BANK OF BOTSWANA
BANKA YA BOTSWANA

MONETARY POLICY STATEMENT | 2022

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;
- safe, sound and stable financial system;
- efficient payment 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.

MONETARY POLICY STATEMENT 2022

Moses D Pelaelo

Governor

February 23, 2022

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1. INTRODUCTION

1.1 The Monetary Policy Statement (MPS) is the main medium through which the Bank of Botswana (the Bank) informs stakeholders about the framework for the formulation and implementation of monetary policy. In this regard, the Bank, through the MPS, reviews inflation trends and policy performance and articulates the policy choices for the ensuing year. The MPS also serves to fulfil the public's expectation of a transparent and accountable central bank in pursuit of the monetary policy mandate, as enshrined in the Bank of Botswana Act (CAP 55:01).

1.2 The 2022 MPS, therefore, reports on the previous year's economic and policy developments and evaluates the determinants of changes in the level of prices and their impact on inflation in Botswana. This entails an assessment of economic and financial developments that are likely to influence the inflation path in the medium term and the Bank's policy choices in 2022. Price developments and policy options are evaluated in the context of a forward-looking monetary policy framework, the Bank's medium-term inflation objective range of 3-6 percent and the financial stability objective. In this respect, the MPS promotes an understanding of prospective conduct of monetary policy in order to anchor public expectations on the objective of a low, predictable and sustainable level of inflation.

1.3 The global economic performance and sentiment strengthened in 2021, amid improving demand resulting from the easing of the disease containment measures and consequent opening of economies. This was made possible by the effective roll-out of COVID-19 vaccination programmes in many countries (mainly advanced countries), notwithstanding uneven distribution and inequitable supply of vaccines adversely affecting developing countries. Nevertheless, all regions experienced growth in 2021.

1.4 The global economy is estimated to have expanded by 5.9 percent in 2021 from a contraction of 3.1 percent in 2020. However, the pandemic took a turn for the worst in some parts of the world in the second half of the year, with the emergence of new variants, notably Omicron first detected in Botswana and South Africa in November 2021. Meanwhile, speedy vaccine rollouts in some regions, particularly in advanced economies, helped contain the spread of the virus, and boosted economic recovery. In the circumstances, global inflation increased from 3.2 percent in 2020 to 4.3 percent in 2021.[1] Considering improved demand and higher inflation, some central banks in emerging market economies raised policy rates in 2021, both to control inflation and forestall anticipated capital outflows out of emerging markets as advanced economies normalise policy rates (reversing exceptionally low interest rates). In advanced economies, the United Kingdom (UK) was the first country to raise the policy rate, with some economies such as the United States of America (US) and

[1] In advanced economies, inflation increased from 0.7 percent in 2020 to 3.1 percent in 2021, and from 5.1 percent to 5.7 percent for emerging market economies in the same period.

Japan tapering asset purchase programmes that were introduced in 2020 to provide liquidity support to the financial sector on the onset of the COVID-19 pandemic.

1.5 In Botswana, real gross domestic product (GDP) grew by 8.6 percent in the twelve months to September 2021, compared to a contraction of 7.3 percent in the year to September 2020. The increase in output was mainly reflecting base effects associated with the negative economic impact of the COVID-19 pandemic containment measures in 2020. Inflation breached and remained above the upper bound of the Bank's medium-term objective range from May 2021, averaging 6.7 percent in 2021.[2] Overall, price developments were in the context of modest recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines, increase in administered prices and government taxes, as well as the faster increase in foreign prices during the year.

1.6 The Bank maintained an accommodative monetary policy stance during 2021 in view of the positive inflation outlook in the medium term. The Bank Rate was, therefore, maintained at 3.75 percent in 2021, following a cumulative 100 basis points cut in 2020, to support economic activity. The annual downward rate of crawl of the nominal effective exchange rate (NEER) of the Pula was maintained at 2.87 percent during 2021, as well as the Pula basket weights of 45 percent for the South African rand and 55 percent for the Special Drawing Rights (SDR). Bilaterally, the Pula depreciated against the SDR and the South African rand. On the other hand, the real effective exchange rate (REER) appreciated by 0.2 percent in 2021, because of a higher positive inflation differential between Botswana and trading partner countries than the downward rate of crawl.

1.7 Inflation is forecast to remain above the upper bound of the Bank's 3 - 6 percent objective range in the short term. However, inflation is expected to revert to within the objective range in the third quarter of 2022. This outlook is subject to significant upside risks, including the continuing adverse impact of the COVID-19 pandemic, constrained supply relative to demand and, domestically, regular annual price adjustments, notably administered prices. These risks are, however, moderated by the possibility of weak domestic and global economic activity and restrained commodity prices.

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 also formulated with a view to safeguard the stability of the financial system. A low and predictable level of inflation and conducive monetary and financial conditions foster effective savings mobilisation, productive investment and international competitiveness

[2] Inflation breached the upper bound of the objective range in May (6.2 percent), June (8.2 percent), July (8.9 percent), August (8.8 percent), September (8.4 percent), October (8.8 percent), November (8.6 percent) and December (8.7 percent).

of domestic producers, which, in turn, contribute towards the broader national objectives of sustainable economic development and employment creation.

2.2 The monetary policy framework is forecast-based, with a medium-term outlook that primarily guides the Bank's response to projected movements in inflation, while considering prospects for economic growth and developments relating to stability of the financial system. To this end, in formulating an appropriate policy stance, the Bank factors in projections of real monetary conditions[3], relevant domestic and international economic and financial developments, and their impact on the output gap[4] and, ultimately, inflation.

2.3 The Bank recognises the importance of communication in sustaining and reinforcing transparency, predictability and accountability with respect to the policy framework and actions; thus, fostering market participation, influencing expectations, policy credibility and, consequently, effective policy transmission. In this regard, besides the MPS, the Bank publishes three Monetary Policy Reports annually, following the April, August and December Monetary Policy Committee (MPC) meetings. Furthermore, the Bank publishes MPC meeting dates for the year ahead and the Governor delivers a statement at a press briefing, which is widely circulated to media houses, after each meeting of the MPC to disseminate the Bank's policy stance and allow for the engagement with the media.

3. IMPLEMENTATION OF MONETARY POLICY AND RELATED ECONOMIC DEVELOPMENTS IN 2021

(a) External Developments

3.1 At the global level, monetary policy was generally accommodative in both advanced and emerging market economies, and most central banks maintained relatively low policy rates, following the aggressive reduction of rates in 2020 in response to the COVID-19 pandemic. Policymakers continued to focus on the need to achieve sustainable economic growth through facilitating access to finance in an uncertain environment. However, some central banks increased their policy rates and/or signalled that they would tighten at upcoming meetings to control inflation and, in some instances, tapering the asset purchase programmes that were introduced in 2020 to support the financial sector (Table 3.1).

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3 The real monetary conditions index (RMCI), which reflects the state of real monetary conditions, 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 RMCI combines, through a weighted average, deviations of the real exchange rate and real interest rate from their respective trend values.

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

Table 3.1: 2021 Monetary Policy Decisions

Central Bank	Policy Rate as at December 2021	Policy Change from Previous Year	Asset Purchase Programmes
United States Federal Reserve	0 – 0.25 percent	No change	• At the first six Federal Open Market Committee (FOMC) meetings: holdings of Treasury securities increased by at least USD480 billion; holdings of agency mortgage-backed securities increased by at least USD240 billion • At the last two FOMC meetings: holdings of Treasury securities decreased by at least USD30 billion; holdings of agency mortgage-backed securities decreased by at least USD15 billion • Discontinued dollar swap lines and the repurchase agreement for International Monetary authorities effective April 2021
Bank of England	0.25 percent	Increased by 15 basis points	• Maintained its holdings of UK government and corporate bonds worth £895 billion (includes the stock of sterling non-financial investment-grade corporate bond purchases worth £20 billion and government bond purchases worth £875 billion, both financed by the issuance of central bank reserves) • Drawdown period under the Term Funding Scheme with additional incentives for Small and Medium-sized Enterprises (TFSME), financed by the issuance of central bank reserves ended on April 30, 2021
European Central Bank	0.0 percent	No change	• Recalibrated targeted longer-term refinancing operations (TLTROs) by, among others, raising the total amount that counterparties are entitled to borrow in TLTRO III operations from 50 percent to 55 percent of their stock of eligible loans. The special conditions applicable under TLTRO III are expected to end in March 2022 • Continued to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1 850 billion. However, the conduct of PEPP will be at a lower pace effective January 2022 and will be discontinued at the end of March 2022 • Net purchases under the asset purchase programme (APP) continued at a monthly pace of €20 billion, but was to be increased to a monthly pace of €40 billion in the second quarter of 2022. APP is expected to be decreased to a monthly pace of €30 billion and €20 billion in the third quarter and from October 2022 onwards, respectively

Bank of Japan	-0.1 percent	No change	● Continued buying of risky assets such as exchange traded funds at an annual pace of ¥12 trillion and Japanese real estate trust funds (J-REIT) at an annual pace of ¥180 billion ● Pledged to continue purchasing Commercial Paper (CP) and corporate bonds with an upper limit on the amount outstanding of about ¥20 trillion in total, until the end of March 2022
Bank of Botswana	3.75 percent	No change	Not applicable
South African Reserve Bank	3.75 percent	Increased by 25 basis points	Not applicable
People's Bank of China	3.80 percent	Decreased by 5 basis points	Not applicable
Central Bank of Brazil	9.25 percent	Increased by 725 basis points	Not applicable
Reserve Bank of India	4 percent	No change	Not applicable
Central Bank of Russia	8.50 percent	Increased by 425 basis points	Not applicable

Source: Surveyed central banks' websites.

