	1,452
Of which : Capital Investment Fund (CIF), managed by CBS.	1,537	1,220	713	667	569
Government	382	10	27	207	9
Net domestic assets	-2,517	-1,544	-975	-973	-973
Central government (net)	-2,112	-1,300	-1,031	-933	-864
CBS claims on government	0	57	83	252	187
Government deposits with CBS	-2,112	-1,357	-1,113	-1,185	-1,051
Domestic	-193	-127	-374	-311	-473
Foreign 2/	-1,919	-1,230	-739	-874	-578
Private sector	15	13	12	10	8
Commercial banks (net)	0	0	0	0	0
Other items (net)	-420	-257	44	-50	-117
Reserve money	254	329	430	477	488
Commercial banks					
Net foreign assets	866	715	469	490	304
Reserves	110	176	194	211	211
Domestic credit	1,443	1,985	2,614	3,344	3,836
Central government (net)	60	215	286	331	326
Claims on Government	60	215	287	332	345
Government deposits	0	0	0	2	19
Private sector	1,384	1,770	2,328	3,013	3,510
Other items (net)	-332	-519	-613	-1,100	-1,275
Private sector deposits	2,086	2,357	2,664	2,946	3,076
Monetary survey					
Net foreign assets	3,636	2,588	1,874	1,941	1,765
Domestic credit	-654	699	1,595	2,421	2,980
Central government (net)	-2,053	-1,084	-744	-602	-538
Private sector	1,399	1,783	2,340	3,023	3,518
Other items (net)	-681	-685	-500	-1,084	-1,308
Broad money	2,301	2,602	2,969	3,278	3,437
Currency in circulation 3/	135	155	213	236	271
Deposits	2,166	2,447	2,756	3,042	3,166
	(Annual change in percent of beginning-of-period broad money) 4/				
Broad money	10.7	13.1	14.1	10.4	4.9
Net foreign assets	42.1	-45.5	-27.5	2.2	-5.4
Domestic credit	-9.9	58.8	34.5	27.8	17.1
Central government (net)	-16.7	42.1	13.1	4.8	2.0
Private sector	6.8	16.7	21.4	23.0	15.1
Other items (net)	-21.5	-0.1	7.1	-19.6	-6.8
Memorandum items:					
Currency/broad money (percent)	5.9	6.0	7.2	7.2	7.9
Reserve money/deposits (percent)	11.7	13.5	15.6	15.7	15.4
Money multiplier (broad money/reserve money)	9.1	7.9	6.9	6.9	7.0

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 September 2005, change from December 2004.

Table 4. Swaziland: Commercial Banks' Performance Ratios, Dec. 2003 - Sept. 2005

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

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 after its recapitalization and relaunch by the government in 2001.

Table 5. Swaziland: Balance of Payments, 2003-2009 1/
(In millions of U.S. dollars, unless otherwise specified)

	2003	2004	2005 Est.	2006 Proj.	2007	2008	2009
Current account balance	36.4	40.0	-43.5	-65.8	-84.2	-91.5	-112.7
Trade balance	42.8	-32.0	-104.4	-111.0	-106.9	-105.7	-110.3
Exports, f.o.b.	1,484.9	1,877.9	1,889.3	1,964.6	1,923.1	2,014.2	2,071.9
Imports, f.o.b.	-1,442.1	-1,909.9	-1,993.7	-2,075.5	-2,029.9	-2,119.9	-2,182.2
Services (net)	-49.3	-52.4	-86.6	-89.8	-87.3	-92.2	-94.5
Exports of services	156.5	482.3	495.8	513.9	499.7	527.4	540.5
Imports of services	-205.7	-534.7	-582.4	-603.7	-587.0	-619.6	-635.0
Goods and services balance	-6.5	-84.4	-191.0	-200.8	-194.2	-197.9	-204.8
Income (net)	-3.6	31.9	25.3	30.3	22.9	27.7	21.7
Income (credits)	143.5	160.8	162.6	171.7	168.5	178.1	175.6
Income (debits)	-147.1	-128.9	-137.3	-141.4	-145.6	-150.4	-153.9
Of which : interest	-18.1	-24.9	-28.7	-32.9	-36.7	-41.1	-45.4
Transfers (net)	46.4	92.4	122.3	104.6	87.0	78.7	70.4
Official sector (mainly SACU receipts) 2/	145.4	213.0	255.3	246.4	238.8	242.9	247.1
Private sector	-99.0	-120.6	-133.1	-141.7	-151.8	-164.2	-176.7
Capital and financial account balance	-28.5	28.7	23.4	45.7	42.8	41.5	40.2
Capital account balance	0.0	-0.6	0.0	0.0	0.0	0.0	0.0
Financial account balance (excluding reserve assets)	-28.5	29.2	23.4	45.7	42.8	41.5	40.2
Direct investment	-70.7	64.9	51.4	53.4	51.6	49.8	48.2
Portfolio investment	-2.2	-11.0	-3.2	-2.8	-2.8	-2.9	-3.0
Other investment	44.4	-24.7	-24.8	-4.9	-6.0	-5.4	-4.9
Errors and omissions	-28.8	-23.3	0.0	0.0	0.0	0.0	0.0
Overall balance	-20.9	45.3	-20.1	-20.1	-41.5	-50.0	-72.5
Memorandum items:							
Current account/GDP (in percent)	1.9	1.6	-1.6	-2.4	-3.0	-3.1	-3.7
Goods and services balance/GDP (in percent)	-0.3	-3.3	-7.1	-7.3	-6.8	-6.7	-6.8
Direct Investment/GDP (in percent)	-3.7	2.6	1.9	1.9	1.8	1.7	1.6
Net official reserves (end of period)	211.5	257.6	225.9	200.3	157.7	106.7	33.3
In months of imports of goods and services	1.5	1.3	1.1	0.9	0.7	0.5	0.1
Gross official reserves (end of period)	264.8	261.8	230.2	204.5	161.9	110.9	37.5
In months of imports of goods and services	1.9	1.3	1.1	0.9	0.7	0.5	0.2
External debt service (in percent of exports of goods and services)	1.1	1.1	1.2	1.3	1.5	1.6	1.7
Total external debt	412.9	571.0	589.4	649.7	734.6	821.5	907.6
Public	352.2	501.0	525.5	581.5	657.1	733.9	808.9
Private	60.7	70.0	63.9	68.3	77.5	87.6	98.6
Total external debt/GDP (in percent)	21.7	22.6	21.9	23.5	25.8	27.9	30.1
GDP at current prices (at market exchange rates)	1,907	2,521	2,686	2,765	2,847	2,943	3,010
Lilangeni per U.S. dollar (end of period)	6.64	5.63	6.33	6.73	6.82	6.94	7.09
Lilangeni per U.S. dollar (period average)	7.56	6.45	6.36	6.64	6.82	6.94	7.09

Sources: Central Bank of Swaziland; and staff projections.

1/ Without corrective policy measures.
2/ SACU: Southern African Customs Union.

