MONETARY POLICY REPORT

APRIL 2022

BANK OF BOTSWANA

STRATEGIC INTENT STATEMENTS

VISION

The Bank aspires to be a world-class central bank with the highest standards of corporate governance and professional excellence.

MISSION

The mission of the Bank is to contribute to the sound economic and financial well-being of the country. The Bank seeks to promote and maintain:

- monetary stability;
- a safe, sound and stable financial system;
- an efficient payments mechanism;
- public confidence in the national currency;
- sound international financial relations; and to provide:
  - efficient banking services to its various clients; and
  - sound economic and financial advice to Government.

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1. PREFACE

1.1 Purpose of the report

The Monetary Policy Report (MPR) is the main medium through which the Bank of Botswana (the Bank) informs the public about the conduct of monetary policy on a regular or timely basis. It serves to meet the public's expectation of a transparent and accountable central bank in fulfilling the monetary policy mandate set out in the Bank of Botswana Act (Cap 55:01).

The MPR presents the Bank's review of economic and inflation trends as well as policy performance. The report also provides an assessment of economic and financial developments that are likely to influence the inflation path in the medium term and, in turn, the Bank's future policy choices. In this respect, the MPR promotes an understanding of the conduct of monetary policy in order to anchor public expectations of a low, predictable and sustainable level of inflation.

1.2 Monetary policy framework

The primary objective of the Bank's monetary policy is to achieve price stability. For Botswana, price stability is defined as a sustainable level of annual inflation, as measured by the consumer price index (CPI), that is within the Bank's medium-term objective range of 3 – 6 percent. The policy is also formulated with a view to safeguarding the stability of the financial system. The monetary policy framework is anchored on the crawling band exchange rate mechanism, which seeks to maintain a stable real effective exchange rate (REER) conducive for macroeconomic stability and the international competitiveness of domestic producers of tradeable goods and services. The Ministry of Finance (MoF), in consultation with the Bank, makes a recommendation on the parameters of the exchange rate mechanism (weights of currencies that comprise the Pula Basket and the rate of crawl) that determine the value of the Pula, for approval by His Excellency, the President. In addition, the Bank has traditionally used the Bank Rate to influence short-term interest rates to steer the economy through the business cycles, thus contributing to sustainable economic growth.

In evaluating policy options, the Bank implements a forward-looking monetary policy framework with a central role for a medium-term inflation forecast. The Bank sets the policy to direct projected movements of inflation towards the medium-term objective, while considering the prevailing rate of crawl of the exchange rate mechanism, prospects for economic growth and developments relating to the stability of the financial system. The policy horizon is up to 3 years, and evaluated on a rolling basis, because monetary policy affects price developments with a lag estimated at up to four quarters. A proactive approach to setting policy necessitates a continuous review of the inflation outlook.

The monetary policy stance, effective April 2022, is signalled by the Monetary Policy Rate (MoPR). To support this signal, the Bank uses open market operations, which entail, primarily, auctioning of the Bank of Botswana Certificates (BoBCs) using fixed rate full allotment system, engaging in Repo/Reverse Repo transactions with commercial banks (primary dealers), and introducing a one-month BoBC paper that will help address some of the structural liquidity positions and support the construction of the short-end of the yield curve.

1.3 Decision-making process

Monetary policy is implemented in line with the decisions of the Monetary Policy Committee (MPC). The Committee comprises: the Governor (Chairman); Deputy Governors; the Chief Operating Officer; Director and Deputy Directors of the Research and Financial Stability Department responsible for monetary policy and financial stability; Director and Deputy Director of the Financial Markets Department responsible for the domestic market operations; and Director of the Banking Supervision Department.

The MPC holds six pre-scheduled meetings or more per year, as necessary, during which the monetary policy stance is determined. Prior to the commencement of the year, the dates for the MPC meetings for the ensuing year are announced.

1.4 Announcement of the monetary policy decision

The monetary policy decision is announced through a Press Release shortly after each MPC meeting. The Press Release informs the public of the Committee's decision regarding the Monetary Policy Rate (MoPR) and the reasons for the policy choice. The Governor holds a Press Briefing to allow for interaction with members of the media and to promote understanding of the Bank's economic analysis and policy stance (Box 4).

The first MPC meeting of the year, held in February, is accompanied by the issuance of the Monetary Policy Statement, through which the Bank reports on inflation trends, policy performance and the likely policy posture for the ensuing year. Subsequently, the MPR is produced for the April, August and December meetings. The MPR is published on the Bank website (www.bob.bw) within a week of the announcement of a policy decision.

2. EXECUTIVE SUMMARY

In 2022, monetary policy is being implemented in the context of projections for higher inflation in the near term, associated with upward adjustment of taxes/levies and administered prices, a modest recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines, and projected increase in foreign prices. Overall, the current state of the economy and the outlook for both domestic and external economic activity provide scope for maintenance of an accommodative monetary policy to support durable recovery and economic activity.

The Bank's formulation and implementation of monetary policy focuses on entrenching expectations of low, sustainable and predictable level of inflation through a timely response to price developments. The Bank remains committed to responding appropriately to preserving price stability without undermining economic activity.

Globally, economic activity improved in 2021, owing to recovery in demand, resulting from easing of the disease containment measures and consequent opening of economies, amid effective roll-out of vaccination programmes in many countries. However, the pandemic took a negative turn in some parts of the world in the fourth quarter of 2021, due to emergence of new variants of the virus, resulting in slowdown in output growth of some economies during this period. The euro area output growth slowed down, quarter-on-quarter, from 2.3 percent in the third quarter of 2021 to 0.3 percent in the fourth quarter, as movement restrictions impacted negatively on the services sector and resulted in labour shortages, due to the spread of the Omicron COVID-19 variant. Similarly, the economy of China slowed from an annualised growth of 4.9 percent in the third quarter of 2021 to 4 percent in the fourth quarter, mainly resulting from rising economic challenges including property market downturn, power shortages, supply chain bottlenecks and the outbreak of new variants of the COVID-19 virus in some regions. Meanwhile, the United Kingdom (UK)'s quarter-on-quarter output growth was constant at 1 percent between the third and fourth quarters of 2021, driven mostly by the rise in COVID-19 health mitigating measures, particularly the large increase in coronavirus testing and tracing activities, as well as the extension of the vaccination programme. However, there was a notable output expansion in the United States of America (US), registering an annualised gross domestic product (GDP) growth of 6.9 percent in the fourth quarter of 2021, from 2.3 percent in the third quarter, resulting from an increase in non-residential fixed investments and a rebound in residential fixed investment.

The global economic outlook for 2022 was revised downwards in the International Monetary Fund (IMF)'s April 2022 World Economic Outlook (WEO) report. Prospects for advanced economies are much weaker compared to the January 2022 projection, mostly reflecting downgrades in major economies, particularly Germany, Italy and the UK. The global economy is forecast to expand by 3.6 percent in 2022, from an estimated growth of 6.1 percent in 2021, largely due to the ongoing war in Ukraine and sanctions imposed on Russia and their spill over effects on the rest of the world. The invasion of Ukraine by Russia on February 24, 2022, and the consequent decision by major European countries and the US to impose sanctions on Russia, portend significant downside risks to global economic growth and, also, engender upward pressure on energy, food and other prices generally.

Global commodity prices increased in the first quarter of 2022, mainly due to the Russia-Ukraine war that started in February 2022, which has resulted in supply shortages and sanctions, given that Russia is the main player in the commodity export market. In particular, the global rough diamond price index increased due to the global diamond supply disruption, given that Alrosa, the world's largest producer of rough diamonds is based in Russia. Furthermore, Russia is the main exporter of crude oil and the largest natural gas exporter therefore, international oil prices also increased, averaging above USD95 per barrel in the first quarter of 2022. Similarly, the United Nations' Food and Agriculture Organisation (FAO) food price index increased during the same period, as a result of significant negative supply shock for the global economy due to the war, given that the two countries at war are the world's largest exporters of wheat and sunflower oil, respectively.

Domestically, headline inflation averaged 10.4 percent in the first quarter of 2022, higher than the 2.6 percent in the first quarter of 2021, mostly accounted for by the increases in domestic fuel prices and associated second-round effects. Inflation is forecast to remain above the Bank's 3 - 6 percent objective range in the near term, but is expected to fall from the second quarter of 2022 and to revert to within the objective range in the first quarter of 2023. Compared to the February 2022 forecast, inflation is projected to be higher in the forecast horizon, mainly reflecting the increase in domestic fuel prices effected in March 2022, the upward revision in forecasts for trading partner countries' inflation and international commodity prices, as well as a higher rate of depreciation of the Pula against the South African rand than previously projected.

Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistance of supply and logistical contraints due to lags in production; the economic and price effects of the ongoing Russia-Ukraine conflict; uncertain COVID-19 profile; domestic risk factors relating to regular annual price adjustments, short-term unintended consequences of import restrictions (shortages leading to price increases); as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, the likelihood of further increases in domestic fuel prices in response to persistent high international oil prices, and the possible increase in public service salaries could add upward pressure to inflation. These risks are, however, moderated by the possibility of weak domestic and global economic activity due to geo-political tensions and possible periodic lockdowns and other forms of restrictions in response to the emergence of new COVID-19 variants, with a likely further dampening effect on productivity. Lower international commodity prices than currently projected, could also result in lower inflation, as would capacity constraints in implementing the Economic Recovery and Transformation Plan (ERTP) initiatives.

Botswana's real GDP grew by 8.6 percent in the year to September 2021, compared to a contraction of 7.3 percent in the corresponding period in 2020, attributable to the expansion in production of both the mining and non-mining sectors. The increase in output resulted from an improved economic performance from a low base in the corresponding period in the previous year, emanating from the negative output effects of the COVID-19 pandemic containment measures. The prevailing accommodative monetary conditions, reforms to further improve the business environment, and government interventions against COVID-19, including vaccine rollout and implementation of the ERTP, should generally be positive for economic activity in the medium term. The domestic economy is forecast to expand by 4.3 percent in 2022, from a higher projected expansion of 9.7 percent in 2021.

The annual growth rate of commercial bank credit accelerated from 3.6 percent in February 2021 to 4.6 percent in February 2022, reflecting, in part, the increase in loan uptake by businesses (as the economy opened), as well as the recovery from the low base arising from the impact of COVID-19 pandemic in 2020.

At the end of December 2021, the official foreign exchange reserves amounted to P56 billion, an increase of 4.9 percent from P53.4 billion in December 2020. The increase was a result of the Special Drawing Rights (SDR) inflows of P3 billion paid to the Government by the IMF. The current account of the balance of payments (BoP) recorded a deficit of P3.6 billion in the fourth quarter of 2021, compared to a revised deficit of P3.2 billion in the corresponding period in 2020.

Following the annual exchange rate policy review in December 2021, an annual downward rate of crawl of 2.87 percent was maintained for 2022, with a view to enhancing domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. Consequently, the nominal effective exchange rate (NEER) of the Pula depreciated by 2.81 percent in the twelve months to March 2022. Against the basket currencies, the Pula depreciated by 5.4 percent against the South African rand and by 0.6 percent against the SDR in the twelve months to March 2022. In the year to February 2022, the REER appreciated by 1.6 percent, because of a higher positive inflation differential (4.6 percent) between Botswana and trading partner countries than the downward rate of crawl (2.8 percent).

3. RECENT ECONOMIC DEVELOPMENTS

3.1 Recent global economic developments

Global growth improved
According to the April 2022 WEO report, the global economy is estimated to have expanded by 6.1 percent in 2021, compared to a contraction of 3.1 percent in 2020 (Table 3.1). The improved global economic performance was on the backdrop of recovery in demand resulting from the easing of the COVID-19 pandemic containment measures and consequent opening of economies. This was made possible by the effective rollout of vaccination programmes in many countries (mainly advanced countries), notwithstanding uneven distribution and inequitable supply of vaccines adversely affecting developing countries. Nevertheless, all regions experienced positive growth in 2021. However, the pandemic took a negative turn in some parts of the world in 2021, with the emergence of new variants, notably Delta and Omicron. Meanwhile, speedy vaccine rollouts in some regions, particularly in advanced countries, helped to contain the spread of the virus, and boosted economic recovery.

The US economy expanded
The US output grew by an annualised 6.9 percent in the fourth quarter of 2021, compared to an expansion of 2.3 percent in the third quarter, and was the strongest GDP growth in five quarters. The expansion in output was mainly due to an increase in private inventory investment, which was led by motor vehicle dealers and wholesale trade industries. Acceleration in non-residential fixed investments as well as the increase in exports also contributed to the expansion in output, although at a lesser magnitude than initially estimated.

Euro area growth slowed
In the euro area, quarter-on-quarter GDP grew by 0.3 percent in the fourth quarter of 2021, from an estimated growth of 2.3 percent in the third quarter, the slowest growth in three quarters, as the Omicron COVID-19 variant spread across the European continent later in the year, and movement restrictions impacted negatively on the services sector and resulted in labour shortages. Among the bloc's largest economies, output in Spain, France and Italy expanded by 2 percent, 0.7 percent, 0.6 percent, respectively, while the German economy contracted by 0.3 percent.

UK growth unchanged
GDP in the UK expanded, quarter-on-quarter, by 1 percent in the fourth quarter of 2021, the same as in the third quarter, but slightly below the market expectation of 1.1 percent and remaining below pre-pandemic level. The expansion in output growth reflected the increase in both government and household spending, gross fixed capital formation, as well as exports. In addition, the increase in output was driven by a rise in COVID-19 health mitigating measures, particularly the large increase in coronavirus testing and tracing activities, as well as the extension of the vaccination programme.

Emerging markets' growth slowed
Output growth in emerging markets slowed down in the fourth quarter of 2021, primarily due to the rise in COVID-19 cases associated with the Omicron variant and containment measures. The lower growth for the economic group also reflects a slow pace of vaccination and the withdrawal of monetary and fiscal support, as well as deteriorating economic conditions in few large emerging economies, particularly China.

China's economy slowed from an annualised growth of 4.9 percent in the third quarter of 2021 to 4 percent in the fourth quarter. The slowdown in output growth was a result of rising economic challenges including property downturn, power shortages, supply chain bottlenecks and the outbreak of new variants of the COVID-19 virus in some regions.

In India, GDP grew, year-on-year, by 5.4 percent in the fourth quarter of 2021, easing from a growth of 8.5 percent in the third quarter and was below market expectations of 6 percent. The expansion in the fourth quarter was driven by the festive season boost to consumer demand, policy support and a rapid fall in COVID-19 cases. By sectors, the expansion was mainly driven by growth in services sectors (notably, trade, hotels, transport and communication and financial, real estate and professional services), as well as mining, agriculture and construction sectors.

South African economy expands

Regionally, output in South Africa expanded, quarter-on-quarter, by 1.2 percent in the fourth quarter of 2021, from an upwardly revised contraction of 1.7 percent in the third quarter.[1] The contributors to growth in the fourth quarter were agriculture, trade, manufacturing and personal services sectors, which expanded by 12.2 percent, 2.9 percent, 2.8 percent and 2.7 percent, respectively.

