MONETARY POLICY REPORT

BANK OF BOTSWANA

BANKA YA BOTSWANA

APRIL 2019

BANK OF BOTSWANA

STRATEGIC INTENT STATEMENTS

VISION

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

MISSION

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

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

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1. PREFACE

1.1 Purpose of the report

The Monetary Policy Report (MPR) is the main medium through which the Bank of Botswana (the Bank) informs the public about the formulation and implementation of monetary policy. It provides a comprehensive, forward-looking framework for policy formulation by the Monetary Policy Committee (MPC) and serves as a basis for policy decisions. It also 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 is published following the April, August and October meetings of the MPC. 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 and Economic Development (MFED), 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 uses short-term interest rates to steer the economy through business cycles, thus helping to maintain price stability.

In evaluating policy options, the Bank pursues a forward-looking monetary policy with a central role for a medium-term inflation forecast. The Bank changes policy whenever required, in order to steer projected movements of inflation towards the medium-term objective, while taking into account 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 is evaluated on a rolling basis, because monetary policy affects price developments with a considerable 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 Bank Rate. To support this signal, the Bank uses open market operations, which consist primarily of auctioning Bank of Botswana Certificates to, and engaging in Repo/Reverse Repo transactions with, commercial banks (primary dealers), as well as adjustment of the Primary Reserve Requirement Ratio (although this is rarely used).

1.3 Decision-making process

Monetary policy is implemented in line with the decisions of the MPC. The Committee comprises: the Governor (Chairman); the two Deputy Governors; General Manager responsible for banking and currency management; Director of Research and Financial Stability Department and the two Deputy Directors of the Department responsible for monetary policy and financial stability, respectively; Director and Deputy Director of the Financial Markets Department responsible for the domestic market operations; and Director of the Banking Supervision Department. The MPC holds six pre-scheduled meetings per year, at which the monetary policy stance is decided. However, the Committee can meet more often if need be. Prior to the commencement of the year, the dates for the MPC meetings are announced for the year ahead.

1.4 Announcement of the monetary policy decision

The monetary policy decision is announced through a statement issued through a Press Release shortly after each MPC meeting. The Press Release informs the public of the Committee's decision regarding the Bank Rate 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.

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 Bank's policy choices for the ensuing year. Subsequently, the MPR is produced for the April, August and October 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 2019, monetary policy is implemented in the context of a favourable medium-term inflation outlook, associated with moderate domestic demand resulting from the restrained increase in personal incomes and expected modest increase in foreign prices. Hence, the Bank Rate was maintained at 5 percent at the April 2019 MPC meeting. The last policy change was in October 2017, when the Bank Rate was reduced by 50 basis points from 5.5 percent to 5 percent.

Upside risks to the inflation outlook relate to any unanticipated substantial upward adjustment in administered prices and government levies and/or taxes, and any increase in international commodity prices beyond current forecasts. There are, however, downside risks associated with restrained global economic activity, and modest growth in both the domestic economy and government expenditure. Overall, risks to the inflation outlook are assessed to be marginally on the upside.

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 ensure price stability without undermining economic activity.

Headline inflation averaged 3.4 percent in the first quarter of 2019, an increase from an average of 3 percent in the first quarter of 2018, mostly accounted for by a faster increase in prices for the operation of personal transport and transport services sub-indices. Inflation is expected to remain within the 3 – 6 percent objective range in the short to medium term.

Gross domestic product (GDP) grew by 4.5 percent in 2018, higher than the 2.9 percent growth in 2017, mainly attributable to the continued good performance in non-mining sectors and the recovery in mining output. Output growth is projected at 4.2 percent and 4.8 percent in 2019 and 2020, respectively, reflecting the anticipated positive prospects for global economic activity, accommodative domestic monetary conditions and expected growth in government spending. The accommodative monetary conditions in the domestic economy and the expected expansion in government expenditure are expected to add impetus to economic activity in the non-mining sectors, hence have a positive impact on overall economic growth. However, output is projected to remain below potential in the forecast horizon.

Annual growth in commercial bank credit accelerated to 7.7 percent at the end of the fourth quarter of 2018 from 5.6 percent in the corresponding period in 2017, reflecting, in part, increased growth in lending to the business sector, including increased utilisation of existing credit facilities by construction, trade and business services companies and for households, resulting from increase in personal loans.

At the end of December 2018, foreign exchange reserves amounted to P71.4 billion, a decrease of 3.1 percent from P73.7 billion in December 2017; this is equivalent to 15 months of import cover of goods and services. The decrease reflects, among others, deficit funding by government and valuation losses from changes in asset prices. The current account recorded a deficit of P925 million, mainly due to an increase in diamond imports.

The nominal effective exchange rate (NEER) of the Pula depreciated by 0.1 percent in the twelve months to March 2019, consistent with the transition from an annual downward rate of crawl of 0.3 percent implemented in 2018 to an upward annual rate of crawl of 0.3 percent, effective January 2019. The Pula appreciated against the South African rand, but depreciated against the SDR currencies in the twelve months to March 2019. The Pula depreciated against all SDR currencies, influenced by performance of the rand against those currencies. Meanwhile, in the year to March 2019, the real effective exchange rate (REER) appreciated by 0.2 percent, because of higher inflation in Botswana than in trading partner countries, this is only partially offset by the 0.1 percent depreciation of the NEER.

Global economic output grew by 3.6 percent in 2018 and it is anticipated to ease to 3.3 percent in 2019, amongst others due to the slowdown in economic activity associated with trade tensions between the United States (US) and its trading partners, especially China, as well as uncertainty surrounding the Brexit. US GDP increased by 2.6 percent in the fourth quarter of 2018, mainly driven by improved consumer spending, non-residential fixed investment, exports and private investment. The increase in GDP in the United Kingdom (UK) was modest, as growth in services eased and manufacturing and construction output declined. Economic activity weakened in the emerging market economies, due to trade tensions, tightening financing conditions, capital outflows and volatile oil prices. In South Africa, there was a recovery from the technical recession recorded in the first half of 2018, as output increased by an annualised 2.6 percent and 1.4 percent in the third and fourth quarters of 2018, respectively. Growth in the fourth quarter of 2018 was propelled by positive contributions from the transport, manufacturing and finance sectors.

The global rough diamond price index decreased in the first quarter of 2019 against the backdrop of deteriorating consumer and investor sentiment, excess supply of smaller diamonds and underperformance in the Indian consumer market. International oil prices (Brent crude and OPEC) remained above USD60 per barrel in the first quarter of 2019, against the background of US sanctions imposed on major exporters, Iran and Venezuela. In addition, the Organisation of the Petroleum Exporting Countries (OPEC) and the non-OPEC partners agreed to cut oil production from January 2019 in an effort to reverse low oil prices arising from the surge in US oil output. Meanwhile, the United Nation's Food and Agriculture Organisation (FAO) food price index declined in the first quarter of 2019, as prices of meat, dairy and vegetable oil groups decreased.

3. RECENT ECONOMIC DEVELOPMENTS

3.1 Recent inflation environment

CPI rebased to December 2018

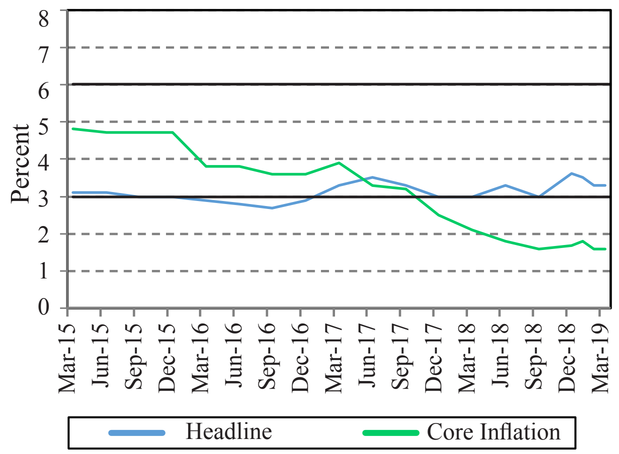
Statistics Botswana rebased the CPI from September 2016 to December 2018, therefore, effective January 2019, the price indices are based on the new base year (see Box 1 and Tables 3.2 and 3.3).

Headline inflation increases in the first quarter of 2019

Headline inflation averaged 3.4 percent in the first quarter of 2019 and was higher than the 3 percent average inflation in the first quarter of 2018 (Chart 3.1), mostly accounted for by a faster increase in prices for the operation of personal transport and transport services sub-indices[1]. Inflation was unchanged at 3.3 percent in February and March 2019 (Table 3.1), with modest annual price changes generalised across most categories of goods and services.

The 3.4 percent average inflation for the first quarter of 2019 was the same as the 3.4 percent forecast for the quarter. The forecast had taken into account the adjustment in private school fees, the relative strength of the Pula in the context of the positive rate of crawl implemented in January 2019 and higher international commodity prices.

Chart 3.1: Botswana Headline and Core Inflation



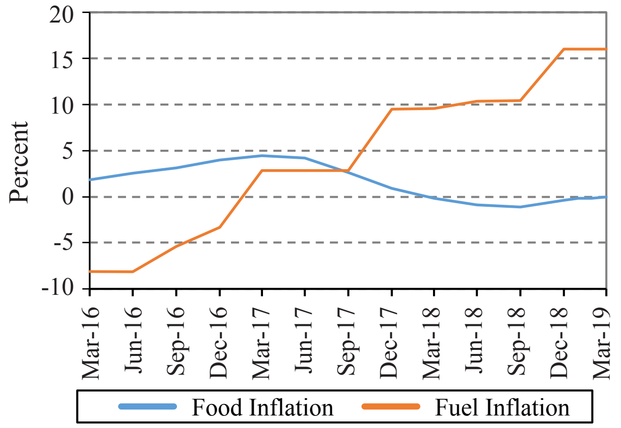
Source: Statistics Botswana and Bank of Botswana calculations

Note: Core Inflation is headline inflation excluding administered prices

Core inflation measures diverge

Core inflation, excluding food and fuel (CPIXFF), averaged 2.7 percent in the first quarter of 2019, lower than the 2.9 percent in the corresponding quarter in 2018 (Table 3.1). Inflation excluding administered prices (CPIXA) averaged 1.7 percent in the first quarter of 2019 compared to 2.7 percent in the first quarter of 2018, as the appreciation of the Pula against the South African rand reduced the costs of imported goods. However, the trimmed mean inflation (CPITM) increased from 2.8 percent to 3.5 percent in the same period. In March 2019, CPIXA and CPITM were 1.6 percent and 3.5 percent, respectively, while CPIXFF was 2.4 percent.

Chart 3.2: Food and Fuel Inflation



Source: Statistics Botswana and Bank of Botswana calculations

[1] Operation of personal transport sub-category includes, among others, tyre repairs, replacement of brake pads and full car wash, while transport services sub-category includes, among others, car rentals and transport fares.

