MONETARY POLICY REPORT

AUGUST 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.

Table of Contents

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 (uses the Monetary Policy Rate (MoPR) as of April 2022)[1] 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 is signalled by the 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 a one-month BoBC paper to 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

[1] Effective April 28, 2022, the MoPR is used as the new policy signaling rate in place of the Bank Rate (see Box 1 for further details).

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 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 3).

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 administered prices, fuel and food 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 in the short term. Overall, the current state of the economy is characterised by high inflation, and elevated short-term inflation outlook that partly emanates from the second-round effects and entrenched expectations for higher inflation. Thus, the MPC increased the MoPR by a cumulative 151 basis points to 2.65 percent at the April, June and August 2022 meetings, to anchor inflation expectations around the desired low level.

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.

The world economy continues to suffer from multiple shocks stemming from the COVID-19 pandemic, lockdowns in China, subdued consumer spending amid heightened inflation, as well as the Russia-Ukraine war and its associated negative spillovers. The war resulted in exorbitantly high commodity prices and elevated inflationary pressures which have, thus, contributed to tighter financial conditions, and slowdown in global economic activity in the first half of 2022. China's economy slowed significantly from an annualised growth of 4.8 percent in the first quarter of 2022 to 0.4 percent in the second quarter, owing to the negative domestic impact of COVID-19 infections and associated lockdowns imposed across the country to contain the virus. Meanwhile, output growth in the United Kingdom (UK) contracted quarter-on-quarter by 0.1 percent in the second quarter of 2022, from a growth of 0.8 percent in the previous quarter, amid the decrease in the services sector, with the largest negative contribution coming from health and social activities, reflecting a reduction in coronavirus activities. Similarly, in the United States of America (US), real gross domestic product (GDP) contracted by an annualised 0.9 percent in the second quarter of 2022, following a contraction of 1.6 percent in the first quarter, technically entering a recession, mainly due to supply constraints, as well as a decline in inventory and business investments, and government spending. In contrast, the euro area output increased quarter-on-quarter, from 0.5 percent in the first quarter of 2022 to 0.7 percent in the second quarter of 2022, reflecting the easing of COVID-19 restrictions and the summer tourism season.

The global economic outlook for 2022 was revised downwards in the International Monetary Fund (IMF)'s July 2022 World Economic Outlook (WEO) Update. Prospects for advanced economies are much weaker compared to the April 2022 projection, mostly reflecting downgrades in major economies, particularly the US, Japan and the UK. Similarly, growth in emerging market and developing economies is also expected to be restrained, mainly reflecting major downgrades for China, India and, to some extent, the expected output contraction in Russia. Overall, the global economy is forecast to expand by 3.2 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, as well as the ongoing lockdowns in China to contain the spread of the COVID-19 virus. The Russia-Ukraine war and subsequent sanctions on Russia, portend significant downside risks to global economic growth and tighter global financial conditions that could induce debt distress in emerging markets.

Global commodity prices increased in the second quarter of 2022, mainly due to the Russia-Ukraine war that started in February 2022, which has resulted in supply shortages amid sanctions against Russia, given that Russia is a major player in the commodity export market. In particular, Russia is the main exporter of crude oil and natural gas. Therefore, international oil prices increased, averaging above USD100 per barrel in the second quarter of 2022. Similarly, the United Nations' Food and Agriculture Organisation (FAO) food price index increased during the same period, given that Russia and Ukraine are the world's largest exporters of wheat and sunflower oil, respectively. Furthermore, 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.

Domestically, headline inflation averaged 11.4 percent in the second quarter of 2022, higher than the 6.7 percent in the second quarter of 2021, mostly accounted for by the increases in domestic fuel prices and associated second-round effects, as well as the upward adjustment in public transport fares. Inflation is forecast to remain above the Bank's 3–6 percent objective range into the medium term, but is expected to start falling from the fourth quarter of 2022 and to revert to within the objective range in the third quarter of 2024. Compared to the June 2022 forecast, inflation is projected to be higher in the forecast horizon, mainly reflecting the increase in domestic fuel prices effected on June 28, 2022, the recent increase in Air Botswana passenger fares, the upward adjustment in the Bokomo flour and maize prices on August 1, 2022, the possible increase in electricity tariffs in April 2023 and the upward revision in forecasts for trading partner countries' inflation.

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 to production; the economic and price effects of the ongoing Russia-Ukraine conflict, the uncertain COVID-19 profile and the escalating tension between China and Taiwan. Moreover, domestic risk factors relating to possible annual administered price adjustments, short-term unintended consequences of import restrictions; second-round effects of the recent increases in administered prices, the domino effects of the recent increase in public service salaries, and entrenched expectations for higher inflation could lead to general 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.

Botswana's real GDP grew by 13 percent in the twelve months to March 2022, compared to a contraction of 8.8 percent in the year to March 2021, 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 4.2 percent in 2022, from a higher expansion of 11.4 percent in 2021.

In the year to June 2022, commercial bank credit accelerated by 5.7 percent, from 5.3 percent in June 2021, 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 the COVID-19 pandemic in 2020.

At the end of June 2022, the official foreign exchange reserves amounted to P54.2 billion, an increase of 6.5 percent from P50.9 billion in June 2021. The current account of the balance of payments (BoP) recorded a surplus of P1.5 billion in the first quarter of 2022, compared to a surplus of P4.1 billion in the corresponding period in 2021.

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 July 2022. Against the basket currencies, the Pula depreciated by 0.6 percent and 4.6 percent against the South African rand and SDR, respectively, in the twelve months to July 2022. In the year to June 2022, the REER appreciated by 1.8 percent, because of a higher positive inflation differential (4.7 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 July 2022 WEO Update, 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, as countries rolled out effective vaccines and reopened. However, a tentative recovery in 2021 has been followed by gloomy developments in the first half of 2022, because of multiple shocks stemming from the outbreak of COVID-19 and lockdowns in China, subdued consumer spending in the US amid heightened inflationary pressures, as well as the Russia-Ukraine war, resulting in exorbitantly high commodity prices and inflation worldwide. Moreover, higher than expected inflation in advanced economies, especially the US and major European economies has triggered a faster pace of monetary policy tightening which has led to significant tightening of financial conditions across the globe and associated distress in emerging and developing economies.

The US entered a technical recession

The US output contracted by an annualised 0.9 percent in the second quarter of 2022, following a contraction of 1.6 percent in the first quarter, and technically entering a recession. The contraction in output in the second quarter was mainly due to a decline in inventory investment, housing investment, federal government spending and business investment. However, the contraction was offset by an increase in exports and consumer spending, hence an overall smaller contraction, in the same period.

Euro area growth increased

In the euro area, quarter-on-quarter GDP grew by 0.7 percent in the second quarter of 2022, slightly higher than a revised 0.5 percent (0.6 percent previously estimated) growth for the first quarter of 2022. The acceleration in growth reflected the easing of COVID-19 restrictions and the summer tourism season. Among the bloc's largest economies, output in Spain, Italy and France expanded by 1.1 percent, 1 percent and 0.5 percent, respectively, while Germany's output was stagnant.

UK growth contracted

GDP in the UK contracted, quarter-on-quarter, by 0.1 percent in the second quarter of 2022, from a growth of 0.8 percent in the first quarter, but below the market forecast of a contraction of 0.2 percent. The contraction in output mostly reflected the decrease in the services sector, with the largest negative contribution coming from human health and social work activities, reflecting a reduction in coronavirus activities.

Emerging markets' growth slowed

Output growth in emerging markets slowed down in the first quarter of 2022, primarily due to negative spillover effects from the Russia-Ukraine war, continued supply disruptions and elevated commodity prices, particularly for food and fuel. The lower growth for the economic group also reflects the continued withdrawal of monetary policy support leading to tighter financial conditions.

In India, GDP grew, year-on-year, by 4.1 percent in the first quarter of 2022, easing from a growth of 5.4 percent in the fourth quarter of 2021, but slightly higher than the market expectation of 4 percent. The slower growth in the first quarter of 2022 was due to rising Omicron infections, elevated energy prices and ongoing supply chain disruptions. By sector, the expansion was mainly driven by growth in utilities, agriculture, as well as government spending.

China's economy slowed significantly from an annualised growth of 4.8 percent in the first quarter of 2022 to 0.4 percent in the second quarter of 2022, below the market expectations of 1 percent, owing to the negative domestic impact of COVID-19 infections, as well as the associated full and partial lockdowns that were imposed across the country. The crisis in the property market[2] also negatively affected real estate sales and investment. The economic slowdown in China has also added to global supply chain disruptions and reduced China's demand for global goods and services. In addition, the risk of a sharp slowdown in the coming months heightened, amid continued

[2] The property sector is currently debt-stricken; hence China has vowed to help property developers by issuing 1 trillion yuan (USD148.2 billion) in loans for stalled developments to revive the sector and relieve pressure on the economy.

widespread COVID-19 lockdowns, a prolonged downturn in the property sector, uncertainty from the war in Ukraine, as well as tightening of monetary policy and financial conditions across the globe.

South African economy expands

Regionally, output in South Africa expanded, quarter-on-quarter, by 1.9 percent in the first quarter of 2022, from an upwardly revised expansion of 1.4 percent in the fourth quarter of 2021, and above market expectation of 1.2 percent. The contributors to growth in the first quarter of 2022 were manufacturing; trade, catering and accommodation; finance, real estate and business services; and personal services, which expanded by 4.9 percent, 3.1 percent, 1.8 percent, 1.7 percent and 1.1 percent, respectively.

Table 3.1: Growth Estimates and Projections

	Estimate		Projection	
	2020	**2021**	**2022**	**2023**
Global	**-3.1**	**6.1**	**3.2**	**2.9**
Advanced economies	**-4.5**	**5.2**	**2.5**	**1.4**
USA	-3.4	5.7	2.3	1.0
Euro area	-6.3	5.4	2.6	1.2
UK	-9.3	7.4	3.2	0.5
Japan	-4.5	1.7	1.7	1.7
EMDEs	**-2.0**	**6.8**	**3.6**	**3.9**
China	2.2	8.1	3.3	4.6
Brazil	-3.9	4.6	1.7	1.1
India	-6.6	8.7	7.4	6.1
Russia	-2.7	4.7	-6.0	-3.5
South Africa	-6.3	4.9	2.3	1.4
Botswana	**-8.7**	**11.4**	**4.3 (4.2)**	**4.2 (4.1)**

Source: IMF WEO Update July 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 price

Diamond prices increased in the second quarter of 2022

The global rough diamond price index increased by 2.6 percent from 192.78 points in the first quarter of 2022 to 197.80 points in the second quarter, in part, 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 196.08 points in July 2022.

The global polished diamond price index[3] also increased by 2.4 percent from 224.87 points in the first quarter of 2022 to 230.16 points in the second quarter, amidst shortage of supply to India, the world's largest diamond cutting and polishing hub. Meanwhile, polished diamonds index averaged 229.7 points in July 2022.