Table 6. Swaziland: Indicators of External Vulnerability, 2000-2005
(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005 Aug.	
Financial indicators							
Public sector debt 1/	154.0	230.5	239.6	147.7	109.9	...	
Broad money (M2; percent change, 12-month basis)	-6.6	10.7	13.1	14.1	10.4	12.6	
Private sector credit (percent change, 12-month basis)	5.7	5.0	28.3	32.8	30.2	14.3	
Ratio of domestic credit to GDP	99.6	115.7	172.1	142.1	143.1	...	
Treasury-bill yield 2/	8.3	7.2	8.6	10.6	7.9	6.8	
Treasury-bill yield (real) 3/	1.9	-3.6	-2.9	6.0	4.7	...	
External indicators							
Exports (percent change, 12-month basis in U.S. dollars) 4/	12.7	2.0	-2.0	65.9	29.9	...	
Imports (percent change, 12-month basis in U.S. dollars) 4/	7.1	0.0	-15.8	58.9	35.7	...	
Terms of trade (percent change, 12-month basis)	-3.8	0.5	-0.7	-1.5	0.6	...	
Current account balance	-5.4	-4.5	4.8	6.2	4.6	...	
Capital and financial account balance	11.6	-7.6	-24.0	6.9	-23.6	...	
Of which : inward portfolio investment (debt securities, etc.)	0.0	0.0	0.0	0.0	0.0	...	
other investment (loans, trade credits, etc.)	20.0	33.8	92.8	-0.5	-0.2	...	
inward foreign direct investment	45.6	19.4	78.4	-24.2	17.5	...	
Gross official reserves (in millions of U.S. dollars)	338.5	267.4	259.5	264.8	261.8	262.0	
Foreign assets of the banking sector (in millions of U.S. dollars)	86.4	73.6	91.6	78.5	94.4	64.6	
Foreign liabilities of the banking sector (in millions of U.S. dollars)	14.3	2.2	8.8	7.8	7.3	10.0	
Net foreign assests of the banking sector (in millions of U.S. dollars)	72.1	71.4	82.8	70.7	87.1	54.6	
Gross official reserves in months of imports of goods and services	3.0	2.4	2.7	1.8	1.3	1.1	
Ratio of reserve money to reserves (in percent)	10.8	7.8	14.7	24.5	32.4	26.5	
Ratio of broad money to reserves (in percent)	81.1	71.0	116.1	168.9	222.4	203.6	
Ratio of reserves to short-term debt (in percent)	54.7	57.6	44.5	35.4	26.0	28.1	
Total short-term external debt to net reserves	...	...	...	...	...	...	
Total external debt	195.0	277.4	253.8	143.8	127.5	...	
Ratio of total external debt to exports of goods and services (in percent)	31.6	24.9	30.9	21.9	23.4	...	
Nominal exchange rate (lilangeni per U.S. dollar; period average)	6.9	8.6	10.5	7.6	6.4	6.3	(Jan-Oct 05)
Financial market indicator							
Stock market index (e.o.p.)	138.0	205.7	165.9	153.6	157.4	...	
Memorandum items:							
GDP (in millions of U.S. dollars)	1,390	1,261	1,194	1,907	2,521	...	
Nominal exchange rate (lilangeni/U.S. dollar, end-of-period)	7.57	12.13	8.64	6.64	5.63	...	

1/ National government debt.
2/ End of period.
3/ Backward-looking with actual CPI.
4/ Customs-based data, in current U.S. dollar prices.

Table 7: Swaziland: Millennium Development Indicators, 1990 - 2003

	1990	1995	2001	2002	2003
1. Eradicate extreme poverty and hunger	2015 target: halve 1990 $1 a day poverty and malnutrition rates				
Population below $1 a day (%)	..	..	..	..	..
Poverty gap at $1 a day (%)	..	..	..	..	..
Percentage share of income or consumption held by poorest 20%	..	2.7	..	..	..
Prevalence of child malnutrition (% of children under 5)	..		10.3	..	..
Population below minimum level of dietary energy consumption (%)	10.0	16.0	12.0	..	..
2. Achieve universal primary education	2015 target: raise net enrollment to 100				
Net primary enrollment ratio (% of relevant age group)	87.9	93.7	76.7	..	..
Percentage of cohort reaching grade 5 (%)	76.2	74.4	73.9	..	..
Youth literacy rate (% ages 15-24)	85.1	88.0	90.8	91.2	..
3. Promote gender equality	2015 target: raise education ratio to 100				
Ratio of girls to boys in primary and secondary education (%)	96.2	95.4	93.5	94.4	..
Ratio of young literate females to males (% ages 15-24)	100.9	101.5	101.8	101.8	..
Share of women employed in the nonagricultural sector (%)	35.1	33.2	29.6	31.6	31.3
Proportion of seats held by women in national parliament (%)	..	3.0	..	3.0	3.0
4. Reduce child mortality	2015 target: reduce under-5 mortality by two-thirds from 1990 level				
Under 5 mortality rate (per 1,000)	110.0	110.0	142.0	149.0	153.0
Infant mortality rate (per 1,000 live births)	77.0	78.0	101.0	106.0	105.0
Immunization, measles (% of children under 12 months)	85.0	94.0	72.0	72.0	94.0
5. Improve maternal health	2015 target: reduce 1990 maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	370.0	..	..
Births attended by skilled health staff (% of total)	..	56.0	70.0	..	..
6. Combat HIV/AIDS, malaria and other diseases	2015 target: halt, and begin to reverse, AIDS, etc.				
Prevalence of HIV (% ages 15-49) 1/	..	..	39.5	..	38.8
Contraceptive prevalence rate (% of women ages 15-49)	..	..	..	..	..
Number of children orphaned by HIV/AIDS	..	..	35,000.0	..	65000.0
Incidence of tuberculosis (per 100,000 people)	..	..	989.0	996.8	1082.9
Tuberculosis cases detected under DOTS (%)	..	..	..	33.7	34.6
7. Ensure environmental sustainability					
Forest area (% of total land area)	27.0	..	30.3	..	..
Nationally protected areas (% of total land area)	..	2.3	2.0	3.5	..
GDP per unit of energy use (PPP $ per kg oil equivalent)	..	..	..	..	..
CO2 emissions (metric tons per capita)	0.6	0.5	0.4	..	..
Access to an improved water source (% of population)	..	..	..	52.0	..
Access to improved sanitation (% of population)	..	..	..	52.0	..
Access to secure tenure (% of population)	..	..			
8. Develop a Global Partnership for Development					
Youth unemployment rate (% of total labor force ages 15-24)	..	43.6	..	..	..
Fixed line and mobile telephones (per 1,000 people)	17.2	23.2	85.3	95.0	128.54
Personal computers (per 1,000 people)	..	..	15.7	24.2	28.74
General indicators					
Adult literacy rate (% of people ages 15 and over)	71.6	76.0	80.3	80.9	..
Total fertility rate (births per woman)	5.3	4.9	4.4	4.2	4.20
Life expectancy at birth (years)	56.6	57.6	45.4	43.7	43.7
Aid (% of GNI)	5.7	4.0	2.2	2.0	1.43

Source: World Bank, World Development Indicators Database, 2005.

Swaziland: Relations with the Fund

(As of November 30, 2005)

I.	Membership Status:	**Joined September 22, 1969;**	**Article VIII**
II.	General Resources Account:	SDR Million	% Quota
	Quota	50.70	100.0
	Fund holdings of currency	44.15	87.1
	Reserve position in Fund	6.56	12.9
III.	SDR Department:	SDR Million	% Allocation
	Net cumulative allocation	6.43	100.0
	Holdings	2.48	38.5
IV.	Outstanding Purchases and Loans:	None	
V.	Financial Arrangements:	None	

VI. Projected Payments to the Fund:
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest	0.12	0.12	0.12	0.12	0.12
Total	0.12	0.12	0.12	0.12	0.12

VII. Implementation of HIPC Initiative: Not applicable

VII. Exchange Rate Arrangement

The lilangeni (plural: emalangeni) continues to be pegged at parity to the South African rand, which – alongside with the Lilangeni – is also legal tender. The intervention currency is the U.S. dollar; exchange rates for the U.S. dollar are based on the floating middle rate of the South African rand against the U.S. dollar. The rate on Dec. 31, 2005 was E 1 = US$ 0.1581.

