



Monetary Policy Statement 2018



BANK OF BOTSWANA

STRATEGIC INTENT STATEMENTS

VISION

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

MISSION

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

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



MONETARY POLICY STATEMENT 2018

Moses D Pelaelo

Governor

February 27, 2018

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) is the main medium through which the Bank of Botswana informs stakeholders about the framework for the formulation and implementation of monetary policy. Through the MPS, the Bank reports inflation trends, policy performance and the Bank's policy choices for the ensuing year. The Statement also serves to fulfil the public's expectation of a transparent and accountable central bank in implementing the monetary policy mandate as set out in the Bank of Botswana Act (Cap 55:01).*
- 1.2 The 2018 MPS reviews the previous year's economic and policy developments and also evaluates the determinants of changes in the level of prices and their impact on inflation in Botswana. In turn, there is 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 2018. 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 the conduct of monetary policy in order to anchor public expectations to the objective of a low, predictable and sustainable level of inflation.*
- 1.3 Global GDP is estimated to have increased by 3.7 percent in 2017, higher than the growth of 3.2 percent in 2016; the improvement was broad-based. In advanced economies, output in the United States of America (USA) increased by 2.3 percent in 2017 compared to the 1.5 percent growth in 2016, supported by buoyant consumer and business spending, improved financial conditions and stronger global demand. For the euro area and Japan, GDP growth estimates for 2017 were revised upwards from 2.1 percent and 1.5 percent to 2.4 percent and 1.8 percent, respectively, against the backdrop of improved investment and trade, together with stronger business and consumer confidence. In emerging market economies, output growth was strong at 4.7 percent in 2017, reflecting higher export commodity prices, and led by robust economic performance in China and India.*
- 1.4 Inflation was subdued, globally, in 2017, albeit increasing slightly due to the rise in fuel prices, but moderated by restrained global demand and slow wage growth. Consequently, some of the major central banks maintained low policy interest rates and continued to provide liquidity support to the financial sector. However, policy rates were increased in the USA and United Kingdom (UK) during 2017 in a continuing move towards policy normalisation with respect to the former and in a bid to get inflation back down to target for the latter. In emerging market economies, monetary policy was eased to boost economic activity as inflationary pressures dissipated. In addition, improved monetary policy frameworks in emerging market economies helped to lower core inflation, thereby providing scope for using monetary policy to support demand should activity weaken.*
- 1.5 In Botswana, real GDP expanded by 1.8 percent in the twelve months to September 2017, underpinned by growth in non-mining output. Inflation remained close to the lower bound of the Bank's medium-term objective range of 3 – 6 percent during 2017, and was*

3.2 percent in December 2017.¹ Price developments were in the context of moderate domestic demand pressures, restrained growth in personal incomes and benign external price pressures.

- 1.6 Given projected low inflation in the medium term, the Bank maintained an accommodative monetary policy stance and the Bank Rate was reduced by 50 basis points to 5 percent in October 2017. The Bank also implemented an upward 0.26 percent annual rate of crawl of the nominal effective exchange rate (NEER) of the Pula effective January 2017, as inflation in Botswana was expected to be lower than the forecast inflation for trading partner countries. Bilaterally, the Pula appreciated by a modest 0.9 percent against the SDR², while depreciating by 1.8 percent against the South African rand.³ The appreciation of the Pula against SDR currencies is due to a combination of the strengthening of the rand and depreciation of the US dollar in 2017. Given the Pula basket mechanism and the weight of the rand in the basket, as the rand appreciates against the SDR currencies, so does the Pula. The real effective exchange rate (REER) appreciated by 0.35 percent year-on-year to December 2017, reflecting a positive inflation differential between Botswana and trading partner countries, as well as the 0.26 percent upward rate of crawl implemented during 2017.
- 1.7 Inflation is forecast to be within the 3 – 6 percent objective range in the medium term. Upside risks to the outlook relate to any substantial upward adjustment in administered prices and government levies and/or taxes, as well as any increase in international oil and food prices beyond current forecasts. However, there are downside risks associated with modest global economic activity and the potential decline in 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 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 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 taking into account prospects for economic growth and developments relating to stability of the financial system. To this end, in formulating an appropriate policy stance, the Bank

¹ There was a breach of the lower bound of the objective range in November 2017 when inflation was 2.9 percent.

² The SDR is the unit of account of the International Monetary Fund (IMF) that comprises the United States dollar, euro, Chinese renminbi (yuan), Japanese yen and British pound. Effective October 1, 2016, the respective weights were 41.73 percent, 30.93 percent, 10.92 percent, 8.33 percent and 8.09 percent.

³ Pula basket weights for 2017 were 45 percent for the rand and 55 percent for the SDR and have been maintained for 2018.

factors in projections of real monetary conditions ⁴ in the context of other relevant domestic and international economic and financial developments, and their impact on the output gap⁵ and, ultimately, inflation. The policy framework recognises the importance of communication in an effort to maintain transparency, predictability and accountability with respect to the policy framework and actions; thus foster market involvement and influence expectations. In this regard, in addition to the MPS, the Governor delivers a statement at a press briefing after each meeting of the Monetary Policy Committee (MPC) to allow for interaction with the media and dissemination of the Bank's policy stance. Moreover, the Bank publishes, in advance, MPC meeting dates for the year.

3. IMPLEMENTATION OF MONETARY POLICY AND RELATED ECONOMIC DEVELOPMENTS IN 2017

(a) External Developments

- 3.1 *At the global level, monetary policy implementation varied in response to mixed economic performance across countries and regions. Policymakers continued to focus on the need to achieve sustainable economic growth through facilitating access to finance in a stable environment. Monetary policy was accommodative in advanced economies, with low levels of interest rates and liquidity support to the financial sector. Policy interest rates remained low in the euro area, while negative interest rates were maintained by the Bank of Japan and asset purchase programmes were maintained in both jurisdictions.*
- 3.2 *The Bank of England increased interest rates by 25 basis points to 0.5 percent in order to move inflation back down towards the 2 percent target. In the USA, the target range for the federal funds rate was increased three times by a cumulative 75 basis points in 2017 to reach 1.25 – 1.5 percent in December 2017 in a move towards policy normalisation, but remains relatively low and accommodative by historical standards. In the emerging market economies, monetary policy was predominantly accommodative as central banks eased monetary policy to support economic activity as inflationary pressures remained low.⁶*
- 3.3 *GDP growth in advanced countries improved in 2017 against the backdrop of strengthening demand, favourable global financial conditions, improving labour market conditions, increasing commodity prices, as well as the related resurgence in world trade. These developments were also positive for economic performance in the emerging market economies with robust growth overall, albeit mixed across countries. In the*

⁴ *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, the deviations of the real exchange rate and real interest rate from their respective trend values.*

⁵ *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 output gap means the actual level of output for a given period is below the trend level for that period, thus indicating that the economy is operating below its estimated potential.*

⁶ *Policy rates were cut by 0.25 percent each in South Africa and India, and by 6.75 percent and 2.25 percent in Brazil and Russia, respectively, during 2017.*

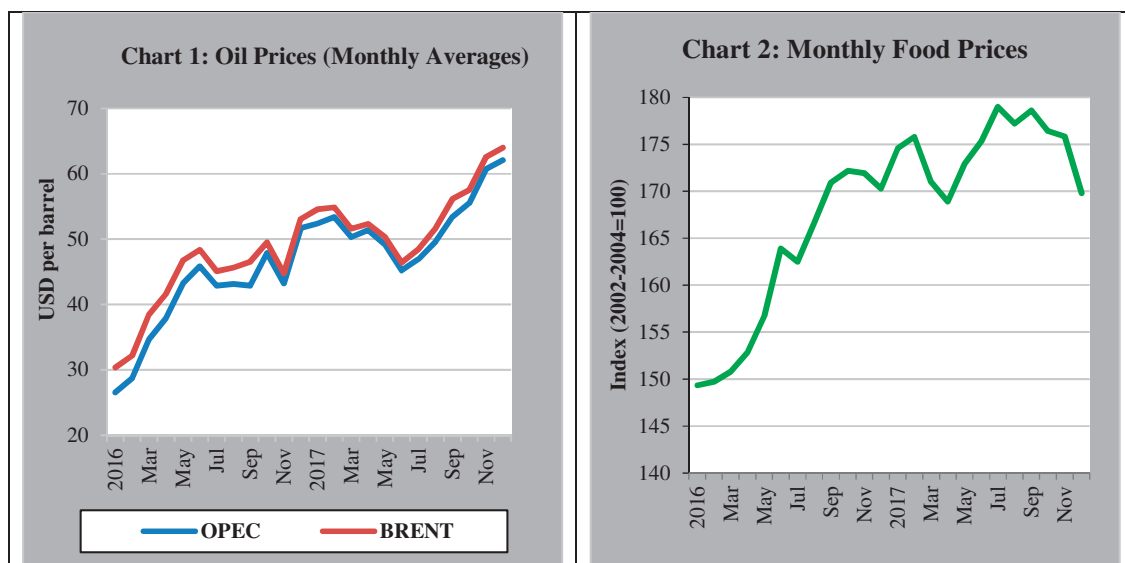
circumstances, global GDP growth is estimated at 3.7 percent in 2017, higher than the 3.2 percent in 2016 (Table 1).

