

# BANK OF BOTSWANA

## PRESS RELEASE

### Monetary and Exchange Rate Policies

#### Introduction

In recent months there have been a number of media commentaries on the level of interest rates and the behaviour of the Pula. Some of the commentators have proposed a reduction in interest rates in order to stimulate economic activity, especially as inflation has slowed since the third quarter of 2001, while others have proposed changes in exchange rate policy ranging from a devaluation of the Pula against the South African rand, to pegging the Pula to the US dollar, to allowing it to float freely on international exchange markets.

The Bank of Botswana welcomes and encourages the interest and exchange of views on these issues of public policy. On its part, the Bank has contributed to public discussion of policy issues through regular briefings of all stakeholders, including the Government, public enterprises, the private sector and the media, on economic and financial trends as they affect inflation and the needed policy responses. The latest such briefing on policy issues was on February 20, 2002 at the public launching of the 2002 Monetary Policy Statement.

#### Inflation and Interest Rates

As explained in the Monetary Policy Statement, the outlook for inflation in 2002 was at the time, and in the Bank's view still is, uncertain. It was the Bank's assessment that the risks of a rise in inflation were greater than the likelihood of a continuation of the downward trend in inflation or its stabilisation at the low levels experienced towards the end of 2001 and in the first two months of this year. In the circumstances, the Bank has preferred to leave the Bank Rate unchanged at 14.25 percent. This policy stance has been adopted in order to continue to restrain the rate of increase in spending that would occur if interest rates were to be reduced, since a lowering of interest rates would stimulate borrowing from the banking system, which would lead to a rise in expenditure and, in the current circumstances, to inflation. In the Bank's view, such an increase in credit-related spending would only add to the already higher levels of expenditure by the Government.

It is the Bank's conviction that a low and stable inflationary environment attracts investment by promoting positive business expectations. Broadly, decisions on interest rates seek a balance

between the needs of savers and borrowers, combining a desire on the part of the Bank not only to promote savings but to support domestic investment as well. We believe this is the best way the Bank can help promote economic development on a sustainable basis without jeopardising the financial stability required for economic growth.

The 2002 Monetary Policy Statement explained that the Bank continuously monitors both the domestic and external macroeconomic and financial trends in order to assess prospects for the future direction of inflation. Therefore, it is important to stress that as soon as the Bank sees that the conditions necessary for an improvement in the inflation situation are in place, the necessary adjustments to interest rates will be made.

In regards inflation, the outlook continues to be clouded by the recent upward pressure on the international price of oil and on inflation in South Africa, and the unacceptably high rate of credit growth domestically at a time of accelerating Government spending. The Consumer Price Index rose to 6.1 percent in March from its recent low level of 5.7 percent registered in the first two months of the year.

#### Exchange Rate of the Pula

Regarding the international value of the Pula, the Bank has regularly informed stakeholders that the objective of the country's exchange rate policy is to ensure that exports are competitive while being mindful of the country's large import needs. Specifically, this is achieved by pegging the Pula to a basket of currencies representing our major trading partners, namely, the rand, US dollar, pound sterling, euro and Japanese yen. The last four international currencies form a unit of account of the International Monetary Fund (IMF), known as the Special Drawing Right (SDR). The weighting of the currencies in the basket is in proportion to the importance of those currencies in Botswana's trade patterns.

It is often the case, when exchange rates are volatile, that concerns are expressed about the continued relevance of the exchange rate arrangement, and alternatives are proposed. The Bank's view, stated clearly at the time of the release of the 2002 Monetary Policy Statement, is that the existing approach is the best arrangement for Botswana in the current circumstances. It is based on a policy that aims to balance competing needs and special interests as reflected in broad trade and capital flow considerations. While the alternatives that have been proposed have their merits, they also have serious shortcomings when compared to the present arrangement. For example, fixing the Pula to a single currency, such as the US dollar or the rand, would imply substantially

more volatility and exchange rate uncertainty against the currencies of the other countries where Botswana has, or might want to develop, export or import interests. It could also make it more difficult for Botswana producers to maintain their international competitiveness. Allowing it to float would have significant implications for other policies - most importantly monetary policy, but fiscal policy as well - that would need to be studied closely before such a change could be considered. Changing to a floating exchange rate regime without a consistent and supportive macroeconomic policy framework would in all likelihood engender a level of uncertainty in the market that would be counterproductive to the interests of most market participants and to the economy more generally.

The Bank recognizes, however, that there is no one exchange rate arrangement that is right for all countries all of the time; circumstances change and so should policies, in response. As with interest rates, the Bank continually reviews the policy stance and policy framework regarding the exchange rate to ensure their overall effectiveness in fulfilling the Bank's mandate and relevance to the broader national economic goals.

Even though the value of the Pula is designed in such a way that its fluctuation against the international currencies included in the exchange rate basket are moderated compared to the behaviour of the individual international currencies, the extreme weakness of the rand against the US dollar, especially in the latter part of 2001, did have an effect on the value of the Pula. This was due mainly to technical factors relating to the way the value of the Pula is calculated.

After losing 37 percent of its value against the US dollar in 2001, the rand has been much more stable during the first part of 2002, and by April 9, 2002, it had recovered nearly 7 percent of its value against the US dollar, compared to the end of 2001. These movements of the rand against the US dollar are in response to improvements in investor sentiment toward emerging markets, good performance by the South African tourism sector, improved commodity prices, and the recent interest rate hikes in South Africa. The Pula has in turn been relatively stable against the rand. However, some concerns still remain with regard to regional socio-political and economic problems that may still continue to affect the rand for some time. Nevertheless, it is still the Bank's view that the Pula's international value is, overall, at an appropriate level.

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