MONETARY POLICY STATEMENT 2014

Linah K Mohohlo
Governor

February 28, 2014

17938 Khama Crescent, Gaborone; Tel: (267) 360-6000; Facsimile: (267) 390-9016
website: www.bankofbotswana.bw

1. INTRODUCTION

1.1 The Monetary Policy Statement (MPS) seeks to promote credibility and understanding of the monetary policy framework with a view to anchoring public expectations of a low, predictable and sustainable level of inflation. The Statement examines prospective economic and financial developments that are likely to affect the inflation path in the medium term and, ultimately, the Bank's policy choices in 2014. The 2014 MPS, therefore, reviews economic and policy developments in the past year and evaluates the determinants of price changes and their impact on inflation in Botswana. Price developments (inflation) are assessed against the Bank's medium-term inflation objective range of 3 – 6 percent.

1.2 World economic activity was subdued in 2013, largely due to developments in major economies where fiscal austerity, restrained demand, high unemployment rates and weak financial intermediation dampened growth. In the circumstances, sluggish demand and stable commodity prices resulted in modest inflation more or less globally. Given the benign inflationary pressures, many central banks responded to weak economic activity and constrained financial flows to industry by maintaining accommodative monetary policies (including low interest rates and provision of liquidity).

1.3 As anticipated in the 2013 MPS, domestic inflation fell within the Bank's objective range of 3 – 6 percent during 2013 and decreased from 7.4 percent in December 2012 to 4.1 percent in December 2013, thus continuing a downward trend that started towards the end of 2011. The current level of inflation reflects mainly modest demand pressures as influenced by the stance of both monetary and fiscal policies. As such, the policy stance and domestic demand conditions accommodated the transmission to domestic prices of modest foreign inflation and favourable exchange rate developments. The impact of changes in administered prices on inflation was also muted. Strong credit expansion helped support demand, but it was counterbalanced by the slower increase in net foreign assets and the increase in government deposits at the Bank of Botswana, which resulted in the annual expansion in money supply (in the year to November 2013) of 8.6 percent. GDP growth was robust at 5.9 percent in the same period (twelve months to September 2013), due to an increase in mining production and a sustained growth of the non-mining sectors (although slower than in 2012).

1.4 In view of the positive medium-term outlook for inflation and expectations of restrained demand pressures and benign external price developments, the Bank Rate was reduced by a cumulative 200 basis points to 7.5 percent in 2013. With respect to the Pula exchange rate, prospects for lower domestic inflation and the narrowing inflation differential between Botswana and her trading partner countries meant that the nominal effective exchange rate (NEER) crawled by minus 0.16 percent in 2013. The result was that in the twelve months to December 2013, the Pula appreciated by 9.7 percent against the South African rand, but depreciated by 11.1 percent against the SDR.[1] The real effective exchange rate was stable and

1 The SDR is the unit of account of the International Monetary Fund comprising the United States dollar, British pound, euro and Japanese yen.

supportive of international competitiveness of producers of tradeable goods and services.

1.5 *Looking ahead, it is expected that economic and financial developments will result in inflation remaining within the objective range in the medium term. However, the inflation outlook is subject to upside risks that include any substantial increase in administered prices and government levies, as well as a possible increase in international food and oil prices beyond current projections. A higher wage settlement beyond that which is justified by price developments would also be inflationary. However, there is a downside risk to the inflation outlook associated with a possible weaker-than-anticipated global economic performance.*

2. MONETARY POLICY FRAMEWORK

2.1 *The primary objective of the Bank's monetary policy is to achieve price stability, which is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. The policy is formulated with a view to safeguarding the stability of the financial system. A low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers and, thus, contribute towards the broader national objective of sustainable economic growth and development.*

2.2 *The monetary policy framework is forecast-based, with a medium-term outlook that primarily guides the Bank's response to forecast movements in inflation, while taking into account prospects for economic growth and developments with respect to financial indicators. The main elements of the policy framework are as follows:*

(a) *generation of a broad-based medium-term inflation forecast, including a projection of the "output-gap"*[2]*, assessment of "real monetary conditions"*[3] *and estimate of the impact of changes in administered prices and government levies;*

(b) *assessment of additional information not incorporated in the inflation forecast, including the twice-yearly Business Expectations Survey and other supplementary data sources;*

(c) *evaluation of financial and other indicators that can impact on the stability of the financial system, including credit, liquidity conditions and property market developments, as well as economic growth and employment prospects;*

---

2 *The output gap refers to the difference between long-term trend output (as an indicator of productive capacity) and actual output. A negative output gap means the actual level of output for a given period is below the trend level for that period, thus indicating the economy is operating below its estimated potential.*

3 *The real monetary conditions index (RMCI) measures the relative looseness 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 real monetary conditions are measured by the RMCI that combines, through a weighted average, the deviations of the real exchange rate and real interest rate from their respective trend values.*

(d) *regular meetings of the Bank's Monetary Policy Committee (MPC) to review recent economic developments, related inflation outlook and the implications for monetary policy, as well as prompt dissemination of decisions to foster policy credibility and help anchor inflation expectations;*

(e) *use of interest rates and open market operations to affect demand conditions in the economy and, ultimately, the rate of increase in prices;[4] in general, the Bank responds to a sustained deviation of inflation from the objective range, and where the causal factors could be influenced by domestic monetary policy; and*

(f) *monitoring of exchange rate developments and implementation of the crawling band exchange rate policy to support competitiveness of local producers.*

3. INFLATION TRENDS AND OTHER ECONOMIC DEVELOPMENTS IN 2013

3.1 *World output growth decelerated marginally from 3.1 percent in 2012 to an estimated 3 percent in 2013, resulting in modest inflationary pressures and stable commodity prices.[5] In particular, capacity underutilisation persisted due to sluggish demand and high unemployment rates in major economies. In addition to the impact of weak demand, international oil prices stabilised in the context of prospects for an increase in supply emanating from new production in the USA and higher output in the Middle East and North Africa that is associated with the easing of geopolitical tensions. The increase in food prices was also modest, given ample grain production. As a result of these developments, world inflation decreased from 4 percent in 2012 to 3.8 percent in 2013.*

3.2 *The trade-weighted average inflation for Botswana's trading partner countries fell from 4 percent in December 2012 to 3.4 percent in December 2013 (Chart 1).[6] For the SDR countries,[7] inflation declined from 1.9 percent in December 2012 to 1.3 percent in December 2013,[8] while headline inflation in South Africa eased from 5.7 percent in December 2012 to 5.4 percent in December 2013, remaining within that country's medium-term target range of 3 – 6 percent.*

