MONETARY POLICY REPORT (EXTERNAL)

BANK OF BOTSWANA

BANKA YA BOTSWANA

DECEMBER 2021

BANK OF BOTSWANA

STRATEGIC INTENT STATEMENTS

VISION

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

MISSION

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

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

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1. PREFACE

1.1 Purpose of the report

The Monetary Policy Report (MPR) is the main medium through which the Bank of Botswana (the Bank) informs the public about the conduct of monetary policy on a regular or timely 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 Act (Cap 55:01).

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

1.2 Monetary policy framework

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

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, while taking into account the prevailing rate of crawl of the exchange rate mechanism, prospects for economic growth and developments relating to the stability of the financial system. The policy horizon is up to 3 years, and evaluated on a rolling basis, because monetary policy affects price developments with a lag estimated at up to four quarters. A proactive approach to setting policy necessitates a continuous review of the inflation outlook.

The monetary policy stance is signalled by the Bank Rate. To support this signal, the Bank uses open market operations, which entail, primarily, auctioning of Bank of Botswana Certificates (BoBCs) to, and engaging in Repo/Reverse Repo transactions with commercial banks (primary dealers), as well as adjustment of the Primary Reserve Requirement Ratio (although this is rarely used).

1.3 Decision-making process

Monetary policy is implemented in line with the decisions of the Monetary Policy Committee (MPC). The Committee comprises: the Governor (Chairman); Deputy Governors; the Chief Operating Officer; Director and Deputy Directors of the Research and Financial Stability Department responsible for monetary policy and financial stability; Director and Deputy Director of the Financial Markets Department responsible for the domestic market operations; and Director of the Banking Supervision Department.

The MPC holds six pre-scheduled meetings or more per year, as necessary, during which the monetary policy stance is determined. Prior to the commencement of the year, the dates for the MPC meetings for the ensuing year are announced.

1.4 Announcement of the monetary policy decision

The monetary policy decision is announced through a Press Release shortly after each MPC meeting. The Press Release informs the public of the Committee's decision regarding the Bank Rate and the reasons for the policy choice. The Governor holds a Press Briefing to allow for interaction with members of the media and to promote understanding of the Bank's economic analysis and policy stance (See Box 6 for further information on central bank communication).

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 December meetings. The MPR is published on the Bank website (www.bob.bw) within a week of the announcement of a policy decision.

2. EXECUTIVE SUMMARY

In 2021, monetary policy was implemented in the context of projections for higher inflation in the near term, associated with upward adjustment of taxes/levies and administered prices (Box 1), a modest recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines, and projected increase in foreign prices. Overall, the current state of the economy and the outlook for both domestic and external economic activity provided scope for maintenance of an accommodative monetary policy to support durable recovery and economic activity.

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.

Globally, the pandemic took a turn for the worst in some parts of the world in the third quarter of 2021 due to emergence of the new variants of the virus, resulting in slowdown in output growth in most economies during this period. The United States of America (US)'s annualised GDP growth slowed down from an expansion of 6.7 percent in the second quarter of 2021 to 2.1 percent in the third quarter, due to resurgence of COVID-19 cases that resulted in new restrictions and delays in the reopening efforts of some establishments in some parts of the country. Similarly, the United Kingdom (UK)'s economic activity slowed, quarter-on-quarter, from a growth of 5.5 percent in the second quarter of 2021 to 1.3 percent in the third quarter, reflecting the contraction of the manufacturing sector and a negative contribution from net trade. China's economy also slowed from an annualised growth of 7.9 percent in the second quarter of 2021 to 4.9 percent in the third quarter, mainly resulting from rising economic challenges including a power crunch and the outbreak of the new COVID-19 virus in some regions. However, the euro area growth maintained momentum in the third quarter of 2021, increasing quarter-on-quarter to 2.2 percent from 2.1 percent in the second quarter of 2021, due to continued re-opening efforts amid rapid pace of COVID-19 vaccinations and ongoing government support.

The global economic outlook for 2021 was revised slightly downwards in the IMF's October 2021 World Economic Outlook (WEO). Prospects for advanced economies are much weaker compared to the July 2021 projection, mostly reflecting downgrades in major economies, particularly the US, Japan and Germany. The global economy is forecast to expand by 5.9 percent in 2021, from an estimated contraction of 3.1 percent in 2020, reflecting expectations of strengthening of activity in the latter part of the year, largely induced by additional policy support and the rollout of the effective COVID-19 vaccination programmes.

The global rough diamond price index increased in the third quarter of 2021 as COVID-19 restrictions continued to ease in most countries, thus improving the manufacturers' demand for rough diamonds and diamond trade, generally. In the third quarter of 2021, international oil prices increased, averaging slightly above USD70 per barrel, influenced by the expansion in demand associated with the rollout of COVID-19 vaccines. Similarly, the United Nations' Food and Agriculture Organisation (FAO) food price index increased in the third quarter of 2021, supported by the rise in meat and sugar prices.

Domestically, headline inflation averaged 8.7 percent in the third quarter of 2021, higher than the 1.2 percent in the third quarter of 2020, mostly accounted for by the increases in domestic fuel prices and associated second-round effects, as well as higher vehicle prices. Inflation is forecast to remain above the upper bound of the Bank's 3 - 6 percent objective range in the short term. Nonetheless, inflation is expected to revert to within the objective range in the third quarter of 2022. Compared to the October 2021 forecast, inflation is projected to be higher in the near term, mainly reflecting the expected increase in domestic fuel prices in the fourth quarter of 2021 and private school fees in the first quarter of 2022, as well as the upward revision in forecasts for trading partner countries inflation and international commodity prices. Meanwhile, inflation in the medium term is expected to be lower compared to the October 2021 forecast on account of the slightly tight monetary conditions.

Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistence of supply and logistical constraints due to lags in production; possible maintenance of travel restrictions and lockdowns due to the COVID-19 pandemic; domestic risk factors relating to regular annual price adjustments; as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, aggressive action by governments (for example, the Economic Recovery and Transformation Plan (ERTP)) and major central banks to bolster aggregate demand, as well as the successful rollout of the COVID-19 vaccination programmes, could add pressure to inflation. These risks are, however, moderated by the possibility of weak domestic and global economic activity, with a likely further dampening effect on productivity due to periodic lockdowns and other forms of restrictions in response to the emergence of new COVID-19 variants. A slow rollout of vaccines, resulting in the continuance of weak economic activity and the possible decline in international commodity prices could also result in lower inflation, as would capacity constraints in implementing the ERTP initiatives.

Botswana's real gross domestic product (GDP) grew by 4.9 percent in the year to June 2021, compared to a contraction of 5.1 percent in the corresponding period in 2020, attributable to the expansion in production of both the mining and non-mining sectors. The increase in output resulted from an improved performance of the economy from a low base in the corresponding period in the previous year, emanating from the negative output effects of the COVID-19 pandemic containment measures. The prevailing accommodative monetary conditions, reforms to further improve the business environment, and government interventions against COVID-19, including vaccine rollout and implementation of the ERTP, should generally be positive for economic activity in the medium term. The domestic economy is forecast to rebound to a growth of 9.7 percent in 2021 from a contraction of 8.5 percent in 2020.

Annual growth in commercial bank credit increased from 4.4 percent in September 2020 to 7.4 percent in September 2021, reflecting, in part, the increase in loan uptake by households, particularly through scheme loan arrangements, as well as the recovery from the lower base effects emanating from the COVID-19 pandemic.

At the end of September 2021, the official foreign exchange reserves amounted to P52.1 billion, a decrease of 11.4 percent from P58.8 billion in September 2020. The decrease was a result of the drawdown in foreign exchange reserves to finance government financial obligations. The current account of the balance of payments (BoP) recorded a deficit of P2.7 billion in the second quarter of 2021, compared to a revised deficit of P7.5 billion in the corresponding period in 2020.

Following the annual exchange rate policy review in January 2021, an annual downward rate of crawl of 2.87 percent was maintained for 2021, with a view to enhancing domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. Consequently, the nominal effective exchange rate (NEER) of the Pula depreciated by 2.8 percent in the twelve months to November 2021. Against the basket currencies, the Pula depreciated by 0.7 percent against the South African rand and by 4.5 percent against the SDR in the twelve months to November 2021. In the year to October 2021, the REER appreciated by 1.1 percent due to the higher positive inflation differential (4 percent) between Botswana and the trading partner countries than the downward rate of crawl (2.8 percent).

3. RECENT ECONOMIC DEVELOPMENTS

3.1 Recent global economic developments

Global growth improving
According to the October 2021 WEO, the global economy is estimated to have contracted by 3.1 percent in 2020 (Table 3.1), a 0.1 percentage point upgrade from the July 2021 WEO Update. All regions experienced negative growth in 2020 as the outbreak and spread of the COVID-19 virus constrained demand and disrupted supply chains on an unprecedented scale. The pandemic took a turn for the worst in some parts of the world in the second and third quarters of 2021, with the emergence of the new variants of the virus. However, speedy vaccine rollouts in some regions, particularly in advanced economies, helped contain the spread of the virus in those countries, and boosted economic recovery. Nonetheless, unequal access to vaccines and higher infections, particularly in emerging market economies, worsened the pandemic. Meanwhile, sizable policy support continues in advanced economies, while many emerging market economies are reducing support this year, as policy space shrinks with the persistence of the pandemic.

The US economy expands
The US output grew by an annualised 2.1 percent in the third quarter of 2021, slowing from an expansion of 6.7 percent in the second quarter of 2021, reflecting mainly a slowdown in consumer spending, as the resurgence of COVID-19 cases resulted in new restrictions and delays in the reopening of some establishments in some parts of the country. However, the realised expansion reflected increases in private inventory investment, personal consumption expenditures, state and local government spending and non-residential fixed investment.

Euro area growth maintains momentum
In the euro area, GDP grew quarter-on-quarter by 2.2 percent in the third quarter of 2021, from a revised growth of 2.1 percent in the second quarter. The expansion reflected the continued re-opening efforts amid rapid pace of COVID-19 vaccinations and ongoing government support. Among the bloc's largest economies, output in France, Italy, Spain and Germany expanded by 3 percent, 2.6 percent, 2 percent and 1.8 percent, respectively.

UK economy expands
GDP in the UK expanded, quarter-on-quarter, by 1.3 percent in the third quarter of 2021, albeit lower than the 5.5 percent growth in the previous quarter. The slowdown in output growth reflected the contraction of the manufacturing sector due to supply chain challenges, as well as a negative contribution from net trade due to a fall in exports. However, the increase in output in the third quarter of 2021 was driven mostly by a substantial increase in the hospitality, arts and recreation as well as health sectors, as the country eased COVID-19 restrictions.

Emerging markets' growth expand
Output growth in emerging markets increased in the third quarter of 2021, primarily due to improved external and domestic demand arising from relaxation of containment measures that were imposed to contain the spread of COVID-19, as well as the rollout of COVID-19 vaccines (although the rollout falls behind that of advanced economies). Growth was also supported by the continued positive output growth in China, as well as accommodative monetary and fiscal stimulus implemented to cushion the economies from the COVID-19 pandemic. China's economy grew by an annualised 4.9 percent in the third quarter of 2021, compared to 7.9 percent growth in the second quarter of 2021, and slightly lower than the market expectation of 5.2 percent. The slowdown in output growth between the second and third quarters of 2021 was a result of rising economic challenges including a power crunch, global supply chain bottleneck and the outbreak of the new COVID-19 virus in some parts of the country. Nonetheless, Chinese output expansion was boosted by the rebound of the retail sector as well as continued support for smaller firms.