3.2 The additional policy support and the roll-out of effective COVID-19 vaccination programmes around the world resulted in stronger economic performance across countries and regions. Consequently, in advanced economies, economic activity is estimated to have rebounded in 2021. Output growth in emerging market economies also increased, influenced by large expansions in India and China, as well as accommodative monetary and fiscal policy stimulus implemented to cushion the economies from the COVID-19 pandemic. In the circumstances, global GDP for 2021 is estimated to have expanded by 5.9 percent, from a contraction of 3.1 percent in 2020 (Table 3.2).

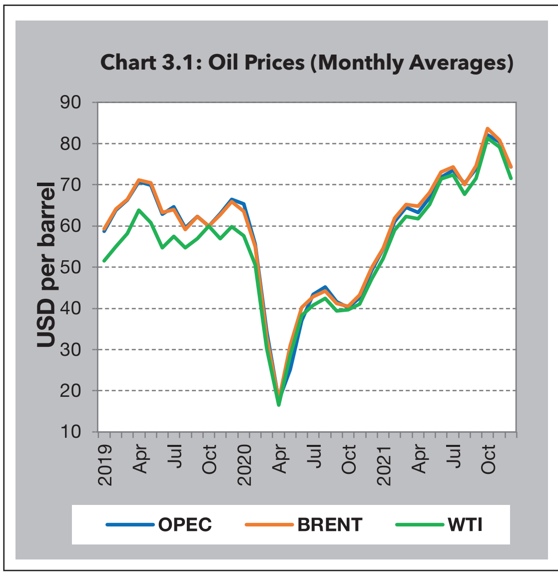
Table 3.2: Real GDP Growth Rates (Percent)

	Estimate		Projection	
	2020	2021	2022	2023
Global	**-3.1**	**5.9**	**4.4**	**3.8**
Advanced economies	**-4.5**	**5.0**	**3.9**	**2.6**
USA	-3.4	5.6	4.0	2.6
Euro area	-6.4	5.2	3.9	2.5
UK	-9.4	7.2	4.7	2.3
Japan	-4.5	1.6	3.3	1.8
EMDEs	**-2.0**	**6.5**	**4.8**	**4.7**
China	2.3	8.1	4.8	5.2
Brazil	-3.9	4.7	0.3	1.6
India	-7.3	9.0	9.0	7.1
Russia	-2.7	4.5	2.8	2.1
South Africa	-6.4	4.6	1.9	1.4
Botswana	**-8.7**	**9.2 (9.7)**	**4.7 (4.3)**	**4.4 (4.2)**

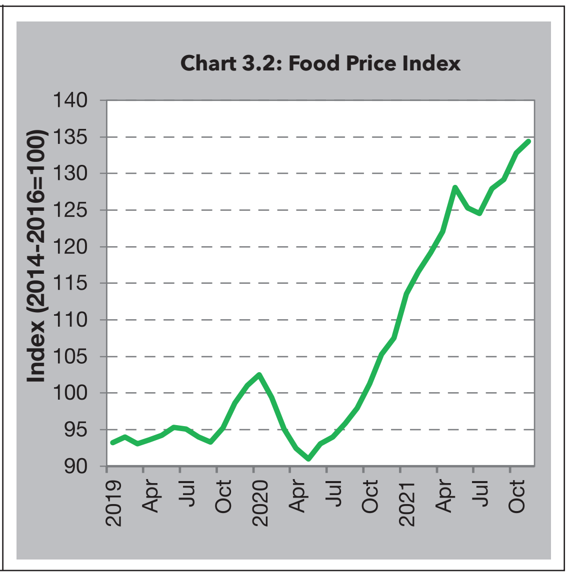
Source: IMF World Economic Outlook (WEO) Update January 2022 and Ministry of Finance and Economic Development (MFED) for Botswana.

Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts by the MFED.

3.3 In 2021, global inflation increased, partly due to improving global economic demand, while supply was constrained, and the rise in commodity prices, particularly oil, as most economies eased movement restrictions and deployed effective COVID-19 vaccines. Global inflation is estimated to have increased from 3.2 percent in 2020 to 4.3 percent in 2021. The increase in oil prices was mainly a result of increased demand for crude oil as COVID-19 containment measures eased. Moreover, higher oil prices resulted from continued drawdown of oil inventories and additional fiscal stimulus implemented in some countries. Thus, the price of the Organisation of the Petroleum Exporting Countries (OPEC) reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 67.2 percent, 65.5 percent and 74.6 percent to an average of USD69.25 per barrel, USD70.02 per barrel, and USD67.44 per barrel in 2021, respectively (Chart 3.1). Similarly, international food prices increased by 28.1 percent in 2021 compared to an expansion of 3.2 percent in 2020 (Chart 3.2), driven by a significant rise in prices of vegetable oils, sugar and cereals. The increase in the price of vegetable oils was mainly due to higher prices for palm, soy, rapeseed and sunflower oils, against the background of subdued production by major producers such as Malaysia, resulting from migrant labour shortages, while global demand for the products recovered. Prices of cereals also rose because of reduced harvest prospects in Argentina and some parts of the US, owing to dry conditions and tighter supplies of quality wheat. Overall, higher international oil and food prices exerted upward pressure on domestic inflation in 2021.

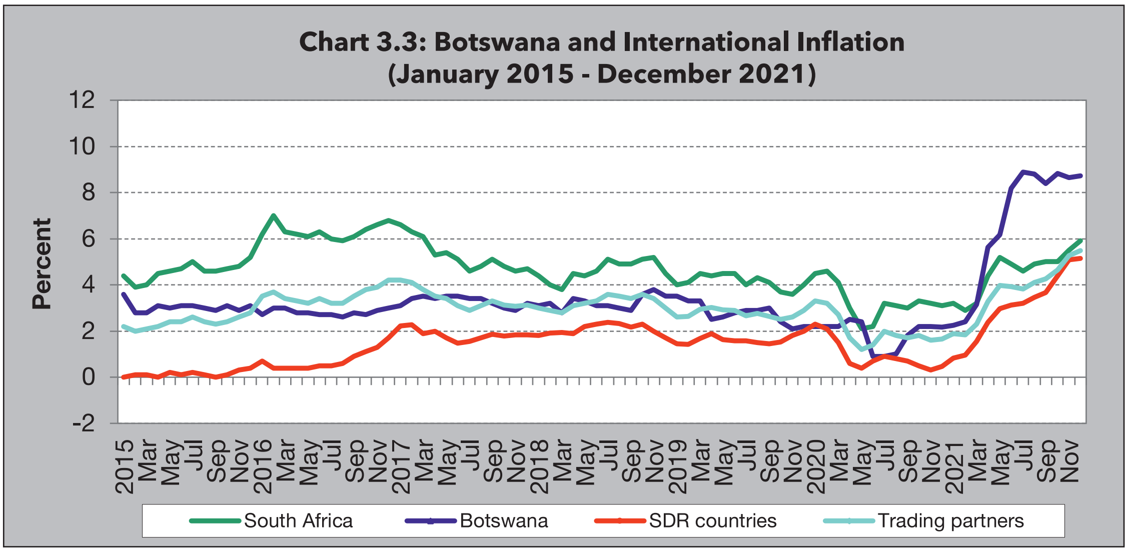


Source: OPEC and US Energy Information Administration.



Source: Food and Agriculture Organisation.

3.4 Inflation for the Special Drawing Rights (SDR) countries (USA, UK, Japan, Eurozone and China) increased significantly from 0.5 percent in December 2020 to 5.1 percent in December 2021. Similarly, headline inflation in South Africa increased from 3.1 percent in December 2020 to 5.9 percent in December 2021 (averaging 4.5 percent for the year) but remained within the country's target range of 3 – 6 percent. Consequently, the trade-weighted average inflation[5] for Botswana's trading partner countries increased from 1.7 percent in December 2020 to 5.5 percent in December 2021 (Chart 3.3).

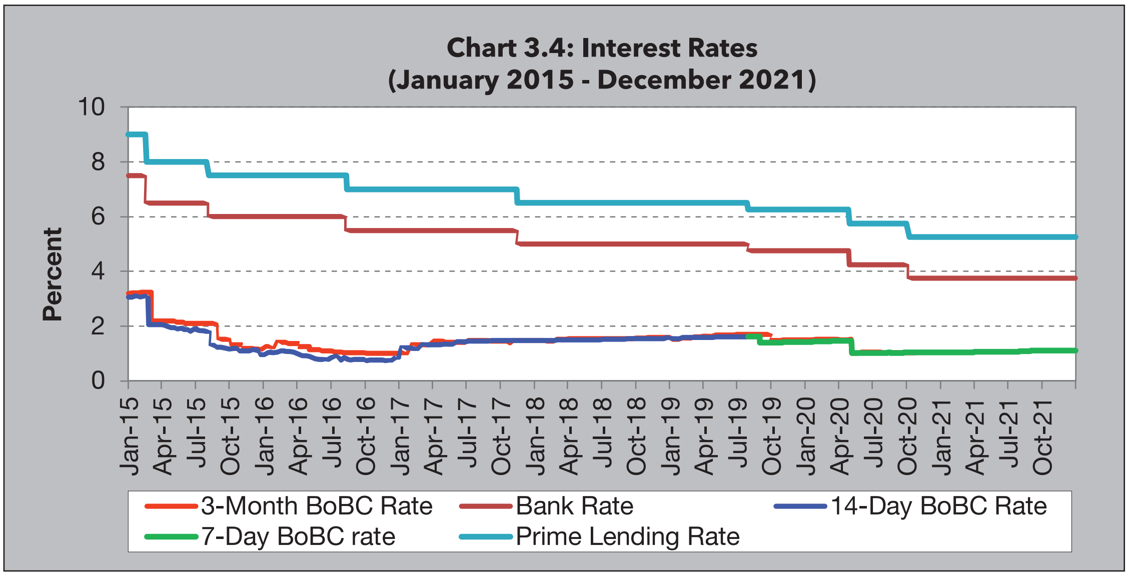


Source: Statistics Botswana and Bloomberg.