VIII. Article IV Consultation

Swaziland is on the standard 12-month cycle. The last Article IV consultation discussions were held in Mbabane in October/November 2004. The staff report (www.imf.org) was considered by the Executive Board on February 18, 2005.

IX. Technical Assistance

FAD provided technical assistance in 1997 to Swaziland on tax reform. A technical assistance mission visited Swaziland in 1999 to advise on a new income tax bill.

In 1998, **LEG** assisted Swaziland in drafting a new income tax bill and amendments to the Sales Tax Act. In January 2004, LEG carried out a Legislative Draft/FIU Mission to Swaziland. In March 2004, LEG and MFD carried out a joint mission on AML/CFT at the Central Bank of Swaziland, and in May 2004, a follow up mission was undertaken on Legislative drafting /FIU.

MFD (then MAE) provided technical assistance in 1997 to assist in the drafting of the Financial Institutions Act, and, in 1998, MFD provided an advisor to strengthen bank supervision at the Central Bank of Swaziland (CBS). Until January 2000, MFD had provided a long-term general advisor to the CBS. A multi-topic mission visited Mbabane in February 2003 to provide technical assistance in further strengthening the CBS and the financial system, focusing on monetary and foreign exchange operations, development of the government securities market, the payment system, and banking supervision. A follow-up mission in July 2003 provided advice on implementing some of the recommendations regarding the development of the government securities market, and the strengthening monetary and foreign exchange operations at the CBS. In March 2004, a mission on AML/CFT for the central bank was undertaken, and in July a workshop for Senior Bank Supervisors in East and Central Africa was undertaken. In July, MFD participated in a *Financial Sector Reform and Strengthening* (FIRST) Initiative to develop a single supervisory body for most non-bank financial institutions in Swaziland. While it is not a Fund-led project, MFD is assisting the FIRST Initiative in overseeing the project. Following a TA mission on foreign exchange operations and foreign exchange reserves management in January 2005, a long-term resident expert will advise the CBS on reserves management (now scheduled for Oct. 2005 – April 2006). A multi-topic mission took place in November 2005, to follow up on central bank accounting, central bank organization and financial sector supervision.

An **STA** mission visited Swaziland in 1998 with the objectives of identifying weaknesses in the statistical system and assisting in capacity building, particularly relating to the national accounts and other real sector data. An STA mission visited Swaziland in April 1999 to assist with balance of payments statistics; another STA mission also visited Swaziland in April 1999 to establish an action plan for improving government finance statistics. An initial mission in July 2002 made progress with the implementation of GDDS. It was followed by a GFS mission in July 2003. In 2004, STA GDDS related missions took place in June-July (Government Finance Statistics), July (National Accounts Statistics), and October (Consumer Prices); a follow-up mission on consumer prices took place in September 2005.

X. Resident Representative None

Swaziland: Relations with the World Bank Group

(As of December 2005)

Since 1962 the World Bank Group has approved 17 IBRD loans, two IDA credits, and seven IFC investments (loans and equity) for a total of US$136.9 million. Total IDA commitments amounted to US$8.4 million; IBRD commitments amounted to US$104.8 million (of which US$97.1 million was disbursed, US$4.4 million was cancelled). The IDA/IBRD assistance has been for a broad range of operation in several sectors: roads, education, power, water supply/sewerage, rural and urban development, and development finance.

The last CAS for Swaziland was approved by the Board of Directors in 1994. Currently there are no loans for Swaziland. The last operation, an IBRD loan for an Urban Development Project (US$29 million) closed in March 2005, achieving its development objectives despite long preparation and implementation delays. An Implementation Completion Report (October 2005) could serve as a basis for a follow up project. Two projects managed under the Cities Alliance facility, focus on slum-upgrading and housing finance. The Mbabane Upgrading and Finance Project is developing a plan to upgrade all informal settlements in the city, and the African Union Housing Finance Initiative aims to increase access to housing institutions to develop appropriate finance products to support upgrading activities.

Recent assistance has focused on providing policy advice and conducting a range of analytical economic and sector work (ESW), including the on-going Public Expenditure Review (PER), financial sector study, education sector reform analysis with strong emphasis on the effect of HIV on education of orphans and vulnerable children; reviews of the regulatory framework for public utilities and services; and PPIAF study on the railway regulatory framework with view of advising on concession strategy and model. Preparatory work is well advanced for a GEF-funded project for Biodiversity Conservation and Participatory Development (BCPD).

The Bank has been providing assistance through an Institutional Development Fund (IDF) Grant to assist the NERCHA (National Emergency Response Committee for HIV/AIDS) in capacity building, monitoring and evaluation of HIV/AIDS programs. Since FY03 under special arrangements, and for the first time ever, the Bank has been providing technical assistance (TA) to assist Swaziland in the implementation of its national programs and use of Global Fund resources, working in close cooperation and coordination with all donors active in Swaziland.

IFC: The committed portfolio in Swaziland amounts to $10.6 million (5 projects) including projects in textiles, food and beverage, pulp and paper, chemicals as well as finance and insurance.

MIGA: Swaziland joined MIGA in 1990. The outstanding portfolio consists of two contracts of guarantee in the infrastructure sector with a total gross exposure of US$46.6 million and a net exposure of US$23.3 million. The estimated total amount of foreign direct investment facilitated by MIGA in Swaziland is $84.4 million.

WBI: Swaziland is not actively targeted by WBI programs, but has been invited to send participants (between 40 and 50 a year) to events held in other countries. In FY05, the largest participations were in Trade (13), Public-private Partnerships in Infrastructure (12), and Private Sector Development (7), for a total of 52 participants for the year.

Swaziland: Statistical Issues

Deficiencies in the quality of economic data are pervasive and hamper internal policymaking and effective surveillance. The authorities provide available data to the Fund with a lag of 1 to 2 months, except for the national accounts and international trade data, which are reported with irregular periodicity and substantial lags, and are subject to frequent revisions.

As one of fifteen countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries, Swaziland has undertaken to use the GDDS as a framework for the development of national statistical systems. The Anglophone Africa project (funded by the U.K. Department for International Development (DFID)) aims to assist participating countries to implement plans for improvement identified in the metadata, to meet GDDS recommended statistical practices. GDDS metadata for Swaziland were posted on the Fund's Dissemination Standards Bulletin Board on February 11, 2003. These metadata, except for the financial sector, were updated in October 2005.

Real sector

National accounts suffer from serious shortcomings. For example, data on GDP by sector of origin are available in current prices only up to 2001; data on GDP by expenditure at constant prices are not available. For national accounts data, missions rely on estimates provided by the Central Statistical Office (CSO). Another shortcoming is that unemployment data are not reported on a regular basis. A follow-up STA GDDS mission in July 2004 assisted in improving national accounts by reviewing existing data and methodologies and developing new data sources. The CSO is currently revising its GDP series, to address serious inconsistencies noted during the 2005 Article IV consultation discussions.

Prices

The consumer price index (CPI) was significantly revised in 1998. Monthly consumer price data are published by the CSO with a one-month lag. For *International Financial Statistics (IFS)* purposes, the CPI is reported for the all-income group. Swaziland has received technical assistance on CPI compilation in the context of the GDDS initiative.

