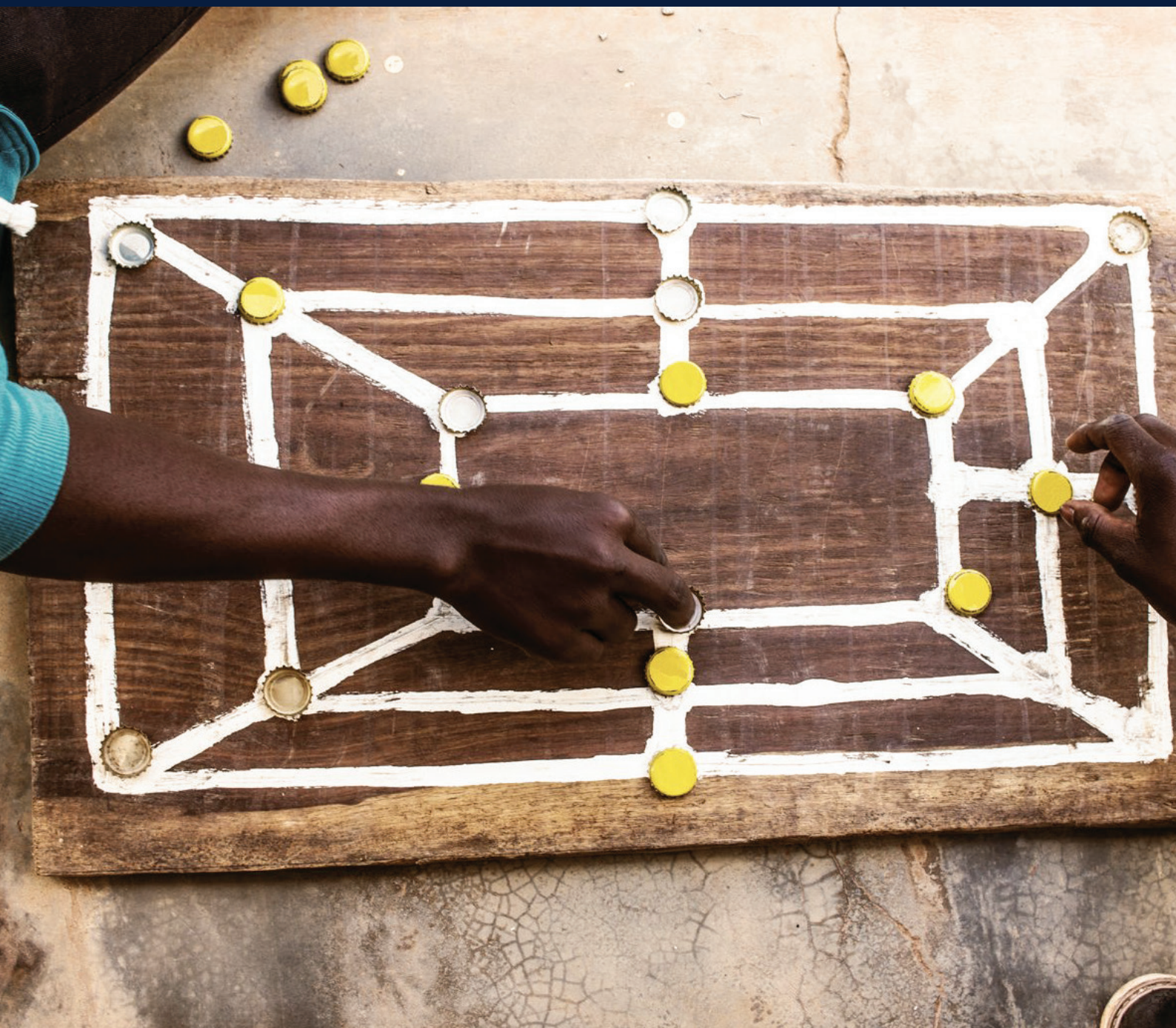
MONETARY POLICY REPORT

AUGUST | 2024



STRATEGIC INTENT STATEMENTS

VISION

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

MISSION

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

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

Monetary Policy Report
August 2024

17938, Khama Crescent, Gaborone, Botswana
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TABLE OF CONTENTS

1. PREFACE

1.1 Purpose of the report

The Monetary Policy Report (MPR) is the main medium through which the Bank of Botswana (the Bank) informs the public about the conduct of monetary policy on a regular basis. It serves to meet the public's expectation of a transparent and accountable central bank in fulfilling the monetary policy mandate set out in the Bank of Botswana (Amendment) Act, 2022.

The MPR reviews economic and inflation trends as well as policy performance. The report also assesses economic and financial developments that are likely to influence the inflation path in the medium term and, in turn, the Bank's future policy choices. In this respect, the MPR promotes an understanding of the conduct of monetary policy to anchor public expectations of a low, predictable and sustainable level of inflation.

1.2 Monetary policy framework

The primary objective of the Bank's monetary policy is to achieve price stability. For Botswana, price stability is defined as a sustainable level of annual inflation, as measured by the consumer price index (CPI), that is within the medium-term objective range of 3 – 6 percent. Consequently, as of April 2022, the Bank uses the Monetary Policy Rate (MoPR) to influence short-term market interest rates to steer the economy through business cycles, thus contributing to sustainable economic growth. The policy is also formulated with a view to safeguarding the stability of the financial system. The monetary policy framework is anchored on the crawling band exchange rate mechanism, which seeks to maintain a stable real effective exchange rate (REER), conducive for macroeconomic stability and the international competitiveness of domestic producers' tradeable goods and services. The Ministry of Finance (MoF), in consultation with the Bank, recommends parameters for the exchange rate mechanism (weights of currencies that comprise the Pula Basket and the rate of crawl) that determine the value of the Pula for approval by His Excellency, the President.

In evaluating policy options, the Bank implements a forward-looking monetary policy framework with a central role for a medium-term inflation forecast. The Bank sets the policy to direct projected movements of inflation towards the medium-term objective range, while considering the prevailing rate of crawl of the exchange rate mechanism, prospects for economic growth and developments relating to the stability of the financial system. The policy horizon is up to 3 years, and evaluated on a rolling basis, because monetary policy affects price developments with an estimated lag of up to four quarters. A proactive approach to setting policy necessitates a continuous review of the inflation outlook.

The monetary policy stance is signalled by the MoPR. To support this signal, the Bank conducts open market operations, which entail, primarily, auctioning of the Bank of Botswana Certificates (BoBCs) through a fixed rate full allotment system, engaging in repo/reverse repo transactions with commercial banks (primary dealers), and issuing a one-month BoBC paper to address structural liquidity issues and support the construction of the short-end of the yield curve (see Box 2 on page 24 for details on monetary policy implementation and operations framework).

1.3 Decision-making process

Monetary policy decisions are made by the Monetary Policy Committee (MPC). As of 14 February 2023, following the Bank of Botswana (Amendment) Act, 2022, the MPC comprises nine members: four external members appointed by the Minister of Finance and five internal members. The internal members are the Governor, two Deputy Governors, the head of department responsible for economic research and the head of department responsible for treasury operations. The MPC meets at least six times a year, or more if necessary, to determine the monetary policy stance. Meeting dates for the upcoming year are pre-announced.

1.4 Announcement of the monetary policy decision

The Governor announces the monetary policy decision shortly after each MPC meeting during a Press Briefing. The Press Briefing allows for interaction with members of the media and facilitates understanding of the Bank's economic analysis and policy stance. Following the briefing, a Press Release is issued to inform the public of the Committee's decision regarding the MoPR and the rationale behind the policy choice.

The first MPC meeting of the year, held in February, is accompanied by the issuance of the Monetary Policy Statement, through which the Bank reports on inflation trends, policy performance and the likely policy posture for the ensuing year. Subsequently, the MPR is produced for the April, August and October meetings and is published on the Bank's website (www.bankofbotswana.bw) within a week of the announcement of a policy decision.

BANK OF BOTSWANA'S MONETARY POLICY COMMITTEE

Mr. Cornelius Dekop
Governor (Chairman)

Dr. Kealeboga Masalila
(Deputy Governor)

Dr. Tshokologo Kganetsano
(Deputy Governor)

Mr. Innocent Molalapata
Director, Research and Financial Stability

Mr. Lesego Moseki
Director, Financial Markets

Professor Patricia Makepe
External Member

Dr. Pinkie Kebakile
External Member

Dr. Onkokame Mothobi
External Member

Dr. Taufila Nyamadzabo
External Member

2. EXECUTIVE SUMMARY

In 2024, monetary policy is being implemented in the context of projections for lower inflation in the short-to-medium term, due to base effects associated with upward adjustments in domestic fuel prices; impact of the reduction in domestic fuel prices on 21 December 2023; the projected appreciation of the Pula against the South African rand; and anticipated lower international commodity prices and trading partner countries' inflation. At the August 2024 meeting, the MPC projected the economy to continue to operate below full capacity into the medium term and, thus, not generate demand-driven inflationary pressures. Therefore, the state of the economy and the outlook for both domestic and external economic activity provided scope to ease monetary policy. Thus, the Bank decreased the MoPR by 25 basis points to 1.9 percent at the August 2024 MPC meeting, the second consecutive cut.

The Bank's formulation and implementation of monetary policy focuses on entrenching expectations of low, sustainable and predictable level of inflation through a timely response to price developments. The Bank remains committed to responding appropriately to preserving price stability without undermining economic activity.

In 2023, global economic performance and sentiment were adversely affected by the ongoing Russia Ukraine war, global monetary policy tightening and lingering effects of the COVID-19 pandemic, particularly the zero-COVID policies and lockdowns in China. In addition to the adverse impact on global economic activity, the war resulted in significantly elevated commodity prices and, therefore, inflationary pressures. In response, there was generalised increase in policy interest rates and, hence, tightening of financial conditions.

According to the International Monetary Fund (IMF)'s July 2024 World Economic Outlook (WEO) Update, the global economic outlook for 2024 was unchanged from the April projections. The anticipated growth is largely due to stronger-than-earlier forecast performance for the United States (US) and some large emerging market economies, particularly China and India. However, global output growth remains below the historical (2000 – 2019) annual average of 3.8 percent, on account of restrictive monetary policies and withdrawal of fiscal support measures introduced during COVID-19 pandemic, increasing geoeconomic fragmentation, extreme weather conditions and low underlying productivity growth. Thus, prospects for growth in both advanced and emerging market economies remain broadly restrained. Growth is forecast to remain constant at 1.7 percent between 2023 and 2024 for advanced economies, while it is expected to decrease marginally from 4.4 percent to 4.3 percent for emerging market economies, in the same period. Overall, global economic growth is forecast to decrease slightly from 3.3 percent in 2023 to 3.2 percent in 2024.

Global inflationary pressures are generally moderating in both advanced and emerging market economies, due to high borrowing costs associated with tight monetary policy implemented in 2023 and squeezed household budgets. Global inflation is estimated to have eased to 6.7 percent in 2023, from 8.7 percent in 2022. However, international oil prices increased and remained above pre-pandemic levels in the second quarter of 2024, influenced by OPEC and its allies' production cuts, as well as Saudi Arabia and Russia's decision to voluntarily increase their production cuts. Similarly, the United Nations' Food and Agriculture Organization (FAO) food price index increased in the second quarter of 2024, mainly attributable to reduced supply due to prolonged dry weather conditions, as well as increase in oil prices, an input in food production.

Domestically, headline inflation averaged 3 percent in the second quarter of 2024, down from 6.1 percent in the second quarter of 2023, mostly accounted for by the dissipating impact of the increase in fuel prices in 2023, as well as the slower growth in the prices for transport, particularly motor vehicle prices resulting from dealership discounts. Inflation is forecast to hover around the lower bound of the 3 – 6 percent objective range in the short term and be within the objective range on a sustained basis from the second quarter of 2025. The August 2024 inflation forecast has been revised downward compared to the June 2024 forecast.

Botswana's real gross domestic product (GDP) was stagnant (zero percent growth) in the twelve months to March 2024, down from 5.2 percent in the year to March 2023. The lacklustre performance is partly attributable to unfavourable global economic conditions, and geopolitical events, including the war in Ukraine, which have negatively affected demand for diamond jewellery and rough diamonds. Weak economic activity could also be attributable to slow and muted impact of economic transformation initiatives so far, continuance of low productivity and drought conditions. Further, the IMF revised downwards the projection for domestic economic expansion for 2024 from 3.6 percent to 1 percent, reflecting continued unfavourable global economic conditions and geopolitical events. Going forward, effective implementation of the economic transformation reforms would be supportive of economic activity through facilitating expansion of productive capacity, accelerating economic transformation and enhancing economic resilience in the medium term, although the prospects for significant economic growth are still not visible.

As at the end of June 2024, the foreign exchange reserves were estimated at P62 billion, a decrease of 6.2 percent from P66.1 billion in June 2023, which translated into 8.4 months of import cover of goods and services. The current account is estimated to have recorded a deficit of P2.5 billion in the first quarter of 2024, compared to an estimated surplus of P1.8 billion in the corresponding period in 2023.

Commercial bank credit growth decelerated to 3.9 percent in the year to June 2024, down from 6.3 percent in June 2023, driven by lower growth in lending to the business sector due to decreased overdraft credit utilisation and revolving credit facilities, as well as some loan repayments. Meanwhile, money supply (M2) rose by 18 percent in the year to May 2024, compared to 4.5 percent in May 2023.

For 2024, the Bank's implementation of the exchange rate policy entails the maintenance of an annual downward rate of crawl of 1.51 percent, with a view to enhancing domestic industry competitiveness. Consequently, the nominal effective exchange rate (NEER) of the Pula depreciated by 1.5 percent in the year to July 2024. Against the Pula basket currencies, the Pula depreciated by 2.6 percent against the Special Drawing Rights (SDR) and 0.1 percent against the South African rand. In the year to June 2024, the REER depreciated by 2.3 percent, due to the depreciation of the NEER (rate of crawl) and lower inflation in Botswana compared to trading partner countries.

3. RECENT ECONOMIC DEVELOPMENTS

3.1 Recent global economic developments

Global growth subdued

According to the IMF's July 2024 WEO Update, the global economy is estimated to have grown by 3.3 percent in 2023, down from an expansion of 3.5 percent in 2022 (Table 3.1). The lower growth for 2023 was partly due to the impact of central banks' policy rate hikes to combat inflation and associated tighter financial conditions across the globe, the negative spillover effects from the Russia Ukraine war, withdrawal of COVID-19 fiscal support measures, extreme weather events, weaker growth in some advanced economies (particularly the euro area), as well as subdued growth in China amid a property sector crisis.

Meanwhile, growth outturn for the first quarter of 2024 was stronger than expected, especially in China, due to the increase in domestic consumption and global demand. Conversely, Japan experienced a slowdown in growth due to temporary supply disruptions from a major plant shut down.

The US economic growth expanded

In the US, real output expanded by an annualised 2.8 percent in the second quarter of 2024, higher than the 1.4 percent growth in the first quarter of 2024. The higher output growth was driven by increased consumer spending, private inventory investment and non-residential fixed investment.

Euro area growth unchanged

In the euro area, GDP grew by 0.3 percent in the second quarter of 2024, the same as in the first quarter, beating market expectations of a marginal 0.2 percent expansion. Despite this, growth remained subdued because of relatively high inflation and borrowing costs, as well as weak external demand. Among the bloc's largest economies, Spain led with an output growth of 0.8 percent, followed by France and Italy at 0.3 percent and 0.2 percent, respectively, while Germany contracted by 0.1 percent, in the same period.

United Kingdom (UK) growth slowed slightly

The UK's GDP expanded by 0.6 percent in the second quarter of 2024, from a 0.7 percent growth in the first quarter of 2024, in line with market expectations. This expansion was driven by services and household consumption.

Emerging markets' growth improved

Output growth in emerging markets improved in the first quarter of 2024, primarily due to higher growth in China, as well as lower global commodity prices, particularly for food and fuel. The improvement in growth for the economic group also indicates governments' efforts to stimulate economic activity.

China's economy expanded annually by 5.3 percent in the first quarter of 2024, slightly higher than the 5.2 percent in the fourth quarter of 2023, and exceeded the market expectation of 5 percent growth. Growth in the first quarter of 2024 was supported by spending related to the Lunar New Year Festival. This was the largest yearly expansion since the second quarter of 2023. However, the Chinese economy slowed down to 4.7 percent in the second quarter of 2024 due to a persistent property downturn, weak domestic demand, falling yuan and trade frictions with the West.

The Indian economy grew, by 7.8 percent year on year in the first quarter of 2024, compared to an expansion of 8.4 percent in the fourth quarter of 2023, surpassing the market expectation of 6.7 percent. Growth in the first quarter of 2024 was driven by acceleration of output in manufacturing, construction, public administration, defence, other services and mining sectors.

South African economy contracted

Regionally, output growth in South Africa remained subdued, contracting, by 0.1 percent quarter on quarter in the first quarter of 2024, down from a revised growth of 0.3 percent in the fourth quarter of 2023. Most economic sectors experienced decline in output growth due to power cuts, with manufacturing (-1.4 percent), mining (-2.3 percent) and construction (-3.1 percent) contributing the most to the poor economic performance.

Table 3.1: Growth Estimates and Projections

	Estimate		Projection	
	2022	2023	2024	2025
Global	**3.5**	**3.3**	**3.2**	**3.3**
Advanced economies	**2.6**	**1.7**	**1.7**	**1.8**
USA	1.9	2.5	2.6	1.9
Euro area	3.4	0.5	0.9	1.5
UK	4.3	0.1	0.7	1.5
Japan	1.0	1.9	0.7	1.0
EMDEs	**4.1**	**4.4**	**4.3**	**4.3**
China	3.0	5.2	5.0	4.5
Brazil	3.0	2.9	2.1	2.4
India	7.0	8.2	7.0	6.5
Russia	-1.2	3.6	3.2	1.5
South Africa	1.9	0.7	0.9	1.2
Botswana	**5.5**	**2.7**	**1.0 (4.2)**	**4.6 (5.4)**

Source: IMF WEO July 2024 Update and MoF for Botswana.
Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts by the MoF.