In India, GDP grew, year-on-year, by 8.4 percent in the third quarter of 2021, from a record growth of 20.1 percent in the second quarter of 2021, as COVID-19 related disruptions continued to ease and economic activity rebounded, helped by a faster pace of vaccinations and a drop in COVID-19 cases. The expansion was mainly driven by growth in trade, hotels, transport and communication; financial, real estate and professional services; and public administration, defense and other services.

South African economy slows

Regionally, output in South Africa expanded, quarter-on-quarter, by 1.2 percent in the second quarter of 2021, higher than the 1 percent growth in the first quarter of 2021.[1] Growth for the second quarter of 2021 marked four quarters of consecutive growth. The largest drivers of growth in the second quarter were transport, personal services and trade industries, which expanded by 6.9 percent, 2.5 percent and 2.2 percent, respectively.

Table 3.1: Growth Estimates and Projections

	Estimate		Projection	
	2019	2020	2021	2022
Global	**2.8**	**-3.1**	**5.9**	**4.9**
Advanced economies	**1.7**	**-4.5**	**5.2**	**4.5**
USA	2.3	-3.4	6.0	5.2
Euro area	1.5	-6.3	5.0	4.3
UK	1.4	-9.8	6.8	5.0
Japan	0.0	-4.6	2.4	3.2
EMDEs	**3.7**	**-2.1**	**6.4**	**5.1**
China	6.0	2.3	8.0	5.6
Brazil	1.4	-4.1	5.2	1.5
India	4.0	-7.3	9.5	8.5
Russia	2.0	-3.0	4.7	2.9
South Africa	0.1	-6.4	5.0	2.2
Botswana	**3.0**	**-8.5**	**9.2 (9.7)**	**4.7 (4.3)**

Source: IMF WEO October 2021 and MFED for Botswana
Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts from the MFED.

Global commodity prices

Diamond prices increased in the third quarter of 2021

The global rough diamond price index increased by 7.9 percent from 154.5 points in the second quarter of 2021 to 166.7 points in the third quarter of 2021, as most countries continued to ease COVID-19 restrictions and rolled out effective vaccines, thus, improving manufacturers' demand and trade for rough diamonds. However, the recovery in demand remains fragile owing to ongoing restrictions on the movement of people and goods to contain the spread of the COVID-19 virus. The global rough diamond price index averaged 177.1 points in November 2021.

The global polished diamond price index[2] also increased by 5.2 percent from 134 points in the second quarter of 2021 to 141 points in the third quarter. In October 2021, the global polished price index averaged 142 points.

Oil prices increased in the third quarter of 2021

International oil prices averaged slightly above USD70 per barrel in the third quarter of 2021 (Chart 3.1). The price of the OPEC reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 7.7 percent, 6.4 percent and 6.6 percent, from an average of USD67.42 per barrel, USD68.63 per barrel and USD66.19 per barrel in the second quarter of 2021 to an average of USD72.58 per barrel, USD73.00 per barrel and USD70.54 per barrel, respectively, in the third quarter of 2021. International oil prices increased, in part, supported by the recovery in global demand, following the relaxation of some COVID-19 containment measures and effective rollout of vaccination programmes, especially in advanced economies. Furthermore, economic rebound in major economies, supported by stimulus programmes, also boosted the demand for oil in the third quarter of 2021.

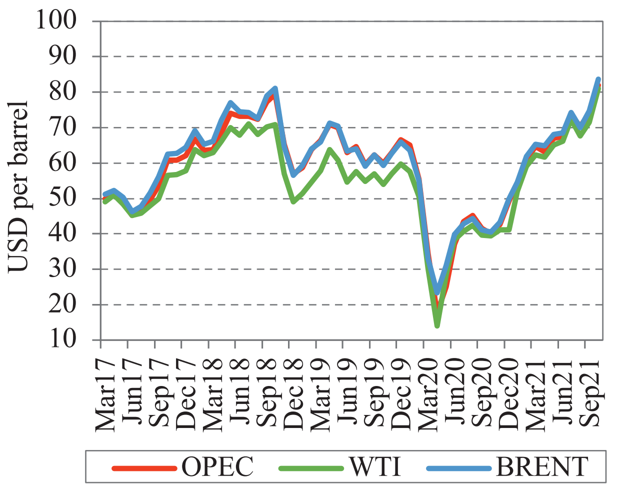
Meanwhile, international oil prices decreased slightly, month-on-month, in November 2021. The OPEC reference crude oil basket decreased by 1.9 percent to an average of USD80.37 per barrel, while Brent crude price and WTI decreased by 3.5 percent and 2.3 percent to an average of USD80.80 per barrel and USD79.18 per barrel, respectively. The decrease in oil prices was, in part, due to the decision by the US to release about 50 million barrels of oil from its strategic reserves in coordination with major oil consuming countries, including China, India, Japan, UK and South Korea to counter the rising oil prices. Furthermore, the discovery of a new COVID-19 variant, Omicron[3], and fears that vaccines are unlikely to be as effective against it as they have been against other variants, resulted in the decrease in prices at the end of November 2021.

1 This is Statistics South Africa's (Stats SA) first GDP release after the completion of its benchmarking and rebasing exercise. Stats SA no longer uses the quarterly annualised rate as the headline growth rate.

2 The Antwerp Diamond Index, which is based on prices in US dollars, and gives the average price evolution of polished diamonds in the Antwerp markets.

3 The newly identified coronavirus variant (Omicron) in Southern Africa is considered by scientists to be the most prevalent variant they have encountered to date in their research. The variant has a spike protein that is dramatically different to the one in the original coronavirus that COVID-19 vaccines are based on. On November 26, 2021, the World Health Organisation declared Omicron as a "variant of concern".

Chart 3.1: Oil Prices



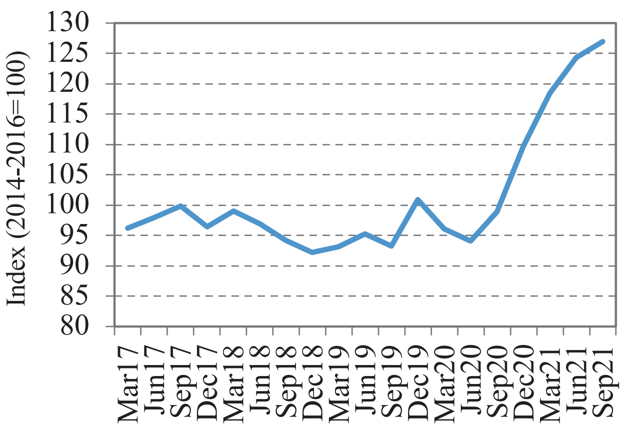
Source: OPEC and US Energy Information

Food prices increased in the third quarter of 2021

According to FAO, the global food price index averaged 126.9 points in the third quarter of 2021, a 2.2 percent increase from an average of 124.3 points in the second quarter of 2021 (Chart 3.2). The increase was attributable to higher meat and sugar prices. Moreover, brisk trade activity, supported by the recovery in global demand following relaxation of some COVID-19 containment measures in the same period, helped to increase food prices. Furthermore, the rising concerns over production in the Southern hemisphere and dry conditions in many parts of Europe resulted in overall higher food prices.

The food price index averaged 134.4 points in November 2021, an increase of 1.2 percent from October 2021. and was 27.3 percent higher than in the corresponding period last year.

Chart 3.2: Food Price Index

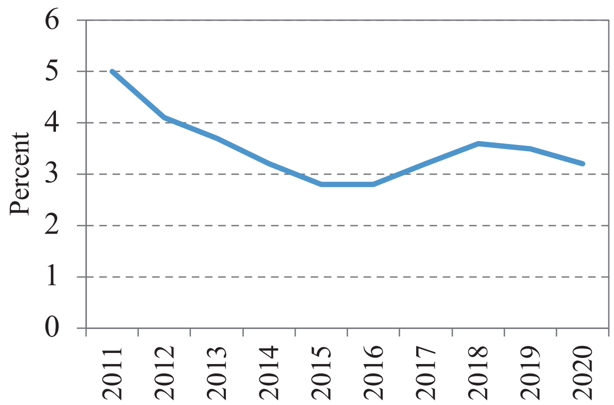


Source: Food and Agriculture Organisation

Inflation rose across the regions

Inflation increased, globally, in the third quarter of 2021, owing to the rise in commodity prices, as well as improving global economic demand as most economies eased movement restrictions and deployed effective COVID-19 vaccines. For advanced economies, inflation increased from 3.5 percent in the second quarter of 2021 to 3.9 percent in the third quarter, consistent with the faster rates of deployment of vaccines, particularly in the UK and US. Similarly, inflation increased from 2.9 percent to 3.7 percent in emerging market economies in the same period. Global inflation declined from 3.5 percent in 2019 to 3.2 percent in 2020 (Chart 3.3).[4]

Chart 3.3: Global Inflation



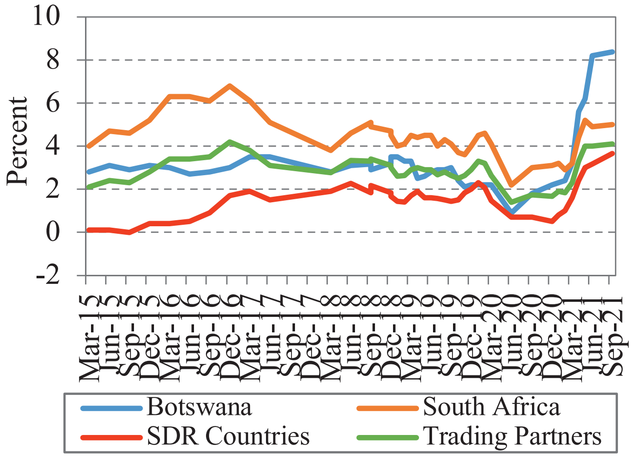
Source: IMF October 2021 WEO

In South Africa, headline inflation was constant at 4.8 percent between the second and third quarters of 2021. Similarly, inflation was unchanged at 5 percent between September and October 2021, remaining within the SARB's target range of 3 – 6 percent.

The average trade-weighted inflation for Botswana's trading partners (Chart 3.4) increased from 4.3 percent in September to 4.7 percent in October 2021.

[4] The quarterly inflation estimates are sourced from Bloomberg.

Chart 3.4: Botswana Inflation and International Inflation



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

Accommodative monetary policy stance maintained

In the most recent policy decisions in advanced economies (Table 3.2), the European Central Bank (ECB) maintained the deposit rate, refinancing rate and lending rate at -0.50 percent, zero and 0.25 percent, respectively, in October 2021, to support the Eurozone economy. The ECB announced that it would continue conducting a moderately lower pace of asset purchases under the pandemic emergency purchase programme for the rest of the year due to improved economic and financial conditions. The ECB is expected to continue to provide ample liquidity through its refinancing operations as part of the measures for supporting economic recovery and counteracting the negative impact of the pandemic on the projected inflation path.

