

2018 NATIONAL BUSINESS CONFERENCE DINNER

Transition to High Income Status – The Role of Monetary Policy and Communication

Welcome Remarks

by

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Distinguished Guests, Ladies and Gentlemen, good evening.

It is my honour to welcome you to this Dinner hosted by the Bank of Botswana on the eve of the National Business Conference here in the City of Francistown. On behalf of the Board, Management and Staff of the Bank and on my own, I thank you all for honouring the invitation; your presence here tonight is valued and highly appreciated.

Role of National Business Conference and Theme

The Bank of Botswana is privileged and accepts the honour to host this Welcome Dinner to the 15th National Business Conference, organised by Business Botswana, in collaboration with the Government under the theme, “Breaking through to a High-Income Botswana - The Role of the Private Sector in Charting the Path”. This should provide an opportunity to evaluate prospects for Botswana, with respect to structural transformation, policies, strategies and, especially, implementation frameworks that would enhance international competitiveness of local firms and support the transition to high-income status in line with Vision 2036. I am reliably informed that, His Excellency the President of the Republic of Botswana, Mr Mokgweetsi Eric Keabetswe Masisi will, in

addition to performing the official opening, actively participate in this Conference and, in particular, share his thoughts on the growth of business in Botswana in one of the sessions, tomorrow.

Background and Broad Structural Issues

Distinguished guests, it is common cause that the economy of Botswana has, over the last 52 years, recorded impressive growth and structural transformation, leading to the country attaining upper middle income status, currently with a per capita annual income of approximately USD 8 000. Similarly, over the years, the country has enjoyed relatively sound and stable macroeconomic and financial conditions. Despite episodes of terms-of-trade shocks and volatile commodity prices during this period, the economy has been largely characterised by relatively low and predictable levels of inflation; balance of payments surpluses; substantial foreign exchange reserves; stable real effective exchange rate; low public debt; and continued pursuance of prudent fiscal policies. However, as we are well aware, in the last decade or so the country's growth momentum seems to have lost steam. Evidently, this is constrained by several factors including the narrow economic base, high levels of unemployment, insufficient innovation and private investment spending, infrastructure constraints, thin and fragmented markets as well as low level of financial sector development and, relative to other upper middle-income countries, less inclusive growth.

Distinguished Guests, the IMF Executive Board, on August 31, 2018, completed the 2018 Article IV Consultation with Botswana, and as usual, the Botswana authorities were commended for a track record of sound policies that has supported strong growth and macroeconomic stability. However, it is considered opportune to leverage on the favourable

prospects to accelerate implementation of structural reforms to unlock the country's growth potential. The specific areas highlighted by the IMF include preserving priority infrastructure and social spending, restructuring and privatisation of parastatals, promotion of private sector development and economic diversification, sustained efforts to improve the business climate, including facilitating foreign direct investment as well as skills and realignment of education policies to eliminate existing skills mismatches.

The Bank's Role in Supporting Economic Activity and Growth

As a contribution to the theme of this National Business Conference my remarks, this evening, will focus on the role of monetary policy and communication in transiting to high-income status and, also, take the opportunity to launch the Bank's maiden Monetary Policy Report. Therefore, in a broad sense, the intent is to project the relevance and role of the Bank of Botswana in contributing to the journey towards high-income status for Botswana.

To give perspective, you will be aware, Distinguished Ladies and Gentlemen, that the Bank exists to protect the value of the local currency, the Pula and thebe, through currency management operations, monetary policy, exchange rate management, regulation and supervision of relevant financial institutions and facilitating sound payments and settlement frameworks. Essentially, the Bank promotes the desire and willingness to hold the local currency, as well as to transact and save locally in Pula premised on the quality and durability of the banknotes and coin; stable, predictable domestic price changes; safety and soundness of the financial system and reliable payment infrastructure. Inevitably, where central banks fail to achieve these outcomes, or are constrained by political interference, economic performance and development suffer

considerably; recent examples include Venezuela and Zimbabwe. Overall, by fostering appropriate conditions, the Bank of Botswana has, throughout its 43 years of existence, contributed to stability of the macroeconomic environment and financial system, as well as integrity and reliability of payments and settlement platforms; therefore, enabling economic activity, as manifested in the ability to transact and access financial services.