Table 3.1: Growth Estimates and Projections

	Estimate		Projection	
	2020	2021	2022	2023
Global	**-3.1**	**6.1**	**3.6**	**3.6**
Advanced economies	**-4.5**	**5.2**	**3.3**	**2.4**
USA	-3.4	5.7	3.7	2.3
Euro area	-6.4	5.3	2.8	2.3
UK	-9.3	7.4	3.7	1.2
Japan	-4.5	1.6	2.4	2.3
EMDEs	**-2.0**	**6.8**	**3.8**	**4.4**
China	2.2	8.1	4.4	5.1
Brazil	-3.9	4.6	0.8	1.4
India	-6.6	8.9	8.2	6.9
Russia	-2.7	4.7	-8.5	-2.3
South Africa	-6.4	4.9	1.9	1.4
Botswana	**-8.7**	**12.5 (9.7)**	**4.3 (4.3)**	**4.2 (4.2)**

Source: IMF WEO April 2022 and MoF for Botswana.
Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts from the MoF.

Global commodity prices

Diamond prices increased in the first quarter of 2022

The global rough diamond price index increased by 8.8 percent from 177.26 points in the fourth quarter of 2021 to 192.78 points in the first quarter of 2022, due to global diamond supply disruption caused by the Russia-Ukraine war, given that Alrosa, the world's largest producer of rough diamonds is based in Russia. Moreover, most countries continued to ease COVID-19 restrictions and rolled out effective vaccines, thus, improving manufacturers' demand and trade for rough diamonds. Meanwhile, the global rough diamond price index averaged 198.83 points in March 2022.

The global polished diamond price index[2] also increased by 8.8 percent from 212.9 points in the fourth quarter of 2021 to 224.87 points in the first quarter of 2022, amidst shortage of supply to India, the world's largest diamond cutting and polishing hub. In March 2022, the global polished diamond price index averaged 224.87 points.

Oil prices increased in the first quarter of 2022

International oil prices averaged above USD95 per barrel in the first quarter of 2022 (Chart 3.1). The price of OPEC's reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 24.3 percent, 25.3 percent and 23 percent, from an average of USD78.84 per barrel, USD 79.43 per barrel and USD77.31 per barrel in the fourth quarter of 2021 to an average of USD 97.96 per barrel, USD 99.55 per barrel and USD 95.09 per barrel, respectively, in the first quarter of 2022. International oil prices increased, in part, buoyed by the Russia-Ukraine conflict that started in February 2022, which has resulted in supply shortages and sanctions, given that Russia is the world's second largest exporter of crude oil and the largest natural gas exporter. Furthermore, the increase in oil prices was supported by the recovery in global demand, following the relaxation of some COVID-19 containment measures and effective rollout of vaccination programmes, especially in advanced economies. In addition, failure of some OPEC members, such as Nigeria, Angola and Libya to increase monthly output targets,[3] as agreed earlier to counteract high prices, also led to tight market supply and boosted oil prices in the fourth quarter of 2021. Moreover, higher oil prices resulted from continued drawdown of oil inventories, as well as global shortages of natural gas and coal that increased energy supply concerns, thus, increasing the demand for oil as a substitute.

The international oil prices also increased, month-on-month, in March 2022. The OPEC reference crude oil basket increased by 21.1 percent to an average of USD113.74 per barrel, while Brent crude and WTI prices increased by 20.8 percent and 18.7 percent to an average of USD115.64 per barrel and USD108.86 per barrel, respectively. The increase in oil prices was, in part, buoyed by

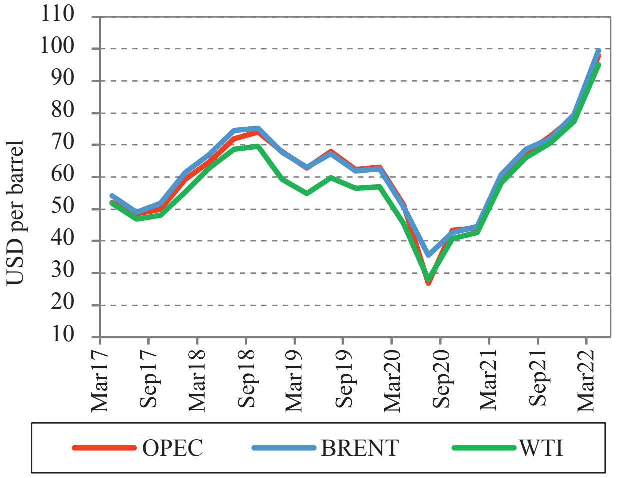
1 Statistics South Africa's (Stats SA) first GDP release after the completion of its benchmarking and rebasing exercise was in August 2021. Stats SA no longer uses the quarterly annualised rate as the headline growth rate.

2 The Antwerp Diamond Index, which is based on prices in US dollars, and gives the average price evolution of polished diamonds in the Antwerp markets.

3 OPEC and its allies agreed to increase production by 400 000 barrels per day each month starting August 2021.

the intensifying Russia-Ukraine conflict, continued energy supply concerns, drawdown of oil inventories, as well as underperformance by OPEC and its allies in meeting its output targets exerted pressure on oil prices in March 2022.

Chart 3.1: Oil Prices



Source: Bloomberg

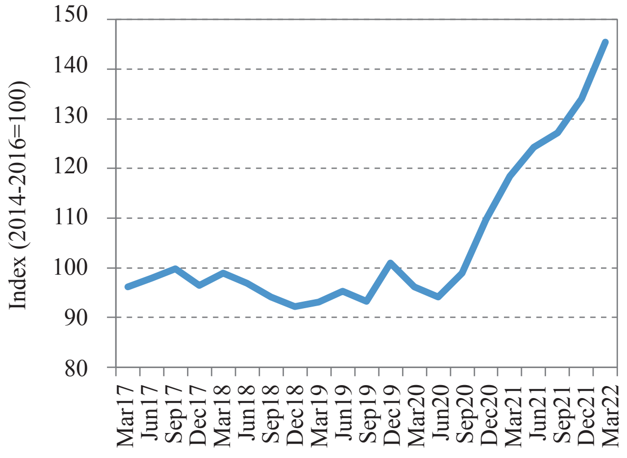
Food prices increased in the first quarter of 2022

According to FAO, the global food price index averaged 145.44 points in the first quarter of 2022, a 8.5. percent increase from an average of 134.08 points in the fourth quarter of 2021 (Chart 3.2). The increase was attributable to higher vegetable oils, cereals and dairy prices.[4] Higher food prices were a result of significant negative supply shock for the rest of the world economy, due to the Russia-Ukraine conflict given that the two economies are the world's largest exporters of wheat and sunflower oil, respectively. Furthermore, the increase in food prices was a result of improvement in global demand as countries continued to deploy effective COVID-19 vaccines, as well as tightening of global supply associated with COVID-19 related labour and inputs shortages.

The food price index averaged 159.3 points in March 2022, an increase of 12.6 percent from February, and 33.6 percent higher than in the corresponding period last year. The March increase was the highest level to be reached since the inception of the FAO index in 1990.

4 The increase in the price of vegetable oil was mainly due to subdued production by major producers, such as Malaysia and Indonesia, resulting from migrant labour shortages, as well as recovery in demand for global imports. Prices of cereals also rose because of persistent drought conditions in Argentina, Brazil and some parts of the US. Meanwhile, the increase in dairy prices was underpinned by tightening global supply, reflecting a reduction in exports, associated with COVID-19 related labour shortages.

Chart 3.2: Food Price Index

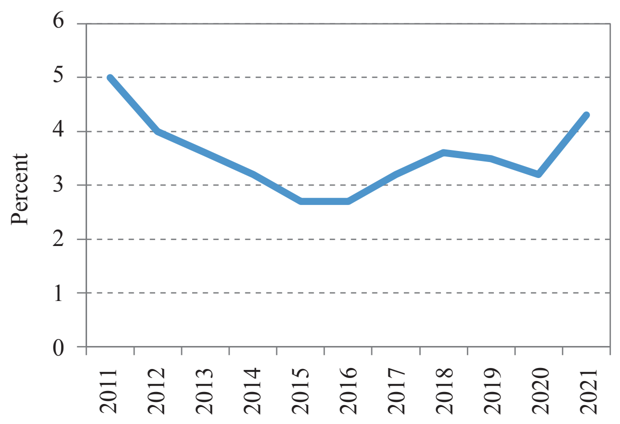


Source: Food and Agriculture Organisation

Inflation rose across the regions

Inflation increased, globally, in the first quarter of 2022, ignited by the increase in commodity prices amid the Russia-Ukraine conflict, as well as improving global economic demand as most economies eased movement restrictions and deployed effective COVID-19 vaccines. Moreover, bottlenecks in global supply chains also contributed to the increase in inflation. For advanced economies, inflation increased from 5.5 percent in the fourth quarter of 2021 to 8.1 percent in the first quarter of 2022, consistent with faster rates of deployment of vaccines, which led to further relaxation of containment measures and boosted economic activity. Meanwhile, inflation decreased slightly from 3.6 percent to 3.5 percent in emerging market economies in the same period. Global inflation increased from 3.2 percent in 2020 to 4.3 percent in 2021 (Chart 3.3).[5]

Chart 3.3: Global Inflation



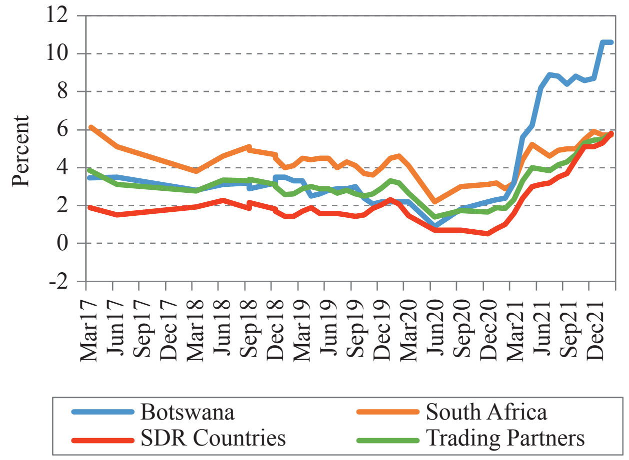
Source: IMF October 2021 WEO

5 The quarterly inflation estimates are sourced from Bloomberg.

In South Africa, headline inflation increased from 4.8 percent in the third quarter of 2021 to 5.5 percent in the fourth quarter. However, inflation was constant at 5.7 percent between January and February 2022, remaining closer to the upper bound of the South African Reserve Bank (SARB)'s target range of 3 – 6 percent.

The average trade-weighted inflation for Botswana's trading partners increased from 5.5 percent in January 2022 to 5.8 percent in February 2022 (Chart 3.4).

Chart 3.4: Botswana Inflation and International Inflation



Source: Statistics Botswana, Bank of Botswana, Statistics South Africa and Bloomberg

Monetary policy stance normalising across the globe

In the most recent policy decisions in advanced economies (Table 3.2), the European Central Bank (ECB) maintained the deposit rate, refinancing rate and lending rate at -0.50 percent, zero and 0.25 percent, respectively, in March 2022 to support the Eurozone economy. The ECB reiterated that it would end its pandemic assets purchase programme in March 2022. However, the ECB revised its monthly net asset purchases, increasing asset purchases for the second quarter from €40 billion to €90 billon, to cushion the economy against uncertainty associated with the Russia-Ukraine conflict.

At the March 2022 meeting, the US Federal Open Market Committee (FOMC) increased the target policy rate range by 25 basis points to 0.25 - 0.50 percent, as indicators of economic activity and employment showed further improvement, and inflation remained elevated. The FOMC indicated that it will hike the target rate further at the next meeting, as well as reduce its holdings of treasury securities, agency debt and mortgage backed securities at future meetings.

The Bank of England (BoE) increased the Bank Rate by 25 basis points to 0.75 percent in March 2022, the third consecutive hike since the onset of the COVID-19 pandemic, to combat elevated inflationary pressures. The BoE's MPC also announced that it would start to reduce the stock of UK government bond purchases, financed by the issuance of the BoE reserves, by ceasing to reinvest in maturing assets. The Committee expects inflation to increase further in the next few months, and thus, signaled that further tightening would be appropriate if the economy grows in line with current projections.

The Bank of Japan (BoJ) kept the key short-term interest rate unchanged at -0.1 percent and maintained the long-term government bond yield at around zero at the March 2022 meeting. In addition, the BoJ agreed to continue purchasing exchange-traded funds (ETFs) and Japan real estate investment trusts (JREITs) until the amounts outstanding increased to approximately 12 trillion yen and 180 billion yen, respectively. The BoJ maintained that, until the end of March 2022, it would conduct additional purchases with an upper limit on the amount outstanding of these assets of approximately 20 trillion yen in total. Thereafter, the bank will conduct purchases at the pace of 5 trillion yen per month, thus returning to pre-pandemic asset purchase levels.

In emerging market economies, the Central Bank of Brazil increased the policy rate by 100 basis points to 11.75 percent in March 2022, the ninth consecutive interest rate hike, amid uncertainty about economic growth and rising inflationary pressures. In addition, the Central Bank of Brazil announced that it would raise the policy rate by a similar magnitude at its next meeting. Meanwhile, the Central Bank of Russia (CBoR) reduced the key rate by 300 basis points to 17 percent at an unscheduled meeting on April 8, 2022, reflecting a change in the balance of risks of accelerated consumer price growth, decline in economic activity and financial stability risks. The CBoR had increased the policy rate by 1150 basis points in February 2022, the highest increase in almost twenty years, to offset the increased risk of currency depreciation and high inflation amid

Western sanctions in retaliation against the invasion of Ukraine.

Similarly, the People's Bank of China (PBoC) maintained the one-year Loan Prime Rate (LPR) at 3.7 percent in April 2022, following cuts of 5 and 10 basis points in December 2021 and January 2022, respectively, to support economic activity. The PBoC affirmed its commitment to remain accommodative and increase support for key sectors in the economy, amid volatile internal and external conditions that would require more counter-cyclical policy adjustment.

The SARB increased the repo rate by 25 basis points to 4.25 percent in March 2022, the third consecutive hike, due to forecast higher inflation risks associated with higher global commodity prices, resulting from the Russia-Ukraine conflict. The SARB considered risks to the medium-term domestic growth outlook to be balanced, while risks to the short-term inflation outlook were assessed to be on the upside. The SARB expected higher inflation in 2022, before moderating in 2023. Given the expected trajectory for headline inflation and upside risks, the SARB's Monetary Policy Committee indicated that the gradual rise in the repo rate would be sufficient to keep inflation expectations well anchored and moderate the future path of interest rates.

In February 2022, the Reserve Bank of India (RBI) maintained the policy rate at 4 percent and the reverse repo rate at 3.35 percent, to support economic recovery and help mitigate the negative impact of the COVID-19 pandemic, while also ensuring that inflation remains within the target. The RBI also maintained its projection for headline inflation for the year 2021/22 at an average of 5.3 percent, amid the easing of food prices, combined with favourable base effects, but downgraded the projection for the year 2022/23 from 5.2 percent to 4.5 percent.

Table 3.2: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting
Bank of Botswana	April 2022	1.65	Increased by 51 basis points
SARB	March 2022	4.25	Increased by 25 basis points
US Federal Reserve	March 2022	0.25 – 0.50	Increased by 25 basis points
BoE	March 2022	0.75	Increased by 25 basis points
ECB	March 2022	0.00	No change
BoJ	March 2022	-0.10	No change
PBoC	April 2022	3.70	No change
Brazil	March 2022	11.75	Increased by 100 basis points
India	February 2022	4.00	No change
Russia	April 2022	17.00	Decreased by 300 basis points

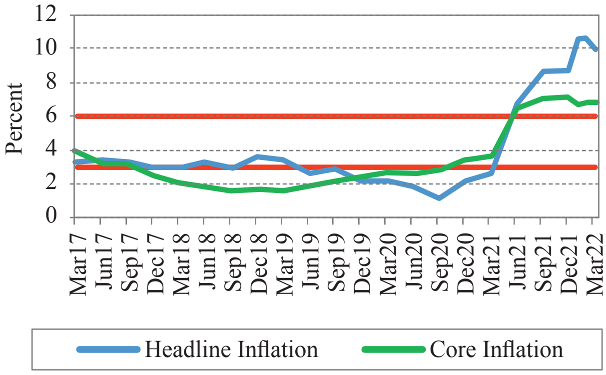
Source: Various central banks' websites.