Oil prices increased in the second quarter of 2022

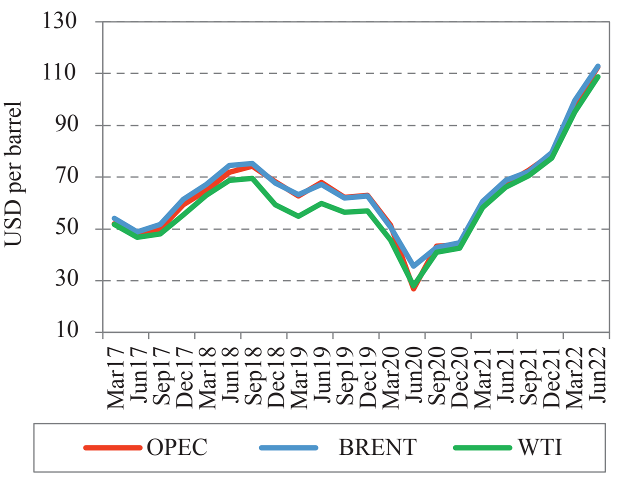
International oil prices averaged above USD100 per barrel in the second quarter of 2022 (Chart 3.1). The price of OPEC's reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 14.8 percent, 13.4 percent and 14.3 percent, from an average of USD98.11 per barrel, USD99.53 per barrel and USD95.17 per barrel in the first quarter of 2022 to an average of USD112.62 per barrel, USD112.85 per barrel and USD108.77 per barrel, respectively, in the second quarter.

International oil prices increased, supported in part, by the ongoing Russia-Ukraine war, which has resulted in supply shortages given sanctions against Russia, which is the world's largest exporter of crude oil and natural gas. In addition, political unrest in Ecuador and Libya led to disruption of production in both countries, thus further tightening global oil supply. Furthermore, the increase in oil prices was buoyed by the struggle to increase output by some OPEC members, such as Nigeria and Angola, undershooting their production quotas, and the refusal by some members (Saudi Arabia and the United Arab Emirates) to increase monthly output targets, as agreed earlier to counteract high prices. 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.

[3] 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.

In contrast, the international oil prices decreased, month-on-month, in July 2022, although remaining above the pre-pandemic levels. The OPEC reference crude oil basket, Brent crude and WTI prices decreased by 7.8 percent, 9.3 percent and 12.9 percent to an average of USD108.55 per barrel, USD108.92 per barrel and USD99.85 per barrel, respectively. The decrease in oil prices was, in part, underpinned by the lockdowns in China, the world's biggest oil importer, as well as resumption of crude oil exports by Libya and appreciation of the dollar.

Chart 3.1: Oil Prices



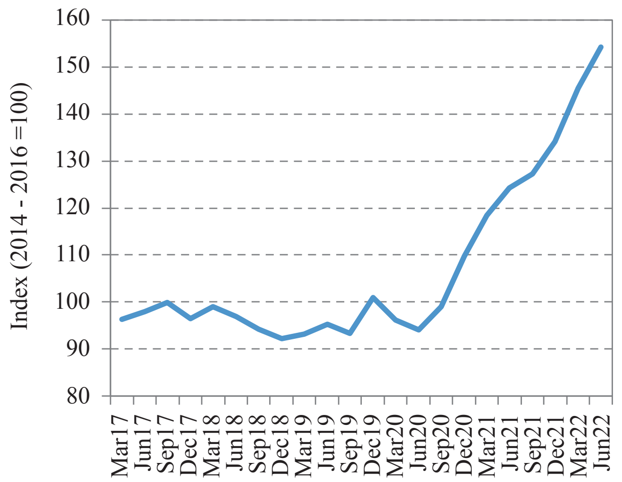
Source: Bloomberg

Food prices increased in the second quarter of 2022

According to FAO, the global food price index averaged 156.87 points in the second quarter of 2022, a 7.8 percent increase from an average of 145.46 points in the first quarter of 2022 (Chart 3.2). The increase was attributable to higher vegetable oils, cereals and meat prices. Higher food prices were a result of significant negative supply shock for the rest of the world economy, due to the war between Russia and Ukraine, given that the two economies are the world's largest exporters of wheat and sunflower oil, respectively. Rising input costs, particularly oil prices due to the war, also contributed to the increase in food prices during this period. 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 140.9 points in July 2022, a decrease of 8.6 percent from June, but 13.1 percent higher than in the corresponding period in 2021. Prices of all food groups fell, led by significant declines in prices of vegetable oil and cereal due to ample vegetable oil exports out of Indonesia and the agreement between Russia and Ukraine to resume grain exports, respectively.

Chart 3.2: Food Price Index



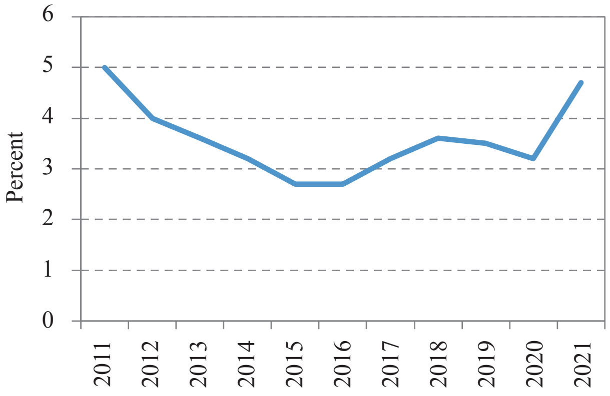
Source: Food and Agriculture Organisation

Inflation rose across the regions

Inflation increased, globally, in the second quarter of 2022, ignited by the increase in commodity prices amid the Russia-Ukraine war, 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 7.2 percent in the first quarter of 2022 to 8.2 percent in the second quarter of 2022, consistent with higher energy and food prices resulting from the disruptions caused by the Russia-Ukraine war. Similarly, inflation increased from 3.7 percent to 5.9 percent in emerging market economies in the same period. Global inflation increased from 3.2 percent in 2020 to 4.7 percent in 2021 (Chart 3.3)[4].

[4] The quarterly inflation estimates are sourced from Bloomberg.

Chart 3.3: Global Inflation

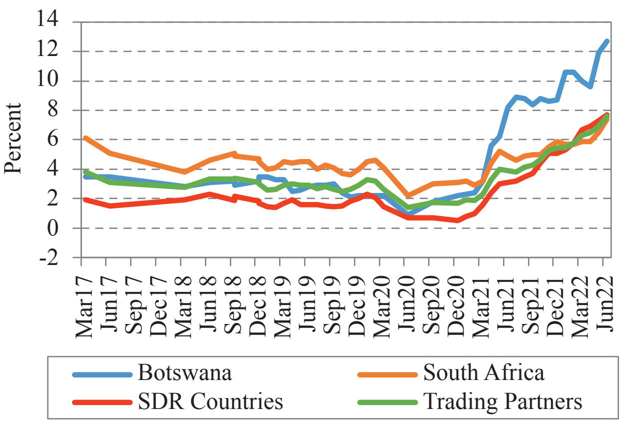


Source: IMF April 2022 WEO

In South Africa, headline inflation increased from 5.8 percent in the first quarter of 2022 to 6.6 percent in the second quarter of 2022. Similarly, inflation increased from 6.5 percent in May 2022 to 7.4 percent in June, remaining above the South African Reserve Bank (SARB)'s target range of 3–6 percent.

Consequently, the average trade-weighted inflation for Botswana's trading partners increased from 6.9 percent in May 2022 to 7.6 percent in June 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) increased the deposit rate, refinancing rate and lending rate by 50 basis points to zero percent, 0.50 percent and 0.75 percent, respectively, in July 2022, the first increase since 2011, ending eight years of negative rates to combat inflationary pressures. The increase was 25 basis points more compared to the commitment signalled at the June 2022 meeting. The ECB reiterated that further normalisation of the policy interest rates at future meetings will be appropriate to control inflationary pressures and anchor expectations. In addition, the ECB approved the Transmission Protection Instrument (TPI) to ensure that the monetary policy stance is transmitted smoothly across all euro area countries.

At the July 2022 meeting, the US Federal Open Market Committee (FOMC) increased the target policy rate range by 75 basis points to 2.25–2.5 percent, the fourth consecutive hike, 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 if elevated inflation pressures were to persist, 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 50 basis points to 1.75 percent in August 2022, the sixth consecutive hike since the onset of the COVID-19 pandemic (the highest increase in 27 years), to combat elevated inflationary pressures. For continued policy normalisation efforts, the BoE's MPC reiterated its decision 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 over the remainder of the year, reaching above 13 percent in the last quarter of 2022 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 percent at the July 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 also reiterated that it will not hesitate to take extra easing measures if needed, indicating that the Japanese economy had improved despite some weaknesses due to the impact of COVID-19 and surging commodity prices.

In emerging market economies, the Central Bank of Brazil increased the policy rate by 50 basis points to 13.75 percent in August 2022, the twelfth consecutive interest rate hike, amid rising inflationary pressures to control inflation and anchor inflation expectations. In addition, the Central Bank of Brazil announced that the policy rate would be increased by a lesser magnitude at its next meeting. Conversely, the Central Bank of Russia (CBoR) reduced the key rate by 150 basis points to 8 percent at its July 2022 meeting, the fifth rate cut since April 2022, as inflationary pressures eased amid subdued consumer demand and negative effects of the sanctions imposed on Russia, following its invasion of Ukraine in February 2022. The CBoR noted that inflation expectations of both households and businesses have decreased significantly since the last meeting. However, the decline in economic activity was of smaller magnitude than initially expected in June 2022.

The People's Bank of China (PBoC) reduced the one-year Loan Prime Rate (LPR) from 3.7 percent to 3.65 percent, and the five-year LPR from 4.45 percent to 4.30 percent, in August 2022, to support the economy that has been severely affected by the COVID-19 containment measures. The reduction in the five-year LPR was an effort to bring down the cost of home mortgage repayments, as the economy faces a property crisis that has seen some building projects grind to a halt.

The SARB increased the repo rate by 75 basis points to 5.50 percent in July 2022, the fifth consecutive hike, due to elevated inflation risks associated with higher global commodity prices resulting from the Russia-Ukraine war. The SARB considered risks to the inflation outlook to be on the upside and anticipated inflation to remain above the target range until the second quarter of 2023, but to revert to the mid-point of the 3–6 percent target in 2024. Given the expected trajectory for headline inflation and upside risks, the SARB's MPC indicated that the gradual rise in the repo rate would be sufficient to keep inflation expectations well anchored and to moderate the future path of interest rates.

In August 2022, the Reserve Bank of India (RBI) raised the policy rate by 50 basis points to 5.4 percent, the third rate hike in a row, to ensure inflation remains within target going forward, while supporting growth. Headline inflation in India was 7.01 percent in June 2022, remaining above the RBI's objective range of 2 - 6 percent for the fifth consecutive month. The RBI indicted that going forward, it would focus on withdrawal of monetary policy accommodation to contain inflationary pressures.

Table 3.2: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting
Bank of Botswana	August 2022	2.65	Increased by 50 basis points
SARB	July 2022	5.50	Increased by 75 basis points
US Federal Reserve	July 2022	2.25–2.5	Increased by 75 basis points
BoE	August 2022	1.75	Increased by 50 basis points
ECB	July 2022	0.50	Increased by 50 basis points
BoJ	July 2022	-0.10	No change
PBoC	August 2022	3.65	Decreased by 5 basis points
Brazil	August 2022	13.75	Increased by 50 basis points
India	August 2022	5.40	Increased by 50 basis points
Russia	July 2022	8.00	Decreased by 150 basis points

Source: Various central banks' websites.