---

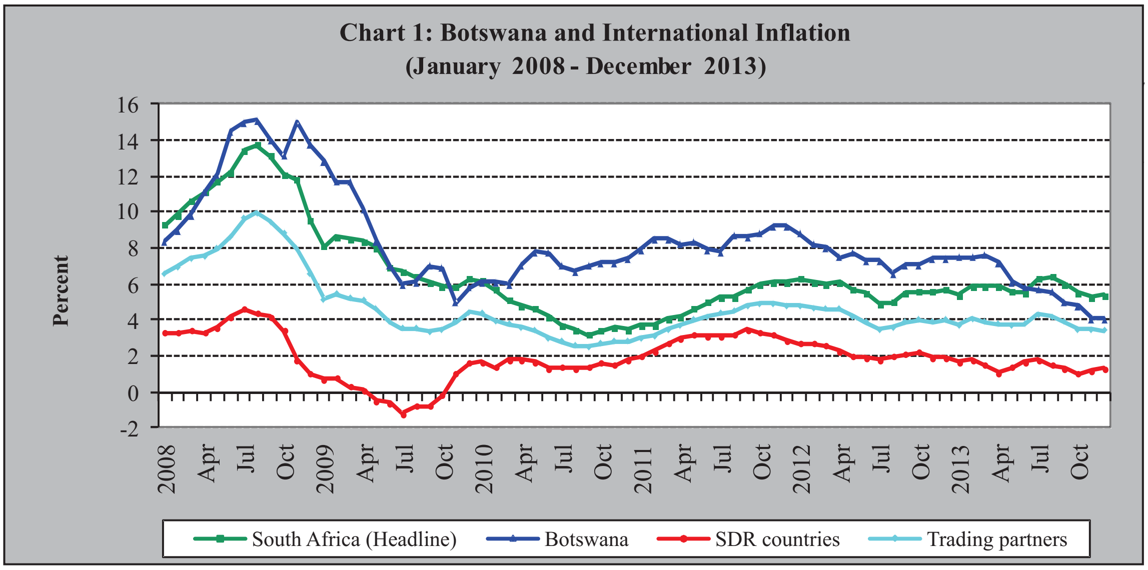
4 *For example, a sustained level of economic performance above trend is potentially inflationary and could signal the need to increase interest rates to dampen inflationary pressures, while output below trend could require a reduction of interest rates to stimulate economic activity.*

5 *World Economic Outlook Update published by the International Monetary Fund (January 2014).*

6 *The trade-weighted average inflation comprises South Africa's headline inflation and the SDR countries' inflation.*

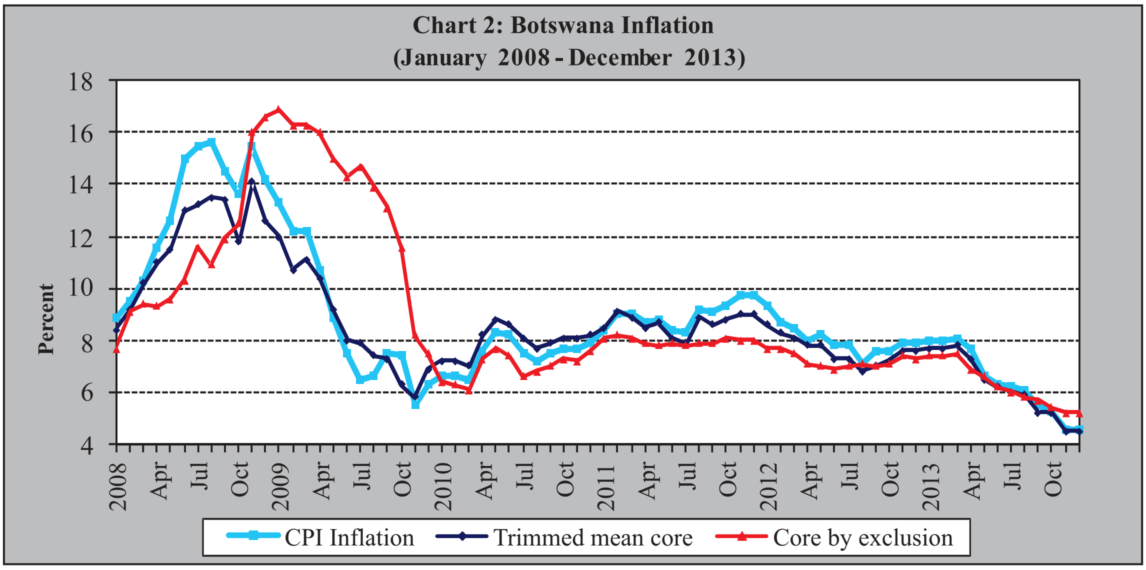
7 *USA, UK, Japan and the euro area. Inflation was below target in the euro area, Japan and the USA.*

8 *Inflation declined in most of the SDR countries in the second half of the year, with the exception of Japan, which reversed its deflation trend, as the country hopes to ignite growth through higher inflation.*