3.2 Domestic inflation environment

Headline inflation increased in the first quarter of 2022

Headline inflation averaged 10.4 percent in the first quarter of 2022, from 2.6 percent in the first quarter of 2021 (Charts 3.5 and Table 3.3), accounted for by the increases in domestic fuel prices and associated second-round effects. Headline inflation decreased from 10.6 percent in February 2022 to 10 percent in March, remaining above the Bank's medium-term objective range of 3 – 6 percent, and was higher than the 3.2 percent in March 2021. The decline in inflation between February and March 2022 mainly reflects the base effects associated with the increase in domestic fuel prices in the corresponding period last year, which added approximately 0.68 percentage points to headline inflation.

Chart 3.5: Botswana Headline and Core Inflation

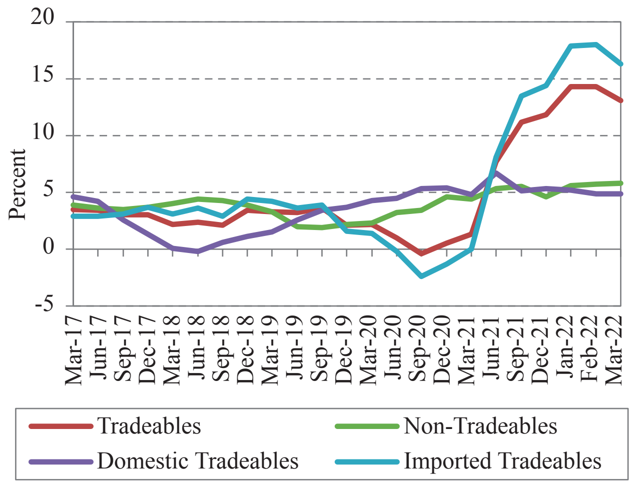


Source: Statistics Botswana and Bank of Botswana
Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic tradeables and imported tradeables increased in the first quarter of 2022

Inflation for domestic tradeables increased from an average of 4.8 percent in the first quarter of 2021 to an average of 5 percent in the first quarter of 2022 (Charts 3.6 and 3.7), largely due to an increase in prices of some food items. Similarly, imported tradeables inflation increased significantly from an average of 0.1 percent to an average of 17.4 percent in the same period, mainly due to the upward adjustment in domestic fuel prices. As a result, all tradeables inflation increased from an average of 1.3 percent in the first quarter of 2021 to an average of 13.9 percent in the first quarter in 2022, while inflation for non-tradeables also increased from an average of 4.4 percent to 5.7 percent in the same period. In March 2022, domestic tradeables, imported tradeables, non-tradeables and all tradeables inflation were 4.9 percent, 16.3 percent, 5.8 percent and 13.1 percent, respectively.

Chart 3.6: Inflation for Tradeables and Non-Tradeables



Source: Statistics Botswana

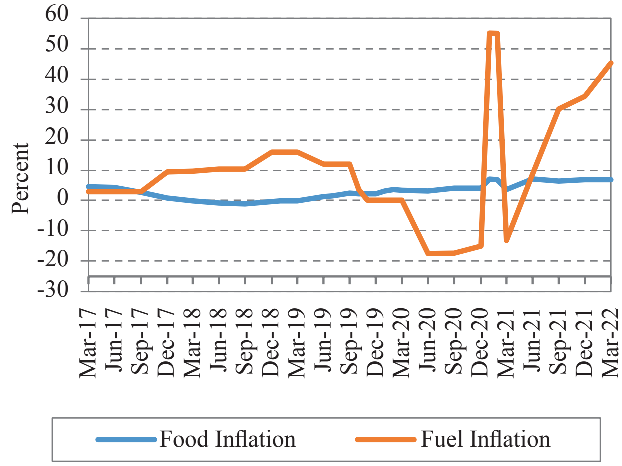
Generally, there has been an upward trend in non-tradeables inflation since June 2019 and domestic tradeables inflation from June 2018, mainly due to the increase in prices for administered items and food, respectively. The increase in food prices was partly a result of bad weather conditions experienced in the 2018/19 ploughing season, and economic disruptions occasioned by COVID-19 in 2020.

Accordingly, therefore, upward trends in non-tradeables and domestic tradeables inflation are not a result of domestic demand pressures, as the output gap is estimated to be negative (Section 4.2 refers).

Core inflation measures increased in the first quarter of 2022

The trimmed mean inflation (CPITM) increased to 8.7 percent in the first quarter of 2022, from 2.5 percent in the first quarter of 2021, while inflation excluding administered prices (CPIXA) averaged 6.8 percent, compared to 3.6 percent in the same period due to the increase in prices for food and non-alcoholic beverages (Table 3.3). Similarly, inflation excluding food and fuel (CPIXFF) averaged 6.5 percent in the first quarter of 2022, higher than the 4.4 percent recorded in the corresponding quarter in 2021, mainly because of the increase in value added tax (VAT) and administered prices. In March 2022, CPITM, CPIXA and CPIXFF were 8.6 percent, 6.8 percent and 6.3 percent, respectively.

Chart 3.7: Food and Fuel Inflation



Source: Statistics Botswana and Bank of Botswana

Table 3.3: Annual Price Changes for Categories of Goods and Services (Percent)

Category of commodities	Basket Weights	March 2022	Q1 2022	Q1 2021
Food and non-alcoholic beverages	13.6	6.9	6.9	3.7
Alcoholic beverages and tobacco	4.3	9.3	9.5	6.7
Clothing and footwear	6.0	4.0	4.0	2.8
Housing, water, electricity, gas and other fuels	17.5	8.0	8.0	7.1
Furnishing, h/h equipment and routine maintenance	4.9	5.0	5.2	2.0
Health	3.4	2.6	2.6	2.2
Transport	23.4	23.8	25.8	-0.6
Communications	6.9	1.4	1.3	0.8
Recreation and culture	2.8	3.9	3.7	1.6
Education	4.6	2.4	2.3	1.7
Restaurants and hotels	3.7	4.6	4.8	1.6
Miscellaneous goods and services	9.0	8.1	7.9	1.3
Annual Inflation (All items)	**100.0**	**10.0**	**10.4**	**2.6**
CPITM		8.6	8.7	2.5
CPIXA		6.8	6.8	3.6
CPIXFF		6.3	6.5	4.4

Source: Statistics Botswana and Bank of Botswana calculations

3.3 Recent domestic economic developments

In July 2021, Statistics Botswana published rebased national accounts from 2006 prices to the new base year 2016 (Box 1).

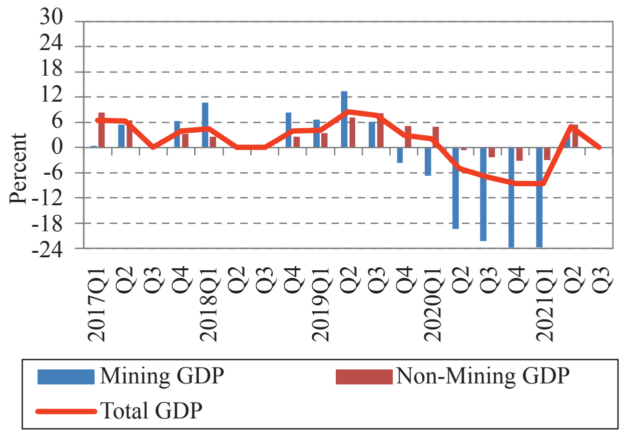
GDP expanded in the third quarter of 2021

Real GDP grew by 8.6 percent in the twelve months to September 2021, compared to a contraction of 7.3 percent in the year to September 2020 (Chart 3.8). The increase in output was attributable to the expansion in production of both the mining and non-mining sectors. This resulted from an improved economic performance from a low base in the corresponding period in the previous year, emanating from the negative output effects of the COVID-19 pandemic containment measures. Mining output increased by 15.6 percent in the year ending September 2021, compared to a contraction of 22.2 percent recorded in the corresponding period ending September 2020. This was largely due to a 16.3 percent increase in diamond mining output, compared to a significant contraction of 22.6 percent in the year to September 2020. Rough diamond demand is gradually gaining traction after the COVID-19 travel restrictions, which impeded the sight-holder calendar. All other mining subsectors also recorded an increase in output except mining of gold and other metal ores, which recorded a lower contraction of 10.1 percent, from a higher contraction of 19.5 percent in September 2020.

Non-mining GDP grew by 6.9 percent in the year to September 2021, compared to a decrease of 2.8 percent in the corresponding period last year. The increase in non-mining GDP was mainly due to expansion in output of most sectors, including: Construction; Water and Electricity; Manufacturing; Diamond Traders; Transport and Storage; Wholesale and Retail; Real Estate Activities; Professional, Scientific and Technical Activities; Information and Communication Technology; Finance and Insurance and Pension Funding Public Administrative; Defence; Human Health and Social Work; and Other Services sectors.

Meanwhile, Statistics Botswana reported a 8.4 percent increase in real GDP in the third quarter of 2021[6] from a contraction of 4 percent in the third quarter of 2020.

Chart 3.8: GDP Growth Rates



Source: Statistics Botswana
Note: Growth rates are reported on a rolling 12-month basis.

6 Calculated as the current quarter over the corresponding quarter in the previous year.

In terms of GDP by expenditure, government final consumption increased by 4.6 percent in the year to September 2021, compared to 5.6 percent in the corresponding period in 2020 (Table 3.4). This was attributable to an acceleration in growth of collective consumption[7] from 5 percent to 5.4 percent, while individual consumption[8] decelerated from 7.5 percent growth in 2020 to 1.8 percent growth in the review period. Meanwhile, household final consumption grew by 3.3 percent, compared to a growth of 2 percent registered in the previous period. The expansion in household final consumption was mainly due to an increase in both household consumption expenditure and expenditure by non-profit institutions serving households.

Gross fixed capital formation (GFCF) grew marginally by 0.3 percent in the year to September 2021, compared to a decline of 7 percent in the corresponding period in the previous year. The increase in GFCF was due to the expansion in investment in buildings and structures subsector (2.4 percent from a contraction of 9.6 percent).

Table 3.4: Real GDP Growth by Sector and Expenditure (Percent)

	2020Q3	2021Q2	2021Q3
Total GDP	-7.3	*5.2* (4.9)	8.6
By Sector:			
Mining & Quarrying	-22.2	3.0	15.6
Non-Mining	-2.8	*5.7* (5.4)	6.9
Agriculture, Forestry & Fishing	-2.3	*-3.8* (-3.2)	-4.9
Manufacturing	-15.0	*-1.5* (-1.8)	5.1
Water and Electricity	-4.3	*21*(15.6)	12.8
Construction	-8.7	*0.5* (0.7)	3.8
Wholesale & Retail	2.2	13.1	14.5
Diamond Traders	-37.3	*58.9* (59.1)	71.8
Transport and Storage	-5.0	3.1	4.7
Accommodation & Food Services	-23.0	-19.2	-8.7
Information & Communication Technology	1.9	*4.6* (7.1)	5.1
Finance, Insurance & Pension Funding	0.7	5.1	4.0
Real Estate Activities	-1.6	4.8	7.0
Professional, Scientific & Technical ActivitieS	-1.4	6.1	6.8
Administrative & Support ActivitieS	-5.7	2.6	6.4
Public Administration & Defence	7.8	*8.3* (6.9)	6.0
Education	0.5	0.4	1.3
Human Health & social work	3.9	4.6	5.3
Other services	-4.3	0.9	2.8
By Type of Expenditure:			
Government Final Consumption	5.6	*7.2* (4.6)	4.6
Household Final Consumption	2.0	*6.1* (2.1)	3.3
Gross Fixed Capital Formation	-7.0	*-2.2* (-0.7)	0.3
Exports of Goods and Services	-20.2	*53.6* (53.4)	36.7
Imports of Goods and Services	4.2	*28.1* (28.2)	10.4

Note: The figures in italics are revisions of the figures in brackets, previously reported in the Q4 estimates.
Source: Statistics Botswana and Bank of Botswana Calculations.

7 The collective consumption expenditure of general government covers the sovereign functions (or governing functions or general administrative functions) of government bodies, such as the justice system, defence and police.

8 The actual and imputed final consumption expenditure incurred by households on individual goods and services.

Box 1: Rebasing and Revision of GDP

Rebasing of GDP is the process of replacing an old base year with a more recent base year in line with the evolution of prices. Constant price estimates are then recalculated in terms of the prices of the new base year and provides a reference point to which future values of GDP are then compared. In July 2021, Statistics Botswana published rebased estimates of GDP at current and constant prices. The objective of rebasing Botswana's GDP was to take into account changes that occurred in the economy since the last rebasing exercise in 2012. The rebasing exercise presents an opportunity to incorporate new statistical methods outlined in the 2008 System of National Accounts (SNA) using the Supply and Use Tables (SUT) as the framework. It enables the GDP series to reflect a more accurate picture of the size and structure of the economy. The relevance of the GDP series is, therefore, enhanced and made more internationally comparable with other jurisdictions. The rebasing also took care of tax harmonisation with the Southern African Customs Union (SACU) regional agreements on tax collections. The 2016 base year series features 18 industry groupings versus the previous 10 industry groupings. The rebased GDP provides a better understanding of which industries are driving growth.

Changes in the Rebased Series

The nominal value of GDP in the benchmark year (2016) was revised downwards by an amount of P6.2 billion, or 3.6 percent, due to the P8.2 billion or 51.5 percent decline in taxes on products in the revised estimates, compared to the previous figures. Consequently, contributions of various sub-industries to total Gross Value Added (GVA) changed in the period 2006 to 2016. It is important to note that the GVA obtained from the GDP series based on the 2016 base year is not strictly comparable with the previously published data for GVA at current prices. This is mainly because of changes in the methodology and use of improved data sources within industries. In addition, revised estimates, particularly for Public Administration and Defence, Diamond Traders and Electricity, as well as the implementation of the latest version of the International Standard Industrial Classification (ISIC) revision 4 were mainly responsible for the changes in the composition of sub industries. As a result of these developments, the weights used to extrapolate the base-year estimates of GVA at current and constant prices in 2016 differ from the weights that were used in the 2006 base year.

Diamond production increased in the first quarter of 2022

Debswana produced 6.2 million carats of diamonds in the first quarter of 2022, 24.7 percent higher than the 5 million carats produced in the corresponding period in 2021. The significant increase in production was mainly due to increased planned production to meet stronger demand for rough diamonds in 2022. Demand for rough diamonds continued to be robust, with positive midstream sentiment, reflecting strong demand for polished diamond jewellery, particularly in the key markets of the US and China. However, as the seasonally slower second quarter of the year approaches, diamond businesses are adopting a more cautious approach in light of the war in Ukraine and associated sanctions, as well as the impact of COVID-19 lockdowns in China. Looking ahead, Debswana's production target for 2022 has been set at 23.6 million carats, while production guidance for the larger De Beers Group is at 30-33 million carats.