Government finance statistics

Fiscal data are provided to AFR staff only during missions and/or following budget announcements. Missions in 2003 and 2004 under the GDDS Project for Anglophone Africa reviewed the compilation of fiscal statistics and introduced the *GFSM 2001* framework. A mission in November 2005 reviewed progress implementing the recommendations of these missions, and made further recommendations to improve the coverage, classification, and dissemination of fiscal statistics. In addition, a detailed action plan for GFS-related work, and a plan for increasing adoption of the *GFSM 2001* methodology were prepared. The Ministry of Finance reported fiscal data for 2001-03 to STA, in *GFSM 2001* format, for publication in the *2005 GFS Yearbook*.

Monetary statistics

The Central Bank of Swaziland (CBS) reports monetary and financial statistics (MFS) to STA on a timely and regular basis. The monetary statistics technical assistance mission conducted in November 2004 concluded that, although some progress had been made in commercial bank data reporting, several problems in the classification and sectorization of the CBS accounts remained. Moreover, the Swaziland Building Society (SBS) was not yet reporting data to be included in the coverage of the other depository corporations. The mission made recommendations on the classification of the CBS accounts and assisted the authorities in improving the report forms and accompanying instructions for commercial banks and the Swaziland Building Society to report monetary data to the CBS. The mission assisted in developing the standardized forms for reporting monetary statistics to STA that could serve as the basis to set up an integrated database for monetary statistics to be used by STA, AFR, and the authorities. A follow-up mission is scheduled for March 2006 to review and finalize the new depository corporations survey, covering the commercial banks and Swaziland Building Society, and finalize the monetary statistics integrated database. An MFD multi-topic mission scheduled in November 2005 addressed central bank accounting issues.

Balance of payments statistics

The CSO publishes data on foreign trade on a quarterly basis, but the lack of sufficient computer resources continues to result in long lags in the production of trade data, especially regarding imports. Missions use trade data provided by the CBS. The CBS publishes balance of payments statistics on a half-yearly and annual basis. It now adheres to a methodology consistent with the fifth edition of the *Balance of Payments Manual*. However, there is a need to examine the quality and coverage of data for all components of the balance of payments. Though a new BOP reporting system was launched in October 2003, this measure has not translated into improved timeliness and availability of data.

An IMF technical assistance mission in October 2005 focused on the development of quarterly balance of payments statistics, harmonization of treatment of SACU and pension transactions, clarification of the legal basis for balance of payments data collection, ways to increase private sector response, and improvement of data on Swazis working abroad and tourism.

SWAZILAND: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of January 9, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Jan 2006	Jan 2006	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov 2005	Jan 2006	M	Q	Q
Reserve/Base Money	Nov 2005	Jan 2006	M	Q	Q
Broad Money	Nov 2005	Jan 2006	M	Q	Q
Central Bank Balance Sheet	Nov 2005	Jan 2006	M	Q	Q
Consolidated Balance Sheet of the Banking System	Nov 2005	Jan 2006	M	Q	Q
Interest Rates[2]	Dec 2005	Jan 2005	M	M	M
Consumer Price Index	Oct 2005	Dec 2005	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Aug 2005	Nov 2005	M	I	A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Aug 2005	Nov 2005	M	I	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	April 2005	Oct 2005	Q	Q	Q
External Current Account Balance	2004	Nov 2005	Q	A	A
Exports and Imports of Goods and Services	2004	Nov 2005	Q	A	A
GDP/GNP	2004	Nov 2005	A	A	A
Gross External Debt	Mar 2005	Oct 2005	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

Swaziland: Social and Demographic Indicators

Area (sq. km.)	17,364	**Population Density** (per sq. km.)	64.3
Population	1.1 million		
Population		**Health**	
Population growth rate	1.6	Population per physician (2000)	5,675
Life expectancy at birth (in years)	33	Public health expenditure (2002, in percent of GDP)	3.6
Infant mortality rate (per thousand)	105		
Urban Population (% total)	27.4	HIV prevalence rate (ages 15-49)	39
Population younger than 15 (in percent of total population)	42.1		
GDP per capita (in US dollars)	1,722	**Education (2002)**	
Access to safe water (2002)		Adult literacy rate (in percent)	80.9
Percent of total population	52	Primary school enrollment (net, in percent)	75.3
urban	87		
rural	42		
		Poverty Indicators (1994)	
Labor Statistics (in thousands)			
		Share of income, lowest 20 percent (in percent)	2.1
Labor Force	410		
		GINI Index	61
Formal Employment (thousands)	94		
Private Sector	60		
Public Sector	33		

Sources: *International Financial Statistics;* World Bank, *World Development Indicators, 2005*, United Nations, *World Population Prospects*, 2004 Revision; and national authorities. Data refer to 2003, unless otherwise indicated.

Debt Sustainability Analysis

Swaziland's Debt: Total public debt is estimated at 22 percent of GDP by end-2005, of which external debt accounted for 17 percent of GDP.[25] Most of the public external debt is owed to bilateral and multilateral creditors, with maturities ranging from 15 – 20 years. The largest portfolio of debt is owed to the African Development Bank. Since 2001, external debt has declined, falling from 25 percent of GDP. However, the decline is not the result of fiscal adjustment, but mainly reflects an appreciation of the exchange rate.

Debt Sustainability Analysis: The analysis covered the years 1994 – 2004 and 2005-2010. The main assumptions are that, without policy reforms, annual real GDP growth would decline gradually from about 2.1 percent during 2004 to below one percent by 2010. The nominal exchange rate will depreciate by an average of 2.3 percent per year during the period. In line with developments in South Africa, the GDP deflator will increase by an average of 5 percent. Nominal external interest rate will average 9.7 percent during the period. Import and exports will maintain their trend growth of 3.0 and 2.6 percent per annum, respectively, while the noninterest current account will average 1.0 percent.

The Result: Based on current fiscal trends, public debt would rise to 44 percent of GDP by 2010, and the external debt-to-GDP ratio to 24.2 percent in 2010. Gross external financing needs[26] rises from US$68 million in 2005 to US$147 million or 4.6 percent of GDP by the end of the projection period. While in the historical period, the main driver of the debt dynamics was the exchange rate, variations in the interest rate, and the feedback from higher debt to higher interest payments are the key determinants of the outcome during the projection period.

Sensitivity Analysis: Under a scenario that assumes that the key variables are at their historical averages in 2005-10, public debt declines to 14.5 percent of GDP and external debt to 5.4 percent of GDP by end 2010. This reflects the recent deteriorations in the fiscal balance, and the fact that Swaziland's terms of trade were, on average, more favorable in 1995-2004. External debt appears most sensitive to a current account shock: the debt ratio increases to 35.1 percent by the end of the projection period, the highest under any of the stress tests. Changes in Swaziland's terms of trade can also have a significant effect on external debt – a deterioration in the terms of trade of 5 percent could result in an increase in the external debt ratio of over 5 percent of GDP by end-2009.

[25] Not including domestic arrears, for which reliable data do not exist, and which are estimated at around 2 percent of GDP at end-2004/05.

[26] Includes scheduled interest payments and amortization, and the noninterest current account.

