



# Monetary Policy Statement 2016



**BANK OF BOTSWANA**

## ***STRATEGIC INTENT STATEMENTS***

### ***VISION***

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

### ***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;*
- safe, sound and stable financial system;*
- efficient payments mechanism;*
- public confidence in the national currency;*
- sound international financial relations;*

*and to provide:*

- efficient bank services to its various clients; and*
- sound economic and financial advice to Government.*



# **MONETARY POLICY STATEMENT 2016**

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*Governor*

*February 25, 2016*

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## **1. INTRODUCTION**

- 1.1 The 2016 Monetary Policy Statement (MPS) reviews the preceding year's economic and policy developments and evaluates the determinants of changes in the level of prices and their impact on inflation in Botswana. In addition, the Statement makes an assessment of economic and financial developments that are likely to influence the path of inflation in the medium term and, in turn, the Bank's policy choices in 2016. Price developments and policy choices are evaluated in the context of a forward looking monetary policy framework, the Bank's medium-term inflation objective range of 3 – 6 percent and the financial stability objective. The MPS seeks to promote an understanding of the conduct of monetary policy in order to anchor public expectations of a low, predictable and sustainable level of inflation.*
- 1.2 Global economic activity was weaker in 2015 than in 2014, with performance varying across countries and regions. Output increased most rapidly in the United States of America (USA) and United Kingdom (UK), while it improved in the euro area and Japan. In emerging market economies, output growth decelerated owing to the decline in commodity prices, tighter external financing conditions and lower demand by China. Global inflation was restrained in 2015, mainly reflecting subdued commodity prices (notably oil prices), modest global demand and persistent spare capacity in advanced economies. Against this background, major central banks maintained accommodative monetary policy, including low interest rates and provision of liquidity to the financial sector<sup>1</sup>, while emerging market economies pursued divergent policies to either boost economic activity or restrain inflationary pressures.*
- 1.3 In Botswana, GDP increased by 1.2 percent in the twelve months period to September 2015, weighed down by a contraction in mining output. Inflation fluctuated around the lower end of the Bank's medium-term objective range of 3 – 6 percent during 2015 and decreased from 3.8 percent in December 2014 to 3.1 percent in December 2015. Price developments were characterised by modest domestic demand pressures, restrained growth in personal incomes, reduction in fuel prices, moderate increase in other administered prices, low food price inflation (which benefited from additional value added tax (VAT) concessions) and benign external inflationary pressures.*
- 1.4 On account of projected low inflation in the medium term, the monetary policy stance was accommodative and the Bank Rate was reduced by a cumulative 150 basis points to 6 percent in 2015<sup>2</sup> in support of economic activity. The Bank also implemented a zero rate of crawl of the nominal effective exchange rate (NEER) of the Pula effective January 2015, given that inflation in Botswana was close to the lower end of the*

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<sup>1</sup> With the exception of the USA Federal Reserve Board, which increased the policy rate from 0 - 0.25 percent to 0.25 - 0.5 percent in December 2015, in the context of considerable improvement in labour market conditions and confidence that inflation would increase to the 2 percent target in the medium term.

<sup>2</sup> The Bank Rate was reduced by 100 basis points and 50 basis points in February and August, respectively.

objective range (similar to forecast inflation of trading partner countries).<sup>3</sup> Bilaterally, the Pula appreciated by 13.6 percent against the South African rand and depreciated by 11.6 percent against the SDR in the twelve months period to December 2015.<sup>4</sup> The real effective exchange rate (REER) was stable (appreciating by a marginal 0.4 percent year on year to December 2015), given the small differential between inflation in Botswana and the average inflation of trading partner countries.

- 1.5 Inflation is forecast to remain within the 3 – 6 percent objective range in the medium term. Upside risks to the inflation outlook relate to any considerable upward adjustment in administered prices and government levies and any increase higher than current projections in international food and oil prices. There are, however, downside risks associated with restrained global economic activity and possible further decrease in commodity prices.

## **2. MONETARY POLICY FRAMEWORK**

- 2.1 The primary objective of the Bank's monetary policy is to achieve price stability, which is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. The policy is also formulated with a view to safeguarding the stability of the financial system. A low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers, which, in turn, contribute towards the broader national objective of sustainable economic development.
- 2.2 The monetary policy framework is based on a forecast, with a medium-term outlook that primarily guides the Bank's response to projected movements in inflation, while taking account of prospects for economic growth and developments relating to stability of the financial system. To this end, in assessing the policy stance, the Bank factors in projections of real monetary conditions<sup>5</sup> in the context of other relevant domestic and international economic and financial developments, and their impact on the output gap<sup>6</sup> and, ultimately, inflation. The policy framework also recognises the importance of communication with stakeholders in order to influence expectations. Accordingly, the Bank issues a press release after meetings of the Monetary Policy Committee to announce policy decisions and their rationale.

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<sup>3</sup> The respective Pula basket weights for 2015 were 50 percent each for the South African rand and SDR.

<sup>4</sup> The SDR is the unit of account of the International Monetary Fund (IMF) comprising the United States dollar, euro, British pound and Japanese yen. In late 2015, the IMF Executive Board approved inclusion in the SDR basket of the Chinese renminbi (yuan) with a weight of 10.92 percent effective October 1, 2016.

<sup>5</sup> The real monetary conditions index (RMCI) measures the relative looseness or tightness of monetary conditions and gauges the likely effect that monetary policy has on the economy through changes in the exchange rate and interest rates. The real monetary conditions are measured by the RMCI that combines, through a weighted average, the deviations of the real exchange rate and real interest rate from their respective trend values.

<sup>6</sup> The output gap refers to the difference between actual output and long-term trend output (as an indicator of productive capacity). A negative output gap means the actual level of output for a given period is below the trend level for that period, thus indicating the economy is operating below its estimated potential.



### 3. **IMPLEMENTATION OF MONETARY POLICY AND RELATED ECONOMIC DEVELOPMENTS IN 2015**

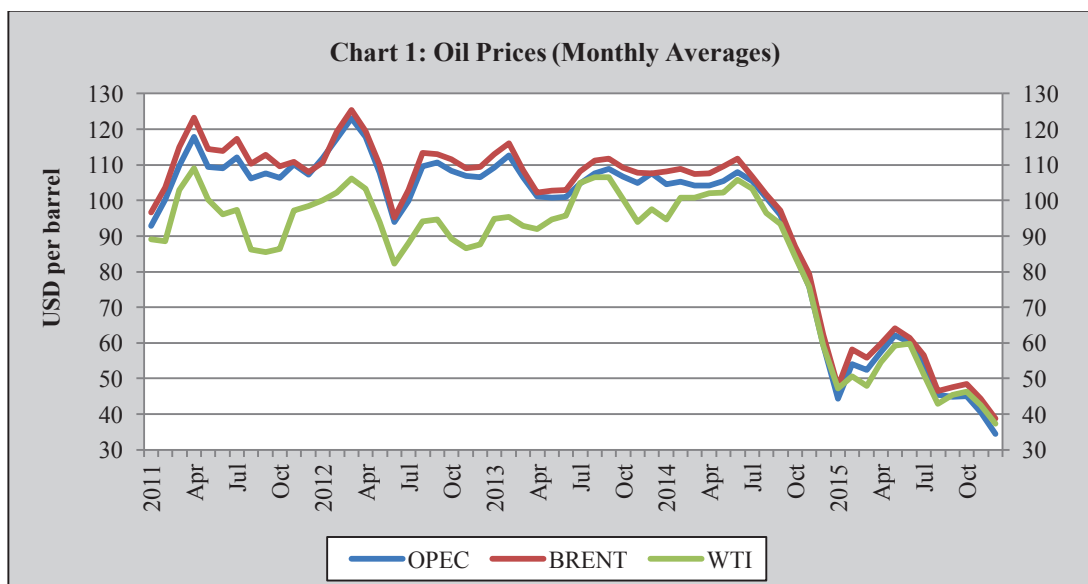
#### **(a) External Developments**

- 3.1 Monetary policy was conducted in an environment of varied economic performance across countries and regions. Policymakers generally focused on achieving sustainable economic growth through accommodative monetary policy, liquidity support to the financial sector and structural reforms to foster competitiveness in the long term. Accommodative monetary policy was dominant in advanced countries and involved maintenance of policy interest rates at low levels and provision of liquidity to the financial sector. In emerging market economies, monetary policy responses were divergent as central banks either reduced interest rates to support growth or tightened monetary policy to ward off inflationary pressures.
- 3.2 Output in the USA and UK grew rapidly compared to other advanced economies in 2015, supported by improvement in domestic demand as real incomes increased, in part, due to the fall in energy prices. Output expansion also benefited from the accommodative financing conditions, less aggressive fiscal austerity measures and improving labour market conditions. These factors supported modest economic recovery in the euro area and Japan. In contrast, activity in emerging market economies was constrained by tighter external financing conditions, subdued domestic demand, adverse impact of falling commodity export prices and slower growth in economic activity in China. Overall, global output growth is estimated at 3.1 percent in 2015, lower than the estimated 3.4 percent of 2014 (Table 1). In 2015, global inflation eased from 3.5 percent in 2014 to 3.3 percent in 2015 due to subdued demand, persistent excess capacity in major economies and low commodity prices (including oil, Chart 1).

