

BANK OF BOTSWANA
2013 MONETARY POLICY STATEMENT

by

Linah K Mohohlo
Governor

February 26, 2013

I wish to welcome you to the launch of the *Monetary Policy Statement* for 2013. We at the Bank are particularly grateful that, each year, you accommodate us in your busy schedules of “Things to Do”, to attend this event. Your presence is an indication that you do attach importance to the need for the Bank to be transparent and accountable to you and other stakeholders, in its conduct of monetary policy. We sincerely value and appreciate your dedicated patronage.

As you are aware, the Bank’s *Monetary Policy Statement* and its Mid-Term Review are fundamental in guiding the direction of monetary policy in Botswana. The Bank seeks to strengthen policy credibility through rigorous analysis of economic developments and through an assessment of future trends and associated risks. This provides a solid foundation for guiding the Bank’s policy choices and instruments at any given time, with a view to influencing demand conditions in the economy and, ultimately, influencing the rate at which prices increase.

In my submission this morning, I will highlight the external and domestic economic and inflation developments of 2012. I will also touch on the main determinants of price changes in the past year, as well as prospective economic and financial developments that could affect the medium-term outlook for inflation. I will explain the reasons for the monetary policy stance adopted in the course of last year and share with you the Bank's assessment of the economic prospects and inflation outlook for this year, from which to appreciate the direction of monetary policy as the year unfolds.

The need for careful analysis and monitoring of unfolding economic and financial events is readily apparent given the uncertainty that continues to characterise the global economy. This uncertain environment has made the attainment of the price stability objective increasingly challenging. However, this should not stand in the way of the Bank discharging the responsibility of achieving price stability on a sustainable basis, as represented by the medium-term objective for the consumer price inflation of 3 – 6 percent. Far from being restrictive, the pursuit of this measure of price stability is supportive of economic growth through, among others, promoting savings and productive investment, the competitiveness of domestic producers and more equitable income distribution.

Distinguished Ladies and Gentlemen:

Let me now provide a broad perspective of the general economic and price developments for 2012, from a global standpoint and here at home.

Both developed and emerging market economies experienced moderate inflation pressures during 2012, due to three main factors: lacklustre growth in global demand, persistent underutilisation of productive capacity and high unemployment rates in major economies. Overall, global inflation eased from **four and a half** (4.5) percent in 2011 to **three point nine** (3.9) percent in 2012, as output expansion weakened from **three point nine** (3.9) percent in 2011 to an estimated **three point two** (3.2) percent in 2012. Nonetheless, there were instances of significant increases in prices around mid-year, when the price of grain rose sharply as a result of unfavourable weather conditions. International oil prices were also volatile, but they generally trended downwards in the course of the year.

Average inflation for Botswana's trading partner countries declined from 4.8 percent in 2011 to 4 percent in 2012. For the countries whose currencies constitute the Special Drawing Rights (United States of America, Eurozone, Japan and United Kingdom), inflation fell from **two point nine** (2.9) percent to **one point nine** (1.9) percent, due mostly to weak economic activity, lower food inflation and the moderation in international oil prices. Inflation in South Africa also fell for similar reasons, from **six point one** (6.1) percent in 2011 to **five point seven** (5.7) percent in 2012, a rate which was

just below the top-end of the country's medium-term target range of 3 – 6 percent.

Inflation in Botswana eased steadily in the first 8 months of the year due to the global trend; there was also a wage restraint and the dissipation of the earlier increase in administered prices. After reaching a low of 6.6 percent in August 2012, inflation took an upturn, and this was attributable to a higher alcohol levy and the increase in fuel prices, transport fares and water tariffs. These previously unforeseen price adjustments added almost 2 percentage points to headline inflation, of which 1.3 percentage points were accounted for by higher fuel prices. The increase in the price of fuel, at a time when global oil prices were falling, was explained by the delayed adjustment to past increases in the global price of oil. Nevertheless, inflation fell from **nine point two** (9.2) percent in December 2011 to **seven point four** (7.4) percent at the end of 2012. When administered prices are excluded, inflation ended the year at **six point eight** (6.8) percent, compared to **seven point five** (7.5) percent in December 2011.

There was virtually no pressures on inflation arising from domestic demand during 2012. Household demand was constrained by continued low growth in public sector wages, while the increase in government expenditure was also modest, given the focus on fiscal consolidation. However, expansion of credit by commercial banks helped to stabilise aggregate demand. It should be recalled that the

higher credit growth was, in part, due to the 2011 capping of excess liquidity absorption to P10 billion, which was intended to encourage banks to lend to profitable ventures. Indeed, there is some evidence that this was the right course of action.

In the event, borrowing by households from banks rose by **twenty-eight and a half** (28.5) percent in 2012 compared to last year's **eighteen point eight** (18.8) percent. Lending to businesses was also strong, at **seventeen point eight** (17.8) percent, albeit lower than the previous year's growth of **thirty-six point nine** (36.9) percent. Overall, year-on-year expansion in credit to the private sector slowed down only slightly from **twenty-six point four** (26.4) percent in 2011 to **twenty-three point six** (23.6) percent and was supportive of economic activity. I hasten to add that the Bank constantly reviews the effect of credit growth on the quality of bank assets and remains on guard in case of a possible related emergence of a price bubble in the property market.

Distinguished Guests:

The Bank implemented and conducted monetary policy in an environment of continuing downside risks to the global economy, associated with excessive debt, fiscal austerity, bank deleveraging and weak international trade. Furthermore, persistently high unemployment and policy uncertainty in the United States of America and the Eurozone had an adverse impact on consumer and business confidence. Growth of the global economy was driven

mostly by the strong economic performance of emerging market and developing economies, although these were also adversely affected by subdued trade with developed countries.