3.2 Domestic inflation environment

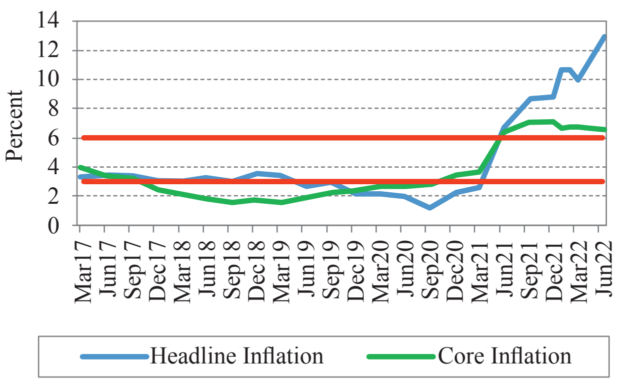
Headline inflation increased in the second quarter of 2022

Headline inflation averaged 11.4 percent in the second quarter of 2022, from 6.7 percent in the second quarter of 2021 (Charts 3.5 and Table 3.3), accounted for by the increases in domestic fuel prices[5] and associated second-round effects, as well as the upward adjustment in public transport fares. Headline inflation increased from 12.7 percent in June to 14.3 percent in July 2022, the highest value since December 2008 (13.7 percent), remaining above the Bank's medium-term objective range of 3–6 percent, and significantly higher than the 8.9 percent in July 2021. The rise in inflation between June and July 2022 mainly

[5] The increase in domestic fuel prices effected on March 28 and May 13, 2022, added approximately 1.08 percentage points and 1.43 percentage points to the second quarter inflation, respectively.

reflects broad-based increase in the annual price changes for most categories of goods and services, and in particular the upward adjustment in domestic fuel prices effected on June 28, 2022, and Air Botswana passenger fares effected on July 8, 2022, which added approximately 1.13 percentage points and 0.16 percentage points, respectively, to the current level of inflation.

Chart 3.5: Botswana Headline and Core Inflation

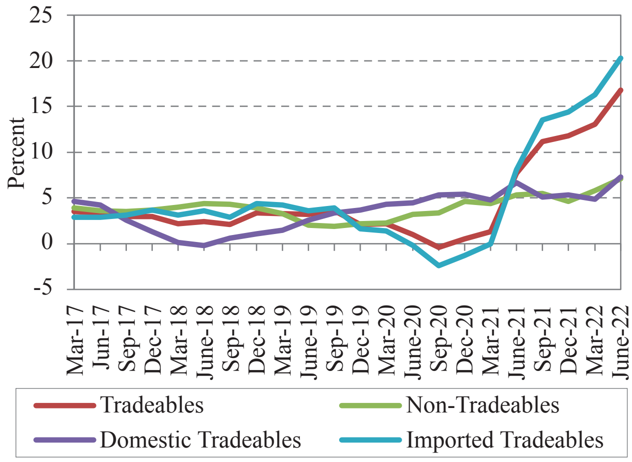


Source: Statistics Botswana and Bank of Botswana
Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic tradeables decreased while imported tradeables increased in the second quarter of 2022

Inflation for domestic tradeables decreased from an average of 6.7 percent in the second quarter of 2021 to an average of 5.3 percent in the second quarter of 2022 (Charts 3.6), largely due to base effects associated with the increase in domestic value added tax (VAT) in April 2021. However, imported tradeables inflation increased significantly from an average of 8.1 percent to an average of 18.7 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 7.7 percent in the second quarter of 2021 to an average of 15 percent in the second quarter in 2022, while inflation for non-tradeables also increased from an average of 5.3 percent to 6.4 percent in the same period. In July 2022, domestic tradeables, non-tradeables, imported tradeables inflation and all tradeables inflation increased to 9.9 percent, 7.3 percent, 23 percent and 19.4 percent, respectively.

Chart 3.6: Inflation for Tradeables and Non-Tradeables



Source: Statistics Botswana

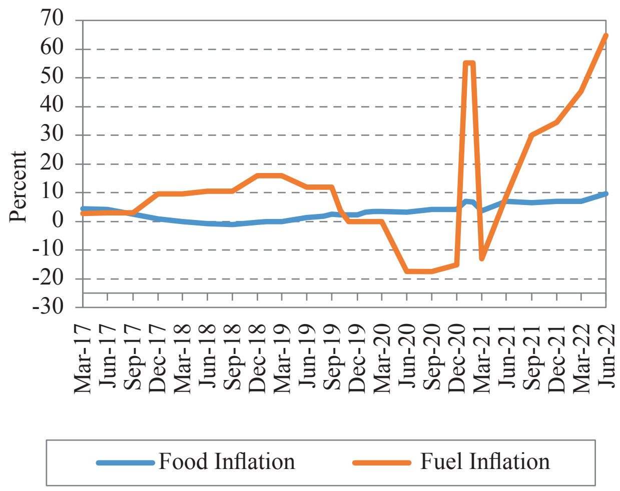
Generally, there has been an upward trend in non-tradeables inflation since June 2019 and domestic tradeables inflation from June 2018, mainly due to the increase in prices for administered items and food, respectively. The increase in food prices was partly a result of bad weather conditions experienced in the 2018/19 ploughing season, and economic disruptions occasioned by COVID-19 in 2020 and more recently, due to supply disruptions associated with the Ukraine-Russia war, as well as import restrictions set out in 2022 to promote domestic production.

Accordingly, therefore, upward general 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 diverged in the second quarter of 2022

The trimmed mean inflation (CPITM) increased to 9.3 percent in the second quarter of 2022, from 6.4 percent in the second quarter of 2021, while inflation excluding administered prices (CPIXA) averaged 6.3 percent, compared to 6.5 percent in the same period last year (Table 3.3). However, inflation excluding food and fuel (CPIXFF) averaged 6.4 percent in the second quarter of 2022, slightly lower than the 6.5 percent recorded in the corresponding quarter in 2021, mainly because of the base effects associated with the increase in VAT in 2021 and administered prices. In July 2022, CPITM, CPIXA and CPIXFF were 11.5 percent, 7.6 percent and 7.5 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	July 2022	Q2 2022	Q2 2021
Food and non-alcoholic beverages	13.6	11.8	8.0	6.8
Alcoholic beverages and tobacco	4.3	4.2	4.9	11.3
Clothing and footwear	6.0	4.4	3.8	3.7
Housing, water, electricity, gas and other fuels	17.5	6.6	7.4	7.2
Furnishing, h/h equipment and routine maintenance	4.9	5.6	5.0	3.4
Health	3.4	2.8	2.2	3.0
Transport	23.4	39.3	30.0	11.2
Communications	6.9	0.5	0.5	1.6
Recreation and culture	2.8	4.7	4.2	4.0
Education	4.6	2.6	2.5	1.8
Restaurants and hotels	3.7	5.8	4.5	3.0
Miscellaneous goods and services	9.0	9.7	8.4	5.9
Annual Inflation (All items)	**100.0**	**14.3**	**11.4**	**6.7**
CPITM		11.5	9.3	6.4
CPIXA		7.6	6.3	6.5
CPIXFF		7.5	6.4	6.5

Source: Statistics Botswana and Bank of Botswana calculations

3.3 Recent domestic economic developments

GDP expanded in the first quarter of 2022

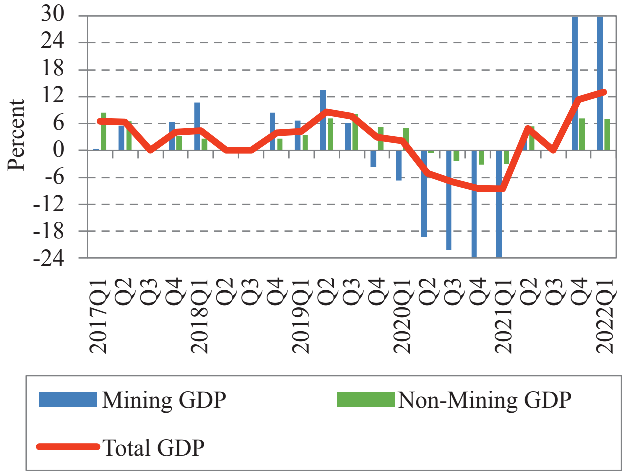
Real GDP grew by 13 percent in the twelve months to March 2022, compared to a contraction of 8.8 percent in the year to March 2021 (Chart 3.8). The increase in output was attributable to the expansion of production in both the mining and non-mining sectors. The expansion in output reflects improved economic 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 42 percent in the year to March 2022, compared to a contraction of 27.8 percent recorded in the corresponding period in 2021. This was largely due to a 44.1 percent increase in diamond mining output, compared to a significant contraction of 29.1 percent in the year to March 2021. Rough diamond demand continued to gain traction after incremental relaxation of COVID-19 travel restrictions, which impeded the sightholder calender. All other mining subsectors also recorded an increase in output except mining of gold and other metal ores, which recorded a higher contraction of 26.8 percent, from a contraction of 15 percent in the year to March 2021. The contraction was mainly due to the decrease in production resulting from the deteriorating lifespan of the Mupane Gold mine (resource depletion).

Non-mining GDP grew by 6.9 percent in the year to March 2022, compared to a decrease of 3.3 percent in the corresponding period last year. The increase in non-mining GDP was mainly due to expansion in output of all sectors, apart from that of the agriculture, forestry and fishing sector that contracted mainly due to the COVID-19 movement restrictions which negatively impacted support services and livestock farming.

Meanwhile, Statistics Botswana reported a 7 percent increase in real GDP in the first quarter of 2022[6], from a marginal increase of 1 percent in the first quarter of 2021.

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

Chart 3.8: GDP Growth Rates



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

In terms of GDP by expenditure, government final consumption increased by 2.4 percent in the year to March 2022, compared to a slightly higher growth of 3.5 percent in the corresponding period in 2021 (Table 3.4). This was attributable to a deceleration in growth of collective consumption[7] from 3 percent to 2.4 percent, while individual consumption[8] decelerated from 5.3 percent to 2.3 percent in the review period. Meanwhile, household final consumption grew by 3.8 percent, compared to a marginal growth of 0.02 percent registered in the previous period. The expansion in household final consumption was mainly due to an increase in both household consumption and expenditure and non-profit institutions serving households (NPISH).

Gross fixed capital formation (GFCF) grew by 3.6 percent in the year to March 2022, compared to a decline of 13.4 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 (8.4 percent from a contraction of 15.4 percent).

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

	2021Q1	2021Q4	2022Q1
Total GDP	-8.8	*11.4*	13.0
By Sector:			
Mining & Quarrying	-27.8	29.9	42.0
Non-Mining	-3.3	*7.2*	6.9
Agriculture, Forestry & Fishing	-1.5	*-2.9*	-1.7
Manufacturing	-16.1	*8.1*	13.0
Water and Electricity	-29.1	*9.7*	2.7
Construction	-13.5	*6.5*	8.7
Wholesale & Retail	1.7	14.6	12.4
Diamond Traders	-12.0	*78.0*	30.1
Transport and Storage	-6.8	5.9	5.9
Accommodation & Food Services	-35.4	-1.5	11.7
Information & Communication Technology	1.7	*4.4*	4.4
Finance, Insurance & Pension Funding	3.3	3.6	2.3
Real Estate Activities	-3.7	7.9	7.8
Professional, Scientific & Technical Activities	-0.5	6.8	5.9
Administrative & Support Activities	-7.6	8.9	9.6
Public Administration & Defence	5.2	*2.8*	2.7
Education	-0.2	1.6	1.7
Human Health & social work	1.9	6.0	5.7
Other services	-7.4	4.6	6.3
By Type of Expenditure:			
Government Final Consumption	3.5	*3.2*	2.4
Household Final Consumption	0.0	*3.3*	3.8
Gross Fixed Capital Formation	-13.4	*-0.3*	3.6
Exports of Goods and Services	2.6	*32.8*	4.8
Imports of Goods and Services	13.5	*2.7*	7.0

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.

Diamond production decreased in the second quarter of 2022

Debswana produced 5.5 million carats of diamonds in the second quarter of 2022, 3.6 percent lower than the 5.7 million carats produced in the corresponding period in 2021. The decrease in production was due to lower grade ore being

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.

processed at both Jwaneng and Orapa mines. Meanwhile, Debswana's production target for 2022 has been set at 23.6 million carats, while production guidance for the larger De Beers Group increased to 32–34 million carats (previously 30–33 million carats).