**Table 1: Real GDP Growth Rates (Percent)**

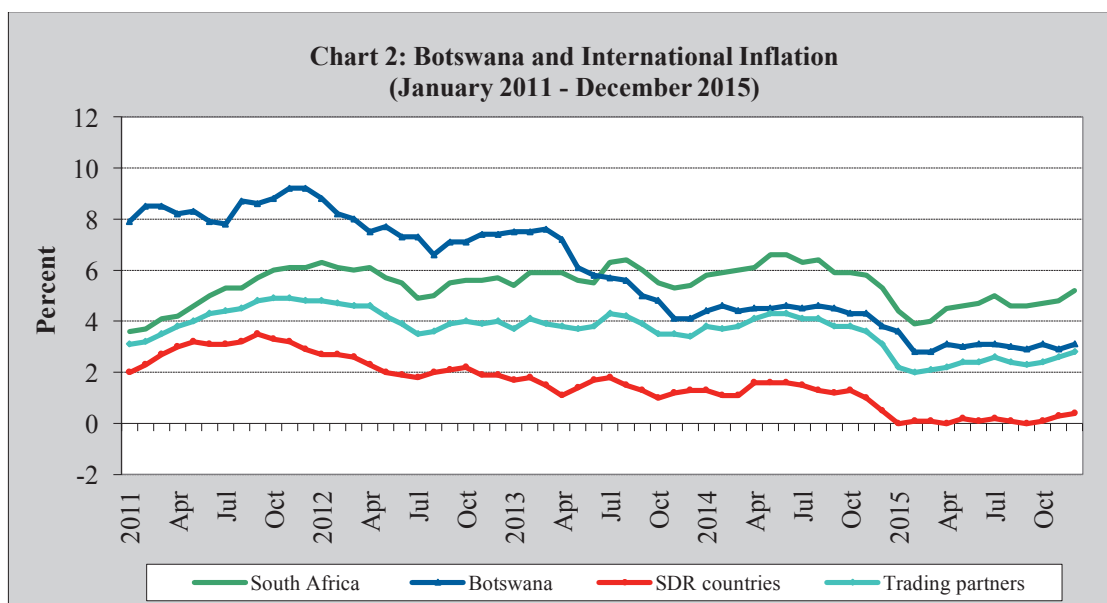
			<b>Projection</b>
	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>Global</b>	3.4	3.1	3.4
<b>Advanced economies</b>	1.8	1.9	2.1
United States of America	2.4	2.5	2.6
Euro Area	0.9	1.5	1.7
United Kingdom	2.9	2.2	2.2
Japan	0.0	0.6	1.0
<b>Emerging market and developing economies</b>	4.6	4.0	4.3
China	7.3	6.9	6.3
Brazil	0.1	-3.8	-3.5
India	7.3	7.3	7.5
Russia	0.6	-3.7	-1.0
South Africa	1.5	1.3	0.7
<b>Botswana</b>	3.2	1.0	4.2

Source: International Monetary Fund, January 2016 World Economic Outlook Update and 2016 Budget Speech, Botswana.



Source: [www.opec.org](http://www.opec.org) and [www.eia.gov](http://www.eia.gov).

- 3.3 With respect to Botswana's trading partner countries, trade-weighted average inflation decreased from 3.1 percent in December 2014 to 2.8 percent in December 2015.<sup>7</sup> Inflation for SDR countries eased from 0.5 percent in December 2014 to 0.4 percent in December 2015<sup>8</sup>, while in South Africa, inflation fell slightly from 5.3 percent in December 2014 to 5.2 percent in December 2015 (Chart 2).<sup>9</sup>



Source: Statistics Botswana.

### (b) Monetary Policy Implementation in Botswana

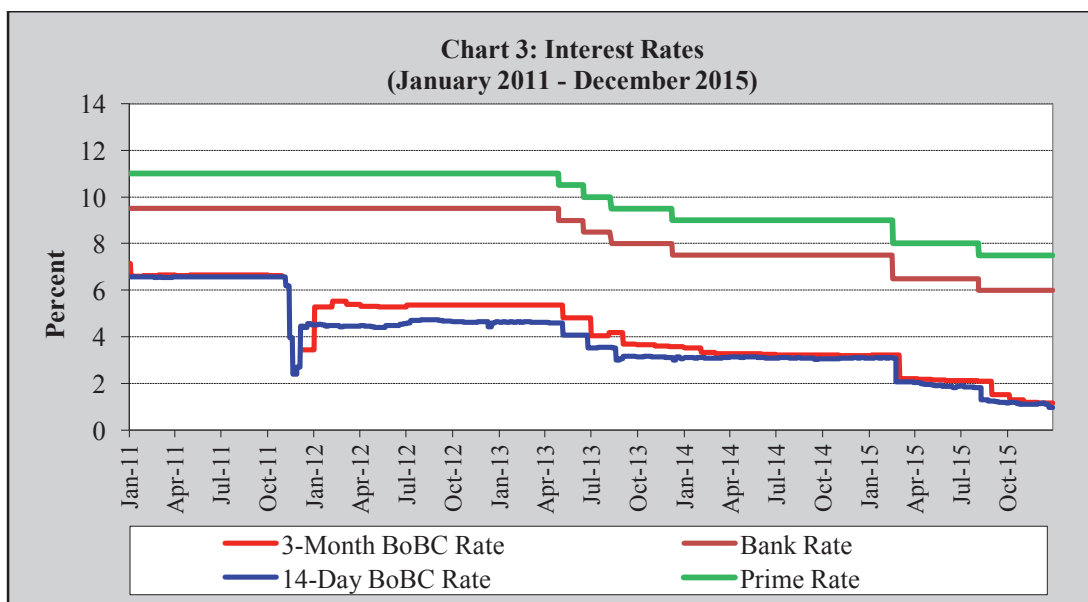
- 3.4 Domestic monetary policy was implemented in the context of below-trend economic growth (a non-inflationary output gap) and a positive medium-term outlook for

<sup>7</sup> The trade-weighted average inflation comprises South Africa's headline inflation and average SDR countries' inflation.

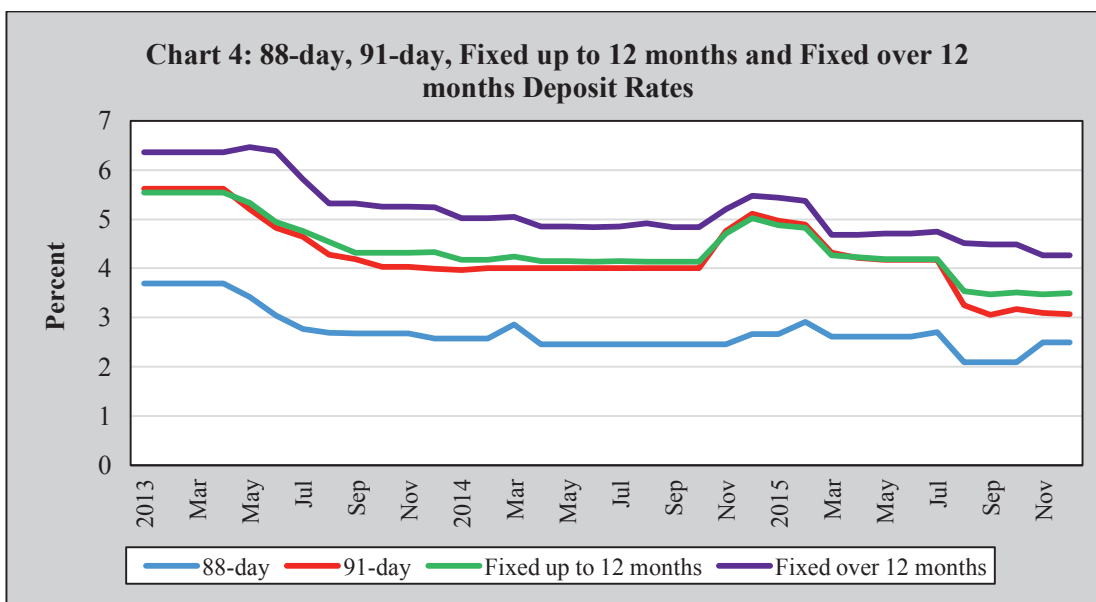
<sup>8</sup> Inflation was below target in the UK, USA, Japan and the euro area; on occasion, inflation was negative in the UK, USA and the euro area, thus generating concerns about deflation.