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

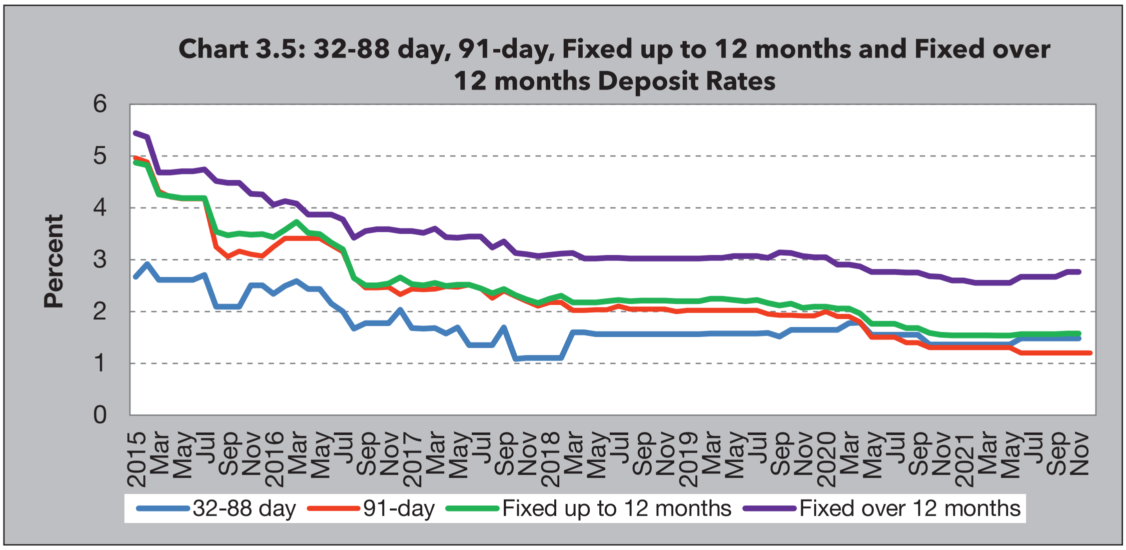
(b) Monetary Policy Implementation in Botswana

3.5 During 2021, monetary policy in Botswana was conducted in the context of projected high inflation in the near term, associated with upward adjustment of taxes/levies and administered prices, a modest recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines, and projected increase in foreign prices. These conditions provided scope for an accommodative monetary policy stance in support of stronger output growth. In the assessment of policy action, it was observed that the projected increase in inflation in the short term was primarily due to transitory supply-side factors that, except for second-round effects and entrenched expectations (for example, through price adjustments by businesses, contractors, property owners and wage negotiations), do not normally attract monetary policy response. Hence, the Bank Rate was maintained at 3.75 percent in 2021, following a cumulative 100 basis points reduction in 2020, to support economic activity that was adversely affected by the COVID-19 containment measures. Consequently, the prime lending rate of commercial banks was constant at 5.25 percent, while deposit interest rates generally increased, mainly because of competition for the corporate deposits that are volatile and form an important component of the deposit base for many of the commercial banks (Charts 3.4 and 3.5).



Source: Bank of Botswana and commercial banks.

Note: The 7-day BoBC was introduced on April 30, 2019, replacing the 14-day BoBC, while the issuance of the 91-day BoBC rate was discontinued in October 2020.



Source: Commercial banks.

3.6 Open market operations remained the main tool to manage liquidity in the domestic market, as well as implement decisions of the MPC. This entailed the use of Bank of Botswana Certificates (BoBCs) to mop-up excess liquidity[6] in order to maintain interest rates that are consistent with the monetary policy stance. Repurchase Agreements (repos) and reverse repos were used during the year to manage liquidity between auctions. The operations were conducted in an environment of subdued market liquidity on the back of sustained foreign exchange outflows. However, the measures introduced by the Bank in April 2020 to help alleviate any adverse impact of the COVID-19 pandemic on the economy and financial markets remained in place in 2021 (2021 Monetary Policy Statement).

3.7 A 12-month Treasury Bill[7] (T-Bill) was introduced effective January 2021. This followed the decision, as authorised by Parliament, to increase the ceiling of the bond issuance programme from P15 billion to P30 billion. The 12-month T-Bill is issued quarterly and the issuance size is determined on a need basis by the Joint Bank of Botswana/MFED Bond Auction Technical Committee. Since its introduction, the 12-month T-Bill has performed relatively well with a cumulative total allocation of P2.094 billion out of the P2.144 billion issued during the year. Meanwhile, since the introduction of the Primary Reserve Requirement Averaging (PRRA) in 2019, most commercial banks continued to actively use it as a tool for effective management of liquidity. As a result, the introduction of PRRA has contributed to reduced demand for excess reserves held by commercial banks for precautionary purposes, thus helping to free up additional resources for productive lending. In the circumstances, outstanding

6 Excess liquidity is the sum of commercial banks' overnight deposits with the Bank (current account), money absorbed through BoBCs and outstanding reverse repos, less both repos and borrowing from the Bank's credit facility. This is 'excess' in the sense that it is the net liquidity that the central bank has to absorb (take out of the system), over and above the structural liquidity that is held by the banks in the Primary Reserve Requirement accounts.

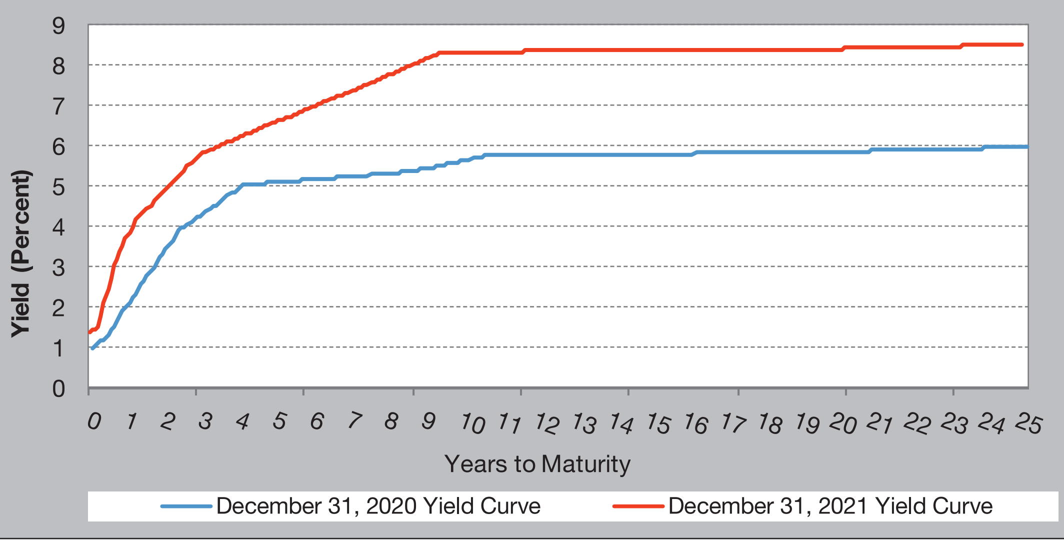
7 The 12-month T-Bill forms part of the Government T-Bill issuance programme and will help support the development and building up of the T-Bill programme.

BoBCs amounted to P2.3 billion in December 2021, a significant decrease from P7.8 billion in December 2020, reflecting a decline in liquidity resulting mainly from settlement of government securities and foreign exchange sales.

3.8 The stop-out yield for the 7-day BoBC increased from 1.03 percent in December 2020 to 1.10 percent in December 2021, staying within the prevailing Open Market Auction Committee (OMAC) mandate and reflecting bidding preferences by commercial banks. However, due to the larger increase in the inflation rate compared to the nominal interest rates between December 2020 and December 2021, the real rate of interest for the 7-day BoBC decreased from -1.14 percent to -6.99 percent.

3.9 A comparison of T-Bill, Government bond and BoBC yields as at the end of December 2021 and December 2020 indicates that yields generally increased across the maturity spectrum. Yields increased more in the longer-end of the curve, indicating partly subdued demand for longer dated securities (Chart 3.6).

Chart 3.6: Yield curves for December 31, 2020 and December 31, 2021



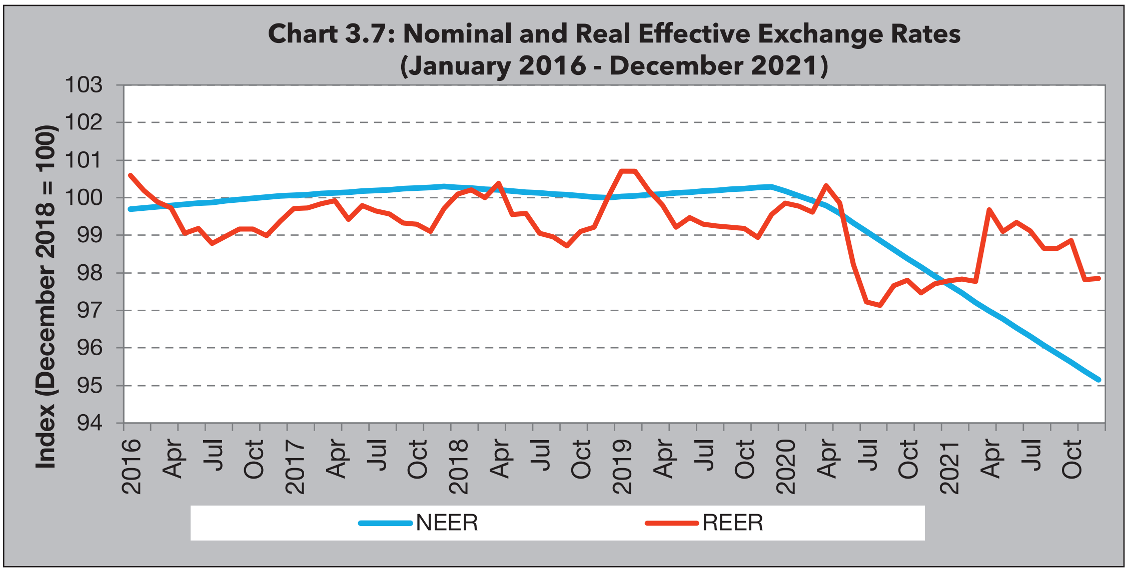
Source: Bank of Botswana.