At the November 2021 meeting, the US Federal Open Market Committee (FOMC) left the target policy rate range unchanged at 0 - 0.25 percent, as indicators of economic activity and employment showed an improvement, amid progress on vaccinations and strong policy support. Financial conditions remained accommodative, reflecting, in part, policy measures to support the economy and the flow of credit to households and businesses. However, the Fed indicated that it would start reducing its monthly holdings of Treasury securities and agency mortgage-backed securities by USD10 billion and USD5 billion later in November 2021, respectively, but could revise the amounts depending on the economic outlook. The FOMC further noted the elevated inflation, and indicated that it would increase the target policy rate range in future if inflation continued to remain high.

The Bank of England (BoE) maintained the Bank Rate at 0.1 percent and the total target stock of its asset purchases at £895 billion in November 2021, as the MPC weighed concerns over rising prices against the downside risks from slowing global growth and a potential rise in unemployment. The Committee considered that the elevated inflationary pressures were transitory, but highlighted that there was a possibility of tightening the monetary policy stance in the coming months to bring inflation back to the 2 percent target.

The Bank of Japan (BoJ) kept the key short-term interest rate unchanged at -0.1 percent and maintained the long-term government bond yield at around zero at the October 2021 meeting. In addition, the BoJ agreed to continue purchasing exchange-traded funds (ETFs) and Japan real estate investment trusts (JREITs) until the amounts outstanding increased to approximately 12 trillion yen and 180 billion yen, respectively. With regards to the commercial paper and corporate bonds, the BoJ maintained the amounts outstanding at 2 trillion yen and 3 trillion yen, respectively. In addition, until the end of March 2022, the bank will conduct additional purchases with an upper limit on the amount outstanding of these assets of approximately 20 trillion yen in total. The bank announced that it will start climate change loans in December 2021 and that it will implement more easing measures, if necessary, to stimulate economic activity.

In emerging market economies, the Central Bank of Brazil increased the policy rate by 150 basis points to 7.75 percent in October 2021, the sixth raise this year and the highest in almost two decades, amid uncertainty about economic growth and rising inflationary pressures. In addition, the Central Bank of Brazil announced that it would raise the policy rate by another 150 basis points in December 2021 to control inflation. Similarly, the Central Bank of Russia (CBoR) increased the key rate by 75 basis points to 7.5 percent in October 2021, the highest since June 2019, as aggregate demand increased faster than output expansion, and inflation expectations remained elevated. CBoR also signalled further rate increases at the upcoming meetings.

Meanwhile, the People's Bank of China (PBoC) maintained the one-year Loan Prime Rate (LPR) for the nineteenth consecutive month at 3.85 percent in November 2021, as the economy continues to recover from the downturn caused by the COVID-19 pandemic.

The SARB increased the repo rate by 25 basis points to 3.75 percent in November 2021, following a cumulative 300 basis points rate cut in 2020 to support an economy that was already in recession before the pandemic shock. The SARB considered the risks to the growth outlook to be to the downside, while risks to the short-term inflation outlook were assessed to be on the upside. The SARB expected higher inflation for the rest of 2021, before moderating in 2022, on account of higher electricity and oil prices, while weaker currency, higher domestic import tariffs, as well as escalating wage demands are anticipated to present additional upside risks to the inflation forecast. Moreover, the SARB signalled further 25 basis points increases in the repo rate in each quarter of 2022, 2023 and 2024.

In October 2021, the Reserve Bank of India (RBI) maintained the policy rate at 4 percent and the reverse repo rate at 3.35 percent, to support economic recovery and help mitigate the negative impact of the COVID-19 pandemic amid high inflationary pressure. Meanwhile, the RBI lowered its projection for headline inflation for the year 2021/22 from 5.7 percent to 5.3 percent, amid the easing of food prices, combined with favourable base effects, but upgraded the projection for the year 2022/23 slightly from 5.1 percent to 5.2 percent.

Table 3.2: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting
Bank of Botswana	December 2021	3.75	No change
SARB	November 2021	3.75	Increased by 25 basis points
US Federal Reserve	November 2021	0 – 0.25	No change
BoE	November 2021	0.10	No change
ECB	October 2021	0.00	No change
BoJ	October 2021	-0.10	No change
PBoC	November 2021	3.85	No change
Brazil	October 2021	7.75	Increased by 150 basis points
India	October 2021	4.00	No change
Russia	October 2021	7.50	Increased by 75 basis points

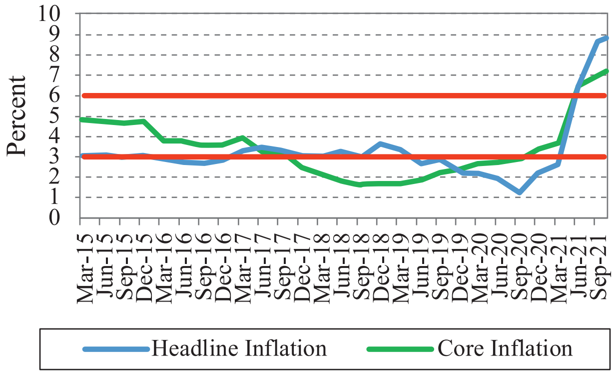
Source: Various central banks' websites.

3.2 Domestic inflation environment

Headline inflation increased in the third quarter of 2021

Headline inflation averaged 8.7 percent in the third quarter of 2021, from 1.2 percent in the third quarter of 2020 (Charts 3.5 and Table 3.3) accounted for by the increases in domestic fuel prices and associated second-round effects, as well as higher vehicle prices. Headline inflation rose from 8.4 percent in September 2021 to 8.8 percent in October, remaining above the upper bound of the Bank's medium-term objective range of 3 – 6 percent. The increase in inflation between September and October 2021 mainly reflects the upward adjustment in domestic fuel prices in October 2021, which added approximately 0.64 percentage points to headline inflation.

Chart 3.5: Botswana Headline and Core Inflation



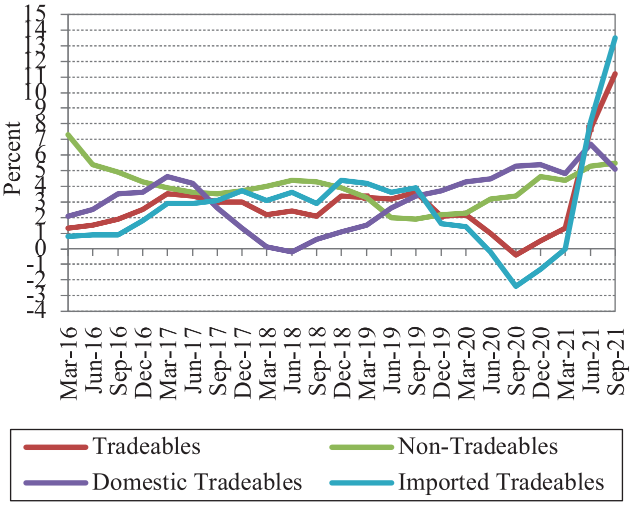
Source: Statistics Botswana and Bank of Botswana

Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic and imported tradeables increased in the second quarter of 2021

Inflation for domestic tradeables decreased slightly from an average of 5.3 percent in the third quarter of 2020 to an average of 5.1 percent in the third quarter of 2021 (Charts 3.6 and 3.7), largely due to a fall in prices of some food items. In contrast, imported tradeables inflation increased from an average of -2.4 percent to 13.5 percent in the same period, due mainly to the upward adjustment in domestic fuel prices. As a result, all tradeables inflation increased from an average of -0.4 percent in the third quarter of 2020 to an average of 11.2 percent in the corresponding quarter in 2021, while inflation for non-tradeables increased from an average of 3.2 percent to an average of 5.5 percent in the same period. In October 2021, domestic tradeables, imported tradeables, non-tradeables and all tradeables inflation were 5.4 percent, 14.7 percent, 4.6 percent and 12 percent, respectively.

Chart 3.6: Inflation for Tradeables and Non-Tradeables



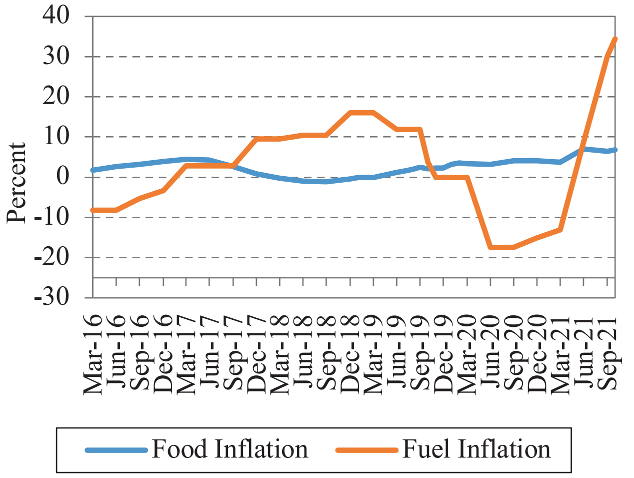
Generally, there has been an upward trend in non-tradeables inflation since June 2019 and domestic tradeables inflation from June 2018, mainly due to the increase in prices for administered items and food, respectively. The increase in food prices was partly a result of bad weather conditions experienced in the 2018/19 ploughing season, and economic disruptions occasioned by COVID-19 in 2020.

Accordingly, therefore, upward trends in non-tradeables and domestic tradeables inflation are not a result of domestic demand pressures, as the output gap is estimated to be negative (Section 4.2 refers).

Core inflation measures increased in the third quarter of 2021

The trimmed mean inflation (CPITM) increased to 8.2 percent in the third quarter of 2021 from 1.3 percent in the third quarter of 2020, while inflation excluding administered prices (CPIXA) averaged 7 percent compared to 2.9 percent in the same period due to the increase in prices for food and non-alcoholic beverages (Table 3.3). Similarly, inflation excluding food and fuel (CPIXFF) averaged 6.9 percent in the third quarter of 2021, higher than the 3.1 percent recorded in the corresponding quarter of 2020, mainly because of the increase in value added tax (VAT) and administered prices. In October 2021, CPITM, CPIXA and CPIXFF were 8.2 percent, 7.2 percent and 6.5 percent, respectively.

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	October 2021	Q3 2021	Q3 2020
Food and non-alcoholic beverages	13.6	6.8	6.4	4.1
Alcoholic beverages and tobacco	4.3	8.8	8.5	6.5
Clothing and footwear	6.0	3.8	3.6	2.4
Housing, water, electricity, gas and other fuels	17.5	8.2	8.3	6.1
Furnishing, h/h equipment and routine maintenance	4.9	5.0	4.5	2.0
Health	3.4	2.9	2.7	1.5
Transport	23.4	19.3	19.7	-5.9
Communications	6.9	1.0	1.6	0.5
Recreation and culture	2.8	4.3	4.3	-0.4
Education	4.6	2.8	2.1	4.7
Restaurants and hotels	3.7	4.1	3.6	3.0
Miscellaneous goods and services	9.0	7.4	7.0	0.6
Annual Inflation (All items)	**100.0**	**8.8**	**8.7**	**1.2**
CPITM		8.2	8.2	1.3
CPIXA		7.2	7.0	2.9
CPIXFF		6.5	6.9	3.1

Source: Statistics Botswana and Bank of Botswana calculations

Box 1: Administered Prices

The two prominent channels through which governments can have a direct impact on price-setting are levies/taxes and administered prices. However, the analysis given in this box aims to define and analyse the composition of administered prices in Botswana, as well as the recent adjustments in administered prices and their impact on headline inflation. Administered price items in the CPI basket are goods or services for which prices are set or controlled by the Government outside the normal free market price determination. These price adjustments are, however, to some degree, influenced by general price developments. For example, cost adjustments in some administered prices are often justified as a way of catching up with market prices, a response to higher input costs and a move towards cost recovery.