Table 3.1: Annual Price Changes for Categories of Goods and Services (Percent)

Category of commodities	Basket Weights	Mar 2019	Q1 2019	Q1 2018
Food and non-alcoholic beverages	13.6	0.1	0.0	0.3
Alcoholic beverages and tobacco	4.3	0.6	0.6	1.9
Clothing and footwear	6.0	1.3	1.5	2.0
Housing, water, electricity, gas and other fuels	17.5	3.2	3.3	5.7
Furnishing, h/h equipment and routine maintenance	4.9	1.6	1.9	2.1
Health	3.4	1.1	1.1	1.4
Transport	23.4	9.9	9.9	4.8
Communications	6.9	-9.3	-9.3	1.2
Recreation and culture	2.8	1.0	1.2	1.9
Education	4.6	3.2	3.1	5.5
Restaurants and hotels	3.7	2.8	2.6	3.4
Miscellaneous goods and services	9.0	5.7	6.1	3.1
Annual Inflation (All Items)	**100.0**	**3.3**	**3.4**	**3.0**
CPITM		3.5	3.5	2.8
CPIXA		1.6	1.7	2.1
CPIXFF		2.4	2.7	2.9

Source: Statistics Botswana and Bank of Botswana calculations
Note: The basket weights have been revised based on the results of the 2015/16 Botswana Multi-Topic Household Survey

Box 1: Rebasing and Revision of the Consumer Price Index (CPI) Basket

CPI rebasing entails changing the old base year used for calculating weights of the components of the CPI basket to a new and more recent base year, and this instance also involves changing the basket weights to take into account the change in the consumption pattern. CPI rebasing eliminates the influence of historical trends on the current measurement of inflation. In addition, it provides an opportunity to incorporate new data sources and methodological updates which can result in further revisions.

Statistics Botswana rebased the CPI from September 2016 to December 2018, therefore, effective January 2019, the price indices are on the new base year. Consequently, the consumer basket composition and item weights have been adjusted based on the results of the 2015/16 Botswana Multi-Topic Household Survey. Furthermore, basket items were increased from 393 to 400, while the categorisation of the items was maintained at 51 sections and 12 commodity groups. The increase in the basket items and adjustment of weights reflect changes in the consumption pattern. Thus, items that are no longer available in the market were removed from the CPI basket, while new items were included (Table 3.2).

The weights of items and category groups in the basket reflect their relative importance in relation to the entire basket (Table 3.3). *Alcoholic beverages and tobacco, food and non-alcoholic beverages, transport* and *communications* experienced the largest revisions. Generally, there has been a substitution from goods to services in the current consumption basket, in line with changes in sectoral influences on GDP and growth in the average income. Thus, the weights of services categories such as *transport, communications, housing, water and electricity, education,* and *restaurants and hotels* have been revised upwards, and downwards for goods such as *food and non-alcoholic beverages* and *alcoholic beverages and tobacco.*

Table 3.2: New and Removed Items from CPI Basket

New Items	Removed Items
1) Food and non-alcoholic beverages a. Basmati rice 1kg b. Bread roll (sold loose) c. Instant noodles 77g d. Pork, loin chop per kg e. Tuna in vegetable oil 125g f. Liquid yoghurt (yogo fun) 250g g. Olive oil, extra virgin h. Fresh cucumber i. Fresh green pepper **2) Alcoholic beverages and tobacco** a. Cigarettes, slim vogue **3) Health** a. Consultation with Gynaecologist b. Consultation with Pediatrician **4) Transport** a. Replacement of brake pads, labour only b. Car wash (motor car) c. Railway passengers' fee (Gaborone to Francistown) **5) Communications** a. Mobile data pass (1 GB; a month) b. Phone repair, replacement of screen for Samsung S6 c. Telephone charges/rate to mobile (all mobile)	**1) Clothing and footwear** a. Babies disposable nappies (pampers; 0 to 3kg) **2) Housing, water, electricity and other fuels** a. Water: 10kl per month in cities and towns **3) Furnishing, household equipment and routine maintenance** a. Non-electric iron **4) Health** a. Painkillers, Grandpa small packets **5) Recreation and culture** a. Membership fee, one adult, Notwane club b. Entrance to night clubs (Saturday evening, one man) **6) Miscellaneous goods and services** a. Hairdressing set

Source: Statistics Botswana

Table 3.3: Basket Weights

Category of Commodities	**Weight**	
	New	**Old**
Transport	23.43	20.65
Housing, water, electricity and other fuels	17.45	14.90
Food and non-alcoholic beverages	13.55	16.51
Miscellaneous goods and services	9.01	10.55
Communications	6.94	4.27
Clothing and footwear	5.95	6.27
Furnishing, household equipment and routine maintenance	4.85	6.39
Education	4.60	3.34
Alcoholic beverages and tobacco	4.34	7.83
Restaurants and hotels	3.66	2.76
Health	3.38	3.62
Recreation and culture	2.82	2.92
Annual Inflation (All Items)	**100.00**	**100.00**

Source: Statistics Botswana

3.2 Recent economic developments in Botswana

Notable GDP growth in 2018

Real GDP grew by 4.5 percent in 2018, compared to a lower expansion of 2.9 percent in 2017 (Table 3.4). This was mainly attributable to the continued good performance of the non-mining sectors (albeit at a lower rate) and recovery in mining output. Mining output expanded by 7.4 percent in 2018, compared to a contraction of 11.1 percent in 2017 (Chart 3.3). The improved performance in mining was driven by the diamond industry and the return to full production of soda ash at the Botash Mine, following a maintenance programme in the second quarter of 2017. Other mining sub-sectors also registered positive growth rates in the period under review, with a notable increase of 21.2 percent in copper output, mainly reflecting the base effects associated with the closure of BCL mine in October 2016, and resumption of production by the Mowana Mine[2].

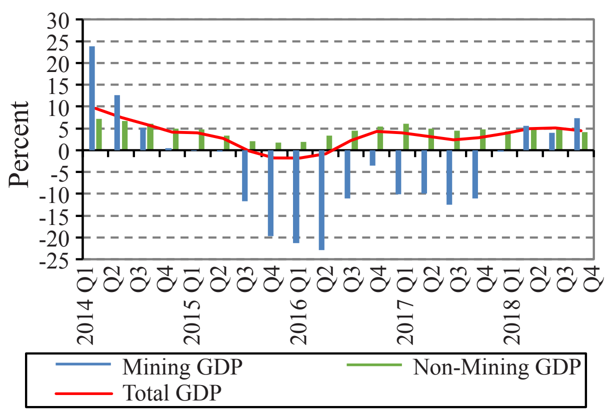
Non-mining GDP grew by 4.1 percent in 2018, compared to 4.8 percent in 2017. The overall expansion in non-mining GDP was mainly supported by finance and business services (5 percent) and trade, hotels and restaurants (3.2 percent)[3]. Notably, there was significant growth with respect to water and electricity (21 percent) as local electricity production increased and the effects of closure of the BCL mine in 2016 fell out of the calculation, although the sector's contribution to total GDP is marginal (about one percent).

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

	2017	2018
Total GDP	2.9	4.5
Mining	-11.1	7.4
Non-Mining	4.8	4.1
Agriculture	2.2	2.9
Manufacturing	2.2	3.6
Water and Electricity	39.9	21.0
Construction	3.5	3.7
Trade, Hotels and Restaurants	9.0	3.2
Transport and Communications	4.7	6.4
Finance and Business Services	4.1	5.0
General Government	1.5	3.0
Social and Personal Services	2.8	3.6
Government Final Consumption	1.5	3.4
Household Final Consumption	5.7	3.9
Gross Fixed Capital Formation	-7.0	6.8
Exports	-6.3	4.1
Imports	-20.8	12.1

Source: Statistics Botswana and Bank of Botswana calculations

Chart 3.3: GDP Growth Rates



Source: Statistics Botswana

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

[2] Mowana Mine had started producing copper effective April 2017, and later suspended its operations in November 2018, due to lack of capital.

[3] This sector incorporates elements of tourism.

Diamond production increased in the fourth quarter of 2018

Debswana produced 6.3 million carats of diamonds in the fourth quarter of 2018, an increase of 15.3 percent from the corresponding period in 2017, mainly due to higher production at Orapa[4]. Production at Orapa Mine increased by 20.4 percent in the fourth quarter of 2018 compared to quarter four of 2017, while production at the Jwaneng Mine increased by 9.2 percent in the same period. Overall, Debswana production increased by 6.4 percent from 22.7 million carats in 2017 to 24.1 million carats in 2018, which is 1.3 percent higher than the initial target of 23.8 million carats for 2018. Looking ahead, Debswana anticipates production of around 24 million carats in 2019, almost unchanged compared to 2018.

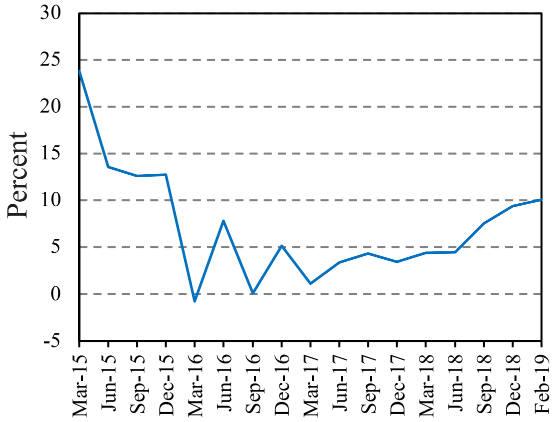
Production by Lucara Diamond Corporation (Karowe Mine) increased by 26.9 percent to 81 850 carats in the fourth quarter of 2018, from 64 477 carats in the corresponding period in 2017. The increase in production is attributable to improved efficiency in the recovery of smaller sized diamonds. During the fourth quarter of 2018, a total of 161 special stones (single diamonds larger than 10.8 carats) were recovered, including seven diamonds greater than 100 carats and one diamond greater than 200 carats. Special stones accounted for 6.8 percent of total carats recovered during the period. Overall, Karowe Mine produced 366 086 carats in 2018, exceeding the revised target of between 325 000 and 350 000 carats for the year. For 2019, Karowe Mine anticipates to produce between 300 000 and 330 000 carats.

3.3 Monetary developments

Larger growth in banking sector assets in December 2018

Annual growth in banking sector assets increased from 3.4 percent in the twelve months to December 2017 to 9.4 percent in the same period in 2018 (Chart 3.4). Faster growth continued into 2019, with banking assets increasing by 10.1 percent in the twelve months to February 2019 (from 4 percent in the year to February 2018). This was due to the overall increase in the growth of loans and advances, which account for the largest proportion of commercial banks' assets, while placements in foreign banks, holdings of BoBCs and Repos also contributed significantly.

Chart 3.4: Year-on-Year Growth in Total Assets of Commercial Banks



Source: Commercial Banks

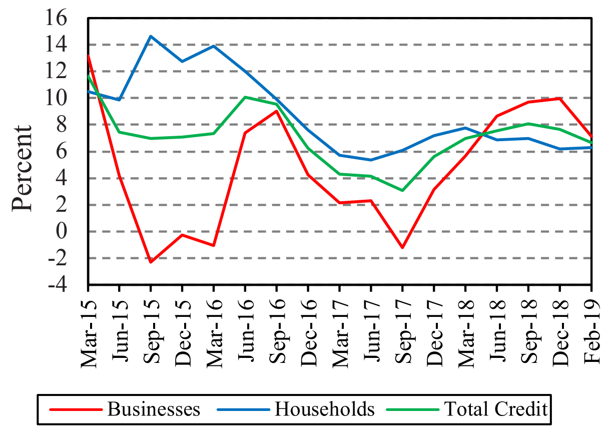
Credit growth accelerates in December 2018

Annual growth in commercial bank credit was 7.7 percent in the twelve months to December 2018, compared to 5.6 percent in the corresponding period in 2017 (Chart 3.5). This was due to the increased growth in lending to both the business sector (increased utilisation of existing credit facilities by construction, trade and business services companies) and households (as a result of the increase in personal loans from new and existing bank loan schemes).