Table 1: Real GDP Growth Rates (Percent)

	<i>Estimates</i>		<i>Projections</i>
	2016	2017	2018
World	3.2	3.7	3.9
Advanced economies	1.7	2.3	2.3
United States of America	1.5	2.3	2.7
Euro Area	1.8	2.4	2.2
United Kingdom	1.9	1.7	1.5
Japan	0.9	1.8	1.2
Emerging market and developing economies	4.4	4.7	4.9
China	6.7	6.8	6.6
Brazil	-3.5	1.1	1.9
India	7.1	6.7	7.4
Russia	-0.2	1.8	1.7
South Africa	0.3	0.9	0.9
Botswana	4.3	4.7	5.3

Source: IMF, January 2018 World Economic Outlook (WEO) Update and 2018 Budget Speech, Botswana.

- 3.4 Global inflation was subdued in 2017, mainly due to restrained global demand, slow wage growth and the impact of globalisation and enhanced international trade. However, the increase in commodity prices (especially crude oil prices) contributed to the modest increase in inflation. International oil prices generally increased in 2017. For example, the Brent crude price increased by 20.6 percent between December 2016 and December 2017 (Chart 1).⁷ The recovery in oil prices was mainly sustained by adherence by some of the large producers to agreed production cuts, while geopolitical tensions also posed risks to supply. Meanwhile, international food prices decreased by 0.3 percent in 2017 compared to an increase of 11 percent in 2016 (Chart 2), driven by a decrease in prices of vegetable oils and sugar. Generally, international oil and food prices exerted marginal upward pressure on domestic inflation in 2017.

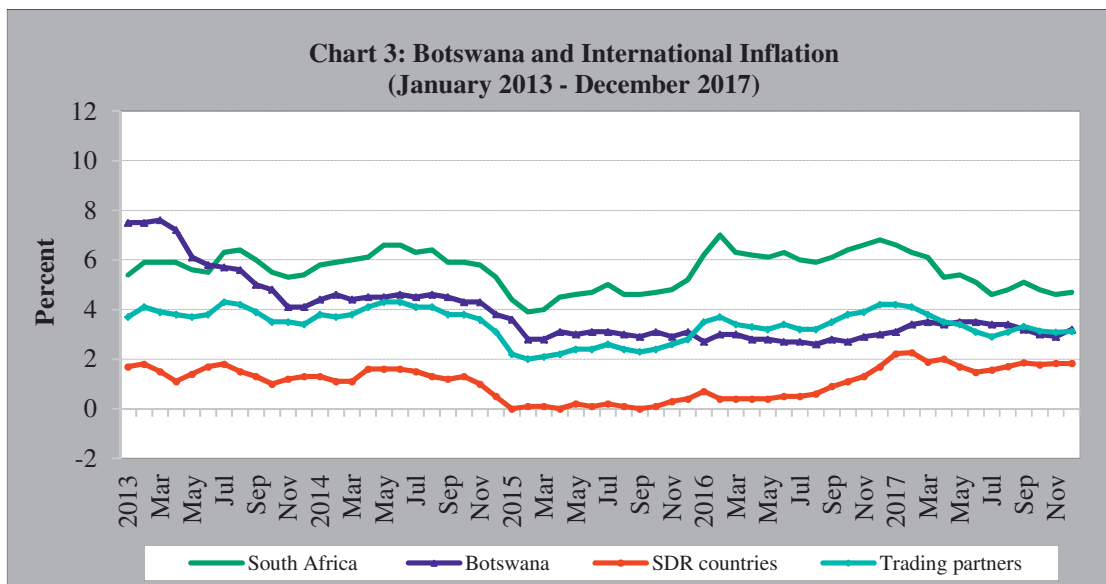


Source: OPEC and US Energy Information Administration.

Source: Food and Agricultural Organisation.

⁷ Oil prices reached USD70 in January 2018.

3.5 For Botswana's trading partner countries, trade-weighted average inflation decreased from 4.2 percent in December 2016 to 3.1 percent in December 2017.⁸ Average inflation was subdued in the SDR countries, increasing slightly from 1.7 percent in December 2016 to 1.8 percent in December 2017, while in South Africa⁹, inflation decreased from 6.8 percent to 4.7 percent in the same period (Chart 3).



Source: Statistics Botswana and Bloomberg.

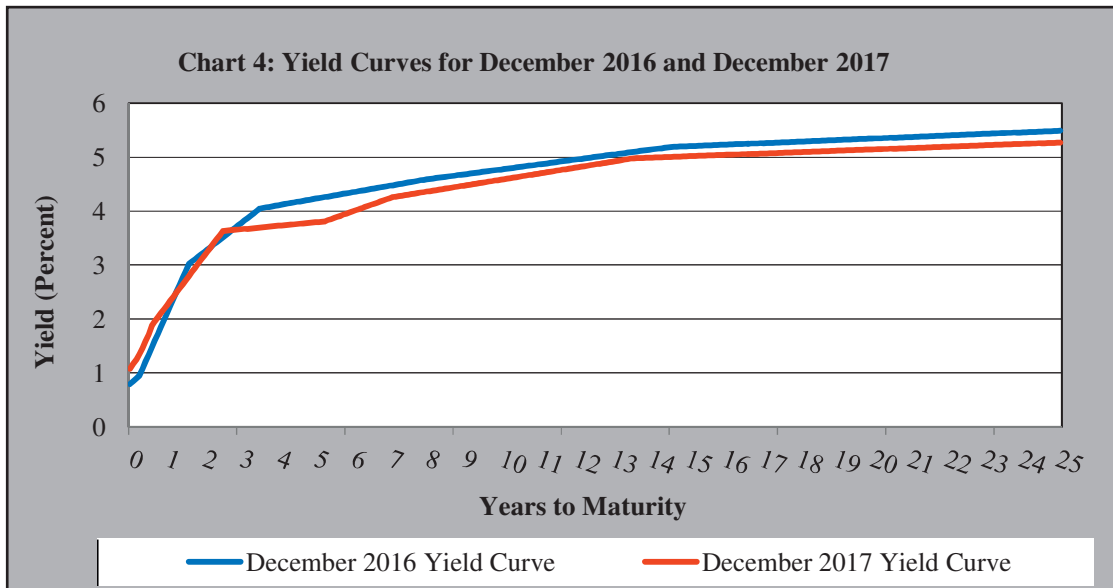
(b) Monetary Policy Implementation in Botswana

3.6 Domestically, monetary policy was conducted against the background of below-trend economic activity (a non-inflationary output gap) and a positive medium-term inflation outlook. These developments provided scope for an accommodative monetary policy stance in support of stronger output growth. Thus, the Bank Rate was reduced by 50 basis points in October 2017 to 5 percent, and consequently the prime lending rate of commercial banks decreased from 7 percent to 6.5 percent (Chart 5).¹⁰ Deposit interest rates also fell in line with the reduction in the Bank Rate (Chart 6).

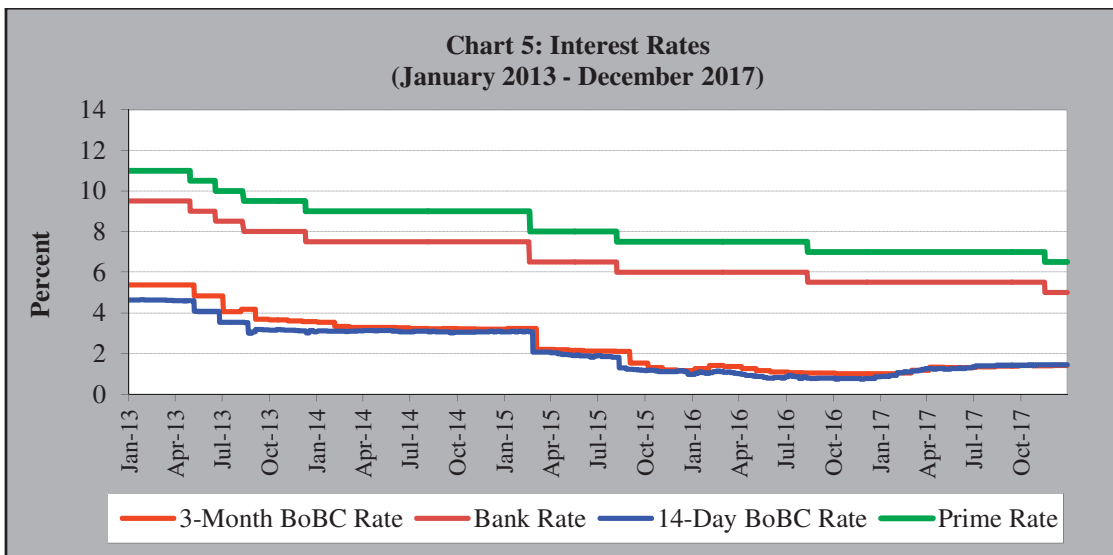
⁸ The trade-weighted average inflation comprises South Africa's headline inflation and average SDR countries' inflation.

