

## **Statement of the Monetary Policy Committee: December 18, 2009.**

### **1. Introduction**

- 1.1 At the meeting of December 18, 2009, the Bank's Monetary Policy Committee observed that prospects for the level of inflation being sustained within the 3 – 6 percent objective range during 2010 remain good. Furthermore, there is an improvement in economic prospects as the world economy recovers from the recent deep recession. It is, nevertheless, anticipated that both the domestic and world output growth will be below trend with low inflationary pressures. The sustainability of the global economic recovery depends on normalisation of the global financial system, as well as a smooth and coordinated exit from the policy stimulus packages that the advanced countries undertook to support economic activity. It is considered that timely exit would minimise the risk of inflationary pressures. On the other hand, there is an upside risk to inflation arising from a rebound in oil prices as the world economy recovers.

### **2. Recent Economic Developments**

- 2.1 Botswana inflation, which has generally been on a downward trend, fell to 5 percent in November 2009 and, therefore, within the Bank's objective range of 3 - 6 percent. The decline in inflation occurred in the context of benign external price pressures, sluggish domestic economic activity, as well as the influence of previously restrictive monetary policy. These factors have contributed to the largely stable prices across commodity groups and a notable decrease in food and fuel inflation, while the increase in the alcohol levy implemented in 2008 also dropped out of the inflation calculation.

- 2.2 It is estimated that in the second quarter of 2009, output was 1.3 percent higher than for the same period last year. This followed an annual contraction of 18.8 percent (revised) in the first quarter of 2009. The improved performance reflects recovery in global demand which had collapsed in the last quarter of 2008, leading to the closure of some diamond mines. While mining production still contracted by 18.6 percent in the second quarter, non-mining GDP was resilient, registering a healthy 12.7 percent expansion. However, output projections for the second and third quarters show slower quarterly growth of non-mining output.
- 2.3 The deceleration in growth and inflation happened against the background of the substantial decline in the rate of monetary expansion, resulting from the reduction in the foreign exchange reserves and lower rates of increase in both government expenditure and private sector credit.

### **3. Economic Outlook and Assessment of Risks**

- 3.1 Following a contraction in the first half of 2009, South Africa's GDP is projected to increase in the second half, but overall output for the year is expected to be lower than in 2008. Going forward, improvements in global demand for base metals and manufacturing output that started in the latter part of 2009 is expected to contribute to a stronger performance in 2010. It is, however, forecast that output will remain below potential, thus exerting low pressures on inflation. The upside risks to inflation in South Africa include the demand for wage increases and a large upward adjustment in electricity tariffs. The projection is, however, for inflation to remain within the 3 – 6 percent target for most of 2010.
- 3.2 Globally, economic recovery is projected to be unbalanced across countries and regions, with faster growth in the emerging and developing economies, led by

strong resurgence in Asia, particularly China. While recovering at a slower pace, improvement in performance in the major economies and the restoration of effective financial intermediation within an improved supervisory framework are critical for sustained growth of the world economy. Hence the major economies have largely maintained the stimulus packages that were implemented to support economic activity. However, plans are underway to effect a coordinated exit from the policy measures and financial support, with minimum disruption to the incipient global economic recovery, and to pre-empt a build up of inflationary pressures. Overall, the world economy is expected to grow by 3.3 percent in 2010, after contracting by 2.6 percent in 2009, but this rate of increase would still be below potential.

- 3.3 In the circumstances, it is expected that demand pressures on inflation will be low in the medium term. In addition, excess industrial capacity, lower commodity prices compared to the previous year, as well as the weak labour market conditions, also imply sustenance of low rates of price increase globally.
- 3.4 On the domestic front, the transition to lower rates of non-mining GDP growth is projected to extend to the medium term. The forecast slowdown in economic activity partly reflects the effects of the hitherto tight monetary conditions (relatively high real interest rates and a slightly stronger real exchange rate). However, the easing of monetary policy in 2009 resulted in a loosening of monetary conditions and, therefore, contributes to future improvement in the performance of the non-mining sectors, although the rate of growth is still forecast to be below potential. The below-trend economic expansion also occurs in the context of a currently slower rate of monetary expansion, including an earlier budgeted decrease in government expenditure growth and deceleration in the rate of increase in credit to the private sector. The latest Business

Expectations Survey (September 2009) indicates an improvement in confidence by both domestic and export oriented businesses, compared to the March Survey. Business confidence appears to be underpinned by both the incipient world economic recovery and the commitment by the Government to borrow to fund the budget deficit, rather than curtail spending substantially.

- 3.5 These developments, together with projected benign external inflationary pressures, contribute to the positive inflation outlook. Although fluctuating somewhat in the short-term, inflation is expected to stabilise around the objective range in the medium term. In particular, it is anticipated that inflation will be within the objective range on a sustained basis towards the end of 2010. The risks to this scenario include any substantial upward adjustment in administered prices and uncertainty surrounding international oil prices. So far, oil prices appear to be largely stable, fluctuating within a narrower range compared to a volatile trajectory exhibited a few years earlier. Nevertheless, there is a risk that an increase in the momentum of the world economic recovery could lead to a significant rise in oil prices. Meanwhile, it is anticipated that the Pula exchange rate will be largely stable with a minimal impact 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 a loosening bias is consistent with the achievement of the Bank's 3 – 6 percent inflation objective over the medium term. Accordingly, the Bank has reduced the Bank Rate by one percent to 10 percent with immediate effect.

- 4.2 The Bank expects commercial banks to effect a symmetrical adjustment to the deposit and lending interest rates. In that regard, the banks should insure that savers generally earn real positive returns on their savings.