Production by Lucara Diamond Corporation (Karowe Mine) increased by 2.1 percent, from 373 748 carats produced in 2020 to 381 681 carats in 2021. The increase was attributable to the relatively strong and stable global diamond market in 2021. With respect to quarterly performance, production for the fourth quarter of 2021 decreased by 7 percent, to 90 634 carats, from 97 412 carats in the third quarter of 2021.

Budget deficit recorded in the third quarter of the 2021/22 fiscal year

Government budget was in a deficit of P0.5 billion in the third quarter of the 2021/22 fiscal year (Table 3.5). The deficit was mainly due to the lower SACU revenue than envisaged in the revised budget. Regarding other major revenue streams, domestic taxes (VAT and Non-Mineral Income Tax) surpassed the projected tax collections in the revised budget, mainly due to the increase in VAT from 12 percent to 14 percent and the introduction of other levies in the first quarter of the fiscal year.

Total government expenditure and net lending was P16.6 billion, lower than the P18.4 billion anticipated in the revised budget.

For the 2020/21 fiscal year (April 2020 - March 2021), the final budget outturn was a deficit of P16.4 billion, lower than the revised budget deficit of P21 billion, reflecting the upward revision of revenue and grants from P48.3 billion to P49.4 billion. Total public expenditure amounted to P65.8 billion, which is P3.6 billion lower than the revised budget (or 95 percent of the revised budget estimate, and same proportion to that of the 2019/20 fiscal year). Going forward, the overall budget outcome is expected to improve further, with the deficit declining to P10.2 billion or 5.1 percent of GDP in the 2021/2022 fiscal year. Total revenue and grants, and total expenditure are projected to increase to P63.4 billion and P74 billion, respectively in the 2021/22 fiscal year.

Table 3.5: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2020/21 Q1	12 391	14 303	-1 912
2020/21 Q2	9 887	17 636	-7 748
2020/21 Q3	11 822	18 199	-6 377
2020/21 Q4	15 275	15 703	-428
2021/22 Q1	17 328	17 700	-372
2021/22 Q3	16 178	16 644	-466

Source: Cash Flow Unit, Ministry of Finance

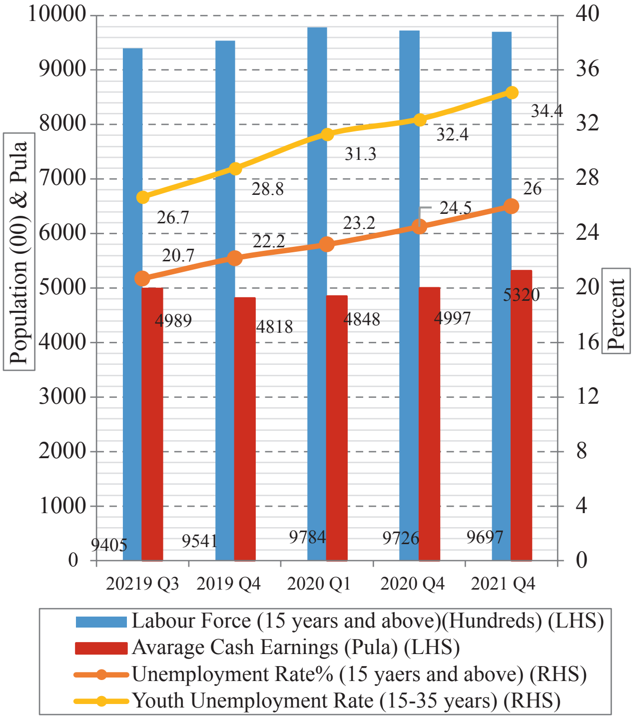
Labour Force and Wage Developments Trends[9]

According to the Quarterly Multi-Topic Survey (QMTS) Report for the fourth quarter of 2021, the unemployment rate was 26 percent in the fourth quarter of 2021 compared to 24.5 percent in the corresponding period in 2020 (youth unemployment rate rose to 34.4 percent from 32.4 percent) (Chart 3.9). The survey also indicates that formal sector employment increased by 3.5 percent to 494 457, from 477 716 in the review period. Regarding other indicators, the survey showed that the Government continued to be the single largest employer, with employment in public administration constituting 22.9 percent of total formal sector employment. In this regard, personal emoluments constitute the largest share in the government recurrent budget, consistently averaging more than 40 percent and about 10 percent of GDP. Meanwhile, formal sector average earnings per month were estimated at P6 219 for citizens, P9 275 for non-citizens and P6 299 for all employees in the fourth quarter of 2021. The average monthly earnings for all employees are estimated to have increased by 4.7 percent or P285 from P6 014 estimated for the fourth quarter of 2020.

A longer-term trend analysis of the QMTS data since the third quarter of 2019 indicates that the total labour force (15 years and above) increased by 3 percent to 969 734 persons in the fourth quarter of 2021 from 940 546 persons in the third quarter of 2019. Over the same period, the unemployed population rose by 29.4 percent, while the employed labour force declined by 3.8 percent. The overall unemployment rate is estimated at 26 percent in the fourth quarter of 2021, compared to 20.7 percent recorded in the third quarter of 2019. Youth labour force (15-35 years) increased by 1.1 percent, to 486 706 persons in the fourth quarter of 2021 from 481 441 persons in the third quarter of 2019. The youth unemployment rate, which continues to be a national concern, rose to 34.4 percent in the fourth quarter of 2021, compared to 26.7 percent in the third quarter of 2019. The advent of the COVID-19 pandemic has impacted the labour force in both negative and positive ways (some people lost, while others gained employment). The total number of persons who lost jobs or businesses due to COVID-19 stood at 64 347 in the fourth quarter of 2021. On the contrary, 17 770 persons gained employment during the COVID-19 period. Meanwhile, average earnings for all employees increased by P331 from the P4 989 estimated for the third quarter of 2019.

9 The QMTS is conducted by Statistics Botswana. Since its inception in the third quarter of 2019, Statistics Botswana published the first QMTS (July-September 2019) Report in January 2020. This was followed by reports for the fourth quarter of 2019, first and fourth quarters of 2020 and the fourth quarter of 2021. However, the conduct of the rest of the quarterly surveys for 2020 and 2021 was hampered by the outbreak of COVID-19 and subsequent movement restrictions to contain the pandemic, resulting in data gaps.

Chart 3.9: Trends in Selected Labour Force Indicators



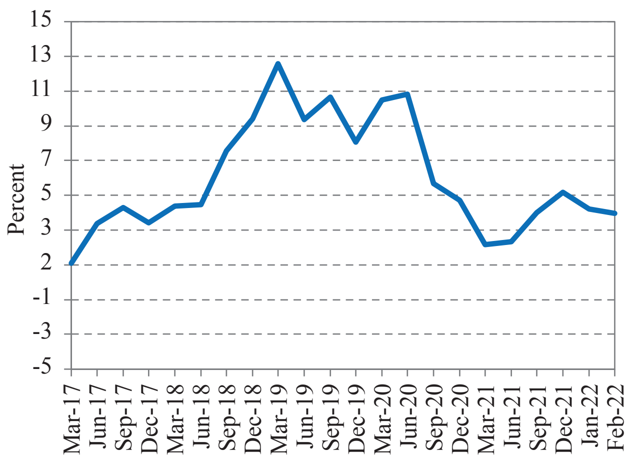
Source: Statistics Botswana

3.4 Monetary developments

Banking sector assets decelerated in February 2022

Annual banking sector assets decelerated from 4.8 percent in February 2021 to 4 percent in February 2022 (Chart 3.10). This was mainly due to the decrease in holdings of BoBCs and balances at Bank of Botswana (in particular, reserve requirements and reverse repos). Meanwhile, loans and advances, which accounted for the largest proportion of commercial banks' assets (63.3 percent), T-Bills, as well as balances due from foreign banks, increased in February 2022.

Chart 3.10: Year-on-Year Commercial Banks' Growth in Total Assets



Source: Commercial Banks

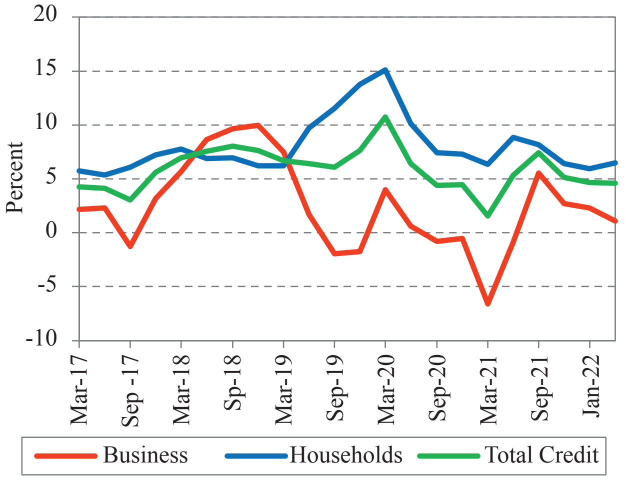
Credit growth accelerated in the year to February 2022

Annual commercial bank credit increased from 3.6 percent in February 2021 to 4.6 percent in the twelve-month period to February 2022 (Chart 3.11). The increase in commercial bank credit growth was, in part, indicative of the increase in loan uptake by businesses as the economy opened up, as well as the recovery from the low base arising from the impact of COVID-19 pandemic in 2020.

Household loans increased by 6.5 percent in the year to February 2022, from 6.1 percent in February 2021. The higher growth in household credit was mainly attributable to the increase in growth of property, personal unsecured lending, and credit card loans. There was, however, a decrease in motor vehicle loans in the year to February 2022. The share of the household sector in total lending by commercial banks increased to 66.4 percent in February 2022, from 65.2 percent in February 2021.

Lending to the business sector increased by 1.1 percent in the year to February 2022, compared to a contraction of 0.7 percent in the corresponding period in 2021. Credit to businesses excluding parastatals also increased by 4.5 percent in the year to February 2022, compared to an annual contraction of 2.3 percent in February 2021. The increase in credit to businesses excluding parastatals was mainly due to utilisation of loan and overdraft facilities by some companies in the manufacturing, agriculture, finance, real estate and business services industries, as economic activity increased, following the end of the State of Public Emergency in September 2021. However, credit to parastatals decreased by 32.4 percent in the year to February 2022, compared to the 18.1 percent expansion in the corresponding period to February 2021, due to repayment of overdraft facilities.

Chart 3.11: Year-on-Year Commercial Banks' Growth in Total Credit

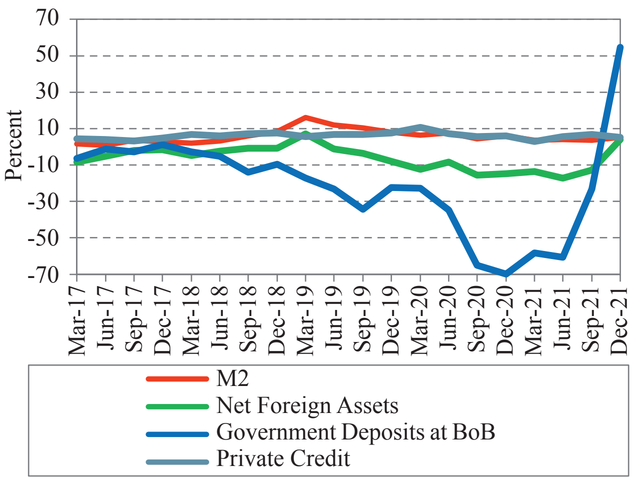


Source: Commercial Banks

Money supply decelerated in December 2021

Money supply (M2) grew by 5 percent in December 2021, slightly lower than the 5.9 percent in the corresponding period in 2020 (Chart 3.12). The relatively low growth in money supply was because of the increase in net foreign assets and the acceleration in government deposits at the Bank of Botswana. In addition, there was a slight decrease in growth of credit to the private and parastatals sectors.

Chart 3.12: Year-on-Year Growth in Money Supply



Source: Other Depository Corporations and Bank of Botswana

The 7-day BoBC stop-out yield increased in the first quarter of 2022

The 7-day BoBC stop-out yield increased from an average of 1.04 percent in the first quarter of 2021 to an average of 1.12 percent in the corresponding period in 2022. Meanwhile, the real rate of interest decreased from an average of -1.55 percent in the first quarter of 2021 to an average of -8.75 percent in the fourth quarter of 2021, reflecting the increase in the inflation rate.

The stop-out yield for the 7-day BoBC increased from 1.11 percent in February 2022 to 1.13 percent in March. Meanwhile, the real rate of interest for the 7-day BoBC decreased from -8.58 percent to -9.09 percent between February and March 2022, reflecting the increase in the inflation rate.

The Bank continues to evaluate its monetary policy implementation framework on a regular basis for effectiveness, with a view to introducing refinements where necessary. In this respect, the Bank introduced further improvements and changes to monetary policy effective April 28, 2022 (Box 2).

S&P Global Ratings affirms Botswana's credit rating and revised economic outlook from negative to stable

In September 2021, S&P Global Ratings (S&P) affirmed Botswana's sovereign credit rating for long-term foreign and domestic currency bonds at "BBB+", and "A-2" for short-term foreign and domestic currency bonds. S&P indicated that the affirmation of the ratings was underpinned by strong, stable and predictable institutional frameworks; modest net general government debt levels; relatively strong net external position; and the positive impact of the monetary policy framework, all of which contribute to sound macroeconomic stability. However, the economic outlook was revised from negative to stable on account of the anticipated rebound in Botswana's economic growth, partially driven by recovery in the diamond market, which in turn would result in substantial improvement in the domestic fiscal and external sectors' performance over the next two years. The economic outlook could be revised further upwards if the country's public budget performance improved, resulting in increased fiscal and external buffers, along with sustainable diversification of the export base. On the other hand, the ratings could be lowered if sustainable recovery in the demand and prices for diamonds waned, resulting in weaker fiscal and external performance.

Moody's downgrades Botswana's sovereign credit rating but changed Botswana's outlook from negative to stable

In April 2021, Moody's Investors Service downgraded Botswana's sovereign credit rating for long-term bonds, denominated in both domestic and foreign currency, from 'A2' to 'A3'. However, the economic outlook was changed from negative to stable. The downgrade is due to the reduction in the capacity of government to absorb future shocks as a result of the erosion of fiscal buffers, occasioned by the COVID-19 pandemic, and relatively weaker economic resilience, reflecting the less diversified economy. The revision of the outlook reflects broadly balanced risks, the continued strong financial position despite downside risks to the post-pandemic fiscal consolidation path, low political risk, prudent policy making, limited risks pertaining to government liquidity and external vulnerability. The ratings could be revised upwards if there is improved resilience to shocks, reduced vulnerability of the budget structure and notable progress on economic diversification.