Meanwhile, growth in total credit in the twelve months to February 2019 accelerated to 6.6 percent, compared to 4.9 percent for the corresponding period in 2018. Over the same review period, growth in business credit increased to 7.1 percent, while growth in lending to households decreased from 7.3 percent to 6.3 percent.

[4] Orapa output constitutes production from Orapa, Damtshaa and Letlhakane mines.

Chart 3.5: Year-on-Year Growth in Commercial Bank Credit

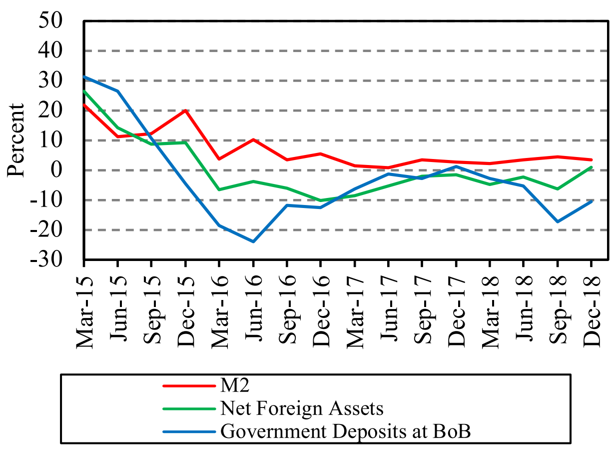


Source: Commercial Banks

Money supply accelerates in December 2018

Annual growth in money supply (M2) accelerated from a contraction of 2.7 percent in the twelve months to December 2017 to growth of 8.2 percent in the same period in 2018 (Chart 3.6). This was due to the 9.7 percent decline in government deposits at Bank of Botswana, which was partly offset by the 1 percent decline in net foreign assets. Claims on other sectors of the economy increased from 4.9 percent to 7.4 percent during the period.

Chart 3.6: Year-on-Year Growth in Money Supply



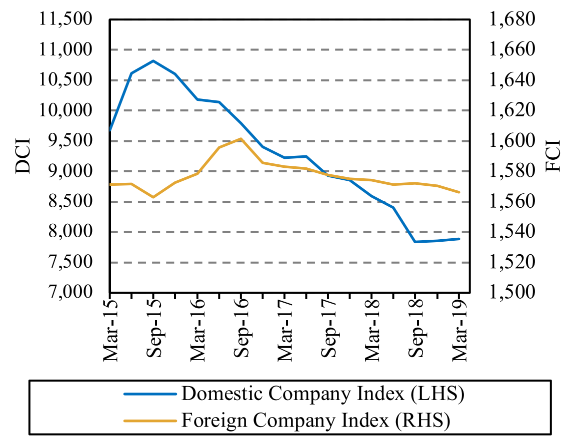
Source: Commercial Banks and Bank of Botswana

Stock market index declines

The Domestic Companies Index (DCI) declined by 8.2 percent in the twelve months to March 2019 compared to a reduction of 6.9 percent in the year to March 2018 (Chart 3.7). The decline was mainly due to lower share prices for Botswana Telecommunications Corporation Limited, Stanchart and Sefalana, which fell by 25 percent, 24.8 percent and 4.3 percent, respectively, in the same period. According to Stockbrokers Botswana[5], the continuous decline in the DCI was reflective of the sluggish corporate earnings due to the restrained economic environment.

The Foreign Companies Index (FCI) declined by 0.5 percent in the year to March 2019, compared to a decline of 0.6 percent in the corresponding period ending in March 2018. This was largely attributed to the year-on-year decrease in share prices for Lucara (-25.7 percent) and New Platinum (-4.6 percent). Despite good performance in 2018 at Lucara, the decline in its share price was partly due to low shareholder sentiment following lack of further discoveries of large stones since 2016.

Chart 3.7: Stock Market Indices



Source: Botswana Stock Exchange

Bank of Botswana Certificates Yields increase

The 14-day BoBC stop-out yield increased to an average of 1.61 percent in the first quarter of 2019 from 1.48 percent in the corresponding period in 2018, while the 3-month BoBC stop-out yield also increased to an average of 1.64 percent from 1.49 percent in the same period. Meanwhile, the real rate of interest for the 14-day BoBC averaged -1.70 percent in the first quarter of 2019 from -1.51 percent in the corresponding period in 2018, while for the 3-month BoBC, the real interest rate also decreased from -1.50 percent to -1.67 percent in the same period, reflecting a higher increase in average inflation compared to the increase in nominal interest rates. Box 2 discusses changes to monetary operations.

[5] Stockbrokers Botswana is a brokerage firm registered and licensed with the Botswana Stock Exchange Limited.

Box 2: Reforms to Monetary Operations Framework

The Bank evaluates monetary policy implementation framework on a regular basis for effectiveness, and introduces refinements where necessary. In this respect, during 2019, the Bank will adopt "Reserves Averaging" in the determination of the Primary Reserves Requirement for banks and shorten the maturity of the 14-day Bank of Botswana Certificates (BoBCs) to seven days.

Under "reserves averaging", commercial banks do not have to meet the primary reserve requirement daily but, rather, fulfil this statutory requirement on an average basis over the maintenance period which is, in Botswana's case, a calendar month. Reserves averaging, which is used in numerous jurisdictions, has been shown to improve liquidity management by commercial banks, foster more effective resource allocation through the interbank market and reduce the demand for excess reserves held for precautionary purposes.

Specifically, reserves averaging will involve the following features:
- As is currently the case, at the beginning of each maintenance period, each commercial bank will be advised of the amount of the reserve requirements for the coming period.
- The primary reserve requirement (PRR) and current accounts will continue to be kept separately, but with banks allowed to move funds between the two accounts.
- At the end of each month, a bank complies if the average end-of-day balances on its required reserves account through maintenance period are equal to, or, greater, than the PRR as computed by the Bank.
- If there is non-compliance, a fine will be applied based on the average daily deficit and in line with the Bank of Botswana Act (Cap 55:01; Part VII; 40 (5)).

The reduction of the maturity period of the primary Open Market Operations tool, from 14 to seven days will enable a shorter and simpler forecasting horizon for liquidity management by both the Bank and commercial banks, resulting in more accurate outcomes. In turn, it is expected to provide a solid basis for the starting point of the monetary policy transmission mechanism, supporting the extension of the policy signal along the yield curve. These enhancements require input and cooperation from commercial banks and, in that regard, consultations with the commercial banks have commenced, with a view to ensure implementation of these measures within a short period of time.

In addition, during the coming months, the Bank will consult the market on further possible changes to monetary operations and the "anchor policy rate"; for example, whether the Bank Rate or the BoBC rate is the more relevant to market considerations for policy transmission purposes. The objective of these refinements is to enhance the potency of the policy rate in the transmission of monetary policy signals, as well as its influence on subsequent market reaction and posture. Furthermore, there is need to spur the development and efficacy of the money markets, for the purposes of effective policy transmission, as well as management, access and flow of liquidity, through the interbank market. It is envisaged that these consultations will be completed by mid-year.

Finally, alongside these measures, designed to ensure better structural alignment of short-term market rates and desirable policy transmission, any notional ceiling on the issuance of BoBCs has been lifted. This approach allows greater scope and flexibility for unconstrained and, therefore, effective liquidity absorption by the central bank in response to market developments.

3.4 Property market

Property market remains weak in the third quarter of 2018

According to the latest Riberry Report[6] (third quarter of 2018), the residential market for the lower end and medium-cost properties continued to have good demand and supply compared to the higher-end residential housing, where the demand was weaker. Overall, the average price for residential property sold in the third quarter of 2018 decreased by 11.6 percent to P710 748 compared to the previous quarter, reflecting the weaker demand for the higher-end residential housing. Looking ahead, the demand for lower-end prime located residential housing is expected to improve in the short term, while the current cautious lending environment is likely to impact negatively on value prospects for medium-cost and higher-end residential housing.

The market for office space remains weak due to increasing supply from completed construction developments. Despite the general modest demand for office space, there has been reasonable take-up of office space at the Gaborone Central Business District (CBD) by Government, a major office space occupier, as well as by some corporates. The supply for office space is likely to increase further going forward, given the ongoing construction projects and planned office buildings at the CBD, such as by the Botswana Housing Corporation and Water Utilities Corporation. Meanwhile, the demand for retail space remains fair across all market segments, with proposed major shopping centres in the CBD, Block 10 (Gaborone) and Mogoditshane. In addition, other centres with good demand for retail space are Palapye, Maun, Francistown and Mahalapye. With regard to industrial property, the supply of bigger warehouse space has decreased, while the demand has improved. The demand for prime location industrial space is expected to improve, going forward.

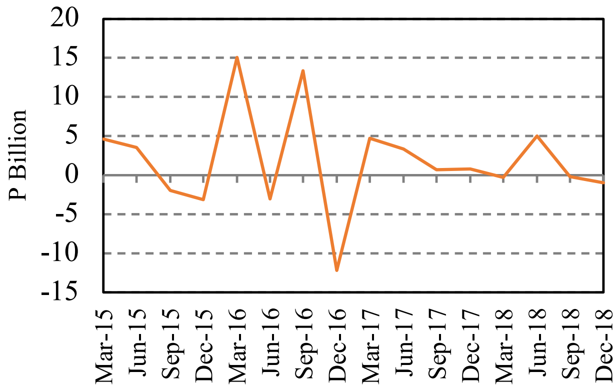
[6] This is a quarterly report produced by independent valuers, Riberry Botswana (Pty) Ltd.

3.5 Balance of payments

Current account records a deficit in the fourth quarter of 2018

In the fourth quarter of 2018, the current account was P924 million in deficit, compared to a surplus of P806 million in the fourth quarter of 2017 (Chart 3.8). The deficit was partly attributable to a larger increase of 44.1 percent in diamond imports, particularly rough diamonds for aggregation, compared to a smaller increase of 12.4 percent in diamond exports. Diamonds constituted nearly 90 percent of total exports, while the relative share of imports fluctuated between 25.6 percent in the fourth quarter of 2017 to 31.2 percent in the corresponding period in 2018.

Chart 3.8: Quarterly Current Account Balance



Source: Bank of Botswana

The P3.2 billion deficit in the income account also contributed to the current account deficit and was mainly accounted for by dividends and reinvested earnings paid to foreign investors. These increased by P3.7 billion in the fourth quarter of 2018. The services account, which registered a deficit of P798 million, together with the 18.3 percent reduction of Southern African Customs Union inflows between the two quarters, also added to the current account deficit.

Net inflows in the financial account in the fourth quarter of 2018

The overall financial account had an estimated net inflow of P6.9 billion during the fourth quarter of 2018 compared to a revised net outflow of P1.8 billion in the fourth quarter of 2017. The inflow is attributable to, among others, a decrease in offshore investments, in particular, offshore pension fund assets abroad which fell by 9.6 percent in the fourth quarter of 2018, compared to an increase of 1.3 percent in the fourth quarter of 2017.