Global commodity prices

Rough diamond prices decreased in the second quarter of 2024

The global rough diamond price index decreased by 2.3 percent from 149.5 points in the first quarter of 2024 to 146.1 points in the second quarter of 2024. This decline was mainly driven by reduced demand, influenced by high inflation and interest rates. In addition, the demand for natural diamonds has been impacted by increased competition from lab-grown diamonds, which are gaining popularity as a substitute product. Lab grown diamonds are expected to make up around 10 percent of the total diamond market by 2030, up from nearly zero percent in 2015. The global rough diamond price index averaged 138.9 points in July 2024.

Polished diamond prices remained constant in the first quarter of 2023

The global polished diamond price index remained stable at 109 points between the fourth quarter of 2023 and the first quarter of 2024, following a significant decrease from 121.6 points in the third quarter of 2023, amid a rise in inventory levels due to weaker demand and a challenging global economic outlook. The global polished diamond price index averaged 107 points in May 2024.

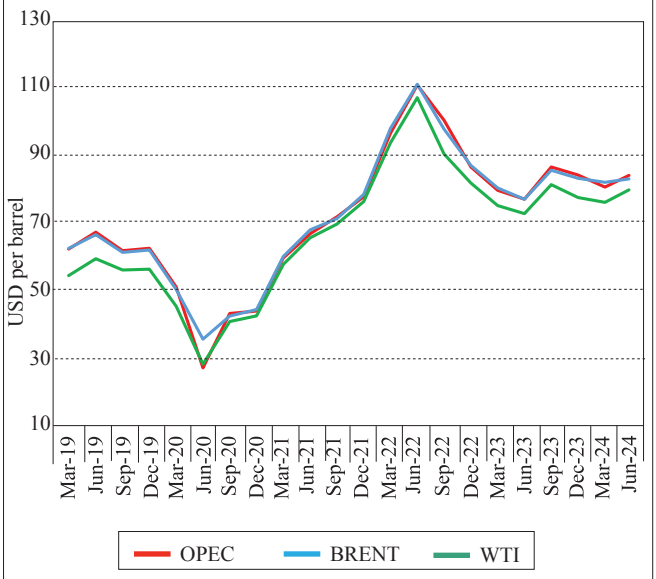
Oil prices increased in the second quarter of 2024

International oil prices increased in the second quarter of 2024 compared to the first quarter of 2023, remaining above pre-pandemic levels (Chart 3.1). The price of the OPEC reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 4.3 percent, 2.1 percent and 4.9 percent, from an average of USD81.77 per barrel, USD83.06 per barrel and USD77.01 per barrel in the first quarter of 2024 to an average of USD85.32 per barrel, USD84.84 per barrel and USD80.80 per barrel, respectively, in the second quarter of 2024.

The increase in oil prices was, in part, due to OPEC and its allies' production cuts, as well as Saudi Arabia and Russia's decision to voluntarily increase their production cuts. In addition, continued attacks on commercial shipping vessels by Houthis rebels in the Red Sea, linked to the Israel-Hamas war, also contributed to the higher oil prices.

Similarly, international oil prices increased month on month, in July 2024. The increase in oil prices was mainly driven by the escalation of tensions in the Middle East, continued draw down in US crude oil inventories and OPEC and its allies' production cuts.

Chart 3.1: International Oil Prices



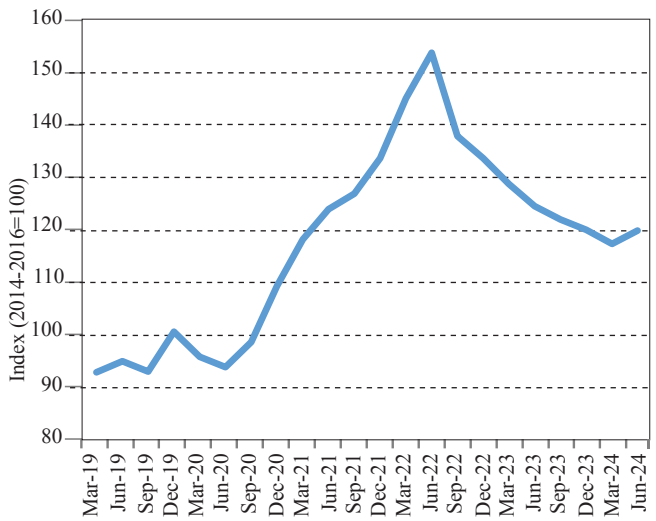
Source: Bloomberg

Food prices increased in the second quarter of 2024

According to FAO, the global food price index increased by 2 percent from an average of 117.6 points in the first quarter of 2024 to an average of 120.2 points in the second quarter of 2024 (Chart 3.2). The increase was due to higher prices of soy and sunflower oil (driven by higher demand from the biofuel sector in the US and declining supply of soy and sunflower oil from the Black Sea region), increased milk powder prices (due to higher demand and seasonally lower milk production in Australia), higher pork prices (due to increased demand), and higher sugar prices (because of prolonged dry weather conditions in India and Thailand). Furthermore, the increase in oil prices also contributed to higher food prices in the second quarter, as oil is a key input in food production.

In contrast, the global food price index decreased marginally by 0.2 percent to an average of 120.8 points between June and July 2024, owing to the decrease in the price index of cereals, attributable to increased seasonal harvests in major producer countries, such as Canada and the US, which outweighed increases in the price indices for vegetable oil, meat products and sugar, while the dairy index was almost unchanged.

Chart 3.2: Food Price Index

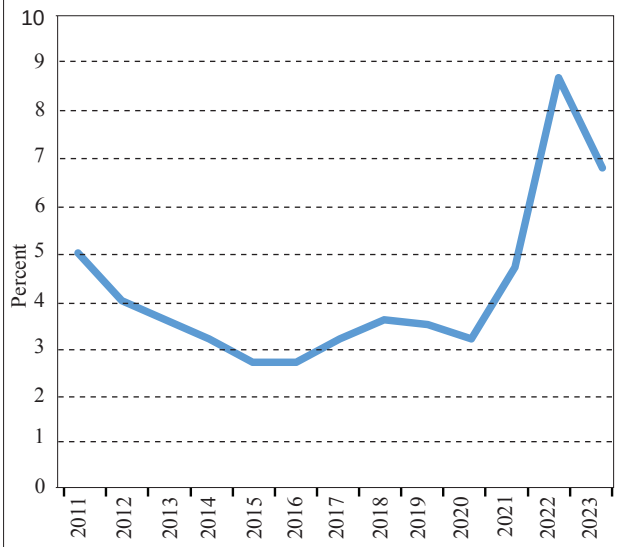


Source: FAO

Global inflation eased in the second quarter of 2024

Globally, inflationary pressures eased in the second quarter of 2024[1], due to tight monetary policy and squeezed household budgets. Inflation for advanced economies decreased from 4.3 percent in the first quarter of 2024 to 4.2 percent in the second quarter. Similarly, inflation for emerging market economies decreased from 7.9 percent to 7.6 percent in the same period. Global inflation is estimated to have decreased from 8.7 percent in 2022 to 6.7 percent in 2023 (Chart 3.3).

Chart 3.3: Global Inflation

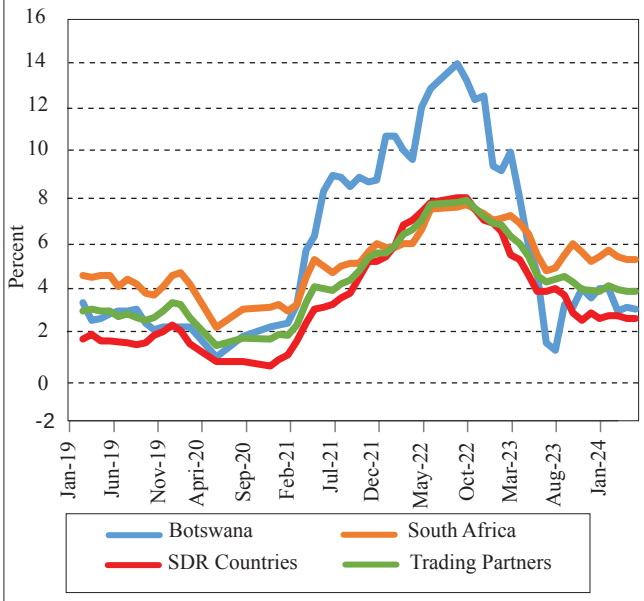


Source: IMF July 2024 WEO Update

In South Africa, headline inflation decreased slightly from 5.4 percent in the first quarter of 2024 to 5.2 percent in the second quarter of 2024, remaining within the South African Reserve Bank (SARB)'s target range of 3 – 6 percent. Meanwhile, headline inflation decreased from 5.1 percent in June to 4.6 percent in July 2024.

The average trade-weighted inflation for Botswana's trading partners decreased slightly from 3.9 percent in the first quarter of 2024 to 3.7 percent in the second quarter (Chart 3.4). Meanwhile, trade-weighted inflation for Botswana's trading partners decreased slightly from 3.8 percent in May 2024 to 3.6 percent in June 2024.

Chart 3.4: Botswana Inflation and International Inflation



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

Divergent monetary policy stance across the globe

In recent policy reviews, majority of central banks maintained their monetary policy rates to support economic activity (Table 3.2). The US Federal Open Market Committee (FOMC) maintained the target policy rate at 5.25 – 5.50 percent in July 2024, for the eighth consecutive time, reflecting policymakers' dual focus on returning inflation to the 2 percent target, while also promoting maximum employment. The FOMC indicated that it will carefully assess incoming data and the evolving outlook before any adjustments to the policy rate. In addition, the Committee will continue to reduce the speed of its quantitative easing.

The Bank of England (BoE) reduced the policy rate by 25 basis points to 5 percent in July 2024, marking the first cut in four years and aligning with a small portion of the market's expectations, amid signs of easing inflationary pressures. However, the BoE stated that it would move cautiously in loosening monetary policy further until there is certainty that inflation will sustainably remain at the 2 percent target. The BoE anticipates inflationary persistence to fade away over the next few years, owing

1 The quarterly inflation estimates are sourced from Bloomberg.

to the restrictive stance of monetary policy. The BoE acknowledged that the restrictive stance of monetary policy was weighing on activity in the real economy.

The Bank of Japan (BoJ) increased the key short term interest rate by 15 basis points to 0.25 percent in July 2024, the second increase this year, to curb the weakening of the Japanese Yen (JPY) against the US dollar. The BoJ indicated that it would reduce the pace of monthly bond purchases from the current pace of around JPY6 trillion to JPY3 trillion in January-March 2026 in pursuit of a more normal monetary policy. In an effort to lower its USD5 trillion balance sheet and gradually withdraw from the bonds market, the BoJ has offered to buy JPY400 billion of 5 and 10-year government bonds at each of its operations, removing the ongoing offer range of JPY400-550 billion.

The European Central Bank (ECB) maintained the refinancing rate, lending and deposit rate at 4.25 percent, 4.50 percent and 3.75 percent, respectively, in July 2024, in line with market expectations and following a 25 basis points decrease in June 2024. The ECB judged that although inflation fell in June and the inflation outlook had improved markedly, domestic price pressures and services inflation remained high, with overall inflation expected to remain above the 2 percent target into 2025. Consequently, the Governing Council reaffirmed its determination to ensure that inflation returned to target over the medium term, and that it will keep interest rates sufficiently restrictive for an extended period until the target is achieved. The Council emphasised that future policy decisions will be dependent on economic data, underlying inflation trends and the effectiveness of monetary policy.

In emerging market economies, the Central Bank of Brazil (CBB) maintained the policy rate at 10.5 percent in July 2024, following seven consecutive cuts, against the backdrop of a challenging global environment marked by uncertainty over US monetary policy and global inflation trends. The CBB observed that economic indicators showed unexpected resilience, although the decline in consumer inflation had slowed down while core inflation remained above target. However, the CBB highlighted risks, such as unanchored inflation expectations and resilient services inflation, alongside potential downside risks from the global economic slowdown. Consequently, the CBB emphasised that monetary policy would continue being contractionary for a sufficient time.

The Central Bank of Russia (CBoR) increased the key policy rate by 200 basis points to 18 percent in July 2024, as inflation accelerated, and signalled potential further rate hikes to achieve its inflation target. The CBoR stated that domestic demand continued to outstrip the current capacity levels that the Russian economy can achieve, driving an imbalance between aggregate supply and demand, and lifting inflation risks.

In August 2024, the People's Bank of China (PBoC) maintained the one year and five-year Loan Prime Rates (LPR) at 3.35 percent and 3.85 percent, respectively, to support a fragile economic recovery.

The SARB maintained the repo rate at 8.25 percent for the seventh consecutive meeting in July 2024 to anchor inflation expectations more firmly around the mid-point of the 3 – 6 percent target range. The SARB considered the policy rate to be restrictive in light of elevated inflation expectations and associated risks. Despite an improved inflation outlook, the SARB considered risks to the inflation outlook to be on the upside and indicated that, high inflation expectations required that they deliver on the target sooner, to re anchor expectations. The SARB emphasised that future policy decisions will be data-dependent and sensitive to the balance of risks to the inflation outlook.

In August 2024, the Reserve Bank of India (RBI) maintained the policy rate at a relatively high rate of 6.5 percent for the nineth consecutive meeting, to ensure inflation returns to the 4 percent medium-term target while supporting economic growth. The RBI projected headline inflation to average 4.5 percent in 2024, unchanged from the previous projection. Additionally, the RBI judged it to be appropriated for monetary policy to remain disinflationary and focused on withdrawal of the accommodative policy stance to ensure that inflation progressively reaches the midpoint (4 percent) of the 2 – 6 percent inflation target.

Table 3.2: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting	Likely Policy Decision at the Next Meeting
Bank of Botswana	August 2024	1.9	Decreased by 25 basis points	No indication of the direction of policy.
SARB	July 2024	8.25	No change	With the latest inflation projection (July 2024) showing that inflation is expected to remain within target and revert to the mid-point of the target range in 2025, the policy rate is likely to remain unchanged. However, the SARB is expected to respond to new data and risks.
US Federal Reserve	July 2024	5.25–5.50	No change	In assessing the appropriate stance of monetary policy, the FOMC reinforced that it does not foresee a hike as likely and believes that the current policy is sufficiently restrictive to achieve the 2 percent inflation target.
BoE	July 2024	5.25	Decreased by 25 basis points	The BoE stated that it would move cautiously in loosening monetary policy further until they are more certain that inflation will sustainably remain at the 2 percent target.
ECB	July 2024	4.25	No change	Likely to maintain policy stance sufficiently restrictive for an extended period until it achieves the 2 percent target despite the decline in inflationary pressures.
BoJ	July 2024	0.25	Increased by 10 basis points	The BoJ's future conduct of monetary policy will depend on developments in economic activity and prices as well as financial conditions going forward. Given that real interest rates are at significantly low levels, if the outlook for economic activity and prices presented in the July Outlook Report will be realised, the BoJ will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.
PBoC	August 2024	3.35	No change	The PBoC is committed to keeping liquidity adequate at a reasonable level, credit growing reasonably at a stable pace and ensure that the growth of money supply and the aggregate financing to the real economy are generally in line with the nominal GDP growth. Given this commitment, the PBoC is likely to keep the LPR low until the economy has recovered.
Brazil	July 2024	10.50	No change	The Central Bank highlighted that the uncertain global environment and the domestic developments, marked by resilient economic activity, an increase in its own inflation projections and deanchored inflation expectations, require diligent monitoring and even greater caution. Therefore, the Selic rate is likely to be maintained at a high level of 10.5 percent for sufficiently long until inflation reaches its target.
India	August 2024	6.50	No change	RBI remains focused on bringing down inflation to the 4 percent target going forward, while supporting growth. Thus, the policy rate is likely to remain unchanged at the relatively high level, with the first cut projected for December 2024.
Russia	July 2024	18.00	Increased by 200 basis points	Noted that inflation had accelerated, with risks judged to be on the upside. Signalled that it might increase the policy rate further, thus keeping borrowing costs at a restrictive level for a long period to achieve its inflation target. Likely to increase policy rate at next meeting.

Source: Various central banks' websites.

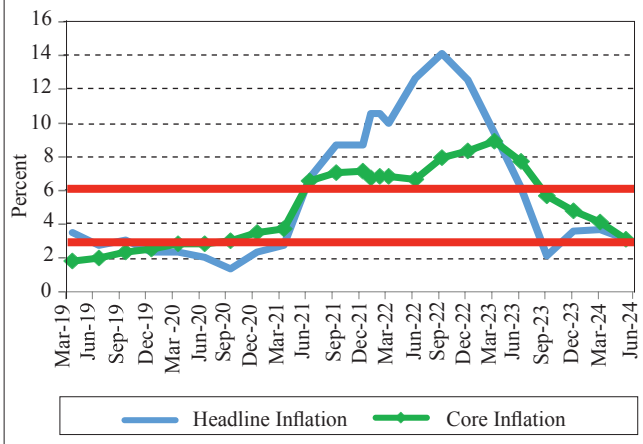
3.2 Domestic inflation environment

Headline inflation decreased in the second quarter of 2024

Headline inflation decreased in the second quarter of 2024, averaging 3 percent compared to 6.1 percent in the second quarter of 2023 (Chart 4.1 and Table 4.1). The decrease in inflation in the second quarter of 2024 was mainly due to subdued demand, the dissipating impact of the increase in fuel prices in 2023[2], as well as the slower growth in the prices for transport, particularly motor vehicle prices resulting from dealership discounts.