Box 2: Reforms to Monetary Operations Framework

The Bank evaluates monetary policy implementation framework on a regular basis with the aim of better policy transmission, getting the desired market response and liquidity management. Excess liquidity in the banking system has significantly reduced but continues to remain adequate. The 2022 Monetary Policy Statement announced a wide range of reforms to introduce further improvements and changes to monetary policy, with three key objectives. Firstly, to enhance policy transmission and the desired market response to monetary policy and monetary operations adjustments. Second, to designate an anchor policy rate capable of affecting liquidity management decisions, and thus providing a direct link to policy changes. Lastly, to achieve an interest rate structure that influences commercial bank decisions and market responses, fostering an active interbank market and effectively reflecting the policy stance and desired impact of monetary operations. These reforms took effect immediately following the April 28, 2022 MPC meeting. The changes as outlined in the 2022 Monetary Policy Statement are as follows:

(a) adopt the yield on the main monetary operations instrument (currently the 7-day BoBCs as the anchor policy interest rate (in place of the Bank Rate); this new policy signalling rate will be called Monetary Policy Rate (MoPR);

(b) change the auction format for the main monetary operations instrument (7-day BoBCs) from the current multiple price system to a fixed rate full allotment system;

(c) establish an interest rate corridor, with a 200-basis points margin, comprising a new Standing Deposit Facility at the Bank of Botswana at 100 basis points below the anchor policy rate and a new Standing Credit Facility at 100 basis points above the anchor policy rate;

(d) retain the Credit Facility at a Credit Facility Rate (CFR) to be anchored on the policy rate with the margin to be determined by the Bank;

(e) undertake liquidity absorption or injection (fine tuning operations) on a less frequent basis (two to three times within the Primary Reserves Averaging maintenance period), conducted at the policy rate;

(f) introduce a one-month paper (BoBC), auctioned once a month, that will help address some of the structural liquidity positions and support the construction of the short-end of the yield curve, especially since government treasury bills are not issued for this tenor; the one-month BoBC will be issued at fixed-amount flexible-price auctions for price discovery. The fixed amount would be much lower than the main seven-day operation to keep traction of the seven-day rate as the main market rate;

(g) allow commercial banks to independently determine their own Prime Lending Rates (PLR) to facilitate market competition. However, in order to ensure a smooth and orderly transition and treatment of pricing of existing products/financial contracts, the PLR should not be more than 5.25 percent for the period of a year except in the event of an adjustment of the anchor policy rate.

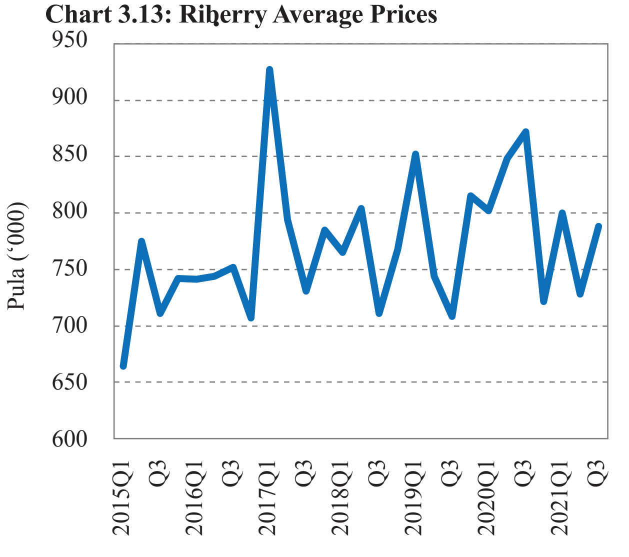
3.5 Asset markets

Property market generally deteriorated in the third quarter of 2021

According to the latest (2021Q3) Riberry Report[10], the residential rental market showed signs of deterioration in the third quarter as compared to the previous quarter, due to reduced/lower demand in the middle and upper end properties. However, the rental market still enjoyed good demand and supply in low-end houses.

The average price for residential properties sold in the third quarter of 2021 increased by 8 percent to P788 000, compared to the previous quarter (Chart 3.13), reflecting an increase in the number of high-valued properties traded in the quarter under review. Looking ahead, the demand for lower-end, medium and prime located residential housing is expected to improve further, given the affordability of properties in these categories compared to those in the upper-end market, which continue to experience a weak demand.

Chart 3.13: Riberry Average Prices



The market for office space remains weak due to increasing supply from completed construction developments, such as the Innovation Hub and Botswana Unified Revenue Service building at the Gaborone Central Business District (CBD). Furthermore, demand remains weak and uncertain due to COVID-19 and generally subdued business conditions. Despite the negative impact of the pandemic and generalised weaker demand in the third quarter for office space, there has been continued good office enquiries and/or uptake in the CBD and Showgrounds. Going forward, there is a likelihood of a slowdown in uptake at the CBD, especially if Government institutions remain in their current premises and location. In addition, the supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the CBD, such as by the Botswana Housing and Water Utilities Corporations. These will further exert downward pressure on rentals, especially in the decentralised office locations.[11]

Similar to the previous quarter, the demand for retail space remains fair across all market segments, while the supply is expected to increase on completion of the ongoing construction of a major shopping centre in the CBD, while another one is proposed for Mogoditshane. In addition, other centres with good demand for retail space are Jwaneng, Lobatse, Ramotswa, Selibe Phikwe, Maun, Francistown, Mahalapye and Letlhakane. This is because most of these locations have a few retail schemes at planning and/or construction stage which are to be anchored by reputable supermarkets. With regard to industrial property, the supply of unoccupied big warehouse space has decreased, while demand has improved.[12] Meanwhile, the availability of prime location industrial space is expected to decrease going forward, given that most of the centrally located industrial land is almost fully developed and occupied.

Stock market indices diverge

The Domestic Companies Index (DCI) increased by 10.7 percent in the twelve months to March 2022, compared to a reduction of 12.9 percent in the year to March 2021 (Chart 3.14). The increase was mainly due to the higher share prices for Letshego, Standard Chartered Bank and Seedco, which increased by 164.7 percent, 34 percent and 22.7 percent, respectively, in the same period. The higher share prices were a reflection of increased trading activity following the low base arising from the impact of the COVID-19 pandemic in 2020.

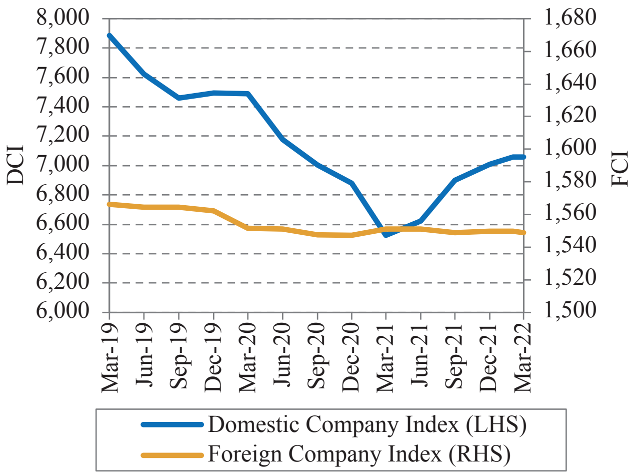
10 This is a quarterly report produced by independent valuers, Riberry Botswana (Pty) Ltd.

11 Prime rentals are about P100/m^2. However, rentals in secondary areas, such as Gaborone International Finance Park (also known as Kgale Mews), situated at the foot of Kgale Hill, adjacent to Game City Shopping Mall, cost P75/m^2, while prime industrial areas like Gaborone International Commerce Park cost P65/m^2

12 Investors prefer bigger warehouses, but available warehouse space is limited.

The Foreign Companies Index (FCI) decreased slightly by 0.1 percent in the year to March 2022, compared to a decline of 0.03 percent in the corresponding period in 2021 (Chart 3.14). This was largely due to the year-on-year decrease in the share prices for New Platinum (14.1 percent) and Lucara (12.9 percent) on account of low trading activity and liquidity.

Chart 3.14: Stock Market Indices



Source: Botswana Stock Exchange

3.6 Balance of payments (BoP)

The interpretation of the BoP statistics, especially on the financial account, have been revised to meet the latest international reporting standards. See Box 3 for more details.

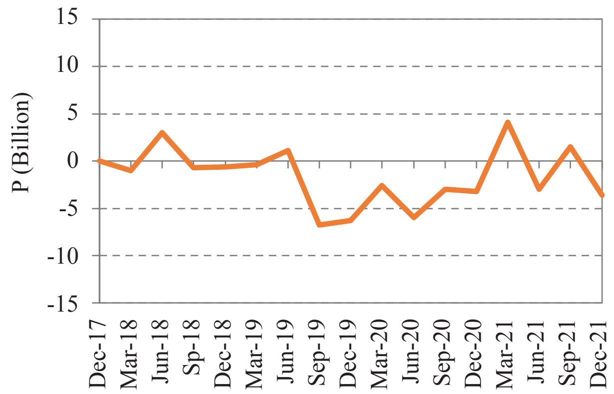
Current account recorded a deficit in the fourth quarter of 2021

The current account is estimated to have recorded a deficit of P3.6 billion in the fourth quarter of 2021, compared to a revised deficit of P3.2 billion during the corresponding period in 2020 (Chart 3.15). The merchandise trade, services and primary income accounts recorded a combined deficit of P6.8 billion, which was partly offset by a surplus of P3.2 billion in the secondary income account, which is dominated by the SACU revenue receipts (P3.5 billion). Exports increased by 7.4 percent from P17.5 billion to P18.8 billion, while imports increased by 2.7 percent from P22.3 billion to P22.9 billion, leading to a deficit of P4.1 billion in the merchandise trade account.

Diamond exports, which accounted for 88.5 percent of total exports of goods in the fourth quarter of 2021, increased from P15.9 billion in the fourth quarter of 2020 to P16.7 billion in the fourth quarter of 2021. During the same period, diamond imports decreased from P8.6 billion to P7.8 billion. The increase in diamond exports mainly stemmed from recovery in demand by major rough diamond markets, such as the US and China, due to easing of both global travel restrictions and movement of goods across borders, which were implemented in 2020 to contain the spread of the COVID-19 pandemic.

The other commodities that contributed to an increase in exports include vehicles and transport equipment (174.6 percent), hides and skins (60 percent), textiles (21 percent) and salt and soda ash (9.2 percent). In addition, copper and nickel increased from P1 million to P481 million as a result of commencement of copper sales by the US private equity company Cupric Canyon, which started production at Khoemacau Copper Mine in 2021. Commodities that contributed to an increase in imports are fuel, textiles and footwear, chemicals and rubber products, as well as machinery and electrical equipment, which increased by 71.4 percent, 38.1 percent, 25.8 percent and 14.1 percent, respectively.

Chart 3.15: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account records a net capital outflow in the fourth quarter of 2021

The financial account registered an estimated net capital outflow of P3.3 billion during the fourth quarter of 2021, compared to a revised net capital outflow of P1.8 billion in the fourth quarter of 2020. The net outflow was mainly attributable to the growth in offshore investments held by local pension fund managers.

The balance of payments was in surplus in the fourth quarter of 2021

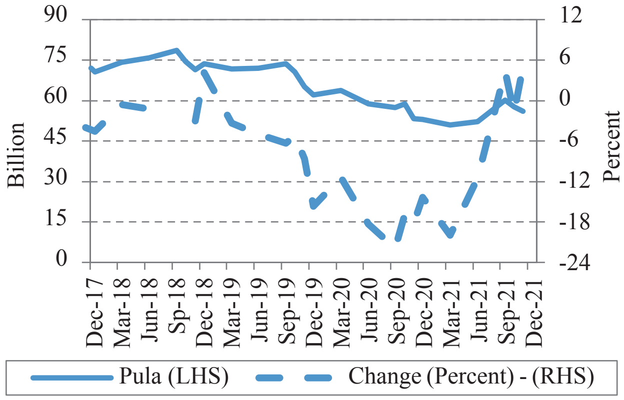
The overall BoP recorded an estimated surplus of P1.1 billion during the fourth quarter of 2021, from a deficit of P5.2 billion during the corresponding period in 2020. The surplus was mainly attributable to SDR inflows amounting to nearly P3 billion paid to the Government by the IMF.

Foreign exchange reserves increase

As at the end of December 2021, foreign exchange reserves amounted to P56 billion, an increase of 4.9 percent from P53.4 billion in December 2020 (Chart 3.16). The increase was a result of SDR inflows of P3 billion paid to the Government by IMF.

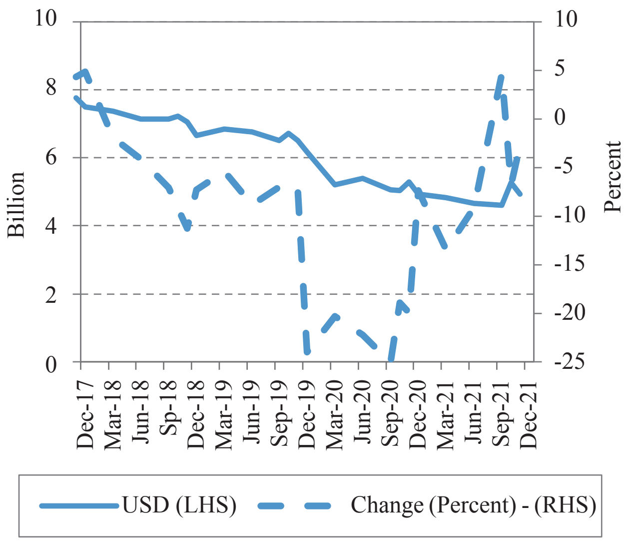
In foreign currency terms, the level of reserves are estimated to have decreased by 2 percent from USD4.9 billion in December 2020 to USD4.8 billion in December 2021 (Chart 3.17). The reserves remained the same at SDR3.4 billion in the same period. The level of reserves as at the end of December 2021 was equivalent to 9.1 months of import cover of goods and services.

Chart 3.16: Foreign Exchange Reserves in Pula and Annual Percentage Change



Source: Bank of Botswana

Chart 3.17: Foreign Exchange Reserves in US Dollars and Annual Percentage Change



Source: Bank of Botswana

Box 3: Adoption of Balance of Payments (BoP) and International Investment Position Manual Six (BPM 6)

The compilation of BoP is guided by the IMF compilation manuals with a view to ensuring standardisation, hence international comparability of external sector statistics. The manuals and compilation guidelines evolve overtime in response to change in methodologies and data, economic and financial developments, analytic interest and technological advancement. In this regard, the IMF has thus far released six editions of the Balance of Payments Manual (BPM) and the International Investment Position (IIP) Manual, the latest being the BPM6, released in 2009. BPM6 introduced methodological and classification changes, with most of the amendments occurring in the goods and services account. Other noticeable changes are sign conversions in the financial account.

Botswana adopted the BPM6 reporting in 2018, through the IMF's yearbook submission. Locally, the dissemination of data reported in the BPM6 format commenced with the Botswana Financial Statistics (BFS) publication of September 2020. Generally, the changes brought about by BPM6 have not affected net balances of BoP accounts, except for the change in signs in the financial account. However, the migrants' transfers have been removed from the BoP and placed under the IIP. Migrant transfers consist of personal effects, financial assets and liabilities of individuals changing their residence. Tables 3.6 and 3.7 provide a summary of the changes made pertaining to signs and classification.

Sign Changes and Interpretation

The rationale for changing the signs in the financial account was to bring the BoP interpretation in line with the IIP, as well as to harmonise the financial account presentation with other macroeconomic datasets, such as the system of national accounts SNA and government finance statistics. In this case a positive sign now represents an increase in either an asset or liability account while a negative sign represents a decrease in an asset or liability account, in both the BoP and the IIP. The balances on the different components within the financial account are now calculated by subtracting net incurrence of liabilities from net acquisition of assets instead of adding them. The net balance on the financial account has the opposite sign in BPM6 compared to BPM5. In BPM 6, a positive net balance represents a net outflow, while a negative net balance represents a net inflow, in contrast to the BPM5 interpretation.