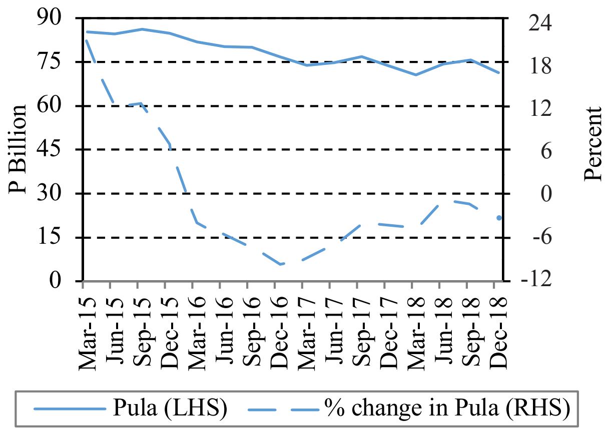
Foreign exchange reserves decrease

As at the end of December 2018, the foreign exchange reserves amounted to P71.4 billion, a decrease of 3.1 percent from P73.7 billion in December 2017 (Chart 3.9). The decrease is, among others, due to deficit financing drawdowns by government and significant adverse valuation charges, specifically in relation to global equity markets towards the end of the year.

In foreign currency terms, the level of reserves decreased by 10.7 percent from USD7.5 billion in December 2017 to USD6.7 billion in December 2018 (Chart 3.10). The reserves decreased by 9.4 percent from SDR5.3 billion to SDR4.8 billion in the same period. The level of reserves as at end of December 2018 was equivalent to 15 months of import cover of goods and services.

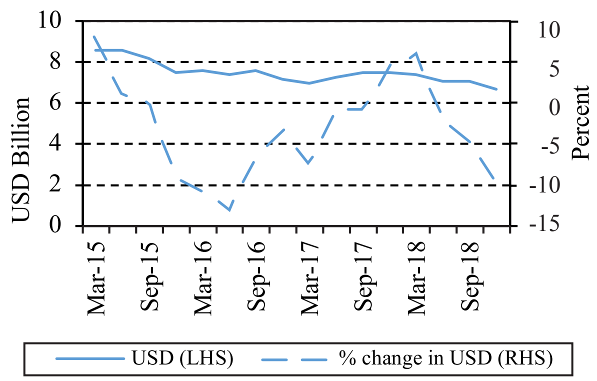
The overall balance of payments was P1.6 billion in deficit in the fourth quarter of 2018, compared to a deficit of P1.3 billion in the corresponding period in 2017. The deficit is due to both trade and financial flows.

Chart 3.9: Foreign Exchange Reserves in Pula and Annual Percentage Change



Source: Bank of Botswana

Chart 3.10: Foreign Exchange Reserves in US Dollars and Annual Percentage Change



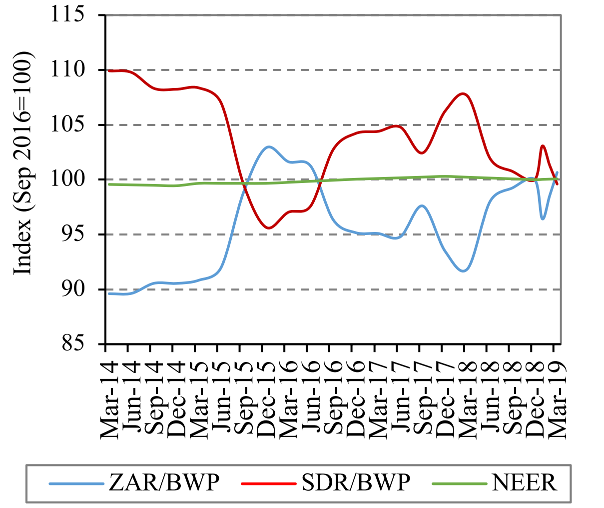
Source: Bank of Botswana

3.6 Exchange rate developments

The Pula basket weights were maintained at 45 percent for the South African rand and 55 percent for the SDR, while the rate of crawl of the NEER was adjusted from a 0.3 percent downward annual rate of crawl to a 0.3 percent upward annual rate of crawl (Box 3). The upward rate of crawl seeks to maintain the stability of the REER as domestic inflation is projected at around the lower end of the Bank's inflation objective range and slightly lower than the forecast average inflation for trading partner countries.

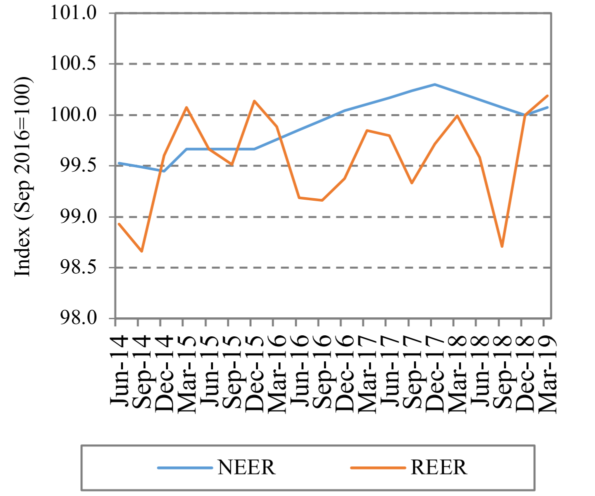
Bilaterally, the Pula appreciated by 9.6 percent against the South African rand and depreciated by 7.5 percent against the SDR over the twelve months to March 2019 (Chart 3.11). The Pula depreciated against all the SDR constituent currencies; by 11.6 percent against the US dollar, 8.2 percent against the Japanese yen, 5.3 percent against the Chinese renminbi, 4.8 percent against the British pound and 3.1 percent against the euro.

Chart 3.11: Nominal Exchange Rate Indices



Source: Bank of Botswana

Chart 3.12: Nominal and Real Effective Exchange Rates



Source: Bank of Botswana

Furthermore, the South African rand depreciated against major trading currencies amidst uncertainty over the US and China trade deal which dampened demand for emerging market currencies. The impact of power outtages on economic performance and sentiment affected the value of the currency.

The movement of the Pula against the constituent SDR currencies largely reflects the depreciation of the South African rand against the SDR currencies. Thus, it depreciated by 19.4 percent against the US dollar, 16.2 percent against the Japanese yen, 13.6 percent against the Chinese renminbi, 13.1 percent against the British pound and 11.5 percent against the euro.

There continues to be downside risks to the value of the rand mainly emanating from the power shortage and the threat it poses to the country's economic growth as well as market sentiment and related sovereign credit risk.

NEER depreciates in March 2019

The NEER of the Pula depreciated by 0.1 percent in the twelve months to March 2019 (Chart 3.12), consistent with the transition from an annual downward rate of crawl of 0.3 percent implemented in 2018 to an upward annual rate of crawl of 0.3 percent, effective January 2019.

REER appreciated in March 2019

The REER appreciated by 0.2 percent in the twelve months to March 2019 (Chart 3.12), due to higher inflation in Botswana than in trading partner countries; the marginal depreciation of the NEER was not sufficient to offset the positive inflation differential. Average inflation for the trading partner countries was 2.9 percent in the review period, compared to 3.3 percent for Botswana. With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) appreciated by 8.3 percent against the South African rand and depreciated by 6 percent against the SDR. Against the SDR constituent currencies, the Pula depreciated by 10.4 percent against the US dollar, 5.7 percent against the Japanese yen, 4.4 percent against the Chinese yuan, 3.5 percent against the British pound, 1.3 percent against the euro.

Box 3: Botswana's Exchange Rate Framework

The Exchange Rate Policy

Botswana's exchange rate policy is aimed at maintaining the level of competitiveness of local producers of tradeable goods and services in both international and domestic markets. By extension, the policy supports the national objective of economic diversification, together with the associated industrial development and employment creation objectives. The Pula exchange rate is determined on the basis of a peg to a basket of currencies, the choice of which is guided by the trade pattern and currencies used in international trade and payments. It is pegged to a trade-weighted basket of currencies that comprise the South African rand and the International Monetary Fund's unit of account, the Special Drawing Rights (SDR). Pegging to a basket of currencies rather than a single currency means that movements in the Pula exchange rate are not subject to an extreme influence of exceptional volatility of any single currency.

Current Exchange Rate Framework

The crawling band mechanism was adopted in May 2005 to allow for continuous gradual adjustment (crawling) of the Pula exchange rate to avoid misalignment (i.e., either over-valuation or under-valuation) of the exchange rate. This was an improvement over the discrete adjustment (through either devaluation or revaluation) of the exchange rate that may be implemented unexpectedly. In the crawling band framework, prospects for changes in competitiveness (i.e., inflation differentials between Botswana and trading partner countries) are projected and the exchange rate is set to adjust gradually to forestall the potential loss in price competitiveness. When the inflation objective range for Botswana is higher (lower) than the average forecast inflation of the trading partners, a downward (upward) crawl is implemented; and when they are equal (zero inflation differential), the rate of crawl ought to be zero. A gradual upward adjustment of the annual rate of crawl, such as 0.3 percent for 2019, means that the exchange rate is adjusted daily in very small fixed amounts, which accumulate to an annual change of 0.3 percent.

Therefore, an important intermediate goal (or performance measure) of the exchange rate policy is the stabilisation of the real effective exchange rate in relation to Botswana's main trading partners. In line with this objective, the authorities closely monitor the inflation performance for Botswana and the trading partner countries.

3.7 Recent global economic developments

Global growth set to moderate in the near-term

According to the April 2019 World Economic Outlook (WEO), global output is expected to grow by 3.3 percent in 2019, from an estimated expansion of 3.6 percent in 2018 (Table 3.5). Growth for 2018 was revised downwards by 0.1 percentage point relative to the January 2019 WEO Update, reflecting weakness in the second half of the year from the negative effects of trade frictions, country-specific shocks, a decline in business confidence, as well as tightening financial conditions. Risks to global economic performance remain on the downside, amidst heightened policy uncertainty. Meanwhile, trade tensions could flare up again, which could further dent business confidence, investment and growth. Downside risks also relate to "deeper than envisaged slowdown in China", a no-deal Brexit, accumulated vulnerabilities related to high public and private debt and tightening financial conditions.

Growth in US economic activity slows in the fourth quarter of 2018

According to initial estimates, the US economy grew by 2.6 percent in the fourth quarter of 2018, lower than the increase of 3.4 percent in the third quarter of 2018. The growth was due to increases in consumer spending, non-residential fixed investment, exports and private investment that were partly offset by a decrease in residential investment. The USD1.4 trillion income tax cut package, which came into effect in January 2018, also continued to spur economic growth as consumers and government increased spending in the fourth quarter. Meanwhile, the slowdown in the rate of growth of GDP in the fourth quarter reflected the negative effects of the November 2018 California wildfires as well as the partial government shutdown that occurred between December 2018 and January 2019. The annual GDP growth forecast for 2019 has been revised down by 0.2 percentage points to 2.3 percent, on account of the trade tensions between the US and its trading partners, especially China. Moreover, the tax cuts are expected to widen the current account deficit; while the effect of the fiscal stimulus dissipates.

Euro zone annual growth subdued

The euro zone GDP increased by 0.2 percent in the fourth quarter of 2018, slightly higher than the revised 0.1 percent in the third quarter of 2018. The expansion in the fourth quarter was driven by higher exports, household consumption, fixed investment and public spending, which offset a sharp decline in inventories. In addition, the subdued growth resulted from the contraction in the level of output and recession in Germany and Italy, respectively.

Growth modest in the UK

In the UK, GDP grew at a modest pace of 0.2 percent in the fourth quarter of 2018, easing from a 0.6 percent expansion in the previous quarter, as growth in services decreased and manufacturing and construction output declined. Furthermore, the lower growth is associated with the continued Brexit uncertainty, which weighs on aggregate domestic demand. There have been increasingly strident warnings that businesses could relocate jobs and investment to the EU after Brexit.

