

BANK OF BOTSWANA

2015 MONETARY POLICY STATEMENT

by

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Governor

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On behalf of the Board and staff of the Bank, it is my pleasure to welcome you to the launch of the *Monetary Policy Statement* for 2015. The Bank fulfils the statutory mandate of maintaining low and predictable level of inflation through an orderly conduct of monetary policy, while ensuring that the banking system remains stable and sound. In fulfilling this mandate, the Bank creates an environment in which economic growth can sustainably take place. In the process, the Bank is obligated to be accountable and transparent, and this is why it is important that we are in here this morning; this is why the Bank embraces your patronage.

The key message contained in this year's Monetary Policy Statement is that favourable external and domestic trends, together with the Bank's monetary policy actions undertaken in 2014, kept inflation within the Bank's medium-term objective range of 3 - 6 percent for an unprecedented twenty consecutive

months. Indeed, for much of 2014, headline inflation was close to the bottom end of the range, and expectations are that this will be the case, at least in the short to medium term.

My summary of the published Statement, copies of which will be availed to you at the end of my submission, will highlight three key messages. First, I will delve on the favourable external price trends which, in turn, affected domestic inflation, given the openness of the domestic economy; to this I will add home-grown factors. Second, I will highlight how the Bank conducted monetary policy in the context of a supportive environment. Last but by no means least, I will share with you the Bank's crystal ball gazing, which is the inflation outlook for the medium-term.

On **external developments**, the global economy is estimated to have expanded by 3.3 percent in 2014, in line with the growth rate for 2013. After an extended period of low interest rates, supplemented by quantitative easing, the United States of America led a resurgence of growth in advanced economies and reduced unemployment. Similarly, the United Kingdom reinvigorated economic activity and also made a positive dent on unemployment. The result is that both countries are on the cusp of a shift to monetary policy tightening. For the Eurozone, the better-than-expected, but still anaemic growth and the threat of

deflation necessitated more accommodative monetary policy, which included extensive quantitative easing. As you are aware, Greece is doing just enough to stave off pressure of falling in line on austerity measures, but the country and, by extension, the Eurozone is in economic choppy waters nevertheless. Emerging market economies, our neighbour South Africa being a case in point, are expected to register a marginally lower economic growth than was the case in 2014. Indeed the slack in economic activity will be more pronounced in countries that are heavily reliant on commodity exports, especially oil.

Overall, despite continued geopolitical tensions, which will present downside risks to economic performance for both developed and developing economies, the global economy is projected to improve its performance, albeit by a whisker, to 3.5 percent in 2015.

The broadly subdued global demand, precipitous decline in international oil prices since the second half of 2014, and the downward trend in international food prices, combined to ease global inflation from 3.9 percent in 2013 to 3.8 percent in 2014. The outlook is that inflation will remain low in 2015.

Botswana's trading partner countries also experienced lower inflation, from 3.6 percent in 2013 to 3.1 percent in 2014. The

countries whose currencies constitute the Special Drawing Rights (United States of America, Eurozone, Japan and United Kingdom) experienced the sharpest decrease in inflation of almost one percentage point, to an average of 0.5 percent. This was mostly due to weak economic activity, lower food inflation and the declining international oil prices. Despite some upward pressure earlier in the year, inflation in South Africa slowed marginally to 5.3 percent in 2014, and remained within the target range of 3 - 6 percent.

The downward trend in global inflation, particularly in Botswana's trading partner countries, spilled over to domestic price trends. By the end of 2014, inflation in Botswana was 3.8 percent, compared to 4.1 percent in December 2013, before decreasing further to 3.6 percent last month. When measured by the exclusion method, inflation increased slightly to 4.9 percent, while the 16 percent trimmed mean measure of inflation showed a decrease to 3.7 percent.

The benign trend in domestic inflation benefitted from the reduction in the price of fuel; there was also a dissipation of the previous year's increase in the alcohol levy and the lower rate of adjustments in some administered prices, both of which had a favourable impact on price developments. This generally slower

pace of price increases was also the result of subdued domestic demand pressures, despite higher government spending. Recurrent outlays too, which included a modest 4 percent increase in civil service salaries, had a small impact on overall demand.

Credit growth rose at a slower rate of 13.5 percent in 2014; this compares with the previous year's growth rate of 15.1 percent. Household borrowing slowed sharply from 24.2 percent to 9.4 percent in 2014. This was attributable to a significant decrease in mortgage lending from 40.1 percent to 18.4 percent, and a steep fall in the growth of personal loans from 19.6 percent to 5.3 percent between 2013 and 2014. The sharp decline in household credit expansion augured well for the maintenance of financial stability. Nevertheless, household debt remains a concern in an environment of slow growth in incomes. The Bank will, of course, continue to monitor household credit even though current default risk indicators provide some reassurance.