⁹ Inflation remained within the country's medium-term target range of 3 – 6 percent throughout 2017.

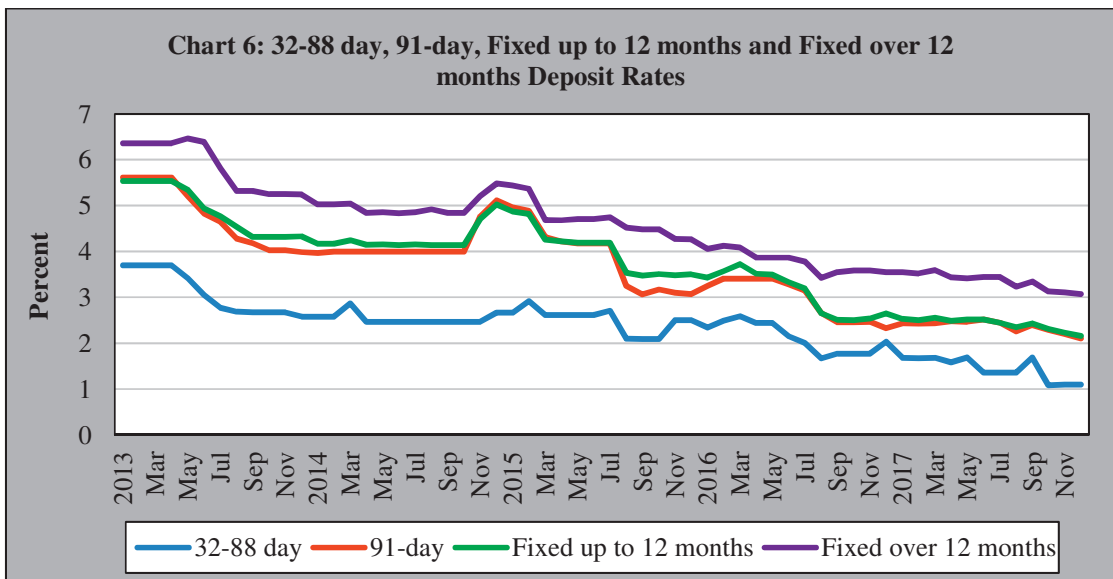
¹⁰ The MPC maintained the Bank Rate at 5.5 percent at its meetings in February, April, June and August 2017. After the reduction in the Bank Rate to 5 percent in October, the rate was maintained in December 2017 and February 2018.



Source: Bank of Botswana.



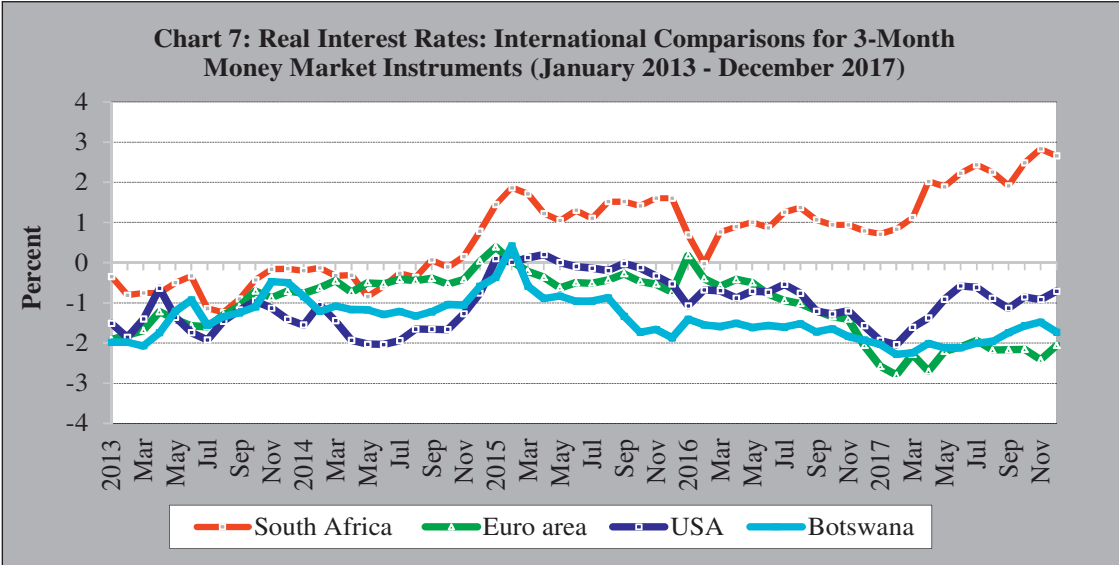
Source: Bank of Botswana and commercial banks.



Source: Commercial banks.

3.7 Monetary policy implementation entailed the use of Bank of Botswana Certificates (BoBCs) to mop up excess liquidity¹¹ in an effort to maintain interest rates that are consistent with the monetary policy stance. The Bank introduced measures to improve market efficiency and effectiveness of monetary operations, in particular to better align market interest rates to the policy stance. Notably, relaxation on the amount of BoBCs used to mop up excess liquidity helped to alleviate downward pressure on interest rates and misalignment with the policy stance. In addition, the range of securities eligible for use by commercial banks as collateral when accessing the Bank’s credit facility were broadened to include all government securities, regardless of maturity.¹² Commercial banks were, therefore, able to manage liquid assets more efficiently, with less reliance on BoBCs for collateral purposes. In turn, this further reduced the cost of monetary policy implementation. Outstanding BoBCs amounted to P6.3 billion in December 2017, a decrease from P7.9 billion in December 2016.

3.8 BoBC yields increased modestly in 2017, reflecting a process of normalisation in money market rates. Thus, the 14-day BoBC yield increased from 0.84 percent in December 2016 to 1.45 percent in December 2017, while the 3-month BoBC yield increased from 1.01 percent to 1.41 percent in the same period.¹³ Consequent to the larger increase in nominal interest rates compared to inflation between December 2016 and December 2017, the real 14-day BoBC rate increased from -2.10 percent in December 2016 to -1.7 percent in December 2017, while the real 3-month BoBC yield increased from -1.93 percent to -1.73 percent in the same period (Chart 7).¹⁴



Source: Bank of Botswana, South African Reserve Bank and Bloomberg.

¹¹ Excess liquidity is money balances in excess of what is needed by commercial banks for investment and daily flows, with no credit extension obligation and, hence, can be invested temporarily. Importantly, each commercial bank holds a specific level of excess liquidity that reflects its asset-liability management policy.

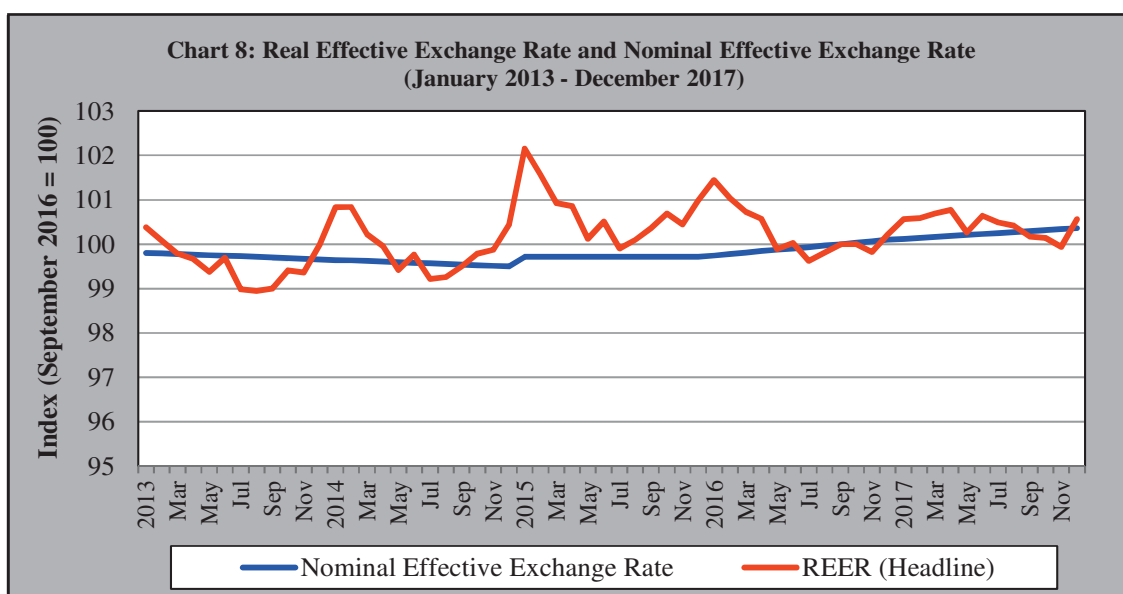
¹² Bonds issued by the International Finance Corporation, a member of the World Bank Group, are also acceptable as collateral for the Bank’s credit facility.