Emerging markets' growth moderates

Economic growth in emerging market economies softened, primarily due to trade tensions, restrictive financing conditions, rising US interest rates, dollar appreciation, capital outflows and volatile oil prices. In addition, activity slowed more markedly in Argentina, Brazil and Turkey due to tighter financial conditions, geopolitical tensions and higher oil import bills. China's economy grew by 6.4 percent year-on-year in the fourth quarter of 2018, easing from 6.5 percent growth in the previous quarter and matching market expectations. It was the weakest pace of expansion since the global financial crisis amid the intense trade dispute with the US, weak domestic demand and off-balance sheet exposure by local governments.

In India, GDP grew by 6.6 percent year-on-year in the fourth quarter of 2018, below the 7.7 percent growth in the previous quarter and below market expectations of 6.9 percent. It is the weakest growth in the past five quarters. Slower growth in household spending and a contraction in government spending contributed to the overall slowdown of the growth of the economy.

South African growth slows

Despite the technical recession in the first half of 2018, positive growth in the third and fourth quarters pushed the overall growth for the year into positive territory, supported by President Ramaphosa's economic stimulus measures. The measures consist of five broad parts: the implementation of growth enhancing economic reforms, reprioritisation of public spending to support job creation, the establishment of an infrastructure fund, addressing urgent and pressing matters in education and health and investing in municipal social infrastructure.

Output in South Africa increased by an annualised rate of 1.4 percent in the fourth quarter of 2018, lower than the market expectation of an expansion of 1.8 percent and the revised growth of 2.6 percent in the third quarter of 2018. The largest positive contributors to GDP growth in the fourth quarter were the transport, manufacturing and finance sectors, which grew by 7.7 percent, 4.5 percent and 2.7 percent, respectively.

Table 3.5: Growth Estimates and Projections

	Estimate		Projection	
	2017	**2018**	**2019**	**2020**
Global	3.8	3.6	3.3	3.6
Advanced economies	2.4	2.2	1.8	1.7
USA	2.2	2.9	2.3	1.9
Euro area	2.4	1.8	1.3	1.5
UK	1.8	1.4	1.2	1.4
Japan	1.9	0.8	1.0	0.5
EMDEs	4.7	4.5	4.4	4.8
China	6.9	6.6	6.3	6.1
Brazil	1.1	1.1	2.1	2.5
India	6.7	7.1	7.3	7.5
Russia	1.5	2.3	1.6	1.7
South Africa	1.3	0.8	1.2	1.5
Botswana	2.4	4.5	4.2	4.8

Source: IMF WEO April 2019 and Botswana 2019 Budget Speech
Note: EMDEs stands for emerging market and developing economies.

Global commodity prices

Diamond prices decrease

The global rough diamond price index decreased by 1.1 percent from 148.4 in the fourth quarter of 2018 to 146.9 in the first quarter of 2019, reflecting the deteriorating consumer and investor sentiment, excess supply of smaller diamonds and underperformance in the Indian consumer market.

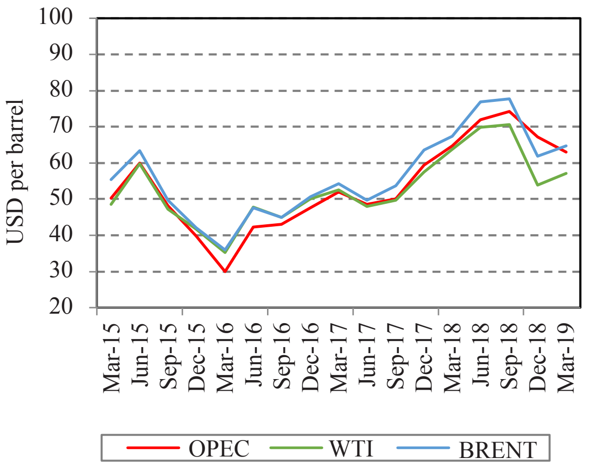
Oil price developments mixed in the first quarter of 2019

The price of Brent crude increased by 4.7 percent to an average of USD64.74 per barrel in the first quarter of 2019, from an average of USD61.82 per barrel in the fourth quarter of 2018 (Chart 3.13)[7]. Similary, West Texas Intermediate (WTI) crude oil price increased by 5.9 percent from an average of USD53.88 per barrel to an average of USD57.05 per barrel in the same period. The movements in oil prices are in response to prospects of a shortfall in supply arising from sanctions against major crude exporters, Iran and Venezuela, by the US, and Saudi Arabia's pledge to cut oil exports and keep output well below 10 million barrels per day to counter excess supply and support oil prices. However, the OPEC reference crude oil basket price fell by 6.3 percent, averaging USD62.98 per barrel in the first quarter of 2019 compared to USD67.22 per barrel in the fourth quarter of 2018. Meanwhile, the agreement among OPEC and some non-OPEC producers which came into effect in January 2019, to reduce production by 1.2 million barrels per day is expected to exert an upward pressure on oil prices.

Overall, developments in the international oil market imply marginal upward pressure on Botswana inflation.

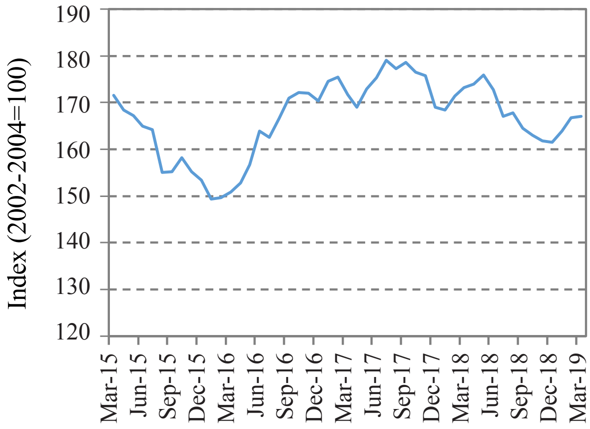
[7] In April 2019, Brent crude reached a daily high of USD75 per barrel, following the news that the US will remove any waivers for countries that had been importing Iran oil, with effect from May 1, 2019.

Chart 3.13: Oil Prices (Quarterly Averages)



Source: OPEC and Bloomberg

Chart 3.14: Food Price Index



Source: Food and Agriculture Organisation

Food prices decreased in the first quarter of 2019

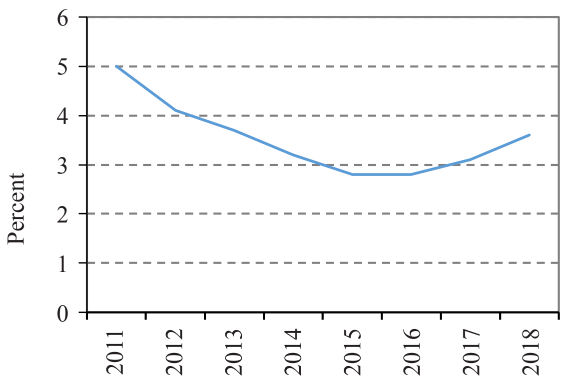
According to the United Nations Food and Agriculture Organisation (FAO), the global food price index averaged 166.4 points in the first quarter of 2019, a 2.7 percent decrease from an average of 171 points in the corresponding period in 2018. The fall in prices was attributable to lower meat, dairy and vegetable oil prices. However, the food price index was constant at 167 points between February and March 2019, and was 3.58 percent below its level in March 2018 (Chart 3.14).

In Southern Africa, food prices are expected to increase on account of lower than expected crop production in 2018/19. This is due to below average seasonal rains that impeded planting, spill-over effects from the international commodities market as well as recent concerns about El Nino and cyclone Idai's impact on the 2019 harvest. Overall, there is potential modest upward pressure from food prices on domestic inflation.

Global inflation increases

Global inflation increased from 3.1 percent in 2017 to 3.6 percent in 2018 (Chart 3.15). The increase was broad-based, as inflation firmed in both developed and emerging market economies, with the US, the euro zone and India recording noticeable increases. South Africa's headline inflation averaged 4.2 percent in the first quarter of 2019 and was slightly higher than the average of 4.1 percent in the corresponding quarter in 2018, remaining within the South African Reserve Bank's (SARB) target range of 3 - 6 percent.

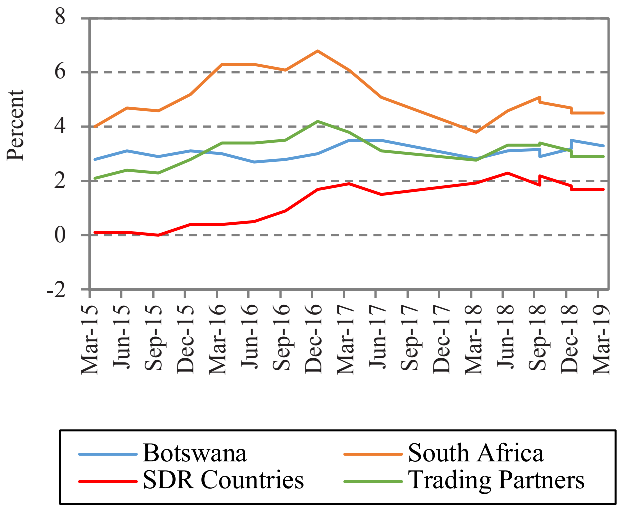
Chart 3.15: Global Inflation



Source: Bloomberg

Meanwhile, the average trade-weighted inflation for Botswana's trading partners was unchanged at 2.9 percent between December 2018 and March 2019 (Chart 3.16).

Chart 3.16: Botswana Inflation and International Inflation



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

Mixed monetary policy developments

In the recent policy decisions (Table 3.6) in advanced economies, the European Central Bank (ECB)[8] and Bank of England (BoE) maintained their ultra-accommodative monetary policy, particularly asset purchases and low policy rates. The US Federal Funds Rate range was maintained at 2.25 - 2.50 percent in March 2019, as economic activity slowed, but risks to the outlook remain balanced. The Bank of Japan (BoJ) maintained the policy rate at 0.1 percent. The BoJ intends to maintain the current extremely low levels of interest rates for an extended period of time, taking into account uncertain prospects for economic activity and prices, including the effects of the consumption tax hike scheduled for October 2019.

Meanwhile, in emerging market economies, the policy rates were maintained in the majority of the countries, except for India. The Central Bank of Russia maintained the key rate at 7.75 percent in February 2019 as risks remain moderate. The Bank of Brazil maintained the policy rate at 6.5 percent in March 2019, in the context of balanced risks to the inflation outlook. The SARB also maintained the policy rate at 6.5 percent at the March 2019 MPC meeting. The assessment of risks to the inflation outlook remain on the upside, with key risks of rising administered prices, as well as food and international oil prices.

The People's Bank of China (PBoC) maintained its policy rate at 4.35 percent at the MPC meeting of April 2019, given the stable and resilient growth momentum. In addition, the PBoC injected funds to selected commercial banks through its targeted medium-term lending facility. This was a step to reinforce views that the PBoC is likely to put any broader policy easing measures (such as reserve ratio cuts) on hold after stronger than expected growth in the first quarter of 2019. In contrast, the Reserve Bank of India reduced its policy rate by 25 basis points to 6 percent in April 2019, in order to stimulate private investment and support economic activity, amid the downward revision of inflation forecasts.