Production by Lucara Diamond Corporation (Karowe Mine) decreased by 14.8 percent to 86 317 carats in the second quarter of 2022, from 101 330 carats produced in the corresponding period in 2021. The decrease was attributable to the uncertainty caused by geopolitical events, including the conflict in Ukraine and continuing implications of the COVID-19 pandemic (specifically in China where diamond demand has not yet fully recovered). With respect to quarterly performance, production for the second quarter of 2022 increased by 2.9 percent, to 86 317, from 83 917 carats in the first quarter of 2022.

Budget surplus recorded in the first quarter of the 2022/23 fiscal year

Government budget was in a surplus of P0.8 billion in the first quarter of the 2022/23 fiscal year (Table 3.5). The surplus was mainly due to the higher mineral revenue reflecting an increase in diamond sales, underpinned by the easing of COVID-19 restrictions on movement of goods and people. Regarding other major revenue streams, SACU revenues and domestic taxes (Value Added Tax and Non-mineral Income Tax) were generally in line with the 2022/23 budget. Total government expenditure and net lending was P19.8 billion, higher than the P18.7 billion anticipated in the proposed budget.

The preliminary budget outturn for the 2021/22 fiscal year (April 2021–March 2022), was a deficit of P8.1 million, lower than the revised budget deficit of P10.2 billion, reflecting an over performance of revenue and grants and lower public expenditure. Total public expenditure amounted to P68.5 billion, which is P5.1 billion lower than the revised budget (or 93 percent of the revised budget estimate). The overall budget outcome is expected to decline further, with the deficit increasing to P7 billion or 3.2 percent of GDP in the 2022/2023 fiscal year. Total revenue and grants, and total expenditure are projected to increase to P67.9 billion and P74.8 billion, respectively in the 2022/23 fiscal year.

Table 3.5: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2021/22 Q1	16 224	17 662	-1 438
2021/22 Q2	15 614	16 453	-839
2021/22 Q3	15 603	16 606	-1 003
2021/22 Q4	21 012	17 740	3 272
2022/23 Q1	20 631	19 793	838

Source: Cash Flow Unit, Ministry of Finance

Labour Force and Wage Developments Trends[9]

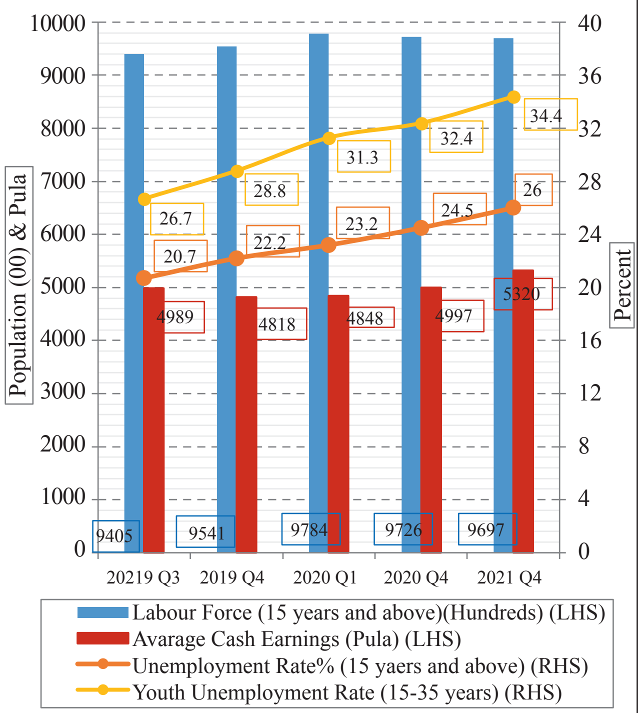
According to the Quarterly Multi-Topic Survey (QMTS) Report for the fourth quarter of 2021, the unemployment rate was 26 percent in the fourth quarter of 2021, compared to 24.5 percent in the corresponding period in 2020 (youth unemployment rate rose to 34.4 percent from 32.4 percent). The fourth quarter of 2021 survey also indicates that formal sector employment increased by 3.5 percent to 494 457, from 477 716 recorded in the fourth quarter of 2020. 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

[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.

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.

Chart 3.9: Trends in Selected Labour Force Indicators



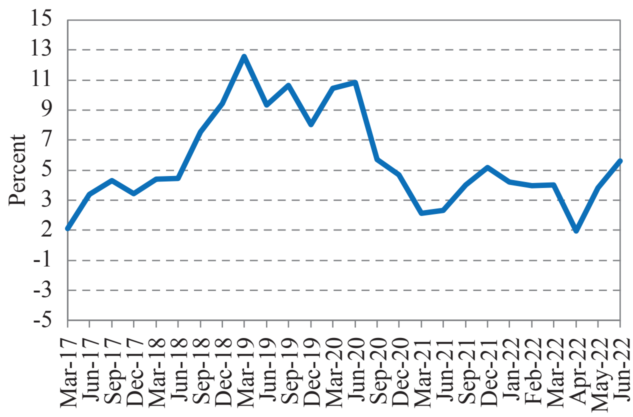
Source: Statistics Botswana

3.4 Monetary developments

Banking sector assets accelerated in June 2022

Annual banking sector assets accelerated from 2.3 percent in June 2021 to 5.6 percent in June 2022 (Chart 3.10). This was mainly due to the increase in loans and advances, which accounted for the largest proportion of commercial banks' assets (63.5 percent), Treasury Bills, as well as balances due from foreign and domestic banks. Meanwhile, holdings of BoBCs and balances at Bank of Botswana (in particular, reverse repos) decreased in June 2022.

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

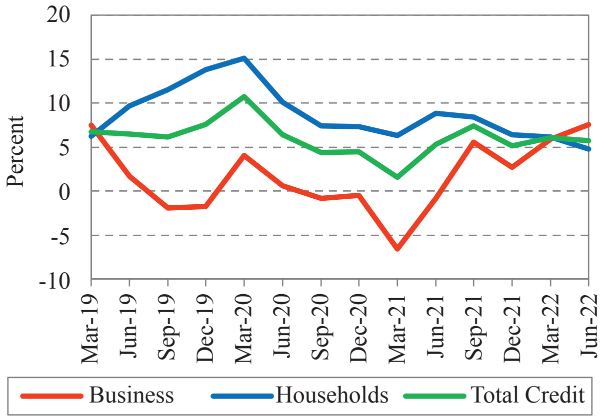


Source: Commercial Banks

Credit growth accelerated in the year to June 2022

Annual commercial bank credit increased from 5.3 percent in June 2021 to 5.7 percent in the twelve-month period to June 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, as well as the recovery from the low base arising from the impact of the COVID-19 pandemic in 2020. Although credit growth maintained an upward trend from March to May 2022, it slowed down in June 2022 possibly reflecting the effects of monetary policy tightening in April and June 2022.

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



Source: Commercial Banks

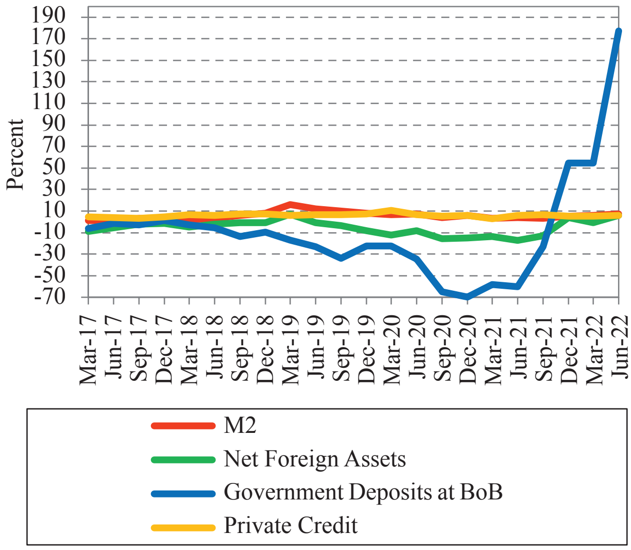
Household loans decreased from 8.9 percent in the year to June 2021 to 4.8 percent in June 2022. The lower growth in household credit was mainly attributable to the decrease in growth of personal unsecured lending and the contraction in motor vehicle loans in the year to June 2022. The share of the household sector in total lending by commercial banks decreased from 65.5 percent in June 2021 to 64.9 percent in June 2022.

Lending to the business sector increased by 7.6 percent in the year to June 2022, compared to a contraction of 0.9 percent in the corresponding period in 2021. Credit to businesses excluding parastatals also increased by 9.9 percent in the year to June 2022 from 1 percent in June 2021. The increase in credit to businesses excluding parastatals was mainly due to utilisation of loan and overdraft facilities by some companies in the agriculture, communications, manufacturing, electricity and water, trade, finance and real estate industries, as economic activity opened, following the end of the State of Public Emergency in September 2021. Meanwhile, credit to parastatals decreased by 18.9 percent in the year to June 2022, compared to 18.2 percent contraction in the corresponding period to June 2021, due to loan repayments.

Money supply accelerated in June 2022

Money supply (M2) grew by 7.2 percent in June 2022, higher than the 3.8 percent in the corresponding period in 2021 (Chart 3.12). The growth in money supply was because of the increase in credit to the private and parastatal sectors. Meanwhile, the acceleration in net foreign assets and government deposits (on account of the revenue inflow from SACU in April 2022) at the Bank of Botswana had a counteracting effect on growth in money supply during the period under review.

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



Source: Other Depository Corporations and Bank of Botswana

The 7-day nominal BoBC yield increased in the second quarter of 2022

The 7-day nominal BoBC yield increased from an average of 1.06 percent in the second quarter of 2021 to an average of 1.65 percent in the corresponding period in 2022, following the Bank's decision to increase the MPoR in April and June 2022. Meanwhile, the real rate of interest decreased from an average of -5.25 percent in the second quarter of 2021 to an average of -8.75 percent in the second quarter of 2022, reflecting the higher increase in the inflation rate than the nominal interest rate in the same period.

Meanwhile, the stop-out yield for the 7-day BoBC was constant at 2.15 percent between June and July 2022. In contrast, the real rate of interest for the 7-day BoBC decreased from -9.36 percent in June 2022 to -10.36 percent July, reflecting the increase in the inflation rate.

On June 28, 2022, the Bank introduced the one-month BoBC which is aimed at addressing some of the structural liquidity positions and support the construction of the short-end of the yield curve. Subsequently, the stop-out yield on the 1-month paper increased from 2.34 percent in June to 2.44 percent in July 2022. Meanwhile the real rate of interest for the 1-month paper stood at -10.38

percent in the same period.

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 1).

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

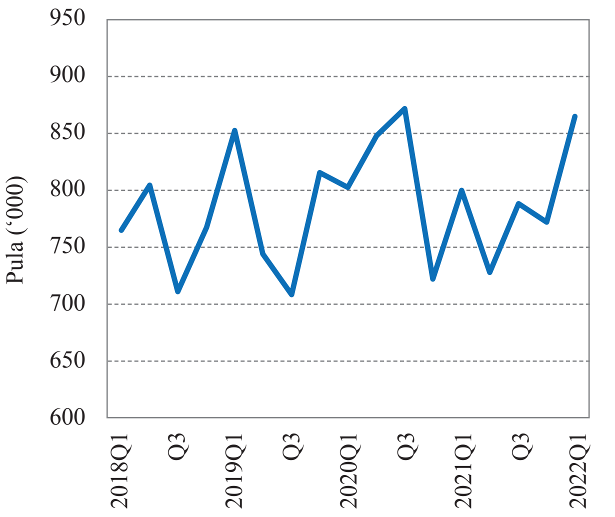
In April 2021, Moody's Investors Service downgraded Botswana's sovereign credit rating for long-term bonds, denominated in both domestic and foreign currency, from 'A2' to 'A3'. However, the economic outlook was changed from negative to stable. The downgrade is due to the reduction in the capacity of 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.