Table 3.6: Sign Changes and Interpretation

Account	BPM5 Interpretation	BPM6 Interpretation
Current and Capital Balance from current and capital account	Credits were positive (+) Debits were negative (-) Balance = credits plus debits Surplus +, deficit -	Both credits and debits recorded as positive (+) values Balance = credits minus debits Surplus +, deficit - + net lending - net borrowing
Financial Balance	+ net borrowing - net lending Balance = Assets + Liabilities	+ net lending - net borrowing Balance = Assets - Liabilities
Net acquisition of Financial Assets (NAFA)	Increases in foreign assets – Decreases in foreign assets +	Increases in foreign assets + Decreases in foreign assets -
Net Incurrence of Liabilities (NIL)	Increases in liabilities to non-residents + Decreases in liabilities to non-residents -	Increases in liabilities to non-residents + Decreases in liabilities to non-residents -
Reserve Assets	Increase – Decrease +	Increase + Decrease -
Net private sector capital inflows/outflows	Capital inflows + Capital outflows -	Capital inflows - Capital outflows +

Table 3.7: Classification Changes (of highlighted items in BPM5)

BPM5 Item Classification	**BPM6 Item Reclassification**
‘Goods for processing’ recorded in the goods account	Reclassified to services, renamed ‘manufacturing services on physical goods owned by others’
‘Repairs on goods’ recorded in the goods account	Reclassified to services, renamed “maintenance and repair services”
‘Goods procured in ports by carriers’ recorded separately in the goods account	Recorded as part of general merchandise within the goods account
‘Merchanting’ recorded as a service	Renamed as ‘Net exports of goods under merchanting’ and recorded under goods
‘Postal and courier services’ reported as part of communication services	Moved to ‘transport services’
‘Royalties and licence fees’	Renamed as ‘charges for use of intellectual property’
Interest on loans and deposits recorded in the income account on a gross basis	Split to service and income components Pure interest recorded in primary income The services part termed ‘Financial intermediation services indirectly measured’ (FISIM) recorded under services
High value goods acquired by travellers recorded under travel services	Moved to merchandise goods

3.7 Exchange rate developments

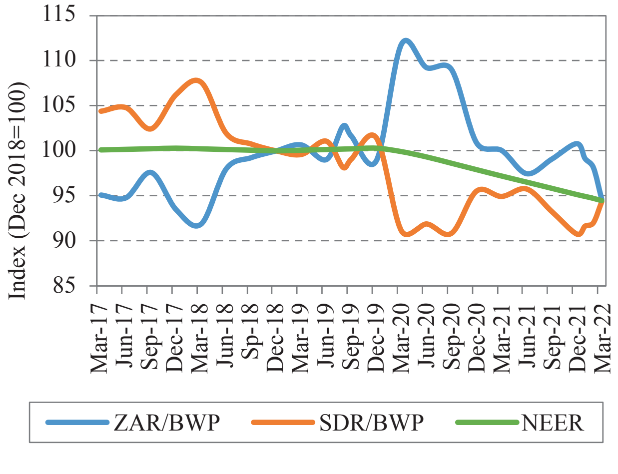
For 2022, the Bank’s implementation of the exchange rate policy entails the maintenance of an annual downward rate of crawl of 2.87 percent (Box 5). This downward rate of crawl was implemented from May 1, 2020 with a view to enhance domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. The Pula basket weights were also maintained at 45 percent for the South African rand and 55 percent for the SDR, guided by Botswana’s trade pattern and international transactions.

In the twelve months to March 2022, the Pula depreciated against both Pula basket currencies. It depreciated by 5.4 percent against the South African rand and 0.6 percent against the SDR (Chart 3.18). Against the SDR constituent currencies, the Pula depreciated by 6 percent against the Chinese renminbi and 2.8 percent against the US dollar, while it appreciated by 6.9 percent against the Japanese yen, 2 percent against the euro and 1.7 percent against the British pound.

Ideally, the movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. However, in the same review period, the South African rand appreciated by 5.1 percent against the SDR. With respect to the SDR constituent currencies, the South African rand appreciated by 13 percent against the Japanese yen, 7.9 percent against the euro, 7.6 percent against the British pound and 2.8 percent against the US dollar, while it depreciated by 0.6 percent against the Chinese renminbi.

The South African rand appreciated against most major currencies on the back of signs of sustained global economic rebound, fueled by positive manufacturing data in the US, which boosted the demand for risky emerging market assets, including the South African rand. The South African rand strengthened after President Cyril Ramaphosa of the Republic of South Africa set out brief plans to stimulate economic growth in 2022 during his State of the Nation Address on February 10, 2022. The President highlighted that Eskom has established a separate transmission subsidiary, and is on track to complete its legal separation by December 2022. In addition, the power utility has continued with its intensive maintenance programme to reverse many years of neglected maintenance and underperformance of the existing plants. Furthermore, the South African rand appreciated due to rising commodity prices, which have provided support to South Africa’s raw material and precious metal export.

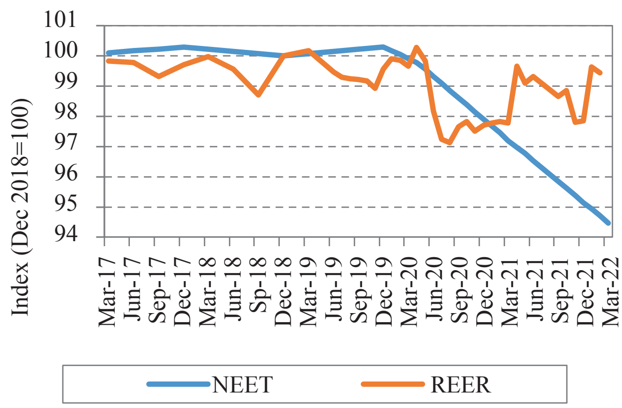
Chart 3.18: Nominal Exchange Rate Indices



NEER depreciated in March 2022

The NEER of the Pula depreciated by 2.81 percent in the twelve months to March 2022 (Chart 3.19), consistent with the downward annual rate of crawl of 2.87 percent.

Chart 3.19: Nominal and Real Effective Exchange rates



Source: Bank of Botswana

REER appreciated in February 2022

The REER appreciated by 1.6 percent in the twelve months to February 2022 (Chart 3.19), because of a higher positive inflation differential (4.6 percent) between Botswana and the trading partner countries than the downward rate of crawl (2.8 percent). With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) appreciated by 2.2 percent against the SDR and 0.9 percent against the South African rand. Against the SDR constituent currencies, the domestic currency appreciated by 12.8 percent against the Japanese yen, 7.5 percent against the euro, 2.7 percent against the British pound and 0.9 percent against the Chinese yuan, while it depreciated by 3.1 percent against the US dollar.

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook for 2022 was revised downwards in April 2022 compared to the January 2022 WEO Update projections, largely due to the Russia-Ukraine war and associated sanctions. In addition, unwinding of fiscal and monetary policy support, as well as frequent and wider-ranging lockdowns in China are expected to further weigh on global activity. Thus, prospects for recovery in both advanced and emerging economies remain broadly restrained, although uneven. Regionally, in South Africa, growth is projected to remain subdued, mainly due to the continuing negative impact of the COVID-19 containment measures. With regard to price developments, global inflation is projected to remain elevated in 2022, influenced by prolonged supply chain disruptions and increases in commodity prices assocociated with the Russia-Ukraine war.

Global economic activity to slowdown

According to the April 2022 WEO, global output growth is forecast at 3.6 percent in both 2022 and 2023, from an estimated expansion of 6.1 percent in 2021. The growth forecast for 2022 was revised downwards by 0.8 percentage points compared to the January 2022 projection, largely due to the Russia-Ukraine war and associated sanctions, as well as their spillover effects on the rest of the world. The downward revision also reflects frequent and wider-ranging lockdowns in China, including its key manufacturing hubs that could cause new bottlenecks in global supply chains. Furthermore, the lower forecast considers the slow pace of vaccination and reopening in emerging and developing market economies.

For advanced economies, output is forecast to expand by 3.3 percent in 2022, a moderation from an expansion of 5.2 percent in 2021. The 2022 projection was downgraded by 0.6 percentage points from the January 2022 WEO Update, mostly reflecting macroeconomic effects of a sharp tightening of global financial conditions, as well as weaker consumer and business confidence and the expected unwinding of fiscal support.

Risks to the global economic outlook are assessed to be on the downside. These include possible worsening of the Russia-Ukraine war, escalation of sanctions imposed on Russia and probalibity of higher commodity prices, continued lockdowns in China to control the spread of the COVID-19 virus, as well as emergence of more virulent COVID-19 variants which could slow down global economic activity.

UK economy to slow down in 2022

The UK economy is expected to grow by 3.7 percent in 2022 (1 percentage points lower compared to the January 2022 forecast), from an expansion of 7.4 percent in 2021. The expected slowdown in output expansion in 2022 reflects weaker than expected consumption as elevated inflationary pressures erode real disposable incomes, as well as tighter financial conditions which are expected to reduce investment. Economic activity is forecast to expand by 1.2 percent in 2023, still remaining below pre-pandemic levels.

Output growth for US to moderate

For the US, output is forecast to grow by 3.7 percent in 2022, a decline from an expansion of 5.7 percent in 2021, before moderating further to an expansion of 2.3 percent in 2023. The 2022 forecast is 0.3 percentage points lower compared to the January 2022 projection, mainly reflecting supply disruptions and resultant large drawdowns of inventory and faster normalisation of monetary policy than in the previous projection.

Growth for the euro area to moderate

In the euro area, economic activity is projected to moderate to 2.8 percent in 2022 (1.1 percentage points downgrade compared to the January 2022 WEO Update) from an expansion of 5.3 percent in 2021, largely due to major downgrade in output projections for Germany and Italy because of the economies' exposure to supply chain shocks due to their relatively large manufacturing sectors and greater dependence on energy imports from Russia. The downward revision of growth prospects for the economic bloc also takes into account the prolonged supply constraints and the continued COVID-19 disruptions. Meanwhile, GDP for the region is forecast to slow further to 2.3 percent in 2023, 0.2 percentage points lower compared to the projection made in January 2022.

Emerging markets GDP projected to moderate
Economic activity in emerging market and developing economies is projected to expand by 3.8 percent in 2022, from an estimated expansion of 6.8 percent in 2021. The 2022 economic performance has been revised downwards by 1 percentage point relative to the January 2022 WEO Update, reflecting downgrades in a few large emerging economies, particularly Russia, owing to its sanctions due to the country's invasion of Ukraine, disrupting trade flows, particularly for energy and food. Thus, economic prospect for Russia has been marked down by 11.3 percentage points to a contraction of 8.5 percent in 2022. Furthermore, the downward revision of the region's economic performance reflects major downgrades of India and China.

GDP in India is forecast to grow by 8.2 percent and 6.9 percent in 2022 and 2023, respectively. The 2022 projection is 0.8 percentage points lower than the January 2022 forecast, reflecting, in part, weaker domestic demand as higher oil prices are expected to weigh on private consumption, investment and lower net exports.

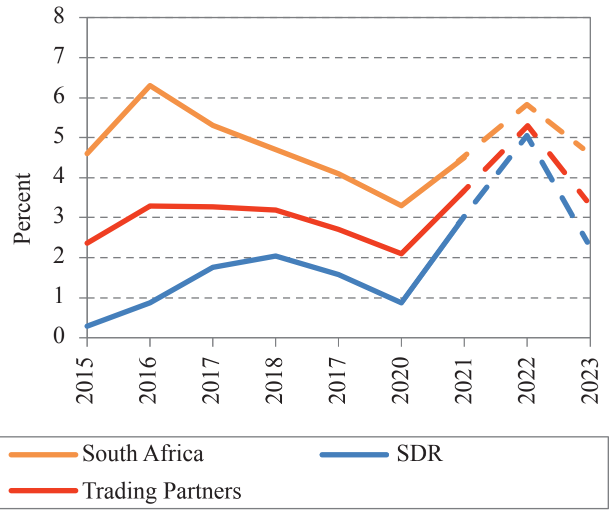
In China, the recent lockdowns in key manufacturing and trade hubs are likely to compound supply disruptions globally. Moreover, continued tight policies towards the real estate sector, as well as deteriorating prospects for employment in the construction sector are projected to slow China's economy. Therefore, China's output growth for 2022 is forecast at 4.4 percent, 0.4 percentage points lower than the January 2022 projection.

Growth prospects for the South African economy remain weak
Growth prospects in South Africa are expected to remain restrained on account of continued COVID-19 episodes, restraint fiscal support, lingering supply bottlenecks and the longstanding power supply shortage crisis. Thus, South African output is forecast to expand by 1.9 percent and 1.4 percent in 2022 and 2023, respectively, from an expansion of 4.9 percent in 2021. The projections remain unchanged from the January 2022 WEO Update. Meanwhile, in March 2022, the SARB revised forecasts for GDP growth for 2022 and 2023 to 2 percent and 1.9 percent, from 1.7 percent and 1.8 percent, respectively, at the January MPC 2022 meeting. The higher projection for 2022 was due to a combination of factors, including stronger growth in 2021 and higher commodity prices.

Global inflation to increase
Globally, inflation is expected to remain elevated in 2022, driven by escalation of the Russia-Ukraine war and subsequent sanctions imposed by some major countries on Russia, as well as improved global demand conditions as most economies progressively deploy effective COVID-19 vaccines and reopen. The anticipated inflationary pressures also stem from prolonged supply chain disruptions arising from the pandemic and those induced by the war. Thus, inflation for advanced economies is forecast to increase from 3.1 percent in 2021 to 5.7 percent in 2022, while for emerging market economies, it is forecast to increase from 5.9 percent to 8.7 percent. Overall, global inflation is expected to increase from 4.7 percent in 2021 to 7.4 percent in 2022.

Meanwhile, according to the SARB, South African inflation is forecast to average 5.8 percent and 4.6 percent in 2022 and 2023, respectively. The forecast for 2022 is 0.9 percentage points higher compared to the January 2022 projection, reflecting higher food and fuel prices amidst Russia-Ukraine war, which is expected to impair production and add more to the already existing pandemic-induced supply shortages. Moreover, the easing of lockdowns and rollout of COVID-19 vaccines is expected to support economic recovery, thus resulting in inflationary pressures. Overall, inflation is anticipated to be above the mid-point of the SARB's target range in 2022, but within the target range of 3 – 6 percent in the 2022 and 2023 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



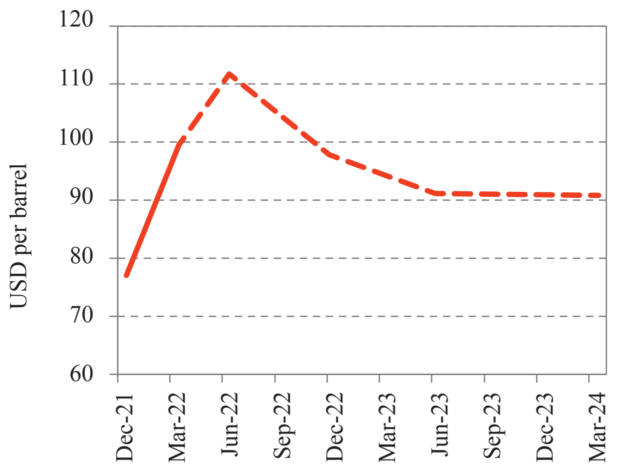
Source: SARB and Bloomberg

Global commodity prices to increase

Global rough diamond prices are expected to increase in the short to medium term, buoyed by the supply disruption resulting from the exclusion of Russian diamonds in the global market following Russia's invasion of Ukraine as well as successful rollout of effective COVID-19 vaccines. In addition, the easing of lockdowns and other containment measures are anticipated to continue to strengthen demand for jewellery, thus exerting upward pressure on rough diamond prices. Likewise, polished diamond prices are expected to rise in the short to medium term as prospects for global end-consumer demand improve.