Table 3.6: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting
Bank of Botswana	April 2019	5.00	No change
SARB	March 2019	6.75	No change
US Federal Reserve	March 2019	2.25 – 2.50	No change
BoE	March 2019	0.75	No change
ECB	April 2019	0.00	No change
BoJ	March 2019	-0.10	No change
PBoC	April 2019	4.35	No change
Brazil	March 2019	6.50	No change
India	April 2019	6.00	Decreased by 0.25 percent
Russia	March 2019	7.75	No change

[8] In order to preserve favourable bank lending conditions and smooth transmission of monetary policy, the ECB will launch a new series of quarterly targeted longer-term refinancing operations (TLTRO) starting in September 2019 and ending in March 2021.

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook has been revised downwards, mostly because of forecast weaker growth for the euro area. The euro area economy slowed down due to, among other factors, weaker consumer and business confidence, disruptions in car production in Germany due to new emission standards and lower external demand. The projected slowdown in advanced economies accounts for over two thirds of the expected deceleration in global growth in 2019 compared to 2018. For emerging market and developing economies, the 2019 downward revisions were mainly due to the contraction in the level of output in Argentina, Turkey and Iran. Financial regulatory tightening and trade tensions are also expected to negatively affect economic performance in China and other Asian economies, thus restraining overall growth for the emerging market economies. In South Africa, the growth outlook is expected to improve on account of the recently announced fiscal stimulus. With regard to price developments, global inflation is forecast to ease slightly in 2019, and decline further in 2020, largely due to the anticipated weaker growth in global economic activity.

Global economic outlook revised downwards
According to the April 2019 WEO, global output is forecast at 3.3 percent in 2019 and 3.6 percent in 2020. The forecasts for 2019 and 2020 are 0.4 and 0.1 percentage points lower than the October 2018 WEO forecasts, respectively. The revisions mainly reflected the anticipated slowdown in the rate of growth of economic activity in the first half of 2019, which, however, is followed by acceleration in activity in the second half. The projected pickup in growth in the second half is predicated on the ongoing build-up of policy stimulus in China, recent improvements in global financial market sentiment, waning temporary drags on growth in the Euro area and gradual stabilisation of conditions in emerging market economies.

For advanced economies, output growth is forecast to expand by 1.8 percent in 2019, before softening to 1.7 percent in 2020. The projected slowdown in growth accounts for two-thirds of the expected deceleration in global growth. Average growth in most advanced economies is expected to decline to below pre-global financial crisis averages. Slower expansion in the working-age population and projected lacklustre productivity gains are the prime drivers of the expected lower medium-term growth rates. Risks to global output expansion are skewed to the downside in a context of tighter financial conditions, uncertainty about Brexit, rising trade tensions, a greater than expected slowdown in China and higher geopolitical risk.

UK economic growth uncertain
The UK economy is expected to grow by 1.2 percent and 1.4 percent in 2019 and 2020, respectively, compared to 1.4 percent in 2018. The downward revisions relative to the October 2018 WEO and January 2019 Update reflect the negative effect of prolonged uncertainty about Brexit, which was partially offset by the positive impact from the stimulus announced in the 2019 budget. The uncertainty about Brexit has increased following the British parliament vote against the proposed exit deal.[9]

US economic prospects revised down for 2019
For the US, output growth is forecast to decline to 2.3 percent in 2019. The US economic expansion is expected to soften further to 1.9 percent (0.1 percent higher than the previous forecast) in 2020, owing to unwinding fiscal stimulus. The downward revision of the growth in 2019 relates to the impact of the government shutdown and somewhat lower fiscal spending than previously anticipated, while the modest upward revision for 2020 takes into account a more accommodative monetary policy stance than in the October forecast. Even then, strong domestic demand is expected to lead to a rise in imports which will, in turn, increase the US current account deficit. Nonetheless, the projected expansion is above the US economy's estimated potential growth.

Growth for the euro area set to moderate
In the euro area, economic expansion is projected

[9] In an effort to avoid a no-deal Brexit, the EU has granted the UK a six-month extension to the Brexit deadline until October 31, 2019.

to ease from 1.8 percent in 2018 to 1.3 percent in 2019 (0.6 percentage points lower than in the October 2018 WEO forecast), before increasing to 1.5 percent in 2020. The downward revision for the euro area reflects slower economic growth carried over from the second half of 2018. Moreover, idiosyncratic factors in different member countries will constrain the region's growth[10].

Emerging markets GDP expansion projected to be lower

Growth in economic activity in emerging markets and developing economies is projected at 4.4 percent for 2019 (0.3 percentage points lower than the October 2018 WEO), slightly down from 4.5 percent in 2018, before improving to 4.8 percent in 2020. The decline in the 2019 projection mainly reflects lower growth in China due to the impact of lingering trade tensions with the US, the recession in Turkey as well as a deepening contraction in Iran. Trade tensions are also expected to negatively affect economic performance in emerging and developing Asia. In addition, tighter financial conditions, geopolitical tensions and higher oil import bills are also expected to weigh down on economic activity. Emerging markets experienced larger volumes of capital outflows, as investors shifted their money out on the back of prospects for higher interest rates in the US. Furthermore, much weaker economic activity in Iran following the re-imposition of US sanctions contributes to the projected lower growth. Nonetheless, higher oil prices have boosted growth prospects for oil exporters.

Growth in the South African economy to improve marginally

Growth prospects in South Africa are promising as the economy is currently recovering from the technical recession in the first half of 2018, although remaining modest, with activity generally constrained by sluggish demand as a result of weaker business confidence. Output growth is expected to increase from 0.8 percent in 2018 to 1.2 percent in 2019, and accelerate to 1.5 percent in 2020, against a backdrop of the recently announced stimulus package with which the government intends to re-prioritise spending, establish an infrastructure fund and remove some regulatory restrictions, including tourism in order to boost economic performance and reduce unemployment. In addition, the projected recovery reflects modestly reduced but continued policy uncertainty in the South African economy after the May 2019 elections.

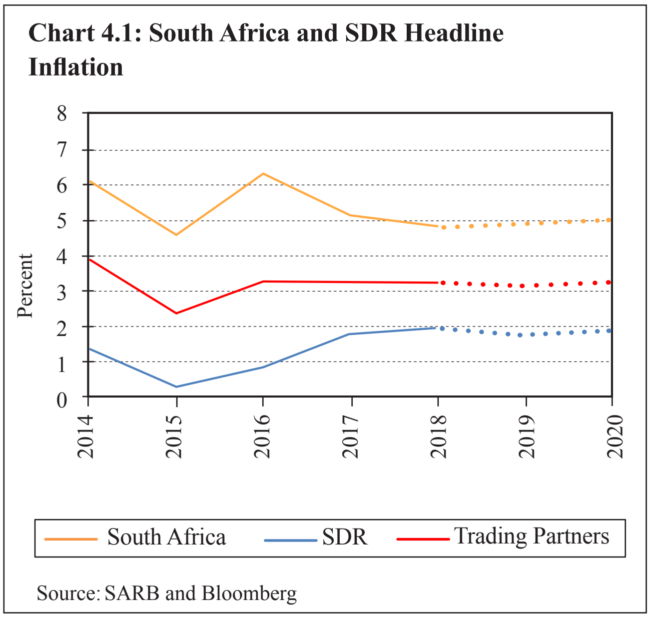
In addition, risks to the outlook are assessed to remain on the downside with both business and consumer confidence weighing down on fixed capital formation and the possibility of protracted electricity supply constraints. Moreover, Eskom's 9.4 percent electricity tariff increase is expected to raise costs for industry, with an adverse effect on growth prospects. In particular, the mining and manufacturing industries are expected to be severely affected as the major consumers of electricity. The tariff increase is expected to add an average of 0.3 percent to headline inflation in 2019 and 2020.

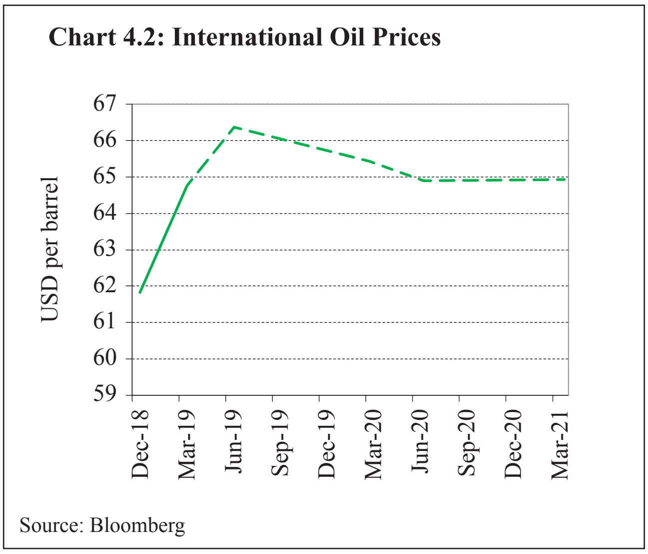
Global inflation to be modest

The global inflation outlook remains favourable in 2019, although there are indications of emerging upside pressures, partly from higher oil prices. Global inflation is forecast to be 3.6 percent in 2019, before easing to 3.5 percent in 2020. In advanced economies, inflation is expected to maintain a slight upward trajectory as oil prices increase. Similarly, for emerging market economies, inflation is expected to rise in 2019 on account of higher international oil prices and fiscal stimulus. Meanwhile, in South Africa, inflation is forecast to average 4.8 percent in 2019, before increasing to 5.3 percent in 2020 due to the weaker rand exchange rate and the expected higher oil prices in the first half of 2019. However, inflation is anticipated to remain within the SARB's target range in the short-to-medium term (Chart 4.1).

Furthermore, in the short-to-medium term, the role of monetary policy in supporting growth in emerging economies may be constrained by the policy tightening cycle in the US. Monetary policy across many countries is, therefore, expected to tighten in order to curb inflation and anchor expectations on inflation targets.

[10] Growth rates were marked down notably in Germany due to weak industrial production following the introduction of the revised auto emissions standards; in Italy due to weak domestic demand and elevated sovereign yields; while in France it was due to the negative impact of street protests.

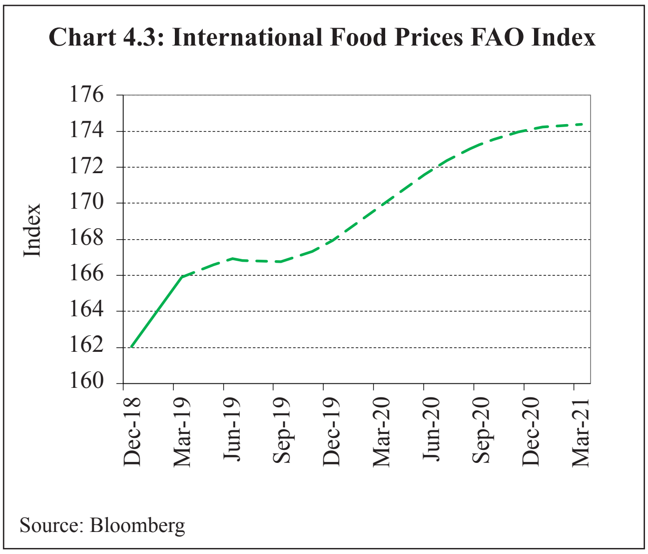




Commodity prices to increase in the first half of 2019

It is projected that international oil prices[11] will increase in the first half of 2019 and stabilise in the medium term (Chart 4.2). The increase is due to the agreement by OPEC and non-OPEC members to cut production, sanctions by the US on major exporter Iran to cut supply as well as political and economic disruptions in Venezuela. However, the US oil output surge is anticipated to offset efforts by OPEC to tighten market supply, thus stabilising prices. Moreover, China and the US are closing in on a trade deal, which will see both countries remove most, if not all, tariffs levied on goods and, as such, normalise global trade, as well as demand and, hence, oil prices. Overall, developments in the international oil market imply modest upward pressure on domestic inflation.