Table V.1. Swaziland: Public Sector Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	22.2	26.8	22.8	19.5	17.0	**21.7**	**25.0**	**29.0**	**33.7**	**38.8**	**44.0**	**0.9**
o/w foreign-currency denominated	21.5	26.1	20.3	16.2	13.6	16.4	18.8	20.7	22.7	24.7	26.6	
Change in public sector debt	1.9	4.6	-4.0	-3.3	-2.5	4.6	3.3	3.9	4.8	5.1	5.2	
Identified debt-creating flows (4+7+12)	2.9	12.7	-5.8	-4.4	1.0	3.3	4.1	4.8	5.0	5.3	5.2	
Primary deficit	0.8	2.2	3.4	1.6	3.3	2.7	3.9	4.6	4.7	4.8	4.8	
Revenue and grants	29.3	28.7	27.3	27.1	29.8	31.2	29.4	28.6	28.5	28.4	28.4	
Primary (noninterest) expenditure	30.1	30.9	30.7	28.7	33.1	33.9	33.3	33.2	33.2	33.2	33.2	
Automatic debt dynamics 2/	2.1	10.5	-9.2	-6.1	-2.4	0.6	0.1	0.1	0.3	0.5	0.4	
Contribution from interest rate/growth differential 3/	-1.9	-1.5	-2.3	-1.7	0.1	0.6	0.1	0.1	0.3	0.5	0.4	
Of which contribution from real interest rate	-1.5	-1.2	-1.7	-1.3	0.5	0.9	0.3	0.4	0.6	0.8	0.7	
Of which contribution from real GDP growth	-0.5	-0.3	-0.7	-0.5	-0.4	-0.3	-0.2	-0.2	-0.3	-0.3	-0.3	
Contribution from exchange rate depreciation 4/	4.1	12.0	-6.9	-4.3	-2.5	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-1.1	-8.1	1.8	1.2	-3.5	1.3	-0.7	-0.8	-0.3	-0.3	0.0	
Public sector debt-to-revenue ratio 1/	75.8	93.4	83.5	72.1	57.2	69.5	85.2	101.3	118.5	136.7	155.1	
Gross financing need 6/	3.5	4.8	6.4	5.7	8.1	9.4	12.1	13.8	16.1	19.2	22.2	
in billions of U.S. dollars	0.0	0.1	0.1	0.1	0.2	0.3	0.3	0.4	0.5	0.6	0.7	
Scenario with key variables at their historical averages 7/						**21.7**	**19.8**	**17.9**	**16.7**	**15.4**	**14.5**	**-1.1**
Scenario with no policy change (constant primary balance) in 2005-2010						**21.7**	**21.4**	**23.6**	**26.2**	**28.9**	**31.7**	**0.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.6	1.6	2.9	2.4	2.1	1.8	1.0	1.0	0.9	0.9	0.9	
Average nominal interest rate on public debt (in percent) 8/	3.7	4.8	5.8	6.1	6.0	10.1	7.6	7.2	7.1	7.1	6.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-8.0	-6.0	-6.8	-6.0	2.6	5.6	1.8	1.6	2.2	2.6	2.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-18.7	-37.6	40.4	30.1	17.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	11.6	10.8	12.6	12.1	3.4	4.5	5.8	5.5	5.0	4.5	4.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	-3.6	4.2	2.0	-4.1	25.8	4.7	-1.3	0.1	0.0	0.1	0.1	
Primary deficit	0.8	2.2	3.4	1.6	3.3	2.7	3.9	4.6	4.7	4.8	4.8	

Source: Staff simulations

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
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.

Table V.2. Swaziland: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual					Estimates/Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	23.5	24.5	19.9	17.0	14.2	**16.7**	**18.7**	**20.6**	**23.0**	**24.8**	**24.2**	**0.0**
Change in external debt	2.7	1.0	-4.6	-2.9	-2.8	2.4	2.0	1.9	2.5	1.8	-0.7	
Identified external debt-creating flows (4+8+9)	-0.1	3.3	-11.0	-5.6	-7.4	-0.6	0.3	0.9	1.2	1.9	1.0	
Current account deficit, excluding interest payments	4.7	3.6	-6.2	-3.1	-2.6	0.0	0.8	1.2	1.1	1.4	0.3	
Deficit in balance of goods and services	15.6	15.4	0.3	0.3	3.3	7.1	7.2	6.7	6.6	6.6	5.0	
Exports	81.6	91.8	94.9	86.1	93.6	88.5	88.9	83.8	84.3	84.0	86.0	
Imports	97.2	107.1	95.2	86.4	97.0	95.6	96.1	90.5	90.9	90.6	91.0	
Net non-debt creating capital inflows (negative)	-5.3	-3.7	-7.5	3.7	-2.6	-1.9	-1.9	-1.8	-1.7	-1.5	-1.4	
Automatic debt dynamics 1/	0.5	3.3	2.7	-6.2	-2.2	1.3	1.4	1.5	1.7	2.0	2.1	
Contribution from nominal interest rate	0.7	0.9	1.3	1.2	1.1	1.6	1.5	1.7	1.9	2.2	2.3	
Contribution from real GDP growth	-0.5	-0.4	-0.7	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	
Contribution from price and exchange rate changes 2/	0.4	2.8	2.1	-7.1	-3.0	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.8	-2.2	6.4	2.8	4.6	3.0	1.7	0.9	1.3	-0.1	-1.7	
External debt-to-exports ratio (in percent)	28.8	26.7	21.0	19.8	15.2	18.8	21.0	24.6	27.3	29.5	28.1	
Gross external financing need (in millions of US dollars) 4/	110.3	102.8	0.6	24.5	20.9	67.5	92.1	119.5	137.4	170.9	146.7	
in percent of GDP	7.9	8.2	0.0	1.3	0.8	2.5	3.3	4.1	4.6	5.5	4.6	
Scenario with key variables at their historical averages 5/						**16.7**	**15.4**	**13.5**	**12.0**	**9.2**	**5.4**	**-3.7**
Terms of trade deteriorate by 5 percent						**16.7**	**19.6**	**22.4**	**25.9**	**28.8**	**29.5**	**0.0**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.6	1.6	2.9	2.4	2.1	2.0	1.0	1.0	0.9	0.9	0.9	
GDP deflator in US dollars (change in percent)	-1.7	-10.7	-7.9	55.8	21.3	4.8	2.4	2.7	3.2	2.3	2.4	
Nominal external interest rate (in percent)	3.2	3.6	5.2	9.7	8.0	12.1	9.5	9.3	9.8	9.9	9.7	
Growth of exports (US dollar terms, in percent)	12.7	2.0	-2.0	44.8	43.8	1.1	3.9	-2.2	4.9	2.8	5.8	
Growth of imports (US dollar terms, in percent)	7.1	0.0	-15.8	44.9	48.4	5.4	4.0	-2.3	4.7	2.8	3.8	
Current account balance, excluding interest payments	-4.7	-3.6	6.2	3.1	2.6	0.0	-0.8	-1.2	-1.1	-1.4	-0.3	
Net non-debt creating capital inflows	5.3	3.7	7.5	-3.7	2.6	1.9	1.9	1.8	1.7	1.5	1.4	

Source: Staff simulations

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) 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.

Medium-Term Scenarios

The mission analyzed two scenarios for the medium-term economic outlook: a “baseline” scenario that assumes unchanged policies, and a “reform” scenario that assumes the implementation of reform policies that include fiscal adjustment and the implementation of structural reforms to raise economic efficiency.

Baseline Scenario

The “baseline” medium-term scenario assumes a continuation of current policies and developments, in particular:

- a continued expansionary fiscal policy;
- wages and salaries remaining, as a percentage of GDP, at the high level attained in 2005;
- a reduction in SACU revenue on account of continued trade liberalization; and
- a further decline in foreign reserves.