(c) Implementation of Exchange Rate Policy

3.10 Implementation of the exchange rate policy in 2021 was in line with the objective of maintaining a stable inflation-adjusted trade-weighted exchange rate of the Pula. This entailed the Pula basket weights of 45 percent for the South African rand and 55 percent for the SDR, as well as an annual downward rate of crawl of 2.87 percent, which were maintained from 2020 with a view to sustain domestic industry competitiveness, given the continuing adverse impact of the COVID-19 pandemic on the economy and the unfavourable inflation differential.

3.11 Consequently, the trade weighted NEER of the Pula depreciated by 2.82 percent in 2021. Meanwhile, the REER appreciated by 0.2 percent in 2021 (Chart 3.7), because of a higher positive inflation differential between Botswana and the trading partner countries than the downward rate of crawl, suggesting loss of international competitiveness of domestic firms.

3.12 The current exchange rate policy framework is anchored on a strong performance of foreign exchange reserves, which have improved slightly from P53.4 billion and 10.1 months of import cover in December 2020 to an estimated P57.1 billion and 10.8 months of import cover in December 2021 due to recovery in domestic economic performance, as driven by improvement in external demand. The economic disturbances generated by the COVID-19 pandemic demonstrated the importance of maintaining adequate level of foreign exchange reserves in supporting the economy, as well as the flexibility inherent in the exchange rate framework in facilitating adjustments necessary to generate improvements in international competitiveness of the domestic industry.



Source: Bank of Botswana.

(d) Fiscal Policy

3.13 Government expenditure and net lending increased by 2.2 percent in the eight months (of the fiscal year) to November 2021 compared to an expansion of 4.3 percent in the corresponding period ending in November 2020. Recurrent expenditure was constant (0.01 percent increase), while development expenditure increased by 14.7 percent in the eight months to November 2021. Overall spending included COVID-19 related responses such as health and wellness procurements and financial support to targeted industries. Specific to development spending, the expansion was attributable to the resumption of some development projects which were halted during the COVID-19 containment measures implemented in 2020.

3.14 The combination of increases in revenue and overall spending resulted in a cumulative surplus of P863.2 million in the eight months to November 2021, compared to a deficit of P12.2 billion in the corresponding period in 2020. Given the deficit financing needs, and in the context of a P30 billion domestic bond issuance programme, yields have increased as market players sought higher rates to take part in the programme.

3.15 For the entire 2021/22 fiscal year, the revised budget estimates show a deficit of P10.2 billion (5.1 percent of GDP), compared to the original budget deficit of P6 billion. The higher revised deficit resulted from a combination of a supplementary recurrent budget that was channelled towards the containment of COVID-19, and lower revenue (than projected in the original budget), mainly due to the underperformance of the mineral revenue. The decline in mineral revenue was a result of the COVID-19 pandemic-associated economic disturbances, giving rise to lower sales of rough diamonds than originally envisaged.

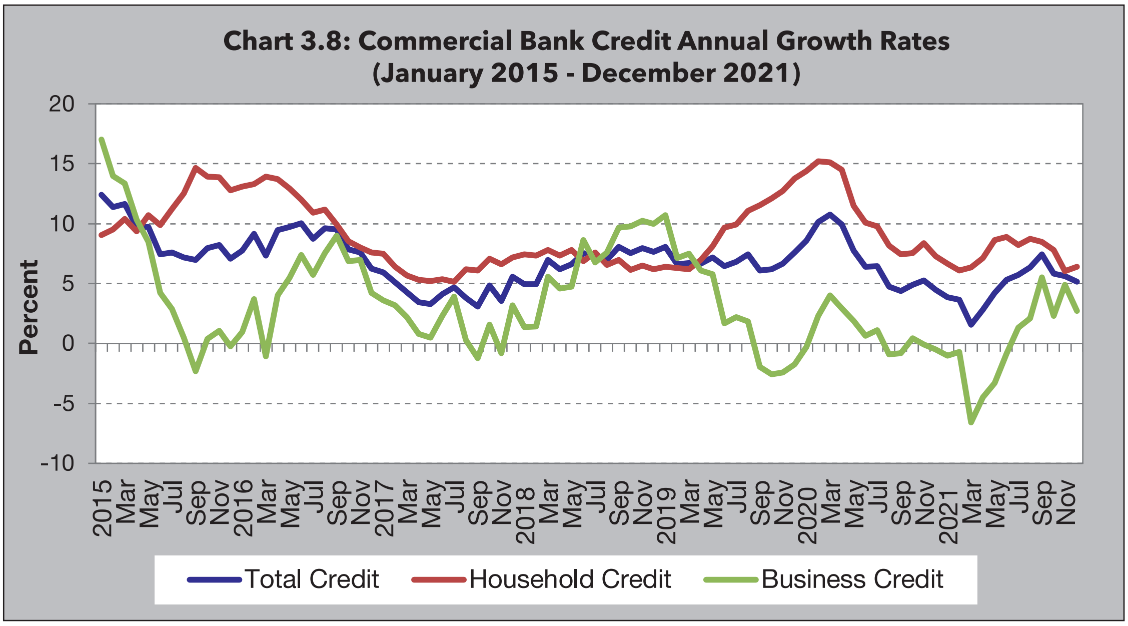
(e) Employment and Wage Developments

3.16 According to Statistics Botswana's quarterly labour force survey, the unemployment rate was 26 percent in the fourth quarter of 2021 compared to 24.5 percent in the fourth quarter of 2020 (youth unemployment rate rose to 34.4 percent from 32.4 percent). The survey also indicates that formal sector employment increased by 3.5 percent to 494 457, from 477 716 in the review period.

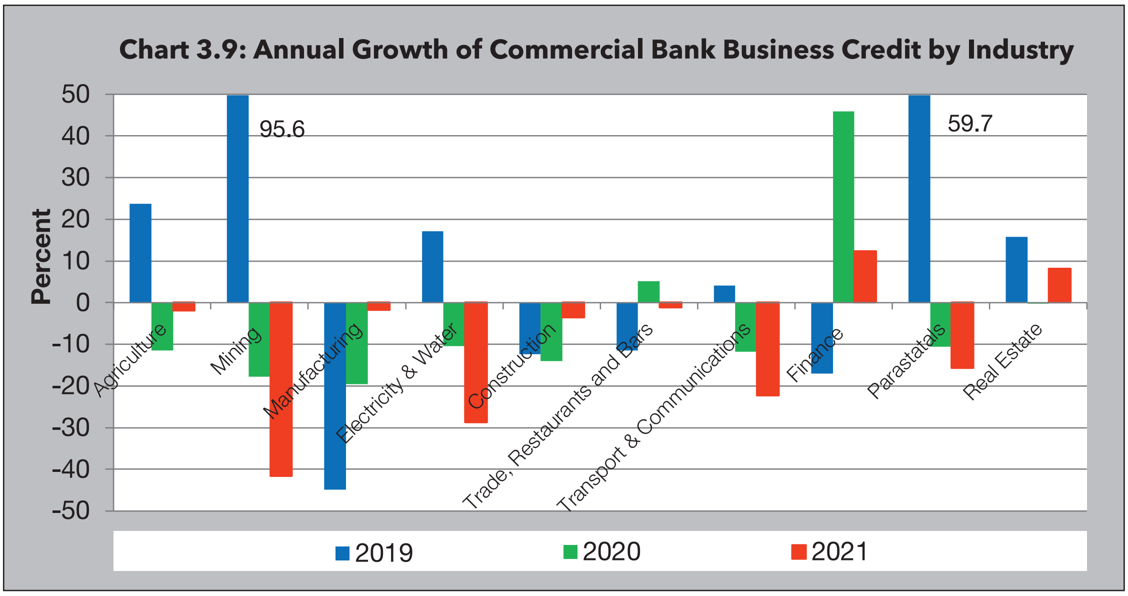
3.17 Regarding other indicators, the survey showed that the Government continued to be the single largest employer, with employment in public administration constituting 22.9 percent of total formal sector employment. In this regard, personal emoluments constitute the largest share (above 40 percent) of the government recurrent budget, and about 10 percent of GDP. Meanwhile, formal sector average earnings per month were estimated at P6 219 for citizens, P9 275 for non-citizens and P6 299 for all employees in the fourth quarter of 2021. The average monthly earnings for all employees are estimated to have increased by 4.7 percent or P285 from P6 014 estimated for the fourth quarter of 2020.

(f) Credit and Financial Stability Review

3.18 Annual growth in commercial bank credit accelerated to 5.1 percent in 2021 from 4.5 percent in 2020 (Chart 3.8). The faster growth in commercial bank credit was, in part, indicative of the increase in loan uptake by businesses, as well as recovery from the low base effects induced by the COVID-19 pandemic in 2020. Business sector credit grew, annually, by 2.7 percent in 2021, following a 0.5 percent contraction in 2020. Meanwhile, credit to businesses excluding parastatals increased by 4.1 percent during 2021, compared to an annual expansion of 0.4 percent in 2020. The improvement in the allocation of credit to businesses was in the form of utilisation of overdraft facilities and loans extended to parastatals, as well as to some companies in the finance, business services and real estate industries, as the economy opened up, following the end of the State of Public Emergency in September 2021. This improvement was partly offset by decreased utilisation of credit facilities by some companies in the electricity and water, mining as well as transport and communications industries (Chart 3.9).