3.5 Asset markets

Property market generally remained stable in the first quarter of 2022

According to the latest (2022Q1) Riberry Report[10], the average price for residential properties sold in the first quarter of 2022 increased by 12 percent to P865 150, compared to the previous quarter (Chart 3.13), reflecting an increase in the number of high-valued properties traded in the quarter under review. However, the residential rental market continued to show signs of weakness in the first quarter of 2022 compared to the fourth quarter of 2021, indicating a decline in rentals of upper-end properties. Nevertheless, the rental market continued to enjoy good demand and supply for low-end properties. Middle-end houses for rent experienced weaker demand and supply.

Chart 3.13: Riberry Average Prices



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

The market for office space remained weak due to increasing supply from completed construction developments, such as the Botswana Unified Revenue Service building at the Gaborone Central Business District (CBD) and the Innovation Hub building. Furthermore, demand remains weak and uncertain due to generally subdued business conditions following the advent of COVID-19 pandemic. Despite the negative impact of the pandemic and generalised weak demand for office space, there has been continued good office enquiries and/or uptake in the CBD and Showgrounds. Going forward, there is a possible likelihood for a slowdown in uptake at the CBD should Government institutions remain in their current premises and location. In addition, the supply of office space is projected 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]

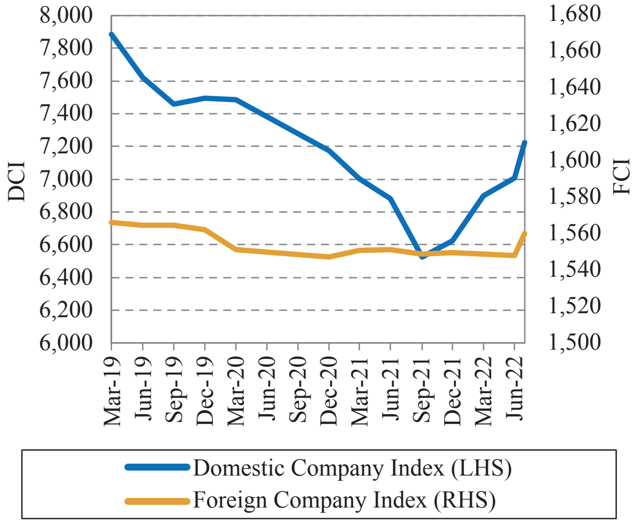
Similar to the previous quarter, the demand for retail space remained fair across all market segments, while the supply is expected to increase following completion of The Fields Mall in the CBD, while two other malls are proposed for Mogoditshane. In addition, other centres with good demand for retail space are Jwaneng, Selibe Phikwe, Maun, Francistown, Mahalapye and Letlhakane. Most of these locations have a few retail schemes, to be anchored by reputable supermarkets, at planning and/or construction stage. Regarding industrial property, the supply of unoccupied big warehouse space has decreased, while the demand has improved.[12] Meanwhile, the availability of prime location industrial space is expected to improve going forward.

Stock market indices increased

The Domestic Companies Index (DCI) increased by 8.2 percent in the twelve months to July 2022, compared to a reduction of 5.5 percent in the year to July 2021 (Chart 3.14). The increase was mainly due to the higher share prices for Letshego, Standard Chartered Bank and Letlole, which increased by 41.9 percent, 28.6 percent and 27.7 percent, respectively, in the same period. The higher share prices reflected increased trading activity following the low base arising from the impact of the COVID-19 pandemic in 2020.

The Foreign Companies Index (FCI) also increased by 0.6 percent in the year to July 2022, higher than an increase of 0.1 percent in the corresponding period in 2021 (Chart 3.14). This was largely due to the year-on-year increase in the share prices for Botswana Diamonds PLC (BOD) (25 percent) on account of higher trading activity and liquidity.

Chart 3.14: Stock Market Indices



Source: Botswana Stock Exchange

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.

Box 1: 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 effected 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.

3.6 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 2 for details.

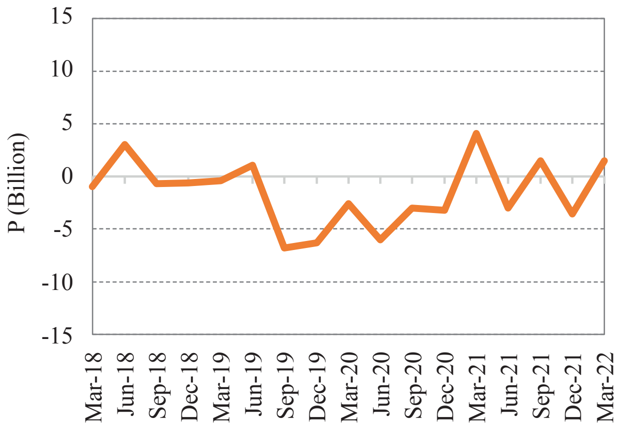
Current account recorded a surplus in the first quarter of 2022

The current account is estimated to have recorded a surplus of P1.5 billion in the first quarter of 2022, compared to a surplus of P4.1 billion during the corresponding period in 2021 (Chart 3.15). The surplus was primarily attributable to positive balances in both merchandise trade and secondary income accounts. Exports increased by 7.1 percent from P24.1 billion to P25.8 billion, while imports increased by 9.4 percent from P22.4 billion to P24.5 billion, leading to a surplus of P1.2 billion in the merchandise trade account. SACU revenues, which dominates the secondary income account, amounted to P3.5 billion during the quarter.

Diamond exports, which accounted for 90.1 percent of total exports of goods in the first quarter of 2022, increased from P22.7 billion in the first quarter of 2021 to P23.2 billion in the first quarter of 2022. During the same period, diamond imports increased slightly from P9.1 billion to P9.2 billion. The increase in diamond exports mainly stemmed from growing demand by major rough diamond markets in the United Arab Emirates (UAE), Belgium and India, driven by consumer demand for diamond jewellery in key 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 meat and meat products (131.9 percent), live cattle (49.1 percent) and textiles (21.2 percent). In addition, copper and nickel exports notably increased from P1.1 million to P652.3 million owing to the 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, machinery and electrical equipment, as well as chemicals and rubber products, which increased by 52.3 percent, 24.6 percent and 22.1 percent, respectively.

Chart 3.15: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account recorded a negative net balance in the first quarter of 2022

The financial account is estimated to have recorded a negative net balance of P7.5 billion in the first quarter of 2022, implying that the country was a net debtor to countries abroad, compared to a positive net balance of P2.7 billion in the first quarter of 2021. The negative net balance was mainly attributable to a substantial drop in equity assets held abroad by local pension fund managers. International equity markets have been falling, amid increased risks and disruptions from the war in Ukraine.

The balance of payments was in surplus in the first quarter of 2022

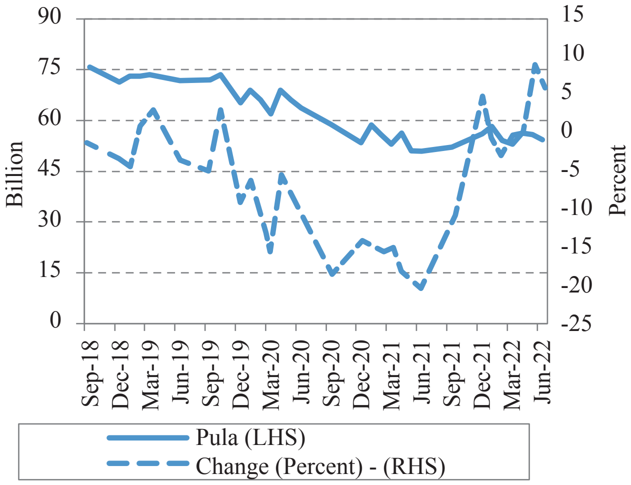
The overall BoP recorded an estimated surplus of P2.2 billion in the first quarter of 2022, from a deficit of P904 million in the corresponding period in 2021. The surplus was mainly attributable to diamond exports and SACU revenue inflows.

Foreign exchange reserves increase

As at the end of June 2022, foreign exchange reserves amounted to P54.2 billion, an increase of 6.5 percent from P50.9 billion in June 2021 (Chart 3.16).

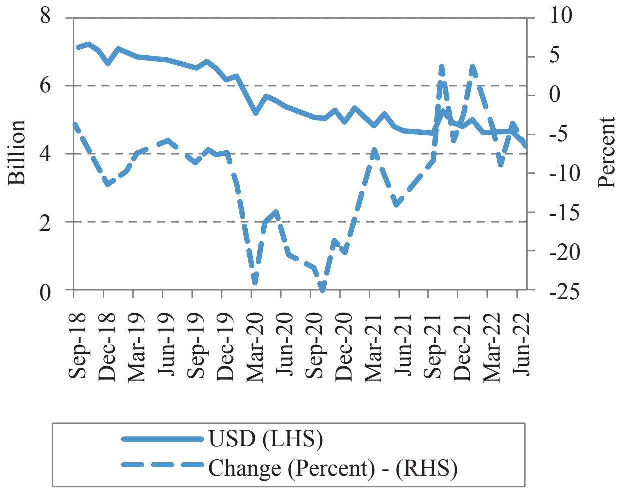
In foreign currency terms, the level of reserves decreased by 6.4 percent from USD4.7 billion in June 2021 to USD4.4 billion in June 2022 (Chart 3.17). The reserves remained unchanged at SDR3.3 billion during the same period. The level of reserves as at the end of June 2022 was equivalent to 8.8 months 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 2: 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. This downward rate of crawl was implemented from May 1, 2020 with a view to enhancing 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 July 2022, the Pula depreciated by 4.6 percent and 0.6 percent against the SDR and South African rand, respectively. (Chart 3.18). Against the SDR constituent currencies, the Pula depreciated by 11.5 percent against the US dollar and 7.7 percent against the Chinese renminbi, while it appreciated by 7 percent against the Japanese yen, 2.6 percent against the euro and 1 percent against the British pound.

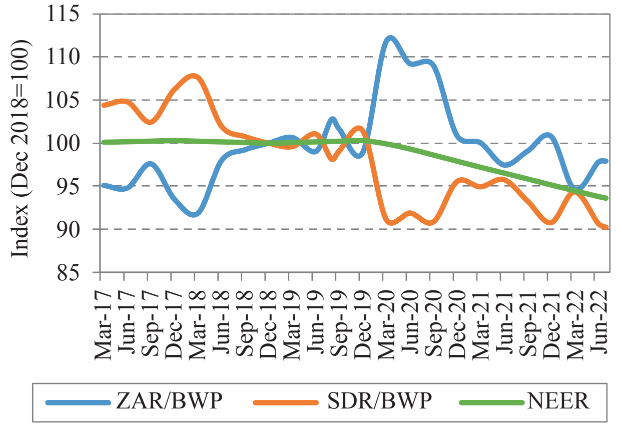
Ideally, the movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. Therefore, in the same review period, the South African rand depreciated by 4.1 percent against the SDR. With respect to the SDR constituent currencies, the South African rand depreciated by 11 percent against the US dollar and 7.2 percent against the Chinese renminbi, while it appreciated by 7.6 percent against the Japanese yen, 3.1 percent against the euro and 1.5 percent against the British pound.