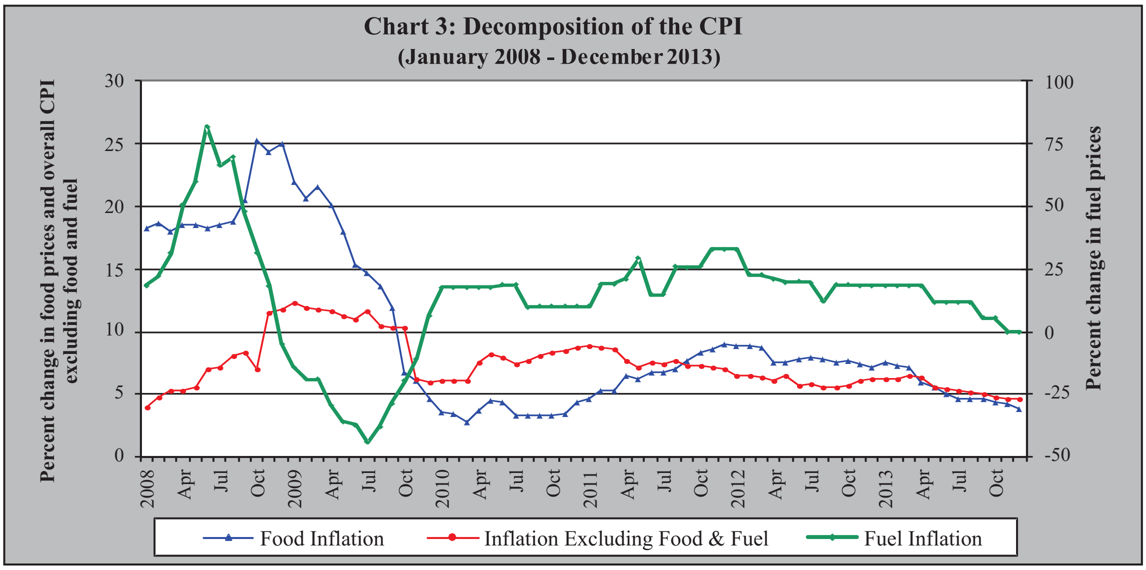


Source: Statistics Botswana

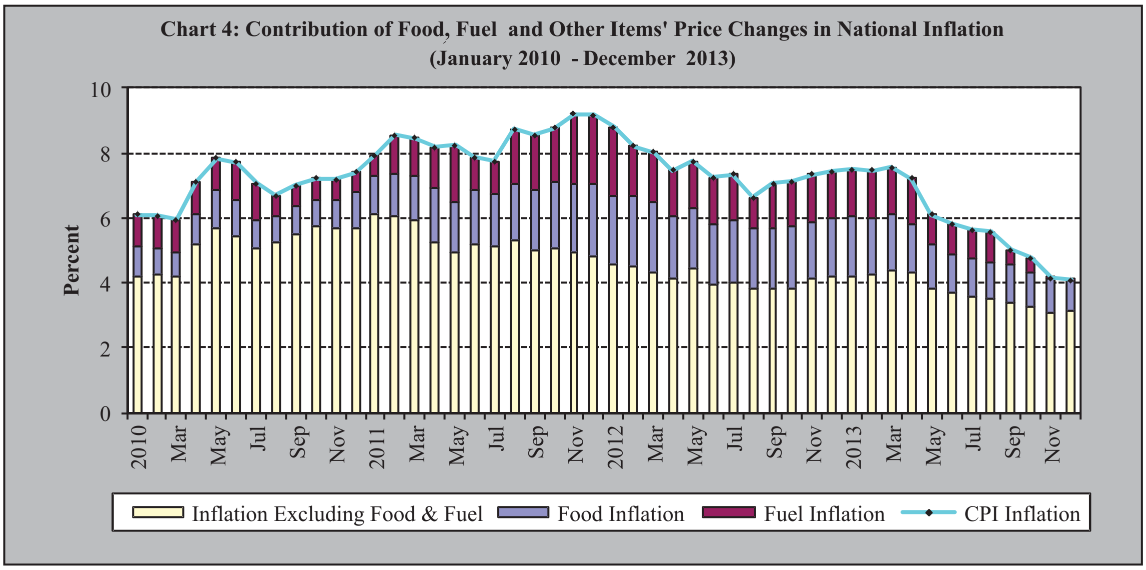
3.3 *Domestic inflation maintained a downward trend during the year and was within the Bank's medium-term objective range of 3 – 6 percent from June 2013 (Chart 2). In the context of modest underlying demand pressures (reflected in lower price changes for most categories of goods and services), inflation fell from 7.4 percent in December 2012 to 4.1 percent in December 2013 (Charts 3 and 4), as the impact of the previous year's increase in administered prices dissipated. Moreover, the adjustment in administered prices and government levies of 2013 were more or less to the same extent as that of the previous year, thus not exerting upward pressure on inflation. On average, the increase in administered prices added approximately 0.34 percentage points to inflation in 2013 compared to 1.95 percentage points in 2012. Inflation excluding administered prices decreased from 6.8 percent in December 2012 to 4.7 percent in December 2013, while the 16 percent trimmed mean measure of core inflation fell from 7.1 percent to 4 percent in the same period.*



Source: Statistics Botswana



Source: Statistics Botswana



Source: Statistics Botswana

3.4 *The impact of government spending on economic activity was small in the context of fiscal consolidation measures, with annual government expenditure growth of 2 percent in December 2013. Restrained government spending and its influence on demand included a negligible growth in public sector wages. However, strong growth in credit to the household sector helped stabilise demand and supported economic activity (Chart 5). The year-on-year increase in credit to the household sector accelerated from 21 percent in December 2012 to 24.2 percent in December 2013, driven by growth in mortgages (43.3 percent, albeit from a low base) and personal loans (19.1 percent).*

3.5 *Nevertheless, there was a marked deceleration in annual credit expansion with respect to businesses, from 26.8 percent in December 2012 to only 4.6 percent in December 2013. The slowdown in business credit growth is reflected across virtually all sectoral business activities and led to the moderation in value added by various sectors of the economy in 2013 (Charts 6 and 7). Thus, annual growth in non-mining GDP decelerated to 5.1 percent in September 2013 compared to 8 percent in September 2012. However, resurgence in mining output from the contraction of 11.9 percent in the year to September 2012, to the 11 percent growth in the corresponding period ending in September 2013, helped to raise the overall GDP growth from 4.9 percent in the 12 months to September 2012 to 5.9 percent in September 2013 (Chart 8).*

3.6 *Overall, the year-on-year expansion in credit to the private sector[9] decreased from 23.6 percent in December 2012 to 15.1 percent in December 2013.[10] Credit growth and the increase in net foreign assets were the main expansionary factors on money supply, which grew at an annual rate of 8.6 percent in November 2013. In contrast, the annual increase in government deposits at the Bank of Botswana in the same period had a contractionary effect on money supply.*

3.7 *The substantial increase in credit to households, which is much larger than growth in nominal GDP, in part reflects improvements in provision of financial services and greater financial inclusion; hence the significant increase in the intermediation ratio from 73 percent in December 2012 to 82 percent in December 2013.[11] The rate of credit expansion to households, which is dominated by personal loans in an environment of slow growth in incomes, could increase the debt repayment burden; this development needs closer attention. Moreover, to the extent that the associated growth in mortgages is in the context of emerging oversupply and weak demand in some segments of the property market, it could pose a risk to banking assets and household wealth. Accordingly, the Bank continues to monitor credit developments in order to address any threats to financial stability. Furthermore, the concentration of funding of banks in the form of bulky business deposits (72 percent of total deposits) to support the net debtor position of households (accounting for 58 percent of total credit) represents a market imbalance.*

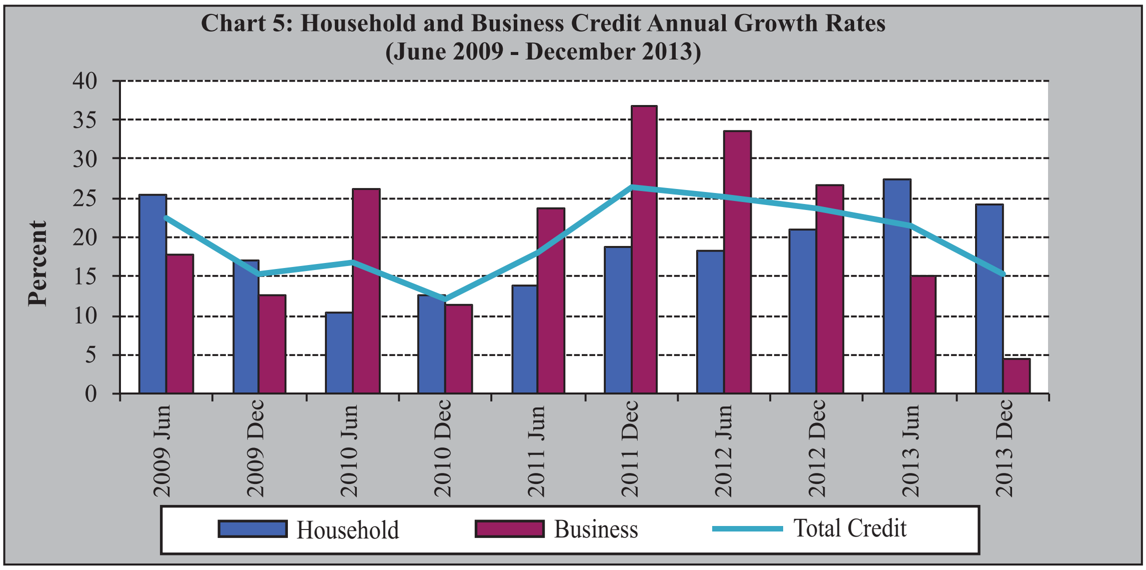
3.8 *However, current indicators, including low and stable default ratios for household loans suggest that widespread default risks are not imminent. Similarly, activity in the property sector suggests that the major components of the residential and commercial property are currently broadly balanced. Furthermore, given projected positive GDP growth, there is less risk of generalised loss of employment income that can adversely affect debt repayment.*