Reform Scenario

At the core of the reform program is a fiscal adjustment which, in the absence of concessional external financing, envisages a move to a balanced budget. Strong policy reforms are assumed to enable the country to mobilize external financing on acceptable terms, which would allow a more gradual adjustment path, as indicated in the attached table. Measures under the reform program include:

- a reduction in the wage bill as a share of GDP by completing the civil service restructuring program, including a voluntary retirement scheme implemented in early 2006, and measures to reduce the numbers of budgeted positions;
- the introduction of a Revenue Authority and a broad-based VAT, which will result in an increase in domestic revenues;
- improvements in governance and public expenditure management, which will not only improve the delivery of public services, but also help attract some external grants to address urgent social needs;
- policy measures to encourage private sector development and reduce the role of the state in the economy.

As a consequence of these measures,

- the improved macroeconomic outlook and business confidence will encourage investment, and will result in higher economic growth, especially in the outer years of the projection horizon;
- the budget deficit declines to about 2 percent of GDP in the 2006/07 budget, and approaches zero in the 2008/09 budget; and
- gross international reserves will increase to just under 2 months of import coverage by 2009.

Swaziland: Medium-Term Scenarios, 2002-2009

	2004	2005	2006	2007	2008	2009
			Projections			
Unchanged Policies Scenario						
			(Annual percentage change)			
National Income and Prices						
GDP at constant prices	2.1	1.8	1.0	1.0	0.9	0.9
CPI (period average)	3.4	4.5	5.8	5.5	5.0	4.5
			(In percent of GDP)			
Investment and savings						
Gross domestic investment	17.4	18.5	17.3	17.0	15.9	15.9
Gross national savings	19.0	16.8	15.0	14.0	12.8	12.2
Central government finance (fiscal year)						
Total revenue and grants	29.3	30.7	29.0	28.2	28.1	28.0
Total expenditure and net lending	33.6	35.0	34.3	34.5	34.7	35.1
Central government balance (including grants)	-4.3	-4.3	-5.4	-6.2	-6.6	-7.0
External financing (net)	1.5	0.9	1.1	1.3	1.2	1.2
Government debt	18.0	21.9	25.2	29.5	35.0	40.1
External sector						
Current account balance (in percent of GDP)	1.6	-1.6	-2.4	-3.0	-3.1	-3.7
Gross official international reserves (in millions of U.S. dollars)	261.8	230.2	204.5	161.9	110.9	37.5
Gross official international reserves (in months of imports)	1.3	1.1	0.9	0.7	0.5	0.2
Total external debt (in millions of U.S. dollars)	571	589	650	735	822	908
Reform Scenario						
			(Annual percentage change)			
National Income and Prices						
GDP at constant prices		1.8	2.2	2.6	3.2	3.3
CPI (period average)		4.5	5.8	5.5	5.0	4.5
			(In percent of GDP)			
Investment and savings						
Gross domestic investment		18.5	17.0	17.7	18.5	18.5
Gross national savings		16.8	16.1	17.1	18.0	17.4
Central government finance (fiscal year)						
Total revenue and grants		30.7	29.4	29.2	29.1	29.1
Total expenditure and net lending		35.0	30.5	29.4	29.1	29.1
Central government balance (including grants)		-4.3	-1.1	-0.2	0.0	0.0
External financing (net)		0.9	1.3	0.8	1.0	1.0
Government debt		21.9	21.9	20.6	19.4	17.8
External sector						
Current account balance		-1.6	-0.9	-0.6	-0.5	-1.1
Gross official international reserves (in millions of U.S. dollars)		230.2	242.0	261.0	313.0	382.0
Gross official international reserves (in months of imports)		1.1	1.1	1.2	1.3	1.6
Total external debt (in millions of U.S. dollars)		589	624	629	638	635

Source: Swazi authorities; and staff estimates and projections.

INTERNATIONAL MONETARY FUND
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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Swaziland

On February 8, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the 2005 Article IV consultation with Swaziland.[1]

Background

Economic growth in Swaziland has weakened over the past decade. More recently, real GDP growth decelerated to 2.1 percent in 2004 and an estimated 1.8 percent in 2005. A prolonged drought affected agricultural output, particularly maize, the main staple crop, and cotton. The real effective appreciation of the exchange rate of 24 percent in 2002–04 and high oil import prices hurt Swaziland's main exports (sugar, wood pulp, and garments) and manufacturing activities. In addition, the removal of textile quotas in industrialized countries in January 2005 has led to factory closures and significant job losses in the garment sector, further worsening the unemployment rate (estimated at 30 percent).

The fiscal deficit has increased in the last two fiscal years. In 2004/05, despite a large one-time windfall in South African Customs Union revenues and efforts to increase domestic revenue by removing some tax exemptions, the wage bill and other current expenditures were sharply increased, resulting in a deficit (including grants) of 4.3 percent of GDP, significantly higher than the original budget of

[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.

2.8 percent of GDP. Spending pressures have continued to rise in 2005/06, because of the full-year effect of the civil service wage increase granted in 2004, and further wage increases through a supplementary budget in the third quarter of the fiscal year, further widening the budget deficit. The deficits have been financed by external and domestic borrowing, drawing down of government financial assets, including the Capital Investment Fund (CIF), and an accumulation of domestic arrears. As the budgeted obligations exceed inflows of revenues and available financing, the government is facing a serious cash flow problem.

Monetary developments have reflected those in South Africa. In line with interest rate reductions in South Africa, the Central Bank of Swaziland reduced its discount rate to 7 percent in April 2005. Market yields on treasury bills have moved downward and interest rate spreads relative to South Africa have remained small, as new issues of treasury bills have been contained to avoid incurring higher short-term borrowing costs, notwithstanding the government's large financing needs. Available data indicate that the banking system, which is dominated by South African banks, remains strong.

In the face of shocks to exports and strong pressure to finance the fiscal deficit, gross international reserves (which include the Capital Investment Fund) declined from 1.9 month of imports at end-2003 to 1.1 months of at end-September 2005, the lowest level among members of the Common Monetary Area (CMA). In the meantime, public debt (excluding outstanding domestic payment arrears), which is mostly on nonconcessional terms, has increased to 22 percent of GDP.

The authorities completed a "Poverty Reduction Strategy and Action Plan" in October 2004. The document spells out policies with the overall objective of halving the 1995 poverty rate by 2015. However, little progress has been made toward this and other Millennium Development Goals (MDGs). There are indications that the share of the population living below the national poverty line (less than US$1/day) has been increasing in the last several years. According to the Ministry of Health, the infection rate among women attending ante-natal clinics increased from 39 percent in 2002 to 43 percent in 2004. The latest data show, however, that preventive measures may begin to have effect as HIV/AID infection rate for the 15-19 age group has declined by 3 percentage points to 29 percent for the first time.

Executive Board Assessment

Executive Directors noted that Swaziland's economic performance had deteriorated over the past two years. Output growth had slowed as a result of a substantial real appreciation of the lilangeni that undermined external competitiveness, the elimination of textile quotas by industrial countries, and a persistent drought. In addition, the fiscal deficit had widened and had been increasingly financed through accumulation of domestic payment arrears, while foreign reserves had declined to a critically low level. At the same time, the very high HIV/AIDS prevalence rate was exacting a heavy toll on society, food shortages persisted in parts of the country, and poverty remained widespread.

Directors considered that the key policy challenges facing the Swazi authorities were to restore fiscal sustainability and external competitiveness so that progress could be made in reducing poverty. They noted that these challenges were complicated by the prospects of a further loss of trade preferences and declining revenues from the South African Customs Union. In light of the pressing challenges, Directors urged the authorities to embark promptly on an adjustment strategy centered on fiscal consolidation and structural reforms and noted that the key elements of such a strategy had already been discussed within the country and with development partners. Directors underscored that further delays would make the eventual correction more costly and widen the growth gap between Swaziland and South Africa and other countries in the region.