Source: Commercial banks.



Source: Commercial banks.

3.19 For households, annual credit growth decelerated from 7.3 percent in 2020 to 6.4 percent in 2021. The lower credit growth was mainly attributable to the slower rate of increase in personal unsecured lending and motor vehicle loans during the period under review. Meanwhile, growth rate for credit extended to property and for credit card balances was higher in the same period. However, the share of mortgages in total bank credit decreased slightly from 23.6 percent to 23.1 percent in the same period.

3.20 In general, the rate of increase of credit continues to be supportive of economic activity albeit the level of bank credit to output remains comparatively low by global standards (Appendix, Table A1). The bank credit to GDP ratio decreased (Table 3.3) in 2021, reflecting faster improvement in output relative to credit growth. In this context, there is scope for prudent credit extension to enhance support for economic activity. The assessment of vulnerabilities and risks to financial stability, as measured by the credit-to-GDP gap (Chart 3.10), also shows that the modest credit growth is commensurate with the rate of increase in GDP; hence signifying that the current level of credit relative to economic activity is sustainable and could be further enhanced.

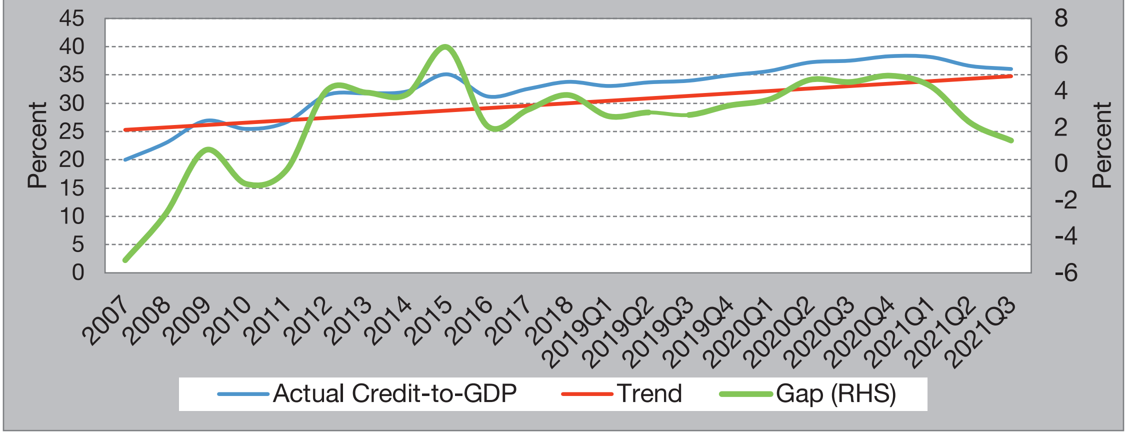
Table 3.3: Commercial Bank Credit-to-GDP Ratio

	Percent of GDP			
	2018	**2019**	**2020**	**2021[2]**
Total Commercial Bank Credit[1]	**33.8**	**35.2**	**38.3**	**36.5**
Business	**13.5**	**12.8**	**13.3**	**12.6**
Parastatals	0.7	1.0	1.0	1.3
Agriculture	0.7	0.8	0.8	0.7
Mining	0.2	0.3	0.3	0.2
Manufacturing	2.1	1.1	0.9	0.9
Construction	0.7	0.6	0.5	0.5
Trade	3.0	2.5	2.8	2.4
Transport and Communications	0.4	0.4	0.3	0.3
Finance and Business Services	2.9	2.6	3.1	3.3
Real Estate	2.2	2.5	2.6	2.4
Households	**20.4**	**22.2**	**25.1**	**23.8**
Retail Credit[3]	14.8	16.7	19.1	18.3
Mortgage	5.6	5.5	5.9	5.6

Source: Commercial banks, Statistics Botswana and Bank of Botswana calculations.

Notes: 1. Although not shown in the table, electricity and water, other and non-resident sub-sectors are included in the business credit to GDP ratio.
2. Data covering the twelve months to September 2021.
3. Includes motor vehicle, personal and credit card loans.

Chart 3.10 : Aggregate Credit to GDP Gap

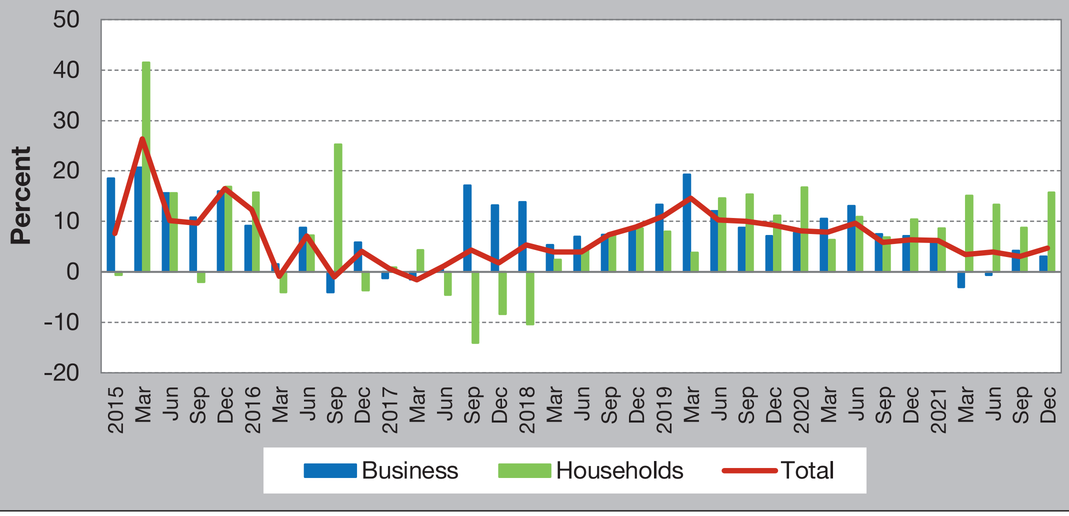


Source: Bank of Botswana.

3.21 Household deposits increased by 15.8 percent in December 2021, compared to 10.5 percent in December 2020, while business deposits (excluding parastatals) increased by 3 percent from 7.1 percent during the same period.

Overall, deposits at commercial banks increased by 4.7 percent, compared to 6.4 percent growth in the prior year (Chart 3.11). Given the higher increase in bank lending than in bank deposits, the financial intermediation ratio increased from 81.4 percent in December 2020 to 81.7 percent in December 2021.

Chart 3.11: Annual Growth in Business and Household Deposits at Commercial Banks



Source: Commercial banks.

3.22 Overall, notwithstanding the challenges caused by the onset of the COVID-19 pandemic, vulnerabilities that could elevate risks to financial stability remain contained, as reported in the published October 2021 Financial Stability Report. In particular, the sector was assessed to be resilient and characterised by strong capital and liquidity buffers, moderate profitability as well as being adaptive and innovative. The enduring stability of the financial system is supported by sound macroeconomic environment, efficient and robust market infrastructure, prudently managed banks, and effective regulation and supervision. While economic performance is constrained by the impact of COVID-19, proactive policy actions, including the prevailing accommodative real monetary conditions, availing of additional liquidity channels into the banking system, other measures instituted by non-bank financial institutions to mitigate the negative effects of COVID-19 and expansionary fiscal policy support continue to anchor the soundness of the financial sector.

3.23 Banks maintained good quality assets in 2021, with a decline in credit default rates. The ratio of non-performing loans (NPLs) to total credit was 4.2 percent in December 2021, compared to 4.3 percent in December 2020. Nevertheless, there continues to be a risk to asset quality associated with the high proportion of the relatively more expensive unsecured lending (at 72.5 percent of household credit in December 2021) in commercial bank credit. This profile of assets potentially exposes the household sector to any sudden and sharp increase in borrowing costs and loss of employment. The risks are, however, moderated to the extent that credit is widely distributed to many employees in different sectors of the economy, a large proportion of which are in the public sector. Moreover, the extension of credit to salaried individuals enables proper credit evaluation using ascertained income as the basis for determining repayment capacity.

Furthermore, credit risk is mitigated in cases of loans that are protected by insurance for loss of employment. Overall, the capital, asset quality, liquidity and profitability levels that meet prudential requirements indicate a generally sound and stable banking system (Table 3.4).