International oil prices are projected to increase in the short term (Chart 4.2), amid supply disruptions due to heighted Russia-Ukraine crisis, as well as continued failure by some OPEC members to increase output production as agreed. Moreover, the anticipated rebound in demand and continued momentum in deployment of vaccines and boosters are expected to exert an upward pressure on international oil prices. Overall, developments in the international oil market imply marginal upward pressure on domestic inflation in the short term.

Chart 4.2: International Oil Prices



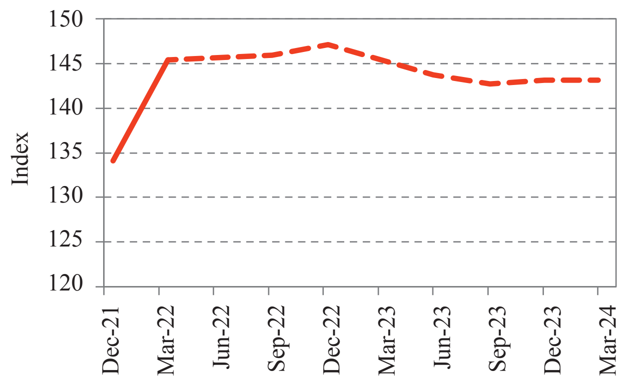
Source: Bloomberg

Global food prices are expected to trend upwards in the short term (Chart 4.3). The expected increase in food prices mainly reflects increased demand and cost push pressures arising from supply disruptions caused by possible lockdowns and other containment measures that have reduced production hours and constrained the flow of goods. The COVID-19 pandemic posed logistical challenges for food harvesting, leading to reduced supply. Furthermore, supply disruptions will also stem from Russia-Ukraine conflict, and expected to put upward pressure on food prices, given that these two countries are the main exporters of food items such as wheat, corn and sunflower oil.

In Southern Africa, food prices are expected to also increase in the short term due to anticipated bad climatic conditions/drought as well as cyclones such as tropical cyclone Ana, which hit some parts of the region in late January 2022.

Overall, there is potential upward pressure from international food prices on domestic inflation in the short term.

Chart 4.3: International Food Prices FAO Index



Source: Bloomberg

4.2 Outlook for domestic economic activity

Projections by MoF indicate that GDP growth will rebound to 9.7 percent and 4.3 percent in 2021 and 2022, respectively, from a contraction of 8.7 percent in 2020. The economy is anticipated to continue operating below its potential into the medium term, with recovery supported by the prevailing accommodative monetary conditions, improvements in the diamond industry and water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including vaccine rollouts, the implementation of the ERTP, among others.

Output growth to moderate in 2022

MoF projects GDP to expand by 4.3 percent in 2022, from a higher projected expansion of 9.7 percent in 2021, driven mainly by the expected continued recovery of mining activity and anticipated improvement in global demand. It is also anticipated that the performance of the non-mining sectors will improve, underpinned by, among others, the accommodative monetary conditions, improvements in electricity and water supply, as well as finance, insurance and pension funds sectors. Furthermore, government interventions to mitigate the impact of COVID-19, as well as implementation of the ERTP, are anticipated to restore economic activity and improve incomes, facilitate expansion of productive capacity, accelerate economic transformation and build economic resilience. However, given the downside risks to global economic activity, including the possible outbreak of new COVID-19 variants, weaker global demand and adverse impact of the Russia-Ukraine war, the growth trajectory remains uncertain.

The Bank's March 2022 Business Expectations Survey (BES) indicates that firms are less optimistic about business conditions in the first quarter of 2022 than they were in the previous survey. The reduced level of optimism partly reflects the increase in cost pressures arising from the geopolitical crisis in Eastern Europe. Firms expect GDP to expand by 3.2 percent in the first quarter of 2022, in line with the anticipated improvement in performance of sectors such as mining and quarrying and manufacturing, as well as the envisaged global economic recovery in 2022. Overall, non-mining economic activity is anticipated to improve in the short term although continuing to operate below potential into the medium term.

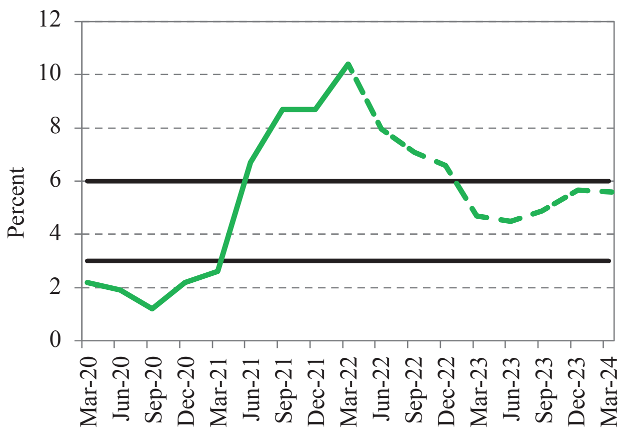
4.3 Monetary policy and the inflation outlook

Inflation is forecast to remain above the Bank's 3 - 6 percent objective range in the near term. Nonetheless, the inflation forecast has been revised upwards over the forecast horizon, with inflation now expected to fall from the second quarter of 2022 and revert to within the objective range in the first quarter of 2023. The inflation projection profile has been revised upwards compared to the February 2022 forecast, reflecting the impact of the recent increase in domestic fuel prices, the revision in forecasts for trading partner countries inflation, the likely increase in international commodity prices and the anticipated depreciation of the Pula against the South African rand. Overall, risks to the inflation outlook are assessed to be skewed to the upside.

Inflation is projected to be high in the near term
Inflation is projected to remain above the objective range in the near term, mainly reflecting the impact of transitory supply-side factors. Nonetheless, inflation is expected to start falling from the second quarter of 2022, mainly reflecting the dissipating impact of the upward adjustment in VAT and administered prices from the inflation calculation, during 2021, which all together contributed 5.9 percentage points to inflation.

Inflation is expected to revert to within the objective range in the first quarter of 2023 (Chart 4.4), reflecting the base effects associated with increases in public transport fares and domestic fuel prices during the first quarter of 2022, which (together) contributed 1.9 percentage points to headline inflation in the same period.

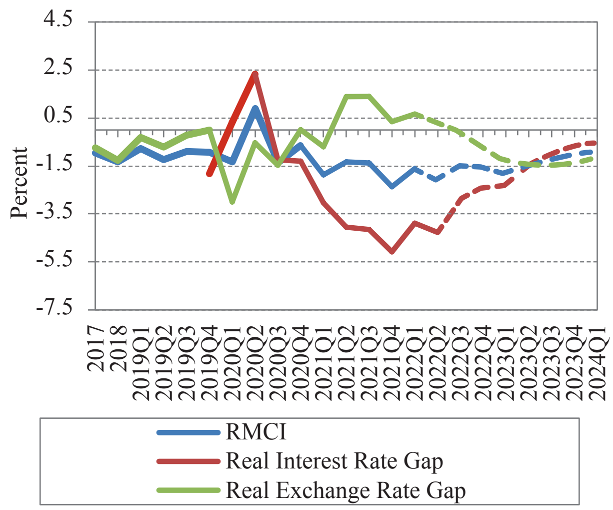
Chart 4.4: Botswana Headline Inflation Forecast



Source: Bank of Botswana

The projection (to 2023) considers the anticipated positive growth in domestic output in response to the overall accommodative monetary conditions (Chart 4.5); the recent increase in domestic fuel prices; the expected upward adjustment of Botswana Housing Corporation (BHC) rentals; the revision in forecasts for trading partner countries inflation; the likely increase in international commodity prices; the anticipated depreciation of the Pula against the South African rand over the forecast horizon; and the base effects associated with adjustments in VAT and administered prices. The increase in domestic fuel prices effected on March 29, 2022, is expected to add approximately 1.08 percentage points to inflation in the second quarter of 2022, while the increase in BHC rentals is expected to add approximately 0.21 percentage points to inflation in the same period. Meanwhile, according to the March 2022 BES, the business community expects inflation (on average) to remain above the Bank's objective range in 2022, at 8.3 percent.

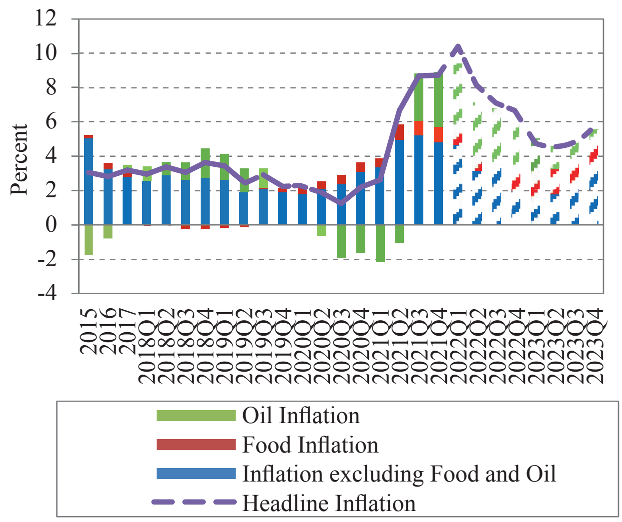
Chart 4.5: Real Monetary Conditions



Source: Bank of Botswana

Core inflation to decrease in the short term
Inflation excluding food and fuel prices is forecast to decrease in the short term, on account of the dissipating impact of the upward adjustment in VAT and administered prices of 2021 from the inflation calculation. Nonetheless, core inflation is expected to rise marginally in the medium term, mainly reflecting the expected improvement in non-mining output growth (Chart 4.6).

Chart 4.6: Headline Inflation and its Components

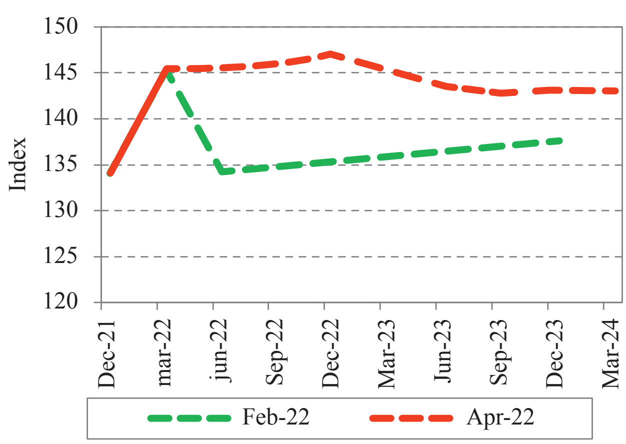


Source: Bank of Botswana

International food prices to increase

Compared to the February 2022 forecast, international food prices have been revised upwards over the forecast horizon. However, international food prices are expected to stabilise in the medium term (Chart 4.7). The upward revision reflects increased unmet demand, due to production lags arising from the supply and logistical disruptions caused by COVID-19 containment measures and the anticipated lower crop production resulting from bad climatic conditions in some regions. The revision also depicts the ongoing Russia-Ukraine conflict, which has exacerbated supply disruptions, given that these two countries are the main exporters of wheat and sunflower oil, respectively. Moreover, Russia is among the world's largest crude oil producers (oil is an input in the food production process).

Chart 4.7: International Food Prices FAO Index

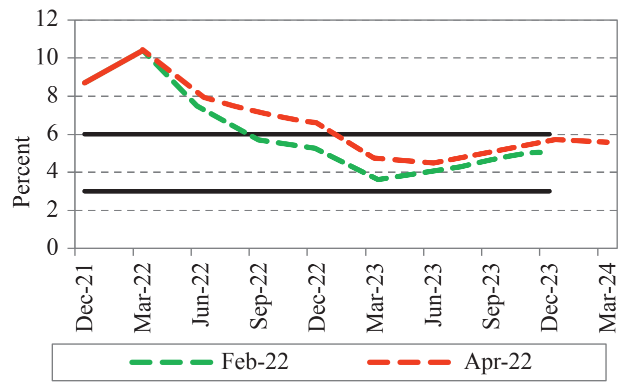


Source: Bloomberg

International oil prices revised upwards

Relative to the February 2022 projection, international oil prices have been revised upwards (Chart 4.8), supported by the ongoing Russia-Ukraine war, which has resulted in supply shortages due to the sanctions imposed on Russia, given that it is the world's second-largest exporter of crude oil and the largest natural gas exporter. Furthermore, the expected recovery in global oil demand following the relaxation of some COVID-19 containment measures amid the rollout of vaccines, and stimulus programmes around the world are expected to add upward pressure on international oil prices.

Chart 4.8: Botswana Headline Inflation Revision



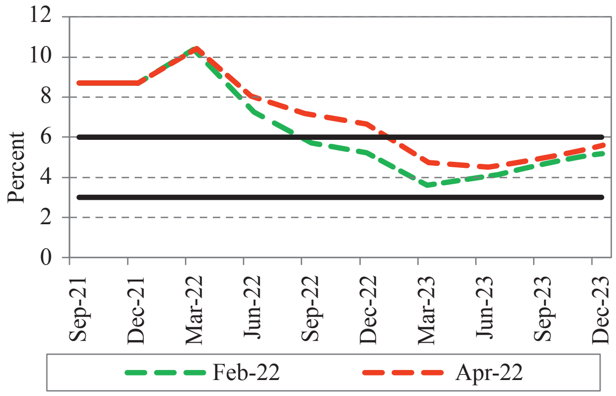
Source: Bank of Botswana

Overall, developments with respect to international oil and food prices imply upward pressure on domestic inflation.

Inflation forecast revised upwards over the forecast horizon

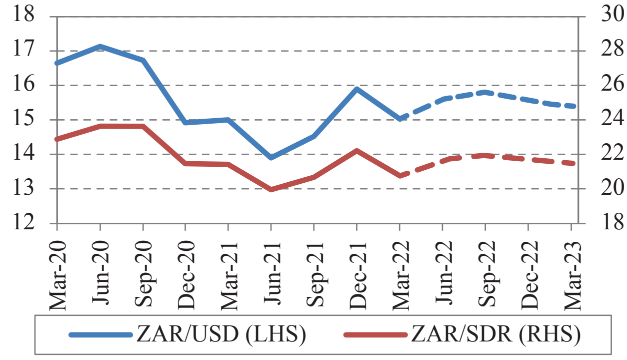
Compared to the February 2022 forecast, inflation is projected to be higher in the short to medium term, reflecting the recent increase in domestic fuel prices, the upward revision in forecasts for trading partner countries inflation and international commodity prices, as well as a higher rate of depreciation of the Pula against the South African rand than previously projected (Chart 4.9).

