Swaziland

Recent economic developments – April 2009

Overview

Growth outlook for 2009 is on the downside, clouded by the gradual cut in European Union (EU) sugar prices; the expected decline in Southern Africa Customs Union (SACU) transfers amid a new revenue sharing formula; the continued deteriorating world economic environments, which put risks on domestic export growth; continued slow down in foreign direct investment (FDI) inflows which are mostly likely to be exacerbated by the second-round effects of the financial crisis if unabated; and fiscal pressures and the impact of HIV/AIDS. On the positive side, the economy is most likely to benefit from the low cost of borrowing if the current downward trend in inflation is sustained in the medium to long term. The agricultural sector is also expected to underpin growth in 2009, due to the implementation of the Lower Usuthu Smallholder Irrigation Project (LUSIP) and the good rains which saw the Maguga Dam overflowing.

Monetary and financial developments

Gross official reserves

The country's gross official reserves amounted to E7,808.7 million at the end of February 2009, reflecting an increase of E867,8 million (12,5 per cent) over the two months under review. At this level, the estimated import cover of goods and services reached 5,5 months, slightly higher than the 4,9 months registered at the end of December 2008. Contributing to the rise in reserves was an inflow of customs union revenue during the month of January 2009. Over the year, the level of gross official reserves increased by a notable 31,5 per cent.

Valued in Special Drawing Rights (SDRs), the gross official reserves recorded a lower increase of 9,3 per cent over the two months under review to reach SDR524,8 million, due to the depreciation in the lilangeni/rand exchange rate over the review period. Over a 12-month period, the reserves reflected respective increments of 31,5 per cent in emalangeni terms and 10,7 per cent in SDRs.

Domestic claims (net)

Net domestic claims reflected a substantial decline between December 2008 and February 2009, on account of a fall in credit extended to the private sector combined with a notable increase in government net balances with the banking sector. Credit extended to the private sector fell by 1,8 per cent to E5,646.5 million and was mainly reflected in borrowing by other non-financial corporations (industry sector), which recorded a decrease of 4,9 per cent. Government net balances with the banking system amounted to E6,153.4 million, reflecting an increase of 16,8 per cent over the two months.

Monetary liabilities

Broad money supply (M2) reflected a bi-monthly decrease of 2,8 per cent to E5,912.3 million, in line with the contraction in credit extended to the private sector. The decrease in M2 was discernible in both narrow and quasi money supply. Narrow money supply (M1), constituting emalangeni in circulation and demand deposits, recorded a decline of 3,3 per cent to reach E1,905.5 million. Quasi money supply, constituting savings and time deposits, declined by a margin of 2,6 per cent, reaching a level of E4,006.8 million. Over a period of 12 months, narrow money supply registered an increase of 19,8 per cent, while quasi money supply fell by 3,4 per cent.

Domestic liquidity

The liquid assets of the banking system amounted to E873,4 million at the end of February 2009, reflecting a decline of 9,3 per cent over the two months under review. Notable contractions were recorded in balances held with the Central Bank and currency in bank vaults.

Outstanding Treasury bills amounted to E318,3 million at the end of March 2009. Participation continued to be dominated by local banks as they held 83,5 per cent of the bills. Individuals held 9,6 per cent, while the Central Bank and non-bank financial institutions combined held 7 per cent.

The Central Bank continued to issue its own paper (CBS Bills) for which the objective is to supplement issues of government Treasury bills in an effort to mop up excess liquidity of the banking system. As at the end of March 2009, the amount of CBS Bills outstanding stood at E200 million and all these were held by the banks.

Interest rate developments

Following a relaxed monetary policy stance adopted by the Central Bank in December 2008, a further reduction in the interest rate was implemented on two occasions, in February 2009 and March 2009. The easing in monetary policy is, in essence, to provide a stimulus for credit expansion to support economic growth. This has been viewed as not being harmful to the inflation outlook, which has relatively subsided in the review period. The Central Bank of Swaziland has reduced the discount rate by a cumulative 250 basis points since December 2008, from a level of 11,5 per cent in November 2008 to 9 per cent in March 2009. Consequently, the banks had reduced their prime lending rate from 15 per cent to a level of 12,5 per cent by the end of March 2009. Changes in the deposit rates were also effected during the three months, with the 31-day deposits being revised from a level of ,.66 per cent to 6,08 per cent and 12-month deposits rates were reduced from 10,68 per cent to 6,35 per cent.