The South African rand depreciated against most major trading currencies due to raised concerns over the country's economic outlook on account of severe power cuts and increasingly unstable labour relations and associated labour strikes[13] across South Africa as workers demand higher pay to cope with the soaring cost of living.

Furthermore, the risk appetite was dented by global factors including a deterioration in projections for global growth due to rising energy prices and lack of progress in Russia-Ukraine peace talks, which has been driving demand for the safe-haven currencies, such as the US dollar and the Japanese yen. However, the South African rand was partially supported by rising commodity prices, which have boosted export income for the country, and expectations of continued monetary policy tightening by the SARB.

[13] During July 2022, there were industrial actions at Eskom, the South Africa Revenue Service (SARS), the trucking industry and some mines. Meanwhile, the National Union of Metalworkers of South Africa (Numsa) has also threatened industrial action as it calls for a wage increase of up to 20 percent.

Chart 3.18: Nominal Exchange Rate Indices

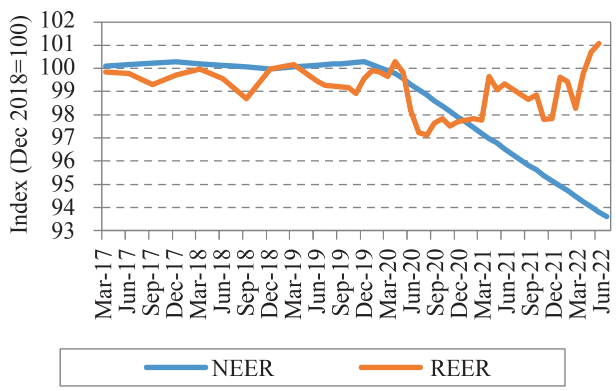


Source: Bank of Botswana

NEER depreciated in July 2022

The NEER of the Pula depreciated by 2.8 percent in the twelve months to July 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 June 2022

The REER appreciated by 1.8 percent in the twelve months to June 2022 (Chart 3.19), because of a higher positive inflation differential (4.7 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 5.2 percent against the South African rand and depreciated by 1 percent against the SDR. Against the SDR constituent currencies, the domestic currency appreciated by 19.8 percent against the Japanese yen, 4.2 percent against the euro, 3.6 percent against the British pound and 0.7 percent against the Chinese renminbi, while it depreciated by 8.8 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 July 2022 compared to the April 2022 WEO projections, largely due to the Russia-Ukraine war and associated sanctions, lockdowns in China to contain the COVID-19 virus, reduced household purchasing power due to elevated inflationary pressures, as well as tighter financial conditions to contain inflation. 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 extensive power shortages and temporay production disruptions following the Kwa-Zulu Natal floods. With regard to price developments, global inflation is projected to remain elevated in 2022, influenced by the increases in food and fuel prices associated with the Russia-Ukraine war, as well as prolonged supply chain disruptions.

Global economic growth to slowdown

According to the July 2022 WEO Update, global output growth is forecast at 3.2 percent and 2.9 percent in 2022 and 2023, respectively, from an estimated expansion of 6.1 percent in 2021, driven mostly by major downgrades for the US, China, Germany and India. The growth forecast for 2022 was revised downwards by 0.4 percentage points compared to the April 2022 projection, in part, 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 projected slowdown in the Chinese economy owing to extended lockdowns to contain the spread of the COVID-19 virus, as well as restrained consumer spending in the US.

For advanced economies, output is forecast to expand by 2.5 percent in 2022, a moderation from an expansion of 5.2 percent in 2021. The 2022 projection was downgraded by 0.8 percentage points from the April 2022 WEO, mostly reflecting macroeconomic effects of a sharp tightening of global financial conditions resulting from aggressive tightening of monetary policy by major central banks amid elevated inflationary pressures, as well as weaker consumer and business confidence.

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, particularly food and fuel, 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. Furthermore, the possiblity of inflation remaining stubbornly high, necessitating further worldwide monetary policy tigtening, could trigger debt distress in emerging market and developing economies, thus negatively affecting financial stability and economic activity.

UK economic growth to slow down in 2022

The UK economy is expected to grow by 3.2 percent in 2022 (0.5 percentage points lower compared to the April 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 moderate to 0.5 percent in 2023, remaining below pre-pandemic levels.

Output growth for US to moderate

For the US, output is forecast to grow by 2.3 percent in 2022, a decline from an expansion of 5.7 percent in 2021, before moderating further to an expansion of 1 percent in 2023. The 2022 forecast is 1.4 percentage points lower compared to the April 2022 projection, mainly reflecting weaker-than-expected growth in the first half of 2022, on the backdrop of restrained private consumption, in part, reflecting the erosion of household purchasing power and expected faster normalisation of monetary policy than in the previous projection.

Growth for the euro area to moderate

In the euro area, economic growth is projected to moderate to 2.6 percent in 2022 (0.2 percentage points downgrade compared to the April 2022 WEO) from an expansion of 5.4 percent in 2021, largely due to major downgrade in output projections for Germany, Spain and France 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, as well as the assumption of tighter financial conditions with the ECB ending net asset purchases and raising interest rates in July 2022 for the first time since 2011. Meanwhile, GDP growth for the region is forecast to slow further to 1.2 percent in 2023, 1.1 percentage points lower compared to the projection made in April 2022.

Emerging markets GDP growth projected to moderate

Economic activity in emerging market and developing economies is projected to expand by 3.6 percent in 2022, from an estimated expansion of 6.8 percent in 2021. The 2022 economic performance has been revised downwards by 0.2 percentage points relative to the April 2022 WEO, mainly reflecting the steep slowdown of the Chinese economy, the moderation in India's economic growth and, to some extent, the expected contraction in Russia (by 6 percent in 2022), owing to the sanctions following to the country's invasion of Ukraine, which disrupted trade flows, particularly for energy and food.

GDP in India is forecast to grow by 7.4 percent and 6.1 percent in 2022 and 2023, respectively. The 2022 projection is 0.8 percentage points lower than the April 2022 forecast, mainly reflecting less favourable external conditions and more rapid policy tightening which are expected to weigh on private consumption, investment and lower net exports.

In China, the ongoing lockdowns in key manufacturing and trade hubs are anticipated 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 is expected to slow down substantially from 8.1 percent in 2021 to 3.3 percent in 2022, 1.1 percentage points lower than the April 2022 projection.

Growth prospects for the South African economy remain weak

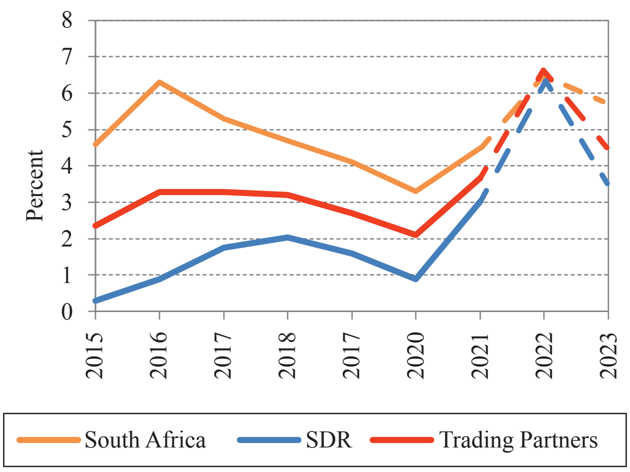
Growth prospects in South Africa are expected to remain restrained on account of tight monetary policy conditions to control inflationary pressures, as well as continued COVID-19 episodes, restrained fiscal support, lingering supply bottlenecks and the long-standing power supply shortage crisis. Thus, South African output is forecast to expand by 2.3 percent and 1.4 percent in 2022 and 2023, respectively, from an expansion of 4.9 percent in 2021. The 2022 projection is 0.4 percentage points higher than the April 2022 WEO, but unchanged for 2023. Meanwhile, in July 2022, the SARB revised forecasts for GDP growth for 2022 and 2023 to 2 percent and 1.3 percent, from 1.7 percent and 1.9 percent, respectively, at the May 2022 MPC meeting. The higher projection for 2022 was due to a combination of factors, including stronger growth in the first quarter of 2022. Nonetheless, the SARB indicated that the flooding in Kwa-Zulu Natal and more extensive load shedding are expected to negatively affect economic activity and result in contraction of GDP in the second quarter.

Global inflation to increase

Globally, inflation is expected to remain elevated in the second half of 2022, driven by escalation of the Russia-Ukraine war and subsequent sanctions imposed by some major countries on Russia, the soaring food and fuel prices, 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 6.6 percent in 2022, while for emerging market economies, it is forecast to increase from 5.9 percent to 9.5 percent. Overall, global inflation is expected to increase from 4.7 percent in 2021 to 8.3 percent in 2022.

Meanwhile, according to the SARB, South African inflation is forecast to average 6.5 percent and 5.7 percent in 2022 and 2023, respectively. The forecast for 2022 is 0.6 percentage points higher compared to the May 2022 projection, reflecting higher food and fuel prices amidst Russia-Ukraine war, which is expected to further impair production and add more to the already existing pandemic-induced supply shortages. Overall, inflation is anticipated to be above the SARB's target range in 2022, and to revert to within the target range of 3–6 percent in the second quarter of 2023 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



Source: SARB and Bloomberg

Global diamond prices to increase

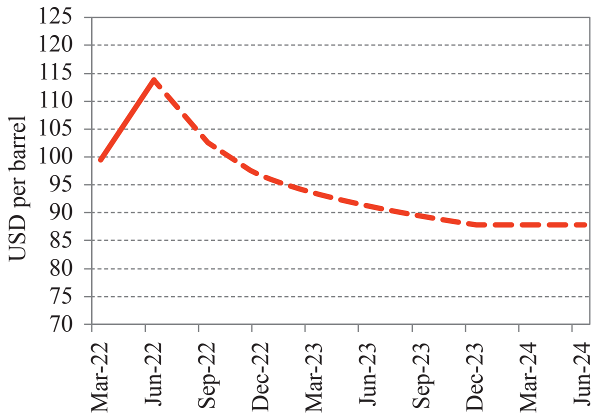
Global rough diamond prices are expected to increase in the short to medium term, buoyed by the supply chain disruption resulting from the exclusion of Russian diamonds in the global market following Russia's invasion of Ukraine, as well as successful rollout of effective COVID-19 vaccines. In addition, 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. However, a deterioration of global macro-economic conditions and reduced consumer spending in US and China could negatively impact the demand for diamond jewellery, going forward.

International oil and food prices to slow down but remain relatively high

International oil prices are projected to remain relatively high in the short term but anticipated to slow from a peak realised in the second quarter of 2022 (Chart 4.2). The projected slowdown in oil prices considers the continued lockdowns in China, the world's biggest oil importer, release of strategic crude oil reserves in the US, as well as the use of alternative sources of energy and the resumption of gas supply to Europe by Russia. However, international oil prices are projected to remain relatively high, amid supply disruptions due to heightened Russia-Ukraine crisis, as well as continued failure by some OPEC members to increase output as agreed. Moreover, should there be a complete cessation of exports of Russian gas to European countries, this could contribute to high energy prices and inflation in general.

Overall, developments in the international oil market imply marginal downward pressure on domestic inflation in the short term.

Chart 4.2: International Oil Prices



Source: Bloomberg

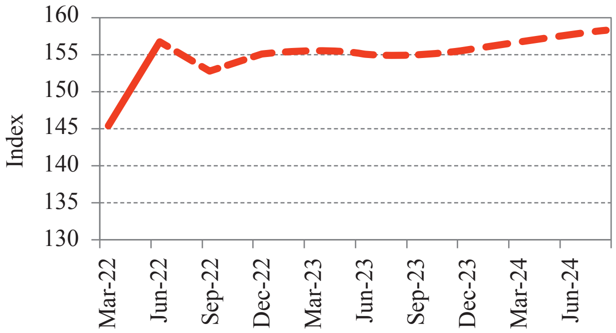
Global food prices are expected to trend downwards in the short term (Chart 4.3) but remain relatively high. However, the anticipated relatively high food prices mainly reflect increased demand and cost push pressures arising from supply disruptions caused by the COVID-19 pandemic and the Russia-Ukraine war, given that the two countries are the main exporters of food items, such as wheat, corn and sunflower oil.