With global inflationary pressures generally moderate in 2012, monetary policy in many economies remained accommodative in support of economic growth. In particular, major central banks, such as the Federal Reserve Bank, Bank of Japan, Bank of England and European Central Bank, maintained low interest rates, complemented by substantial further injection of liquidity to the banking system (the so called quantitative easing). Similarly, monetary policy was accommodative in major emerging market countries, notably Brazil, China and India.

In Botswana, inflation was above the 3 – 6 percent objective range, due mainly to the upward adjustment of administered prices, the inflationary impact of which was considered transitory. This was despite the non-mining output having remained below trend. Although the medium-term outlook remained positive, the Bank Rate was unchanged at 9.5 percent throughout the year, as was the case last year. Commercial banks' prime lending rate was also constant at 11 percent. The conduct of monetary policy also included absorption of excess liquidity as a way of maintaining interest rates at required levels, with the result that Bank of Botswana Certificate yield movements were marginal throughout the year.

This year, the global economy is projected to grow by 3.5 percent, which is slightly higher than last year's 3.2 percent. This is a downward revision from earlier projections and it is reflective of the uncertain prospects for the global economic recovery. Despite the inconclusive direction of fiscal policy, indications are that economic recovery in the United States of America will hold, while in Japan, United Kingdom and Eurozone, economic growth prospects are forecast to be only modest, at best. As was the case last year, emerging market economies are expected to be the main source of global growth.

This relatively weak economic outlook suggests that, in 2013, monetary policy in major economies will continue to be easy. In the medium- to long-term, fiscal consolidation, productivity improvement and debt reduction will need to be implemented concurrently. Similarly, it is expected that the emerging market and developing economies will also maintain loose monetary policy, given the moderation in economic growth, uncertain prospects for trade and low pressure on inflation.

Projections for global inflation for 2013 are moderate at 3.7 percent, compared to last year's 3.9 percent. This is against the background of stable commodity prices, subdued output growth, persistence of spare capacity and high unemployment in major economies. In contrast, there is likely to be upward pressure on inflation in some

emerging market countries, due to the robust economic activity resulting from sound economic fundamentals.

The domestic economy is forecast to grow at a slower rate of **five point nine** (5.9) percent in 2013, compared to **six point one** (6.1) percent in 2012. Unlike in the recent past, demand will be supported by an increase in government expenditure, within which development spending will increase by 18.7 percent in the 2013/14 fiscal year. Moreover, activity relating to the transfer of diamond aggregation to Botswana, as well as the related downstream processing should be positive for economic growth.

Nevertheless, it is expected that domestic demand will not exert undue pressure on inflation. Moreover, the impact of foreign price developments is also forecast to be low, and the effect of the earlier increase of administered prices will dissipate. Even so, the current forecast points to inflation remaining above the objective range in the short term. In addition, any substantial upward adjustment in administered prices and government levies, and any increase in international food and oil prices beyond current projections, present risks to the inflation outlook.

As a related matter, and as announced in the recent Budget Speech, the Government has now disclosed the weights of the Pula basket; they are 55 percent for the South African rand and 45 percent for the Special Drawing Rights. The rate of crawl has also been made

public and, in order to offset the inflation differential, the nominal effective exchange rate of the Pula is currently set to crawl downwards by 0.16 percent on an annual basis. This is derived from the fact that the Bank's medium-term inflation objective of 3 – 6 percent is marginally higher than the forecast average inflation of trading partner countries. For instance, the 2013 average inflation forecast for SDR countries is 1.8 percent, and inflation for South Africa for the same period is forecast to average 5.6 percent. This disclosure of the exchange rate policy parameters is in the best interest of transparency, as market participants should be able to make informed business and/or investment decisions since they will have the requisite data.

So far as the monetary policy stance for 2013 is concerned, there is scope for supporting economic activity through an accommodative policy posture, in an environment where demand will be non-inflationary and potential for further fiscal stimulus remains limited. That said, the formulation and implementation of monetary policy will need to factor in the impact of short-term price developments that may occur on inflation expectations. Moreover, this generally positive assessment assumes that the transient factors that have kept inflation above the medium-term objective range in recent years will not be repeated, at least not to the same extent. Accordingly, the Bank will respond in a timely manner to any sustained deviation of inflation from the medium-term objective range, particularly when the causal factors can be influenced by domestic monetary policy action.

Honourable Minister, Distinguished Ladies and Gentlemen:

I conclude by restating that, despite the impact of last year's upward adjustment of administered prices and other levies, inflation declined in line with global trends. In this context, the decision to maintain the Bank Rate at 9.5 percent throughout the year was consistent with keeping inflation in check; it was also consistent with ensuring that economic activity is not constrained. For this year, the Bank expects inflation to generally moderate and ultimately fall within the medium term objective range of 3 – 6 percent in the latter part of the year. As I said earlier, there are considerable upside risks associated with this forecast, and this requires the Bank to be alert to the emergence of renewed inflationary pressures. Consistent with established practice, the Monetary Policy Committee will review all related developments regularly and advise you and other stakeholders, accordingly.

Director of Ceremonies, Honourable Minister, Honoured Guests:

This concludes my submission of the highlights of the Monetary Policy Statement for 2013. Copies of the detailed *Statement* are available just outside the Auditorium; I commend it to you.

I am grateful for your kind attention.