Headline inflation increased from 2.8 percent in June to 3.7 percent in July 2024, reverting to within the medium-term objective range of 3 – 6 percent, and was significantly higher than the 1.5 percent in July 2023. The increase in inflation between June and July 2024 was mainly due to base effects associated with the decrease in domestic fuel prices effected 21 June 2023, which subtracted 0.59 percentage points from headline inflation.

Chart 3.5: Botswana Headline and Core Inflation

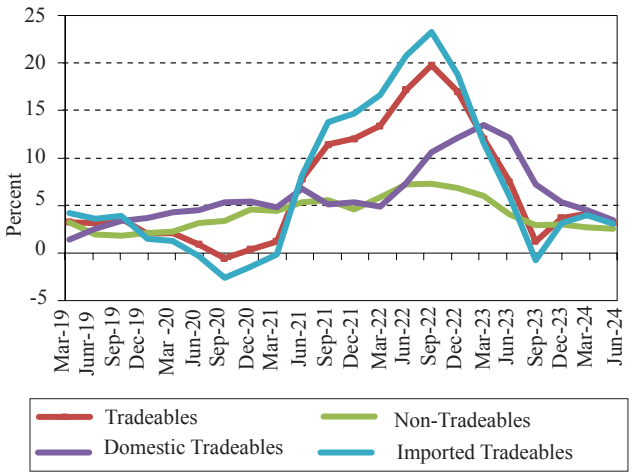


Source: Statistics Botswana and Bank of Botswana
Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic tradeables and imported tradeables decreased in the second quarter of 2024

Inflation for domestic tradeables decreased from an average of 11.9 percent in the second quarter of 2023 to an average of 3.5 percent in the second quarter of 2024 (Chart 4.2), due to a broad-based deceleration in food prices. Imported tradeables inflation decreased from an average of 5.9 percent to an average of 3.1 percent in the same period, due to deceleration in vehicle prices mainly on account of dealership discounts, the decrease in domestic fuel prices and broad based decrease in prices of imported goods. As a result, all tradeables inflation decreased from an average of 7.4 percent in the second quarter of 2023 to an average of 3.2 percent in the second quarter of 2024. Inflation for non-tradeables also decreased from an average of 4.1 percent to 2.6 percent in the same period. In July 2024, domestic tradeables, imported tradeables inflation and all tradeables inflation increased to 3.7 percent, 4.9 percent and 4.6 percent, respectively, while non-tradeables inflation decreased to 2.5 percent.

Chart 3.6: Inflation for Tradeables and Non-Tradeables



Source: Statistics Botswana

Generally, non-tradeables inflation has been on a downward trend since June 2022 and domestic tradeables inflation has decreased since April 2023. The reduction in non-tradeables inflation was mainly due to the base effects associated with the upward adjustment in administered prices in 2022 and 2023, while domestic tradeables fell due to restrained growth in food prices, partly influenced by lower oil prices.

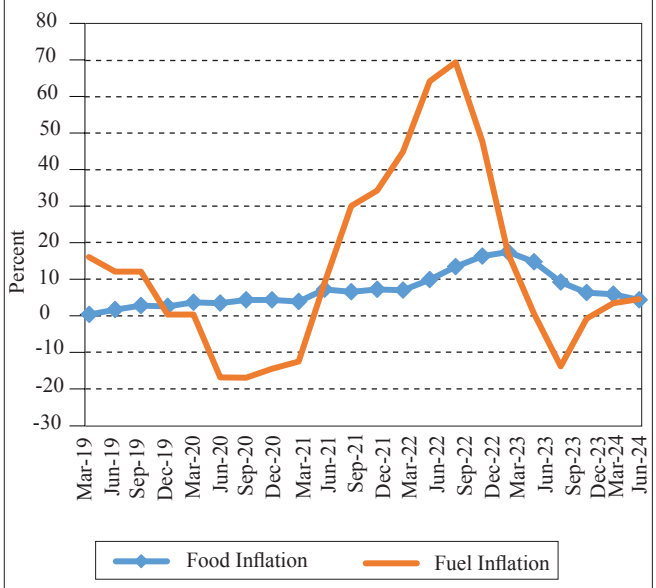
Core inflation measures also decreased in the second quarter of 2024

The trimmed mean inflation (CPITM) decreased to 2.8 percent in the second quarter of 2024, from 5.6 percent in the second quarter of 2023, while inflation excluding administered prices (CPIXA) averaged 2.9 percent from 7.7 percent (Table 4.1), due to the decline in prices of food and non alcoholic beverages, as well as deceleration in prices of vehicles. Similarly, inflation excluding food and fuel[3] (CPIXFF) averaged 2.6 percent in the second quarter of 2024, lower than the 5.6 percent recorded in the corresponding quarter in 2023, due to the decrease in vehicle prices, mainly on account of dealership discounts, in the same period. In July 2024, CPITM and CPIXA were 3.5 percent and 2.9 percent, respectively.

2 Increase in fuel prices had added 2.35 percentage points to inflation in 2023.

3 Food inflation decreased from an average of 5.6 percent in the first quarter of 2024 to an average of 4.1 percent in the second quarter of 2024, while fuel inflation increased from an average of 3.3 percent to an average of 4.3 percent in the same period. Food inflation was unchanged at 4 percent between May 2024 and June, while fuel inflation was constant at 4.3 percent in the same period (Chart 4.3).

Chart 3.7: Food and Fuel Inflation



Source: Statistics Botswana and Bank of Botswana

Table 3.3: Annual Price Changes for Categories of Goods and Services (Percent)

Category of commodities	Basket Weights	July 2024	Q2 2024	Q2 2023
Food and non-alcoholic beverages	13.6	4.4	4.1	14.6
Alcoholic beverages and tobacco	4.3	5.1	4.9	4.6
Clothing and footwear	6.0	4.1	4.4	5.9
Housing, water, electricity, gas and other fuels	17.5	0.6	0.4	1.5
Furnishing, h/h equipment and routine maintenance	4.9	2.5	3.4	6.5
Health	3.4	1.3	0.8	3.7
Transport	23.4	5.5	2.5	5.6
Communications	6.9	0.4	0.4	2.5
Recreation and culture	2.8	1.3	1.9	2.2
Education	4.6	1.5	1.5	5.2
Restaurants and hotels	3.7	3.4	4.1	6.5
Miscellaneous goods and services	9.0	7.8	8.4	9.2
Annual Inflation (All items)	**100.0**	**3.7**	**3.6**	**9.4**
CPITM		3.5	2.8	5.6
CPIXA		2.9	3.0	7.7

Source: Statistics Botswana and Bank of Botswana calculations

3.3 Recent domestic economic developments

GDP growth declined in 2024Q1

Real GDP growth was stagnant (zero percent growth) in the twelve months to March 2024, down from the 5.2 percent increase in the year to March 2023 (Chart 3.8). The lacklustre performance is partly attributable to unfavourable global economic conditions, and geopolitical events, including the war in Ukraine, which have negatively affected demand for diamond jewellery and rough diamonds. Weak economic activity could also be attributable to slow and muted impact of economic transformation initiatives so far, continuance of low productivity and drought conditions. Mining sector GDP contracted by 6.5 percent in the year ending March 2024, a sharp decline from a growth of 5.1 percent recorded in the year to March 2023. This was due to the decline in output of most sub-sectors, led by diamond mining, which contracted by 6.8 percent, compared to a growth of 4.4 percent in the previous period. Diamond market conditions also affected performance of the Diamond Traders sector (which is part of the non-mining GDP in the national accounts), which contracted substantially (42.4 percent). Furthermore, coal production contracted by 24.2 percent in the year ending March 2024, from a significant growth of 24.6 percent in the previous period, attributable to the reduced demand for coal by Botswana Power Corporation (BPC) due to Morupule B power plant remediation, and maintenance of a boiler.

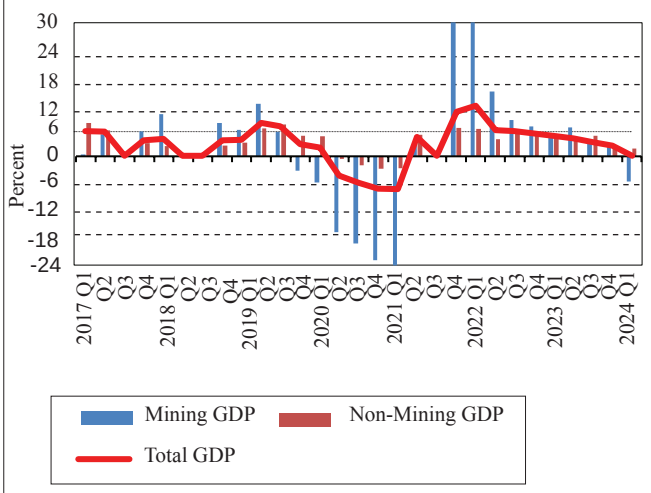
Furthermore, output of mining of gold and other metal ores also contracted due to resource depletion, as the lifespan of the Mupane Mine approaches the end, while plant care and maintenance at the Sowa Pan Mine that took place in the second quarter of 2023, led to a deceleration in the output of the mining of soda ash and salt. Meanwhile, output of other mining sub sectors, such as mining support service activities increased in the year ending March 2024.

Non-mining GDP growth decelerated to 1.9 percent in the twelve-month period to March 2024, down from a growth of 5.2 percent in the corresponding period in 2023. The deceleration in non-mining GDP growth was mainly due to contraction in the output of the Diamond Traders. In addition to the Diamond Traders sector, the deceleration in output growth was most notable with respect to Water and Electricity, Manufacturing, Construction, Information and Communication Technology, Wholesale and Retail, Transport and Storage, Education and Other Services sectors.

Thus, while global developments are a significant influence on domestic economic performance, it is also notable that sluggish economic activity occurs despite the economic transformation drive and resultant commitment of resources and policy initiatives, as well as largely accommodative monetary policy. Thus, the need for concerted efforts to accelerate traction of transformation initiatives and impact of resource commitments.

Meanwhile, Statistics Botswana reported a contraction of 5.3 percent in real GDP in the year to March 2024[4], compared to an increase of 5.3 percent in the corresponding period in 2023.

Chart 3.8: GDP Growth Rates



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

In terms of GDP by expenditure, Government Final Consumption (GFC) grew by 5.2 percent in the twelve-month period to March 2024, compared to 2.8 percent in the corresponding period in 2023. The accelerated growth in GFC was largely due to a faster growth in the output of individual consumption and collective consumption[5], which rose to 11.4 percent from 4.6 percent, and 3.5 percent from 2.4 percent, respectively, in the review period.

Household Final Consumption (HFC) recorded a growth of 4.8 percent in the 12-month period ending March 2024, compared to 4 percent in the corresponding period ending in March 2023. The expansion in HFC was due to an increase in both the non-profit institutions serving households (NPISH) and Household consumption expenditure.

Gross Fixed Capital Formation (GFCF) also saw an improvement, increasing by 4.4 percent in the year to March 2024, compared to a lower growth of 0.4 percent observed in the previous year. The increase in GFCF was due to the expansion in investment in transport equipment, plant, machinery and equipment, and household consumption expenditure.

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

	2023 Q1	2023 Q4	2024 Q1
Total GDP	**5.2**	**2.7**	**0.0**
By Sector:			
Mining and Quarrying	5.1	3.1	-6.5
Non-Mining	5.2	2.6	1.9
Agriculture, Forestry & Fishing	0.7	1.3	1.2
Manufacturing	6.1	1.9	1.1
Water and Electricity	51.8	-16.9	-22.7
Construction	3.5	3.3	2.7
Wholesale & Retail	5.8	4.5	4.1
Diamond Traders	23.4	-29.4	-42.4
Transport and Storage	5.2	3.8	3.3
Accommodation & Food Services	4.2	4.7	4.4
Information & Communication Technology	5.8	3.9	3.2
Finance, Insurance & Pension Funding	2.5	5.6	5.7
Real Estate Activities	4.0	5.4	5.2
Professional, Scientific & Technical Activities	3.2	4.9	5.3
Administrative & Support Activities	3.4	4.6	4.6
Public Administration & Defence	4.1	5.1	5.4
Human Health & Social Work	4.1	3.7	4.1
Education	5.5	5.2	4.7
Other services	2.4	3.5	3.3
By Type of Expenditure:			
Government Final Consumption	2.8	4.0	5.2
Household Final Consumption	4.0	5.6	4.8
Gross Fixed Capital Formation	0.4	4.2	4.0
Exports of Goods and Services	-4.2	-13.8 (-16.2)	11.7
Imports of Goods and Services	-14.4	-7.4 (-9.9)	0.7

Source: Statistics Botswana and Bank of Botswana Calculations.
Note: Figures in brackets are earlier estimates which have now been revised.

4 Calculated as the current quarter over the corresponding quarter in the previous year.

5 Collective consumption expenditure comprises the expenditures made by general government on services that benefit households collectively, while individual consumption expenditure includes expenditure whose real consumer is identifiable and the ultimate benefit falls to households e.g., education and healthcare.

Diamond production decreased in the second quarter of 2024

Debswana Diamond Company produced 4.7 billion carats of diamonds in the second quarter of 2024, a 19.2 percent decrease from 5.8 billion carats produced in the corresponding period in 2023, given unfavourable global economic conditions, and geopolitical events. Meanwhile, Debswana's production target for 2024 is set at 20.7 million carats (23.7 million carats in 2023), while production guidance for the larger De Beers Group is at 29 – 32 million carats, subject to trading conditions.

Production at Lucara Diamond Corporation (Karowe Mine) increased by 12.2 percent to 93 560 carats in the first quarter of 2024, from 83 374 carats produced in the corresponding period in 2023. The increase was mainly attributable to the increased number of special stones (greater than 100 carats in weight).

Budget surplus recorded in the first quarter of the 2023/24 fiscal year.

Government budget was in a surplus of P5.2 billion in the first quarter of the 2023/24 fiscal year (Table 3.5). The surplus was mainly due to good revenue performance, driven by larger-than-expected mineral receipts, reflecting ramped up production to fill the supply gap left by the G7 and the United States sanctions on Russian diamonds. Regarding other major revenue streams, the Southern African Customs Union (SACU) revenues and Bank of Botswana revenues were generally in line with the 2023/24 budget. Total government expenditure and net lending was P19.2 billion, lower than the P21.8 billion anticipated in the budget.

For the 2023/2024 fiscal year, it is expected that the deficit will be P7.1 billion (2.6 percent of GDP). Recurrent spending included the 5 percent salary increment for public service employees effected in April 2023. Specific to development spending, the budget was used to fill infrastructure gaps (implementation of delayed projects from the previous financial year) in order to unlock economic growth. Consequently, the projection for expenditure and net lending has been revised upwards by 1.6 percent to P88.8 billion, which is equivalent to 31.8 percent of GDP (thus slightly above the fiscal rule limiting total expenditure to 30 percent of GDP). The increase in expenditure and net lending is lower than the change in the consumer price index, hence not inflationary.

Table 3.5: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2022/23 Q1	20 438	19 793	645
2022/23 Q2	17 264	18 287	-1 023
2022/23 Q3	17 670	16 386	1 283
2022/23 Q4	18 727	19 623	-896
2023/24 Q1	24 389	19 215	5 173

Source: Cash Flow Unit, Ministry of Finance

Labour force and wage developments trends[6]

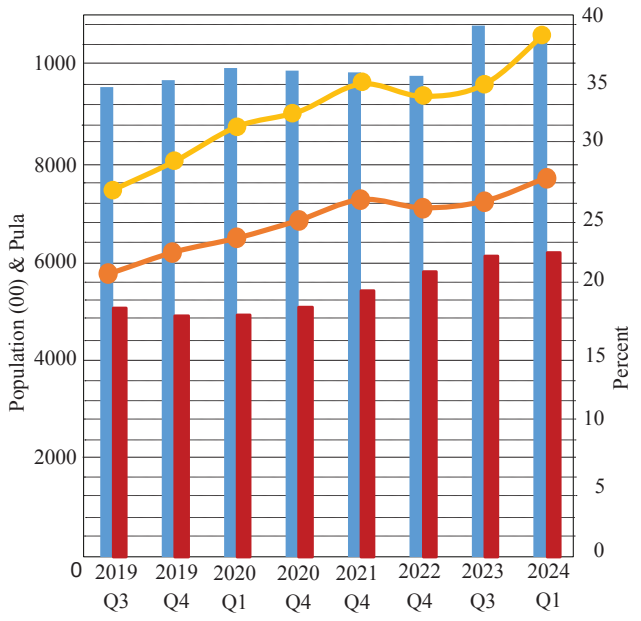
According to Statistics Botswana's Quarterly Multi-Topic Survey (QMTS) report for the first quarter of 2024, the unemployment rate increased to 27.6 percent in the first quarter of 2024, from 25.9 percent in the third quarter of 2023. Youth unemployment rate also rose to 38.2 percent from 34.4 percent. The survey highlights a 2.9 percent increase in formal sector employment, which rose to 504 738, from 490 625 in the previous period.

Regarding other indicators, the survey indicates that Government remains the largest employer, with employment in public administration accounting for 30.3 percent of total formal sector employment. This is followed by Education at 13.2 percent and wholesale and retail and repair of motor vehicles at 12.6 percent. Consequently, personal emoluments constitute over 50 percent of the government recurrent budget, and about 13 percent of GDP. Meanwhile, the formal sector average monthly earnings were estimated at P6 865 for citizens, P14 080 for non-citizens and P7 143 for all employees in the first quarter of 2024. The average monthly earnings for all employees were estimated to have decreased by 10.8 percent or P827 to P6 865 in the first quarter of 2024, from P7 692 in the third quarter of 2023.

