BANK OF BOTSWANA

PRESS RELEASE

Mid-year review of the 2002 Monetary Policy Statement

August 22, 2002

The Monetary Policy Statement (MPS) released in February 2002 specified several objectives that the Bank of Botswana intended to meet during the year. The purpose of this mid-year review of the MPS, released today, is to ascertain the extent to which the objectives have been met as at the middle of the year, to review the outlook for economic and financial trends for the remainder of the year, and to evaluate the need or otherwise for a change in the stance of policy.

Inflation in Botswana stabilised around the upper level of the target range of 4 – 6 percent during the first half of this year. Notwithstanding this, underlying credit growth remained well above target and government spending was expansionary. Given the potential inflationary pressures implied by these developments as well as the rise in inflation in South Africa, monetary policy remained tight, with the Bank Rate maintained at 14.25 percent.

Inflation increased to 8.8 percent in July from 5.9 percent in June, following the introduction of the Value Added Tax (VAT), and as a result moved above the upper end of the target range. However, much of the increase will be a one-off, temporary rise in the inflation rate as long as incomes, in both the public and private sector, are not adjusted upwards to compensate for the increase in taxes. In the circumstances, where the underlying rate of inflation (i.e., excluding the tax effect) has not risen, a monetary policy response is generally not needed.

The outlook is that inflation in the major industrial economies is likely to remain low and stable for the rest of the year. Nevertheless, higher South African inflation is likely to result in a temporary rise in imported inflation. There is also continuing uncertainty about oil prices in light of the ongoing conflict in the Middle East. Domestically, inflationary pressures are likely to remain as a result of the higher than desirable rates of growth in both government spending and commercial bank credit, as well as the possible second round effects of the introduction of VAT, although these may be offset, to some extent, by the lower disposable incomes that will result from VAT.

The 2002 Monetary Policy Statement set a target range of 4 – 6 percent for Botswana inflation necessary to maintain real effective exchange rate stability. The target range was based on forecast weighted average inflation of 5.1 percent for trading partner countries. As at the end of June 2002, the weighted average inflation for trading partner countries was 6.3 percent while the revised forecast for the year is 6.5 percent. While both the actual outturn and the revised forecasts would imply an upward revision of the target range of inflation consistent with real exchange rate stability, there are strong reasons to keep it at its current level for the remainder of the year. The first is that the principal reason for the upward revision of the forecast is higher inflation in South Africa and, as noted earlier, the increase is expected to be short-lived given the recovery of the rand and the commitment of the authorities to eventually achieve prescribed targets. A further reason for maintaining the current desired range is that lower inflation in Botswana, compared to trading partner countries, will help to reverse the undesirable appreciation of the real exchange rate that occurred in 2001.

The Bank will, therefore, maintain the target range of 4 – 6 percent stated in the 2002 Monetary Policy Statement while the range for the growth rate of credit to the private sector that is compatible with achieving this inflation outcome is also maintained at 12.5 – 14.5 percent. The Bank will as well continue to monitor inflation trends very closely, especially over the coming months, for any signs of an increasing underlying rate of inflation, either as a result of the introduction of VAT or from increasing demand pressures. The task for the Bank is to ensure that the stance of monetary policy is appropriate to maintaining low and stable inflation in both the short and medium term.

The full text of the Mid-Year Review of the 2002 Monetary Policy Statement is available on this website. See related articles below.