---

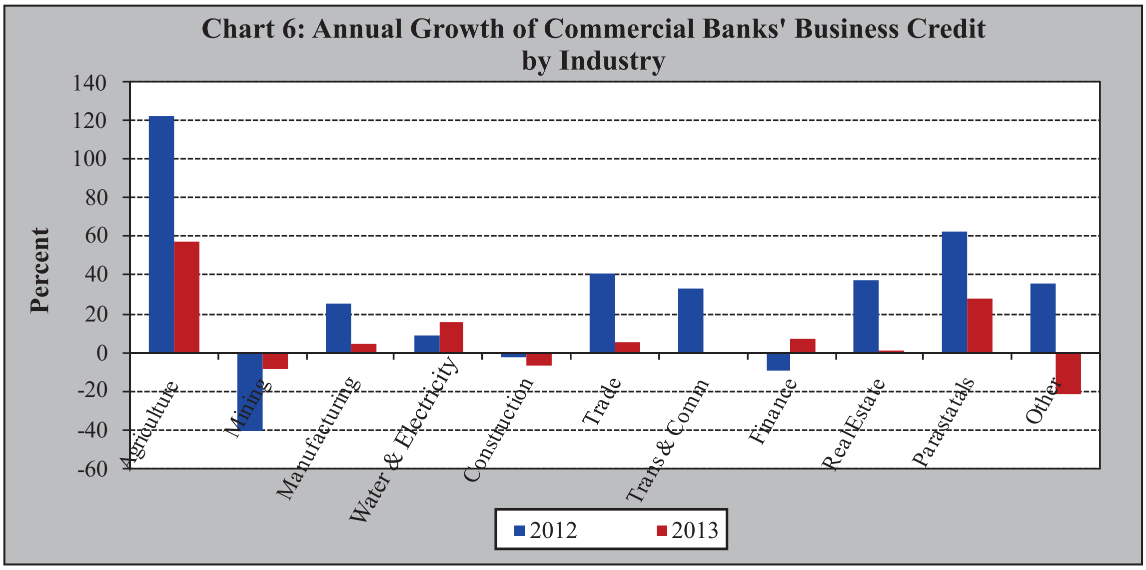
9 *Comprises private businesses, parastatals and households.*

10 *Recent major revisions to the allocation of credit between the household and business sectors mean that the figures used for 2012 differ from those in previous publications, including the 2013 Monetary Policy Statement and its Mid-Term Review. The changes cover the period since August 2012, and are primarily due to revised data submitted by one of the bigger commercial banks.*

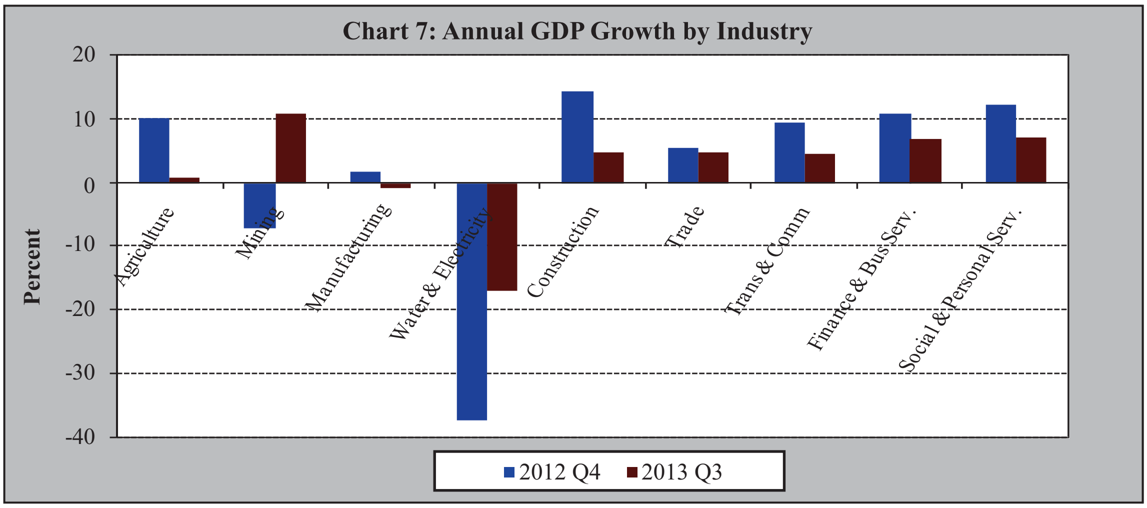
11 *The intermediation ratio refers to the proportion of deposits at commercial banks that is converted into loans.*



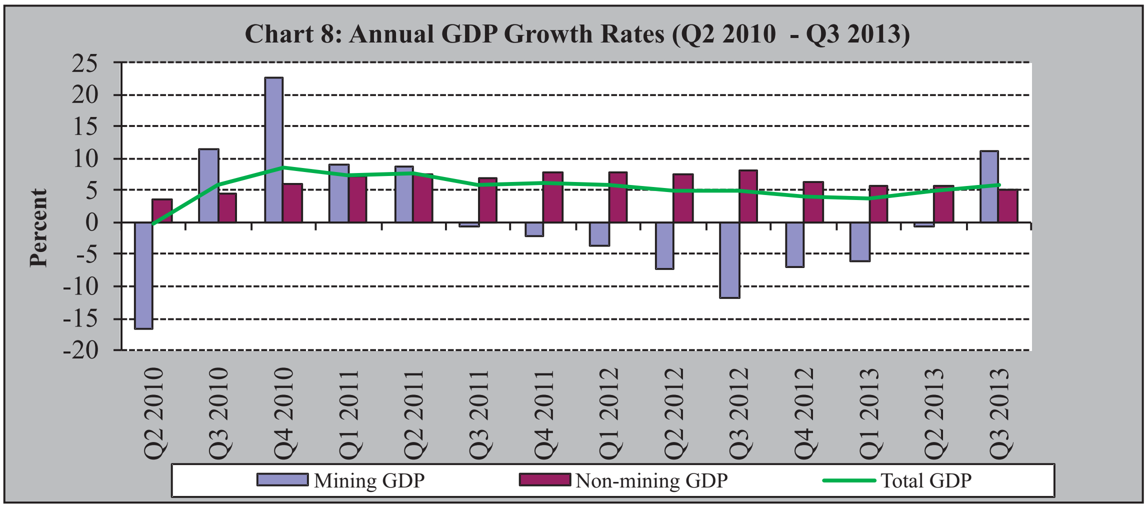
Source: Bank of Botswana



Source: Bank of Botswana



Note: The growth rate is calculated as the percentage change in cumulative GDP over four quarters compared to the corresponding period in the previous year.
Source: Statistics Botswana and Bank of Botswana calculations



Source: Statistics Botswana and Bank of Botswana calculations

4. IMPLEMENTATION OF MONETARY POLICY IN 2013

4.1 Globally, monetary policy was conducted in an environment of sluggish demand, weak economic activity, lacklustre financial intermediation, benign inflationary pressures and stable commodity prices. Moreover, monetary policy carried the burden of supporting economic recovery as fiscal austerity was maintained and structural reforms undertaken in some major economies. However, there was generally positive sentiment and improved prospects for recovery, especially towards the end of 2013, led by faster output growth and a decrease in unemployment rates in the USA and UK, while the euro area emerged from recession. Japan experienced modest growth based on fiscal and monetary stimuli. Meanwhile, output expansion in emerging market economies was robust and supported global economic performance.