Global food prices are expected to increase in 2019 and 2020 due to rising shipping costs and adverse climatic shocks in the Southern African region (Chart 4.3).



[11] Brent crude oil serves as a benchmark price for oil projections.

4.2 Outlook for domestic economic activity

The projected growth in the global economy is expected to benefit the diamond market, although there are some downside risks associated with weakening consumer and business sentiment, as well as the possible escalation of the US-China trade tensions. Furthermore, among others, the accommodative monetary conditions in the domestic economy and the budgeted increase in government expenditure should potentially sustain output expansion in the non-mining sectors. In addition, improvements in water and electricity supply, as well as reforms to further improve the business environment, would be positive for economic activity generally. Hence, there are expectations of continued moderate growth in the short to medium term, with the economy, however, continuing to operate below its potential.

Improvement expected in domestic output
In the context of the anticipated rates of growth in most advanced and emerging market economies, which are major markets for Botswana's rough diamonds, domestic economic activity is expected to increase by 4.2 percent and 4.8 percent in 2019 and 2020, respectively.[12]

The non-mining sectors are projected to increase in 2019 and 2020 (see Box 4 for more details). Prospects for the non-mining sectors are supported by, among others, the accommodative monetary conditions in the domestic economy and the projected growth in government expenditure in the 2019/20 fiscal year. Furthermore, improvements in electricity and water supply, as well as the reforms to further improve the business environment, would be positive for economic activity generally. In addition, prospective recovery of commodity prices and the robust global market for exports should also support performance of the domestic economy. Even then, risks to global economic activity are skewed to the downside and could result in a fall in global demand and commodity prices, especially for rough diamonds, and impact negatively on the domestic economic outlook. Meanwhile, the March 2019 Business Expectations Survey results suggest that the level of optimism regarding economic activity has declined compared to the previous survey, as businesses expect lending conditions to tighten.

[12] These projections are obtained from the 2019 Budget Speech.

Box 4: Expected Drivers of Non-Mining Sectors

Trade, Hotels and Restaurants

- Envisaged increase in De Beers Global Sightholder Sales and Okavango Diamond Company output due to improved global demand for rough diamonds.
- Continued implementation of events-based-tourism initiatives, such as the Khawa Sand Dune Challenge and cultural festivals, promotion of dam tourism and government efforts to develop heritage sites. These developments create employment and enhance economic activity in the recreation and hotels sub-sectors, hence contributing to total output of the sector.
- Government initiatives aimed at facilitating the ease of doing business in Botswana. For example, the extended liquor trading hours and the reduction in the alcohol levy will address public concerns, such as loss of business and jobs and, thus, provide a boost to the economy.

Finance and Business Services

- Increase in financial and business services as a result of implementation of reforms on the ease of doing business in Botswana. FinTech developments, such as electronic and cell phone banking services by some banks, will boost the financial services and business sector and promote greater financial inclusion.

Construction

- Implementation of infrastructure projects through development spending, such as the North-South Water Carrier 2 and implementation of the North-West Electricity Transmission Grid.
- Continued land servicing initiatives will boost the construction sector and, ultimately, industries are expected to start operating in areas outside main cities and towns, which will stimulate economic growth.
- The implementation of the Cut 9 project in Jwaneng, Cut 3 project in Orapa and the Masama Coal Mine.
- Construction of transport-related infrastructure, such as the Boatle-Gaborone dual carriage road, Mohembo Bridge and Kazungula Bridge.

Transport and Communications

- Government's efforts to develop Information and Communications Technology through broadening network coverage, such as the Government data network upgrading.

Manufacturing

- Downstream diamond polishing activities expected to benefit from global economic activity.
- Local manufacturers to benefit from the Economic Diversification Drive (EDD) initiative that requires Government departments to procure products and services from local manufacturers. The EDD initiative has recently been under review with a view of making it more relevant and impactful.
- Reform of Botswana Meat Commission (BMC) and liberalisation of the beef export market. Furthermore, Government is implementing the Beef Productivity Training Programme through development cooperation with the Government of New Zealand to improve productivity of the beef sub-sector through training of farmers, herdsmen and extension staff.
- Expansion of dairy sub-sector by improving strategic dairy farms and leasing out unutilised farms to the private sector. Progress so far includes developments in the Sunnyside Dairy Farm which

continues to increase its dairy herd and secure additional land for fodder production to increase milk output.

Water and Electricity

- Operation of the Morupule A power plant, which has been under refurbishment.
- Establishment of the Botswana Energy Regulatory Authority (BERA) to promote sustainable and secure energy supply across the country. BERA continues to issue trading licences for petrol filling stations, petroleum wholesale and other industrial licences related to petroleum products, as well as standby generator provisional licences.
- Continued Government efforts to increase water supply across the country, such as through the Emergency Water Security and Efficiency Project and the Lesotho-Botswana Water Transfer (LBWT) Project.

Agriculture

- Livestock production expected to improve on account of continued efforts to contain the foot and mouth disease outbreaks.
- Continued Government subsidies through the Livestock Management and Infrastructure Development (LIMID) project and the Integrated Support Programme for Arable Agriculture Development (ISPAAD).

Social and Personal Services

- Continued Government efforts to promote growth of Small, Medium and Micro Enterprises (SMMEs) and citizen economic empowerment initiatives are expected to boost household business enterprises. For example, Government has signed a Memorandum of Understanding (MoU) with the De Beers Group of Companies to facilitate implementation of the Tokafala Enterprise Development Programme. The Programme is aimed at accelerating the growth of SMMEs through mentorship, advisory services and promoting business linkages, which are expected to improve productive capacity of local enterprises to supply both the domestic and export markets.
- The Local Enterprise Authority (LEA), which aims to promote entrepreneurship and SMME development, is also expected to further enhance the SMME participation in the economy, hence improve citizen economic empowerment.

4.3 Domestic inflation outlook

Inflation is forecast to remain within the 3-6 percent medium-term objective range in the short-to-medium term. Compared to the February 2019 forecast, inflation is currently projected to be slightly higher in the short-to-medium term, reflecting the increase in prices of alcoholic beverages in the second quarter of 2019 and the upward revision of international food and oil price forecasts. The main downside risks to the inflation outlook relate to any significant reduction in government levies and weak domestic demand, which can arise from the restrained increase in government expenditure and subdued growth in economic activity. Upside risks to the inflation outlook relate to any substantial upward adjustment in administered prices, government levies and international oil and food prices beyond current forecasts.

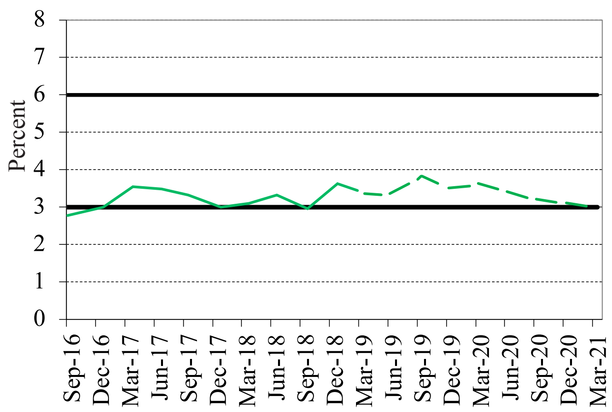
Inflation projected to remain within the objective range

Headline inflation is projected to be within the Bank's medium-term objective range in the short-to-medium term (Chart 4.4).

However, inflation is forecast to increase slighlty in the short term and trend towards the lower bound of the objective range in the medium term. The rise in inflation in the short term mainly reflects the upward adjustments in prices of alcoholic beverages in the second quarter of 2019. The increase in prices of alcoholic beverages follows Kgalagadi Breweries (Pty) Ltd's price review of all their beer portfolio (Clear beer, alcoholic fruit beverages and opaque beer), which is carried out to align prices of domestic alcoholic beverages with regional market prices.

Additional upward pressures on short-term inflation outlook, although not substantial, emanate from the expected improvement in domestic economic activity, driven to some extent, by the increase in public service salaries for the 2019/20 financial year, as well as the projected accommodative real monetary conditions[13]. Furthermore, the upward revision in international food and oil prices contributes to the rise in inflation in the short-to-medium term.

Chart 4.4: Botswana Headline Inflation Forecast



Source: Bank of Botswana

However, the positive rate of crawl of 0.3 percent implemented for the year 2019 is expected to mitigate some of the upward pressures on inflation. As such, headline inflation is forecast to be within the objective range in the short-to-medium term. According to the BES of March 2019, the business community also expects inflation to remain within the objective range in both 2019 and 2020.

[13] The RMCI measures the relative easiness or tightness of monetary conditions and gauges the likely effect that monetary policy has on the economy through changes in the exchange rate and interest rates. The RMCI combines, through a weighted average, the deviations of the real exchange rate and real interest rate from their respective trend values.

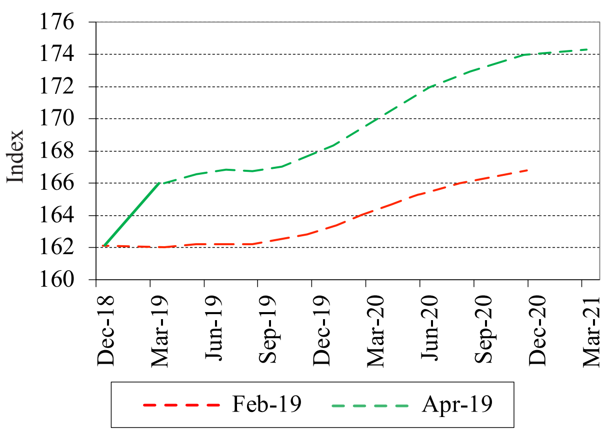
Core inflation to increase in the short term

Core inflation (inflation excluding food and fuel prices) is forecast to rise slightly in the short term, driven by the upward adjustment in prices of alcoholic beverages and the projected improvement in aggregate demand following the increase in public service salaries, as well as the accommodative monetary conditions. However, core inflation is expected to ease and remain stable in the medium term.

International food prices to increase

Compared to the February 2019 forecast, international food prices were revised upwards in the entire forecast period. International food prices are projected to increase in the short to medium term due to rising shipping costs and adverse climatic shocks in the Southern African region. The climatic shocks, mainly, the El Nino condition and tropical cyclone Idai (which resulted in massive flooding in some parts of Mozambique, Zimbabwe and Malawi) are expected to negatively affect crop production in the 2018/2019 harvest period (Chart 4.5).

Chart 4.5: International Food Prices FAO Index

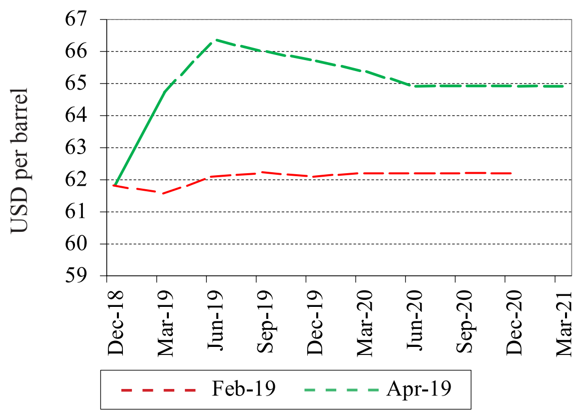


Source: Bloomberg

International oil prices to rise in the short term

International oil prices are projected to increase in the first half of 2019, but to be relatively stable in the medium term. The price of Brent crude oil is expected to gradually increase from an average of USD64.70 per barrel in the first quarter of 2019 to around USD66 per barrel in the second quarter of 2019 (Chart 4.6).