A longer-term trend analysis of the QMTS data from the third quarter of 2019 to the first quarter of 2024 shows that the total labour force, constituted by people who are 15 years and above, increased by 10.7 percent to 1 041 204 persons, from 940 546 persons. Over the same period, the employed labour force increased by 1.2 percent, which is lower than the average GDP growth of 2.7 percent over the same period, indicating that the pace of job creation is lower than that of economic expansion. At 27.6 percent in the first quarter of 2024, the overall unemployment rate represents an increase of 6.9 percentage points from the 20.7 percent recorded in the third quarter of 2019. Youth labour force (15–35 years) increased by 5.9 percent, to 509 683 persons in the first quarter of 2024, from 481 441 persons in the third quarter of 2019. The youth unemployment rate, which continues to be a national concern, increased to 38.2 percent in the first quarter of 2024, compared to 26.7 percent in the third quarter of 2019. Meanwhile, average earnings for all employees increased by P1 104, from the P4 989 estimated for the third quarter of 2019.

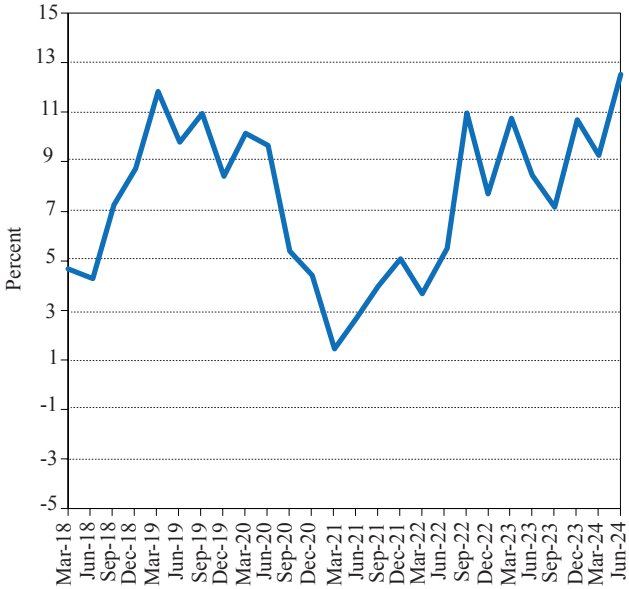
6 The QMTS is conducted by Statistics Botswana and its report is supposed to be published on a quarterly basis. However, due to some challenges, including movement restrictions to contain the COVID-19 pandemic and financial constraints, publication of the QMTS report has not been consistent, resulting in data gaps in labour force developments. Since its inception in the third quarter of 2019, Statistics Botswana published the first QMTS (July-September 2019) Report in January 2020. This was followed by reports for the fourth quarter of 2019, first and fourth quarters of 2020, the fourth quarters of 2021 and 2022, as well as the third quarter of 2023. Therefore, the analysis makes comparisons between the first quarter of 2024 and the third quarter of 2023.

Chart 3.9:Trends in selected Labour Force Indicators



Source: Statistics Botswana

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



Source: Bank of Botswana

3.4 Monetary developments

Banking sector assets growth accelerated in June 2024

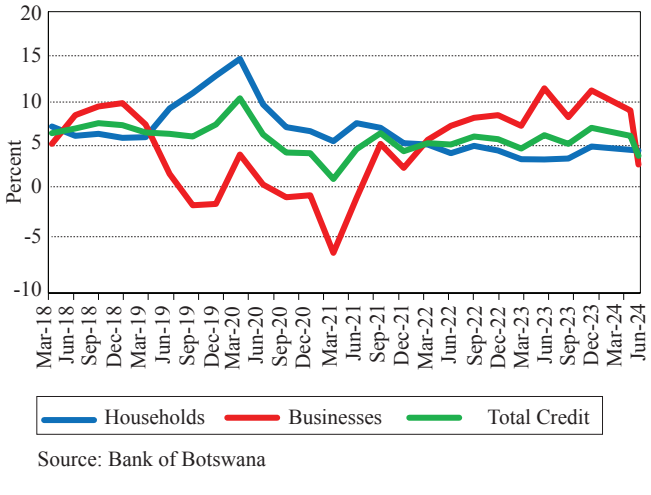
Annual banking sector assets' growth increased from 8.4 percent in June 2023 to 12.6 percent in June 2024 (Chart 3.10). This growth was mainly driven by higher balances at Bank of Botswana (particularly primary reserve requirements and operating account), BoBCs, balances due from foreign banks, debt securities, as well as treasury bills. Loans and advances, which accounted for the largest proportion of commercial banks' assets (58.1 percent), increased by 3.9 percent in June 2024, lower than the 6.3 percent increase in June 2023. Overall, growth in banking sector assets was predominantly funded by customer deposits, which rose annually by 15.8 percent in the same period.

Average daily market liquidity stood at P12.6 billion in June 2024, from P16.2 billion in May 2024. Despite the decrease, market liquidity remains high by historical standards. Given the prevailing liquidity and funding conditions in the market, it is anticipated that banks will be more aggressive in developing new products and to offset the current dominance of household personal loans.

Credit growth decelerated in the year to June 2024

Commercial bank annual credit growth decelerated from 6.3 percent in June 2023 to 3.9 percent in June 2024 (Chart 3.11), associated with lower growth rate in lending to the business sector. The deceleration was mainly due to decreased utilisation of overdraft credit, revolving credit facilities, as well as some loan repayments.

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



Source: Bank of Botswana

Annual growth in household loans increased from 3.5 percent in June 2023 to 4.5 percent in June 2024. The higher growth in household credit was mainly attributable to increased lending for personal loans (6.6 percent) during the period under review. Notably, there has been an improvement in growth of personal loans (loan take-up) following the decrease in MoPR in December 2023. In addition, banks are also likely opening up credit supply to match the increase in demand. However, there was a slowdown in the growth of loans for property, motor vehicle acquisition and credit card-based loans, possibly due to restricted non-collateralised credit supply to guard against increase in default rates. The share of the household sector in total lending by commercial banks increased slightly from 64.3 percent in June 2023 to 64.7 percent in June 2024.

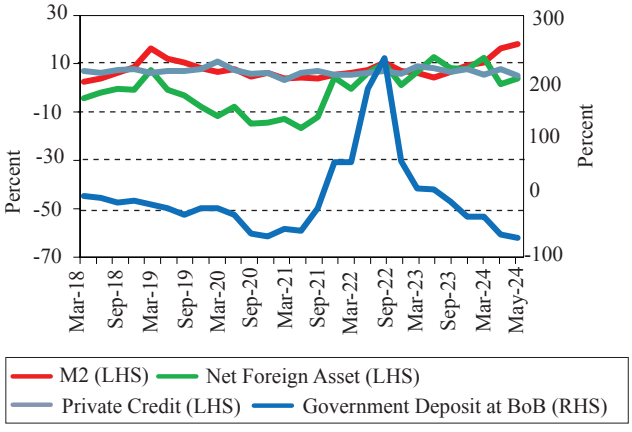
Lending to the business sector increased by 2.9 percent in the year to June 2024, lower than the 11.7 percent expansion in the corresponding period in 2023. This deceleration in growth was largely due to decreased utilisation of overdraft credit facilities by some parastatals. However, credit to businesses excluding parastatals increased by 9.4 percent in the year to June 2024, significantly higher than the 4.3 percent expansion in the corresponding period in 2023. This growth was mainly due to acquisition of new loans and increased use of overdrafts (15.8 percent of total business loans), and revolving credit facilities across various sectors, including trade, manufacturing, finance, construction, electricity and water sectors. Conversely, credit to parastatals decreased by 43.8 percent in the year to June 2024, compared to the 127.6 percent increase in the twelve months to June 2023, due to loan repayments.

Despite these developments, the credit-to-GDP gap, which assesses the build-up of credit-related vulnerabilities, was negative (4.1 percent using total GDP and 6.9 using non-mining GDP) in March 2024. This is well below the threshold of a positive 10 percent, indicating limited risks of credit growth that could overheat the economy. However, according to the Household Indebtedness Survey for 2023/24, credit providers, in general, anticipate that credit demand will increase in 2024, on account of the anticipated materialisation of government policies. However, this outlook might change given the likely impact of the poor performance by the mining sector on overall output (see Box 1 for a summary of the survey).

Money supply growth accelerated in May 2024

Money supply (M2) grew by an annual rate of 18 percent in May 2024, higher than the 4.5 percent in the corresponding period in 2023 (Chart 3.12). The acceleration in money supply expansion was mainly due to the decrease in public sector deposits at the Bank of Botswana. However, the decrease in credit to the private sector and net foreign assets exerted a contractionary effect on M2.

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



Source: Bank of Botswana

The nominal BoBC yields decreased in the second quarter of 2024

The 7-day nominal BoBC yield (MoPR) decreased from an average of 2.65 percent in the second quarter of 2023 to an average of 2.32 percent in the second quarter of 2024, due to a cumulative 50-basis points policy rate cut by the MPC in December 2023 and June 2024. In contrast, the real rate of interest on the 7-day paper increased from -3.21 percent to -0.63 percent in the same period, reflecting the significant decline in the inflation rate.

The 7-day nominal BoBC yield was constant at 2.15 percent between June and July 2024, following a 25-basis points reduction in June. In contrast, the real rate of interest for the 7-day BoBC decreased from -0.63 percent in June 2024 to -1.49 percent July, reflecting the increase in the inflation rate.

The stop-out yield on the 1-month BoBC, which was introduced in June 2022 to address structural liquidity issues and support the construction of the short-end of the yield curve, averaged 2.49 percent in the second quarter of 2024, a decrease from an average of 2.98 percent in the corresponding period in 2023. However, the real rate of interest for the 1-month paper increased from an average of -2.90 percent to an average of -0.46 percent in the same period, reflecting the significant decline in the inflation rate.

The stop-out yield on the 1-month BoBC decreased from 2.47 percent in June to 2.32 percent in July 2024. Meanwhile the real rate of interest for the 1-month paper decreased from -0.32 percent to -1.33 percent in the same period.

Credit ratings S&P Global Ratings and Moody's affirm Botswana's sovereign credit rating and maintain a stable outlook

On 15 March 2024, S&P Global Ratings (S&P) affirmed Botswana's credit rating and maintained the stable economic outlook. S&P affirmed Botswana's sovereign credit rating for long-term foreign and domestic currency bonds at "BBB+", and "A-2" for short-term foreign and domestic currency bonds. The affirmation was supported by Botswana's strong institutional frameworks (compared with that of regional peers), continued prudent management of the domestic natural resource wealth, robust external balance sheet and low government debt burden, as well as a strong monetary policy framework. Meanwhile, a stable economic outlook was maintained on account of the expectation that the demand for Botswana's diamonds and economic growth will remain relatively resilient, thus supporting export receipts and fiscal revenue.

On 27 October 2023, Moody's Investors Service (Moody's) affirmed the Government of Botswana's long-term local and foreign currency issuer ratings at "A3" for 2023 and maintained a stable outlook. The ratings were supported by the country's very low debt levels, and its robust institutional frameworks and governance strength, balancing economic concentration in mining and related activities, as well as very low susceptibility to political, liquidity and banking-related event risks. The stable outlook reflected expectations that demand for Botswana's diamond will remain strong despite a softened global outlook for diamond prices. Meanwhile, there was no credit rating action by Moody's, following consultations in April 2024; however, a full surveillance report was published on 26 April 2024[7].

7 The surveillance report gives a summary of the performance of Botswana's macroeconomic indicators and key rating factors but does not provide an overall credit rating and stance on the economic outlook.

Box 1: Summary of the 2023/24 Household Indebtedness Survey

Introduction
In recent years, the Bank has observed a high concentration of commercial bank lending in the household sector, particularly on unsecured loans. This concentration poses risks to financial and economic stability, especially in the event of wide-spread employment losses. To enhance understanding of household borrowing across the financial system, the Bank conducts an annual Household Indebtedness Survey (HIS) covering banks, micro-lenders and hire purchase stores. The survey identifies, assesses and monitors credit developments in the household sector.

The 2023/24 Survey period was fraught with uncertainty in the global economy. In the first half of 2023, central banks globally battled with balancing financial stability and price stability objectives amid heightened inflationary pressures. Moreover, global economic conditions were uncertain due to heightened geopolitical tensions and trade restrictions involving China and major economies. While higher policy interest rates helped contain inflation, they also increased the cost of living, eroding household real incomes and purchasing power. The second half of 2023 saw a reduction in global inflationary pressures and optimism about potential monetary policy easing in 2024. However, weak fiscal positions in emerging and developing economies continued to pose a threat to global financial stability. Domestically, the economy experienced weaker economic performance, with real GDP growth falling to 2.7 percent in 2023, from 5.5 percent in 2022. This slowdown, driven by a decline in diamond production and sales, is expected to moderate expectations for higher domestic economic growth in 2024, and, possibly, slow household credit growth.

Summary of Findings
As at the end of December 2023, total household debt was estimated at P61 billion, comprising P54.1 billion (88.6 percent) in commercial bank loans, P6.4 billion (10.5 percent) in micro-lender loans and P526 million (0.1 percent) in being hire purchase loans. Compared to the 2022/23 Survey, total household loans grew by 4.6 percent from P58.3 billion. As a percentage of GDP, total household debt was 23.1 percent in December 2023, down from 23.2 percent in December 2022. These rates are significantly lower relative to comparator countries, with latest data for South Africa (2023) and Mauritius (2022) showing ratios of 64.7 percent and 47.7 percent, respectively. The Survey also revealed debt-to-income (DTI) and debt-service-to-income (DSTI) ratios of 53.5 percent and 70.5 percent, respectively, compared to 58 percent and 60 percent in the 2022/23 Survey.

Consistent with previous surveys, the 2023/24 Survey found that men borrow more than women across all financial institutions. This disparity may reflect unequal opportunities across gender and the dynamics of formal employment, where men (51.2 percent) outnumber women 48.8 percent (Quarterly Multi-Topic Survey (QMTS) for 2023). Socio-economic factors, such as higher male earnings and male headed households may also contribute to the disparity in credit access. According to the 2023 QMTS, males earn an average of P8 688 per month (compared to P8 048 in 2024Q1 QMTS), while females earn an average of P6 815 per month (compared to P6 371 in 2024Q1 QMTS). In addition, the 2022 Population and Housing Census indicates that 56.6 percent households are headed by males.

The Survey further establishes that individuals aged 36 - 49 years dominate household borrowing. Households earning between P15 001 and P25 000 account for most of the borrowing across commercial banks and micro-lenders. In general, levels of indebtedness are consistent with employment and income levels across age groups.

The 2023/24 HIS further revealed that banks predominantly lend to government employees, who are considered lower-risk borrowers due to deduction from source arrangements and scheme loans, while micro lenders extend credit mostly to private sector employees and the unemployed. It is apparent that government employees often utilise scheme loans to mitigate high costs of unsecured lending through collective bargaining power.

Regarding borrowing costs, interest rates from micro-lenders and hire purchases increased from an average of 27 percent in 2022 to 29 percent in 2023. Prime lending rates for mortgages and motor loans were lower at 10.5 percent and 11.3 percent, respectively, reflecting easing monetary policy in 2023. Overall, credit card loans are the most expensive, with a maximum prime lending rate of 24.6 percent, followed by unsecured loans with a maximum of 20.5 percent. Meanwhile, default rates were generally low for banks in 2023, with the non-performing loans to total loans ratios ranging from 1 percent to 6 percent, and a default rate of 1.68 percent. Most of the banks anticipate that default rates will remain low in 2024.

For 2024, credit providers generally anticipate an increase in credit demand due to anticipated government policy effects. However, the poor performance of the mining sector poses an underlying risk to this outlook.

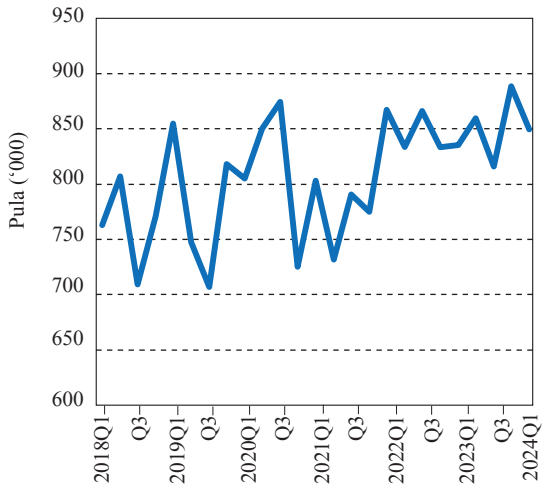
3.5 Asset market prices

Property market weaken in the first quarter of 2024

According to the latest (2024Q1) Riberry Report[8], the residential rental market showed signs of deterioration in the first quarter of 2024, compared to the fourth quarter of 2023. This is evident from the rising number of properties available for rent and declining house prices. Additionally, middle-end houses to let experienced weaker demand and supply, while the rental market for low-end properties continued to show reasonable demand.

Conversely, there is an oversupply of upper-end properties, leading to a possible decrease in the rental prices of these houses. The average price for residential properties sold in the first quarter of 2024 was P854 000, a 4 percent decrease, compared to the previous quarter (Chart 3.13).

Chart 3.13: Riberry Average Prices



The demand for office space remains reasonable and has improved slightly as Government has occupied some vacant properties. Despite a slower pace, there continues to be reasonable interest in office space within the Central Business District, Showgrounds and Government Enclave. In addition, there is limited construction of office space, which will most likely lead to excess demand for the same.