It is worth noting that administered prices have a transitory impact (over a period of up to one year), implying that the supply-side inflationary (deflationary) pressures emanating from the upward (downward) adjustment in administered price are quite pronounced in the short run. Therefore, monetary policy does not have any direct influence on these price changes and, therefore, would not trigger a direct policy response. Policy may, nevertheless, respond to the resultant second-round effects as free market prices also react, particularly in the medium term, as it is the relevant time frame for monetary policy to influence the level of prices. Meanwhile, factors that are likely to have an enduring influence on inflation, such as changes in demand conditions are often subject to monetary policy influence. The approach of distinguishing between prices with a transitory and permanent impact on inflation is important for policy formulation as it helps facilitate appropriate and timely responses to any forecast deviation of inflation from the objective range.

There are currently 51 administered items (12.8 percent) out of the 400 items in the Botswana CPI basket, accounting for a significant weight of 32.3 percent in the basket (Table 3.2). Changes in the prices of these items, therefore, have a significant influence on inflation and inflation expectations as shown by the recent surge in inflation, which reflects the recent upward adjustments in VAT and administered prices, with most of the effect expected to dissipate from the first half of 2022, consequently contributing to lower inflation in the medium term. However, second round effects of the recently announced increases in administered prices pose upside risks to the inflation outlook. It is, therefore, critical for the internal consistency of macroeconomic policy design that administered prices and tax adjustments be set in view of their possible effects on inflation.

For this reason, the Bank monitors and calculates the prospective and actual impact of the changes in administered prices on inflation, with a view to inform the forward-looking monetary policy framework of the Bank.

Table 3.4: Administered Items

Item code	Administered prices	Weights
147	Monthly rent BHC House Type LC48	0.294
148	Monthly rent BHC Type 2 “Improved”	0.379
161	Water: 10kls per month	1.168
162	Water: 20kls per month	0.779
164	Electricity: 100kwh per month	2.143
165	Electricity: 500kwh per month	1.428
167	Paraffin per litre	0.064
237	Consultation with Government doctor	0.168
247	Rate to stay in a public hospital for 24 hours in a private ward (bed only)	0.799
261	Petrol per litre (95)	6.262
262	Diesel per litre (50ppm)	3.708
270	Road worthiness test	0.022
271	Bus fare, single, Gaborone: Mochudi	0.706
272	Minibus fare, Gaborone: Johannesburg	0.631
273	Taxi fare (not “special”)	0.794
274	Bus fare, single, Gaborone: Francistown	0.653
275	Minibus fare, within cities/towns/villages	0.913
278	Railway passenger’s fee	0.089
282	Local standard letter tariff rate	0.013
283	Air parcel to Europe (0.5 kg)	0.009
284	Rental of post office box	0.149
285	Standard letter (weight/size 120x235mm): air	0.021
291	Telephone installation	0.003
292	Telephone charges/rate between zones (per second charge)	0.004
293	Telephone charges/rate within zone (per second charge)	0.004
294	Telephone rate international (per second charge)	0.004
295	Telephone charges/rate to mobile (all mobiles)	0.005
296	Mascom charges/rate to all network (peak hour per minute charge)	0.697
297	Mascom charges/rate to all network (off/off - off peak hour per minute charge)	0.557
298	Orange charges/rate to all network (peak hour per minute charge)	0.697
299	Orange charges/rate to all network (off/off - off peak hour per minute charge)	0.557
300	Bemobile charges/rate to all network (peak hour per minute charge)	0.697
301	Bemobile charges/rate to all network (off/off - off peak hour per minute charge)	0.557
302	Mobile charge international charge (Orange + Mascom + Bemobile)	0.557
303	Prepaid phone card: short message service (SMS)	0.418
305	Mobile data pass (1GB; 1month)	0.836
328	Admission to premier league football match: uncovered stands	0.007
338	Kutlwano magazine	0.003
351	Senior Secondary School fees (public)	0.434
352	Junior Secondary School fees (public)	0.650
354	College and university fees (BA Social Science)	0.285
383	Employee contribution to medical aid: standard benefit, 1, salary (600+)	1.550
384	Employee contribution to medical aid: high benefit, 1, salary (5000 - 8000)	1.250
385	Fully comp. insurance: Toyota Corolla 1.3	0.791
388	Levy + loan (P3500) interest on Self Help Housing Agency plot	0.060
390	Driver’s license charge	0.025
391	Annual road tax: Hilux 2.0 pick-up	0.138
392	Annual road tax: Toyota Corolla 1.4	0.113
393	Fee for the issue of a passport	0.053
394	Council rates to house + plot valued at P200,000	0.091
397	Advertisement (20 words, Botswana Daily News newspaper)	0.025
	Total weight	**32.259**

Source: Statistics Botswana

3.3 Recent domestic economic developments

In July 2021, Statistics Botswana published rebased national accounts from 2006 prices to the new base year 2016, covering both annual and quarterly data from 2014 to the first quarter of 2021 (Box 2).

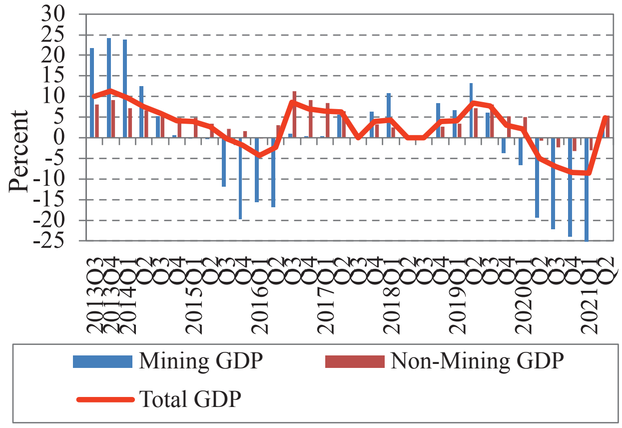
GDP expanded in the second quarter of 2021

Real GDP grew by 4.9 percent in the twelve months to June 2021, compared to a contraction of 5.1 percent in the year to June 2020 (Chart 3.8). The increase in output was attributable to the expansion in production of both the mining and non-mining sectors. This resulted from an improved economic performance from a low base in the corresponding period in the previous year, emanating from the negative output effects of the COVID-19 pandemic containment measures. Mining output increased by 3 percent in the year ending June 2021, compared to a contraction of 19.3 percent recorded in the corresponding period ending June 2020. This was largely due to a 3.2 percent increase in diamond mining output, compared to a significant contraction of 19.3 percent in the year to June 2020. Rough diamond demand is gradually gaining traction after the COVID-19 travel restrictions which impeded the sight-holder calendar. Output of mining support services activities and coal subsectors also grew by 6.1 percent and 4.8 percent, respectively, in the year to June 2021; compared to contractions of 28.4 percent and 21.4 percent, respectively, in 2020. Meanwhile, output of the rest of mining subsectors decreased in the year to June 2021.

Non-mining GDP grew by 5.4 percent in the year to June 2021, compared to a decrease of 0.7 percent in the corresponding period last year. The increase in non-mining GDP was mainly due to expansion in output of most sectors including: Construction; Diamond Traders; Transport and Storage; Wholesale and Retail; Real Estate Activities; Professional, Scientific and Technical Activities; Finance and Insurance and Pension Funding; Public Administration and Defence; and Human Health and Social Work sectors.

Meanwhile, Statistics Botswana reported a 36 percent increase in real GDP in the second quarter of 2021[5] from a contraction of 26 percent in the second quarter of 2020.

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 increased by 4.6 percent in the year to June 2021, compared to 3.7 percent in the corresponding period in 2020 (Table 3.5). This was attributable to an acceleration in growth of collective consumption[6] from 4.2 percent to 5.8 percent; while individual consumption[7] increased by 0.6 percent compared to a growth of 1.9 percent in the corresponding previous period. Meanwhile, household final consumption grew by 2.1 percent compared to a contraction of 0.5 percent registered in the previous period. The expansion in household final consumption was mainly due to an increase in household consumption expenditure and expenditure by non-profit institutions serving households.

Gross fixed capital formation (GFCF) contracted marginally by 0.7 percent in the year to June 2021, compared to a decline of 1.5 percent in the corresponding period in the previous year. The fall in GFCF was due to the notable contraction in investment in plant, machinery and other equipment subsector (-5.5 percent from a growth of 15 percent).

[5] Calculated as the current quarter over the corresponding quarter in the previous year.

[6] The collective consumption expenditure of general government covers the sovereign functions (or governing functions or general administrative functions) of government bodies such as the justice system, defence and police.

[7] The actual and imputed final consumption expenditure incurred by households on individual goods and services.

Table 3.5: Real GDP Growth by Sector and Expenditure (Percent)

	2020Q2	2020Q1	2021Q2
Total GDP	-5.1	-8.6	4.9
By Sector:			
Mining & Quarrying	-19.3	-27.8	3.0
Non-Mining	-0.7	-3.1	5.4
Agriculture, Forestry & Fishing	-1.7	-0.9	-3.2
Manufacturing	-8.9	-16.2	-1.8
Water and Electricity	-20.7	20.4	15.6
Construction	-5.6	-13.5	0.7
Wholesale & Retail	3.8	1.7	13.1
Diamond Traders	-39.3	-10.2	59.1
Transport and Storage	-3.3	-6.8	3.1
Accommodation & Food Services	-13.3	-35.4	-19.2
Information & Communication Technology	5.6	5.3	7.1
Finance, Insurance & Pension Funding	2.5	3.3	5.1
Real Estate Activities	0.7	-3.7	4.8
Professional, Scientific & Technical Activities	-0.5	-0.5	6.1
Administrative & Support Activities	-2.7	-7.6	2.6
Public Administration & Defence	10.0	5.8	6.9
Education	2.3	-0.2	0.4
Human health & social work	4.7	1.9	4.6
Other services	-2.4	-7.4	0.9
By Type of Expenditure:			
Government Final Consumption	3.7	3.2	4.6
Household Final Consumption	-0.5	-4.8	2.1
Gross Fixed Capital Formation	-1.5	-12.0	-0.7
Exports of Goods and Services	-31.8	3.2	53.4
Imports of Goods and Services	-2.9	*14.0(26.3)*	28.2

Note: The figures in italics are revisions of the figures in brackets, previously reported in the Q4 estimates.

Source: Statistics Botswana and Bank of Botswana Calculations

Box 2: Rebasing and Revision of GDP

Rebasing of GDP is the process of replacing an old base year with a more recent base year in line with the evolution in prices. Constant price estimates are then recalculated in terms of the prices of the new base year and provides a reference point to which future values of GDP are then compared. In July 2021, Statistics Botswana published rebased estimates of GDP at current and constant prices for the period 2014 to 2020, as well as GDP estimates for the first quarter of 2021. The objective of rebasing Botswana's GDP was to take into account changes that occurred in the economy since the last rebasing exercise in 2012. The rebasing exercise presents an opportunity to incorporate new statistical methods outlined in the 2008 System of National Accounts (SNA) using the Supply and Use Tables (SUT) as the framework. It enables the GDP series to reflect a more accurate picture of the size and structure of the economy. The relevance of the GDP series is, therefore, enhanced and made more internationally comparable with other jurisdictions. The rebasing also took care of tax harmonisation with the Southern African Customs Union (SACU) regional agreements on tax collections. The 2016 base year series features 18 industry groupings versus the previous 10 industry groupings. The rebased GDP provides a better understanding of which industries are driving growth.

