Statement of the Monetary Policy Committee: February 22, 2011

1. Introduction

1.1 At the meeting of February 22, 2011, the Bank's Monetary Policy Committee observed that the medium-term outlook remained positive. However, short-term price developments imply that it will take longer for inflation to fall within the 3 – 6 percent objective range. Due to the impact of the increase in the alcohol levy, private school fees, fuel prices, possible increase in utility tariffs, higher forecasts for food and fuel prices and for inflation in South Africa, inflation will, in the short term, continue to be higher than the objective range. It is, therefore, forecast that inflation will fall within the 3 – 6 percent objective range in the second quarter of 2012, not in the second quarter of 2011 as was previously forecast.

2. Recent Economic Developments

2.1 The global economy recovery remains on track, underpinned by the robust output expansion in the emerging market economies. Prospects for sustained global economic recovery are enhanced by positive US economic data on manufacturing and less negative data on the labour market. However, high rates of unemployment continue to weaken consumer and business confidence, which is likely to constrain economic activity. Globally, the main focus continues to be on accommodative monetary policy to support demand and investment. However, this is increasingly undermined by threats of rising inflation emanating from an increase in food and oil prices. Furthermore, there is continuing focus on fiscal consolidation to ensure debt and fiscal sustainability. In some of the emerging market economies, capital inflows from low-yield major economies have caused currency appreciation that presents a threat to growth and the potential for asset price bubbles. In the latest round of policy decisions, several central banks in advanced economies maintained their low policy rates, while others tightened monetary policy to curb inflationary pressures.

2.2 Domestic inflation increased for two consecutive months and reached 7.9 percent in January 2011, thus remaining above the Bank's objective range of 3 – 6 percent. The increase was spread across a wide range of categories of goods and services.

2.3 Following contraction in 2009, the domestic economy is projected to grow at a moderate rate in the short to medium-term, with below-trend output. Domestic output developments largely reflect similar prospects for world GDP. The level of output in the twelve months to September 2010 is estimated to be 11.3 percent higher than in the same period in 2009, reflecting the 26.1 percent growth in mining output and the 5.7 percent increase for the non-mining sectors. This occurs against the background of moderate growth in money supply that is due to a reduction in foreign exchange reserves and lower rates of increase in both government expenditure and commercial bank credit to the private sector compared to the previous year.

3. Economic Outlook and Assessment of Risks

3.1 It is anticipated that the recovery of the global economy will be sustained and underpinned by the robust output expansion in emerging market economies. However, high rates of unemployment will continue to undermine consumer and business confidence and constrain global economic activity. Overall, measures to consolidate the fiscal and public debt positions by some advanced economies, as well as the need to implement enhanced financial sector supervisory measures, have the potential to slow down global growth. After a 2.2 percent contraction in 2009, world output expansion is estimated at 3.9 percent in 2010 and projected to be 3.6 percent in 2011. In the context of low levels of capacity utilisation, high unemployment rates and well-anchored inflation expectations, it is anticipated that world inflation will be restrained. Meanwhile, there is considerable uncertainty about international prices of commodities, especially food and oil, which could have an adverse effect on the inflation outlook.

3.2 In South Africa, GDP is estimated to have increased by 2.7 percent in 2010, following a decline of 1.8 percent in 2009. It is projected to rise further by 3.5 percent in 2011, remaining below potential, thus exerting minimal pressure on inflation. The forecast is for inflation to remain within the 3 - 6 percent target range in the medium-term. There are, however, upside risks to the inflation outlook, including wage settlements that are above the inflation target and possible large increase in administered prices; food and petrol prices are also potential longer term risks.

3.3 For Botswana, it is expected that non-mining GDP will remain below trend in the medium term. Although exporting sectors will benefit from recovery in world demand, output in the domestic economy will be moderated due to lower growth in government spending, especially development expenditure. Moreover, it is anticipated that demand and the impact on economic activity will be subdued, reflecting sluggish pace in personal incomes and the increase in VAT, fuel prices, administered prices and other government levies. The monetary policy stance pursued in 2010 continues to be supportive of economic activity and will contribute to a narrowing of the output gap in the medium term.

3.4 Low domestic demand pressures and the forecast modest external inflationary pressures will, therefore, contribute to the positive inflation outlook in the medium term. In the short term, inflation is expected to remain above the objective range of 3 – 6 percent due to the impact of transient factors. These include, inter-alia, the increase in the alcohol levy in December 2010 and the February 2011 increase in fuel prices and possible increase in utility tariffs, fuel and food prices. Thus inflation is forecast to converge to the objective range in the second quarter of 2012. The positive inflation outlook is influenced by the forecast moderate inflationary pressures in South Africa and the dissipation of the impact of VAT and administered price increase. Upside risks to the inflation outlook include any unanticipated large increase in administered prices and government levies and an increase in international oil and food prices beyond current forecasts. Conversely, the proposed downward adjustment of telecommunication tariffs will moderate inflation. Meanwhile, the Pula exchange rate is expected to be relatively stable with minimal effect on domestic prices.

4. Monetary Policy Stance

4.1 The current state of the economy and assumptions on both the domestic and external economic outlook, as well as the inflation forecast, suggest that maintaining the prevailing level of interest rates is consistent with the achievement of the Bank's 3 – 6 percent inflation objective in the medium term. Accordingly, the Monetary Policy Committee decided to maintain the Bank Rate at 9.5 percent.