Table 3.4: Selected Performance Indicators of the Banking Sector

Capital Adequacy (Percent)	Dec 2021	Sep 2021	Jun 2021	Dec 2020	Sep 2020	Jun 2020
Core Capital to Unimpaired Capital	64.8	70.0	70.1	65.9	68.0	65.5
Tier 1 Capital to Risk-Weighted Assets[1]	12.0	12.8	14.1	13.8	13.4	13.3
Unimpaired Capital to Risk-Weighted Assets (Capital Adequacy Ratio)[2]	18.6	18.4	20.1	20.0	19.8	18.5
Asset Quality (Percent)						
NPLs to Gross Loans	4.2	4.2	4.3	4.3	4.1	4.4
NPLs Net of Specific Provisions to Unimpaired Capital	9.2	9.5	7.2	8.3	7.4	8.8
Specific Provisions to NPLs	45.7	59.4	64.5	58.7	62.7	58.9
Liquidity (Percent)						
Liquid Assets to Deposits (Liquidity Ratio)[3]	16.6	18.4	20.9	20.4	20.8	21.2
Advances to Deposits (Intermediation Ratio)	81.9	83.3	82.8	80.9	84.3	85.1
Profitability/Efficiency (Percent)						
Return on Average Assets (ROAA)	1.7	2.2	1.8	1.4	2.1	1.8
Return on Equity (ROE)	19.2	20.8	16.1	15.1	19.2	15.4
Cost to Income	63.3	60.9	59.3	61.3	65.6	69.3

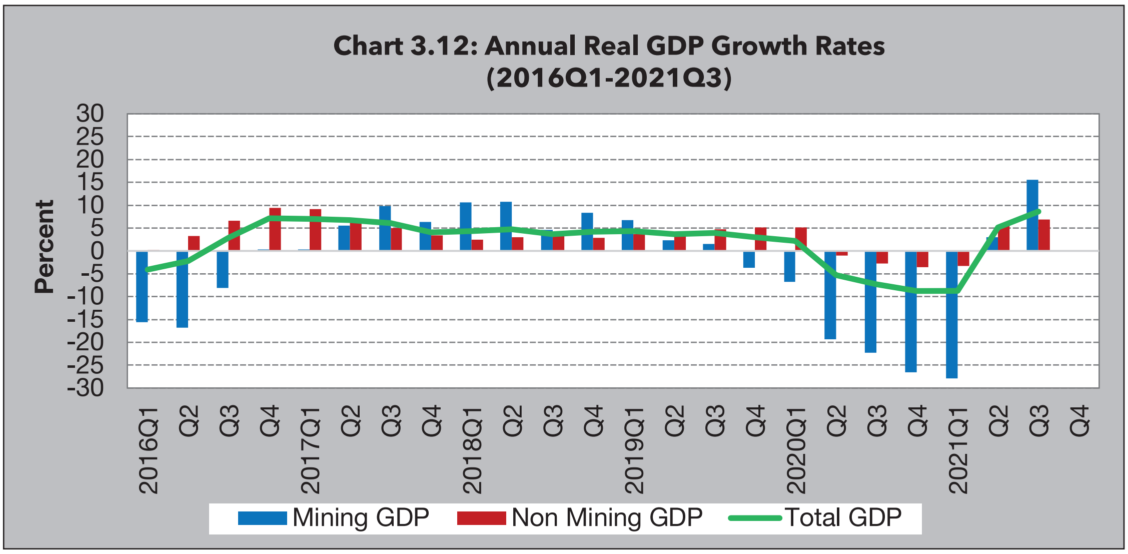
Source: Bank of Botswana.
l. Prudential lower limit is 7.5 percent – Basel II/III.
2. Prudential lower limit is 12.5 percent.
3. The minimum statutory requirement is 10 percent.

3.24 Growth in broad money supply (M2) was 2.6 percent in the year to November 2021, compared to 7.1 percent in the corresponding period in 2020. The growth of money supply resulted from an increase in credit (albeit lower than in 2021) to the private and parastatals sectors to fund growth enhancing opportunities as well as the decline in net foreign assets. Meanwhile, there was, in part, an offsetting effect from an increase in public sector deposits at the Bank of Botswana. By component, current account (transferable) deposits increased by 0.6 percent, while interest-bearing deposits increased by 3.5 percent in the year to November 2021. Deposits in foreign currency accounts increased by 16.4 percent in the same period. The ratio of money supply to GDP (financial deepening) decreased to 48.7 percent in the year to September 2021, compared to 52.5 percent in 2020 signalling shortage of liquidity in the economy (in the prevalence of COVID-19).

(g) Output and Price Developments

3.25 Real GDP in Botswana grew by 8.6 percent in the twelve months to September 2021, compared to a contraction of 7.3 percent in the year to September 2020

(Chart 3.12). The increase in output is mainly attributable to the expansion in output of the mining and non-mining sectors over the same period. The improved performance mainly reflects base effects associated with the negative economic impact of COVID-19 pandemic containment measures, which were progressively eased from the third quarter of 2021. Mining output increased by 15.6 percent in the year to September 2021, compared to a contraction of 22.2 percent in the corresponding period in 2020 as the diamond sub-sector grew by 16.3 percent, compared to a contraction of 22.6 percent in the previous year. Output for other mining sub-sectors also increased, except for mining of gold and other metal sub-sector, which contracted in the year to September 2020. Non-mining GDP grew by 6.9 percent in the year to September 2021, compared to a decrease of 2.8 percent in the corresponding period in 2020. The expansion in non-mining GDP was largely due to an increase in output of all sectors, except for agriculture, forestry and fishing, and accommodation and food services which contracted. Meanwhile, year-on-year GDP increased by 8.4 percent in the third quarter of 2021, an improvement from a contraction of 4.5 percent recorded in the corresponding period in 2020.[8]



Source: Statistics Botswana and Bank of Botswana calculations.

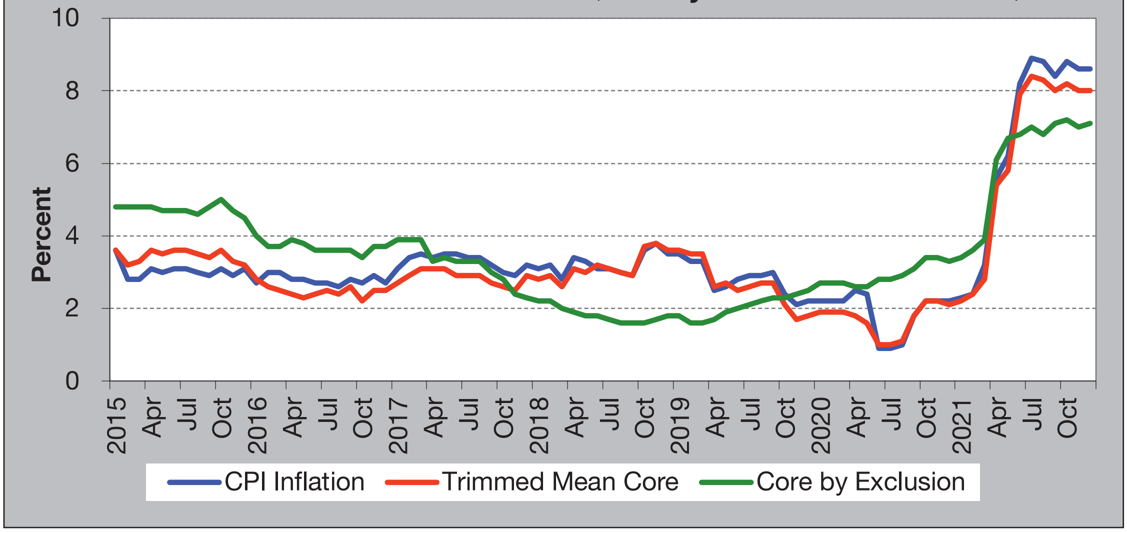
3.26 Inflation was above the Bank's inflation objective range of 3-6 percent for most of 2021, against the background of improved domestic demand, upward adjustment in administered prices and levies/taxes, as well as higher foreign inflation.

3.27 Inflation increased significantly from an average of 1.9 percent in 2020 to an average of 6.7 percent in 2021, thus breaching the upper bound of the Bank's 3-6 percent objective range since May (Chart 3.13). The high inflation in 2021 was mainly due to increases in levies/taxes, as well as significant upward adjustment of administered prices, which altogether added 5.9 percentage

[8] The 8.4 percent annual growth reported in the Statistics Botswana (SB)'s economic briefing release is calculated based on quarterly output compared to the corresponding period the previous year. Thus, SB reports year-on-year growth based on quarterly GDP.

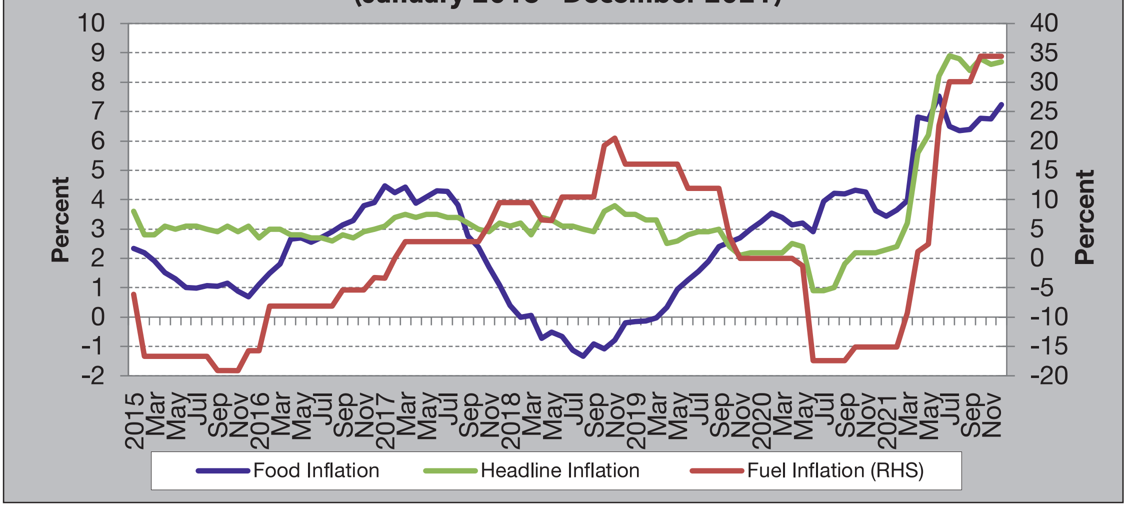
points[9] to inflation during the year and associated second-round effects. Inflation was 8.7 percent in December 2021, higher than the 2.2 percent in December 2020. Food price inflation also increased, from 3.6 percent in December 2020 to 7.2 percent in December 2021, in the context of significant price increases for oils, fish and meat. Regarding core inflation measures, the 16 percent trimmed mean inflation increased from 2.1 percent in December 2020 to 8 percent in December 2021, while inflation excluding administered prices increased from 3.3 percent to 7.1 percent in the same period.