Changes in the Rebased Series

The nominal value of GDP in the benchmark year (2016) was revised downwards by an amount of P6.2 billion, or 3.6 percent, due to the P8.2 billion or 51.5 percent decline in taxes on products in the revised estimates, compared to the previous figures. Consequently, contributions of various sub-industries to total Gross Value Added (GVA) changed in the period 2006 to 2016. It is important to note that the GVA obtained from the GDP series based on the 2016 base year is not strictly comparable with the previously published data for GVA at current prices. This is mainly because of changes in the methodology and use of improved data sources within industries. In addition, revised estimates, particularly for Public Administration and Defence, Diamond Traders and Electricity, as well as the implementation of the latest version of the International Standard Industrial Classification (ISIC) revision 4 were mainly responsible for the changes in the composition of sub industries. As a result of these developments, the weights used to extrapolate the base-year estimates of GVA at current and constant prices in 2016 differ from the weights that were used in the 2006 base year. This, in turn, had an impact on both the level and growth rates of overall GDP as shown in the table below.

Revised Compared to Previous Estimates							
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
GDP at current prices, million Pula							
Revised estimates (2016 base year)	140 518	137 539	164 418	166 473	172 525	178 480	172 552
Previous estimates (2006 base year)	145 869	146 066	170 564	180 103	190 365	197 504	180 799
Annual growth - percent of real GDP							
Revised estimates		**-5.7**	**7.0**	**4.0**	**4.0**	**3.0**	**-8.5**
Previous estimates		**-1.7**	**4.3**	**2.9**	**4.5**	**3.0**	**-7.9**

Diamond production increased in the third quarter of 2021

Debswana produced 6.4 million carats of diamonds in the third quarter of 2021, 32.6 percent higher than the 4.8 million carats produced in the corresponding period in 2020. The overall significant increase in production was mainly due to planned higher production to meet stronger demand for rough diamonds in the third quarter of 2021. Demand for rough diamonds continued to be robust in the third quarter, with positive midstream sentiment reflecting strong demand for polished diamond jewellery, particularly in the key markets of the United States of America and China. Debswana's production target for 2021 has been set at 23 million carats, while production guidance for the larger De Beers Group has been revised downwards to 32-33 million carats (previously 33-34 million carats).

Production by Lucara Diamond Corporation (Karowe Mine) increased by 9.6 percent to 97 412 carats in the third quarter of 2021, from 88 909 carats in the corresponding period in 2020. The increase was attributable to the strong and stable global diamond market in 2021. With respect to quarterly performance, production for the third quarter of 2021 decreased by 3.9 percent, to 97 412 carats, from 101 330 carats in the second quarter of 2021.

Budget deficit recorded in the first quarter of the 2021/22 fiscal year

Government budget was in deficit of P0.4 billion in the first quarter of the 2021/22 fiscal year (Table 3.6). The deficit was mainly due to the lower mineral revenue in the revised budget, largely reflecting the slow recovery of diamond sales due to COVID-19 restrictions imposed at the beginning of the year. Regarding other major revenue streams, domestic taxes (VAT and Non-Mineral Income Tax) surpassed the projected tax collections in the revised budget, mainly due to the increase in VAT from 12 percent to 14 percent and the introduction of other levies in the first quarter of the year. Additionally, Bank of Botswana revenue surpassed expectations of the revised budget by 50 percent due to payment of residual income for the 2020/21 fiscal year. Total government expenditure and net lending was P17.7 billion, lower than the P17.9 billion originally anticipated.

For the 2020/21 fiscal year (April 2020 - March 2021), the final budget outturn was a deficit of P16.5 billion, lower than the revised budget deficit of P21 billion, reflecting the upward revision of revenue and grants from P48.3 billion to P49.3 billion. Total public expenditure amounted to P65.8 billion, which is P3.6 billion lower than the revised budget (or 95 percent of the revised budget estimate, and same proportion to that of the 2019/20 fiscal year). Going forward, the overall budget outcome is expected to improve further, with the deficit declining to P7.2 billion or 3.7 percent of GDP in the 2021/2022 fiscal year. Total revenue and grants, and total expenditure are projected to increase to P63.7 billion and P71 billion, respectively in the 2021/22 fiscal year.

Table 3.6: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2020/21 Q1	12 391	14 303	-1 912
2020/21 Q2	9 887	17 636	-7 748
2020/21 Q3	11 822	18 199	-6 377
2020/21 Q4	15 275	15 703	-428
2021/22 Q1	17 328	17 700	-372

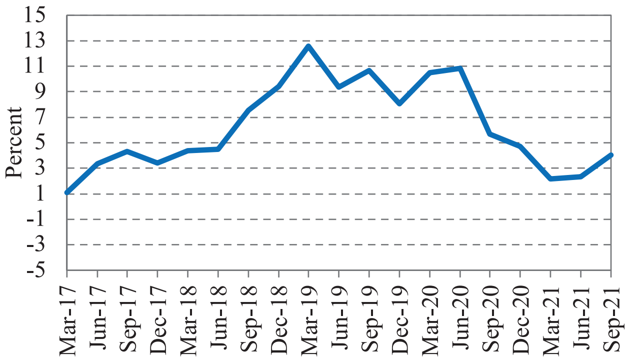
Source: Cash Flow Unit, Ministry of Finance and Economic Development

3.4 Monetary developments

Banking sector assets decelerated in September 2021

Annual banking sector assets decelerated from 5.7 percent in September 2020 to 4 percent in September 2021 (Chart 3.9). This was mainly due to the decrease in holdings of BoBCs and balances due from domestic banks. Meanwhile, loans and advances, which accounted for the largest proportion of commercial banks' assets (63.8 percent), increased in September 2021.

Chart 3.9: Year-on-Year Commercial Banks' Growth in Total Assets



Source: Commercial Banks

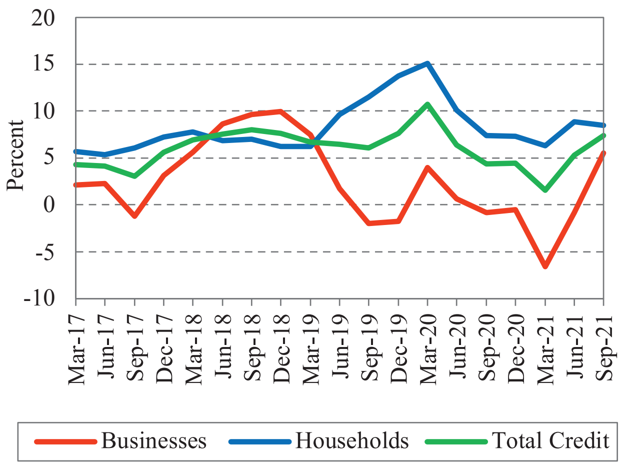
Credit growth accelerated in the year to September 2021

Annual commercial bank credit increased from 4.4 percent in September 2020 to 7.4 percent in the twelve-month period to September 2021 (Chart 3.10). The acceleration in commercial bank credit growth was, in part, due to the increase in loan uptake by households, particularly through scheme loans arrangements, as well as the recovery from the lower base effects created by the COVID-19 pandemic. Banks credit growth has maintained an upward trend since March 2021.

Household loans increased by 8.5 percent in the twelve months to September 2021, compared to 7.4 percent in the corresponding period in 2020. The higher growth was mainly attributable to the increase in personal unsecured lending and property loans during the period under review. There was also an increase (albeit lower) in motor vehicle and credit cards loans in the year to September 2021. The share of the household sector in total lending by commercial banks increased to 65.4 percent in September 2021, from 64.8 percent in September 2020.

Lending to the business sector increased by 5.5 percent in the year to September 2021, compared to a decrease of 0.3 percent in the corresponding period in 2020. Meanwhile, credit to businesses excluding parastatals increased by 4 percent in the year to September 2021, compared to an annual contraction of 1.5 percent in September 2020. The increase in credit to businesses excluding parastatals was mainly due to utilisation of overdraft facilities by some companies in the finance and trade industries. Credit to parastatals increased by an annual rate of 25.9 percent in September 2021, compared to the 9.2 percent annual expansion in September 2020, attributable to utilisation of overdraft facilities.

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

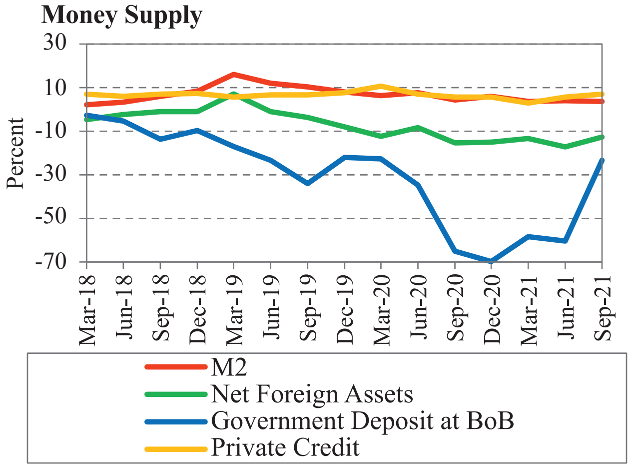


Source: Commercial Banks

Money supply decelerated in September 2021

Money supply (M2) grew by 3.6 percent in September 2021, lower than the 4.3 percent in the corresponding period in 2020 (Chart 3.11). The relatively low growth in money supply was largely a result of the increase in net foreign assets and government deposits at the Bank of Botswana to fund government operations. Meanwhile, there was an acceleration in credit to the private and parastatals sectors.

Chart 3.11: Year-on-Year Growth in Money Supply



Source: Other Depository Corporations and Bank of Botswana

The 7-day BoBC stop-out yield increased in the third quarter of 2021

The 7-day BoBC stop-out yield increased from an average of 1.02 percent in the third quarter of 2020 to an average of 1.08 percent in the corresponding period in 2021. In contrast, the real rate of interest decreased from an average of -0.18 percent in the third quarter of 2020 to an average of -7.01 percent in the third quarter of 2021.

Meanwhile, the stop-out yield for the 7-day BoBC was unchanged at 1.10 percent for the third consecutive month in November 2021. However, the real rate of interest for the 7-day BoBC decreased from -6.73 percent in September 2021 to -7.08 percent in October, reflecting the increase in the inflation rate in the same period.

S&P Global Ratings affirms Botswana's credit rating and revised economic outlook from negative to stable

In September 2021, S&P Global Ratings (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. S&P indicated that the affirmation of the ratings was underpinned by strong, stable and predictable institutional frameworks; modest net general government debt levels; relatively strong net external position; and the positive impact of the monetary policy framework, all of which contribute to sound macroeconomic stability. However, the economic outlook was revised from negative to stable on account of the anticipated rebound in Botswana's economic growth, partially driven by recovery in the diamond market, which in turn would result in substantial improvement in the domestic fiscal and external sectors' performance over the next two years. The economic outlook could be revised further upwards if the country's public budget performance improved, resulting in increased fiscal and external buffers, along with sustainable diversification of the export base. On the other hand, the ratings could be lowered if sustainable recovery in the demand and prices for diamonds waned, resulting in weaker fiscal and external performance.