Chart 4.9: Botswana Headline Inflation Revision



Source: Bank of Botswana

Chart 4.10: ZAR against USD and SDR



Source: Reuters

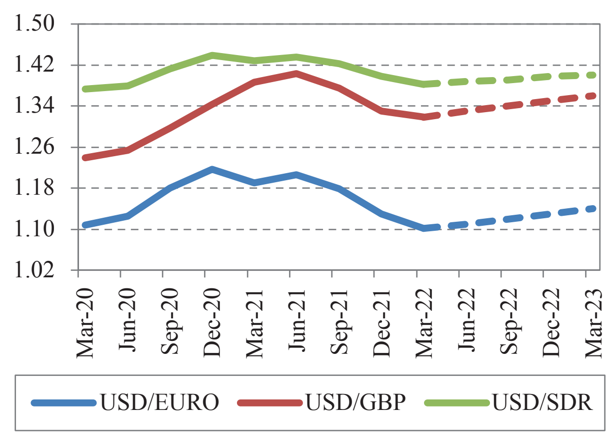
Exchange rate movements

The Pula exchange rate is determined by the performance of the Pula basket currencies and the rate of crawl. Once the basket composition and the rate of crawl (based on inflation differentials) have been determined, the daily changes in the value of the Pula against other currencies are a result of movements in the cross rates of the South African rand and the SDR constituent currencies against each other, and their relative weights in the composite currency basket.

The South African rand is expected to depreciate against all major trading currencies in the next four quarters (Chart 4.10) due to the country's poor economic fundamentals (weak economic growth, high public debt and high budget deficit)[13], power supply constraints, as well as poor-performing highly indebted state-owned enterprises, which may compromise the pace of domestic economic recovery. Meanwhile, uncertainty over the developments of Russia-Ukraine geo-political conflict and unfavourable changes in investor sentiment towards emerging market assets (of which the South African rand is part) are expected to continue putting pressure on the South African rand.

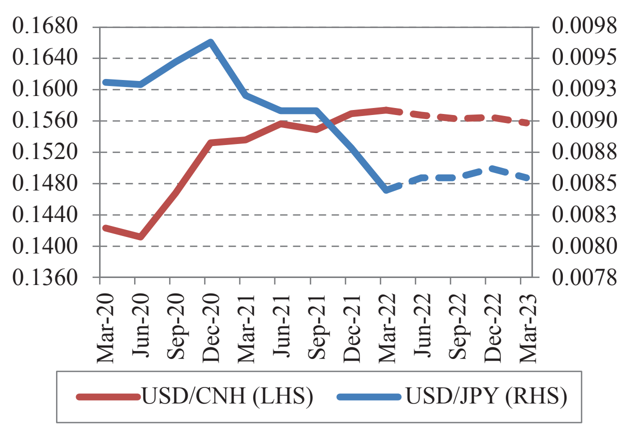
However, the external environment remains favourable to the South African rand due to high commodity prices, which provide support to South Africa's significant raw material and precious metal export sector, supporting the country's trade balance.

Chart 4.11A: Exchange Rates against USD



Source: Reuters

Chart 4.11B: Exchange Rates against the USD



Source: Reuters

13 The South African GDP growth is projected at 2 percent for 2022 and expected to average 1.9 percent over the next two years. The consolidated budget deficit is projected to narrow from 5.7 percent of GDP in 2021/22, to 4.2 percent of GDP by 2024/25. Meanwhile, the debt ratio will stabilise at 75.1 percent of GDP by 2024/25, lower than the 78.1 percent projected in 2021/22. Meanwhile, the prudent fiscal convergence targets for the SADC region member states are an annual GDP growth rate of more than 7 percent, public debt of less than 60 percent of GDP, and a budget deficit of less than 3 percent of GDP.

The US dollar is expected to slightly depreciate against most of major international currencies in the next four quarters (Chart 4.11A and Chart 4.11B) as the Federal Reserve is unlikely to be aggressive in hiking interest rates to fight inflation as was expected at the start of the year for fear of tipping the US economy into recession, amid heightened uncertainty surrounding the global economic outlook emanating from the geo-politicalconflict between Russia and Ukraine. However, the conflict could revive the US dollar's demand in the near term as a safe-haven.

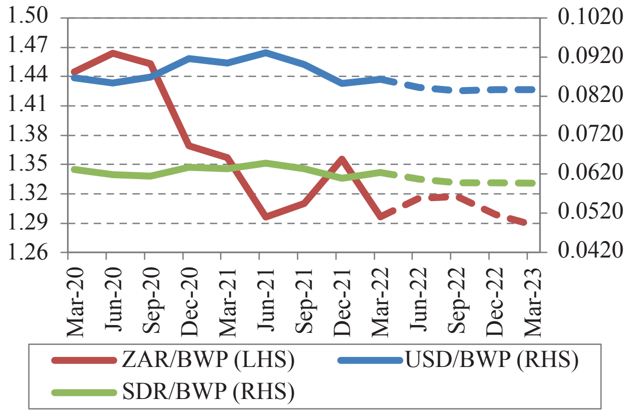
The British pound is expected to appreciate against the US dollar (Chart 4.11A) as money markets speculate that the Bank of England will further hike interest rates in the coming months. Meanwhile, the euro is also anticipated to appreciate against the US dollar as the ECB is expected to raise interest rates faster this year to curb inflation, with money markets pricing four quarter-point hikes in 2022.

The Japanese yen is expected to slightly depreciate against the US dollar due to growing divergence on the direction of monetary policy between Japan and the US. The BoJ repeatedly announced its commitment to maintain ultra-loose monetary policy. This stance contrasts with recent comments from the Fed who indicated readiness to tighten policy to fight inflation. The Japanese yen is also likely to be affected by higher commodity prices given Japan's position as a major energy and raw materials importer, adding pressure to the country's expanding trade deficit.

The Chinese renminbi is expected to slightly depreciate against the US dollar in the next four quarters (Chart 4.11B) as the reimposition of COVID-19 lockdowns and surging commodity prices present escalating risks to China's economic growth. The prospect of further monetary easing, with another cut to China's reserve requirement ratio expected in the second quarter, could also accelerate capital outflows and further undermine the Chinese yuan.

Overall, forecast movements of the SDR constituent currencies imply relative stability of the SDR against the US dollar (Chart 4.11A). The anticipated depreciation of the South African rand against the SDR is, however, expected to exert downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.12). However, the Pula is expected to depreciate against the South African rand in the next four quarters quarters due to high downward rate of crawl being implemented. The performance of the Pula against the basket currencies is expected to have minimal impact on domestic inflation.

Chart 4.12: BWP Exchange Rates against ZAR, USD and SDR



Source: Reuters and BoB calculations

Risks are skewed to the upside

Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistance of supply and logistical constraints due to lags in production; the economic and price effects of the ongoing Russia-Ukraine conflict; uncertain COVID-19 profile; domestic risk factors relating to regular annual price adjustments, short-term unintended consequences of import restrictions (shortages leading to price increases); as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, the likelihood of further increases in domestic fuel prices in response to persistent high international oil prices, and the possible increase in public service salaries could add upward pressure to inflation. These risks are, however, moderated by the possibility of weak domestic and global economic activity due to geo-political tensions and possible periodic lockdowns and other forms of restrictions in response to the emergence of new COVID-19 variants, with a likely further dampening effect on productivity. Lower international commodity prices than currently projected, could also result in lower inflation, as would capacity constraints in implementing the ERTP.

Box 4: Central Bank Communication on Monetary Policy

The last three decades bear witness to central banks progressively using public communication to support their policy objectives, as well as enhance transparency in the formulation and implementation of effective monetary policy (Robison, 2020). The change has been necessitated by the growing recognition that central bank communication enhances both the transmission of monetary policy and the management of inflation expectations, which are fundamental to effective monetary policy.

As noted by Kahveci and Odabas (2016), the post-crisis transmission in central bank policy from mystery and inscrutability to the era of transparency, as well as the importance of 'forward-guidance' demonstrate how rapidly and radically the communication strategy has evolved. Evidently, communication has become a policy tool in its own right. Central bank communication, as defined by Blinder et al. (2008), is the information that the central bank makes available about its current and future policy objectives, current and prospective economic developments pertaining to key policy variables including inflation and output, risks to the inflation outlook and the likely path for future monetary policy decisions. Furthermore, the central bank communicates the rationale for its policy decisions.

The shift towards greater transparency is generally viewed as desirable in so far as it enhances effectiveness of monetary policy in anchoring economic agent's expectations for future policy changes, safeguarding independence, and legitimacy of central banks against the backdrop of enlarged mandates and greater public scrutiny. Furthermore, greater transparency increases predictability, accountability, and credibility of central banks.

The Bank, like most other central banks, recognises the importance of communication in sustaining and reinforcing transparency, predictability, and accountability with respect to the policy framework and actions; thus, fostering market participation, influencing expectations, policy credibility and, consequently, policy transmission. The Bank's communication function has evolved with the establishment of the Communications and Information Services Division, which deals with media relations, public education, the Knowledge Centre (Library), administration of the Bank's website (dissemination of Bank's information) and records management. A Communications Policy (approved in 2020) was developed to provide a framework for effective coordination of communication activities and dissemination of information. These efforts are aimed at enhancing understanding of the Bank's mandate and role in the economy by the public.

Through the Monetary Policy Statement, published at the beginning of the year, the Bank informs stakeholders about the framework for the formulation and implementation of monetary policy, where inflation trends and policy performance are reviewed and the policy choices for the ensuing year are articulated. The MPR was introduced in August 2018 and presents the Bank's review of economic and inflation trends, as well as policy performance. The report also provides an assessment of external and domestic economic and financial developments likely to influence the inflation path in the medium term and, in turn, the Bank's future policy choices. In this respect, the MPR promotes an understanding of the conduct of monetary policy to anchor public expectations of a low, predictable, and sustainable level of inflation. Furthermore, the Bank publishes the MPC meeting dates for the year ahead and the Governor delivers a statement at a press briefing subsequent to each meeting of the MPC to allow for engagement with the media and dissemination of the Bank's policy stance. Following each MPC meeting, a Press Release is issued, informing the public of the Committee's decision regarding the Bank Rate and the reasons for the policy choice.

However, it is worth noting that as new communication technologies increasingly disintermediate traditional media by allowing for new ways of interaction, comprehension of the whole communication process - from the central bank at the sending end, the intermediation and interpretation of central bank messages through markets, media, and analysts, to the perception thereof by the recipients - becomes a crucial input into policy decisions. Thus, the Bank's communication is expected to adapt to these developments in pursuit of openness and transparency, and to enhance the effectiveness of policy transmission.

5. APRIL 2022 MONETARY POLICY COMMITTEE DECISION

At the meeting held on April 28, 2022, the Monetary Policy Committee (MPC) of the Bank of Botswana decided to increase the Monetary Policy Rate (MoPR) by 51 basis points from the prevailing 1.14 percent yield on the 7-day Bank of Botswana Certificate to 1.65 percent.

Inflation declined from 10.6 percent in February 2022 to 10 percent in March 2022, remaining above the Bank's medium-term objective range of 3 - 6 percent. The latest decline in inflation mainly reflects the base effects associated with the upward adjustment in domestic fuel prices in the corresponding period in 2021. The current high level of inflation is mainly driven by supply-side factors which contribute about 7 percentage points to the prevailing inflation (March 2022). However, the MPC projects that inflation will, in the short term, remain above the objective range but continue to trend downward in 2022 and to revert to within the objective range from the first quarter of 2023. This is mainly on account of the dissipating impact of the upward adjustment in the value added tax (VAT) and administered prices from the inflation calculation.

There is significant risk that inflation could remain elevated due to factors that include: the potential increase in international commodity prices beyond current forecasts; persistence of supply and logistical constraints due to lags in production; the economic and price effects of the ongoing Russia-Ukraine conflict; uncertain COVID-19 profile; domestic risk factors relating to possible regular annual administered price adjustments, short-term unintended consequences of import restrictions (shortages in supplies leading to price increases); as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, the likelihood of further increases in domestic fuel prices in response to persistent high international oil prices could add upward pressure to inflation.

These risks are, however, moderated by the possibility of weaker than anticipated domestic and global economic activity due to geo-political tensions and possible periodic lockdowns and other forms of restrictions in response to the emergence of new COVID-19 variants, with a likely further dampening effect on economic activity. Lower international commodity prices than currently projected could also result in lower inflation, as would capacity constraints in implementing the Economic Recovery and Transformation Plan (ERTP) initiatives.

Real Gross Domestic Product (GDP) grew by 8.6 percent in the twelve months to September 2021, compared to a contraction of 7.3 percent in the corresponding period in 2020.

According to the April 2022 World Economic Outlook (WEO), global output growth expanded by 6.1 percent in 2021, and is expected to moderate to 3.6 percent in both 2022 and 2023. The respective growth estimates for Botswana are 12.5 percent, 4.3 percent and 4.2 percent. On the other hand, South African GDP grew by 4.9 percent in 2021, and the South African Reserve Bank estimates growth of 2 percent in 2022 and 1.9 percent in 2023.

The MPC notes the growth-enhancing economic transformation reforms and supportive macroeconomic policies currently being implemented. These include accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including effective vaccination rollout programme.

The MPC notes the elevated inflation outlook emanating from the second-round effects and entrenched expectations (for example, through price adjustments by businesses, contractors, property owners and wage negotiators) for higher levels of inflation arising out of the increases in administered prices, upward adjustment of VAT, as well as the prolonged supply chain disruptions arising from the COVID-19 pandemic and the Russia-Ukraine conflict. In the circumstances, the MPC decided to increase the Monetary Policy Rate (the MoPR) to 1.65 percent; 51 basis points above the prevailing 1.14 percent yield on the 7-day Bank of Botswana Certificate.

As communicated in the 2022 Monetary Policy Statement, commercial banks may increase the Prime Lending Rate by not more than 51 basis points.

In addition, the MPC made the following decisions:

(a) the repo and reverse repo rates to be conducted at the MoPR of 1.65 percent;
(b) the Standing Deposit Facility (SDF) Rate be set at 0.65 percent (100 basis points below the MoPR); and
(c) the Standing Credit Facility (SCF) Rate be set at 2.65 percent (100 basis points above the MoPR).

Note:
The MoPR is the new policy signalling rate in place of the Bank Rate, adopted as part of the recently announced monetary policy reforms. The reforms are aimed at improving and changing the monetary policy with three key objectives. First, and foremost, to enhance policy transmission and the desired market response to monetary policy and monetary operations adjustments. Second, to designate an anchor policy rate capable of affecting commercial banks' liquidity management decisions, and thus providing a direct link to policy changes. Lastly, to achieve an interest rate structure that influences commercial bank decisions and market responses, fostering an active interbank market and effectively reflecting the policy stance and desired impact of monetary operations.

The Monetary Policy Report containing a full update of the Bank's outlook for the domestic economy and inflation will be published on the Bank's website on May 5, 2022. The remaining MPC meetings for 2022 are scheduled as follows:

June 16, 2022
August 25, 2022
October 20, 2022
December 1, 2022

Annex: Inflation Forecast Summary for April 2022 MPC Meeting

	Actual						Forecast									
	2021					2022	2022				2023					2024
	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1
Inflation	2.6	6.7	8.7	8.7	6.7	10.4	8.0 (7.3)	7.1 (5.7)	6.6 (5.2)	8.0 (7.2)	4.7 (3.6)	4.5 (3.9)	4.9 (4.7)	5.6 (5.1)	4.9 (4.3)	5.6 (5.1)

Note: Figures in parentheses represent the previous MPC forecast (February 2022)

Factors contributing to the upward revision of the forecast include the following:

Domestically

1. The increase in domestic fuel prices effected March 29, 2022

Externally

1. Trading partner inflation revised upwards in the short term
2. International commodity prices (food and oil) revised upwards
3. Pula forecast to depreciate against the South African rand