Bank of Botswana at a Glance

THE BANK'S VISION

The Bank aspires to be a world-class central bank with the highest standards of corporate governance and professional excellence.

THE BANK'S MISSION

The mission of the Bank is to contribute to the sound economic and financial well-being of the country. The Bank seeks to promote and maintain:

- monetary stability;
- a safe, sound and stable financial system;
- an efficient payments mechanism;
- public confidence in the national currency;
- sound international financial relations; and to
- provide efficient banking services to its various clients; and sound economic and financial advice to Government

Contents

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Introduction

The Bank of Botswana, the central bank of the Republic of Botswana, was established by an Act of Parliament (Bank of Botswana Act. Cap. 55:01). The Bank came into existence on July 1, 1975. It is wholly owned by the Botswana Government. However, it enjoys a high degree of autonomy in the performance of most of its functions. The Bank's headquarters are in Gaborone; and it has a branch in Francistown.

The Governor is the Bank's chief executive officer. The Governor is appointed by the President of the Republic of Botswana for a renewable term of five years. The Board of the Bank, which is chaired by the Governor, is responsible for policy formulation and general administration of the Bank. The members of the Board, apart from the Governor, are appointed by the Minister of Finance and Development Planning. For the day-to-day running of the Bank, the Governor is assisted by Deputy Governors and Directors, who are Heads of Departments in the Bank.

Primary Objectives of the Bank

The primary objectives of the Bank are to promote and maintain low and stable inflation, ensure an efficient payments system and keep the banking system safe and sound. To achieve these objectives, the Bank undertakes a number of functions, including:

(a) Formulating and implementing monetary policy
(b) Issuing currency
(c) Providing central banking services
(d) Licensing, supervising and regulating commercial banks and other financial institutions
(e) Serving as economic and financial advisor to Government
(f) Implementing exchange rate policy
(g) Managing foreign exchange reserves

Inflation, which refers to the general rise in the level of prices in the country, and is typically measured by the percentage change in the national consumer price index, is the major focus of the Bank. Achieving price stability, keeping the rate of inflation low, stable and predictable, is the principal objective of the Bank because the alternative – high and unstable inflation – would seriously undermine the nation's efforts to develop, diversify, create jobs, raise living standards and eradicate poverty in line with Vision 2016.

Having an efficient payments system, a means by which buyers and sellers of goods and services can engage in transactions using currency (banknotes and coin), cheques, debit-credit cards or electronic funds transfers, is vital to the functioning of any modern economy. Likewise, having a safe and sound banking sector – one in which people can have confidence that their money will not be lost or stolen - plays a crucial role in enabling businesses and households to make efficient decisions regarding production, consumption, investment, saving, supply of labour, etc.

(a) Formulating and Implementing Monetary Policy

Many years ago, when currencies were based on coins made of precious metals, such as gold, they had intrinsic value; that is, the coins had value in themselves from the precious metal they contained. This does not apply with 'paper' money issued by the central bank, which only has value if people believe they can use it to pay for something they need or want, for example, food, clothing or shelter. Thus, establishing and maintaining the buying power of paper money - otherwise known as 'price stability' - is a critical responsibility of the central bank. Price stability is achieved through the implementation of monetary policy. Price stability is necessary because when the value of money is stable (when there is low and stable inflation), the value of people's incomes and savings are protected, and investment in the development of the nation's productive capacity is promoted.

Money helps commerce and trade best when people can enter into contracts knowing that prices set in a contract will remain almost the same for the duration of the contract. If the value of money is changing unpredictably, activities that involve people making financial obligations over time with one another become riskier. Potential transactions in which one person agrees to pay someone else later for something he/she wants now are discouraged and, as a result, the economy and society at large suffer. An employment contract between an employee and an employer is a typical example. A twelve month employment contract will benefit both parties, if the employer and employee know that the rate of pay agreed on at the beginning of the contract will be worth the same value over the twelve month period. A mortgage to help you buy a house is another example. If you take out a mortgage obligating you to pay a certain amount each month for 30 years (for example, P2000 per month), after five years the level of your debt obligation relative to your income will be different, depending on whether inflation has been low or high, and whether or not your income has kept up with inflation. Likewise, deciding whether or not to invest your money in a form of savings that gives a fixed return in the future requires a judgement about how much inflation will erode the purchasing power of the money you'll receive in return for the money you invested.