Moody's downgrades Botswana's sovereign credit rating but changed Botswana's outlook from negative to stable

In April 2021, Moody's Investors Service downgraded Botswana's sovereign credit rating for long-term bonds, denominated in both domestic and foreign currency, from 'A2' to 'A3'. However, the economic outlook was changed from negative to stable. The downgrade is due to the reduction in the capacity of government to absorb future shocks as a result of the erosion of fiscal buffers, occasioned by the COVID-19 pandemic, and relatively weaker economic resilience, reflecting the less diversified economy. The revision of the outlook reflects broadly balanced risks, continued strong financial position despite downside risks to the post-pandemic fiscal consolidation path, low political risk, prudent policy making, limited risks pertaining to government liquidity and external vulnerability. The ratings could be revised upwards if there is improved resilience to shocks, reduced vulnerability of the budget structure and notable progress on economic diversification.

Box 3: Reforms to Monetary Operations Framework

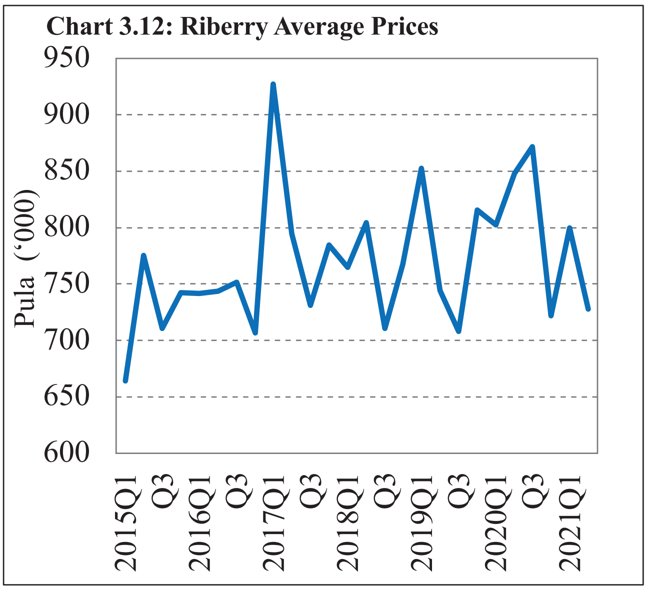
The Bank continues to monitor developments in money market liquidity conditions and evaluate monetary policy implementation framework on a regular basis for effectiveness and enhancements where necessary. Excess liquidity in the banking system has significantly reduced, but continues to remain adequate. Reforms to the monetary operations framework, in particular, possible changes to the policy interest rate structure aimed at strengthening the monetary policy transmission mechanism remain work in progress, while the Bank is reviewing the final recommendations from an IMF Technical Assistance mission on "Monetary Policy Implementation and Operations" held in May 2021. It is envisaged that during 2022, the Bank will implement some of the changes in the operational framework in order to be able to effectively influence market interest rates.

3.5 Asset markets

Property market generally deteriorated in the second quarter of 2021

According to the latest (2021Q2) Riberry Report[8], the residential rental market shows signs of weakness in the second quarter as compared to the previous quarter due to reduced/lower demand in the middle and upper end properties. However, the rental market still enjoys good demand and supply in low end houses.

The average price for residential properties sold in the second quarter of 2021 declined by 9 percent to P728 000, compared to the previous quarter (Chart 3.12), reflecting a decrease in the number of properties traded in the quarter under review. Looking ahead, the demand for lower-end, medium and prime located residential housing is expected to improve further, given the affordability of properties in these categories compared to those in the upper-end market which continue to experience a weak demand.



The market for office space remains weak due to increasing supply from completed construction developments, such as the Botswana Unified Revenue Service building at the Gaborone Central Business District (CBD). Furthermore, demand remains weak and uncertain due to COVID-19 and generally subdued business conditions. Despite the negative impact of the pandemic and generalised weaker demand in the second quarter for office space, there has been continued good office enquiries and/or uptake in the CBD and Showgrounds. Going forward, there is a likelihood of a slowdown in uptake at the CBD, especially if Government institutions remain in their current premises and location. In addition, the supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the CBD, such as by the Botswana Housing and Water Utilities Corporations. These will further exert downward pressure on rentals, especially in the decentralised office locations.[9]

Similar to the previous quarter, the demand for retail space remains fair across all market segments, while the supply is expected to increase on completion of the ongoing construction of a major shopping centre in the CBD, while another one is proposed for Mogoditshane. In addition, other centres with good demand for retail space are Jwaneng, Lobatse, Ramotswa, Selibe Phikwe, Maun, Francistown, Mahalapye and Letlhakane. This is because most of these locations have a few retail schemes at planning and/or construction stage which are to be anchored by reputable supermarkets. With regard to industrial property, the supply of unoccupied big warehouse space has decreased, while the demand has improved.[10] Meanwhile, the availability of prime location industrial space is expected to decrease going forward, given that most of the centrally located industrial land is almost fully developed and occupied.

Stock market indices increase

The Domestic Companies Index (DCI) increased by 0.7 percent in the twelve months to October 2021 compared to a reduction of 8.5 percent in the year to October 2020 (Chart 3.13). The increase was mainly due to the higher share prices for Letshego, Olympia and Standard Chartered Bank, which increased by 89.4 percent, 62.5 percent and 35.2 percent, respectively, in the same period.

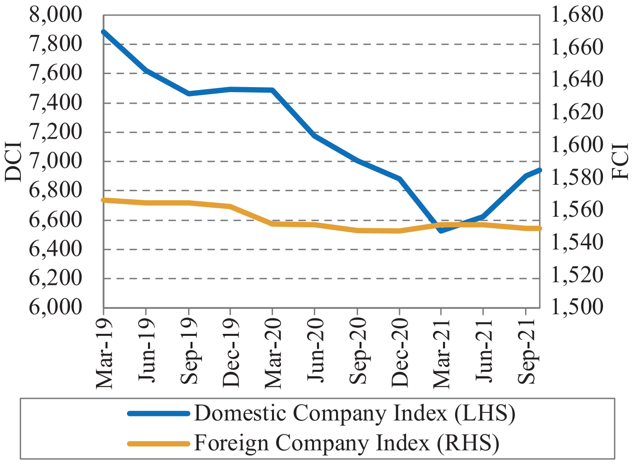
8 This is a quarterly report produced by independent valuers, Riberry Botswana (Pty) Ltd.

9 Prime rentals are about P100/m^2. However, rentals in secondary areas such as Gaborone International Finance Park (also known as Kgale Mews), situated at the foot of Kgale Hill, adjacent to Game City Shopping Mall, cost P75/m^2, while prime industrial areas like Gaborone International Commerce Park cost P65/m^2.

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

The Foreign Companies Index (FCI) increased slightly by 0.1 percent in the year to October 2021, compared to a decline of 1.1 percent in the corresponding period in 2020 (Chart 3.13). This was largely due to the year-on-year increase in the share prices for Tlou (56.3 percent), New Funds (27.6 percent) and Lucara (19.1 percent) on account of improved trading activity and liquidity.

Chart 3.13: Stock Market Indices



Source: Botswana Stock Exchange

3.6 Balance of payments (BoP)

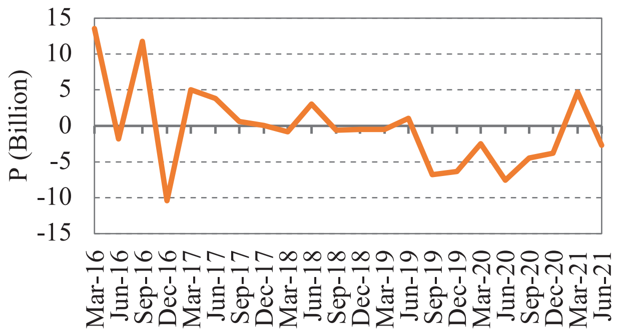
Current account records a deficit in the second quarter of 2021

The current account is estimated to have recorded a deficit of P2.7 billion in the second quarter of 2021, compared to a revised deficit of P7.5 billion during the corresponding period in 2020 (Chart 3.14). The merchandise trade, services and primary income accounts recorded a combined deficit of P6.8 billion, which was partly offset by a surplus of P4.1 billion in the secondary income account, which is dominated by the SACU revenue receipts (P3.5 billion). Exports increased by 286.4 percent from P4.4 billion to P17 billion, while imports increased by 63.6 percent from P13.2 billion to P21.6 billion, leading to a deficit of P4.6 billion in the merchandise trade account.

Diamond exports, which accounted for 89.4 percent of total exports of goods in the second quarter of 2021, increased from P3.6 billion in the second quarter of 2020 to P15.2 billion in the second quarter of 2021. During the same period, diamond imports increased from P4.4 billion to P7.7 billion. The increase in diamond trade mainly resulted from recovery in demand for diamond jewellery in the US and China.

The other commodities that contributed to an increase in exports include textiles (140.1 percent), other goods (201.8 percent) and vehicles (119.3 percent). Commodities that contributed to an increase in imports are metal and metal products, salt ores and related products, and wood and paper products, which increased by 177.2 percent, 128.7 percent and 95.4 percent, respectively.

Chart 3.14: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account records a surplus in the second quarter of 2021

The financial account registered an estimated surplus of P1.8 billion during the second quarter of 2021, compared to a revised surplus of P5 billion in the second quarter of 2020. The surplus was mainly attributable to an increase in offshore investments held by local pension fund managers.

The balance of payments was in deficit in the second quarter of 2021

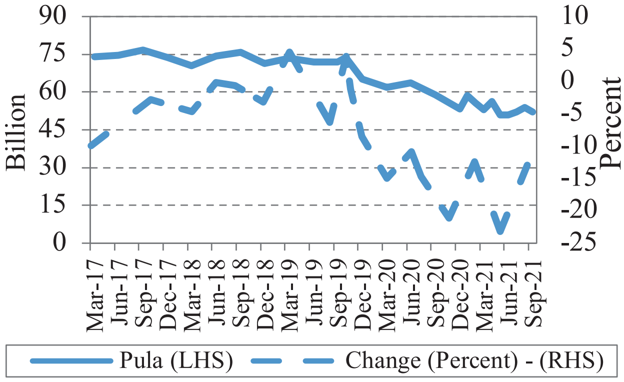
The overall BoP recorded a deficit of P3.3 billion during the second quarter of 2021, slightly up from a deficit of P3 billion during the corresponding period in 2020. The deficit mainly resulted from an increased outflow of foreign exchange to meet the import bill and government obligations, such as external loan servicing and funding of embassies.

Foreign exchange reserves decrease

As at the end of September 2021, foreign exchange reserves amounted to P52.1 billion, a decrease of 11.4 percent from P58.8 billion in September 2020 (Chart 3.15). The decrease was due to drawdowns to finance the balance of payments deficit and government obligations.

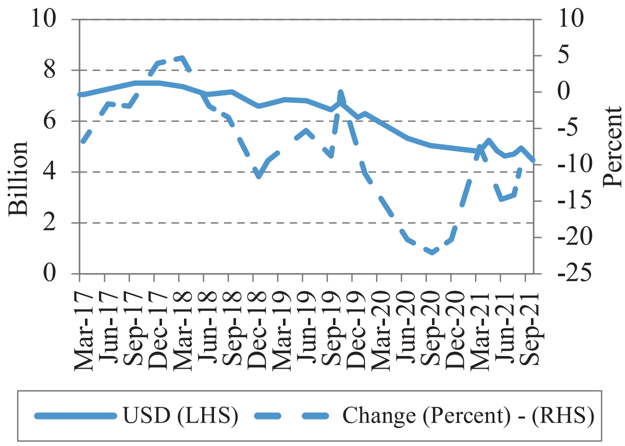
In foreign currency terms, the level of reserves decreased by 9.8 percent from USD5.1 billion in September 2020 to USD4.6 billion in September 2021 (Chart 3.16). The reserves also decreased by 8.3 percent from SDR3.6 billion to SDR3.3 billion in the same period. The level of reserves as at the end of September 2021 was equivalent to 9.8 months of import cover of goods and services.