Distinguished Guests, we are, however, collectively looking ahead and, in this regard, there are several aspects of mandates and operations of the Bank that require modernisation and upgrading in order to remain relevant and contribute to national development aspirations and objectives. Indeed, monetary policy and the various instruments, including communication, can only be effective if undertaken alongside improvements in other operations of the Bank and policy transmission channels. Allow me to highlight four relevant areas in this regard.

Modernisation and Adaptation of the Bank's Functions

First, there is a need to adapt to changing domestic and global conditions and, also, to ensure that the Bank of Botswana is appropriately positioned to adequately address new developments and related challenges. Some of these include fintechs, digital currencies and similar innovations as well as adopt best practice, to sustain national development. In this regard, there is ongoing review of the Bank of Botswana Act, the Banking Act and proposals to promulgate a national payments law. The intention is to enhance operational capability, predictability and integrity of policy and regulatory frameworks, as well as to clarify institutional relationships and promote accountability and transparency. Furthermore, one of the key

lessons from the 2008/9 global financial crisis is the need for joint, speedy and coordinated response, by all relevant stakeholders, to any substantial systemic risks emanating from any parts of the financial sector.

As part of the broader financial development architecture, there is a need to re-configure institutional arrangements for the financial sector oversight to achieve greater focus on macro-prudential dimensions of financial stability policy and financial safety nets. The recent establishment of the Financial Stability Council is a significant step towards protecting the viability, integrity and sustainability of relationships and cross-holding of exposures within the financial sector and with other economic sectors. As I mentioned, this enables coordinated and decisive response when needed; ultimately safety of savings and investments and prospects for attracting more. Also, one of the key tenets, in this respect, include the need for legislation for the establishment of a deposit protection scheme, to further encourage patronage of the domestic financial system, in particular broader financial inclusion.

Monetary Policy Framework

Distinguished Guests, the second area of continuing improvement that I want to highlight relates to the role of the monetary policy framework in facilitating a conducive environment for private businesses to thrive. Broadly, an appropriate policy framework should encompass definition and clarity of objectives and instruments, understanding and calibration of transmission channels and, therefore, predictability and, in turn, accountability. It is for these reasons that the Bank's primary mandate of price stability, is clearly defined as a sustainable level of annual inflation that is within the medium-term objective range of 3 – 6 percent. The policy is also formulated with a view to safeguarding the stability of the financial

system. In essence, protection of the value of the Pula and integrity and safety of channels and platforms for holding money and transacting in local currency.

Let me, once again, underscore the point that low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers which, in turn, contribute towards the broader national objectives of sustainable economic development and employment creation. Equally important is a sound and stable financial system particularly the banking sub-sector, as it serves as the main transmission channel for monetary policy signals and facilitating economic activity through the provision of liquidity and risk mitigation.

It is also apparent to the markets and general public that the key instruments of policy are the Bank Rate and the Bank of Botswana Certificates. The former relates to the cost of money and decisions to save or borrow, while the latter influences the quantity of loanable funds in the banking system. In both cases, the operation of these instruments affects prospects for demand and, in turn, its influence on the rate of price changes, with the Bank's focus being to maintain inflation within the defined objective range of 3 – 6 percent.

The policy is predictable in the sense that the Bank publishes the medium term inflation outlook, which informs the policy response. For example, a forecast for sustained inflation above the objective would imply an increase in interest rates and tightening of financing conditions, to help moderate inflation. On the other hand, sustained lower inflation than the objective range implies subdued economic performance and would require reduction in interest rates to raise demand and stimulate economic

activity. However, for policy transmission to be effective it requires a sound and responsive banking system. Thus, banks should cut interest rates and increase lending when the Bank Rate is reduced, and accordingly raise them when monetary policy is tightened and not be constrained by internal and structural weaknesses. In this regard, the Bank is always available to provide liquidity to the banking system and to solvent individual banks, as needed, to ensure market sustainability and appropriate policy transmission.