Monetary policy, therefore, is directed at creating a predictable background against which businesses and households can make the most efficient decisions and, by so doing, achieve the best results for themselves to the extent possible and contribute to maximising the sustainable economic growth of the nation. The Bank mainly uses two monetary policy instruments to attain price stability; that is Open Market Operations and the Bank Rate. The Bank can also use reserve requirements, moral suasion and direct credit controls to influence monetary conditions in the economy and, hence, the rate of inflation. However, financial sector reforms over the past three decades have led the monetary authorities to move away from using direct credit controls, such as setting limits on consumer credit, imposing sectoral allocations of credit or restricting interest rates commercial banks can pay or charge.

(i) Open Market Operations

Open Market Operations by the Bank involve the buying and selling of Bank of Botswana Certificates (BoBCs) in the money market, in order to influence financial market conditions, especially short-term interest rates. BoBCs are short-money market term instruments, the longest term to maturity being 364 days and the shortest, 14 days, which the Bank sells at auctions to selected participants. The participants in BoBC auctions, known as primary counter-parties, are the commercial banks.

How does this monetary policy instrument work? Every year, the Bank of Botswana sets an inflation range as an objective that it would like to achieve, for example, the inflation objective range set for 2007 is 4 - 7 percent. Then, throughout the year, the Bank has to try to keep inflation within this range. One way to do this is by using BoBCs to control the amount of money in circulation in relation to goods and services available in the economy. When there is too much money in circulation, demand for goods and services increases, putting upward pressure on prices and the rate of inflation. To avoid this, the Bank would auction more BoBCs to mop-up the excess money (or "liquidity") in the banking system, thus reducing the amount of money that the commercial banks could lend out. This lower level of lending by the commercial banks would reduce the demand for goods and services in the economy, thereby serving to curtail inflation. Conversely, if the demand for goods and services falls too low, putting downward pressure on prices, the Bank would issue a smaller amount of BoBCs, leaving the commercial banks with more money that they can lend to households and businesses, which could serve to reinvigorate economic activity.

(ii) Bank Rate

The Bank Rate is the interest rate at which the Bank is prepared to lend money overnight to commercial banks. It can be used to influence short-term interest rates. If the Bank sees inflation rising above the objective range set, it raises the Bank Rate, thereby increasing short-term interest rates that commercial banks have to pay if they need money. The commercial banks would, invariably, adjust the interest rates they charge borrowers, to compensate for their having to pay higher interest rates to the Bank. Higher interest rates discourage borrowing and encourage saving, both of which reduce spending. Falling demand for goods and services then discourages businesses from putting up their prices, which, in turn, curtails inflation. Conversely, if the Bank sees that demand for goods and services has fallen far below the economy's ability to supply them, and thus economic conditions are depressed, with little or no upward pressure on prices, it would reduce the Bank Rate. This would lead the commercial banks to lower short-term interest rates, which would stimulate more borrowing by businesses and households, which would help to get the economy moving again.

(iii) Reserve Requirements

Reserve Requirements are funds that the Bank requires commercial banks to hold on the basis of the deposits they have accepted from the public. The funds are held in a non-interest bearing account at the Bank of Botswana. The Bank of Botswana sets the reserve requirement ratio for commercial banks; currently it is 5 percent. While not generally used as such, this can be an instrument of monetary policy which, when varied, can influence the extent of credit creation. For example, when the reserve requirement ratio is increased, the commercial banks have to put more money on deposit at the Bank of Botswana. This reduces the amount of funds a commercial bank can lend from the deposits they have taken from the public, and this leads to a decrease in the supply of money.