Directors stressed the urgency of sharply reducing the budget deficit during the remainder of this fiscal year and emphasized that the 2006/07 budget would constitute a critical step towards placing public finances on a sustainable path. Looking ahead, they called on the authorities to aim for a balanced budget in the next few years given the absence of concessional external financing, the existence of large payment arrears and contingent liabilities, the limited scope for domestic financing, and low economic growth.

To achieve the fiscal adjustment, Directors emphasized the need for expenditure controls and reforms in the civil service, public investment, and fiscal revenue areas. They noted that weak expenditure controls, including at the line ministry levels, had contributed to the rising fiscal deficits and payment arrears. In this context, Directors welcomed the authorities' intention to reform the public expenditure management system and encouraged the authorities to seek technical assistance in this important area. Directors urged the authorities to follow through with measures to rightsize the civil service and rationalize the government structure, in line with their civil service reform program. Directors also considered that expenditure needed to be re-oriented to productive investment and pro-poor programs, while strong efforts were needed to increase domestic revenue, including through the establishment of a Revenue Authority and the introduction of a broad-based VAT.

Directors underscored that, with the lilangeni pegged to the South African rand under the Common Monetary Area arrangement, the authorities would need to rely primarily on structural reforms to support fiscal consolidation and restore external competitiveness. They urged the authorities to press ahead with measures to increase labor productivity, reduce domestic costs for the export sector, and improve the investment climate. In this regard, the authorities' recent initiatives to support workers' training and enhance their skills were encouraging.

To improve the investment climate, Directors emphasized the need to restructure and privatize the large number of public enterprises, as well as reforms to strengthen governance. The privatization of key utilities could enhance private sector development, and help improve the competitiveness of the Swazi economy through lower costs of key services, including those provided to the government. Directors encouraged the authorities to enact anti-corruption legislation as soon as possible and institute periodic internal and financial audits for all entities benefiting from the consolidated government budget.

Directors welcomed the recent steps by the Central Bank of Swaziland to strengthen its operations—including reserve management—and to further develop Swaziland's financial system, but noted that efforts to strengthen the official foreign reserve position would depend critically on a prudent fiscal policy stance. Directors also encouraged the authorities to enact legislation to strengthen the supervision of financial institutions.

Directors welcomed the authorities' efforts to strengthen the provision of economic data to enable timely economic policy decision making and monitoring. They noted in particular the authorities' commitment to improve the national accounts and balance of payments statistics.

Swaziland: Selected Economic and Financial Indicators, 2001–05

	2001	2002	2003	2004	2005 Est.
Domestic economy	(Annual percentage change)				
Real GDP	1.6	2.9	2.4	2.1	1.8
Consumer price inflation (period average)	7.5	11.7	7.4	3.4	4.8
External economy	(In millions of U.S. dollars, unless otherwise indicated)				
Exports, f.o.b.	1,043	1,032	1,485	1,878	1,889
Imports, f.o.b.	-1,125	-941	-1,442	-1,910	-1,994
Current account balance 1/	-57	58	36	40	-44
(In percent of GDP)	-4.5	4.8	1.9	1.6	-1.6
Gross official international reserves	267	260	265	262	232
(In months of imports of goods and nonfactor services)	2.4	2.7	1.9	1.3	1.1
Debt service (in percent of exports of goods and nonfactor services)	1.3	1.4	1.1	1.1	1.2
Financial variables	(In percent of GDP, unless otherwise indicated)				
Total government revenue and grants 2/	27.6	26.3	26.3	29.3	30.7
Total government expenditure and net lending 2/	30.6	30.8	29.0	33.6	35.0
Overall government balance (incl. grants) 2/	-3.1	-4.5	-2.7	-4.3	-4.3
Change in broad money (in percent)	10.7	13.1	14.1	10.4	10.5
Interest rates (in percent) 3/	6.3	9.5	4.2	4.1	3.5

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 J. Ngumbullu, Executive Director for The Kingdom of Swaziland and Bhadala T. Mamba, Advisor to Executive Director
February 8, 2006

Introduction

1. I would like to extend appreciation of the Swazi authorities to the Fund staff and management for the candid and constructive discussion and advice during the Article IV consultation Mission. The Mission held widespread discussions with various stakeholders in the economy and presented its findings to the authorities who are thankful for the opportunity to exchange views during these meetings and are mindful and equally concerned about the many challenges facing the country. They have always valued the Board and Fund advice on these issues and are in broad agreement with staff's analysis and policy recommendations contained in the staff paper. The authorities also appreciate the excellent and timely technical assistance provided by the Fund on a number of areas. They value the productive and enlightening presentation made by staff to senior government officials at a seminar held during the mission, which focused on Growth and Fiscal Consolidation over the Medium-term and the Common Monetary Area and Improving External Competitiveness.

2. Swaziland has had to deal with a convergence of a multi-pronged set of challenges driven by persistent and unabating humanitarian crisis, arising from food shortages resulting from continued erratic weather patterns, worsening HIV/AIDS pandemic, increasing incidence of poverty and negative changes in international trade arrangements affecting the country's major exports, particularly sugar and textiles. While marginal improvements in food production were realized during the 2005 crop season, the World Food Program (WFP) still estimates that 227,000 people will need food aid by the end of the 2006 crop season. The country's poverty incidence has risen from 66 to 69 percent according to a recent Household and Income and Expenditure Survey. Furthermore, over and above shocks to the important textile and sugar sectors, the country's fiscal performance has also been precarious, resulting in increased expenditures, creating an unsustainable fiscal trend and decline in the country's foreign reserve holdings to historically low levels. The overall balance of payments position since 2000 has become negative, as a result of increased net capital outflows. The authorities are aware of the persistent decline in economic performance and are committed to deal with the deteriorating socio-economic situation and take measures to address the existing structural fiscal imbalances and reform the public expenditure management system, improve the investment climate, enhance restructuring and privatization of public sector enterprises and restore macroeconomic stability through serious implementation of the reform agenda.

Recent Economic Developments

3. The Swazi economy is largely driven by the agriculture and manufacturing sectors. Although contribution of agriculture to GDP has declined over the years, it remains a

crucial supporter of the manufacturing sector, which is agro-based. The agricultural sector, however, remains vulnerable to exogenous factors like the prevalence of natural disasters such as drought and is highly dependent on climatic and international market developments, including exchange rate movements, the world business cycle, in particular, increases in oil prices, as well as changes in international prices of major exports. There has been recently rapid growth of the services sector alongside the expanding manufacturing sector, which is attributable to the continued growth in government activities in trade, banking, finance and transport. The delayed rains during the 2005/06 season and drought, having spanned a number of years, has dealt a harsh blow to the efforts of rural farmers. This delay is likely to prolong the already bad food security situation in the country.

4. The country is also facing challenges in the international trading environment, which are adversely affecting the economy. The textile sector experienced major shocks with an estimated 15,000 jobs lost in 2005 and a number of firms that were exporting to the USA under the American Growth and Opportunities Act (AGOA) closed their operations and left the country. The sugar industry also faced similar shocks following the renegotiation of the country's preferential access to the EU, which resulted in laying-off several hundreds of workers in this sector. These developments further worsened the dire unemployment situation in a country with a youthful demographic structure, requiring fundamental and comprehensive structural changes to be crafted and implemented through collaborative efforts and cooperation between the private sector, the country's development partners and the government. The sluggish economic growth recorded in recent years has not been able to match the population growth rate of 2.9 percent, indicating that the real per capita income has been on a declining trend.