Chart 3.15: Foreign Exchange Reserves in Pula and Annual Percentage Change



Source: Bank of Botswana

Chart 3.16: Foreign Exchange Reserves in US Dollars and Annual Percentage Change



Source: Bank of Botswana

3.7 Exchange rate developments

For 2021, the Bank's implementation of the exchange rate policy entails the maintenance of an annual downward rate of crawl of 2.87 percent (Box 4). This downward rate of crawl was implemented from May 1, 2020[11] with a view to enhance domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. The Pula basket weights were also maintained at 45 percent for the South African rand and 55 percent for the SDR, guided by Botswana's trade pattern and international transactions.

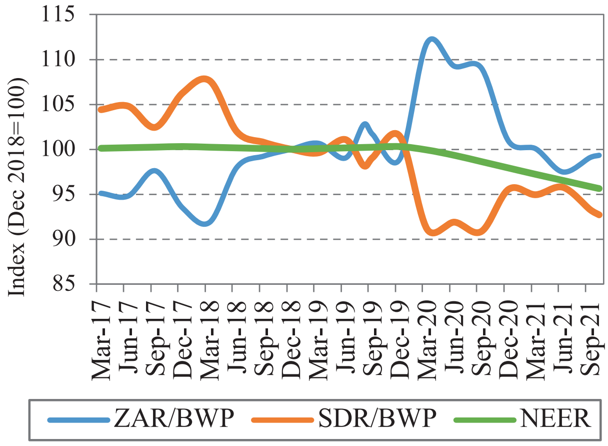
In the twelve months to November 2021, the Pula depreciated against both Pula basket currencies. It depreciated by 4.5 percent against the SDR and 0.7 percent against the South African rand (Chart 3.17). Against the SDR constituent currencies, the Pula depreciated by 9.4 percent against the Chinese renminbi, 6.5 percent against the US dollar, 6.3 percent against the British pound and 1 percent against the euro, while it appreciated by 1.8 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. Notably, in the same review period, the South African rand depreciated by 3.8 percent against the SDR. With respect to the SDR constituent currencies, the South African rand depreciated by 8.7 percent against the Chinese renminbi, 5.8 percent against the US dollar, 5.6 percent against the British pound and 0.3 percent against the euro, while it appreciated by 2.6 percent against the Japanese yen.

The South African rand depreciated along with other emerging market currencies as investors turned to safe-haven assets after the discovery of a new and highly transmissible COVID-19 variant, in South Africa. The new variant, termed Omicron, was also reported to be possibly vaccine-resistant. The risk-off trades owing to the Omicron variant were the dominant driver, however, the South African rand was already under pressure due to expectations of a faster monetary policy tightening by the US Federal Reserve. Further, the South African rand was weakened by the commencement of scheduled daily electricity cuts (necessitated by deteriorating coal-fired power plants), which led to the deterioration of appetite towards South African assets. Meanwhile, Eskom laid out its 18-months load shedding schedule, noting that it expects rolling blackouts to feature heavily in South Africa for the foreseeable future.

[11] Effective May 2020, the Bank implemented an annual downward rate of crawl of 2.87 percent. This was complementary to the reduction in the Bank Rate in April 2020 and contributed to further easing of real monetary conditions to help promote domestic economic activity.

Chart 3.17: Nominal Exchange Rate Indices

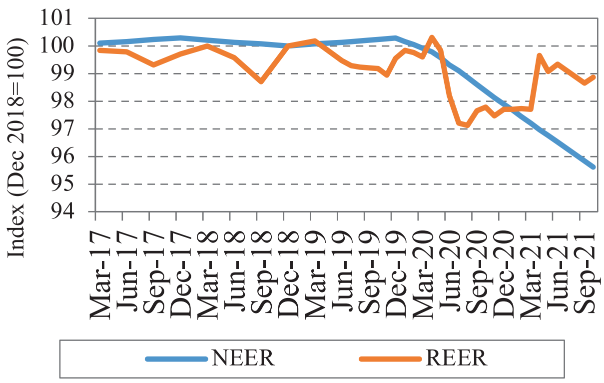


Source: Bank of Botswana

NEER depreciated in November 2021

The NEER of the Pula depreciated by 2.82 percent in the twelve months to November 2021 (Chart 3.18), consistent with the downward annual rate of crawl of 2.87 percent implemented effective May 2020.

Chart 3.18: Nominal and Real Effective Exchange rates



Source: Bank of Botswana

REER appreciated in October 2021

The REER appreciated by 1.1 percent in the twelve months to October 2021 (Chart 3.18), because of a higher positive inflation differential (4 percent) between Botswana and the trading partner countries than the downward rate of crawl (2.87 percent). With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) depreciated by 3.4 percent against the South African rand but appreciated by 4.9 percent against the SDR. Against the SDR constituent currencies, the local currency appreciated by 19.5 percent against the Japanese yen, 5.6 percent against the euro, 3.4 percent against the US dollar and 3.2 percent against the Chinese renminbi, while it depreciated by 1.3 percent against the British pound.

Box 4: Botswana's Exchange Rate Framework

The Exchange Rate Policy

Botswana's exchange rate policy aims to maintain a stable REER to support competitiveness of domestic industry in the international and domestic markets. By extension, the policy supports the national objective of economic diversification, together with the associated industrial development and employment creation objectives. The Pula exchange rate is determined based on a peg to a basket of currencies, the choice of which is guided by the trade pattern and currencies used in international trade and payments. It is pegged to a trade- weighted basket of currencies that comprise the South African rand and the IMF's unit of account, the SDR. Pegging to a basket of currencies rather than a single currency means that movements in the Pula exchange rate are not subject to an extreme influence of exceptional volatility of any single currency.

The main reasons for choosing a pegged exchange rate rather than a floating exchange rate was the desire to avoid "Dutch Disease" problems as diamond production and exports increased. The Dutch Disease can arise when rising export earnings from the dominating export sector and the resultant inflows of foreign exchange cause both the nominal and real exchange rate to appreciate, thereby, eroding the competitiveness of local producers of tradeable goods and services, hence undermine other exports (and the production of other tradeable commodities more generally). As a result, the economy may become less diversified as other tradeable goods sectors fail to grow (or go into decline).

Current Exchange Rate Framework

The crawling band mechanism was adopted in May 2005 to allow for continuous gradual adjustment (crawling) of the Pula exchange rate to avoid misalignment (i.e., either over-valuation or under-valuation) of the exchange rate. This was an improvement over the discrete adjustment (through either devaluation or revaluation) of the exchange rate which could reflect policy failures in other areas as well as undermine the credibility of the crawling peg mechanism. In the crawling band framework, prospects for changes in competitiveness (i.e., inflation differentials between Botswana and trading partner countries) are projected and the exchange rate is set to adjust gradually to forestall the potential loss in price competitiveness. When the inflation differential is positive (negative), a downward (upward) crawl is implemented; and when they are equal (zero inflation differential), the rate of crawl ought to be zero. A gradual downward adjustment of the annual rate of crawl, such as 2.87 percent effective May 1, 2020 (revised from -1.51 percent effected at the beginning of 2020), means that the exchange rate is adjusted daily in very small fixed amounts, which accumulate to an annual change of -2.87 percent.

An important goal of the exchange rate policy is the maintenance of a stable REER. In line with this objective, the authorities closely monitor the relative inflation performance between Botswana and its trading partner countries.

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook for 2021 has been revised slightly downwards compared to the July 2021 WEO Update. Prospects for advanced economies are much weaker compared to the July projections, mostly reflecting downgrades in major economies, particularly the US, Japan and Germany. For emerging market and developing economies, growth prospects for 2021 have been revised slightly upwards on account of improved assessment for some commodity exporters, owing to increased commodity prices which outweighed drags from pandemic developments. Regionally, in South Africa, the growth outlook is projected to improve, mainly due to the relaxation of movement restriction measures and rollout of effective COVID-19 vaccines. With regard to price developments, global inflation is forecast by the IMF to increase to 4.3 percent in 2021 from 3.2 percent in 2020, partly due to base effects associated with the previous year's low commodity prices and transitory supply-demand mismatches.

Global economic activity to expand

According to the October 2021 WEO, global output growth is forecast at 5.9 percent and 4.9 percent in 2021 and 2022, respectively, from an estimated contraction of 3.1 percent in 2020. The growth forecast for 2021 has been revised downwards by 0.1 percentage points compared to the July projection, while it was unchanged for 2022. The downward revision reflects challenging near-term prospects for the advanced economies, in part, due to pandemic related supply disruptions associated with low production hours in the labour-intensive sectors. Moreover, the growth forecast for low-income countries was marked down as the slow rollout of COVID-19 vaccines negatively affected economic recovery. Similar to the July 2021 projections, all regions are projected to experience positive growth in 2021.

For advanced economies, output is forecast to expand by 5.2 percent in 2021, from a contraction of 4.5 percent in 2020. The 2021 projection has been downgraded by 0.4 percentage points from the July 2021 WEO Update, mostly reflecting downgrades in major economies, particularly the US, Japan and Germany. Meanwhile, continued vaccine rollouts and sizeable policy support are expected to add impetus to economic recovery.

Risks to the global economic outlook are assessed to be on the downside. These include slower-than-anticipated vaccine rollouts that could allow the emergence of more transmissible and deadlier COVID-19 variants which would slow down economic activity, tightening financial conditions particularly in advanced economies to control inflation, worsening pandemic dynamics and tighter external financial conditions that could set back recovery in emerging market economies.

UK economy to expand in 2021

The UK economy is expected to grow by 6.8 percent in 2021 (0.2 percentage points lower compared to the July 2021 forecast), from a contraction of 9.8 percent in 2020. The expected expansion in output in 2021 is supported by the COVID-19 vaccination programme that is expected to ease movement restrictions. In addition, the already announced fiscal and monetary policy actions, such as additional spending and asset purchases programme are expected to boost economic activity in the same period. Economic activity is forecast to expand by 5 percent in 2022 supported, in part, by policy stimulus.

Output growth for US to expand

For the US, output is forecast to grow by 6 percent in 2021, before moderating to an expansion of 5.2 percent in 2022, from an estimated contraction of 3.4 percent in 2020. The downward revision for 2021 reflects large inventory drawdowns in the second quarter, in part, reflecting supply disruptions, and softening consumption in the third quarter. However, the anticipated legislation on infrastructure investment and strengthening of social safety nets in the second half of the year are expected to stimulate US' economic activity.

Growth for the euro area to expand

In the euro area, economic activity is projected to expand by 5 percent in 2021 (0.4 percentage points upgrade compared to the July 2021 WEO Update) from a decline of 6.3 percent in 2020. The upward revision of growth prospects in the economic bloc for 2021 reflects gains in momentum of vaccination campaigns, as well as expected policy support through grants and loans. Strengthening momentum is expected in France and Italy in the final quarter of the year and anticipated to carry over into 2022. Thus, GDP for the region is forecast to increase by 4.3 percent in 2022, unchanged from the projection made in July 2021.