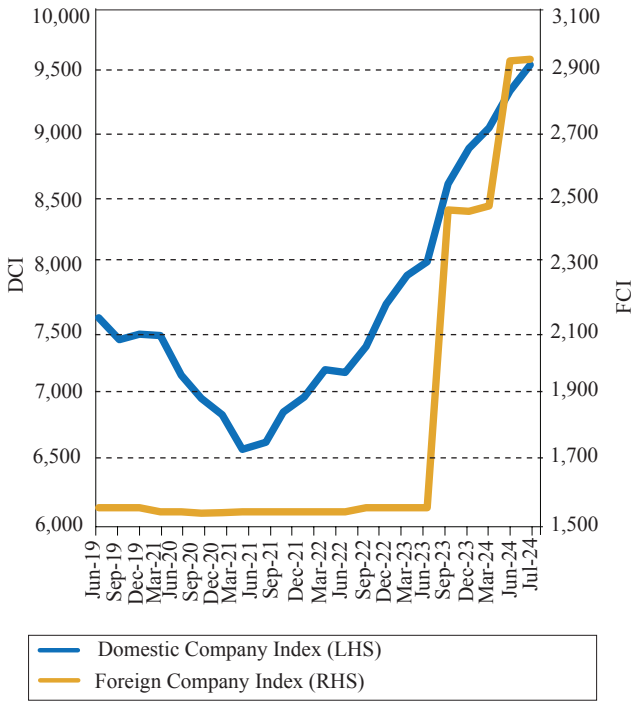
Similar to the previous quarter, the demand for retail space remained fair across all market segments, while the supply is expected to increase due to proposed construction of two malls in Mogoditshane. Other areas with strong demand for retail space include Jwaneng, Selibe Phikwe, Maun and Mahalapye. Most of these locations have a few retail schemes, to be anchored by reputable supermarkets, at planning and/or construction stage. In the industrial property sector, the supply of unoccupied large warehouse spaces has decreased, while the demand has improved.[9] Meanwhile, the demand for industrial space in prime locations is expected to improve going forward.

Stock market indices increased

The Domestic Companies Index increased by 16.1 percent in the twelve months to July 2024, up from an increase of 13.8 percent in the year to July 2023 (Chart 3.14). The increase was mainly due to the higher share prices for Sechaba, Standard Chartered Bank and Chobe, which increased by 42.2 percent, 51.8 percent and 54.9 percent, respectively, in the same period. The rise in share prices was a result of increased trading activity owing to stellar financial performance in 2023, high demand from key markets, effective marketing strategies and portfolio expansions.

The Foreign Companies Index increased by 86.8 percent in the year to July 2024, compared to a modest increase of 1 percent in the corresponding period in 2023 (Chart 3.14). This significant increase was largely due to the year-on-year increases in the share prices for New Gold (27 percent) and CA Sales Holdings Limited (30.8 percent). The increase in CA Sales' share price was driven by growth in fixed and intangible assets, boosted by acquisitions, and increased working capital. Meanwhile, New Gold's share price benefitted from improved performance of the bullion it is backed by.

Chart 3.14: Stock Market Indices



Source: Botswana Stock Exchange

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

9 Investors prefer bigger warehouses, but available warehouse space is limited.

Box 2: Monetary Policy Implementation and Operations Framework

Open Market Operations remain the main liquidity management tool in the domestic market, as well as implementing decisions of the MPC. This entails the issuance of BoBCs to mop up excess liquidity in order to maintain interest rates that are consistent with the monetary policy stance. Moreover, the Bank continuously evaluates its monetary policy implementation framework, aimed at strengthening the monetary policy transmission mechanism where necessary. In this respect, the Bank introduced reforms to the monetary policy operations in April 2022. These included, in the main, the discontinuation of the Bank Rate as the main anchor policy rate and the transition to the MoPR, which is an instrument-based policy rate (7-day BoBCs yield) for effective monetary policy transmission.

The transition also marked the introduction of an interest rate corridor with a 200 basis points width, comprising the Standing Deposit Facility (SDF) at 100 basis points below the MoPR and the Standing Credit Facility (SCF) at 100 basis points above the MoPR. The SDF and SCF serve as the floor and ceiling of the interest rate corridor, respectively, and commercial banks use both facilities at their own discretion for their daily liquidity management. The interest rate corridor helps to ensure that money market interest rates move within a reasonably close range around the MoPR, culminating into a symbiotic relationship between the policy rate and market interest rate, thus providing the fundamental basis for effective monetary policy transmission.

The monetary operations reforms are now embedded in the Bank's monetary policy operations. There has been some noticeable improvement in policy transmission, while the interest rate structure is operating as expected. The adoption of the MoPR as a reference rate has had an immediate impact on the shorter end of the yield curve i.e., overnight interbank rates, as was expected. The interest rate corridor plays a critical role of affording commercial banks an opportunity to manage their liquidity in between BoBC auctions. However, transmission or impact on the longer end is expected to be rather slower as there are other factors that come into play that may counter the expected impact of reforms, such as inflation expectations.

The reforms also allow for the conduct of fine-tuning operations (repos and reverse repos) which are done at the discretion of the Bank upon evaluation of the general market liquidity. If offered, the fine-tuning operations are conducted at the MoPR. Furthermore, a 1-month BoBC is issued for structural liquidity management and price discovery purposes, while the Prime Lending Rate (PLR) is determined by the individual commercial banks (effective 1 April 2023).

3.6 Balance of payments

Current account in deficit during the first quarter of 2024

The current account is estimated to have recorded a deficit of P2.5 billion in the first quarter of 2024, compared to an estimated surplus of P1.8 billion in the corresponding period in 2023 (Chart 3.15). The deficit was mainly on account of merchandise trade and primary income deficits. Exports of goods declined by 21.1 percent, from P21.8 billion to P17.2 billion, while imports of goods increased by 10.3 percent, from P19.4 billion to P21.4 billion, resulting in a trade deficit of P4.2 billion. The decrease in exports was primarily due to the poor diamond trade performance. However, the secondary income account, supported by SACU revenues, increased from P3.2 billion to P5.6 billion, mitigating what would have otherwise been a larger current account deficit. SACU revenues increased from P3.4 billion in the first quarter of 2023 to P6.1 billion in the corresponding period in 2024, resulting from forecast error adjustments related to the 2021/22 financial year.[10]

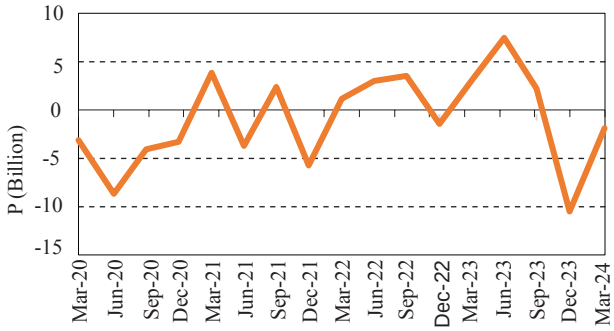
Diamond exports, which accounted for 73.5 percent of total exports of goods in the first quarter of 2024 (83.2 percent in the first quarter of 2023), decreased from P18.2 billion in first quarter of 2023 to P12.7 billion in the first quarter of 2024. During the same period, diamond imports increased from P3.2 billion to P3.8 billion. The decrease in diamond exports was due to lower demand, particularly in major end-product consumers, such as China and the US.

Other commodities that contributed to a decline in exports include live cattle (59.7 percent), vehicle and transport equipment (2.5 percent), coal (55.4 percent), and gold (58.9 percent). In contrast, exports of copper (62 percent), meat and meat products (643.2 percent), iron and steel products (27.6 percent), salt and soda ash (39.7 percent) and textiles (30.1 percent) and other goods (15.6 percent) increased.

The increase in imports was driven by increases across most commodities: diamonds (20.6 percent), fuel (4.4 percent), chemicals and rubber products (15.1 percent), vehicles and transport (32.4 percent), machinery and electrical equipment (9.7 percent), metals and metal products (7 percent), salt ores and related products (48.1 percent), furniture (31.4 percent) and wood and paper products (13.4 percent).

In May 2024 the merchandise trade was in a deficit of P2 billion, with total exports and imports amounting to P5.9 billion and P7.9 billion, respectively.

Chart 3.15: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account records a net outflow in the first quarter of 2024

The financial account is estimated to have recorded a net outflow of P3.5 billion during the first quarter of 2024, compared to a net outflow of P3.8 billion recorded in the first quarter of 2023. This outflow was largely due to an increase in portfolio investments held abroad during the first quarter of the year, although it was lower than in the first quarter of the previous year because of the implementation of the Botswana pension funds foreign assets/domestic assets cap from 70/30 to 50/50, which is expected to reduce offshore portfolio investments.

The BoP was in deficit in the first quarter of 2024

The overall BoP deficit worsened from P1.7 billion recorded in the first quarter of 2023 to P2.1 billion during the same quarter in 2024. The increased deficit was attributable to the current account deficit.

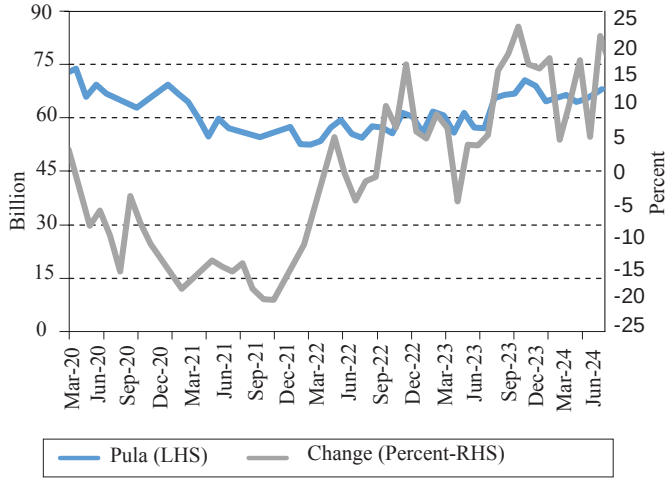
Foreign exchange reserves decreased

As at the end of June 2024, foreign exchange reserves were estimated at P62 billion, a decrease of 6.2 percent from P66.1 billion in June 2023 (Chart 3.16).

In foreign currency terms, the foreign exchange reserves were estimated at USD4.6 billion, a 6.1 percent decline from USD4.9 billion (Chart 3.17) and SDR3.5 billion, a 5.4 percent decline from SDR3.7 billion during the same period. The level of foreign exchange reserves in June 2024 was equivalent to 8.4 months of import cover of goods and services.

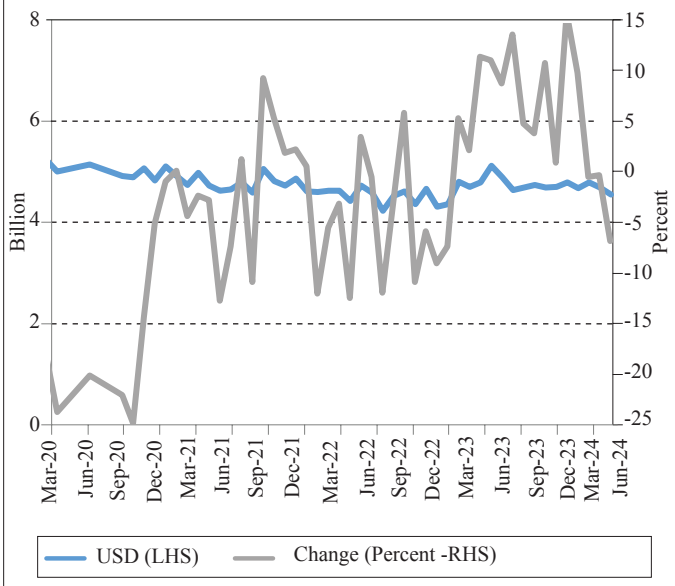
10 The 2002 SACU Agreement provides that adjustments in respect of the differences between the forecast and actual revenue collected in time (t) to be made in years (t+2) to adjust for forecast errors with a two-year lag. As a result, the projected 2023/24 SACU payments include the forecast error adjustment for 2021/22. The substantial increase in the payments resulted from higher-than-expected customs and excise tax collections during the financial year 2021/22.

Chart 3.16: Foreign Exchange Reserves in Pula and Annual Percentage Change



Source: Bank of Botswana

Chart 3.17: Foreign Exchange Reserves in US Dollars and Annual Percentage Change



Source: Bank of Botswana

3.7 Exchange rate developments

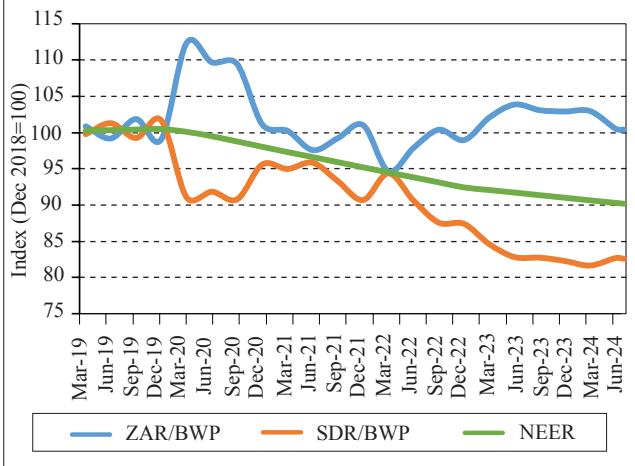
For 2024, the Bank's implementation of the exchange rate policy entails the maintenance of an annual downward rate of crawl of 1.51 percent. This downward rate of crawl was implemented effective 1 January 2023, with a view to enhancing domestic industry competitiveness. During the same period, the Pula basket weights were maintained at 45 percent for the South African rand and 55 percent for the SDR, guided by Botswana's trade pattern and international transactions. Box 3 explains the current exchange rate policy framework and the Pula exchange rate parameters for 2024, which were announced in December 2023.

In the twelve months to July 2024, the Pula depreciated by 2.6 percent against the SDR and 0.1 percent against the South African rand (Chart 3.18). Against the SDR constituent currencies, the Pula depreciated by 3.8 percent against the US dollar, 3.7 percent against the British pound, 2.6 percent against the Chinese renminbi and 2.1 percent against the euro, while appreciating by 3.7 percent against the Japanese yen.

The movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. During the same period, the South African rand depreciated by 2.5 percent against the SDR. Specifically, the South African rand depreciated by 3.7 percent against the US dollar, 3.6 percent against the British pound, 2.5 percent against the Chinese renminbi and 2 percent against the euro, while appreciating by 3.8 percent against the Japanese yen.

The performance of the South African rand was mainly driven by global factors, including increased political uncertainties ahead of the US presidential elections in November 2024, following the former US president, Donald Trump's acceptance of the nomination as the US Republican presidential candidate which dented investor appetite for risky assets and spurred safe-haven demand globally as the likelihood of Trump winning elections intensified concerns of geopolitical risks, particularly the possibility of a broader trade war between the US and China. Risk aversion in global financial markets tends to see a sell-off of emerging market portfolio assets (bonds and equities) and weakens emerging market currencies, of which the South African rand is a part.

Chart 3.18: Nominal Exchange Rate Indices

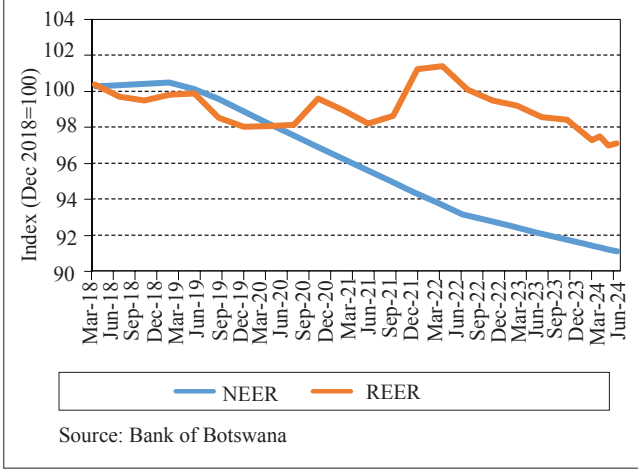


Source: Bank of Botswana

NEER depreciated in July 2024

The NEER of the Pula depreciated by 1.5 percent in the twelve months to July 2024 (Chart 3.19), consistent with the annual downward rate of crawl of 1.51 percent implemented effective January 2023.

Chart 3.19: Nominal and Real Effective Exchange rates



Source: Bank of Botswana

REER depreciated in June 2024

The REER depreciated by 2.3 percent in the twelve months to June 2024 (Chart 3.19), due to depreciation of the NEER (rate of crawl) and the lower inflation in Botswana compared to trading partner countries, suggesting a marginal gain in Botswana's export competitiveness, by this measure.

With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) depreciated by 5.2 percent against the South African rand and appreciated by 0.2 percent against the SDR. It appreciated by 9.8 percent against the Japanese yen, 1.6 percent against the Chinese renminbi and 0.5 percent against the euro, while it depreciated by 1.5 percent against the US dollar and 0.8 percent against the British pound.

Box 3: The Pula Exchange Rate Framework Explained

Definition of Exchange Rate

The exchange rate of a currency is how much one currency can be bought for each unit of another currency or, put differently, the rate at which domestic currency can be converted into a foreign currency or vice versa.

Exchange Rate Policy Frameworks

The exchange rate policy framework refers to the way a country manages its own currency in relation to foreign currencies and the foreign exchange market.

Exchange rate policy frameworks range from flexible to fixed, with variations in between. In a flexible exchange rate framework, the exchange rate is freely determined by the market on the basis of demand and sentiments about the economy. In a fixed exchange rate regime, the domestic currency is linked to another currency or a basket (combination) of other currencies. In between flexible and fixed exchange rates, there is a range of, usually managed exchange rate frameworks, such as a crawling band or peg.

Botswana's Exchange Rate Policy Framework

Since 2005, Botswana adopted and implemented a crawling peg exchange rate policy framework that has three key attributes.

First, the Pula is fixed to a basket of foreign currencies, namely the SDR and the South African rand. The SDR comprises the US dollar, British pound, euro, Japanese yen and Chinese renminbi.

