



Statement of the Monetary Policy Committee: August 26, 2010

1. Introduction

- 1.1 At the meeting of August 26, 2010, the Bank's Monetary Policy Committee observed that the medium-term outlook for inflation remains positive. However, the Committee anticipated that inflation will be higher than the objective range due to the impact of the increase in value added tax (VAT) and the upward adjustment in administered prices. It is, therefore, expected that inflation will fall within the 3 – 6 percent objective range in the second quarter of 2011. Accordingly, it is projected that, following contraction in 2009, the domestic economy will grow at a moderate rate in the short to medium-term, with below-trend output. Domestic output developments reflect similar prospects for world GDP.
- 1.2 However, there is a risk to global economic performance due to uncertain prospects in some major economies. The need to implement enhanced financial sector supervisory measures and fiscal consolidation to ensure sustainability of government finances have the potential to moderate prospective global growth in the short-term. While policymakers continue to face challenges of supporting the fragile economic recovery that is dependent on existing macroeconomic stimuli, the main focus is now on monetary stimulus. As a result, in the latest round of policy decisions, several central banks left interest rates unchanged, due to the need to nurture economic recovery.

2. Recent Economic Developments

- 2.1 Domestic inflation eased to 7 percent in July 2010 from 7.8 percent in May and 7.7 percent in June, but continued to be above the upper end of the medium-term objective range of 3 – 6 percent. The decrease in inflation was evident across a wide range of categories of goods and services. Overall, underlying inflation is restrained due to benign external price pressures and subdued domestic demand.
- 2.2 Output in the first quarter of 2010 is estimated to be 36.4 percent larger than in the same period in 2009, as a result of 135.1 percent increase in mining output following recovery in global demand. The expansion followed a contraction of 3.7 percent in 2009. Non-mining output grew by 8.2 percent in the same period, supported by countercyclical policy measures. Nevertheless, non-mining output is estimated to be below trend with moderate pressures on inflation against the background of subdued growth in money supply after 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 World economic recovery is expected to continue in 2010, underpinned by robust growth in emerging markets. However, recent developments in major economies are likely to result in downward revision of the growth outlook. In particular, measures to consolidate the fiscal and public debt positions, as well as the need to implement enhanced financial sector supervisory measures, have the potential to slowdown prospective global growth. Moreover, the expansion in economic activity in China, which has been a significant contributor to global growth, has plateaued. Therefore, the world economy is projected to grow by 3.4 percent in 2010 and 3 percent in 2011, after a 2.5 percent decline in

2009. In the context of low levels of capacity utilisation, high rates of unemployment and well-anchored inflation expectations, it is expected that world inflation will be restrained.

- 3.2 Although the impact of the World Cup on economic growth in South Africa was more than initially expected, it is now anticipated that there will be moderation due to concerns over lower prospects for global economic recovery. It is projected that growth will decelerate to 2.8 percent in the third quarter of 2010, but recover to 3.4 percent in the fourth quarter. Even so, output is projected to remain below potential, hence exerting low pressure on inflation. There are possible upside risks to inflation outlook, including the recent wage settlements that are above the inflation target and large increase in administered prices. The forecast is, nevertheless, for inflation to remain within target in the medium term.
- 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, growth in the domestic economy will be moderate due to reduced government spending. Moreover, it is anticipated that demand and its impact on economic activity will be subdued, affected by public sector wage freeze, and the increase in VAT, administered prices and other levies. Nevertheless, the loosening of monetary policy in 2009 is supportive of economic activity and will contribute to a narrowing of the output gap in the medium term.
- 3.4 Low domestic demand pressures will, together with the projected benign external inflationary pressures, contribute to the positive inflation outlook in the medium term. The recent moderation in inflation is expected to be sustained in the short-term, as influenced by reduction of inflation in South Africa and low domestic demand pressures. Inflation will, however, remain above the objective range of 3 – 6 percent. In the medium term, it is expected to be

within the objective range on a sustained basis from the second quarter of 2011. There are, nevertheless, upside risks to inflation emanating from any substantial increase in administered prices and government levies. There is also uncertainty about international oil and food prices, which could potentially have an impact on the inflation outlook. It is anticipated that the Pula exchange rate will be largely stable with minimal effect on domestic price developments.

4. Monetary Policy Stance

- 4.1 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 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 10 percent.