Chart 4.6: International Oil Prices



Source: Bloomberg

Compared to the February 2019 projection, international oil prices have been revised upwards on account of the ongoing trade negotiations between China and the US, which, if successful, will result in the removal of most (if not all) trade barriers imposed by the two countries on each other. It is envisaged that the removal of trade sanctions between these leading economies will boost growth in global trade, as well as demand for oil and, hence, exert upward impetus on oil prices. Additional upward pressures on international oil prices arise from the US sanctions against major OPEC exporters, Iran and Venezuela.

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

Inflation forecast revised slightly upwards in the short-to-medium term

Since the February 2019 MPC meeting, there has been new information pertaining to domestic GDP for the fourth quarter of 2018, headline inflation for the first quarter of 2019 and changes in both domestic and external economic assumptions. Overall, these developments have led to the upward revision of the inflation projection presented at the February 2019 MPC meeting. Thus, the current inflation projection is slightly higher in the short-to-medium term compared to the February 2019 forecast.

Exchange rate movements

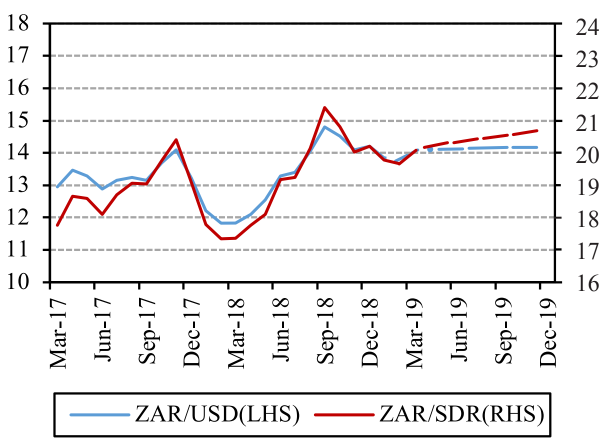
The Pula exchange rate is determined by the performance of the Pula basket currencies and the rate of crawl. Once the basket composition and the rate of crawl (based on inflation differentials) have been determined, the daily changes in the value of the Pula against other currencies are due to factors that are outside the control of Botswana authorities. It is, rather, the movements in the cross rates of the rand, US dollar, euro, pound sterling, Chinese renminbi and Japanese yen against each other, and their relative weights in the composite currency basket, that determine the value of the Pula against any individual currency.

The South African rand is expected to depreciate against major currencies in the next three quarters (Chart 4.7), due to the economy's weak economic fundamentals as highlighted in the South African fiscal budget last month, which are further exacerbated by electricity supply shortages in the country. The 2019 budget showed a worsening fiscal trajectory, predominantly because the National Treasury provided financial support to Eskom at R23 billion. Real GDP growth estimates were revised sharply lower again, and, along with this, revenue collection estimates. Investors believe South Africa is heading into uncharted territory in terms of government debt and rising vulnerabilities from a credit perspective.

Furthermore, the slower pace of global growth, uncertainty over the US and China trade deal and unfavourable changes in investor sentiment towards emerging markets assets are expected to put pressure on the rand.

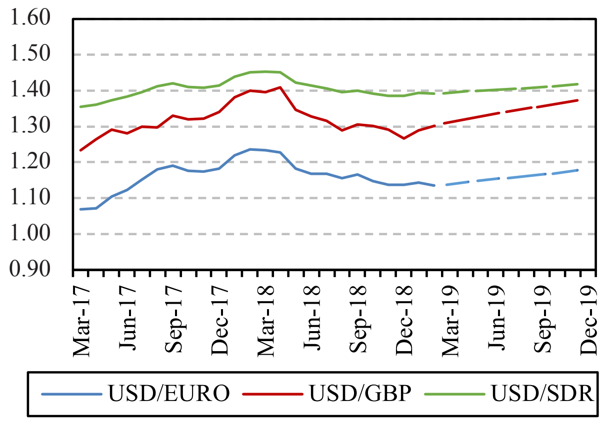
The South African rand is, therefore, expected to depreciate against major international currencies in the next three quarters (Chart 4.7). Consequently, the Pula is expected to appreciate against the rand in the same period.

Chart 4.7: ZAR against USD and SDR



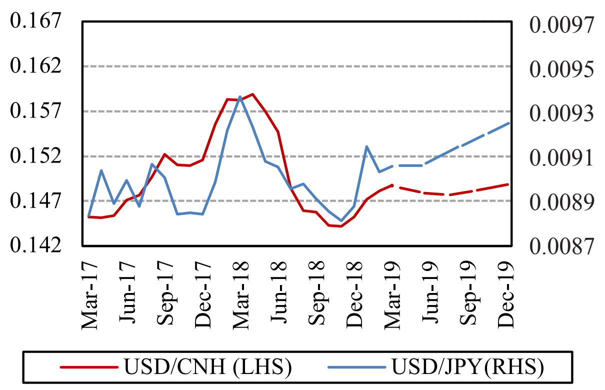
Source: Reuters

Chart 4.8A: Exchange Rates against USD



Source: Reuters

Chart 4.8B: Exchange Rates against USD



Source: Reuters

The US dollar is expected to give up most of 2018's gains against other major international currencies in the next four quarters (Chart 4.8A and Chart 4.8B), due to the US and China trade dispute, the slowing rate of growth of the US economy, a widening fiscal deficit and the Federal Reserve's dovish turn on interest rate hikes. The Fed has hiked its benchmark rate eight times since it began the normalisation process in December 2015 and had indicated two more increases in 2019. However, after the recent Fed meeting and emphasis of the Fed Statement on "being patient" investors do not expect any more hiking this year.

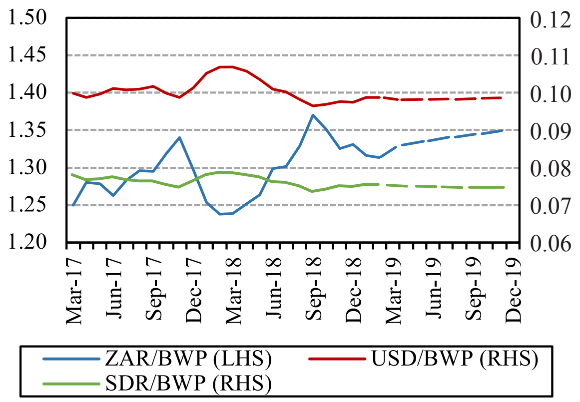
The British pound is expected to appreciate against the US dollar due to growing expectations of a business-friendly Brexit deal. Also, offering some support for the currency, the Bank of England is expected to raise interest rates towards the end of this year. Meanwhile, the euro is expected to appreciate against the US dollar owing to expected stimulus in the form of TLTROs to banks, with the expectation of boosting economic activity in the euro zone.

The Japanese yen is expected to appreciate against the US dollar owing to its safe haven status during times of global economic distress, amidst the struggling US dollar. The currency has been used by investors to hedge against tensions in emerging markets and the risks to the Chinese economy from the US tariffs.

The Chinese renminbi is expected to appreciate against the US dollar amidst positive expectations from the US and China trade deal. Furthermore, a less hawkish Fed should also be helpful for the renminbi. Overall, forecast movements of the SDR constituent currencies would result in appreciation of the SDR against the US dollar (Chart 4.8A).

The anticipated depreciation of the rand against major international currencies is, however, expected to exert marginal downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.9). The expected appreciation of the Pula against the rand will continue to contribute positively to the domestic inflation outlook.

Chart 4.9: BWP Exchange Rates against ZAR, USD and SDR



Source: Reuters and BoB calculations

Risks marginally on the upside

Risks to the inflation outlook identified at the February 2019 MPC meeting remain relevant. On the domestic front, upside risks to the inflation outlook relate to any unanticipated substantial upward adjustments in the administered prices and government levies and/or taxes. Externally, any increase in international commodity prices beyond current forecasts may exert upward pressure on domestic inflation.

However, there are downside risks associated with restrained global economic activity, the tendency of technological progress to lower costs and prices and the potential fall in commodity prices. Domestically, the continuance of modest GDP growth and restrained government expenditure could lead to subdued inflation.

5. APRIL 2019 MONETARY POLICY COMMITTEE DECISION

At the meeting held on April 24, 2019, the MPC of the Bank of Botswana decided to maintain the Bank Rate at 5 percent. The outlook for price stability remains positive as inflation is forecast to remain within the Bank's 3 – 6 percent objective range in the medium term. Inflation was unchanged at 3.3 percent between February and March 2019.

Subdued domestic demand pressures and the modest increase in foreign prices contribute to the positive inflation outlook in the medium term. This outlook is subject to upside risks emanating from the potential rise in administered prices, in particular, domestic fuel prices and government levies and/or taxes, beyond current forecasts. However, restrained growth in global economic activity, technological progress and productivity improvement present downside risks to the outlook.

Real GDP grew by 4.5 percent in 2018, compared to a lower expansion of 2.9 percent in 2017. This was mainly attributable to the continued good performance in non-mining sectors and the recovery in mining output. Mining output expanded by 7.4 percent in 2018, compared to a contraction of 11.1 percent in 2017. Non-mining GDP grew by 4.1 percent in 2018, compared to 4.8 percent in 2017. GDP is projected to increase by 4.2 percent in 2019. The significant influences on domestic economic performance include conducive financing conditions as indicated by accommodative monetary policy and sound financial environment that facilitate policy transmission, intermediation and risk mitigation. Moreover, it is anticipated that the increase in government spending, as well as implementation of initiatives, such as the doing business reforms, should also be supportive of economic activity. Overall, the economy is projected to operate close to, but below full capacity in the short to medium term, thus posing no upside risk to the inflation outlook.

Global output growth is expected to ease to 3.3 percent in 2019, from an estimated expansion of 3.6 percent in 2018. This moderation in global growth was as a result of various country specific factors. These include, amongst others: trade tensions which could flare up again thereby hampering confidence, investment and growth, continuing policy uncertainty, possible slower growth in China, a "no-deal" Brexit, tightening financial conditions, geopolitical risks and high debt levels. Regionally, the South African Reserve Bank revised its forecasts for GDP growth for 2019 downwards to 1.3 percent from 1.7 percent. This results from the larger than expected slowdown in the global economy, decline in business confidence and potential supply-side disruptions from load shedding.

The current state of the economy and the outlook for both domestic and external economic activity suggest that the prevailing monetary policy stance is consistent with maintaining inflation within the objective range of 3 – 6 percent in the medium term. Consequently, the MPC decided to retain the Bank Rate at 5 percent.

In line with the reforms to monetary operations announced at the beginning of the year, the Bank will, with effect from April 30, 2019, introduce a new 7-day Bank of Botswana Certificate (BoBC) as the main instrument for conducting monetary operations to replace the existing 14-day BoBC. It is important to emphasise that the move to the 7-day BoBC represents a purely technical change to the conduct of monetary operations with no shift to the monetary policy stance.

MPC meetings for the remainder of the year are scheduled for June 27, 2019; August 29, 2019; October 31, 2019; and December 5, 2019.

NOTES