Meanwhile, the anticipated decline in food prices in the short term reflects increased seasonal output of major producer countries, such as Argentina, Brazil and Canada, prospects for increased export supply from the recently signed grain supply deal between Ukraine, Russia, Turkey and the United Nations, as well as the expected easing in international oil prices as oil is used as input in food production.

In Southern Africa, food prices are expected to 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 downward 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 moderate to 4.2 percent and 4.1 percent in 2022 and 2023, respectively, from a higher expansion of 11.4 percent in 2021. The economy is anticipated to continue operating below its potential into the medium term. However, economic recovery will be 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 and the implementation of the ERTP initiatives, among others.

Output growth to moderate in 2022

MoF projects GDP to expand by 4.2 percent in 2022, from a higher expansion of 11.4 percent in 2021, as growth in the mining sector moderates. 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 June 2022 Business Expectations Survey (BES) indicates that firms are pessimistic about business conditions in the second quarter of 2022 than they were in the previous survey. The pessimism is reflected by firms' expectations of weaker domestic economic performance, resulting from the increase in cost pressures arising from the geopolitical crisis in Eastern Europe. Firms expect GDP to expand by 3.1 percent in the second 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. The below output trend is also consistent with the high unemployment rate (26 percent as at the fourth quarter of 2021) and restrained growth in real wages.

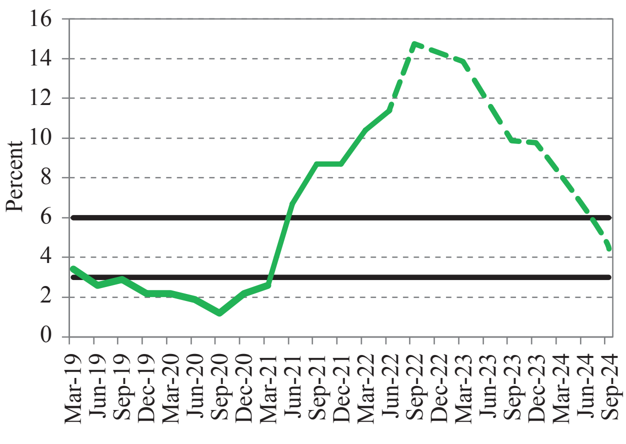
4.3 Monetary policy and the inflation outlook

Inflation is forecast to remain above the Bank's 3–6 percent objective range into the medium term. The inflation forecast has been revised upwards over the forecast horizon, with inflation now expected to fall from the fourth quarter of 2022 and to revert to within the objective range in the third quarter of 2024. The upward revision compared to the June 2022 forecast reflects the impact of the recent increases in domestic fuel prices and Air Botswana passenger fares, the upward adjustment in the Bokomo flour and maize prices on August 1, 2022, the possible increase in electricity tariffs in April 2023, and the upward revision in forecasts for trading partner countries' inflation.

Inflation is projected to be high in the near to medium term

Inflation is projected to remain above the objective range in the near to medium term, mainly reflecting the impact of transitory supply-side factors. Nonetheless, inflation is expected to start falling from the fourth quarter of 2022, albeit high, mainly reflecting the dissipating impact of the upward adjustment in administered prices during 2021 from the inflation calculation, as well the impact of anticipated decrease in trading partner countries' inflation and international commodity prices, as well as tightening financial conditions. Therefore, inflation is expected to revert to within the objective range in the third quarter of 2024 (Chart 4.4).

Chart 4.4: Botswana Headline Inflation Forecast

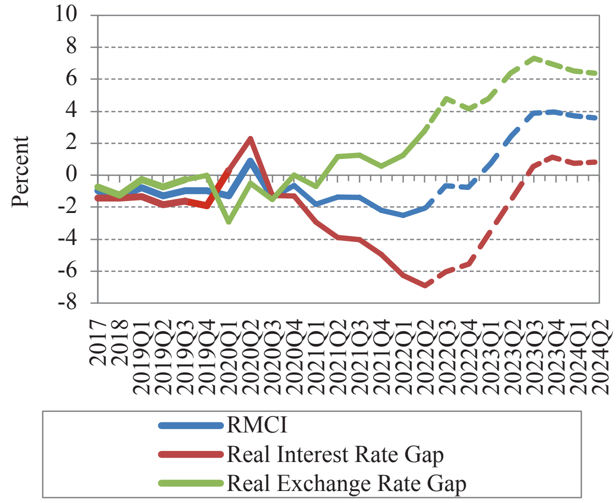


Source: Bank of Botswana

The projection considers the anticipated slowdown in domestic output growth in response to the anticipated overall restrictive monetary conditions (Chart 4.5); the recent increase in domestic fuel prices effected on June 28, 2022; the increase in air passenger fares by Air Botswana on July 8, 2022; the upward adjustment in Bokomo flour and maize prices on August 1, 2022; the possible increase in electricity tariffs in April 2023; the upward revision in forecasts for trading partner countries' inflation; the upward revision in forecasts for the Pula against the South African rand; and the base effects associated with adjustments in administered prices. The projection also considers the inflation relief measures recently announced by Government to reduce VAT from 14 percent to 12 percent, as well as zero rating cooking oil and liquid petroleum gas (LPG).

The increase in domestic fuel prices in June 2022 added approximately 1.13 percentage points to inflation in the third quarter of 2022, while the increase in air passenger fares in July 2022 added approximately 0.16 percentage points to inflation in the same period. Moreover, the increase in Bokomo flour and maize prices is also expected to add 0.32 percentage points to inflation in the third quarter of 2022, while the proposed increase in electicity tariffs in April 2023 is anticipated to add approximately 0.30 percentage points to inflation in the second quarter of 2023. Conversely, the reduction in VAT and zero rating of cooking oil and LPG is expected to reduce inflation by approximately 1.2 percentage points in the third quarter of 2022. Meanwhile, according to the June 2022 BES, the business community expects inflation (on average) to remain above the Bank's objective range in 2022, at 8.5 percent.

Chart 4.5: Real Monetary Conditions

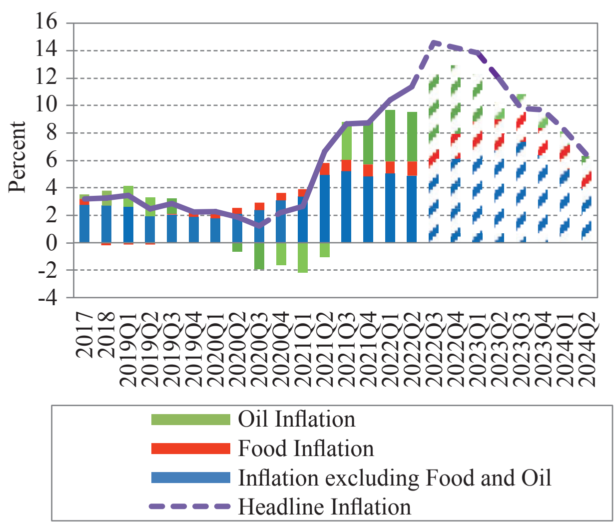


Source: Bank of Botswana

Core inflation to increase in the short term

Inflation, excluding food and fuel prices, is forecast to increase in the short term, on account of the expected improvement in non-mining output growth. Nonetheless, core inflation is expected to decline in the medium term, mainly because of the dissipating impact of the upward adjustment in administered prices of 2022 from the inflation calculation (Chart 4.6).

Chart 4.6: Headline Inflation and its Components

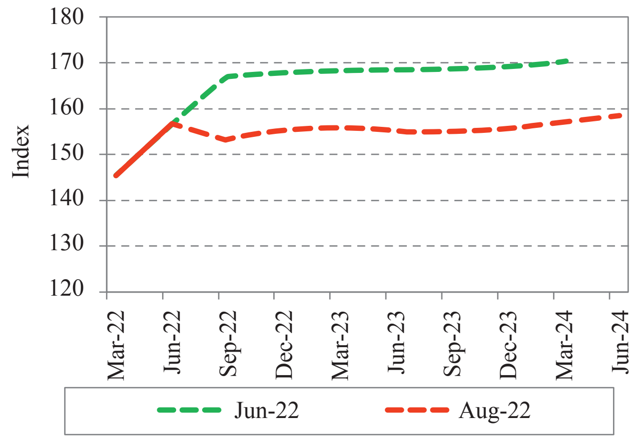


Source: Bank of Botswana

International food prices revised downwards

Compared to the June 2022 forecast, international food prices have been revised downwards over the forecast horizon (Chart 4.7). The downward revision reflects, in part, seasonal output of major producer countries, prospects for increased export supply from the recently signed grain supply deal between Ukraine, Russia, Turkey and the UN, use of alternative food sources and decreased demand prospects amid signs of an economic slowdown.

Chart 4.7: International Food Prices FAO Index

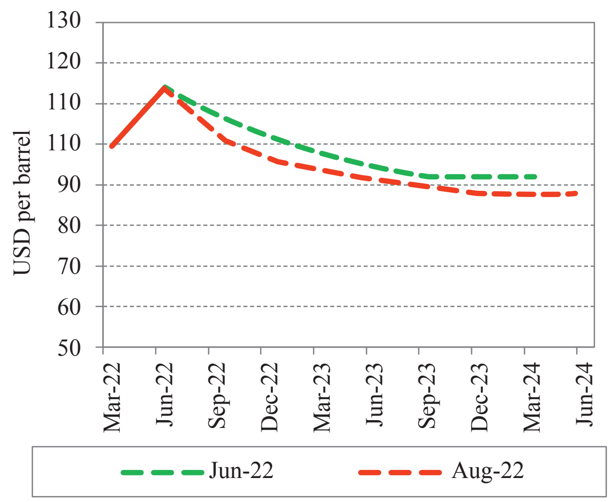


Source: Bloomberg

International oil prices revised downwards

Relative to the June 2022 projection, international oil prices have been revised downwards (Chart 4.8), supported by the strong US dollar, continued lockdowns in China, which is the world's biggest oil importer, fears of a global economic recession following extensive contractionary monetary policy stance by central banks, the use of alternative sources of energy and the resumption of gas supply to Europe by Russia. However, international oil prices are projected to remain elevated amid supply disruptions due to heightened Russia-Ukraine crisis, as well as continued failure by some OPEC members to increase output production as agreed.

Chart 4.8: International Oil Prices



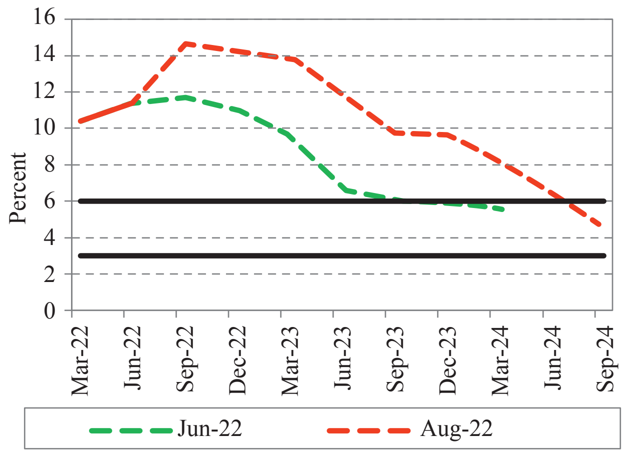
Source: Bloomberg

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

Inflation forecast revised upwards over the forecast horizon

Compared to the June 2022 forecast, inflation is projected to be higher over the forecast horizon, reflecting the impact of the recent increase in domestic fuel prices, the increase in air passenger fares by Air Botswana, the upward adjustment in the Bokomo flour and maize prices on August 1, 2022, the possible increase in electricity tariffs in April 2023 and the upward revision in forecasts for trading partner countries' inflation (Chart 4.9).