¹³ The 14-day and 3-month BoBC yields quoted here are weighted averages of winning bids at auction.

¹⁴ Internationally, the real 3-month money market interest rates were 2.66 percent, -0.71 percent and -2.06 percent in December 2017 for South Africa, USA and the euro area, respectively.

(c) Implementation of Exchange Rate Policy

- 3.9 Implementation of the exchange rate policy was in line with the objective of maintaining a stable inflation-adjusted trade-weighted exchange rate of the Pula. This involved a 0.26 percent upward rate of crawl of the NEER during 2017 as domestic inflation was forecast to be close to the lower end of the medium-term inflation objective range and lower than the expected average inflation for trading partner countries. Consequently, the trade-weighted NEER of the Pula appreciated by 0.26 percent in 2017. Meanwhile, the REER appreciated by 0.35 percent in the twelve months to December 2017 (Chart 8), reflecting a small positive inflation differential between Botswana and trading partner countries, as well as the 0.26 percent upward rate of crawl implemented during 2017.



Source: Bank of Botswana.

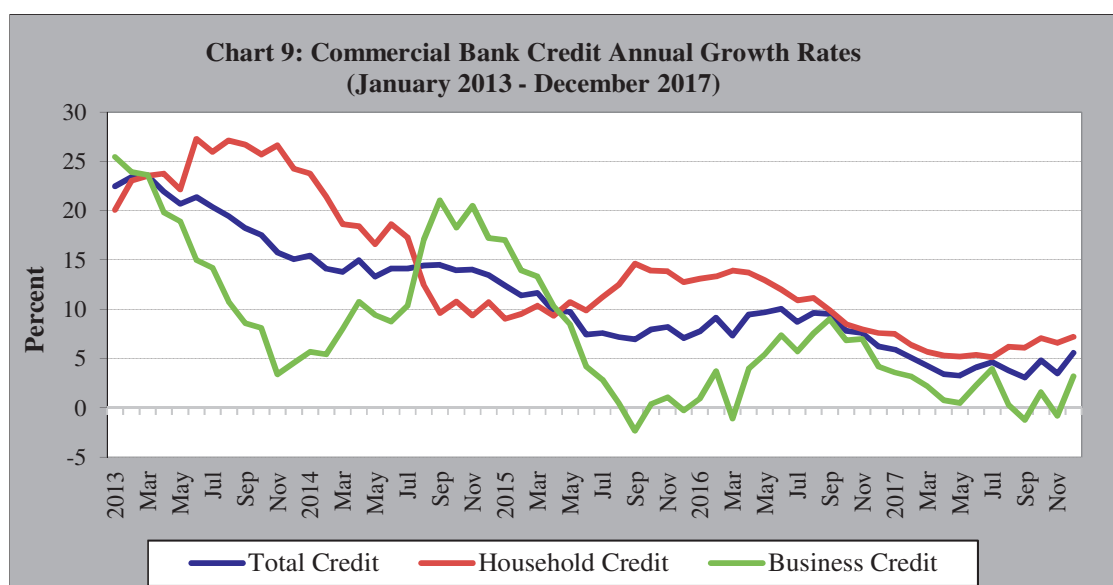
(d) Government Expenditure and Credit Growth

- 3.10 Monetary policy was conducted against the backdrop of a restrained fiscal policy environment as government expenditure contracted by 3.6 percent in 2017 compared to 9.7 percent growth in 2016. Development expenditure contracted by 11 percent, while recurrent expenditure decreased by 0.7 percent in the same period. Within recurrent expenditure, average public sector wages increased by 7.7 percent in the nine months to September 2017. Private sector wages increased by 0.2 percent in the same period. Meanwhile, national wages increased by 2.9 percent in the nine months to September 2017¹⁵, the impact of which was not significant enough on aggregate demand to generate notable inflationary pressures.
- 3.11 Annual growth in commercial bank credit decreased from 6.2 percent in 2016 to 5.6 percent in 2017. The slowdown in annual credit expansion was mostly associated with a decrease in growth of lending to businesses from 4.2 percent in December 2016 to 3.2 percent in December 2017. This was mostly due to loan repayments by parastatals and some diamond manufacturing companies. Lending to businesses excluding parastatals

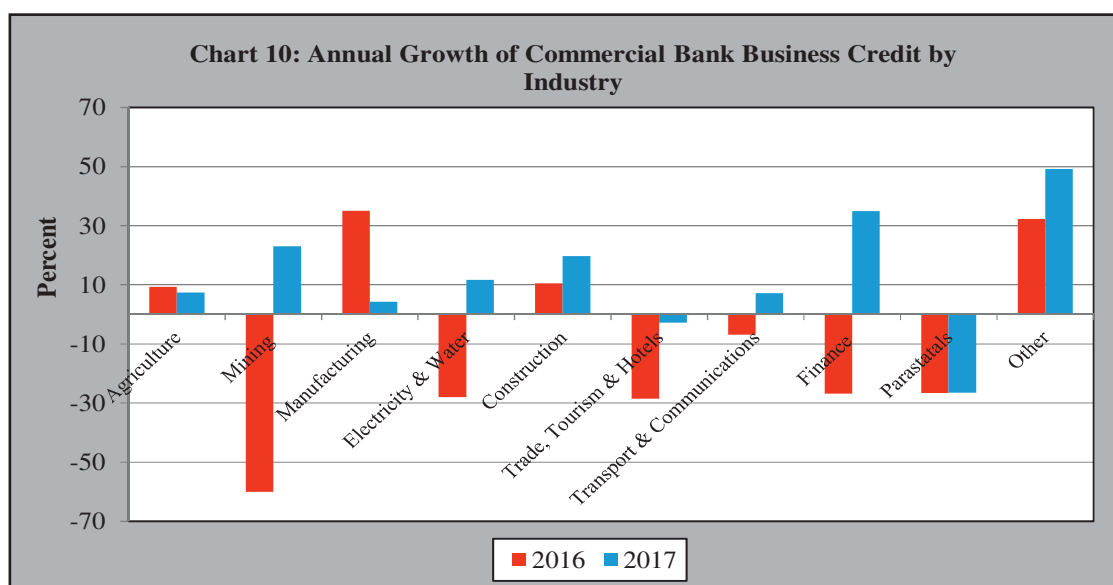
¹⁵ Data sourced from Statistics Botswana's Formal Sector Employment Survey, September 2017. Data for December 2017 not available.

increased by 5.2 percent in 2017, with different economic sectors benefiting from the extension of credit (Chart 10).

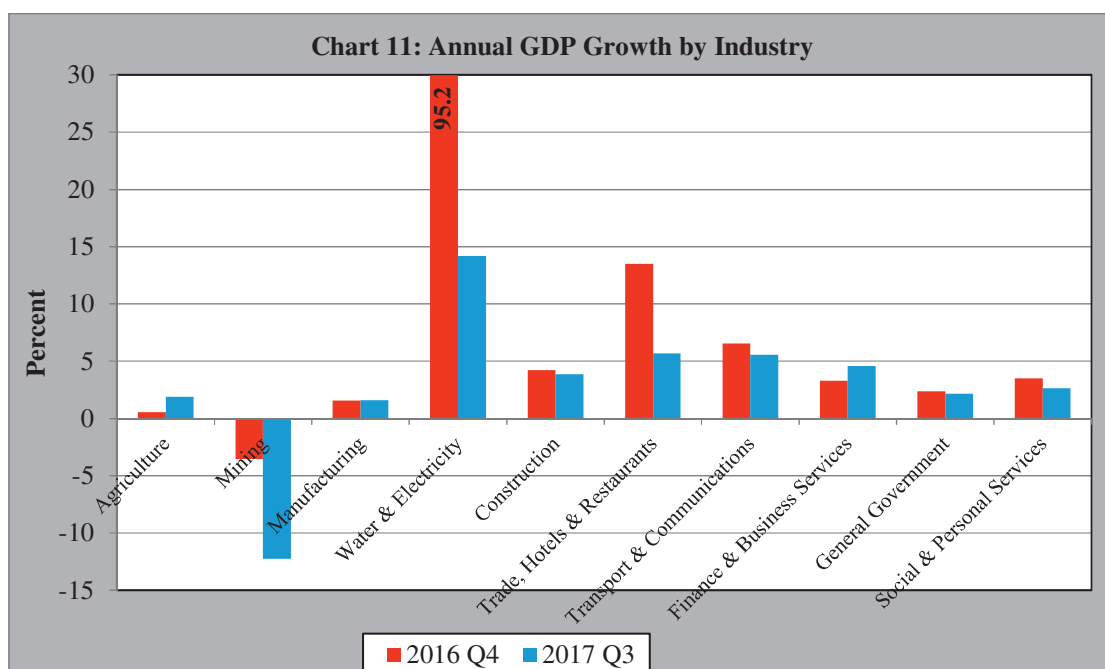
3.12 For households, annual credit growth decreased from 7.6 percent in December 2016 to 7.2 percent in December 2017. The lower rate of increase in lending to households was mostly due to the slowdown in the yearly rate of expansion in mortgage lending to households, which decreased from 6.3 percent in December 2016 to 4.8 percent in December 2017. The lower growth of mortgage lending is consistent with the weak residential property market, especially at the upper-end, and also the 'pro-cyclical' behaviour of lenders (lending to the sector becoming more stringent as a result of concerns about the borrower's ability to repay). Meanwhile, the annual growth in unsecured loans increased from 8.3 percent to 8.8 percent in the same period. The share of mortgages in total bank credit to households decreased from 28.4 percent in December 2016 to 27.8 percent in December 2017. Overall, the credit-to-GDP ratio increased (Table 2), indicating the steadily growing importance of credit in supporting economic activity, albeit remaining comparatively low by global standards (Appendix Table 1).