Second, is the weight of these currencies in the Pula basket (proportions that each of these currencies contribute to the value of the Pula). Currently, the Pula exchange rate is constituted by 55 percent SDR and 45 percent South African rand.

Third, is the annual rate of crawl, which is the amount (rate) by which the exchange rate is allowed to gradually depreciate or appreciate. This amount reflects the projected inflation differential between Botswana and its trading partner countries. For example, the 1.51 percent downward rate of crawl for 2023 was as a result of a determination that inflation in Botswana would be, on average, 1.51 percentage points higher than in the trading partner countries.

Botswana's Exchange Rate Policy Objective

The policy objective is to maintain price competitiveness of local producers for similar products, in both the domestic and international markets by equalising the exchange rate-adjusted prices. In general, this is done through adjusting the nominal Pula exchange rate by an amount that is equal to the differences in projected inflation between Botswana and the trading partner countries. That is, the rate of crawl.

For example, if a bag of potatoes is currently P100 in Botswana and R130 in South Africa, at an exchange rate of P1 = R1.30, and assuming transport costs are not embedded in the pricing, Botswana's producers face similar market price as South African producers and, therefore, competitive. If, however, inflation in Botswana rises to be 5 percentage points higher than in South Africa, Botswana producers will be disadvantaged as it would be cheaper to purchase the same bag of potatoes in South Africa, holding all other things constant. Therefore, the Pula exchange rate needs to adjust downward by 5 percent **(rate of crawl)** to maintain competitiveness of producers in Botswana; technically, maintenance of a stable REER.

The exchange rate and competitiveness also have to relate to countries that Botswana trades with, in terms of goods and services, but also the flow of investments. It has been determined that these are mostly South Africa and the SDR countries (the USA, UK, euro area, China and Japan). This explains the fixing of the Pula to currencies of these countries. The 45 percent South African rand and 55 percent SDR proportions are based on observed historical trade pattern and are also subject to semi-annual review. In addition, the fixing to a basket rather than a single currency helps to moderate volatility of the Pula against any single currency. This explains why during the times when the South African rand and other currencies are volatile, the Pula remains relatively stable.

2024 Pula Exchange Rate Parameters

In the context of Botswana's crawling band exchange rate arrangement for the Pula, the Ministry of Finance in conjunction with the Bank of Botswana, reviews the parameters for the Pula exchange rate twice in a year; being the currencies in the Pula basket and their weights, as well as the rate of crawl. This is done to assess alignment of the Pula exchange rate with the policy objective of maintaining a stable and competitive REER of the Pula; that is, retaining competitiveness of Botswana producers against imports and exports in international markets.

For 2024, it was determined that inflation in Botswana would be on average higher than in the trading partner countries, suggesting maintenance of an annual downward rate of crawl of 1.51 percent, which would be implemented through small daily adjustments that would equal 1.51 percent over twelve months. This annual downward rate of crawl was implemented effective 1 January 2024, with a view to enhancing domestic industry competitiveness. It was also determined that the trade patterns remain largely unchanged and, therefore, the Pula Basket weights were also maintained at 55 percent SDR and 45 percent South African rand.

The Benefits of the Crawling Band Framework for Botswana
The benefits of the current crawling band framework are therefore as follows:

(a) it affords flexibility for adjustments to address deterioration in international price competitiveness of the domestic industry;
(b) any adjustment is gradual and, therefore, not disruptive nor destabilising;
(c) the rate of adjustment is preannounced and, therefore, enables planning for economic decisions;
(d) the framework is broadly in alignment with the price stability objective (inflation objective inherent in the monetary policy framework; and
(e) and the basket composition moderates fluctuations of the Pula exchange rate against any individual currency.

In contrast, alternative arrangements could have disadvantages as follows:

(a) with a small undiversified economy such as Botswana with irregular and lumpy foreign exchange flows, a floating exchange rate regime would imply large exchange rate fluctuations that could be debilitating to price determination and economic activity. In addition, there could be sustained movement of the exchange rate, especially appreciation, that can undermine competitiveness of the non-mining sector and, therefore, diversification efforts;
(b) as demonstrated in the past, a fixed hard peg would often require adjustments that are large and discrete with a destabilising disruptive impact. For example, a large devaluation with significant inflationary impact; and
(c) a peg to a single currency would imply the Pula being subject to fluctuations and shocks to the currency to which it is pegged and, in turn, policy responses that may be inimical or inconsistent with the needs of the domestic economy at the time.

Limits of Exchange Rate Adjustments on Industry Competitiveness

While there are short-term benefits of deliberate exchange rate adjustments to maintain price competitiveness, for it to have the desired long-term impact, there should be adequate production capacity and productivity improvements by the domestic industry. In addition, for government institutions, there should be effective implementation of plans and programmes. Overall, therefore, there is need for generalised entrenchment and traction of structural transformation and policy reforms as being fundamental to industrialisation and productivity improvements that would enhance competitiveness of domestic producers in a low inflation environment.

It is recognised that, in the main, sustained (need for) downward adjustment of the currency is a reflection of weak production capacity and productivity of the economy; and is also inflationary (ultimately affecting price competitiveness).

Transparency and Market Information

The announcements of the Pula exchange rate parameters and any adjustments are intended to enhance transparency and integrity of the framework. In this regard, knowledge of the Pula basket weights, and rate of crawl enable the market and the general public to plan for investments and transactions on the basis of publicly available information that can be used as an input to any economic decisions.

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook remains broadly restrained, with growth forecast for 2024 unchanged in the July 2024 WEO Update compared to the April 2024 projection. However, the growth forecast for 2025 has been revised slightly upwards. The anticipated growth is largely due to stronger than-earlier forecast performance for the US and some large emerging market economies, particularly China and India. Nonetheless, the outlook is restrained due to factors, such as lower consumer demand, the geopolitical tensions and low underlying productivity growth. Regionally, in South Africa, growth prospects remain restrained on account of tight credit conditions and structural bottlenecks in the economy. With regard to price developments, global inflation is projected to moderate further, due to anticipated decrease in food prices, the impact of monetary policy tightening in 2023, as well as squeezed household budgets.

Global economic growth to remain restrained

According to the July 2024 WEO Update, global output growth is forecast at 3.2 percent for 2024, slightly lower than 3.3 percent in 2023 and to increase marginally to 3.3 percent in 2025. The growth forecast for 2024 was unchanged, compared to the April 2024 projection, while it was revised upwards by 0.1 percentage points for 2025. However, the 2024/2025 forecasts are lower than the historical (2000-2019) annual average of 3.8 percent. The restrained growth is on account of higher borrowing costs resulting from monetary policy tightening in 2023, withdrawal of fiscal support amid high debt levels, geopolitical tensions, extreme weather conditions and low underlying productivity growth.

For advanced economies, output is projected to grow by 1.7 percent in 2024, unchanged from 2023, and to accelerate slightly to 1.8 percent in 2025. The 2024 and 2025 growth forecasts are unchanged from the April 2024 projections, reflecting mainly the expected rebound in the US, Europe and UK.

Risks to the global economic outlook are broadly balanced. Upside risks include stronger-than-expected global growth, possibly due to lower inflation, slower than assumed withdrawal of fiscal support, stronger structural reform momentum and faster economic recovery in China. On the downside, new commodity price spikes from geopolitical shocks including those from the Russia-Ukraine war and the conflict in Gaza and Israel, as well as supply disruptions or more persistent underlying inflation could prolong tight monetary conditions. Moreover, the possibility of systemic debt distress in emerging market countries due to a combination of higher borrowing costs and weaker growth could result in lower growth. A divergence in disinflation speeds among major economies could also cause currency movements that put financial sectors under pressure.

UK economic growth to remain subdued

The UK economy is forecast to grow by 0.7 percent in 2024, up from an estimated expansion of 0.1 percent in 2023. This growth is supported by easing inflationary pressures as the lagged negative effects of high energy prices wane and anticipated lower interest rates. Although growth projection remains restrained, the 2024 projection is 0.2 percentage points higher than in the April 2024 WEO.

Output growth for US to increase

In the US, output is forecast to grow by 2.6 percent in 2024, slightly higher than an estimated expansion of 2.5 percent in 2023. However, the 2024 projection is 0.1 percentage points lower compared to the April 2024 forecast, on account of slower than earlier anticipated growth in the first half of the year. Meanwhile, output growth is forecast to moderate to 1.9 percent in 2025 as gradual fiscal tightening and softening labour markets slow aggregate demand.

Growth for the euro area to increase

In the euro area, economic growth is projected to increase to 0.9 percent in 2024 (0.1 percentage points higher compared to the April 2024 forecast), up from an expansion of 0.5 percent in 2023. This growth is driven by stronger momentum in services and higher-than-expected net exports in the first half of the year. Moreover, the anticipated growth is against the backdrop of improved domestic demand as consumers start to recover purchasing power amid lower commodity prices, as the effect of the Russia-Ukraine war to energy prices subside and the fall in inflation supports growth of real income. Meanwhile, GDP growth for the region is expected to further improve to 1.5 percent in 2025, the same forecast as in the April 2024 WEO. The anticipated growth is underpinned by stronger consumption on the back of rising real wages, as the effect of the Russia-Ukraine war to energy prices subside and the fall in inflation supports growth of real income, as well as higher investment from easing financing conditions amid gradual monetary policy loosening this year.

Emerging markets GDP growth to decrease

Growth in economic activity in emerging market and developing economies is projected to expand by 4.3 percent in 2024 and 2025, slightly lower than an estimated expansion of 4.4 percent in 2023, due to subdued performance in China amid persistent property market crisis. However, the forecast for 2024 was revised slightly upwards by 0.1 percentage points due to upgrades of growth for India and China.

In India, growth is expected to expand by 7 percent in 2024 and 6.5 percent in 2025, compared to 8.2 percent in 2023. The growth forecast for 2024 is an upward revision of 0.2 percentage points from the April 2024 forecast, reflecting stronger-than-expected growth in the second half of 2023, stronger domestic consumption (particularly

in rural areas) and investment. Meanwhile, output for China is forecast to grow by 5 percent in 2024 and 4.5 percent 2025, lower than the estimated expansion of 5.2 percent in 2023, as weaker private investment and property market crisis continue to negatively affect the economy. Nonetheless, China's growth forecasts for 2024 and 2025 are both revised upwards by 0.4 percentage points from the April 2024 projections. The 2024 upgrade is mainly on account of a rebound in private consumption and strong exports in the first quarter of 2024, while the moderation for 2025 is because of headwinds from aging and slowing productivity growth.

Growth prospects for the South African economy remain weak

Regionally, growth prospects in South Africa are expected to remain restrained on account of carryover effects of tight monetary policy conditions to control inflationary pressures in 2023, restrained fiscal support, ports and rail logistical constraints, power outages, as well as the grey listing of the economy by the Financial Action Task Force in February 2023. Thus, South African output growth is forecast to remain subdued at 0.9 percent in 2024, from 0.7 percent in 2023, and to increase to 1.2 percent in 2025. Projections for both 2024 and 2025 are unchanged from the April 2024 WEO.

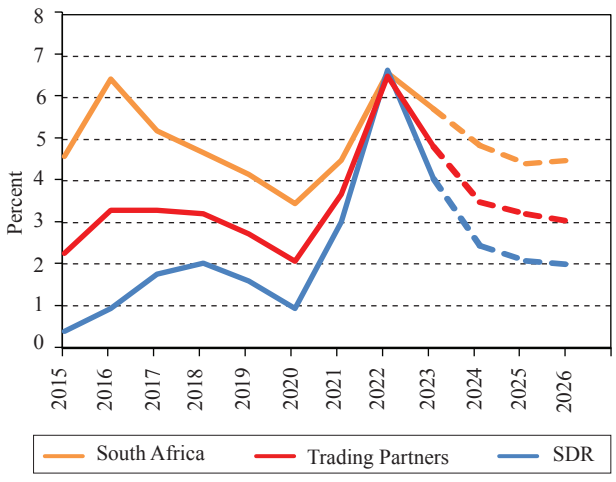
Meanwhile, in July 2024, the SARB revised downwards the forecast for GDP growth for 2024 from 1.2 percent to 1.1 percent but revised slightly upwards the projection for 2025, from 1.4 percent to 1.5 percent. The subdued growth prospects are mostly due to energy and logistical constraints, which continue to weigh on South African economic activity.

Global inflation to moderate

Globally, inflation is expected to moderate further in 2024, supported by lagged effects of monetary policy tightening in 2023 on consumption and investment, squeezing of household budgets, softening labour markets, as well as anticipated lower food prices. Thus, inflation for advanced economies is forecast to ease from 4.6 percent in 2023 to 2.7 percent in 2024, while for emerging market economies, it is forecast to decrease from 8.3 percent to 8.2 percent in the same period. Overall, global inflation is expected to ease from 6.7 percent in 2023 to 5.9 percent in 2024, and further moderate to 4.4 percent in 2025.

Meanwhile, the SARB forecasts South African inflation to average 4.9 percent in 2024 and 4.5 percent in 2025. The forecast for 2024 is 0.2 percentage points lower than the May projection, while the 2025 forecast is 0.1 percentage points lower. Overall, headline inflation reverted to within the SARB's 3 – 6 percent target range in June 2023 and is expected to remain within the target range, albeit higher than the mid-point, before sustainably reverting to the mid-point of the target range in 2025 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



Source: SARB and Bloomberg

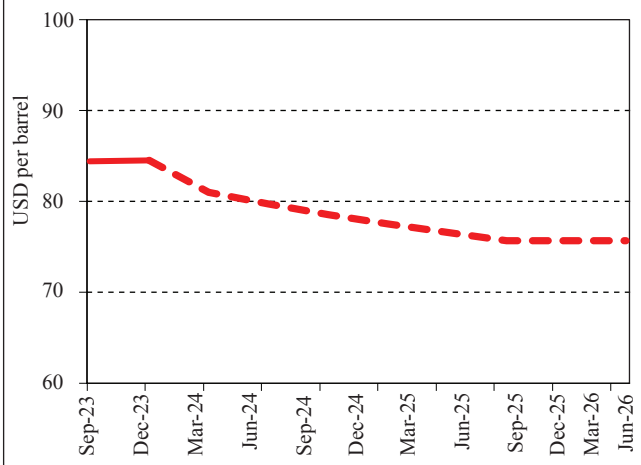
Diamond prices to trend downwards

Diamond prices are expected to continue trending downwards in the short term due to the anticipated slowdown in economic activity in major consuming countries, particularly China and India, as well as decreased demand for the commodity, amid uncertainty in major consuming markets underpinned by tight monetary policy, which has squeezed consumer budgets. Moreover, the increased supply of lab grown diamonds and the growing popularity of gold as a safe-haven commodity has contributed to the decline in diamond prices.

International oil prices to decrease

International oil prices are projected to decrease in the short to medium term (Chart 4.2). The projected decrease in oil prices is due to OPEC and its allies' decision to gradually unwind the extra voluntary production cuts from October 2024 until the end of 2025. In addition, recession fears in the US, weak global economic activity, the increase in oil supply, particularly in the US and Brazil, as well as weak industrial demand for oil in China are expected to weigh on oil prices, thus leading to the decrease in oil prices in the third quarter of 2024 going forward.

Chart 4.2: International Oil Prices



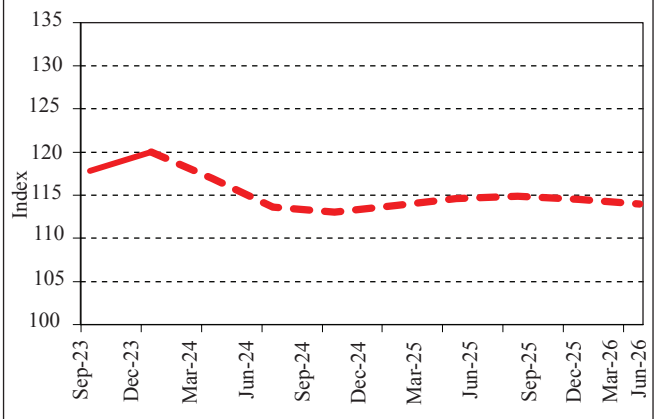
Source: Bloomberg

Overall, there is potential marginal downward pressure from international oil prices on domestic inflation in the short to medium term.

International food prices to decrease

Global food prices are expected to trend downwards in the short term (Chart 4.3). The anticipated decrease in international food prices is driven by larger-than-expected seasonal harvests from leading food producers, such as Brazil, the US and Argentina. Although adverse weather conditions in Latin America have curtailed production prospects of maize, there is still expectations of above average harvest, thus exerting downward pressure on food prices. However, this may be partially offset by the termination of the Black Sea Grain Initiative and the ongoing strikes on Black Sea ports.

Chart 4.3: International Food Prices FAO Index



Source: Bloomberg
Note: Approximated using forecasts for international

In Southern Africa, food prices are expected to remain elevated in the short term, compared to pre-pandemic levels, due to low rainfall experienced at the start of the 2023/24 ploughing season. Furthermore, the El Nino condition has resulted in another drought year, which is expected to exert more pressure on food prices. Most countries in the region are experiencing long dry spells, with Zambia, Zimbabwe and Malawi having declared a national emergency due to drought. In addition, Botswana has declared 2023/2024 an extreme agricultural drought year. Overall, given the expected lower international food prices, there is potential downward pressure on domestic inflation in the short term.

4.2 Outlook for domestic economic activity

The IMF has revised GDP growth for 2024 downwards to 1 percent, from an earlier estimate of 3.6 percent. This adjustment is due to the downturn in the diamond industry, driven by weak global demand and high inventories. The Ministry of Finance is also expected to revise its GDP growth projection for 2024 downwards to reflect, in part, continued unfavourable global economic conditions and geopolitical events. Further, the projected weak economic activity could also be attributable to slow and muted impact of economic transformation initiatives so far, continuance of low productivity and drought conditions. While output in the non-mining sector is anticipated to be below its potential in the short term, total GDP growth over the medium-term is projected to be supported by a rebound in mining production; improvements in some non mining sectors, such as diamond traders and manufacturing, insurance and pension funds; as well as reforms aimed at enhancing the business environment.