In contrast to household borrowing, credit to business rose markedly, from 4.6 percent year-on-year in December 2013 to 19.1 percent a year later. This rapid increase in business lending moderated the extent of the slack in non-mining GDP growth, which had slowed to 4.7 percent in the twelve months to

September 2014, compared to the 5.2 percent growth rate registered a year earlier.

Distinguished Ladies & Gentlemen:

I now turn to the **conduct of monetary policy in 2014**. As many are aware, a leading indicator of the inflation forecast is whether the gap between the long-term output trend and actual output will narrow, widen or remain constant over the medium-term. There are other inputs to the inflation forecast, and they include foreign inflation, exchange rate movements, changes in domestic administered prices and taxes, as well as expectations of future price movements. For purposes of enhancing credibility, information obtained from the Bank's biannual Business Expectations Survey is taken into account, since it covers trends in several economic and financial indicators as observed by economic agents. This is buttressed by regular communication to stakeholders in the form of disseminating the contents of the yearly *Monetary Policy Statement*, as it is happening now. The Bank also publishes the mid-term review of the *Monetary Policy Statement* and conducts economic briefings from time to time. Furthermore, public announcements of monetary policy decisions are made through regular press releases.

Against this background, successive medium-term forecasts of inflation remained positive in 2014. It was also important to take account of the need to preserve financial stability in the context of continued sluggish growth in personal incomes. In the circumstances, the Bank Rate was unchanged at 7.5 percent throughout the year. Accordingly, the prime lending rate at commercial banks was unchanged at 9 percent. Interest rates on deposits increased only slightly, in this way reflecting the commercial banks' drive to attract deposits, after a period of what could be considered over-extended lending, which may have contributed to some banks' undesirably mis-matched lending books.

Consistent with past practice, the conduct of monetary policy in 2014 was such that short-term interest rates were maintained at required levels through open market operations. The Bank regularly assessed the impact of economic and financial developments on inflation and monitored the effect of credit growth on the quality of banks' assets. The Bank also made an assessment of trends in bank deposits, on the growing burden of household debt and on a possible emergence of asset price bubbles.

Looking ahead, the evolution of both external and domestic factors is instructive. In a bid to inform the direction of monetary policy in 2015, and anchor inflation expectations, we have this to say: global inflation is projected to increase slightly from 3.8 percent in 2014 to 3.9 percent this year. For most advanced economies, inflation is forecast to remain low, and deflation will be a concern in the Eurozone and Japan. With these prospects, monetary policy in these countries is expected to be largely accommodative. Although inflation is expected to be higher in emerging market economies, it will be restrained by weakening commodity prices. Therefore, monetary policy is expected to focus on bolstering economic activity.

Here at home, the economy is forecast to grow at a slower pace of 4.9 percent in 2015, compared to last year's 5.2 percent. However, the results of the Business Expectations Survey conducted by the Bank in September last year show some moderately better economic prospects for this year. As indicated in the budgetary outlays for the 2015/16 fiscal year, overall demand should be invigorated by higher government expenditure. But power and water supply constraints, as well as the dry spell in parts of the country, could dampen domestic economic activity.

The exchange rate will continue to support international competitiveness of domestic industries and, in doing so, contribute towards macroeconomic stability and economic diversification. In view of the projected narrowing of the gap between domestic inflation and the average inflation of trading partner countries, this year's exchange rate mechanism will entail a zero rate of crawl for the Nominal Effective Exchange Rate. Consistent with Botswana's trade pattern, the weights of the Pula basket have been adjusted accordingly, such that now the rand and the SDR have equal weights of 50 percent.

Overall, it is anticipated that domestic demand pressures on inflation will be modest this year. As indicated in the 2015 Budget Speech, any increase in civil service salaries is unlikely to generate significant demand or expectations of higher inflation. In view of the favourable domestic prospects, and the outlook for benign external price trends, it is projected that inflation will continue to be within the 3 - 6 percent range in the medium term. The only caveat to this prognosis would be any substantial upward adjustment in administered prices and government levies beyond current projections, as well as a possible spike in food prices due to unfavourable weather in the region. Conversely, recent value-added zero-rating of additional staple foodstuff supports the expectation of low inflation in the

period ahead. Moreover, the weak global economic activity, overall falling commodity prices, technological progress, and growing trade competition, should continue to exert downward pressure on domestic inflation. That is why the Bank rate was reduced last month, to 6.5 percent, a monetary policy signal which will have been instantaneously transmitted by banks to the wider economy, as appropriate.

Honourable Minister (FDP) & your Cabinet Colleagues,

Distinguished Ladies and Gentlemen:

I **conclude** on a note of guarded optimism for this year and the foreseeable period ahead on price developments. For the sake of emphasis, inflation is forecast to remain within the Bank's objective range of 3 - 6 percent in the medium term. As always, the formulation and implementation of monetary policy will focus on entrenching expectations of low and sustainable inflation in the medium term, through timely responses to price changes, while ensuring that credit and other market developments are consistent with lasting financial stability.

I thank you for your attention.