Source: Commercial banks.



Source: Commercial banks.



Source: Statistics Botswana and Bank of Botswana calculations.

Note: The growth rate is calculated as the percentage change in cumulative GDP over four quarters compared to the corresponding period ending in the previous year.

Table 2: Commercial Bank Credit-to-GDP

	<i>Percent of GDP</i>		
	<i>2015</i>	<i>2016</i>	<i>2017³</i>
Total Commercial Bank Credit¹	33.1	30.1	30.6
Business	13.4	12.0	12.1
<i>Parastatals</i>	<i>1.2</i>	<i>0.8</i>	<i>0.6</i>
<i>Agriculture</i>	<i>0.7</i>	<i>0.7</i>	<i>0.7</i>
<i>Mining</i>	<i>0.5</i>	<i>0.2</i>	<i>0.2</i>
<i>Manufacturing</i>	<i>1.7</i>	<i>1.9</i>	<i>1.9</i>
<i>Construction</i>	<i>0.6</i>	<i>0.5</i>	<i>0.6</i>
<i>Trade</i>	<i>4.2</i>	<i>2.5</i>	<i>2.5</i>
<i>Transport and Communications</i>	<i>0.5</i>	<i>0.4</i>	<i>0.3</i>
<i>Finance and Business Services</i>	<i>1.2</i>	<i>0.8</i>	<i>1.1</i>
<i>Real Estate</i>	<i>2.4</i>	<i>2.2</i>	<i>2.2</i>
Households	19.6	18.1	18.5
<i>Retail Credit²</i>	<i>14.0</i>	<i>12.9</i>	<i>13.3</i>
<i>Mortgage</i>	<i>5.6</i>	<i>5.1</i>	<i>5.2</i>

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. Includes motor vehicle, personal and credit card loans.
 3. Data covering the twelve months to September 2017.

(e) Financial Stability Indicators

3.13 Credit default rates rose, with the ratio of non-performing loans (NPLs) to total credit increasing from 4.9 percent in December 2016 to 5.3 percent in December 2017; the NPL ratio for individual banks ranged from 1.3 percent to 10 percent in December 2017. By sector, the ratio of non-performing loans to total loans for households decreased from 4.9 percent in December 2016 to 4.5 percent in December 2017 while, for businesses, it increased from 4.9 percent to 6.4 percent in the same period.¹⁶ There was, however, sufficient provisioning by banks to cover non-performing loans, with banks remaining profitable. Moreover, the capital, asset quality, liquidity and profitability levels that meet prudential requirements for banks indicate a generally sound and stable financial system (Table 3). Overall, current levels of credit continued to be supportive of economic activity.

Table 3: Selected Performance Indicators of the Banking Sector

	Sep 2016	Dec 2016	Sep 2017	Dec 2017
Capital Adequacy (Percent)				
Core Capital to Total Capital ¹	68.9	67.8	69.2	68.3
Core Capital to Risk-Weighted Assets ²	12.5	13.3	12.8	13.3
Unimpaired Capital to Risk-Weighted Assets ³	18.0	19.6	18.5	19.4
Asset Quality (Percent)				
Non-performing loans (NPLs) to Total Loans	4.8	4.9	5.6	5.3
NPLs Net of Specific Provisions to Unimpaired Capital	14.3	12.2	13.9	12.3
Specific Provisions to NPLs	44.5	50.5	51.7	53.7
Liquidity (Percent)				
Liquid Assets to Deposits (Liquidity Ratio) ⁴	18.2	21.6	16.4	17.9
Advances to Deposits (Financial Intermediation Ratio)	84.5	82.2	83.5	85.2
Profitability/Efficiency (Percent)				
Return on Average Assets	2.4	1.8	1.7	0.8
Return on Equity	21.6	14.4	14.5	7.0
Cost to Income	57.8	57.0	60.1	63.9

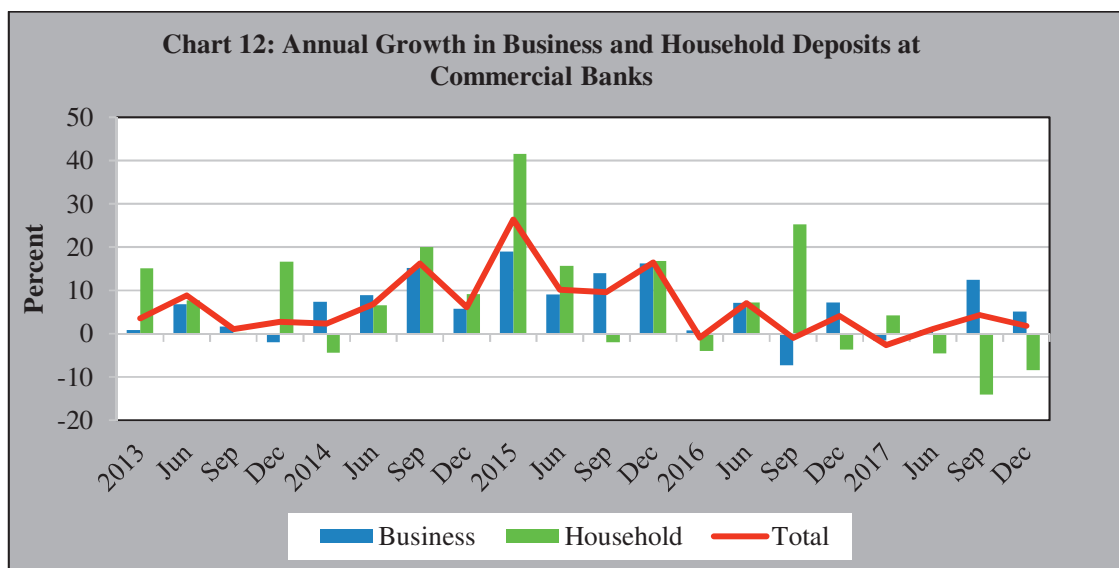
Source: Bank of Botswana.

- Notes: 1. Prudential limit is 50 percent.
 2. Prudential limit is 7.5 percent (prior to January 2016, it was 4 percent).
 3. Prudential limit is 15 percent.
 4. Prudential limit is 10 percent.

¹⁶ The sectoral ratios are calculated as the sectors' NPLs divided by the respective sectoral total loans.

3.14 Household loans, with a share of 61 percent of total loans at the end of 2017, continue to dominate commercial bank credit. It is also observed that household credit is concentrated in unsecured lending (67.1 percent as at December 2017). However, developments with respect to household credit are in line with the slower growth in personal incomes and augur well for maintenance of financial stability. In particular, the reduction in mortgage credit growth in the context of the weaker property market moderates potential risks in this area. Moreover, the risk to financial stability, on account of this credit composition, is moderated by the extent to which unsecured credit is diversified (relatively small amounts spread across many borrowers of differing risk profiles). Furthermore, the bulk of the household credit is to salaried individuals, which enables proper credit evaluation using ascertained income as the basis for determining repayment capacity.¹⁷ In addition, credit risk is lowered where loans are protected by credit life insurance.

3.15 An enduring challenge for commercial banks is the concentration of business deposits in their funding structure (75.8 percent of total deposits in December 2017), reflecting an imbalance in the market and the potential increase in the cost of commercial banks' liabilities¹⁸. Notably, there was a significant decrease in household deposits by 8.4 percent in 2017 following a 3.6 percent fall in 2016. This could reflect potential financial strain on households arising from the sluggish growth in incomes. On the other hand, business deposits increased by 5.1 percent in 2017, after growing by 7.2 percent in 2016. Overall, deposits at commercial banks increased by 1.8 percent in 2017, adding to the 4.1 percent increase in 2016 (Chart 12). Given the lower increase in bank deposits than the growth in bank lending, the financial intermediation ratio increased from 82.2 percent in December 2016 to 85.2 percent in December 2017.¹⁹



Source: Commercial banks.