Output growth to decelerate in 2024

The IMF has revised GDP growth for 2024 downwards to 1 percent from an earlier estimate of 3.6 percent partly due to the downturn in the diamond industry performance, given weak global demand and high inventories. According to the 2024 budget speech, the Ministry of Finance have projected GDP to grow by 4.2 percent in 2024. However, there are indications that this forecast is likely to be revised downwards to reflect continued unfavourable global economic conditions and geopolitical events, as well as the slow and muted impact of economic transformation initiatives so far, continuance of low productivity and drought conditions.

Government is committed to stimulate non-mining sectors through potential growth enhancing economic transformation reforms, initiatives and supportive macroeconomic policies for significant economic growth. These measures aim to expand productive capacity, accelerating economic transformation and enhance economic resilience in the medium term, although the prospects for significant economic growth are still not visible. Monetary policy also remains largely accommodative, therefore, conducive for financing of economic activity facilitated by economic transformation and policy reforms. However, the growth trajectory remains uncertain due to downside risks, including weaker global demand and adverse impact of the Russia-Ukraine war. The below trend output in the short term is consistent with the high unemployment rate (27.6 percent in the first quarter of 2024) and restrained growth in real wages.

The Bank's June 2024 Business Expectations Survey (BES) indicates that firms were more optimistic about business conditions in the second quarter of 2024, compared to the first quarter of 2024. This optimism in the second quarter of 2024 is reflected in the expected increase in both exports and imports of goods and services, production, inventories, profitability, employment, and investment in buildings and plant and machinery. These expectations are likely bolstered by government initiatives to support economic activity, including reforms to enhance the business environment, which are expected to be positive for growth prospects. Firms expect GDP to expand by 3.1 percent and 3.4 percent in the second and third quarters of 2024, respectively. The forecasts are optimistic compared to the projected contraction in the second quarter of 2024 (see Box 4).

Box 4: Leveraging Artificial Intelligence for Macroeconomic Forecasting

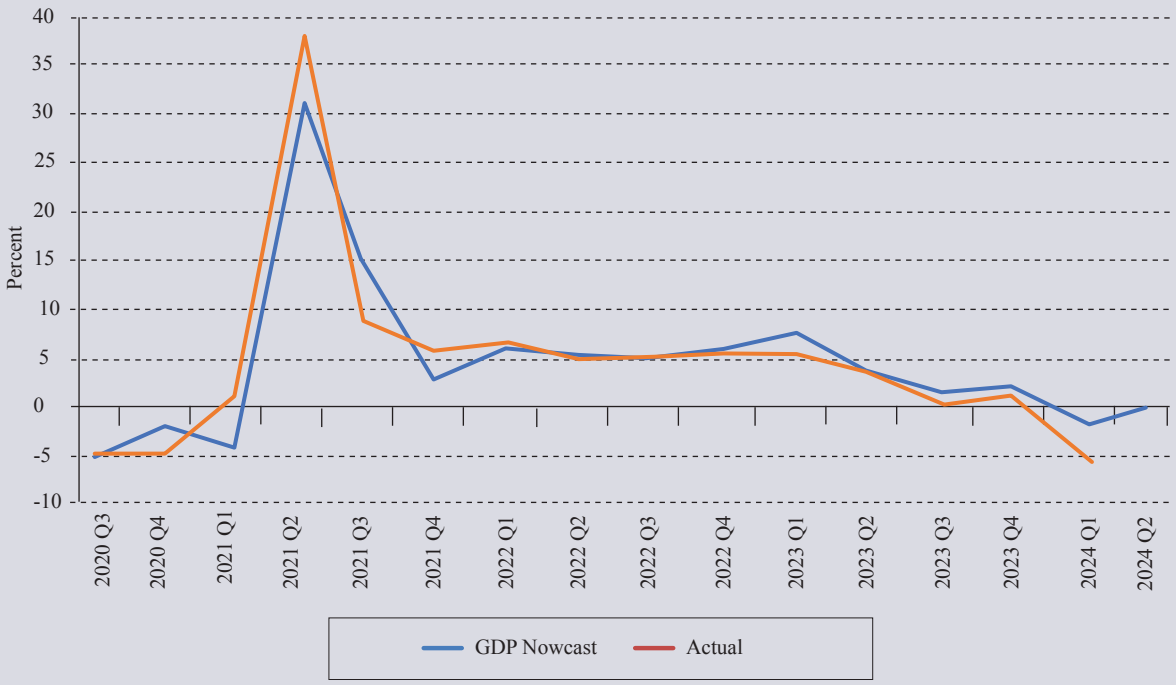
Macroeconomic modelling and forecasting are central to the activities of central banks. Forecasts for key variables, such as GDP growth and inflation, provide policymakers with insights into the likely direction of the economy. Central banks are ordinarily charged with maintaining stability of these variables, which typically involves making policy decisions to influence their development. For instance, adjustments to interest rates aim to influence economic activity and inflation towards desired levels, promoting price stability and sustainable economic growth. Given the evolving nature of modern economies, econometric modelling and forecasting techniques must adapt accordingly.

The increasing complexity and ever-evolving nature of the global economy have exposed significant limitations in traditional models, particularly in handling a large panel of economic predictors that help capture the full structure and dynamics of the economy. These limitations can undermine the accuracy and reliability of economic forecasts, highlighting the need for approaches that effectively incorporate relevant economic data, while excluding irrelevant data. Artificial Intelligence (AI), particularly Machine Learning (ML), presents innovative solutions to these challenges. AI and ML can handle large volumes of high-frequency data, commonly referred to as "big data," in macroeconomic analysis, which traditional models struggle to process. By integrating ML into macroeconomic forecasting frameworks, central banks and economic analysts can leverage advanced algorithms and data-driven insights to enhance the accuracy and reliability of their economic forecasts. This approach also addresses the issues related to data gaps, which often arise from delays in data release, improving the timeliness and precision of economic assessments and policy decisions, making ML an important tool for nowcasting.

In line with global innovations and trends, the Bank adopted ML methods in 2020 to nowcast GDP. As a policymaker, the Bank needs up-to-date and accurate information on current economic conditions to make informed policy decisions. Economic uncertainty necessitates access to real-time data and data analysis. In this regard, GDP growth nowcasting using ML has proven to be an instrumental tool for navigating economic uncertainties. The process of nowcasting real GDP for Botswana through ML involves the use of 23 different models. In this process, each model generates a GDP nowcast and the model with the lowest out-of-sample Root Mean Square Error (RMSE) is selected as the best model. The nowcast value from this best-performing model is then taken as the official GDP nowcast for that specific reporting session.

This ML approach uses a combination of high-frequency and low-frequency indicators to produce a GDP growth nowcast. The variables used are highly correlated with GDP growth and have strong predictive power. Additionally, these variables are available before GDP data is released or at higher frequencies, providing early indications of GDP trends. The variables currently used in the ML models to produce the nowcast include GDP figures for the United States GDP, China and India; electricity generation; bank loans to households; Stock Exchange Index; Government revenue; Google Search Volume Index Travel; diamond production; and diamond exports. Figure 1 plots the GDP nowcast values against actual values from the third quarter of 2020 to the second quarter of 2024. The figure illustrates that the nowcasting framework has been performing well, with the nowcasted GDP growth rates closely aligning with the realised GDP growth rates. This close correspondence indicates that the machine learning model provides a reliable estimate of economic performance.

Figure 1: Real GDP Growth Nowcast vs Actual (y-o-y)



There are, however, limitations and challenges associated with AI techniques, such as ML. These limitations include the need for significant computing power, which requires costly computing infrastructure, and a steep learning curve to develop advanced capabilities for optimal use. Despite these challenges, central banks are committed to infusing technological innovation into their processes and operations to achieve greater efficiency and agility. To build on the satisfactory performance of ML in GDP nowcasting using big data, the Bank continues to invest in computing infrastructure and skills development to harness the power of AI.

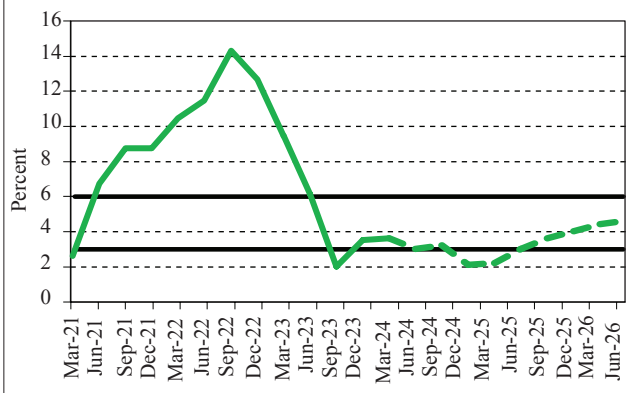
4.3 Monetary policy and inflation outlook

Inflation is expected to hover around the lower bound of the 3 – 6 percent objective range in the short term and be within the objective range on a sustained basis from the second quarter of 2025. The inflation forecast has been revised downwards compared to the June 2024 projection.

Inflation is projected to be around the lower bound of the objective range in the short term

Inflation is expected to hover around the lower bound of the 3 – 6 percent objective range in the short term. The low inflation forecast is mainly due to the anticipated slowdown in domestic fuel inflation. Nonetheless, inflation is expected to revert to within the objective range on a sustained basis from the second quarter of 2025, driven by the expected recovery in non-mining domestic economic activity (Chart 4.4).

Chart 4.4: Botswana Headline Inflation Forecast

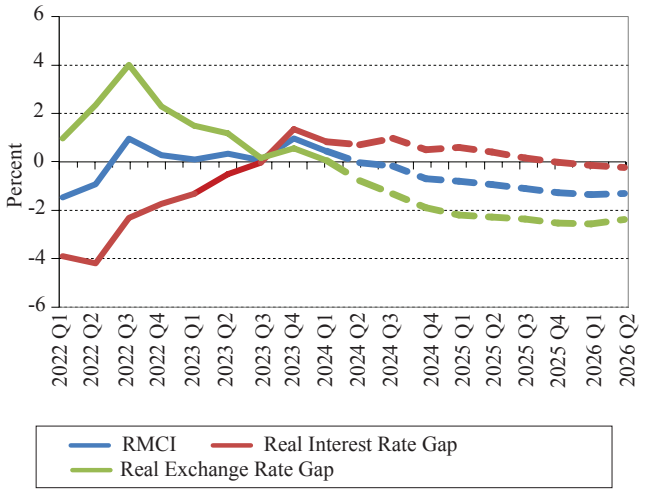


Source: Bank of Botswana

The projection considers, among other factors, the anticipated modest growth in domestic output supported by the generally prevailing accommodative monetary conditions (Chart 4.5); the implementation of an expansionary government budget for the 2024/2025 fiscal year; the marginal upward revision in forecasts for international oil prices; the downward revision in forecasts for international food prices; and the base effects associated with adjustments in administered prices in 2023.

Firms also expect inflation to be lower in 2024 and 2025 in the June 2024 BES compared to the previous survey averaging 4.3 percent in 2024 (down from 4.9 percent in the previous survey) and 3.4 percent in 2025 (from 5 percent in the previous survey, thus remaining within the objective range, suggesting that inflation expectations are well anchored.

Chart 4.5: Real Monetary Conditions

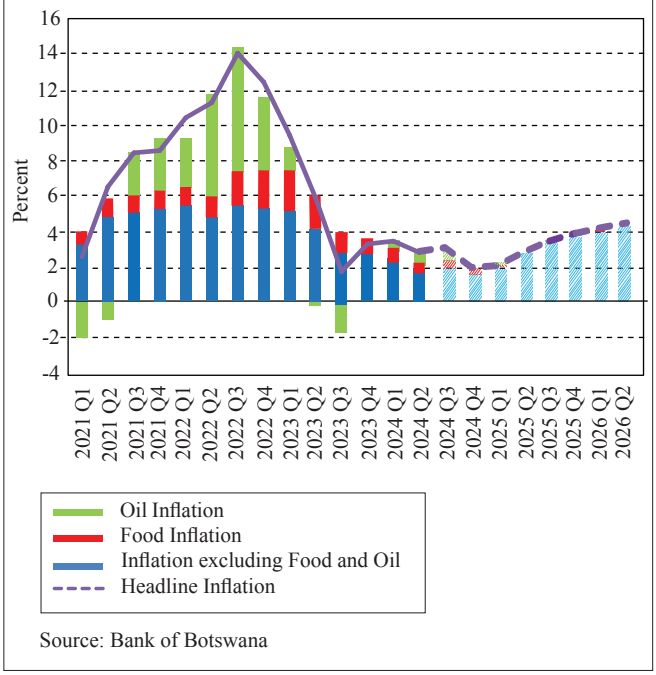


Source: Bank of Botswana

Core inflation to increase in the medium term

Inflation, excluding food and fuel prices, is forecast to increase in the medium term, mainly on account of the expected improvement in non-mining economic activity (Chart 4.6).

Chart 4.6: Headline Inflation and its Components



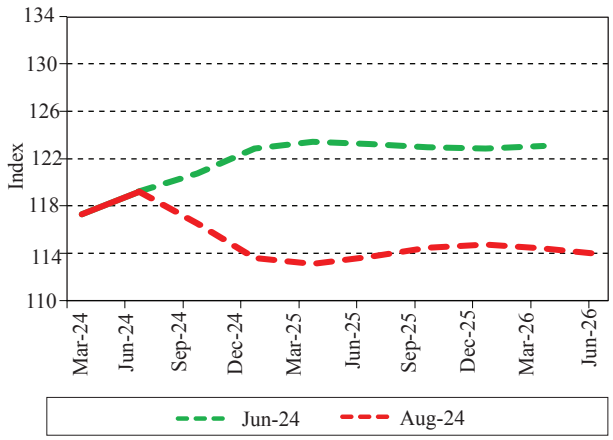
Source: Bank of Botswana

Forecasts for international food prices revised downwards

Compared to the June 2024 forecast, international food prices have been revised downwards into the medium-term (Chart 4.7). The downward revision is mainly due to a decline in export prices of all major cereals, on account of improved production prospects in key exporting countries, such as Kazakhstan and Ukraine for wheat, and Argentina, Brazil and US for maize.

Conversely, in Southern Africa, food prices are expected to increase due to the decline in food production during the 2023/24 ploughing season mainly due to El Niño weather phenomenon, which resulted in below-average rainfall and drought conditions in Southern Africa.

Chart 4.7: International Food Prices FAO Index

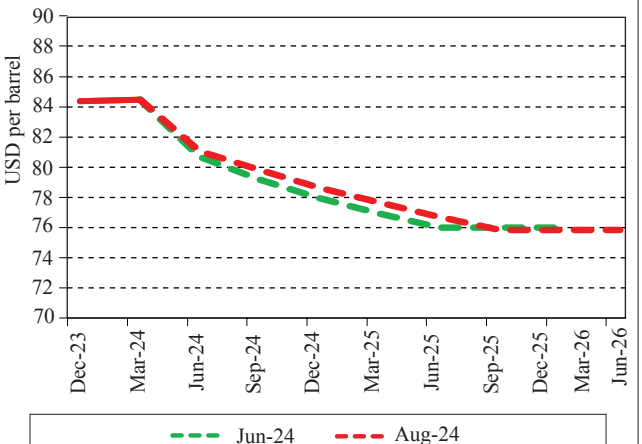


Source: Bloomberg

Forecasts for international oil prices revised slightly upwards

Relative to the June 2024 forecast, projections for international oil prices have been revised slightly upwards (Chart 4.8), mainly due to concerns of global oil supply disruptions stemming from geopolitical tensions in the Middle East.

Chart 4.8: International Oil Prices



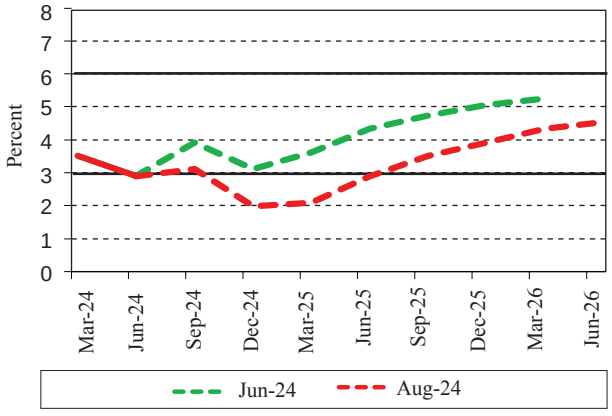
Source: Bloomberg

Overall, developments with respect to international food prices imply downward pressures on domestic inflation into the medium term, while trends in international oil prices indicate marginal upward pressures on domestic inflation over the same period, compared to the June 2024 forecasts.

Inflation forecast revised downwards generally

Compared to the June 2024 forecast, the domestic inflation projection has been revised downwards in the forecast horizon (Chart 4.9). This downward revision is mainly due to the lower-than-expected inflation outturn in the second quarter of 2024, as the increase in electricity tariffs and domestic fuel prices that was anticipated did not materialise. In addition, the restrained growth in the domestic prices across most categories of goods and services, together with the downward revision in forecasts for international food prices into the medium term, and the downward revision in South African inflation in the short term, contributed to the downward revision of the domestic inflation forecast.