Market Development and Financial Inclusion

Aligned thereto is the third developmental area, which is the Bank's role in promoting the growth, spread and deepening of money and capital markets and, also, financial inclusion. The development of a wide range of money and capital markets institutions and instruments enables substitution and access to a variety of purpose-fit saving and investment channels as monetary policy and conditions change; therefore sustained effectiveness of policy transmission in affecting market activity. A diverse and deep market also allows banks to better manage liquidity positions, hence the ability to effectively transmit policy. In addition, with enhanced financial inclusion, changes in monetary policy are more effective as a greater number of businesses, institutions and households, hold and have exposures that are directly affected by the direction and level of interest rates and availability of loanable funds and market liquidity.

Communication

Distinguished Guests, the fourth area of focus for the Bank, as we look ahead, is communication. The Bank considers and uses communication as a direct, practical and potent instrument of policy. It is, therefore,

important that in order to generate the desired response, communication is recognised and acknowledged by the market and general public as a policy instrument. However, this is to the extent that such communication is backed by durable integrity and reliability of the Bank of Botswana, premised on predictability and transparency. Public trust and reputation of the Bank are essential elements for policy effectiveness. Central banks such as the Bank of England, the European Central Bank and the US Federal Reserve demonstrate such effectiveness where, for example, issuance of forward guidance statements (without immediate actual change in interest rates), generate market reaction; thus change in economic behaviour and activity.

More generally, communication works best in an environment of economic and policy awareness by the public as well as informed policy and market analysis and commentary. The combination of economic developments and dissemination of policy analysis and economic projections by the Bank helps the public and economic agents to anticipate policy action; the so-called expectations. For example, expectations about future inflation and, therefore, interest rates, are a key determinant in formulating investment and consumption decisions, hence economic activity. Communication also facilitates accountability and various platforms and media are used in this regard. Overall, increased transparency and communication, regarding the policy framework, objectives and strategy, as well as decisions and progress in meeting the objectives of the Bank can contribute to desired market responses and policy effectiveness.

Distinguished Ladies and Gentlemen, at the launch of the Bank's Monetary Policy Statement, in February this year, I outlined the refinements that the Bank continues to make to the monetary policy framework relating to communication. I indicated that, the more recent

innovations that started in 2017 included the pre-announcement of the dates for the Monetary Policy Committee meetings for the year ahead and media briefings that follow each meeting to announce and engage on the policy decision. I also indicated that, going forward and in an effort to further improve on communication and transparency on economic and policy analysis and implementation, the Bank will publish four Monetary Policy Reports each calendar year, including the Monetary Policy Statement. I am happy to announce that tonight the Bank is launching the first Monetary Policy Report to be published on the Bank's website tomorrow morning. The Report is also available on the Bank of Botswana branded memory sticks that will be distributed to the invited guests tonight. There is also a limited number of hard copies.

The Report will be the main medium through which the Bank will inform the public about the formulation and implementation of monetary policy. It serves to meet the public's expectation of a transparent and accountable central bank in fulfilling the monetary policy mandate. The Monetary Policy Reports in April, August and October will be preceded by the Monetary Policy Statement in February each year.

Distinguished Guests, as I conclude, I would like to assure you that the Bank's implementation of monetary policy will continue to focus on entrenching expectations of low, predictable and sustainable inflation, through timely responses to price developments. At the same time, the Bank will contribute to effective oversight of the financial system to ensure sustained financial stability and integrity of the payments system, while promoting market development and financial inclusion; as a growth imperative and also important for policy transmission. Essentially, this is the enduring contribution of the Bank to an enabling environment for private sector growth and greater participation in economic activity;

therefore, enhanced prospects for economic diversification efforts, employment creation, inclusive growth, and transition to high-income status.

Let me wish you a fruitful conference and deliberations for the next two days. Please enjoy your dinner. However, to conclude the formal proceedings, allow me to call upon the Director of Research and Financial Stability Department, Dr Tshokologo Alex Kganetsano to present a brief outline of the Monetary Policy Report and also highlight its relevance in influencing expectations and economic activity.

I thank you for your kind attention.