Chart 3.13: Botswana Inflation (January 2015 - December 2021)



Source: Statistics Botswana.

Chart 3.14: Headline, Food and Fuel Inflation (January 2015 - December 2021)



Source: Statistics Botswana.

9 Specifically, the increase in value added tax (VAT) from 12 percent to 14 percent, an additional P1 per litre fuel levy, upward adjustment in electricity and water tariffs, increase in domestic fuel prices, sugar tax introduced at 2 thebe above 4g per 100ml as well as the increase in Botswana Housing Corporation rentals. These are estimated to have added 2.14 percentage points, 1.15 percentage points, 0.42 percentage points, 1.94 percentage points, 0.02 percentage points and 0.20 percentage points, respectively.

4. OUTPUT AND INFLATION OUTLOOK

(a) Global Economic Prospects

4.1 The global economic outlook for 2022 remains broadly restrained, with a moderation in global recovery, albeit uneven across regions and countries. The January 2022 WEO Update anticipates a moderation in global economic growth, from 5.9 percent in 2021 to 4.4 percent in 2022 as the new Omicron virus spread and countries reimposed mobility restrictions. The slowdown in output growth is also consistent with challenging prospects for advanced economies, in part due to pandemic related supply disruptions associated with low production hours in the labour-intensive sectors. The growth forecast for 2022 is 0.5 percentage points lower compared to the October 2021 projection, largely due to downgrades for the two largest economies (the US and China). Overall, risks to the global economic outlook are assessed to be on the downside. These include slower-than-anticipated vaccine rollouts, raising the risk of emergence of more transmissible and deadlier COVID-19 variants. This would result in slower economic activity, tightening financing conditions, particularly in advanced economies, worsening pandemic dynamics and leading to tighter external financial conditions that could set back recovery in emerging market economies.

4.2 Growth in advanced economies is projected to moderate from an expansion of 5 percent in 2021 to 3.9 percent in 2022, mostly reflecting macroeconomic effects of a sharp tightening of global financial conditions, as well as weaker consumer and business confidence and the expected unwinding of fiscal support. The US economy is expected to experience a slower growth of 4 percent in 2022 from 5.6 percent in 2021, reflecting continued supply chain disruptions, high levels of vaccine hesitancy, as well as earlier withdrawal of monetary accommodation. In the UK, economic activity is projected to ease from growth of 7.2 percent in 2021 to 4.7 percent in 2022, amid disruptions related to the Omicron variant and supply constraints that could weigh down on performance. In addition, the rate of output expansion in the euro area is forecast to decline from 5.2 percent in 2021 to 3.9 percent in 2022, but with divergence among the bloc's largest economies.

4.3 The pace of recovery in emerging market and developing economies is expected to be subdued and uneven, slowing down from 6.5 percent in 2021 to 4.8 percent in 2022, mainly due to downward revision among few large emerging market economies, particularly China due to deterioration in the housing sector and subdued private consumption. The lower growth projection for 2022 also reflects a slow pace of vaccination and reopening, the withdrawal of macroeconomic support and stabilisation of commodity prices.

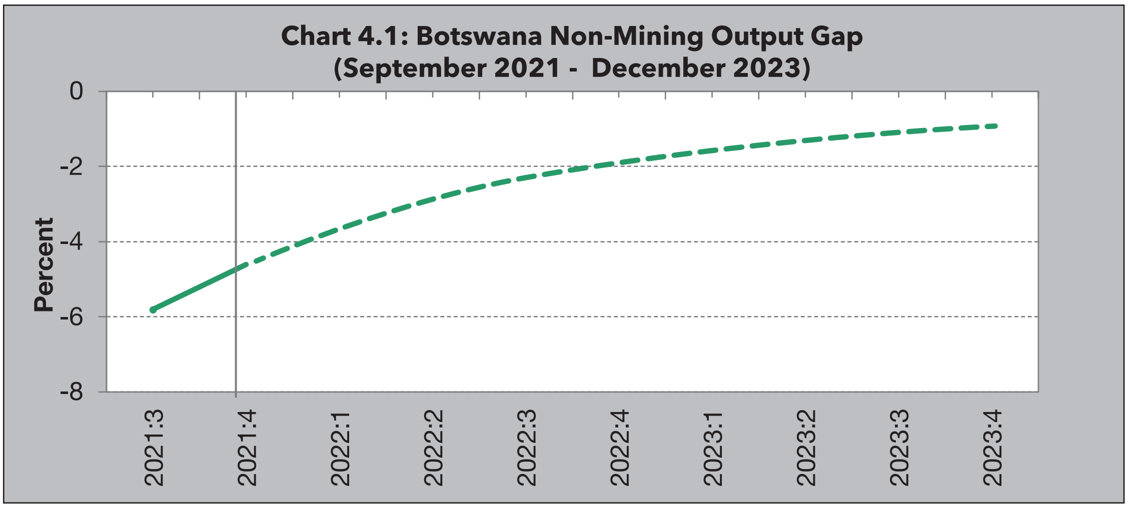
4.4 Global inflationary pressures are projected to remain elevated in 2022, influenced by prolonged supply chain disruptions and anticipated increase in energy prices and higher transportation costs. The anticipated inflationary pressures also stem from improved global demand conditions as most economies progressively deploy effective COVID-19 vaccines and reopen. Thus, inflation for advanced economies is forecast to increase from 3.1 percent in 2021 to 3.9 percent in 2022, while for emerging market economies, it is forecast to increase from 5.7 percent to 5.9 percent. In this environment, it is anticipated that monetary policy will likely tighten in most economies to control inflationary pressures resulting from pandemic-induced supply and demand mismatches that could persist for a while.

4.5 Inflation is forecast to average 2.6 percent and 4.3 percent in the SDR countries and South Africa, respectively, in 2022. Therefore, average inflation for trading partner countries is forecast at 3.4 percent, which is 3.7 percentage points lower than the 7 percent Botswana average forecast inflation for 2022; an inflation differential requiring a downward rate of crawl of the Pula exchange rate (NEER) to maintain stability of the REER. Moreover, there continues to be a need to support economic activity, in particular, international competitiveness of the domestic industry. Against this background, an annual downward rate of crawl of 2.87 percent of the NEER has been maintained for 2022. The Pula basket weights were also maintained at 45 percent for the South African rand and 55 percent for the SDR.

(b) Domestic Economic Prospects

4.6 Domestically, real GDP is projected to expand by 4.3 percent in 2022, driven mainly by expected recovery of mining activity and improvement in global output. It is anticipated that the performance of the non-mining sectors will improve, underpinned by, among others, accommodative monetary conditions, improvements in water and electricity supply, as well as finance, insurance and pension funds sectors. Furthermore, government interventions against COVID-19, such as implementation of the ERTP, are anticipated to restore economic activity and improve incomes, facilitate expansion of productive capacity, accelerate economic transformation and build economic resilience. Although improving, the non-mining output is expected to continue operating below potential in 2022 (Chart 4.1).

4.7 As announced in the 2022/2023 Budget Speech, the Government continues to run budget deficits during the second half of the National Development Plan (NDP) 11, to be financed through both domestic and external borrowing. Domestic borrowing will entail the issuance of Government debt securities, while external borrowing will be in the form of loans from bilateral and multilateral official financial institutions.



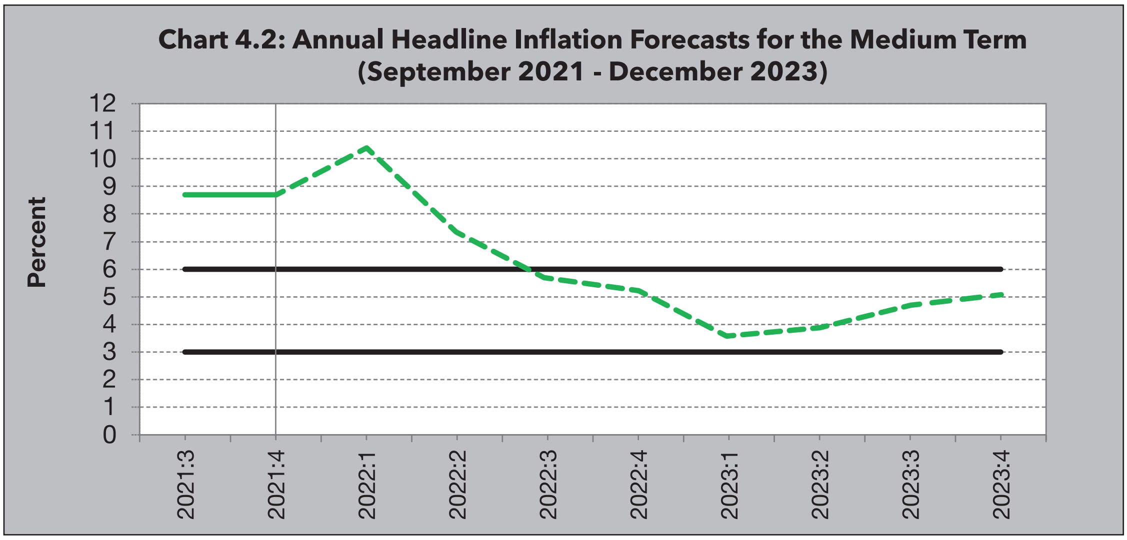
Source: Bank of Botswana.

4.8 Inflation is forecast to remain above the upper bound of the Bank's 3-6 percent objective range in the short term (Chart 4.2). However, inflation is expected to revert to within the objective range in the third quarter of 2022, mainly on account of the dissipating impact of the upward adjustment in value added tax (VAT) and administered prices, introduced in 2021, from the inflation calculation. The projection also considers the anticipated increase in domestic demand in response to the overall accommodative monetary conditions; the impact of the recent increase in domestic fuel prices, private school fees and public transport fares, as well as the expected upward adjustment of Botswana Housing Corporation (BHC) rentals and electricity tariffs[10]; and the developments in international commodity prices.