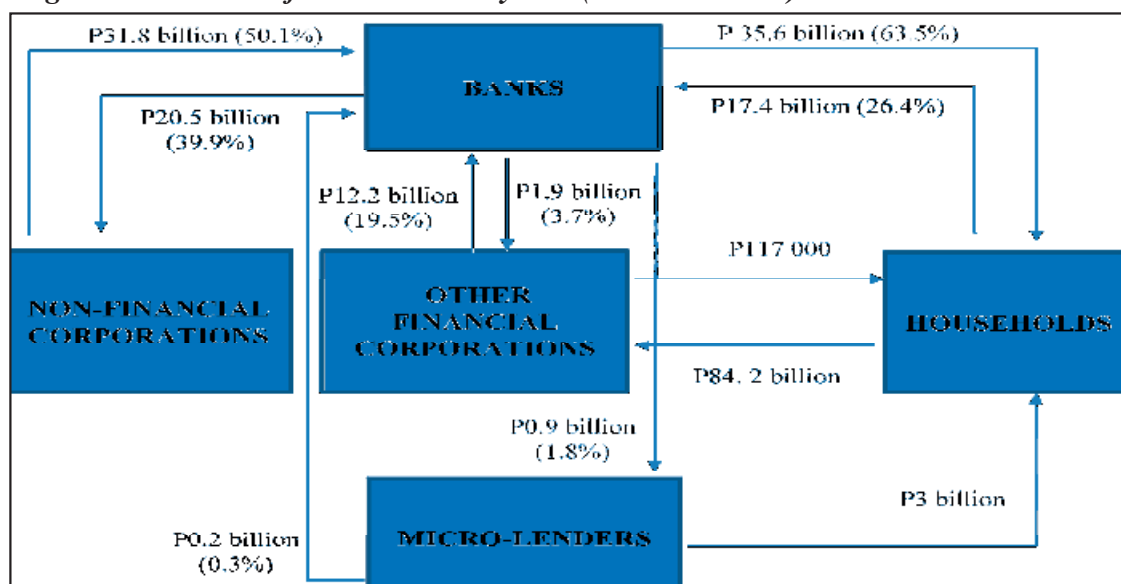
¹⁷ There is, nevertheless, some risk relating to borrowing by individuals from multiple institutions and sources, which could lead to excessive debt burdens due to the absence of credit information sharing.

¹⁸ Business deposits tend to attract higher interest rates.

¹⁹ The financial intermediation ratio is defined as the ratio of total loans to total deposits, thus indicating the proportion of deposits that is intermediated into loans.

3.16 A broad perspective of the formal financial sector (short and long-term savings, including pension funds) shows that households are net savers, a position that has progressively increased since the establishment of the Botswana Public Officers Pension Fund in 2001. In the circumstances, the linkages between banks, non-bank financial institutions and household savings are intricate and symbiotic and require comprehensive oversight, involving monitoring of soundness of the relevant financial institutions, safeguarding of depositor-investor funds and protecting the integrity of the financial system (Figure 1). Therefore, the Bank and the Non-Bank Financial Institutions Regulatory Authority provide the regulatory framework, coverage and enforcement mechanisms that promote sound and productive mobilisation and deployment of financial resources; preservation of value and risk mitigation; proper discharge of fiduciary responsibilities; market discipline; as well as penalise misconduct and enforce restitution as necessary. The regulatory framework also encompasses structures for collaboration among the relevant authorities to achieve comprehensive monitoring and enforcement of legislation and regulations in order to maintain integrity and stability of the financial system. The institutional arrangements for the regulation and supervision of the financial sector continue to be strengthened alongside emerging developments in this regard.

Figure 1: Structure of the Financial System (December 2016)

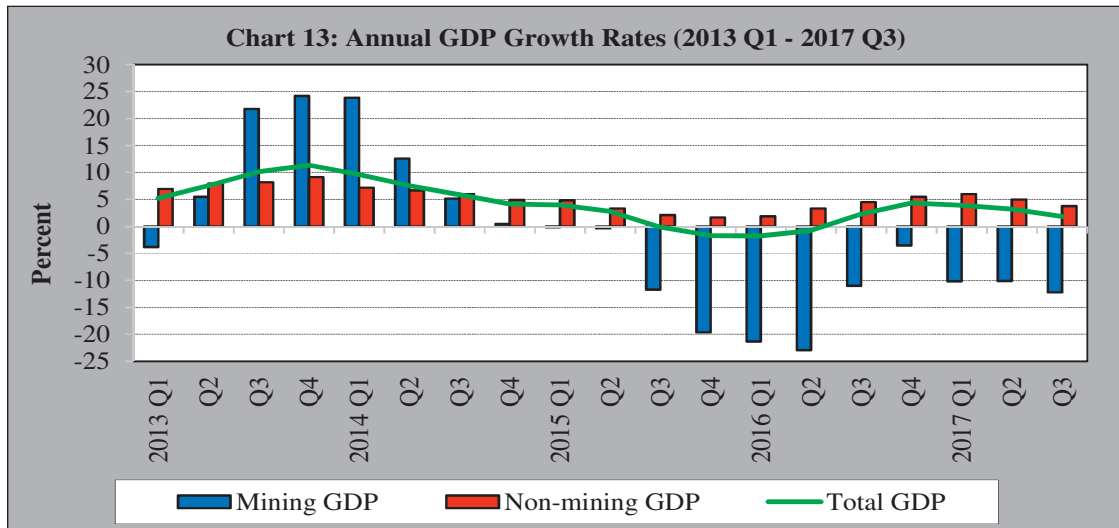


Source: Bank of Botswana; estimates based on data provided by financial institutions regulated by Bank of Botswana and Non-Banking Financial Institutions Regulatory Authority.

(f) Output and Price Developments

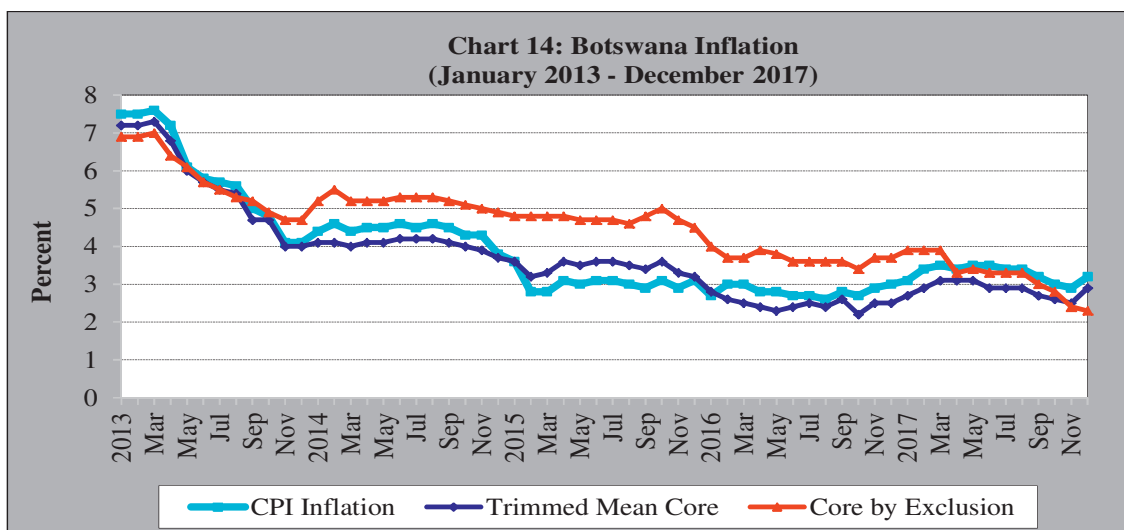
3.17 GDP in Botswana increased by 1.8 percent in the twelve months to September 2017 compared to the 2.3 percent increase in the corresponding period ending in September 2016. This was attributable to the 3.8 percent expansion in non-mining output in the same period (4.5 percent in September 2016). In contrast, mining output contracted by 12.3 percent in the twelve months to September 2017, larger than the decline of 11 percent in the corresponding period ending September 2016 (Chart 13). The larger decline in mining output is due to the closure of the BCL and Tati Nickel mines in October 2016. GDP in the third quarter of 2017 was 1.2 percent higher than the output level for the corresponding quarter in 2016.²⁰

²⁰ The 1.2 percent annual growth reported in the Statistics Botswana (SB)'s economic briefing release is calculated on the basis of quarterly output compared to the corresponding period the previous year. Thus, SB reports year-on-year growth based on quarterly GDP.