Conversely, a decrease in the ratio allows banks to expand their lending, leading to an expansion of the money supply.

(iv) Moral Suasion

The central bank sometimes tries to influence monetary conditions through the technique of "moral suasion", which involves talking to and advising the commercial banks about their lending policies. This "friendly persuasion" usually involves the Bank making monetary policy statements, public pronouncements and/or appeals through press releases and economic briefings with a view to the commercial banks tightening up their lending standards and thus reducing the amount of lending (credit) they extend to borrowers.

(b) Providing Central Banking Services

The Bank of Botswana provides banking services to the Government and commercial banks by maintaining bank accounts for them As a banker to Government, the Bank handles payments for Government's purchases of goods and services and receipts of Government revenues, and the Bank prepares financial reports to account for the Government funds held as public investments. The deposits and investments by Government at the Bank are, in turn, invested abroad as foreign exchange reserves. As a banker to commercial banks, the Bank of Botswana facilitates money transactions between the financial institutions themselves. Most of such transactions are conducted using a computer ledger system connecting the Bank, Government and commercial banks. The Bank is also a lender of last resort to financial institutions licensed by it; that is, it extends short-term loans to the commercial banks on a need basis. The Bank has regulatory and oversight responsibility in ensuring that the payment system does not pose a threat to financial stability.

Since the Bank of Botswana is a central bank, it neither accepts deposits from private companies or individuals, nor extend loans to them. Members of the public only come to the Bank to cash government cheques, exchange mutilated banknotes or make other transactions consistent with the Bank of Botswana Act. Mutilated or damaged banknotes may be exchanged at full face value depending on how much of the original banknote remains. For example, if a person's banknote got mutilated under conditions beyond his/her control and the remaining portion of the banknote still bore adequate security features, the Bank would then give the person the full face value of the banknote that had been damaged. However, it should be noted that any wilful mutilation of currency is an offence under Botswana law, for which a person may be fined and/or imprisoned.

(c) Licensing, Supervising and Regulating

Commercial Banks and Other Financial Institutions

Banking is a regulated industry for two main reasons: firstly, banks take deposits from the public; secondly, banks play a key role in a country's payments system. Because of that, a bank failure or collapse poses a risk to the health and stability of the financial system as a whole, and through that to the entire economy. Thus, there is need to have a regulatory authority for banks to ensure that such a risk does not happen.

The Banking Act, 1995, empowers the Bank of Botswana to license, supervise and regulate deposit-taking institutions in this country. The Bank, in carrying out this function, ensures that there is confidence in the banking system; that depositors' funds are protected; that banks disclose the cost of their services and products; that there is healthy competition among banks in the country; and that banks comply with the country's banking laws and regulations.

The main supervisory approaches followed by the Bank of Botswana are on-site and off-site examinations, and regular bilateral meetings with each supervised financial institution. On-site examination focuses on the safety and soundness of a bank's operations. It involves the assessment and analysis of a bank's books and records to determine whether the bank has adequate capital resources, that its assets are of good quality, that it is profitable and that it has adequate liquid assets to meet its obligations and any contingencies that might arise. The on-site examination also considers the adequacy and effectiveness of management and internal controls of the bank. Off-site examination involves the assessment of a bank's financial condition using information obtained from the statutory returns which the commercial banks submit to the Bank of Botswana. Here the focus is on the levels, trends and comparisons of the bank's key prudential measures (for example, the bank's capital as a percent of its total assets) with the statutory benchmarks set by the Bank in accordance with best international practice.