4.2 *Monetary policy was mostly accommodative in order to stimulate economic activity. It involved maintenance and, in some instances, reduction of already low policy interest rates, alleviation of credit constraints and financial flows, as well as structural reforms to foster competitiveness. Some of the major central banks used forward guidance to indicate thresholds for unemployment and growth that need to be reached before any monetary policy tightening can be considered. Central banks in emerging market economies retained conventional monetary policy implementation against the background of more robust economic performance and, in some cases (e.g., Brazil and India), the imminent threat of rising inflation resulted in some policy tightening (Appendix).*[12]

4.3 *In Botswana, monetary policy was implemented against the background of below-trend growth (a non-inflationary negative output gap) and a positive outlook for inflation in the medium term. As a result, the Bank Rate was cut by a cumulative 200 basis points during the year to 7.5 percent*[13] *and, consequently, the commercial banks' prime lending rate was reduced from 11 percent to 9 percent in the same period, with largely corresponding movements in other market interest rates. The 14-day Bank of Botswana Certificate (BoBC) yield decreased from 4.6 percent in December 2012 to 3.1 percent in December 2013, while the 3-month BoBC yield fell from 5.4 percent to 3.6 percent. Similarly, the average 88-day commercial bank deposit interest rate eased from 3.7 percent in December 2012 to 2.6 percent in December 2013. In a bid to encourage and reward depositors, commercial banks are required to offer and publish a 91-day deposit or equivalent deposit product which pays an interest rate that, at a minimum, is 3.5 percentage points below the prevailing Bank Rate,*[14] *with commensurate higher interest rates for longer-dated deposits. A larger decrease in inflation compared to the reduction in interest rates resulted in an increase in real interest rates, although still negative in real terms, particularly for deposits.*[15]

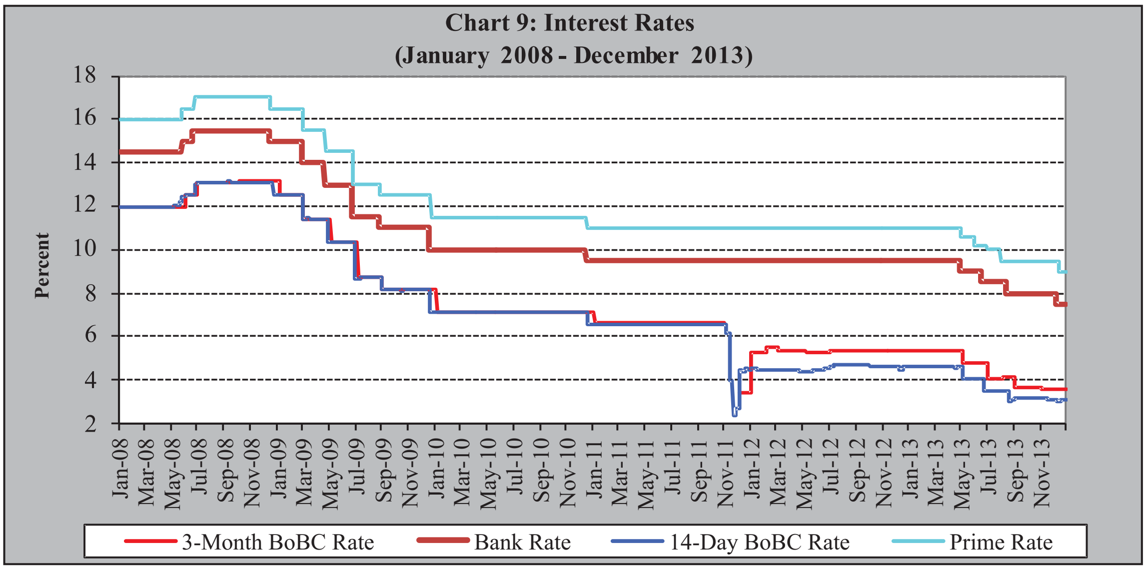
---

12 *However, given prospects of reduction of asset purchases in the USA and tightening monetary conditions (higher yields), there has been an outflow of capital from emerging market economies in early 2014, leading to currency depreciation and threat of inflation. Consequently, policy interest rates were also increased in South Africa and Turkey in January.*

13 *The Bank Rate was reduced by 50 basis points at each meeting of the MPC in April, June, August and December 2013.*

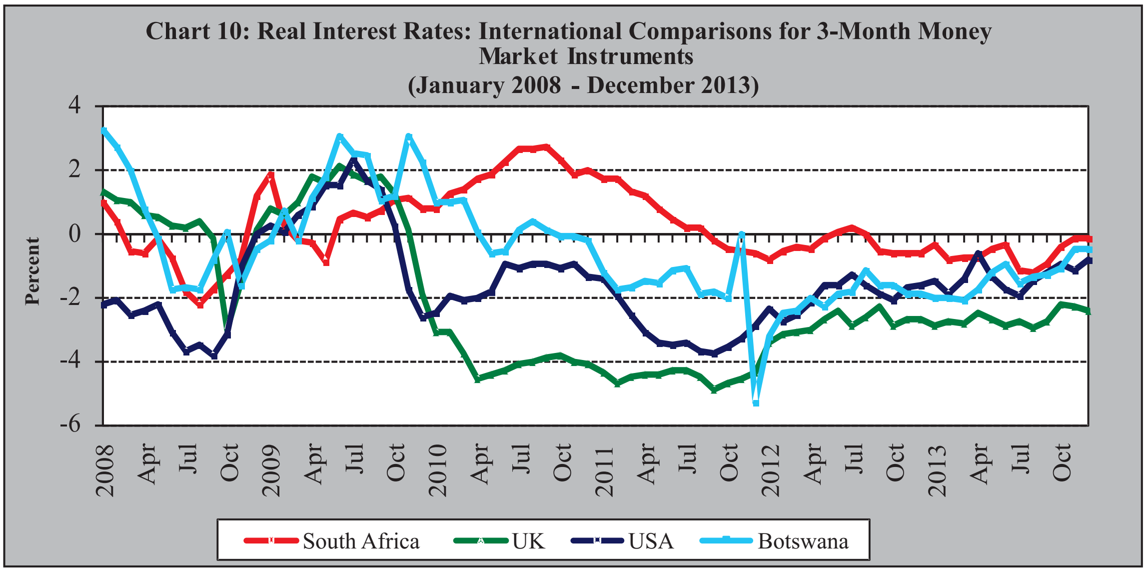
14 *Given the Bank Rate of 7.5 percent, the minimum deposit interest rate is 4 percent for the 91-day deposit.*

15 *The real 14-day BoBC rate increased from -2.6 percent in December 2012 to -1 percent in December 2013, reflecting the deceleration in inflation. In comparison, real 3-month money market interest rates were -0.5 percent, -0.2 percent, -1.7 percent, -0.8 percent and -0.7 percent in December 2013 for Botswana (3-month BoBCs), South Africa, UK, USA and the euro area, respectively.*



Source: Bank of Botswana

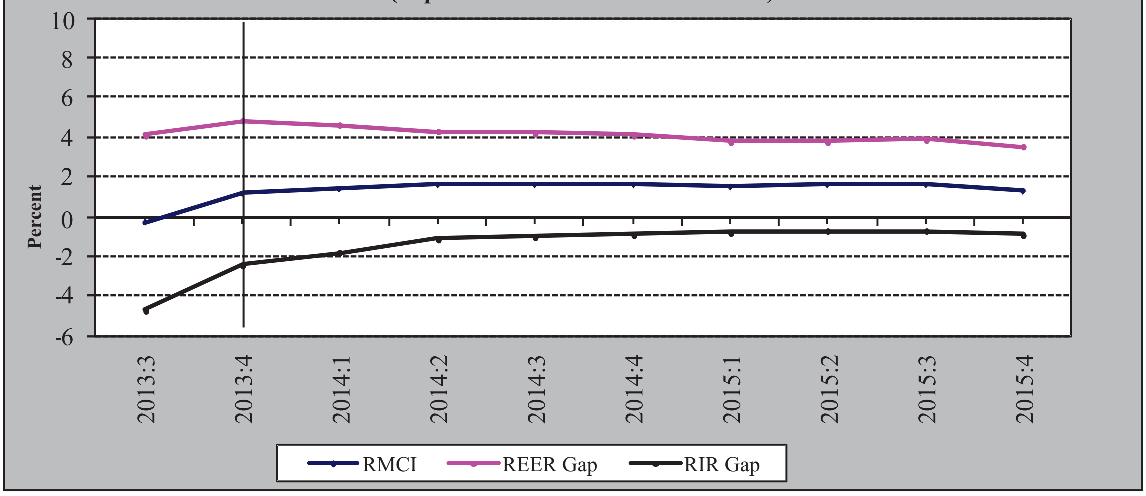
4.4 *Implementation of monetary policy involved the use of BoBCs to absorb excess liquidity in order to ensure maintenance of interest rates that are consistent with the monetary policy stance, while reverse repurchase agreements were used as an intra-auction liquidity mopping instrument. At the end of December 2013, the value of outstanding BoBCs was P5.5 billion, which is a decrease of 36.7 percent from P8.7 billion at the end of 2012. In an effort to encourage commercial banks to look more towards financing viable projects that would support economic development and diversification, the Bank conducts monetary operations with a view to reducing the level of BoBCs to an average of P5 billion. Meanwhile, the primary reserve requirement was maintained at 10 percent (since July 2011) of commercial banks' Pula deposit liabilities.*