Government budgetary operations

Fiscal sector

There has been a budget turnaround in the fiscal year 2007/08 which shows a budget surplus of E787,8 million, which is 3,7 per cent of gross domestic product (GDP). This is a decline from the surplus of 10,1 per cent of GDP recorded in

2006/07. Such a turnaround was mainly a result of collection of taxes falling below target due to delays in implementing tax reforms and a decline in custom duties.

The estimated outturn for 2008/09 indicates a budget deficit of E240,7 million or 1 per cent of GDP, a slight improvement from the initially estimated budget deficit of E330 million or 1,4 per cent of GDP. This improvement is attributed to savings arising from the low implementation rate of capital projects, and the vacancy rate and expenditure control measures that government has put in place. In these difficult times, government is also facing challenges of sluggish growth and the implementation of the country's Constitution.

The 2009/10 budget has been drawn on the basis of policy reforms articulated in previous budgets including the Medium Term Budget Policy Statement (MTBPS) for 2008/09 to 2010/11. The MTBPS outlines the fiscal policy considerations that underlie government budget proposals for the three years running from 2008%2F09?? to 2010/11, with identified expenditure patterns taking priority in terms of delivery. The key priority areas this budget focuses on include provision of safe water and sanitation, access to health care, fight against HIV and AIDS, education, economic growth, curbing corruption and strengthening national security. (but this is more than three)

The budget estimates for 2009/10 project a deficit of E1,986 billion, which translates to 8 per cent of GDP. The huge deficit is mainly attributed to the decline in SACU revenue as a result of reductions in tariffs on trade in line with a World Trade Organization requirement, implementation of ongoing capital projects with new capital projects also taken on board, plus the general increase in expenditure pattern to meet government operations.

Public expenditure continues to grow faster than revenue. In 2009/10 it is projected that government revenue, including grants, will decline by 3 per cent to E9,37 billion in 2009/10, when compared to the revised budget for 2008/09. On the contrary, total expenditure is expected to increase by 20,4 per cent to E11,52 billion over the same period. Government continues to explore means of enhancing revenue collection in a bid to mitigate the imminent decline in SACU revenue which has also been felt in the current budget. This will be achieved through enhancing the internal revenue resources leading to the establishment of a Revenue Authority. Financing the deficit through expanding the domestic market by introducing new instruments with longer maturity may be an ideal solution at this point. This could further bring investment avenues for the Insurance and Pension Funds in meeting the requirement for these funds to invest at least 30 per cent of their total assets locally by November 2009.

On the expenditure pattern, recurrent expenditure is projected to rise by 13,1 per cent to E8,27 billion in 2009/10. The wage bill accounts for about 54 per cent of recurrent expenditure and this is significantly higher than the internationally recommended 35 per cent. In an effort to address this, government has decided to enhance the voluntary exit scheme that it set up to reduce the size of the civil service. The capital budget for 2009/10 is E3,08 billion, reflecting an increase of 36,5 per cent from the previous year's budget. This year's capital budget is aimed at completing the already ongoing projects as a matter of priority, with new identified capital projects also taken on board. These include completion of Mbabane By-pass Road, Sikhuphe Airport, rehabilitation of the Swaziland Broadcasting and Information Services building and Hlathikulu Government Hospital, and construction of water treatment plants for supply of water to Siteki, Lomahasha and Nhlangano. New big projects expected to commence in the coming financial year include the construction of the Sicunusa-Nhlangano Road and Lubombo Regional Hospital.

Debt developments

Swaziland's external indebtedness in emalangeni terms worsened in 2008. At the end of December 2008, total external debt stock, including private-sector non-guaranteed debt, stood at E3,98 billion, denoting an increase of 17,4 per cent from E3,39 billion recorded in December 2007. The increase was primarily due to disbursements of loans for ongoing projects such as the LUSIP) and the Mbabane By-pass Road Project. Further putting pressure on the debt stock was the huge depreciation of the lilangeni against the US dollar and other major currencies in which most of the country's external liabilities are denominated.

Public external debt (which includes public and publicly guaranteed debt) stood at E3,58 billion or 18,5 per cent of GDP at the end of December 2008, reflecting an increase of 21,4 per cent from the E2,95 billion recorded the previous year. The external debt for central government, which constitutes the largest share of the total loan portfolio, stood at E3,36 billion from the E2,76 billion recorded at the end of December 2007.