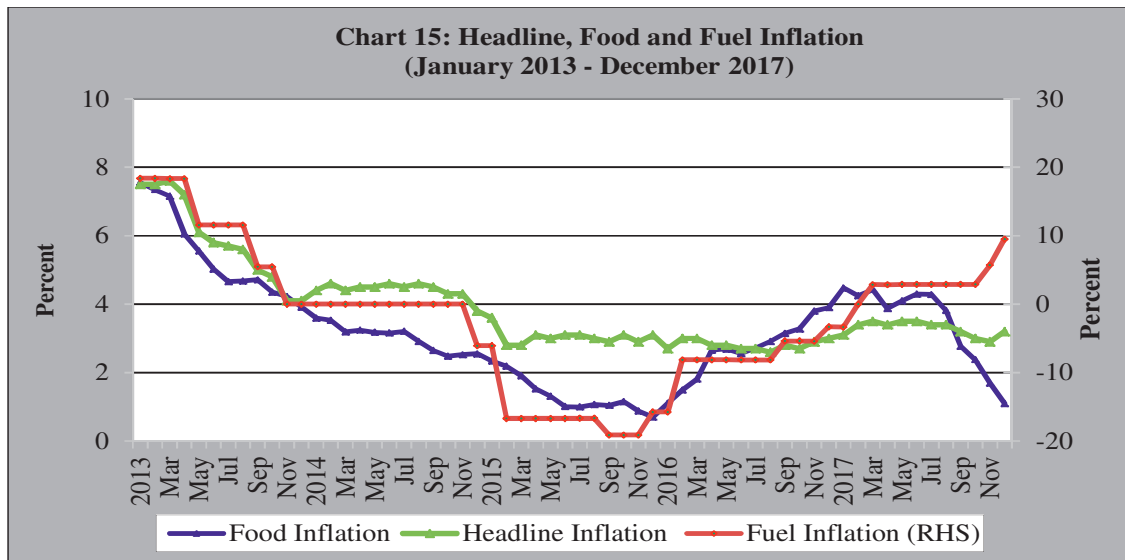


Source: Statistics Botswana and Bank of Botswana calculations.

- 3.18 Inflation was restrained by modest growth in personal incomes, the moderate increase in credit and the resultant subdued domestic demand. Moreover, on average, foreign inflation was low with benign pressure on domestic prices. The impact of the change in administered prices on inflation was similarly modest, adding 1.4 percentage points to inflation in 2017. The relative strength of the Pula exchange rate against the rand moderated the impact of relatively higher inflation in South Africa on domestic prices; therefore, domestic inflation was modest and stable in 2017.
- 3.19 Inflation increased from 3 percent in December 2016 to 3.2 percent in December 2017 and was within the Bank's 3 – 6 percent objective range (Chart 14). The rate of increase in prices was modest for most categories of goods and services. In particular, domestic fuel prices increased by 9.5 percent annually in December 2017, reflecting the upward adjustment of fuel prices in November and December, compared to the 3.3 percent decrease in the corresponding period in 2016. However, food price inflation decreased from 3.9 percent in December 2016 to 1.1 percent in December 2017 (Chart 15). Regarding core inflation measures, the 16 percent trimmed mean inflation increased from 2.5 percent in December 2016 to 2.9 percent in December 2017, while inflation excluding administered prices decreased from 3.7 percent to 2.3 percent in the same period.



Source: Statistics Botswana.



Source: Statistics Botswana.

4. GLOBAL OUTPUT AND INFLATION OUTLOOK

- 4.1 *Global GDP growth is forecast to increase to 3.9 percent in 2018, slightly higher than the estimated 3.7 percent for 2017. The projected improvement in global economic expansion is broad-based and reflects expected stronger growth in advanced countries, above 2 percent, supported by favourable global financial conditions and acceleration in demand, especially investment. Furthermore, it is expected that the USA tax reforms and the related fiscal stimulus will raise growth in the USA with possible positive spill-overs for trading partners. In emerging market and developing economies, GDP is expected to increase by 4.9 percent in 2018, from the estimate of 4.7 percent in 2017, accounting for half of the global expansion. However, the protectionist trade policies, potential build-up of financial vulnerabilities induced by easy financial conditions, geopolitical tensions, political uncertainty and adverse weather conditions present downside risks to global economic performance.*
- 4.2 *It is envisaged that, going forward, the focus for policymakers globally would be on implementation of structural and governance reforms to raise potential output through higher productivity and creation of employment, and ensuring a more inclusive growth. In addition, there is need to increase resilience, including through proactive financial regulation to avoid disruptive portfolio adjustments and capital flow reversals and, where needed, balance sheet repair and strengthening of fiscal buffers. This is particularly important in the prevailing environment of low interest rates and low market volatility²¹ (IMF January 2018 WEO Update).*
- 4.3 *Global inflationary pressures are forecast to be modest in the short-to-medium term, reflecting below-potential output. There are upward pressures on inflation emanating from the increase in commodity prices, including for oil, strengthening labour markets, as well as the expansionary monetary and fiscal policies. Thus, global inflation is*

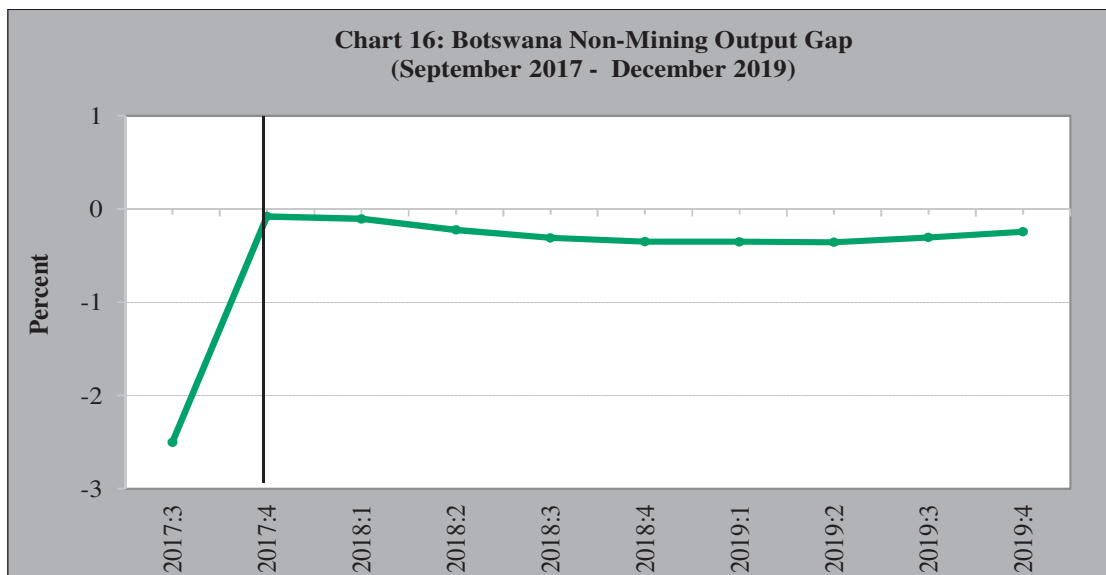
²¹ However, global markets fell in early February 2018 amid concerns that the Federal Reserve could raise interest rates faster than previously anticipated. This view was triggered by the US jobs data that showed higher wage growth and raised fears of higher inflation.

forecast to increase from 3.1 percent in 2017 to 3.3 percent in 2018. Given modest inflation and below-potential output, it is anticipated that monetary policy will remain accommodative in most economies, complemented by measures aimed at facilitating financial intermediation, while fostering resilience of the financial sector, to support economic activity.