<sup>9</sup> Inflation was within that country's medium-term target range of 3 – 6 percent in 2015.

inflation. Thus, the Bank Rate was reduced by a cumulative 150 basis points to 6 percent during 2015, in support of output growth, and this was followed by commercial banks' prime lending rates decreasing from 9 percent to 7.5 percent (Chart 3). Deposit interest rates increased slightly, reflecting a tighter liquidity situation at commercial banks at the beginning of the year. The rates eased in the second half of the year in line with the reduction in the Bank Rate (Chart 4). As at December 2015, bond yields ranged from 4 percent to 5.7 percent for the shortest and longest bond maturities, respectively (Chart 5).

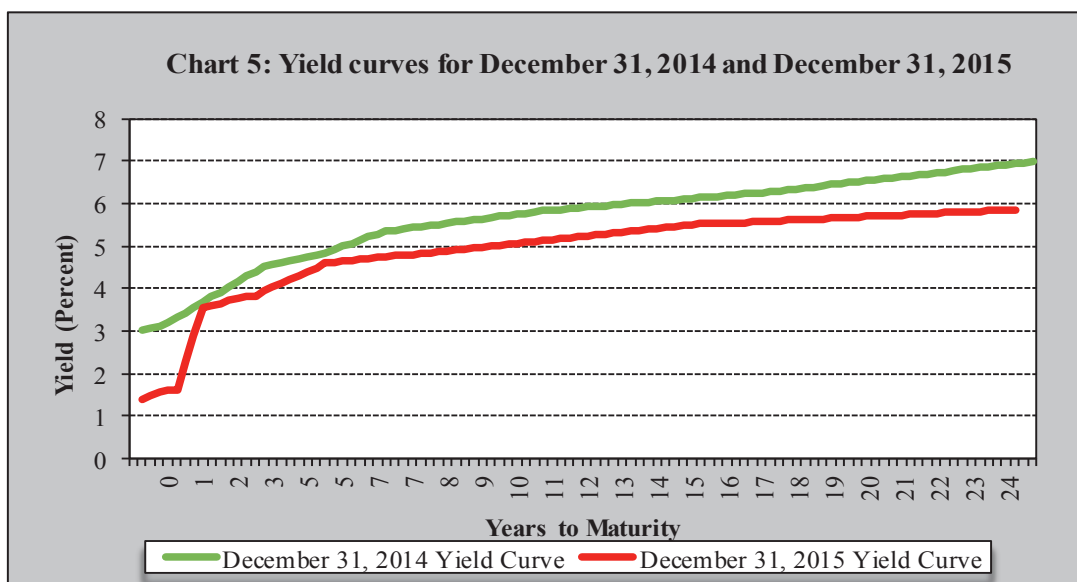


Source: Bank of Botswana.



Source: Commercial banks.



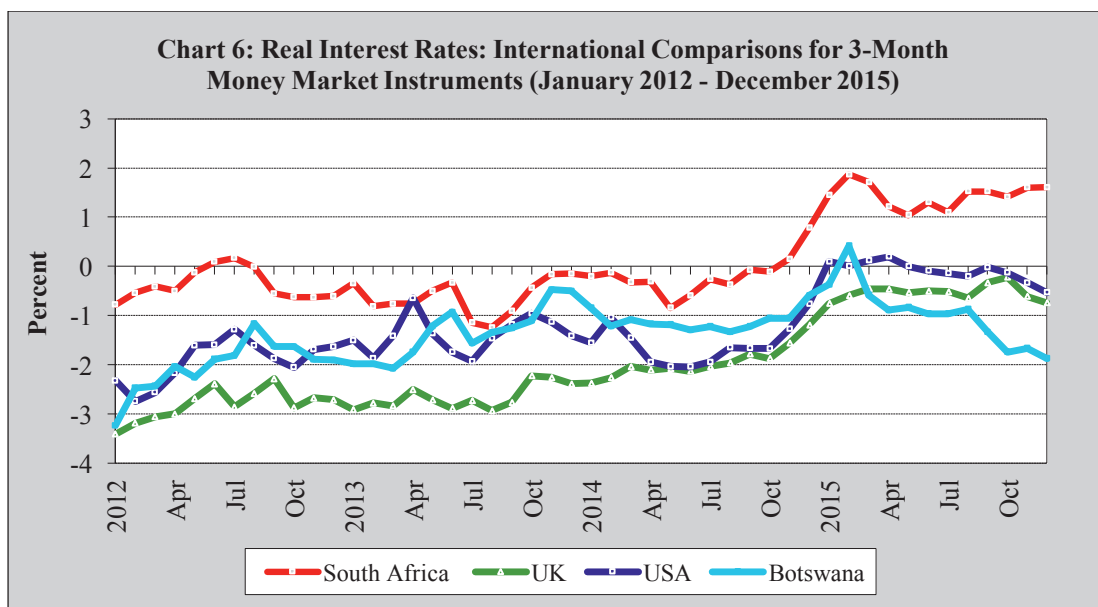


Source: Bank of Botswana.

- 3.5 Monetary policy implementation was supported by auctioning of Bank of Botswana Certificates (BoBCs) as excess liquidity was mopped up in order to ensure maintenance of interest rates that are consistent with the monetary policy stance. Reverse repurchase agreements (repos) were used to absorb excess liquidity between auctions of BoBCs. Temporary liquidity shortfalls experienced by individual banks at the beginning of the year (which, to some extent, reflected inefficiency of the interbank market and mobility of bulky corporate/fund manager deposits) continued to be addressed through recourse to the Bank's credit facilities. The Primary Reserve Requirement (PRR) on Pula-denominated deposits was reduced from 10 percent to 5 percent effective April 1, 2015, thus releasing about P2.3 billion into the banking system.<sup>10</sup>
- 3.6 In order to promote productive deployment of funds and market efficiency, as well as moderate the cost of liquidity absorption, the Bank conducted monetary operations with a cap of P5 billion for auctions. Be that as it may, the value of outstanding BoBCs was P8.2 billion in December 2015, up from P4.2 billion in December 2014. Consequent to the reduction in the Bank Rate, money market interest rates decreased, with the rapid movement influenced by competitive bidding by banks. The 14-day BoBC yield fell from 3.1 percent in December 2014 to 1 percent in December 2015, while the 3-months BoBC yield decreased from 3.2 percent in December 2014 to 1.2 percent in December 2015. The real 3-months BoBC yield decreased from -0.59 percent to -1.87 percent, thus reflecting the bigger decrease in the nominal interest rate compared to that of inflation between December 2014 and December 2015 (Chart 6).<sup>11</sup>

<sup>10</sup> Further increase in excess liquidity resulted from growth in deposits at commercial banks, notably placement by the Botswana Public Officers Pension Fund, and expansion in government spending, including through lending to parastatals. In addition, the government bond (BW003) matured on October 31, 2015, releasing an additional P1.6 billion into the banking system in the absence of a rollover, given its maturity taking place outside the normal bond auction cycle.