Fiscal Developments

5. The authorities are in the process of finalizing the 2006/07 budget, which will focus broadly on the following priority areas:

- revitalization of the economy and pursuing sound macro-economic management;
- poverty reduction and decisive action on the HIV/AIDS pandemic; and
- reverse the humanitarian crisis by dealing with the food security problem.

6. In addition, the Government in presenting this year's Medium Term Budget Policy Statement (MTBPS), adopted an inclusive approach to generate comments and inputs into the budgetary process from the general public, civil society and politicians. The authorities realize that there are limited avenues to deal with the deteriorating economic situation other than steadfastly adopting a tight fiscal stance, persistently implementing a broad structural reform agenda aimed at improving business environment and competitiveness. The government has clearly outlined these intentions in the recent Medium Term Budget Policy Statement, which aims at achieving a 2 percent budget deficit in 2006/07. This framework also envisages

achievement of a balanced budget in 2008/09, through implementation of the following reforms:

- Civil Service reforms aimed at offering an early voluntary retirement for those civil servants who are 55 years and above in 2006. Furthermore, freezing civil service vacancies, and releasing about E250 million for other priority expenditures, stop creating new posts in the civil service and offer no cost of living adjustments for the remaining civil servants;
- Cutting capital expenditure by E200 million; and
- Lowering the budget ceiling through cuts in recurrent expenditures and expenditure on goods and services of at least 5 percent.

7. While implementing this strategy, the authorities have committed themselves to continue to address, through the budget, some of the social challenges facing the country. They intend to increase expenditure on priority social sectors including health and education in dealing with the increasing poverty, worsening HIV/AIDS pandemic and providing services for the growing number of orphan and vulnerable children (OVC). The authorities plan on improving health care service delivery as well as capacity building of this sector by designing appropriate and properly developed projects and programmes. They expect that this will result in an increase in the share of budget to the health sector by about 2 percent.

8. The budgetary tight situation is going to be temporarily propped-up by a slight increase on revenue receipts from internal revenues and an additional EI.1 billion expected from SACU receipts for 2006/07. Though this SACU windfall will augment the authorities' revenue collection efforts, such flows are not expected in the near future and hence their commitment to an austere fiscal strategy. To further consolidate these efforts, they also plan on establishing a Revenue Authority in the coming financial year and also introduce a broad-based VAT in the medium term.

Economic Resuscitation Plans and Medium-term outlook

9. The authorities recognize that, substantial and sustainable poverty reduction can only be achieved in the context of a growing economy requiring improved environment for conducive private sector investment that will create employment and further achieve diversification. Therefore, expectations on future growth will be anchored on focusing on key areas or pillars of the economy through pursuing fiscal and structural reforms, and supporting the key agricultural and manufacturing sectors, embracing good governance principles premised on transparent and accountable systems, and promoting human capital development.

10. The government is committed to fostering and facilitating a conducive environment for a private sector-driven economic recovery to take place. It plans to ensure these efforts succeed, coupled with efficiency in the use of public resources, and better service delivery. Paramount to this effort is the deregulation and commercialization of some industries especially communication, insurance, water and electricity sectors,

which are expected to provide the much needed impetus for a comprehensive economic recovery.

11. The government held a Job Creation Summit in July 2005, where significant amount of money, totaling about E1.6 billion, was pledged for job creating activities and the authorities are making the necessary preparations to ensure that these pledges and investments support capacity building of the SMEs and the informal sector, particularly in the area of business management as well as providing credit as start-up capital. It is expected that this initiative will contribute significantly to employment creation. The government's medium-term strategy is to continue with the ongoing initiatives towards employment generation such as Lower Usuthu, Maguga project, the Millennium Projects, rollout of the SMEs policy and improve efforts at attracting FDI, amongst others.

12. The authorities remain committed to regional integration efforts and have been participating in a number of SACU-led international trade negotiations, which aim at creating new markets for the country's trade arrangements with the USA, EU and MERCUSOR, among others. They are also committed to developing new export-oriented industries and reduce relying predominantly on the traditional sugar and textile manufacturing sectors.

Monetary, Exchange Rate, and Financial Sector Developments

13. Swaziland is currently involved in a broad-based financial sector reform exercise involving legislative reforms and modernization of the financial sector. Several pieces of legislation aimed at improving financial sector development were passed in parliament in the last year, including amendments to the Financial Institutions Act and the Insurance Act. Additional legislation is expected to be passed in 2006, including the Anti-Money Laundering Act (AML/CFT), Securities Bill, Financial Services Regulatory Authority, and the National Clearing and Settlement Systems Bills.

14. The authorities believe that the decision to maintain the peg of the local currency to the South African rand has provided stability and helped usher financial discipline. While the recent appreciation of the rand against major international currencies undermined the country's competitiveness, they believe that the CMA arrangement has helped in keeping inflation low.

Structural Reforms

15. The authorities' formulation exercise of the constitution, which will usher the country into a new governance dispensation that would lead to political and legal reforms conducive to attracting investments into the country, is in its final stages of completion. Improvement of the business climate and reduction of the role of government in the mainstream of the economy is seen as key to the success of the proposed reforms.

16. The National HIV/AIDS coordinating unit (NERCHA) continues to deliver commendable service in augmenting government activities in this critical area. The unit has established several structures and working committees to deal with the HIV/AIDS pandemic. Unfortunately, the HIV/AIDS prevalence continues to rise and worsening the poverty situation. The government with the support of other donors and the Global Aids Fund has made commendable progress in fighting the scourge and in dealing with the sick by rolling out an anti-retroviral program, as well as dealing with the rising orphan population and embarking on civic education campaign and also strengthened home-based care. The successful roll-out of the anti-retroviral drugs achieved the set target of 13,000 people receiving drugs by the end of 2005. The fight against the HIV/AIDS pandemic has been hampered by rising turnover in the nursing profession with most of them leaving the country to go and work abroad. The pandemic has reached crisis proportions and needs further concerted effort by the authorities and the international community.

17. In response to the declining social indicators the authorities are planning on introducing a national program for Universal Primary Education to ensure basic education for all. This Program is being phased and has started with provision of free text books for primary schools and will be followed up by subsidized education for the first four grades of primary schooling in the coming year so that every child can attend school. This process is undertaken in collaboration with the Ministry of Health and Social Welfare, with particular focus on dealing with the rising number of OVCs.

Conclusion

18. The Swazi authorities remain committed to fundamental structural reforms in both the public and private sectors; and are prepared to review all existing systems and structures to enable implementation of a comprehensive recovery package aimed at reversing the economic malaise. They aim at fully taking advantage of all sectors in which the country has a natural comparative advantage, such as sugar, pulp, and minerals, and improve labour productivity and competitiveness.

19. Income distribution in Swaziland is very skewed and as more people fall into the poverty trap, there is a further worsening of the social indicators. Consequently, the authorities believe that it is important to review the current classification of the country as a middle income country so that it can benefit from concessional resources given the deterioration in the country's socio-economic situation. The international community and the IFIs need to assist and cooperate with the authorities to address the existing unique circumstances and challenges being faced, especially on HIV/AIDS and achieving the MDGs by 2015.

20. The HIV/AIDS pandemic, given its multi-pronged consequences, is the single-most significant threat to achieving sustainable macroeconomic stability due to its devastating effect on the most productive human resource base of the country, with a

youthful demographic structure. Given the magnitude and depth of the challenges facing the country, the authorities look forward to working with other cooperating partners in their efforts to deal with the challenges it faces including fighting poverty, dealing with unemployment and forging a sustainable growth path.