STATEMENT OF THE MONETARY POLICY COMMITTEE: DECEMBER 16, 2010.

1. Introduction

1.1 At the meeting of December 16, 2010, the Bank's Monetary Policy Committee observed that the medium-term outlook for inflation was positive. However, the Committee anticipated that inflation will, in the short term, continue to be higher than the upper bound of the medium term 3 – 6 percent objective range. In addition to the continuing effect of the increase in value added tax and administered prices and the December 2010 increase in the alcohol levy, the short term inflation forecast also factors in the expected upward adjustment of private school fees and electricity tariffs. In the absence of these exogenous factors, inflation would be within the Bank's 3 – 6 percent inflation objective range. It is, therefore, expected that inflation will fall within the 3 – 6 percent objective range in the second quarter of 2011, as the impact of these transient factors dissipates. Following the contraction in 2009, the domestic economy is projected to grow at a moderate rate in the short to medium-term, with below-trend output. Domestic output developments largely reflect similar prospects for world GDP.

2. Recent Economic Developments

2.1 The global economic recovery appears to be losing momentum as the impact of earlier fiscal stimuli diminishes, while some of the major countries undertake measures to reduce government expenditure with a view to attaining sustainable budgets and public debt. However, economic performance in the emerging market economies remains generally strong. With the fragile global economic recovery still dependent on macroeconomic stimuli, the main focus is now on monetary policy stimulus to raise private sector demand and investment. Thus, in the latest round of policy decisions, some central banks reduced their policy interest rates and several others left interest rates unchanged at very low levels, while additional measures to increase money supply through quantitative easing were undertaken in some circumstances, thus reflecting the need to nurture economic recovery.

2.2 Domestic inflation increased from 7 percent in September to 7.2 percent for both October and November, remaining above the Bank's objective range of 3 – 6 percent. The marginal increase in the annual rate of price increase from September was evident across a wide range of categories of goods and services. The level of output in the second quarter of 2010 is estimated to be 6.5 percent higher than in the same period in 2009, thus reflecting the 8 percent growth in mining output and the 5.8 percent increase for the non-mining sectors. Output is estimated to be below trend, with moderate pressures on inflation, against the background of subdued growth in money supply that is due to 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 remains fragile given the diminishing impact of earlier fiscal stimuli and continuing high rates of unemployment that contribute to weak consumer and business confidence. Overall, 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 slow down global growth. The world economy is projected to grow by 3.7 percent in 2010 and 3 percent in 2011, after a 2.2 percent decline in 2009. This reflects higher projected growth of 6.9 percent in 2010 and 5.7 percent in 2011 for the emerging market economies against 2.5 percent and 2 percent, respectively in the major economies. Given low capacity utilisation, high unemployment rates and well-anchored inflation expectations, it is anticipated that world inflation will be restrained.

3.2 In South Africa, economic growth is projected to stabilise around 3 percent for the rest of 2010, thus remaining below potential, and exerting limited pressure on inflation. There are, however, possible upside risks to the inflation outlook, including the recent wage settlements that are above the inflation target and possible large increase in administered prices, while food and petrol prices pose potential longer term risks. The forecast is, nevertheless, for inflation in South Africa to remain within the 3 - 6 percent target range 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 continue to benefit from recovery in world demand, growth in the domestic economy will be moderated due to the restrained government spending. Moreover, it is anticipated that demand and its impact on economic activity will be subdued, reflecting sluggish growth in personal incomes and the increase in VAT, administered prices and other government levies. The impact of the recent 10 percent adjustment of public sector wages on demand is expected to be modest, given past erosion of real incomes. Nevertheless, the loosening of monetary policy in 2009 continues to be supportive of economic activity and will contribute to a narrowing of the output gap in the medium term.

3.4 Low domestic demand pressures and the forecast benign external inflationary pressures contribute to the positive inflation outlook in the medium term. Although inflation in the short term is expected to remain above the objective range of 3 – 6 percent, it is forecast to be within the objective range on a sustained basis from the second quarter of 2011. The positive inflation outlook is influenced by the low price pressures in South Africa and the dissipation of the impact of the increase in VAT and administered prices. Meanwhile, the Pula exchange rate is expected to be relatively stable with minimal impact on domestic prices. The latest Business Expectations Survey (September 2010) indicates that businesses have revised downward their estimate of future inflation compared to the March Survey, more in line with the Bank’s commitment to restrain inflation.

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 monetary policy bias 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 reduce the Bank Rate by half a percent to 9.5 percent.

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