Chart 4.9: Botswana Headline Inflation Revision



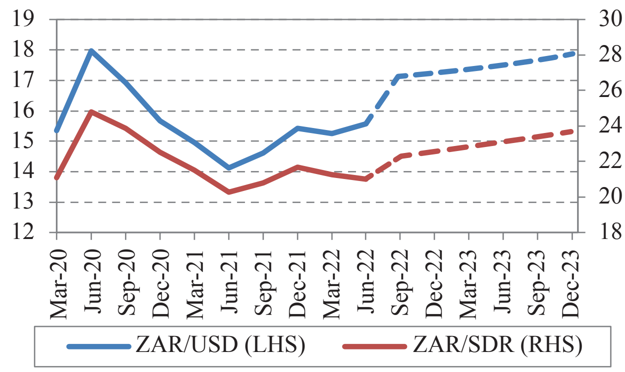
Source: Bank of Botswana

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 the SDR and the US dollar 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)[14], 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 war 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 South African rand is expected to be supported by rising commodity prices and expectations of continued monetary policy tightening by the South African Reserve Bank.

Chart 4.10: ZAR against USD and SDR



Source: Bloomberg

The US dollar is expected to appreciate against most major international currencies, with the exception of the Chinese renminbi, in the next four quarters (Chart 4.11A and Chart 4.11B) as the Federal Reserve is expected to be aggressive in hiking interest rates to fight high inflation. The dollar is also expected to remain strong on the safe-haven status on the back of fears of a looming global economic recession, emanating from the effects of the geo-political conflict between Russia and Ukraine.

The British pound is expected to depreciate against the US dollar (Chart 4.11A) as investors speculate that the BoE will hike interest rates less than money markets discount. The BoE raised the Bank Rate by 50 basis points to 1.75 percent during its August 2022 meeting, the sixth consecutive rate hike, pushing borrowing costs to the highest since

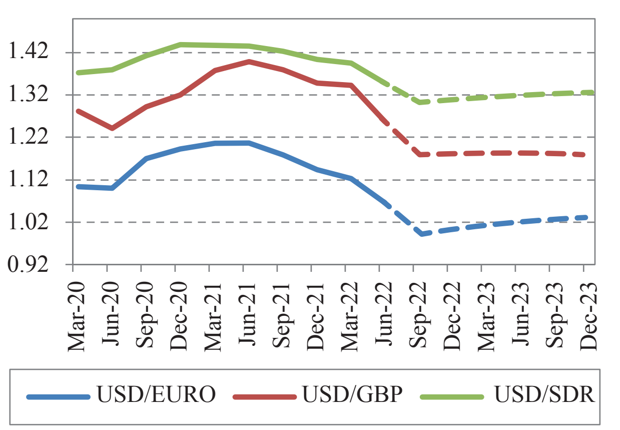
[14] The South African GDP growth is projected at 2 percent for 2022 and expected to average 1.9 percent over the next two years. The consolidated budget deficit is projected to narrow from 5.7 percent of GDP in 2021/22, to 4.2 percent of GDP by 2024/25. Meanwhile, the debt ratio will stabilise at 75.1 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.

2009. Money markets now expect a 25 basis points hike in September, with the central bank anticipating the peak of inflation at 13.3 percent in October 2022. However, investors anticipate the BoE will reverse policy course fairly quickly next year. Meanwhile, the euro is also anticipated to depreciate against the US dollar due to rising inflationary pressures on the back of the energy crisis. However, the ECB is expected to raise interest rates faster this year in attempt to ease the inflationary pressures.

The Japanese yen is expected to depreciate against the US dollar due to the growing divergence in the direction of monetary policy between Japan and the US. The BoJ signalled its commitment to keep monetary policy accommodative despite a global shift toward tighter monetary settings. However, the yen will be supported by its safe-haven status amidst fears of a global recession.

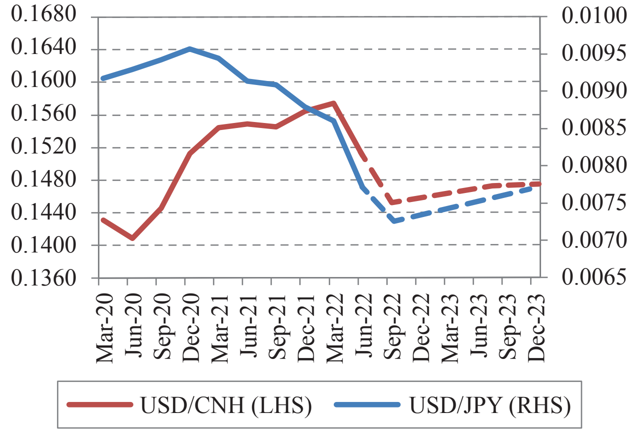
The Chinese renminbi, however, is expected to appreciate against the US dollar in the next four quarters (Chart 4.11B), as the yield differentials is still favourable to the currency, despite the Fed's aggressive monetary policy tightening. Monetary policy support from the People's Bank of China is expected to keep the Chinese economic growth on track.

Chart 4.11A: Exchange Rates against USD



Source: Bloomberg

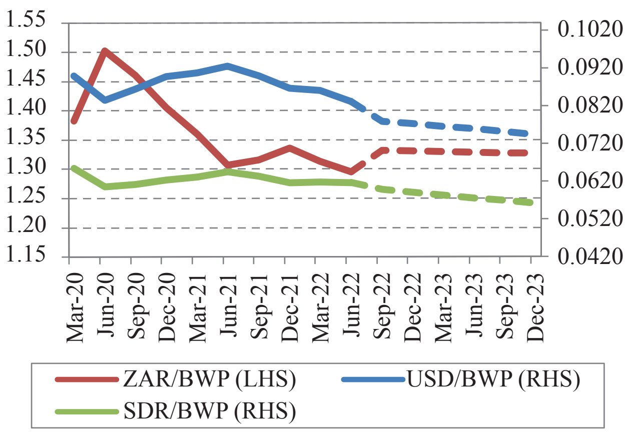
Chart 4.11B: Exchange Rates against the USD



Source: Bloomberg

Overall, forecast movements of the SDR constituent currencies imply a depreciation 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 marginal downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.12). Consequently, the Pula is expected to appreciate against the South African rand over the forecast period. The projected appreciation of the Pula against the South African rand is expected to contribute positively to the domestic inflation outlook.

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



Source: 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; persistence of supply and logistical constraints to production; the economic and price effects of the protracted Russia-Ukraine conflict, the uncertain COVID-19 profile and the escalating tension between China and Taiwan. Moreover, domestic risk factors relating to possible annual administered price adjustments, short-term unintended consequences of import restrictions; second-round effects of the recent increases in administered prices, the domino effects of the recent increase in public service salaries and entrenched expectations for higher inflation could lead to general 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 ERTP initiatives.

Box 3: 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 agents' 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 Monetary Policy 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. AUGUST 2022 MONETARY POLICY COMMITTEE DECISION

At the meeting held on August 25, 2022, the Monetary Policy Committee (MPC) of the Bank of Botswana decided to increase the Monetary Policy Rate (MoPR) by 50 basis points from 2.15 percent to 2.65 percent.

Inflation increased from 12.7 percent in June 2022 to 14.3 percent in July 2022, the highest value since the December 2008 figure of (13.7 percent), remaining above the Bank's medium-term objective range of 3–6 percent. The latest increase in inflation was broad-based across categories of goods and services and, was more pronounced with respect to domestic fuel prices and Air Botswana passenger fares. The MPC projects that inflation will remain above the objective range into the medium term but trend downward from the fourth quarter of 2022 and fall within the objective range from the third quarter of 2024. This represents a revision of the trajectory for inflation from the June forecast, influenced, in part, by subsequent increase in fuel prices. The projected decrease in inflation in the medium term is due to the dissipating impact of earlier increase in administered prices, anticipated decrease in trading partner countries' inflation and international commodity prices, and higher cost of credit, globally.

There is a 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 to production; the economic and price effects of the ongoing Russia-Ukraine war, the uncertain COVID-19 profile and the escalating tension between China and Taiwan. On the domestic front, the risks for higher inflation than currently projected relate to possible annual administered price adjustments; short-term unintended consequences of import restrictions; second-round effects of the recent increase in administered prices; upward pressure on wages across the economy emanating from increase in public service salaries; and entrenched expectations for higher inflation, which could lead to general higher price adjustments.

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 13 percent in the twelve months to March 2022, compared to a contraction of 8.8 percent in the corresponding period in 2021. The increase in output occurred in both the mining and non-mining sectors and reflects an improved economic performance from the low base, associated with the negative impact of COVID-19 pandemic containment measures.

According to the July 2022 World Economic Outlook Update, global output growth was 6.1 percent in 2021 and is forecast to decrease to 3.2 percent and 2.9 percent in 2022 and 2023, respectively. For Botswana, GDP growth is expected to moderate to 4.2 percent in 2022 and 4.1 percent in 2023, from a higher expansion of 11.4 percent in 2021.

The MPC notes the growth-enhancing economic transformation reforms and supportive macroeconomic policies currently being implemented. These include easy access to credit at a modest relative cost, improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including effective vaccination rollout programme. Against this background, enhanced productivity, innovation, increased production capacity and efficiencies, as well as resultant competitiveness of domestic firms against imports and in international markets could contribute to sustained maintenance of modest domestic inflation.

The MPC observes that the elevated inflation outlook partly emanates from supply side factors (for example, increase in food and fuel prices) and related second-round effects and entrenched expectations (including, through price adjustments by businesses, contractors, and property owners). Therefore, in the interest of maintenance of price stability in the medium term, it is important to undertake monetary policy action to moderate demand and prospects for second-round effects and entrenched expectations for high inflation. In the circumstances, the MPC decided to increase the MoPR by 50 basis points to 2.65 percent to anchor expectations for desired low level of inflation.

As a result:

(a) the repos and reverse repos will be conducted at the MoPR of 2.65 percent;

(b) the Standing Deposit Facility (SDF) Rate will be 1.65 percent (100 basis points below the MoPR); and

(c) the Standing Credit Facility (SCF) Rate will be 3.65 percent (100 basis points above the MoPR).

The remaining MPC meetings for 2022 are scheduled as follows:

October 20, 2022

December 1, 2022

Annex: Inflation Forecast Summary for August 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	Q2	Q3
Inflation	2.6	6.7	8.7	8.7	6.7	10.4	11.4	14.6 (11.6)	14.2 (11.1)	12.6 (11.2)	13.9 (9.6)	11.9 (6.7)	9.8 (6.0)	9.7 (5.9)	11.3 (7.1)	8.2 (5.6)	6.4 (5.1)	4.4 (4.7)

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

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

Domestically

1. Higher inflation in July 2022 than was anticipated
2. The increase in domestic fuel prices effected on June 28, 2022
3. The increase in Air Botswana passenger fares effected on July 8, 2022
4. The upward adjustment in the Bokomo flour and maize prices on August 1, 2022
5. The possible increase in administered prices in 2023

Externally

1. Trading partner inflation revised upwards in the short term

NOTE