Chart 4.9: Botswana Headline Inflation Forecast Revision



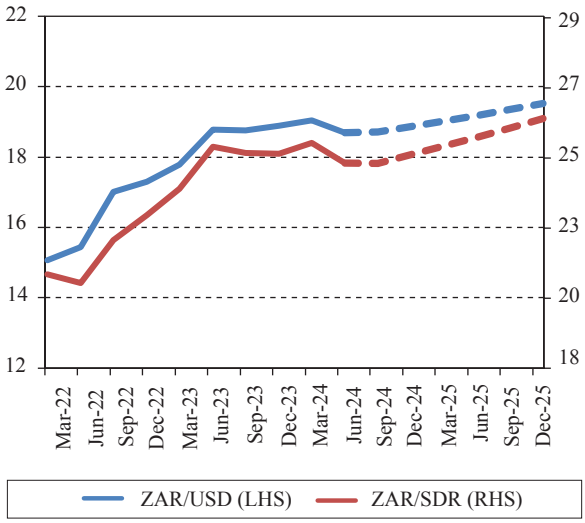
Source: Bank of Botswana

Exchange rate movements

The Pula exchange rate is determined by the performance of the Pula basket currencies and the rate of crawl. Once the basket composition and the rate of crawl (based on inflation differentials) have been determined, daily changes in the value of the Pula against other currencies result from movements in the cross rates of the South African rand and the SDR constituent currencies, considering their relative weights in the composite currency basket.

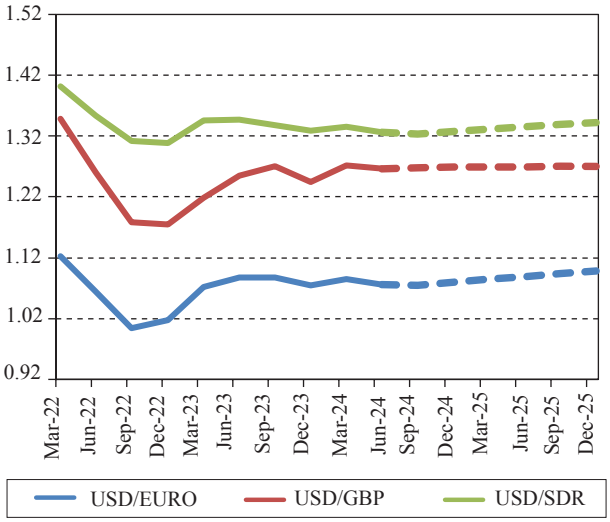
Although the South African rand strengthened following the formation of the GNU, aimed at promoting sustainable economic growth, job creation, land reform and infrastructure development, it is expected to depreciate against major currencies in the next four quarters (Chart 4.10). This is because the country continues to battle with several structural issues, such as high unemployment rate, potential water crisis in some key areas and logistics bottlenecks stemming from problems at the seaports and railway lines, which are expected to continue increasing the cost of doing business, limit economic output growth in South Africa and dampen investors' appetite for the South African rand. Moreover, the GNU remains a risk due to uncertainties over economic and fiscal policies formulation as a result of different political ideologies.

Chart 4.10: ZAR against USD and SDR



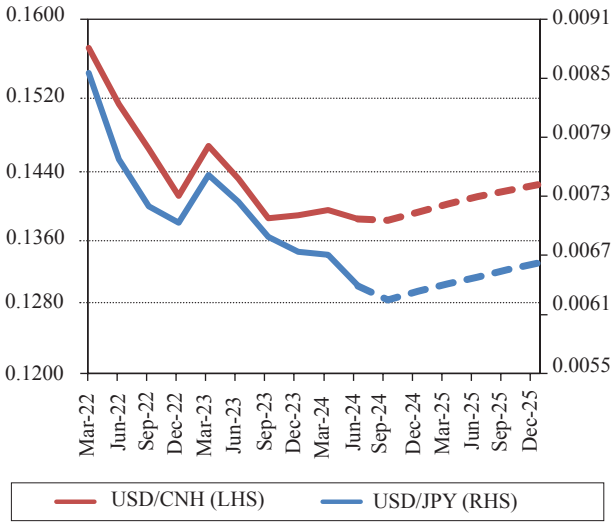
Source: Bloomberg

Chart 4.11A: Exchange Rates against USD



Source: Bloomberg

Chart 4.11B: Exchange Rates against the USD



Source: Bloomberg

The US dollar is expected to depreciate against most major international currencies over the next four quarters (Chart 4.11A and Chart 4.11B) due to diminishing US inflationary pressures, which resulted in global investors fully pricing in the possibility of the Federal Reserve Bank starting its monetary policy easing path as early as September 2024. However, this forecast may be affected by the resilience of the US economy and global investors' favourable sentiment towards the safe haven US dollar.

The British pound is expected to appreciate marginally against the US dollar (Chart 4.11A) due to an improved outlook for the UK economy and the hawkish stance of the Bank of England, which has dispelled expectations of an interest rate cut in August 2024. In addition, the outcome of the UK election, with a sizeable Labour party majority, is seen as positive for the British pound, as it is expected to support domestic investment, political stability, improve the UK-Eurozone relations, as well as growth-oriented reforms and spending policies.

Meanwhile, the euro is anticipated to slightly appreciate against the US dollar as the gradual narrowing of interest rate differentials is anticipated to support the currency's resurgence. The ECB lowered interest rates by 25 basis points in June 2024, with policymakers expecting one more interest rate cut before the end of the year. However, the ECB affirmed that it will keep policy rates sufficiently restrictive for as long as necessary to ensure that inflation returns sustainably to the 2 percent target in a timely manner, without committing to a specific rate path. However, the persistent decrease in Eurozone bond yields could hinder the euro's prolonged gains, although a further decline in US bond yields could alleviate this effect.

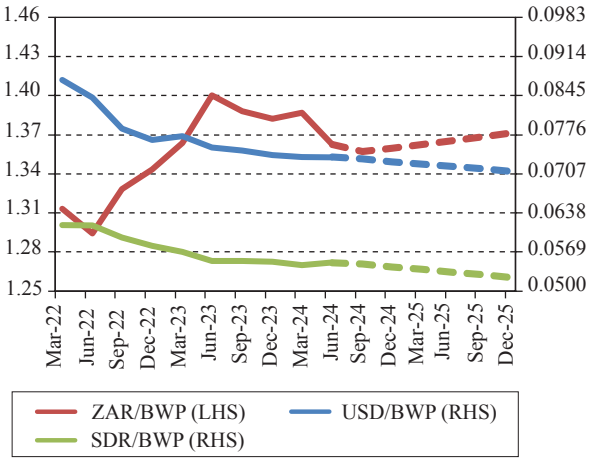
The Japanese yen is expected to appreciate against the US dollar in the medium term, despite the BoJ's reiteration that its decision to raise short-term interest rates from negative levels for the first time in decades at its March 2024 meeting did not signal the beginning of quantitative tightening. However, given Japan's inflation dynamics, the BoJ is expected to announce its bond purchase tapering plans and possibly raise interest rates again in the third and fourth quarters of 2024, thus increasing yields on Japanese yen denominated assets. Moreover, the yen is likely to benefit from the Fed's dovish stance.

The Chinese renminbi is expected to appreciate against the US dollar over the forecast horizon (Chart 4.11B) as China's economy is projected to grow by 5 percent in 2024, due to an increase in the country's industrial and manufacturing output, which adds value, enhances export product diversification and promotes the rise of new technologies and industries.

Overall, the forecast movements of other SDR constituent currencies suggest a marginal appreciation of the SDR against the US dollar (Chart 4.11A).

The anticipated depreciation of the South African rand against major international currencies is expected to exert downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.12). However, the Pula is expected to appreciate against the South African rand into the medium term[11], which is anticipated to exert marginal downward pressure on domestic inflation.

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



Source: Bloomberg and BoB calculations

Risks to the inflation outlook

Overall, risks to the inflation outlook are assessed to be balanced. Inflation could be higher than projected if international commodity prices increase beyond current forecasts, supply and logistical constraints persist and geo-economic fragmentation escalates. Furthermore, inflation may be heightened by possible upward adjustments in administered prices that are not factored in the current projection, and any increase in domestic food prices due to the prevailing El Niño induced drought conditions in Southern Africa. However, these upward risks are offset by likelihood of continued weaker domestic and global economic activity, as well as any decrease in international commodity prices.

11 Given its singular higher weight relative to any other single currency in the Pula currency basket mechanism, the Pula tends to closely follow the performance of the South African rand. However, the depreciation of the Pula is moderated by the effect of the SDR currencies in the basket.

Box 5: THE ROLE OF THE MINING SECTOR IN FUTURE DEVELOPMENT

The Box provides highlights of the 2023 Annual Report Theme Chapter which focuses on the role of the mining sector in Botswana's future development, emphasising beneficiation, industrialisation prospects and macroeconomic policy implications. In drafting the 2023 Annual Report Theme Chapter, the Bank consulted mining stakeholders, including the Ministry of Minerals and Energy, Debswana and Botswana Geoscience Institute (BGI).

INTRODUCTION

Botswana's desire to transition to high-income status, aligned with the nation's Vision 2036, is well entrenched. Critical attributes to this transition include achieving higher rates of economic growth (GDP), estimated at more than 6 percent annually over the next 13 years, as well as enhanced inclusivity, indicated by significant reduction in unemployment, poverty rates and inequality. In pursuit of this transition, there is a conventional and long-standing understanding that key to the nation's growth prospects and inclusivity, is economic diversification. However, economic diversification continues to proceed at a relatively slow pace. Among the various sources of economic potential, it is considered that Botswana's endowments of minerals continue to present potential for economic diversification and higher rates of growth. The impact on the economy and development progress reflects beneficial execution of minerals policy, ownership structures, as well as cost and revenue sharing arrangements in place, which have been subject to progressive review and implementation over time. Overall, this has been the main driver of the country's transition to upper middle-income status attained in the mid-1990s.

OVERVIEW OF THE MINING SECTOR AND OWNERSHIP ARRANGEMENTS

Botswana is endowed with significant mineral deposits which include coal reserves of about 28.2 billion tonnes, 261 kimberlite pipes and significant occurrences of other minerals, which remain under-explored. As such, lack of large-scale exploitation and secondary processing suggest sub-optimal economic activity and a constraint to growth prospects. Few exploitations, particularly diamonds, largely contribute to Botswana's economic prospects. For example, in 2022, the mining sector accounted for about 20 percent of nominal GDP, with diamonds contributing nearly 93 percent of total mining GDP, and approximately 90 percent of total exports of goods. One of the requirements necessary for a lasting beneficial impact of the mining sector in Botswana include protocols for awarding mining rights, ownership and investments, which vary according to type and uses of minerals. Three investment and ownership models exist in Botswana. These include full state ownership, wholly private ownership and shared partnership between the Government and private entities, with varying implications for revenue and cost sharing arrangements. In the context of revenues, royalties, corporate tax, withholding tax on dividends and dividends generate mining revenues. Mineral royalties range between 3 to 10 percent, depending on the quality of minerals mined; 10 percent, 5 percent and 3 percent for precious stones, precious metals and mineral products, respectively, and compares favourably with mining giants, such a Chile, Canada, Russia and Australia.

BENEFICIATION AND INDUSTRIALISATION PROSPECTS

There are four key elements that can facilitate the scope of industrialisation and unlock the full potential of Botswana's mining sector:

1) Beneficiation policies

There is scope for supportive and facilitative policies to promote aspects of beneficiation including downstream processing, side-stream infrastructure services and upstream supplies. Meanwhile, the national strategy is being developed to deliver a robust framework for mineral exploitation and beneficiation. The policy ecosystem is further supported by the 2022 Minerals Policy, which fosters a competitive environment for attracting and sustaining mineral investment and related beneficiation initiatives. Therefore, relentless and timeous implementation of these policies should deliver durable employment, diversification and the need for export opportunities.

2) Secondary processing

This is another way of strengthening local industrialisation as it promotes the transformation of raw materials into finished products. Generally, value addition in the mineral sector has not been inspiring and, in the absence of rapid growth in secondary processing, this economy has transitioned to modest growth rates. Among several opportunities for value chain development include jewellery manufacturing, coal processing and glass production which provide immediate points of impact on industrialisation.

3) Industrial linkages

The impact of the mining sector also relates to backward and forward linkages that include transportation, construction, electricity and water, as well as education and research, among others. These encompass the development and side-stream capacity that would, in turn, support export-oriented production.

4) Community development

Given the exhaustible nature of minerals, mining activities should be accompanied by frameworks for addressing community development and sustainability. In this respect, Corporate Social Responsibility and Environmental, Social and Governance considerations could greatly contribute to reducing socio-economic challenges, provided that adequate attention is given to socialisation and empowerment aspects that also address social ills. Moreover, resource-based industrialisation should contribute to continuous research, innovation and skills development that impact on productivity and competitiveness.

MACROECONOMIC POLICY IMPLICATIONS

Transparent and stable macroeconomic frameworks create a conducive business environment for mining investment. Prudent and predictable fiscal, monetary and exchange rate policies continue to support mining activity and development, thus contributing to overall economic growth prospects. Fiscal rules underpin sustainability through prudent management of mining revenues, while predictable tax regime bolster investor confidence, revenue mobilisation and welfare-enhancing growth in the mining sector. From a financial policy perspective, there is potential for the financial sector to further support the mining sector by mobilising funds for investment. To fully unlock this potential, the country is embarking on the development of a Financial Sector Development Strategy to identify priorities and reforms necessary to engender a vibrant, inclusive and innovative financial sector that can support economic development, including sectoral performance in mining.

CONCLUSION

There is absence of extensive linkages of the mining sector with the rest of the economy, which undermine value chain development, beneficiation, human capital and financial sector development. There are opportunities to overcome these challenges through adaptive beneficiation strategies that promote development of downstream value chains, rapid industrialisation, innovation and environmental sustainability. More crucially, the extractive and finite nature of minerals require that frameworks for addressing economic stabilisation, sustainability and intergenerational equity must accompany these strategies. As such, the fiscal framework should be aligned to the sustainability of mining sector performance, while efforts to strengthen the operating aspects of the Pula Fund need to be accelerated to preserve long-term sustainability.

5. AUGUST 2024 MONETARY POLICY COMMITTEE DECISION

At the meeting held on 22 August 2024, the Monetary Policy Committee (MPC) of the Bank of Botswana reduced the Monetary Policy Rate (MoPR) by 25 basis points from 2.15 percent to 1.9 percent.

Economic Environment

Since the last MPC meeting, data released by Statistics Botswana shows weaker growth than previously forecast due to factors that include the impact of lower external demand for mining sector production (especially diamonds) and weaker performance of the non-mining sectors. This has led to reduced export earnings, especially from diamond sales, which is likely to constrain government spending and its impact on economic activity.

As reported, real gross domestic product (GDP) declined by 5.3 percent in the first quarter of 2024, compared to a growth of 5.3 percent in the same quarter in 2023. Meanwhile, economic activity remained restrained in the second quarter of 2024.

According to the July 2024 World Economic Outlook Update, global output growth is forecast at 3.2 percent for 2024, slightly lower than 3.3 percent in 2023 and to increase marginally to 3.3 percent in 2025. For Botswana, the International Monetary Fund has revised GDP growth for 2024 downwards to 1 percent, from an earlier estimate of 3.6 percent, partly due to the downturn in the diamond industry performance, given weak global demand and high inventories.

Inflation

As reported by Statistics Botswana, headline inflation was 3.7 percent in July 2024. The MPC forecasts inflation to remain low into the medium term, averaging 3 percent in 2024, 3.2 percent in 2025 and 4.7 percent in 2026. The risks to this inflation trajectory were assessed to be balanced.

Furthermore, as previously indicated, the MPC observes that inflation could be higher than projected if international commodity prices increase beyond current forecasts, if supply and logistical constraints persist and geoeconomic fragmentation escalates. Furthermore, inflation may be heightened by possible upward adjustment in prices controlled by government (administered prices) that are not factored in the current projection and any increase in domestic food prices due to the prevailing El Niño induced drought conditions in Southern Africa. However, these upward risks are offset by likelihood of continued weaker domestic and global economic activity, as well as any decrease in international commodity prices.

Decision

The MPC notes that despite the commitment by government to stimulate non-mining sectors through potential growth-enhancing economic transformation reforms, initiatives and supportive macroeconomic policies, the prospects for significant economic growth are still not visible. Therefore, the MPC projects that the economy will continue to operate below full capacity into the medium term and should not generate demand-driven inflationary pressures. Thus, inflation is forecast to remain low and within the objective range into the medium term, averaging 3 percent in 2024, 3.2 percent in 2025 and 4.7 percent in 2026. Similarly, businesses also expect inflation to be within the medium-term objective range; thus, inflation expectations are aligned to the inflation objective (well anchored). As a result, the current economic conditions and the outlook for both domestic and external economic activity provide scope to ease monetary policy. Consequently, the MPC decided to reduce the MoPR by 25 basis points to 1.9 percent.

Accordingly,

(a) the 7-day Bank of Botswana Certificates auctions, repos and reverse repos will be conducted at the MoPR of 1.9 percent;

(b) the Standing Deposit Facility (SDF) Rate is reduced to 0.9 percent, 100 basis points below the MoPR; and

(c) the Standing Credit Facility (SCF) Rate reduces to 2.9 percent, 100 basis points above the MoPR.

Meetings of the MPC

The next MPC meetings for 2024 are scheduled as follows:

31 October 2024
5 December 2024

Annex: Inflation Forecast Summary for August 2024 MPC Meeting

	Actual					Forecast									
	2023			2024		2024			2025					2026	
	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2
Inflation	2.0	2.0	**5.2**	3.6	3.0	3.2 (4.0)	2.1 (3.2)	**3.0 (3.5)**	2.2 (3.7)	3.0 (4.4)	3.6 (4.8)	4.0 (5.1)	**3.2 (4.5)**	5.4 (5.3)	4.6 (5.4)

Note: Figures in parentheses represent the previous MPC forecast (June 2024)

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

Domestically
Lower outturn of the 2024Q2 inflation than previously projected (3.5 percent).

Externally
Downward revision in forecasts for international food prices and South Africa's inflation forecasts.

NOTE

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