

BANK OF BOTSWANA

Statement of the Monetary Policy Committee

At the meeting of April 20, 2010, the Bank's Monetary Policy Committee observed that the medium-term outlook for price developments continues to be positive. However, the Committee anticipated that inflation will move above the objective range in the short-term, due to the impact of the increase in value added tax (VAT) and electricity tariffs. It is, therefore, expected that inflation will fall within the 3 – 6 percent objective range only in 2011. Meanwhile, indications are that output will remain below trend in the short-term, and recover in the medium-term.

The recovery of the world economy is now entrenched with strong output growth projected for both 2010 and 2011. Policymakers are now focusing on a coordinated and orderly withdrawal of stimulus packages, including engendering the normal functioning of the global financial system, thus minimising the risk of unsustainable fiscal burdens and public debt, while simultaneously maintaining an appropriate level of monetary policy stimulus.

Recent Economic Developments

Domestic inflation eased to 6 percent in March 2010 from 6.1 percent in both January and February and was, therefore, at the upper end of the medium term objective range of 3 – 6 percent. The largely stable annual change in prices was evident across a wide range of categories of goods and services. Overall, underlying inflation is restrained in the context of benign external price pressures and subdued domestic demand.

It is estimated that in the fourth quarter of 2009, output was 7.2 percent higher than for the same period in the previous year, following an annual contraction of 7.9 percent in the third quarter of 2009. The increase in Gross Domestic Product (GDP) in the fourth quarter was a result of the 11.5 percent growth in mining output, while non-mining GDP expanded at a slower rate of 5.1 percent.

Broadly, non-mining output is estimated to be below trend with moderate pressures on inflation. This is in the context of a decrease in money supply that is due to a reduction in the level of 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.

Economic Outlook and Assessment of Risks

The global economic recovery appears sustainable, although uneven across regions and countries. After recovering in the second half of 2009, South Africa's GDP growth is expected to increase further in the first half of 2010, supported by improvement in global demand for base metals and manufacturing output, as well as growth in Asia. However, output is projected to remain below potential, hence exerting low pressure on inflation. Even so, there are upside risks to inflation in South Africa, including the possible large upward adjustments in administered prices. The forecast is, nevertheless, for inflation to remain within target in the medium-term.

Output growth in the Asian economies, notably China, underpins projections for the faster rate of global economic recovery. Overall, the world economy is anticipated to grow by 3.9 percent in 2010 and 4.3 percent in 2011, reversing the 0.8 percent decline of 2009. However, this is in the context of low levels of capacity utilisation and high rates of unemployment. It is, therefore, expected that world inflation will be restrained.

On the domestic front, it is expected that GDP, while improving, will remain below trend in the medium-term. Although exporting sectors will benefit from recovery in world demand, domestic economic activity will be subdued because of reduced government spending. Furthermore, demand and its impact on economic activity will be low owing to the effect on real incomes of the wage freeze and the increase in VAT, administered prices and other levies.

The low domestic demand pressures, together with the projected benign external inflationary pressures, contribute to the positive inflation outlook in the medium-term. In the short-term, inflation is projected to rise due to, among others, the faster quarterly price increases given price developments in South African, the increase in both VAT and electricity tariffs. In the medium-term, inflation is expected to be within the objective range on a sustained basis by mid 2011. The risks to this outlook include any substantial upward adjustment in administered prices and government levies. Moreover, there is a risk that any accelerated world economic recovery may lead to a rise in fuel prices. It is anticipated that the Pula exchange rate will be largely stable with minimal effect on domestic price developments.

Monetary Policy Stance

The current state of the economy and the assumptions on both the domestic and external economic outlook, as well as the inflation forecast, suggest that maintaining the prevailing 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 10 percent.

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