Source: Bank of Botswana

4.5 *The Bank implemented a modest downward crawl of the Pula exchange rate (0.16 percent per annum) in line with the policy objective of maintaining a stable real* *effective exchange rate (REER) of the Pula. As a result, the nominal effective exchange rate (NEER) of the Pula depreciated by a similar magnitude against the trade-weighted composite trading partner country currencies in the twelve months to December 2013. Overall, real monetary conditions, as measured by a combination of changes in the inflation-adjusted exchange rate and interest rates, were relatively restrictive in 2013 (Chart 11). The downward crawl, and the resultant depreciation of the NEER, was slightly smaller than the differential between inflation in Botswana and the average inflation for trading partner countries (Chart 12). Hence, the REER of the Pula appreciated marginally by 0.4 percent in the twelve months to December 2013.*

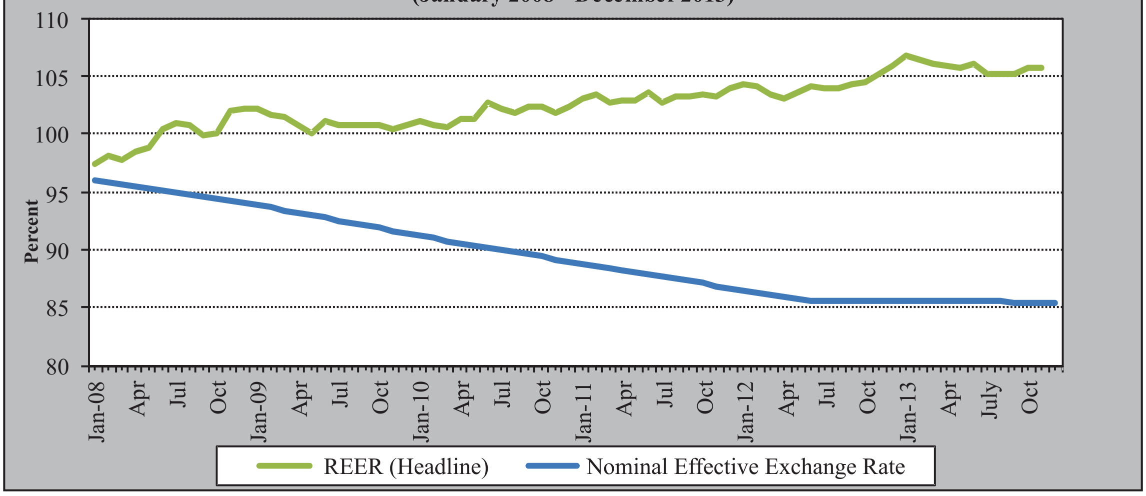
Chart 11: Real Monetary Conditions Index (RMCI)
(September 2013 - December 2015)



Notes: (1) The REER Gap is a measure of the deviation of the actual REER from its trend value.
(2) The Real Interest Rate (RIR) Gap is a measure of the deviation of the real interest rate (3-month real BoBC rate) from its trend value.
(3) The Real Monetary Conditions Index (RMCI) is a weighted average of the REER Gap and RIR Gap.

Source: Bank of Botswana

Chart 12: Real Effective Exchange Rate and Nominal Effective Exchange Rate
(January 2008 - December 2013)



Source: Bank of Botswana

5. *INFLATION OUTLOOK*

5.1 *Global output growth for 2014 is projected to be higher than the estimated 3 percent for 2013 at 3.7 percent. The forecast for faster growth in world economic activity is premised on anticipated stronger performance in major economies, notably the USA[16], as engendered by reduced fiscal austerity and maintenance of accommodative monetary conditions as well as the associated improvement in demand and investment. It is, therefore, expected that the increase in demand and trade will also contribute to faster growth in emerging market economies, which is projected at 5.1 percent in 2014 (4.7 percent in 2013). However, there are risks relating to potential reversal of capital flows from emerging market economies that could follow the ongoing wind-down of asset purchases in the USA. Despite buoyant output and improved demand, it is expected that inflationary pressures will remain subdued in 2014 in the context of stable commodity prices and persistence of spare capacity. Thus, global inflation is projected to be 3.8 percent in 2014 as was the case in 2013. In the circumstances, monetary policy will mostly be accommodative in major economies during the year and will continue to incorporate liquidity support, supplemented by measures aimed at promoting financial flows and fostering resilience of the financial sector to support economic activity.*

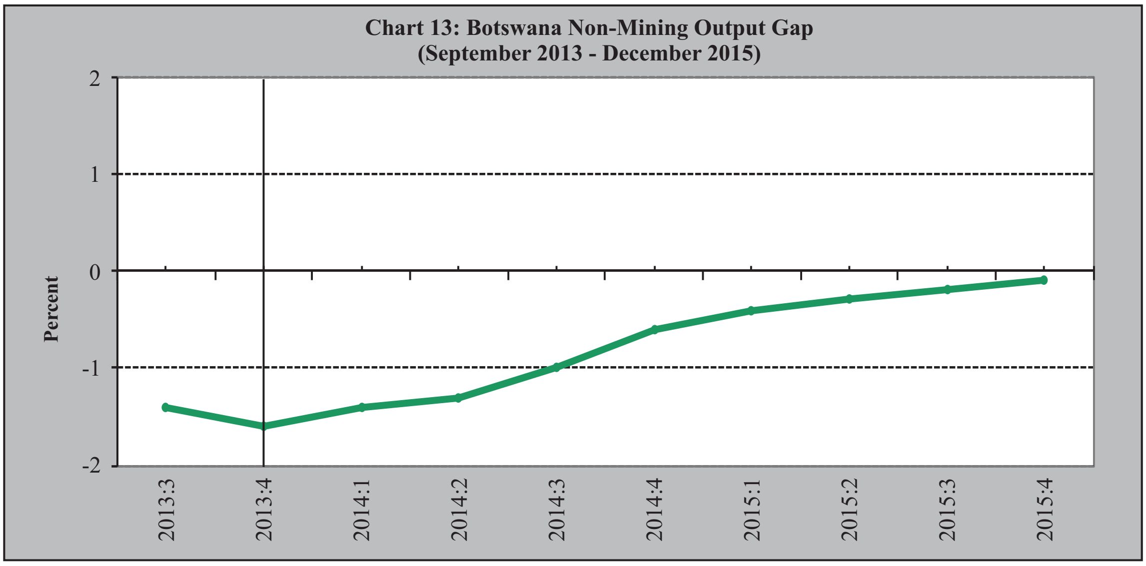
5.2 *The 2014 forecast for inflation in SDR countries is 1.8 percent (higher than the 1.5 percent average in 2013). Headline inflation in South Africa is forecast to increase from an average of 6.3 percent in 2014 to 6.9 percent in 2015. Given Botswana's medium-term inflation objective range of 3 – 6 percent and the forecast average inflation range for trading partner countries of 3 – 4 percent, the NEER will crawl downwards at 0.16 percent in 2014. It is, therefore, expected that the influence of external price developments (through imported inflation and changes in the exchange rate) on domestic inflation will be modest.*