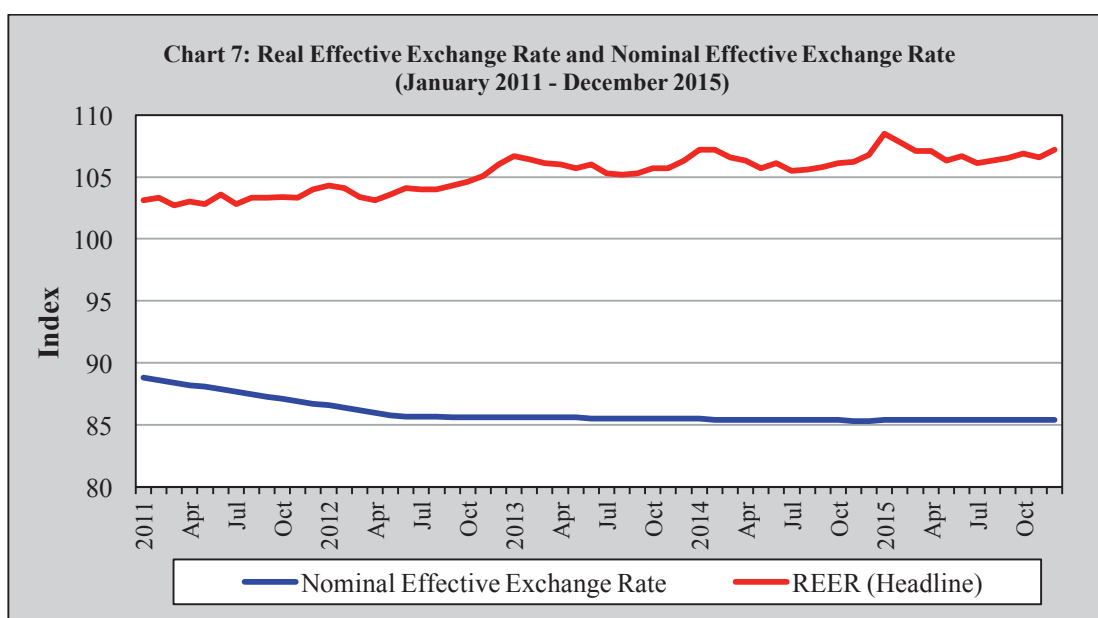
<sup>11</sup> The real 14-day BoBC rate fell from -0.7 percent in December 2014 to -2.1 percent in December 2015. In comparison, the real 3-months money market interest rates were 1.6 percent, 0.3 percent, -0.5 percent and -0.7 percent in December 2015 for South Africa, UK, USA and the euro area, respectively.



Source: Bank of Botswana.

### (c) Implementation of Exchange Rate Policy

- 3.7 Consistent with the policy objective of maintaining a stable REER of the Pula, the Bank implemented a zero rate of crawl of the NEER as the projected domestic inflation was close to the lower end of the medium-term inflation objective, and similar to Botswana's trading partner countries' forecast average inflation. Consequently, the NEER of the Pula was stable in the twelve months period to December 2015. Similarly, the REER was largely constant (0.4 percent appreciation) in the year to December 2015, given the small differential between Botswana inflation and that of trading partner countries (Chart 7).



Source: Bank of Botswana.

### (d) Government Expenditure and Credit Growth

- 3.8 Monetary policy was conducted in the context of the 13 percent annual growth of government expenditure (twelve months to December 2015), in comparison with the 14 percent growth rate of the same period in 2014, which supported domestic

economic activity. The development and recurrent expenditures increased by 20.5 percent and 10.7 percent, respectively, in the same period (2015). The recurrent expenditure growth included the 6 percent increase in civil servants salaries, the impact of which had a minimal influence on aggregate demand and, therefore, inflation.

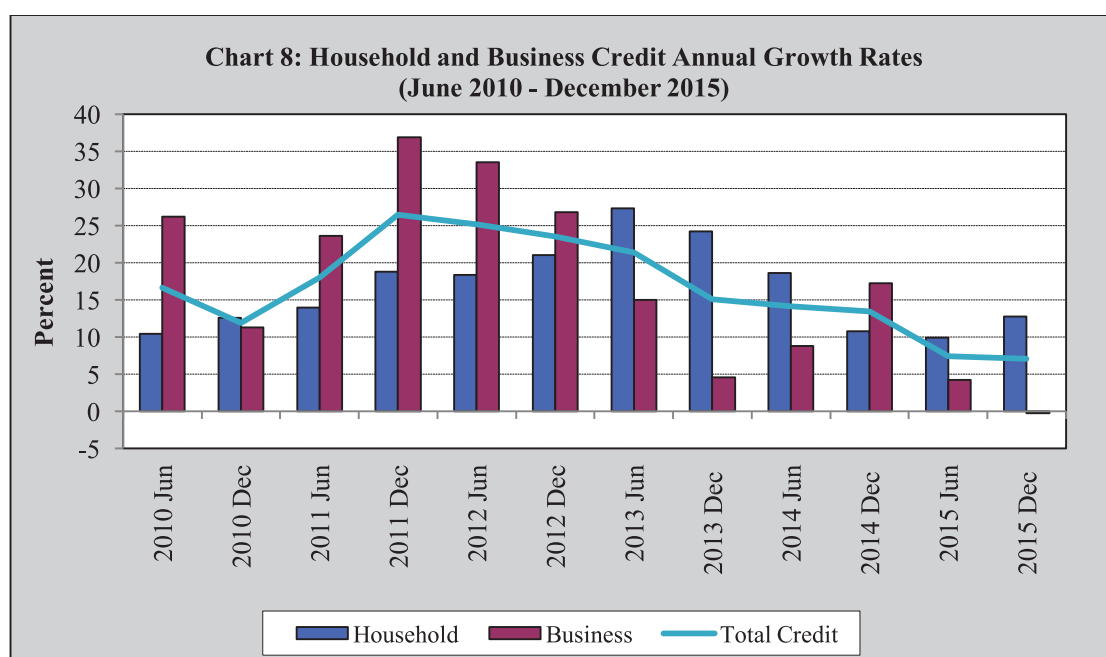
- 3.9 *Despite the accommodative monetary policy stance, credit grew at a slower annual rate of 7.1 percent in the year to December 2015 (13.5 percent in 2014), mostly reflecting lending to businesses. Credit to businesses contracted by 0.3 percent in 2015, from the increase of 17.2 percent in 2014 (Chart 8). Although lending to mining and finance and business services expanded significantly, credit growth for other sectors either decelerated or was negative (Chart 9); hence the overall impact of commercial bank credit on the economy was modest (Chart 10).*
- 3.10 *The reduction in commercial bank lending to businesses reflects an element of crowding out as the Government resumed direct funding to some parastatals, through the Public Debt Service Fund.<sup>12</sup> Weaker economic activity also contributed to subdued requirement for credit by private businesses. On the supply side, banks appear to have adopted a cautious approach (including tighter assessment criteria) to lending following a relatively tight liquidity environment towards the end of 2014 and in early 2015. In turn, there is continuing restructuring of asset-liability management practices by banks to appropriately align loan profile with funding structure.*
- 3.11 *In contrast, annual growth in lending to households was buoyant and increased from 10.7 percent in 2014 to 12.8 percent in 2015, mostly influenced by faster yearly expansion in unsecured lending to households from 7.4 percent in 2014 to 15.5 percent in 2015. Meanwhile, the annual growth in mortgage lending to households decreased from 18.4 percent to 7.2 percent between 2014 and 2015. This appears to be consistent with indications elsewhere<sup>13</sup> that the market for residential property is weakening, especially for high-value properties and associated use of property refinancing to augment spending in other areas. However, the share of mortgage financing in total bank credit extension to households increased further; it was approximately 30 percent in 2015, albeit still a relatively low proportion of the total. As a percentage of GDP, mortgage lending represents about 5 percent.<sup>14</sup>*

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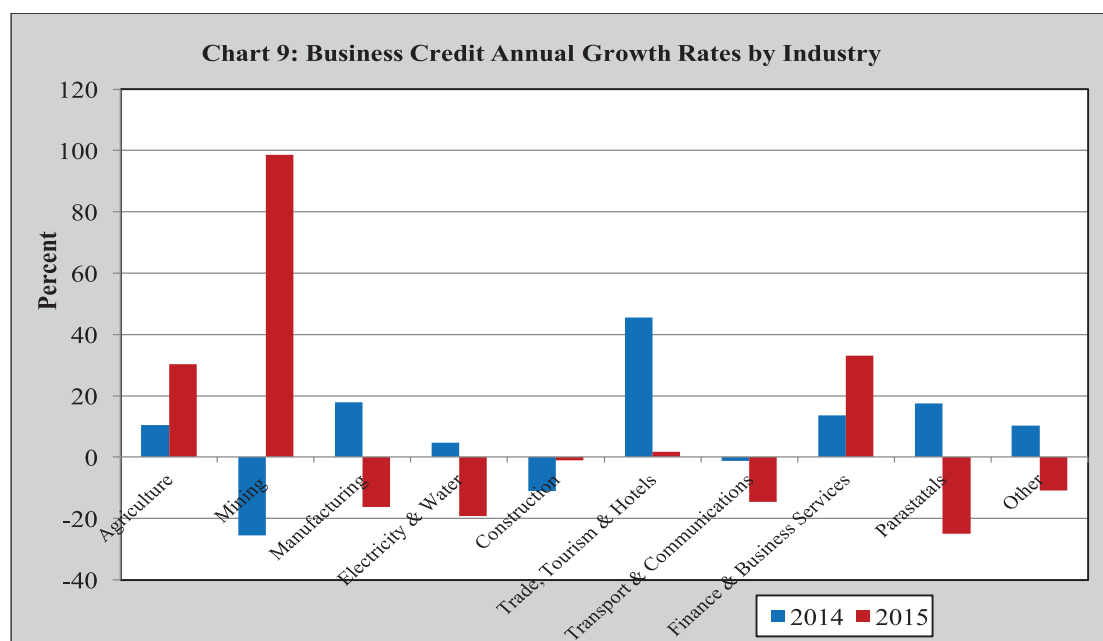
<sup>12</sup> *To the extent that government support for parastatals results in improved performance and effective provision of utilities and services, this could potentially be positive for overall economic activity.*