In addition to deposit-taking financial institutions, the Bank authorises, regulates and supervises companies operating in the International Financial Services Centre (IFSC), for example, African Alliance, African Banking Corporation, Cherubim Ventures, Imara Holdings and Kingdom Bank. Although insurance companies and insurance related businesses operate under the IFSC, they are not regulated by the Bank; they are regulated and supervised by the Registrar of Insurance – currently in the Ministry of Finance and Development Planning. The Bank also derives authority from the Bank of Botswana Act to license, regulate and supervise the foreign exchange bureaux.

(d) Serving as Economic and Financial Advisor to Government

The Bank advises Government on a wide range of issues, including, among others, exchange rate policy, financial sector development, taxation, industrial development, regional economic integration and trade. The Bank's Research Department collects data and undertakes research on economic developments and trends in order to help inform discussions and debates on public policy issues. The Bank prepares a number of publications (for example, the Bank's Annual Report, Research Bulletin and Botswana Financial Statistics) and disseminates information through its website, press releases and economic briefings to the general public, academia, investors and, most importantly, Government, which uses the information to guide the formulation of economic and financial policies.

(e) Implementing Exchange Rate Policy

The exchange rate is the rate at which the Pula can be converted into a desired foreign currency; for example, on June 18, 2007, 1 Pula converted to 1.14 South African Rands. As specified in the Bank of Botswana Act, it is the President who decides how the value of the Pula in relation to foreign currencies is determined. His decision is based on the recommendation of the Minister of Finance and Development Planning, after s/he has consulted with the Bank. On every business day, the Bank implements the President's decision, calculating the value of the Pula in relation to a basket of currencies comprising the SDR (the International Monetary Fund's unit of account) and the South African Rand, and quotes the buying and selling rates for four major international currencies, that is, the US Dollar, Euro, Pound Sterling and South African Rand, to the commercial banks, that, in turn, can then buy foreign exchange from and sell foreign exchange to their clients.

The Bank continuously monitors exchange rate developments in order to advise the Government on how to maintain a stable exchange rate which will ensure that the prices of domestically produced goods and services remain competitive, both locally and abroad. Such competitiveness is vital for Botswana businesses to be able to remain viable, expand their operations and create more employment opportunities for Batswana.

(f) Managing Foreign Exchange Reserves

The Bank, as an agent of the Government, manages the country's official foreign exchange reserves. The country's international reserves consist of international assets, such as US Treasury Bills and Japanese Government bonds, which can be used to obtain foreign currencies that can be used to pay for foreign goods and services which residents of Botswana want to buy from foreigners (for example, petrol or cars). The foreign exchange reserves can also be used to pay for debts which

Botswana residents have with foreigners (for example, for the Government to be able to service loans it has from the African Development Bank which were used to build schools, health facilities and roads).

Over the years, because of Botswana's sound macroeconomic policies and national development strategies, which have contributed to balance of payments surpluses, the country's foreign exchange reserves have grown considerably in value and in terms of months of import cover for goods and services, currently providing over 30 months of import cover. The Bank invests these foreign exchange reserves in a prudent manner in a diversified portfolio of high quality international assets that ensures their safety and liquidity, as well as robust returns on the amounts invested.

Bank of Botswana's Public Education Programme on Banking

In order to increase public awareness and understanding of the Bank of Botswana in particular, and the Botswana banking sector in general, the Bank has embarked on a Public Education Programme on Banking. It is committed to increasing public awareness of the banking system in the belief that a more informed public will lead to improved competition and more efficient delivery of services in the banking system.

The Objectives of the Public Education Programme

The main objectives of the programme are to:

(a) inculcate a culture of saving in society, especially targeting the youth, so that they can develop and benefit from financial discipline as they grow up;

(b) equip the small, medium and micro enterprises sector, in particular, with information on banking and financial services, so that entrepreneurs can be in a better position to understand how to access banking services, including credit facilities;

(c) empower the general public by providing the necessary information so that they can make informed choices and decisions on banking and financial matters.

Public education is carried out through, among others, the publication of pamphlets, booklets, posters and videos on money and banking issues, participation in school and trade fairs, and presentations to interest groups.

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