The public debt stock is expected to increase in 2009 as loans for big government projects such as LUSIP, which has reached its completion stage, continue disbursing. During 2009/10, government is also hoping to contract new loans from the Organization for the Petroleum Exporting Countries Fund and BADEA for the financing of Sicunusa-Nhlangano Road, and the Government of Kuwait for the construction of the access road to Sikhuphe International Airport to be jointly financed with BADEA.

Based on critical ratios established by the Bretton Woods Institutions (the International Monetary Fund and World Bank) for Highly Indebted Poor Countries, Swaziland's debt ratios have been comparatively low compared to those of other African countries. However, for a small economy like Swaziland, it still remains important for government to ensure that its debt remains within sustainable levels and to keep expenditure focused on productive undertakings.

Real-sector developments

Macro indicators

After recording an impressive growth rate of 3,5 per cent in 2007, official estimates put real GDP growth at 2,6 per cent in 2008, which is a downward revision from an initially projected growth rate of 3,5 per cent for 2008.

Dampening growth in 2008 was the negative performance of some export commodities, notably in the textile industry and the persistent slow growth in foreign direct investment. The slowdown in the textile industry is attributed to the decline in the economies of trading partners due to the second-round effects of the global financial crisis on developing countries. The shrinkage in the trading-partners' economies has been translated to lower demand for domestic exports, hence a decline in the volumes of exports. Consequently, given the country's heavy reliance on export for growth, the country experienced a decline in overall real GDP growth. Furthermore, the sharp downturn in the South African economy in 2008 has undermined Swaziland's export demand, given that 50 per cent of the country's exports are destined for the South African markets. The domestic economy has also suffered from the high cost of borrowing as policy-makers hike interest rates to contain inflationary pressures. This has also culminated in a slowdown in the construction sector as high interest rates have dampened demand for housing and credit in general for construction purposes. Further compounding the slowdown in the construction sector was the high prices of raw material resulting from the hike in oil prices that occurred during the better part of the period under review.

The above notwithstanding, there are mitigating factors which helped to cushion the economy from declining further in 2008. One of these is the depreciation of the real effective exchange rate in 2008 which implies that the competitiveness of domestic exports destined to markets outside the Common Monetary Area (CMA) improved. The agricultural sector which showed signs of recovery in light of the good rains received in time for the planting season and the higher price for maize have also helped to underpin growth in 2008.

A quick glance at other macroeconomic indicators confirms the not-so-impressive performance of the domestic economy. Swaziland has maintained relatively low savings and investment rates, which have hardly been above 20 per cent of GDP in recent years. As a proportion of GDP, national savings stood at 17,3 per cent in 2007 and is expected to grow at a slower rate owing to the slowing down of the SACU receipts. National savings growth has been sustained by SACU receipts over the past years, but could be reversed by government's increased recurrent expenditure currently at above 70 per cent of the budget, coupled with the dwindling SACU receipts.

The dependence syndrome of the country on SACU receipts is a major concern and needs government's action to counter the consequences of the declining SACU revenue. With the prevailing situation, the government deficit is likely to escalate to unsustainable levels which will, in turn, compromise government savings. The government should therefore intensify its efforts to enhance tax collection through the establishment of a Revenue Authority in its endeavor to diversify its revenue, to reduce the risk inherent in the sources of revenue for the national budget. If efforts to diversify revenue sources are not intensified, then government is likely to resort to dissaving in the medium term.

Meanwhile, gross investment has remained relatively low in recent years. Total investment stood at 19,4 per cent of GDP in 2007 and is expected to have declined in 2008 owing to high borrowing costs, continuing slowdown in FDI inflows exacerbated by the stiff competition in the region, coupled with the worldwide credit crunch. The financial crisis will lead to a fall in FDI, augmenting the already fierce competition for FDI in the region. While government's newly passed legislation requiring that 30 per cent of the life insurance companies and pension fund assets be invested offshore was meant to boost domestic savings, the positive effects of this requirement are yet to be seen.