<sup>13</sup> *Reports by Investment Property Databank, Vantage Properties and Riberry cover trends in the Botswana property market.*

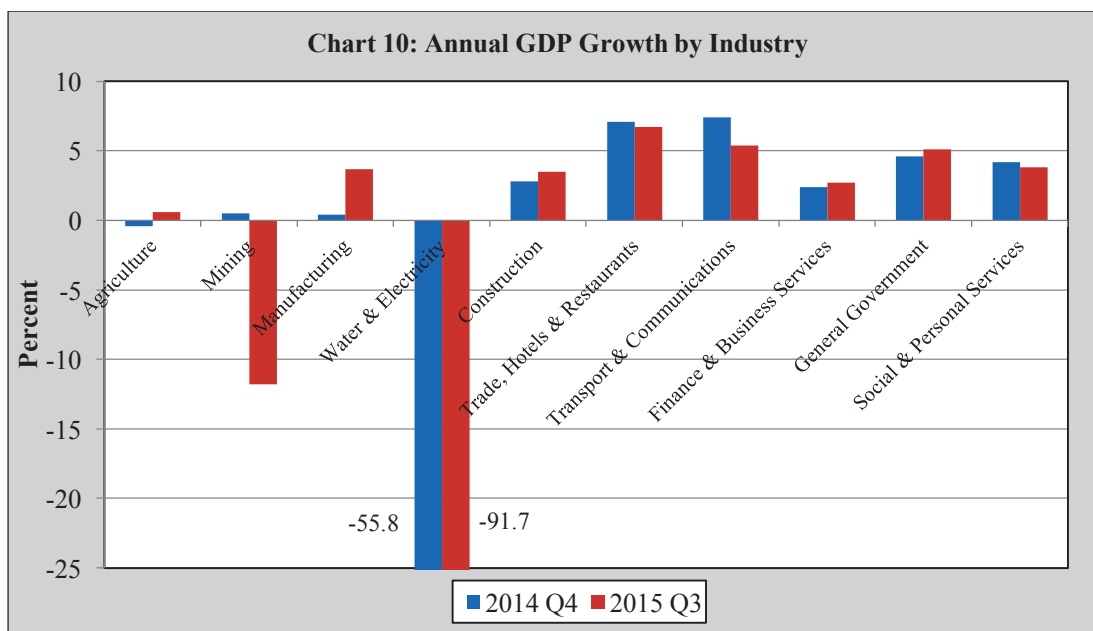
<sup>14</sup> *Total commercial bank credit as a share of overall GDP and non-mining GDP is 32 percent and 40 percent, respectively.*



Source: Commercial banks.



Source: Commercial banks.



Source: Statistics Botswana and Bank of Botswana calculations.

Note: Growth rate is calculated as a percentage change in cumulative GDP over four quarters compared to the corresponding period ending the previous year.

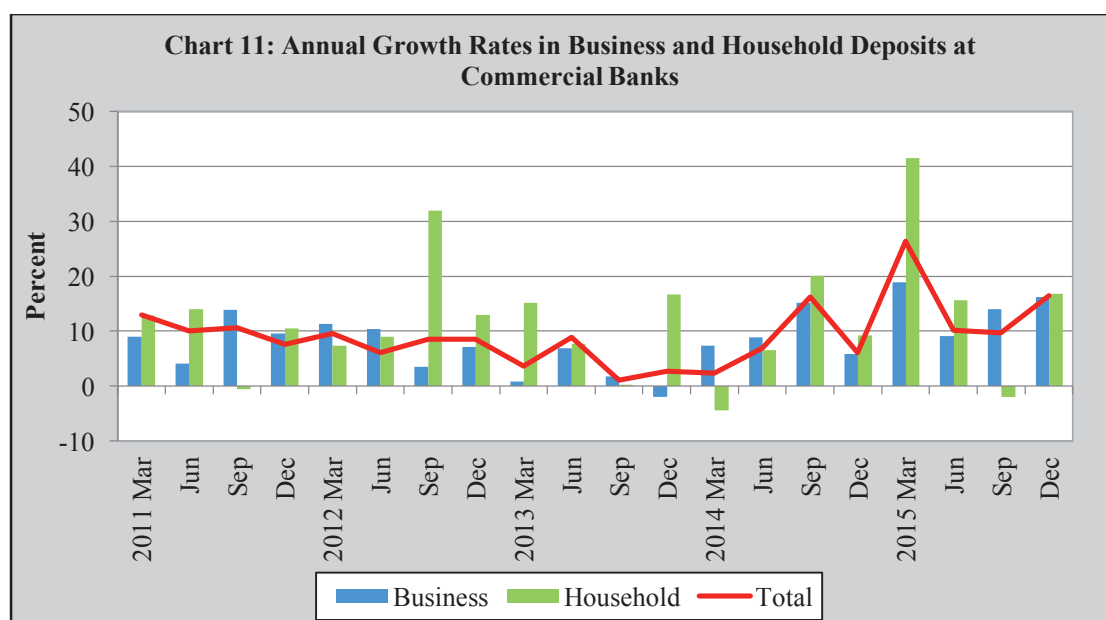
### (e) **Financial Stability Indicators**

- 3.12 *Developments with respect to household credit are in line with the slower growth in incomes and augur well for maintenance of financial stability. In particular, the moderation in mortgage credit growth against the background of the weaker property market reduces potential risks in this area. Thus, the prevailing low and stable default ratios for household borrowing<sup>15</sup> and sufficient provisioning by banks, alongside capital, asset quality, liquidity and profitability levels that meet prudential requirements for banks, underpin a stable financial system. Moreover, the favourable prospects for sustained positive economic performance imply potential growth in incomes and demand to support a sound financial system.*
- 3.13 *Household loans, at 59.4 percent share of credit as at the end of December 2015, continue to dominate commercial bank credit. The concentration of household credit in unsecured lending (65.8 percent) remains a concern, including the degree of productivity of such lending. However, the risk to financial stability is moderated by the extent to which such credit is diversified and potentially contributes to increase in wealth.<sup>16</sup> Furthermore, the bulk of household credit is to salaried individuals, which allows for proper credit evaluation using proven wage income as the basis for determining ability to pay. Where the risk of loss of employment is low and the loan is protected by credit life insurance, credit risk can be low. Business credit is also diversified across economic sectors.*
- 3.14 *The concentration of commercial bank funding in business deposits (71.3 percent of total deposits), part of which are for other financial institutions, reflects a possible imbalance in the market. However, in 2015 there was a notable increase in the annual growth rate of household deposits from 9.2 percent in 2014 to 16.8 percent in 2015,*

<sup>15</sup> The aggregate ratio of non-performing loans to total credit was 3.3 percent at the end of December 2015.