5.3 *For the domestic economy, output expansion is forecast to moderate from the revised forecast of 5.4 percent in 2013 to 5.1 percent in 2014, with persistence of a negative non-mining output gap (Chart 13). The mining sector recovery that started in 2013 is expected to continue and moderate growth in non-mining output is projected to be realised. Activity relating to the relocation to Botswana of diamond aggregation and sales is positive for growth across several sectors, but the ongoing challenges relating to power supply and water shortages may constrain growth in economic activity. For the 2014/15 fiscal year, total government expenditure is estimated to rise by 8.5 percent, with an overall budget surplus of P1.3 billion. Development expenditure and recurrent expenditure are projected to increase by 1 percent and 11.3 percent, respectively, with the slower growth in development*

---

16 *A breakthrough in fiscal policy discussions, which resulted in a budget deal that will fund the Government for two years, has reduced uncertainty, with a likely positive impact on demand and investment.*

spending indicative of some rebalancing of priorities.[17] *In particular, the more rapid growth in recurrent spending reflects the need to satisfy maintenance requirements, ensure efficient operation of the existing infrastructure and increased financial support to parastatals and local authorities.*



Source: Bank of Botswana

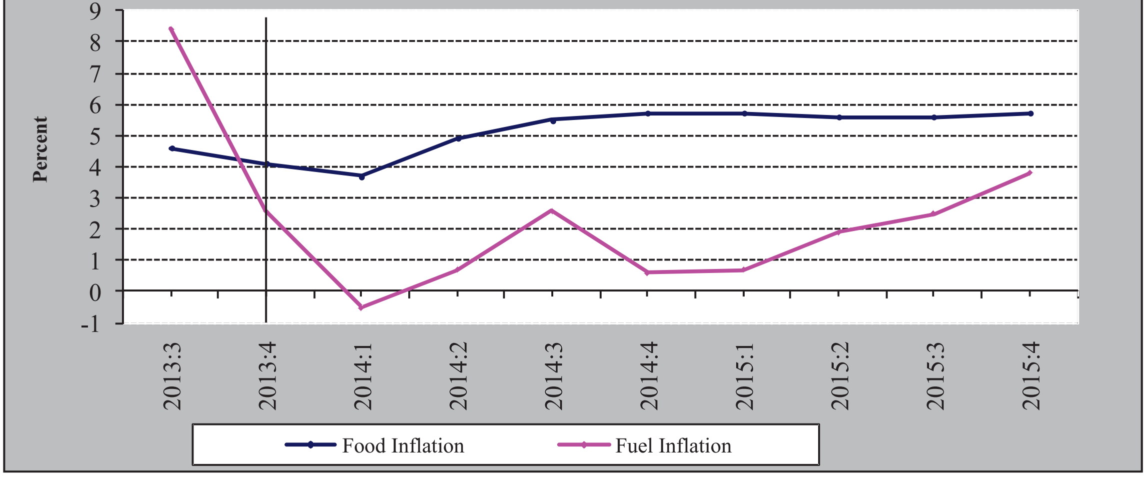
5.4 *The results of the Business Expectations Survey (BES) conducted by the Bank of Botswana in September 2013 show expectations of an improvement in economic prospects for 2014, with domestic-oriented businesses more confident than exporters, although it is anticipated that export volumes will increase. The businesses surveyed forecast the economy to grow by 4.3 percent in 2014, which is lower than the official projection of 5.1 percent. Business expectations of inflation are lower, although higher than the inflation objective.*

5.5 *In consideration of the projected below-trend economic activity and moderate growth in incomes, it is expected that domestic demand pressures on inflation will be restrained in 2014, and be complemented by benign foreign price developments. Consequently, inflation is projected to remain within the medium-term objective range of 3 – 6 percent in the medium term (Chart 15). However, any substantial upward adjustment in administered prices and government levies and any increase in international food and oil prices beyond current forecasts (Chart 14) present upside risks to the inflation outlook. An expansionary wage increase could also generate inflationary pressures through higher demand and an increase in inflation expectations. Nevertheless, there are downside risks arising from weaker global economic activity that could result in lower inflation than currently projected.*

---

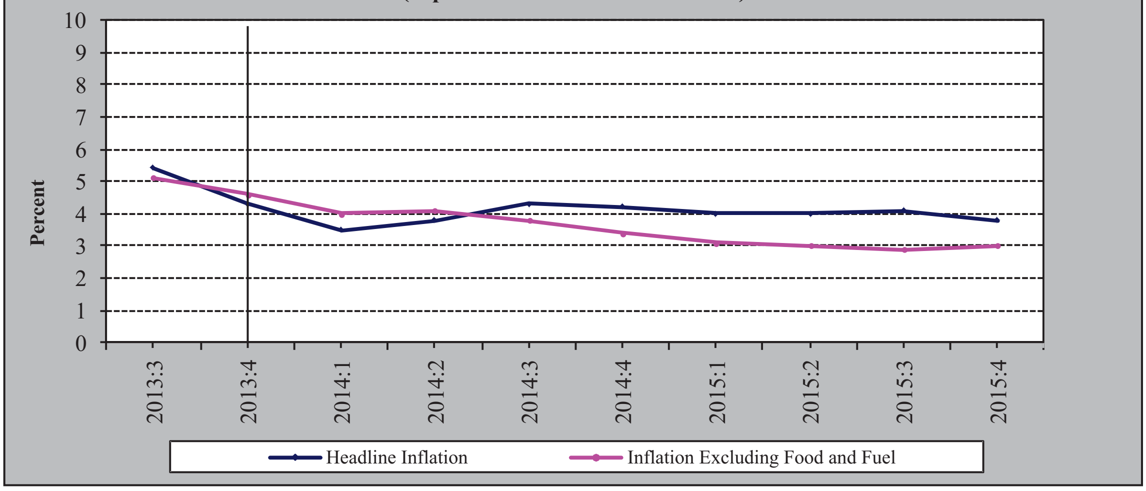
17 *The slow growth in development spending largely reflects the base effects as the original budget was supplemented by additional financing of the Botswana Power Corporation during 2013/14; an outlay with limited direct impact on domestic demand.*

Chart 14: Domestic Fuel and Food Inflation Forecasts for the Medium Term (September 2013 - December 2015)



Source: Bank of Botswana

Chart 15: Annual Inflation Forecasts for the Medium Term (September 2013 - December 2015)



Source: Bank of Botswana

6. 2014 MONETARY POLICY STANCE

6.1 The outlook for low and stable inflation in the medium term suggests a continuation of the current accommodative monetary policy stance, which would be supportive of economic activity, while remaining consistent with the maintenance of price stability. Overall, demand pressure on inflation is expected to be moderate going forward. However, credit expansion is higher than the increase in nominal GDP, and it is considered to be reflective of improvements in financial intermediation and greater financial inclusion. At the same time, it is recognised that credit is dominated by lending to households. Household credit is more likely to be for consumption and, therefore, inflationary in contrast to lending to businesses, which *tends to generate durable and employment creating economic activity.*[18] *In addition, the rapid increase in household credit that exceeds growth of incomes could result in future repayment difficulties that would impact on the performance of financial institutions and on macroeconomic stability. Moreover, any possible future changes in interest rates will have an impact on indebtedness and prospects for sustained financial stability. Therefore, the Bank's monetary policy stance in 2014 will involve evaluation of prospective developments with respect to these factors.*

6.2 The current and prospective developments (below trend output, positive outlook for inflation and a stable financial environment) allow for maintenance of accommodative monetary policy, supplemented by measures to promote business and developmental lending. In any event, the Bank will respond expeditiously to any sustained deviation of the inflation forecast from the objective range, where the causal factors can be influenced by monetary policy action, and to any emerging threats to financial stability.