Inflation and price developments

The Central Bank had noted in its December 2008 monetary policy statement that the inflationary pressures were abating, mainly due to a sharp slowdown in international crude oil prices as well as moderation in food prices, hence the decision to reduce interest rates by 50 basis points to 11,0 per cent. The effect of such a policy stance on inflation is yet to be seen due to the lags in the monetary policy transmission process. It is worth mentioning that the recent downward trend depicted by domestic inflation has not solely been a function of the less-accommodative monetary policy stance adopted by the Central Bank over the period June 2006 to June 2008, but it could be largely attributed to an improvement in the core components of the country's basket (food and transport) which, in the past, have proven to be less responsive to interest rate adjustments (see Figure 2.1.1).

Swaziland’s inflation has continued on a downward trend since September 2008, declining from 12,9 per cent in December 2008 to 11,8 per cent in February 2009. This has been due to lower growth in almost all consumer components, led by transport prices. Growth in transport prices slowed down from 20 per cent in December to 12,4 per cent in February. A decline in the prices of personal transport equipment expenses was the main factor behind the slowdown in overall transport prices. Between January and February 2009 personal transport costs declined by a 10 per cent average. This trend was influenced by lower petrol and diesel prices (135 and 25 cents per litre, respectively) in February this year, compared to the same period in the previous year.

Growth in food prices also declined from 17,9 per cent in December 2008 to 15,6 per cent by February. This was led by falling bread and cereal prices, which fell by 7,3 and 1,7 per cent in the two months, respectively. Cereal prices are expected to continue falling, marking the end of a good crop season. Oils, fats and coffee, and tea and cocoa prices declined by an average of 6,1 per cent and 5,6 per cent in the two months, respectively.

All other components’ growth (excluding food and transport) also slowed down to 8,7 per cent in February from 9,3 per cent the previous month. The slowdown in growth was mainly influenced by the slowdown in education prices, which peaked at 11,4 per cent in January. Growth in alcoholic beverages and tobacco and clothing components declined only marginally, below one percentage point each. Upward pressure came from housing and utilities, recreation and culture and health care components, which recorded higher growth rates in February than in January.

External-sector developments

Reserve position

Based on preliminary figures for 2008, Swaziland's overall balance-of-payments surplus was maintained, though reflecting a decline from a surplus of E2,574.3 million in 2007 to E1,1143.4 million in 2008. This was despite a large estimated outflow of E3,426.8 million recorded in the current account of the year under review. The positive balance-of-payments development resulted mainly from a large inflow of transfers, principally in the form of revenue from SACU coupled with a re-allocation of the government's investments abroad to the custody of the Central Bank of Swaziland.

The services account has been affected by the recent global economic crisis. The rise in energy costs influenced high freight and transportation costs, resulting in the services account deficit swelling to a record E1,659.9 million compared to the E375,6 million deficit recorded the previous year.

Estimated export figures registered an increase of 5,4 per cent in 2008 from E12,292,6 million in 2007. The slower rate of increase in export earnings could be attributed to more subdued growth in both the volume and the lilangeni price of merchandise exports. The much anticipated deceleration in global demand and decline in international commodity prices have, however, encouraged local producers to curtail their output in 2008.

Imports, however, have been threatened by the volatile oil prices with a negative spillover effect on agricultural input and food prices. In 2008 merchandise imports estimates rose by 4,1 per cent from E14,202 2 million the previous year. This sluggish growth in imports was driven by weak consumption that resulted from the high international fuel and food prices, which led to the region realising an average inflation rate of 12 per cent compared to 8,3 per cent in 2007. As a result, the merchandise trade deficit narrowed from E1,910.1 million to E1,834.1 million in 2008.

The income account shows a deficit for the first time in four years, registering a net outflow of E1, 097.8 million in 2008 from E489.7 in 2007.

A slightly higher net inflow of E1,795.2 million was registered in the current transfers account compared to a net inflow of E1, 366.6 million recorded in 2007. SACU receipts continued to dominate this account as the share in the revenue pool was revised to the country’s advantage.

Preliminary data reveal that the financial account excluding reserves posted a net inflow of E4,291.6 million in 2008, depicting a significant improvement from the E2, 918.8 the previous year. Accounting for this increase was a rise in commercial banks’ liquid assets as reflected in banks’ balances with the Central Bank, which suddenly raised their foreign liabilities by E1,445.8 million. Portfolio investment inflows and outflows remained low as few companies dealt in debt and equity securities. Net foreign direct investment inflows recovered slightly during the review period, but did not represent new investments into the economy but rather short-term capital inflows extended to local companies from their foreign head offices.