<sup>16</sup> There can be wealth gains if such borrowing is used to acquire, construct or improve property that subsequently increases in value.

which was a much faster growth compared to the increase in credit to households. This signifies a rebalancing by the household sector, which bodes well for financial stability. Business deposits also increased more rapidly by 16.2 percent in 2015 compared to 5.8 percent in 2014. Overall, total deposits at commercial banks grew by 16.4 percent in 2015 from an increase of 6.1 percent in 2014 (Chart 11). Given the higher increase in deposits than growth in bank lending, the intermediation ratio decreased from 87.6 percent in December 2014 to 80.6 percent in December 2015 and thus contributed to a related increase in excess liquidity in the banking system.<sup>17</sup>



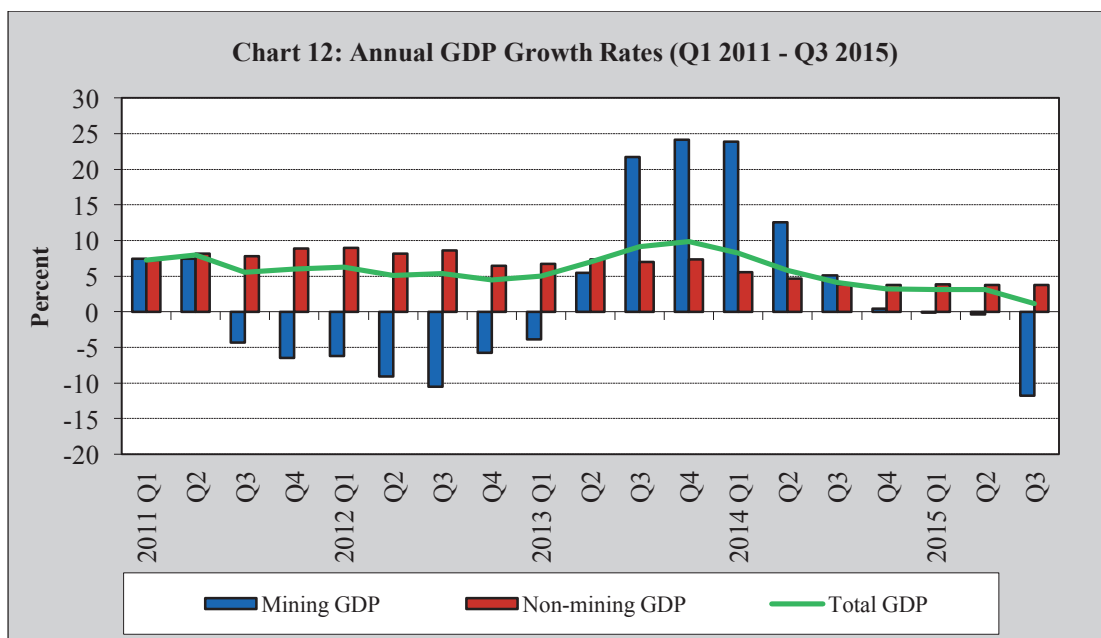
Source: Commercial banks.

#### (f) Output and Price Developments

- 3.15 Botswana's real GDP growth is estimated at 1.2 percent in the twelve months to September 2015, down from 4.1 percent in the corresponding period in 2014, reflecting a sharp contraction of 11.8 percent in mining production (5.1 percent growth rate in 2014). Non-mining output grew by 3.7 percent in the twelve months to September 2015, which is lower than 3.9 percent in the corresponding period in 2014 (Chart 12).

<sup>17</sup> The intermediation ratio is defined as the ratio of total loans to total deposits, which indicates the amount of deposits that is converted to loans.



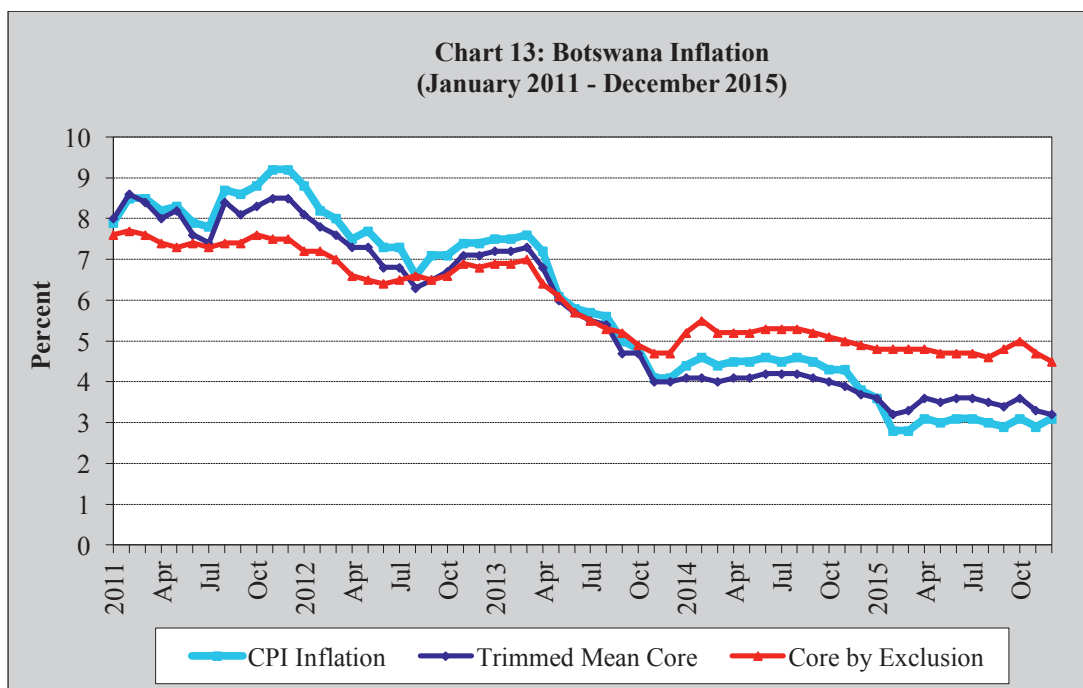


Source: Statistics Botswana and Bank of Botswana calculations.

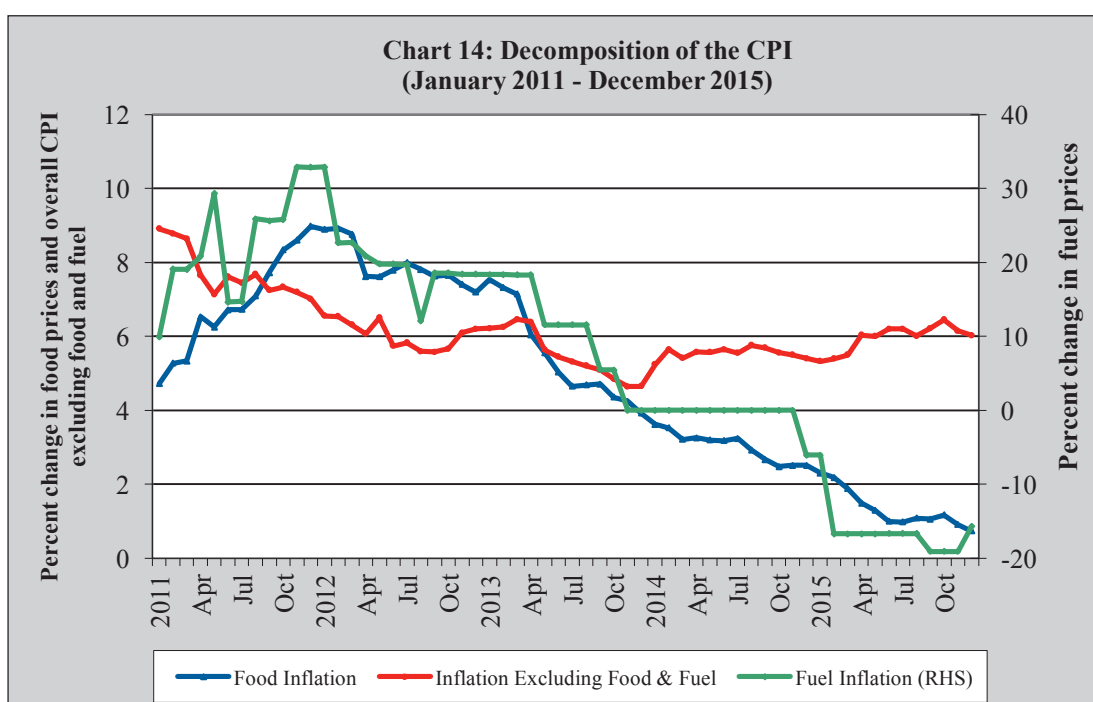
- 3.16 Thus, the lower rate of expansion in economic activity, together with modest wage growth (and associated low demand pressures), and the moderating impact of the net decrease in administered prices and government levies as well as the extension of VAT concessions resulted in dampened inflationary pressures in 2015. External pressures on domestic prices were also benign against the backdrop of low and declining trading partner countries' inflation and an appreciation of the rand/Pula exchange rate. Therefore, domestic inflation was low and stable in 2015 at around the lower end of the Bank's 3 – 6 percent medium-term objective range.<sup>18</sup>
- 3.17 Inflation fell from 3.8 percent in December 2014 to 3.1 percent in December 2015 (Chart 13). This was reflected across most categories of goods and services. In particular, food price inflation eased from 2.5 percent in December 2014 to 0.7 percent in December 2015; while fuel prices fell by 15.7 percent in 2015<sup>19</sup>, following a 6.1 percent decrease in 2014 (Charts 14 and 15). On average, the net effect of adjustments of administered prices was a reduction in inflation by approximately 0.84 percentage points in 2015; this compares to a reduction of 0.39 percentage points in 2014. The core inflation measures, 16 percent trimmed mean and inflation excluding administered prices decreased from 3.7 percent and 4.9 percent in December 2014 to 3.2 percent and 4.5 percent in December 2015, respectively.