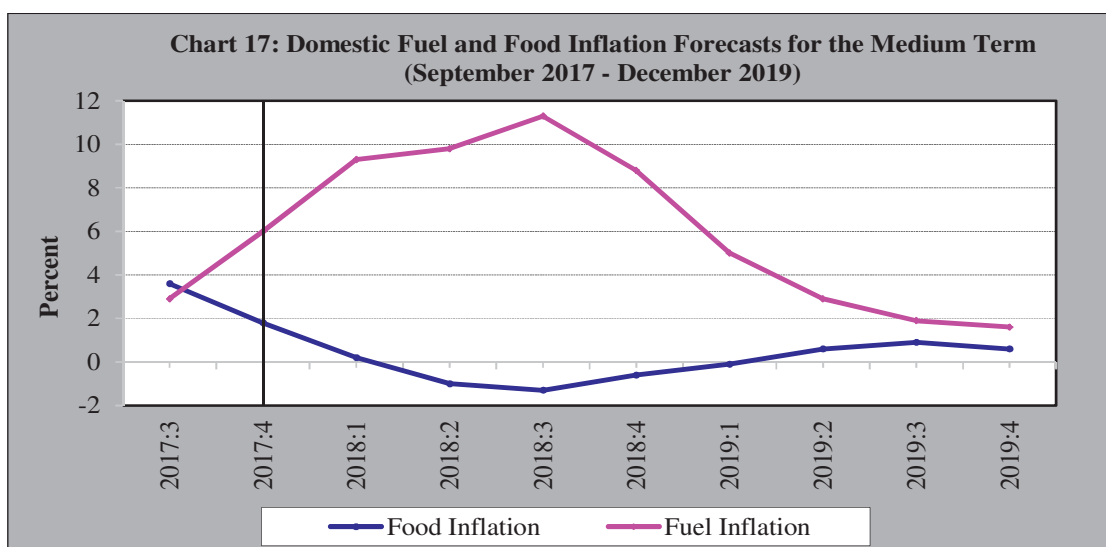
- 4.4 Inflation is forecast to be 1.8 percent in 2018 and 2.2 percent in 2019 in the SDR countries, and to decrease in South Africa from an average of 5.8 percent in 2017 to 5.3 percent in 2018 (and 5.5 percent in 2019).²² Thus, average inflation for trading partner countries is forecast to be in the range of 3 – 4 percent. Consistent with the policy objective of maintaining a stable REER of the Pula, an annual downward rate of crawl of the NEER of 0.3 percent will be implemented in 2018, as the projected domestic inflation is close to the lower end of the Bank's medium-term inflation objective and slightly higher than the trading partner countries' forecast average inflation. The Pula basket weights have been maintained at 45 percent for the South African rand and 55 percent for the SDR. Against this background, it is anticipated that the impact of external price developments on domestic inflation, through imported inflation and changes in the exchange rate, will be modest.
- 4.5 As indicated in the 2018 Budget Speech, domestic output growth is forecast to be 5.3 percent in 2018, higher than the estimate of 4.7 percent for 2017. However, domestic non-mining output will be below trend (Chart 16), influenced mainly by the restrained growth in personal incomes and modest expansion of economic activity in major trading partners. The Bank's September 2017 Business Expectations Survey (BES) indicates a marked improvement in the level of confidence among businesses in 2018, and is premised on the government's projection of improvement in economic performance during 2018.
- 4.6 For the 2018/19 fiscal year, total government expenditure is budgeted to increase by 13.9 percent, while revenue and grants are projected to increase by 12.4 percent, resulting in an anticipated budget deficit of P3.6 billion (1.8 percent of GDP). The deficit is expected to be temporary; hence, Government will finance it through a combination of drawing down on existing loans and cash balances at the Bank of Botswana. It is noted that government spending is more effective in supporting demand in cases where expenditure is mainly in the areas that generate a large multiplier effect, such as infrastructure development²³, improvements in human capital and inputs to production generally, as well as local procurement.

²² These forecasts are obtained from the IMF's WEO Database, October 2017.

²³ It is recognised, nevertheless, that there are leakages in the short-term because of the high import content of infrastructure development



Source: Bank of Botswana.

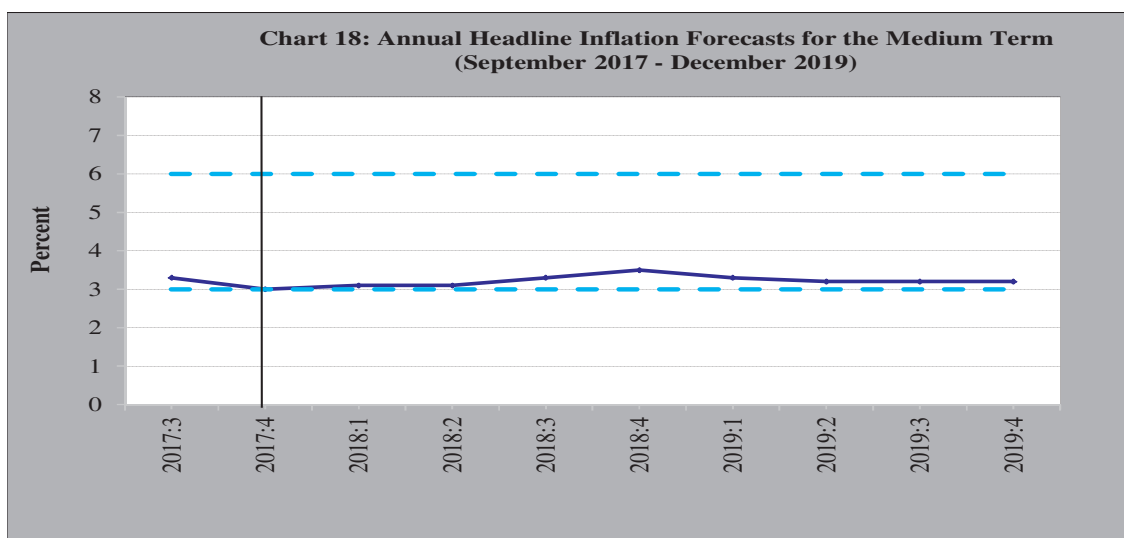


Source: Bank of Botswana.

4.7 *Headline inflation is projected to increase modestly in 2018, although remaining within the 3 – 6 percent objective range. It is anticipated that below-potential economic activity will dampen domestic inflationary pressures. The forecast also factors in a possible increase in some administered prices and the increase in school fees.²⁴ Meanwhile, as indicated in the September 2017 BES, businesses expect inflation to be 3.6 percent in 2018, which is within the Bank’s medium-term inflation objective range. Any additional substantial upward adjustment in administered prices and government levies and/or taxes, as well as any increase in international food²⁵ and oil prices beyond current forecasts, present upside risks to the inflation outlook. However, there are downside risks associated with modest global economic activity, technological progress and the potential fall in commodity prices.*

²⁴ *It is estimated that fees for private schools have increased on average by 8.2 percent in 2018 compared to 8.5 percent in 2017, contributing 0.11 percentage points to inflation in the first quarter of 2018. The fees used are for schools surveyed by Statistics Botswana.*

²⁵ *Poor rainfall, adverse weather, and persistence of the crop-eating army fallworm infestations in southern Africa are expected to result in below average crop and livestock production, which could result in higher food prices than currently anticipated.*



Source: Bank of Botswana.

5. 2018 MONETARY POLICY STANCE

- 5.1 *An evaluation of the determinants of inflation and financial stability suggests continuation of low inflation into the medium term, within a stable financial system. The current levels of growth in credit to both businesses and households are considered to be sustainable. Thus, the recent and prospective developments (positive inflation outlook and a stable financial environment) augur well for an accommodative monetary policy that supports productive lending to businesses and households. 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, to promote effective and growth supporting intermediation and durable financial stability. In this regard, for effective policy transmission, the Bank guides the determination of market interest rates that are consistent with the monetary policy stance, with respect to both the level and direction. The Bank also promotes effectiveness of the interbank market to address liquidity positions of individual banks. In addition, the Bank contributes to financial stability through prudential supervision of commercial banks and statutory banks and promotes, as well as participates in coordinated regulation of the broader financial system.*
- 5.2 *In 2018, the Bank's implementation of the exchange rate policy will entail a 0.3 percent downward rate of crawl of the NEER to stabilise the REER, given that inflation is projected to be around the lower end of the medium-term objective range of 3 – 6 percent. The crawling band exchange rate policy supports international competitiveness of domestic industries and contributes towards macroeconomic stability and economic diversification. Notionally, relatively high interest rates in South Africa and appreciation of the rand would induce related capital outflows. However, short-term capital movements are constrained by the paucity of listed securities (bonds and equities), relative illiquidity of financial instruments in the Botswana market, as well as uncertainty associated with a volatile rand exchange rate and higher South African inflation. Moreover, on its own, Botswana represents a stable macroeconomic environment with developmental and business opportunities for inward investment by expanding regional entities.*

6. CONCLUSION

- 6.1 *Domestic inflation was mostly within, but close to the lower end of the Bank's objective range of 3 – 6 percent in 2017, against the background of benign domestic demand pressures, modest wage growth and favourable foreign price developments. Meanwhile, global inflation is forecast to increase slightly as international oil prices rise modestly and economic activity expands.*
- 6.2 *It is projected that inflation in Botswana will remain low and stable in the medium term, consistent with the Bank's objective range. The Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low 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.*

Appendix

Table 1: Credit to Private Sector by Banks (Percent of GDP)

	2014	2015	2016
<i>United States of America</i>	50.2	51.6	53.0
<i>United Kingdom</i>	137.4	132.7	134.2
<i>India</i>	52.0	52.2	49.8
<i>China</i>	140.1	152.5	156.7
<i>Singapore</i>	130.9	127.0	132.9
<i>Chile</i>	78.5	81.1	80.8
<i>Rwanda</i>	20.5	20.9	21.0
<i>Mauritius</i>	98.7	102.7	96.3
<i>Namibia</i>	49.9	53.4	53.1
<i>Kenya</i>	34.1	34.3	32.8
<i>South Africa</i>	67.0	68.2	66.8
<i>Botswana</i>	31.0	33.8	31.6

Source: World Bank's World Development Indicators

- Notes: 1. Domestic credit to 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 2017 is not available.

MONETARY POLICY COMMITTEE MEETING DATES FOR 2018

<i>Date</i>	<i>Time</i>	<i>Venue</i>
<i>February 13</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>
<i>April 30</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>
<i>June 19</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>
<i>August 23</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>
<i>October 22</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>
<i>December 4</i>	<i>0830 hours</i>	<i>Bank of Botswana</i>