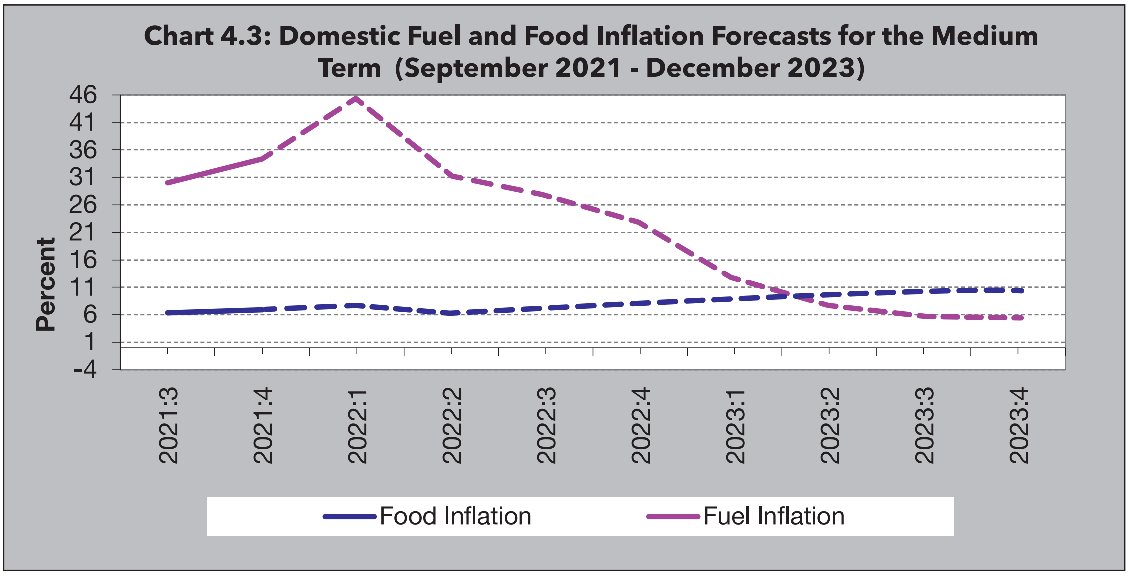
4.9 Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistence of supply and logistical constraints due to lags in production; possible re-introduction of travel restrictions and lockdowns due to the likely emergence of new COVID-19 variants and/or rising infections; domestic risk factors relating to regular annual price adjustments; as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, aggressive action by governments (for example, the ERTP) and the successful rollout of the COVID-19 vaccination programmes, as well as the possible increase in public service salaries, could add upward pressure to inflation. These risks are, however, moderated by the possibility of weak domestic and global economic activity, with a likely further dampening effect on productivity due to possible periodic lockdowns and other forms of restrictions in response to the emergence of new COVID-19 variants. A slow rollout of vaccines globally, resulting in the continuance of weak economic activity and the possible decline in international commodity prices, could also result in lower

[10] The recent increase in domestic fuel prices added approximately 1.54 percentage points to inflation in the first quarter of 2022. Additionally, the increase in private school fees and transport fares added approximately 0.05 percentage points and 0.32 percentage points, respectively, to inflation in the same period. Meanwhile, the increase in BHC rentals and electricity tariffs is expected to add approximately 0.21 percentage points and 0.27 percentage points, respectively, to inflation in the second quarter of 2022. Another increment by BHC is expected to add approximately 0.21 percentage points in the second quarter of 2023.

inflation, as would capacity constraints in implementing the ERTP initiatives. Meanwhile, according to the December 2021 BES, the business community expects inflation to be within the Bank's objective range in 2022, suggesting that inflation expectations are well-anchored.



Source: Bank of Botswana.



Source: Bank of Botswana.

5. 2022 MONETARY POLICY STANCE AND REFORMS TO MONETARY OPERATIONS

5.1 An evaluation of the determinants of inflation and factors affecting financial stability suggests that the level of inflation will be moderate and predictable into the medium term. The evident benign domestic demand pressures contribute to the positive inflation outlook in the medium term. The current state of the economy and the outlook for both domestic and external economic activity suggest that the prevailing accommodative monetary policy stance is consistent with inflation reverting to within the objective range of 3-6 percent in the medium term. Furthermore, the current levels of growth in credit to both businesses and households are considered sustainable, being aligned to nominal growth in GDP and/or incomes. Thus, recent and prospective developments (positive inflation outlook and a stable financial environment) augur well for maintaining an accommodative monetary policy stance that supports productive lending to businesses and households. In the context of weak economic activity, the assessment is that the economy could benefit from a measured depreciation of the Pula against trading partners in order to support domestic industry competitiveness; hence the maintenance of the 2.87 percent downward rate of crawl in 2022.

5.2 The Bank will continue to respond appropriately to changes in banking system liquidity conditions through relevant instruments. Overall, the Bank encourages prudent management, investment and productive allocation of financial resources, with a view to promoting growth-supporting intermediation and durable financial stability. In this regard, for effective policy transmission, the Bank guides the determination of the level and direction of market interest rates that are consistent with the monetary policy stance. The Bank also promotes the effectiveness of the interbank market to address liquidity positions of individual banks. In addition, the Bank contributes to financial stability through prudential and market conduct supervision of commercial and statutory banks and promotes, as well as participates in, coordinated regulation of the broader financial system.

5.3 The Bank evaluates its monetary policy implementation framework on a regular basis for effectiveness, with a view to introducing refinements where necessary. In this respect, in 2022, the Bank will introduce further improvements and changes to monetary policy with three key objectives. First, and foremost, to enhance monetary policy transmission and desired market response to monetary policy and monetary operations adjustments. Second, to designate an anchor policy rate capable of affecting liquidity management decisions, and thus providing a direct link to policy changes. Third, achieve an interest rate structure that influences commercial bank decisions and market responses, fostering an active interbank market and, also, effectively reflecting the policy stance and desired impact of monetary operations.

5.4 The Bank will, therefore, with effect from April 2022, introduce the following reforms to the monetary policy framework:

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

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

(c) establish an interest rate corridor, with a 200-basis points margin, comprising a new Standing Deposit Facility at the Bank of Botswana at

100 basis points below the anchor policy rate and a new Standing Credit Facility at 100 basis points above the anchor policy rate;

(d) retain the Credit Facility, at a Credit Facility Rate (CFR) to be anchored on the policy rate plus a margin that will be determined by the Bank given prevailing circumstances. In the current market environment, the margin will be set above the policy rate;

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

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

5.5 The Bank considers it prudent to allow commercial banks to independently determine their own Prime Lending Rates (PLR). However, to ensure a smooth and orderly transition and treatment of pricing of existing products/financial contracts, the PLR should not be more than 5.25 percent except in the event of an adjustment of the anchor policy rate.

6. CONCLUSION

6.1 Domestic inflation was above the upper end of the Bank's objective range of 3-6 percent for most of 2021, averaging 6.7 percent in 2021, reflecting upward changes in administered prices and levies/taxes, as well as higher foreign inflation. Meanwhile, global inflation is forecast to increase due to prolonged supply chain disruptions and anticipated increace in energy prices and higher transporation costs, as well as improved global demand conditions.

6.2 It is projected that inflation in Botswana will revert to within the Bank's medium-term objective range in the third quarter of 2022, in the absence of transitory factors that led to an increase in inflation in 2021. The Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low, predictable and sustainable inflation, through timely response to price developments, while ensuring that credit and other market developments are in line with durable stability of the financial system. The Bank remains committed to monitoring economic and financial developments with a view to ensuring price and financial stability, without undermining sustainable economic growth.

6.3 Broadly, the Bank contributes to macroeconomic stability and policy congruence through the pursuit and attainment of its primary objectives and coordination with relevant institutions with respect to price and financial stability, as well as stability of the inflation-adjusted trade-weighted exchange rate. By focusing and delivering on its specific roles, the Bank contributes to the maintenance of a conducive environment for structural reforms and transformation initiatives to gain traction, potentially leading to higher rates of growth needed to transition the economy to high income status. Given that both monetary policy and fiscal policy are expansionary, immediate implementation of transformation initiatives and structural reforms are expected to raise prospects for faster growth and economic diversification.

APPENDIX

Table A1: Credit to Private Sector by Banks (Percent of GDP)

	2018	2019	2020
United States of America	52.0	52.0	54.0
United Kingdom	133.6	134.2	133.3
India	50.0	50.0	55.0
China	157.0	157.8	164.7
Singapore	118.1	120.0	132.7
Chile	81.5	87.0	88.6
Rwanda	21.0	21.0	25.0
Mauritius	78.0	80.0	95.9
Namibia	82.0	91.5	97.2
Kenya	31.2	31.0	32.0
South Africa	60.0	60.4	62.4
Botswana	**34.0**	**36.2**	**39.4**

Source: World Bank's World Development Indicators

Notes:
1. Domestic credit to the private sector by banks refers to financial resources provided to the private sector by other depository corporations (deposit taking corporations except central banks), such as through loans, purchases of non equity securities, and trade credits and other accounts receivable, that establish a claim for repayment. For some countries, these claims include credit to public enterprises.
2. Data for 2021 is not available.

MONETARY POLICY COMMITTEE MEETING DATES FOR 2022

Date	Time	Venue
February 24	0830 hours	Bank of Botswana
April 28	0830 hours	Bank of Botswana
June 16	0830 hours	Bank of Botswana
August 25	0830 hours	Bank of Botswana
October 20	0830 hours	Bank of Botswana
December 1	0830 hours	Bank of Botswana

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