<sup>18</sup> There was a breach of the lower end of the medium-term objective range on four occasions: (February and March (2.8 percent): September and November 2015 (2.9 percent)).

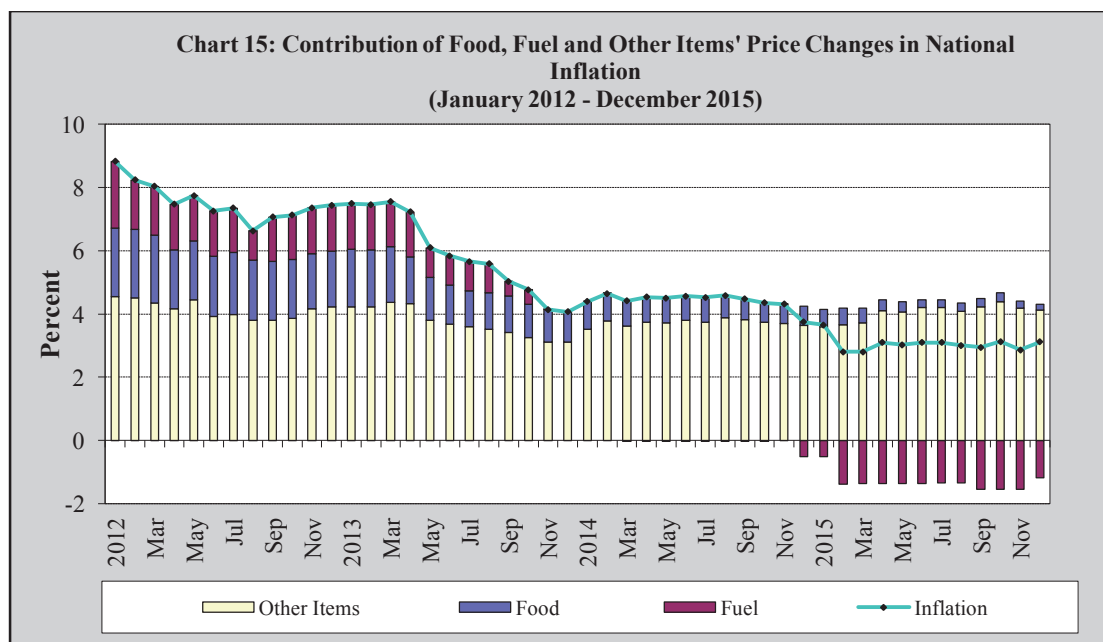
<sup>19</sup> This was in the context of a reduction in fuel prices in March, September and December 2015.



Source: Statistics Botswana.



Source: Statistics Botswana.



Source: Statistics Botswana.

#### 4. INFLATION OUTLOOK

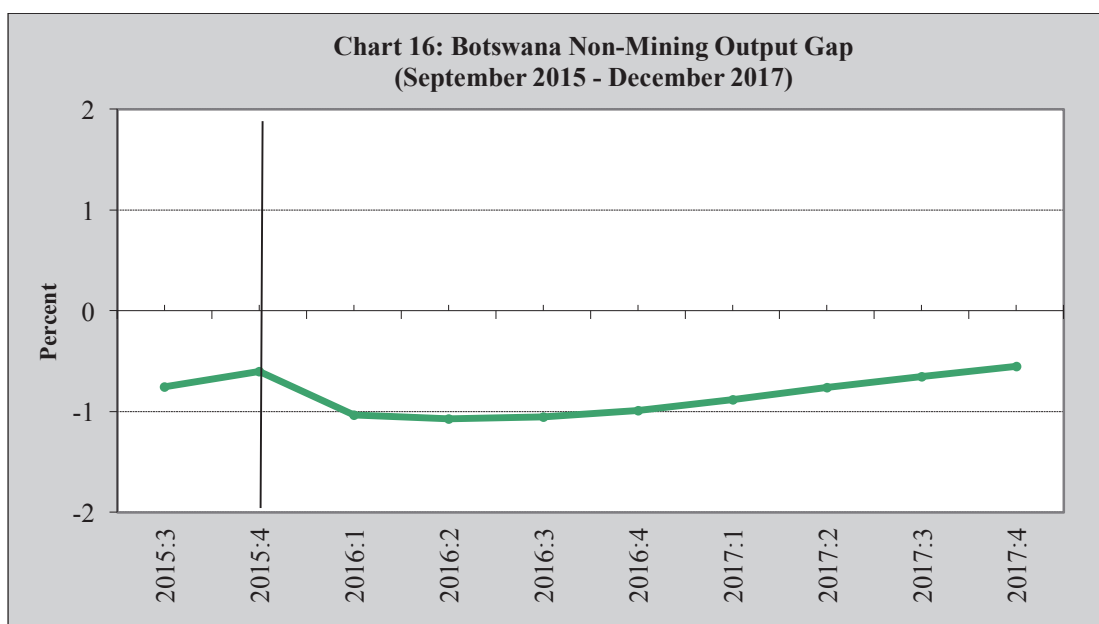
4.1 Global output growth for 2016 is forecast at 3.4 percent, higher than the estimate of 3.1 percent for 2015. The anticipated increase in global economic expansion reflects improvement in performance for both advanced and emerging market economies. Positive prospects for economic activity in advanced economies are supported by low oil prices, durable accommodative financing conditions, less aggressive fiscal austerity measures and improving labour markets. Meanwhile, in emerging market economies, GDP growth for countries in economic distress (for example, Brazil and Russia) is projected to be higher than in 2015, although it is expected to remain weak or negative. These developments are expected to offset the projected further slowdown in China's GDP growth. However, the decrease in commodity prices and normalisation of monetary policy in the USA, together with the associated depreciation of other currencies against the US dollar and persistence of tight financing conditions in some key markets, continue to present downside risks to global economic performance.

4.2 It is anticipated that global inflationary pressures will be restrained in the medium term, largely reflecting low commodity prices (notably oil prices) and persistent excess capacity in advanced countries. Thus, global inflation is forecast to increase slightly from 3.3 percent in 2015 to 3.4 percent in 2016. Inflation remains close to zero in several advanced economies, but it is projected to increase in 2016, although remaining below targets. In emerging market economies, inflation is expected to be under control in 2016 owing to low oil prices. However, currency depreciation, especially for some of the emerging market economies, could result in an increase in inflation. In this environment, it is anticipated that monetary policy will remain accommodative in major economies, complemented by measures aimed at promoting financial intermediation and fostering resilience of the financial sector to bolster economic activity.

4.3 In SDR countries, inflation in 2016 is forecast to be higher than the -0.2 percent of 2015, at 1.1 percent, while for South Africa, headline inflation is expected to increase

from an average of 4.6 percent in 2015 to 5.9 percent in 2016<sup>20</sup>. Thus, average inflation for trading partner countries is forecast to be in the range of 3 – 4 percent. Given that inflation in Botswana is projected to be around the lower end of the medium-term objective range of 3 – 6 percent and, therefore, below the forecast average inflation (mid-point) for trading partner countries, the NEER will crawl upwards by 0.38 percent in 2016 and the Pula basket weights of 50 percent each for the South African rand and SDR will be maintained. Against this background, it is anticipated that the impact of external price developments through imported inflation, and changes in the exchange rate on domestic inflation, will be modest.