6.3 The Bank's implementation of the exchange rate policy in 2014 will entail a modest 0.16 percent downward crawl of the NEER, as the inflation objective is marginally higher than projected average inflation of trading partner countries. The respective Pula basket weights for 2014 are 55 percent for the South African rand and 45 percent for the SDR. The crawling band exchange rate policy is in the best interest of international competitiveness of domestic industries, and is intended to contribute towards macroeconomic stability and economic diversification.

7. CONCLUSION

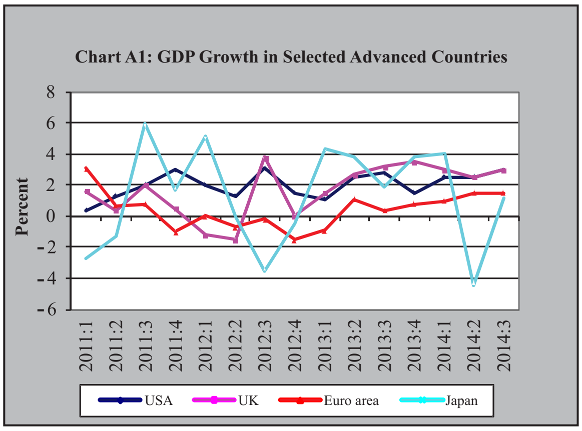
7.1 Domestic inflation fell within the Bank's objective range of 3 – 6 percent in 2013 in the context of modest demand and the absence of upward pressures from changes in administered prices. Global output growth is forecast to be marginally higher in 2014, given improved economic performance in major economies. This would also have a positive impact on performance in emerging market economies and developing countries. Global inflation is forecast to be restrained and unchanged in 2014; this reflects stable commodity prices and persistence of spare capacity, as well as high rates of unemployment in major economies.

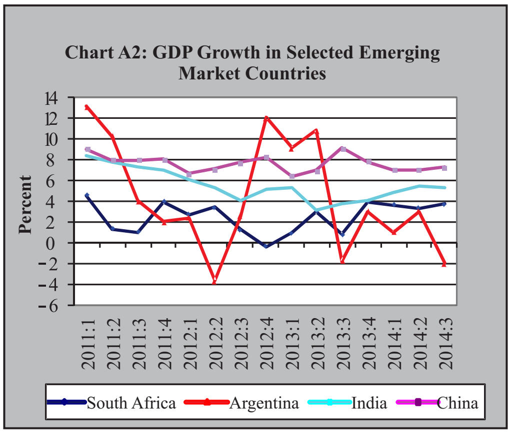
7.2 Domestic inflation is projected to remain within the objective range of 3 – 6 percent in 2014 and into the medium term. The Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low and sustainable inflation in the medium term, through timely responses to price developments, while ensuring that credit and other market developments are consistent with lasting stability of the financial system. The Bank remains committed to responding appropriately to all economic and financial developments with a view to ensuring price stability, financial stability and sustainable economic growth.

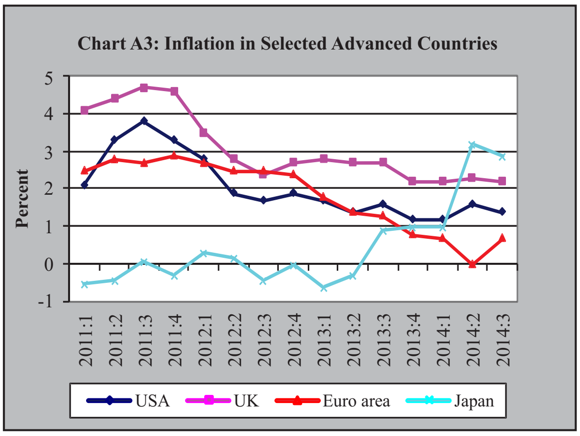
---

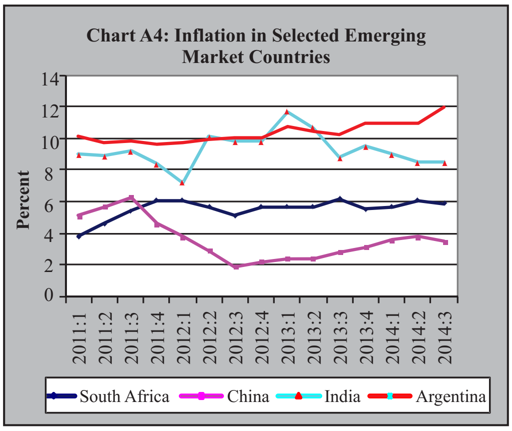
18 The positive impact of consumption on growth should also be recognised as it drives business activity and innovation. In addition, mortgage lending is developmental and promotes household wealth creation.

Output Growth and Inflation for Selected Countries









Source: JP Morgan Chase
Note: Data from Q4 2013 to Q3 2014 are forecasts.

Monetary Policy Implementation in Developed and Emerging Market Economies - 2013

The Federal Reserve (Fed) maintained the Federal Funds Rate within the range of 0 - 0.25 percent and purchased securities amounting to USD85 billion per month. The Fed committed to maintaining an accommodative policy stance until the unemployment rate fell to 6.5 percent and forecast inflation for up to two years remained below 2.5 percent in the context of well-anchored longer-term inflation expectations.

The Bank of England maintained the Bank Rate at 0.5 percent, as well as its total of asset purchases of GBP375 billion. It also introduced forward guidance, which entails keeping the policy rate low until unemployment rate falls below 7 percent. Additional conditions are that CPI inflation for 18-24 months ahead remains less than or equal to 0.5 percentage points above the 2 percent inflation target; medium-term inflation expectations remain well anchored; and the monetary policy stance does not pose a threat to financial stability.

The European Central Bank (ECB) cut the Refinancing Rate by a cumulative 50 basis points during the year to 0.25 percent, and promised to keep the benchmark rate at or below 0.25 percent for an extended period of time, influenced by the outlook for subdued overall inflation into the medium term, in an environment of broad weakness in the real economy. Similarly, the Reserve Bank of Australia cut the Official Cash Rate by a cumulative 50 basis points to 2.5 percent.

The Bank of Japan maintained the Overnight Call Rate at 0 - 0.1 percent, and began a programme of large purchases of Japanese government bonds in an effort to end deflation, and push inflation as high as 2 percent.

The Central Bank of Brazil increased its policy rate (SELIC rate) six times in the year by a cumulative 275 basis points to 10 percent in order to rein in inflation, while the Bank of India cut its Repo Rate by 75 basis points in the first half of the year, before increasing it by a cumulative 50 basis points to 7.75 percent by year-end. The South African Reserve Bank and Bank of China maintained their policy rates, Repo Rate and Base Rate at 5 percent and 6 percent, respectively, during the year.