- 4.4 As indicated in the 2016 Budget Speech, domestic output growth is projected to be 4.2 percent in 2016 and higher than the revised forecast of 1 percent for 2015. However, domestic non-mining output is expected to be below trend in the medium term in the context of electricity and water supply constraints (Chart 16) and weak external demand.
- 4.5 The 2015 Business Expectation Surveys (BES) indicates a generally subdued level of business confidence, particularly among export-oriented businesses. However, optimism about recovery in output improves, going forward, in line with projected higher output growth for 2016. Overall, the key challenges to businesses include weak demand, deficiency of key inputs and the regulatory environment as well as related scarcity of skilled manpower.
- 4.6 For the 2016/17 fiscal year, while total government expenditure is estimated to decrease by 2.7 percent, a budget deficit of P6.05 billion (3.8 percent of GDP) is anticipated, given the projected contraction in government revenue of 6.5 percent. The budget includes spending associated with the Economic Stimulus Programme, which is partly aimed at accelerating completion of NDP 10 projects.

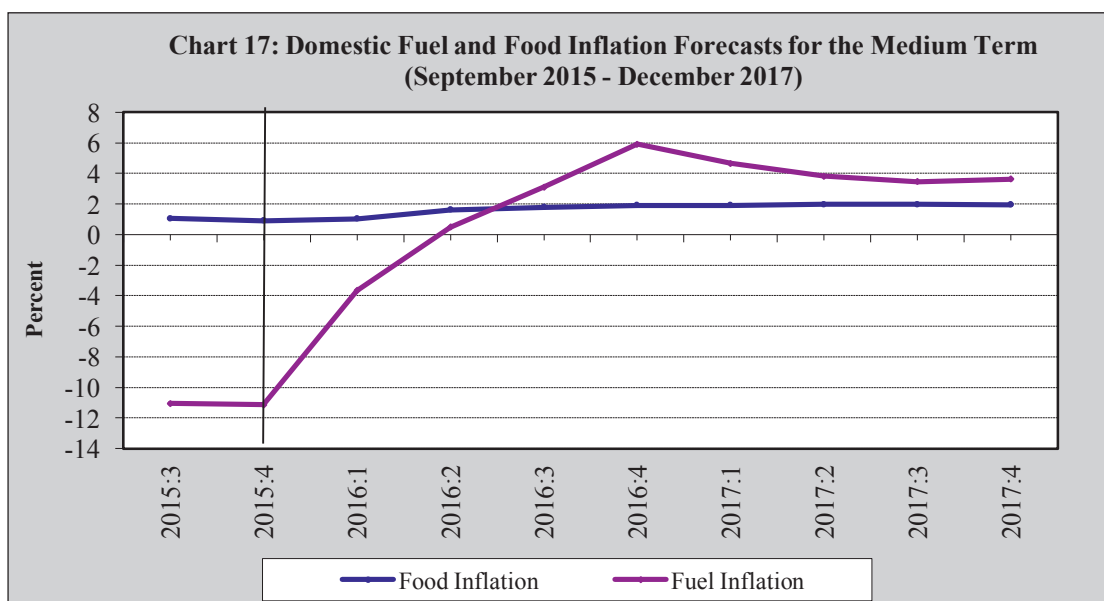


Source: Bank of Botswana.

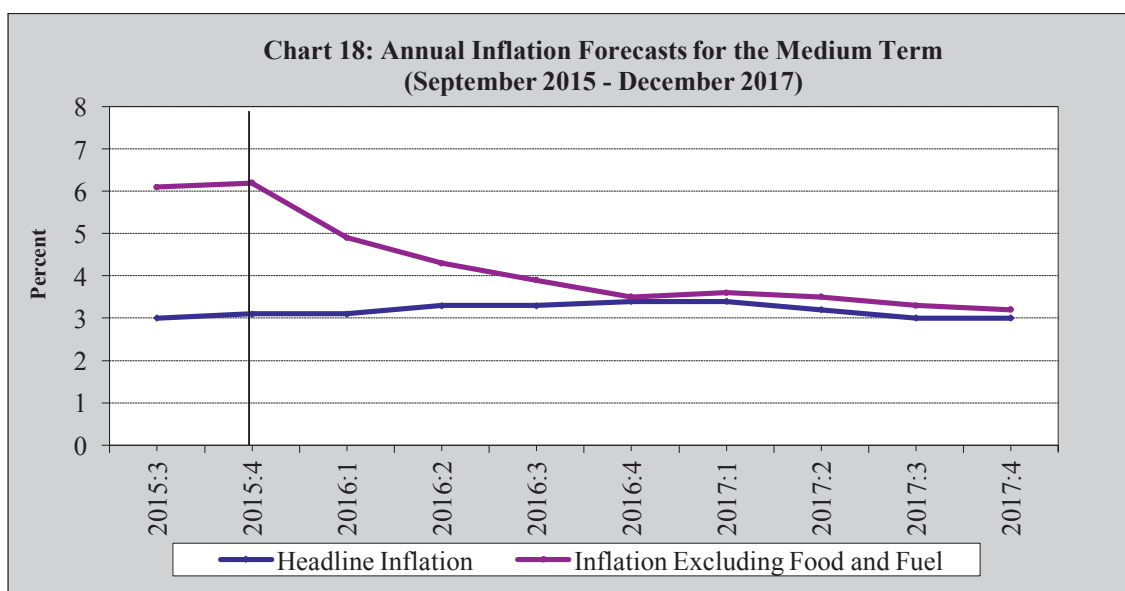
- 4.7 It is projected that inflation will remain within the 3 – 6 percent objective range in the medium term (Chart 18). The anticipated price developments flow from projections for maintenance of growth in wages in line with the inflation objective and, therefore,

<sup>20</sup> These forecasts are obtained from Thompson Reuters. At 6.8 percent, the South African Reserve Bank's inflation forecast for 2016 is higher than that of Thompson Reuters.

modest increase in demand, and prospects for benign foreign inflation. The forecast also factors in a possible increase in some administered prices. Any substantial upward adjustment in administered prices and government levies and any increase in international food and oil prices beyond current forecasts present upside risks to the inflation outlook (Chart 17). It is also noted that, while the current low level of domestic food price inflation is likely to continue, there is a risk that food price inflation could increase in the context of drought in the region and at a time when the base effects of VAT reduction on key food items in 2015 will be dissipating. The downside risks to inflation outlook relate to the restrained global economic activity and a possible further decrease in commodity prices.<sup>21</sup>



Source: Bank of Botswana.



Source: Bank of Botswana.

<sup>21</sup>

The September 2015 BES indicates expectations of inflation of 4.6 and 4.8 percent in 2015 and 2016, respectively. However, despite this, the average expected level of inflation remains significantly above observed levels of inflation which, in the twelve months to December 2015, averaged 3 percent, and has not been as high as 4.6 percent since August 2014.

## **5. 2016 MONETARY POLICY STANCE**

- 5.1 *An evaluation of determinants of inflation and financial stability suggests continuation of low inflation into the medium term, within a robust and supportive financial system. Despite slowing down, commercial bank credit growth is broadly in line with the pace of increase in nominal GDP and continues to support economic activity. However, the recent sharp slowdown in the growth of business credit could reflect a weakness in some aspects of economic activity and associated financing, while household credit is assessed to be at sustainable levels. Thus, the current and prospective developments (positive outlook for inflation and a stable financial environment) bode well for accommodative monetary policy that supports productive lending to businesses and households. The Bank will also respond to any significant changes in banking system liquidity through appropriate instruments. In this regard, the Bank encourages productive deployment of resources, while undertaking cost effective absorption of excess liquidity and providing liquidity support as necessary.*
- 5.2 *In 2016, the Bank's implementation of the exchange rate policy will entail a 0.38 percent upward crawl of the NEER, given that inflation is projected to be around the lower end of the medium-term objective range of 3 – 6 percent. The crawling band exchange rate policy is supportive of international competitiveness of domestic industries and contributes towards macroeconomic stability and economic diversification.*

## **6. CONCLUSION**

- 6.1 *Botswana's inflation fluctuated around the lower end of the Bank's medium-term objective range of 3 – 6 percent in 2015. The environment was characterised by benign domestic demand pressures, modest growth in personal incomes, subdued impact of the increase in administered prices and government levies as well as restrained foreign inflation. Global GDP growth is projected to be higher in 2016 than in 2015, while inflation is forecast to increase only slightly in the context of low energy prices, persistent spare capacity in advanced countries and weak global demand.*
- 6.2 *Inflation is forecast to remain low and stable in the medium term, consistent with the Bank's objective range. The Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low and sustainable inflation, through timely responses to price developments while ensuring that credit and other market developments are in line with durable stability of the financial system. The Bank remains committed to monitoring all economic and financial developments with a view to ensuring price and financial stability, without undermining sustainable economic growth.*