Emerging markets GDP expansion projected to be higher

Economic activity in emerging market and developing economies is projected to expand by 6.4 percent in 2021, from an estimated contraction of 2.1 percent in 2020. The 2021 economic performance has been revised upwards by 0.1 percentage point relative to the July 2021 WEO Update, reflecting upgrades across most regions. The upward revision was on account of improved assessment for some commodity exporters owing to increased commodity prices which outweighed drags from pandemic developments. Nonetheless, economic prospects for China have been marked down slightly by 0.1 percentage point to 8 percent in 2021 due to stronger-than-anticipated scaling back of public investment and overall fiscal support. Meanwhile, India is forecast to grow by 9.5 percent and 8.5 percent in 2021 and 2022, respectively, reflecting the easing of lockdowns and other movement restrictions put in place to mitigate the spread of the virus.

Growth in the South African economy to expand

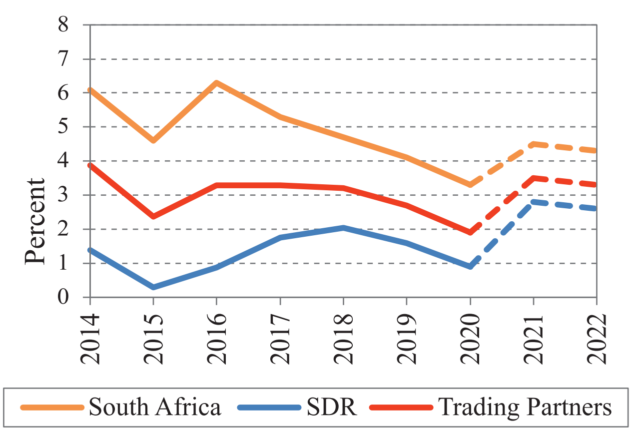
Growth prospects in South Africa are expected to improve on account of the rollout of effective COVID-19 vaccines, supportive global economic activity as well as robust terms of trade. Thus, South African output is forecast to expand by 5 percent and 2.2 percent in 2021 and 2022, respectively, from a contraction of 6.4 percent in 2020. Meanwhile, in November 2021, the SARB revised GDP growth forecast for 2021 downward to 5.2 percent (from 5.3 percent in September) due to the larger negative effect on output than previously estimated, arising out of violent protests and looting associated with the arrest of former President Jacob Zuma. The unrest in July 2021 and associated economic damage as well as the pandemic is anticipated to have lasting effects on investor confidence and job creation. At the November 2021 MPC meeting, the SARB forecast growth at 1.7 percent and 1.8 percent in 2022 and 2023, respectively, unchanged from the September forecast.

Global inflation to increase

Globally, inflation is expected to pick up in 2021 due to base effects associated with the previous year's low commodity prices and recovery in global demand as most economies ease movement restrictions and deploy effective COVID-19 vaccines. Inflationary pressures are expected to mount in advanced economies relative to other regions, reflecting the faster vaccine rollout. Thus, inflation for advanced economies is forecast to increase from 1 percent in 2020 to 2.8 percent in 2021. For emerging market economies, inflation is forecast to increase slightly from 5.1 percent to 5.5 percent in the same period, as the countries continue to face greater constraints in procurement and distribution of COVID-19 vaccines. Overall, global inflation is forecast to increase from 3.2 percent in 2020 to 4.3 percent in 2021. The higher inflation for 2021 is partly due to base effects associated with the previous year's low commodity prices and transitory supply-demand mismatches.

Meanwhile, South African inflation is forecast to average 4.5 percent and 4.3 percent in 2021 and 2022, respectively, by the SARB, both 0.1 percentage points higher than the September 2021 forecast, reflecting anticipated recovery in domestic economic activity amidst the easing of lockdown restrictions and rollout of COVID-19 vaccines. Overall, inflation is anticipated to be around the mid-point of the SARB's target range between 2021 and 2022 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



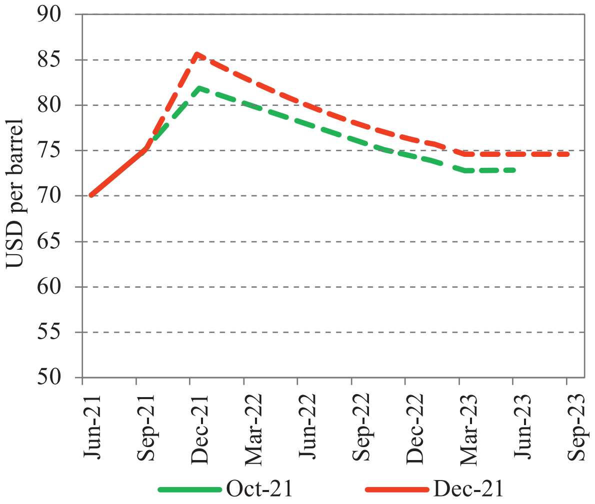
Source: SARB and Bloomberg

Global commodity prices to increase

Global rough diamond prices are expected to increase in the short to medium term, buoyed by the successful rollout of effective COVID-19 vaccines. In addition, the easing of lockdowns and other containment measures are anticipated to continue to strengthen demand for jewellery, thus exerting upward pressure on rough diamond prices. Likewise, polished diamond prices are expected to rise in the short to medium term as prospects for global end-consumer demand improve.

International oil prices are projected to increase in the short term, (Chart 4.2), amid an energy crunch supported by major supply disruptions, both in the US and in OPEC member countries, as well as increasing global demand for oil. Moreover, the draw down on US shale inventories will add more upward pressure on international oil prices in the short term. Meanwhile, the decision of OPEC and its allies to reduce daily production cuts to boost production is expected to ease the supply crunch and exert downward pressure on oil prices. OPEC anticipates to have phased out its production cuts by the end of September 2022. Overall, developments in the international oil market imply marginal upward pressure on domestic inflation in the short term.

Chart 4.2: International Oil Prices

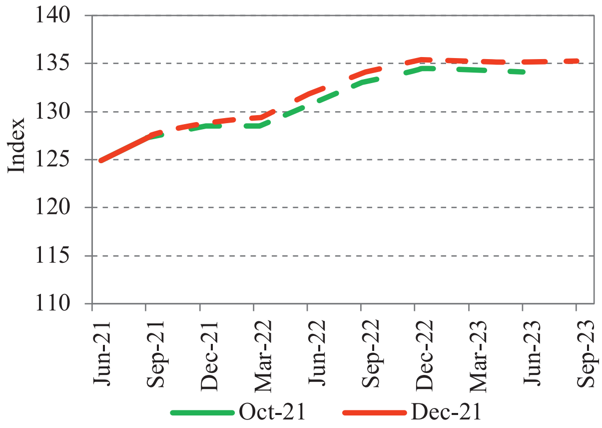


Source: Bloomberg

Global food prices are expected to trend upwards in the short to medium term (Chart 4.3). The expected increase in food prices mainly reflects the increased demand and cost push pressures arising from supply disruptions caused by possible lockdowns and other containment measures that have reduced production hours and constrained the flow of goods. The COVID-19 pandemic posed logistical challenges for food harvesting, leading to reduced supply.

In Southern Africa, despite the favourable 2021 harvests, food prices are expected to also increase in the short term due to anticipated bad climatic conditions/drought in some parts of the region in the upcoming ploughing season. Overall, there is potential modest upward pressure from international food prices on domestic inflation in the short to medium term.

Chart 4.3: International Food Prices FAO Index



Source: Bloomberg

4.2 Outlook for domestic economic activity

Projections by MFED indicate that GDP growth will rebound to 9.7 percent in 2021, from a contraction of 8.5 percent in 2020. The economy is anticipated to continue operating below its potential into the medium term, with recovery supported by the prevailing accommodative monetary conditions, improvements in the diamond industry and water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including vaccine rollouts, the implementation of the ERTP, among others. Notwithstanding prospects of a recovery in 2021, many of the risks that prevailed in 2020 remain in place, although less pronounced.

Higher output growth expected in 2021

MFED projects that GDP will expand by 9.7 percent in 2021, from a contraction of 8.5 percent in 2020, in part, reflecting improving global economic prospects as indicated by a strong performance of the diamond industry in the first half of 2021. Meanwhile, the IMF forecasts the domestic economy to rebound to 9.2 percent growth in 2021. The positive outlook for economic activity is anticipated to continue beyond 2021, supported by the prevailing accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment, government interventions against COVID-19, including vaccine rollouts, the implementation of the ERTP, among others. Box 5 outlines Bank of Botswana's response to COVID-19.

The Bank's September 2021 Business Expectations Survey (BES) indicates that firms were optimistic about economic activity in the third quarter of 2021 compared to the previous quarter wherein they were pessimistic. The optimism partly arose out of the expected gradual easing of COVID-19 movement restrictions. Firms expect GDP to expand by 3.2 percent in the third quarter of 2021, consistent with the anticipated improvement in business conditions, and the envisaged global economic recovery in 2021. Overall, non-mining economic activity is anticipated to improve in the short term although continuing to operate below potential into the medium term. The below output trend is also consistent with the high unemployment rate (24.5 percent as at the fourth quarter of 2020) and restrained growth in real wages.

Box 5: Bank of Botswana's response to the impact of COVID-19 pandemic

Botswana confirmed its first three-imported-cases of COVID-19 on March 31, 2020. As at November 26, 2021; 195 068 total local cases (192 048 local recoveries, 602 local active cases and 2 418 local deaths) had been reported in the country. To curb the spread of the disease, the country was put on a 28-day lockdown (extreme social distancing) effective from midnight of April 2, 2020, with movement outside the home only restricted to essential goods and service providers. On April 9, 2020, Parliament approved His Excellency the President's request for a six-month state of emergency, which was extended by six months to April 2021 and later by another six months to September 2021, to allow the country to adequately respond to the threat posed by COVID-19. Meanwhile, on March 26, 2021, Botswana started its COVID-19 vaccination programme, with priority given to people aged 55 years and above. Effective October 25, 2021, the vaccination rollout program transited to cover phase three category to include those aged 18 and above. By November 26, 2021, a total of 921 104 people had received a first vaccine dose and 508 980 people were fully vaccinated across the country.

For its part, the Bank of Botswana (the Bank) has undertaken measures to alleviate the adverse impact of COVID-19 on the Botswana economy, such as maintaining uninterrupted supply and availability of clean banknotes and coins, as well as banking services, primarily to Government and commercial banks. On the other hand, in an attempt to support the banking system, the Bank offered capital relief and support measures for commercial banks to enable them to satisfy capital requirements and address liquidity challenges as they continue to support economic activity under conditions of possible increase in credit risk. In this regard, since April 2020, the Bank has proceeded as follows:

- The prudential capital adequacy ratio for commercial banks operating in Botswana was reduced from 15 percent to 12.5 percent; and
- To alleviate any liquidity pressures on commercial banks, the following measures were introduced:
  - The cost of accessing overnight funding by licensed commercial banks from the Bank's Credit Facility is accessed at the prevailing Bank Rate (currently 3.75 percent) without the punitive 6 percentage points above the Bank Rate;
  - The Primary Reserve Requirement was reduced from 5 percent to 2.5 percent.
  - Repo facilities currently available only on an overnight basis will be offered against eligible securities with maturities of up to 92 days; and
  - Subject to completing regulations and arrangements relating to valuation and custody, the collateral pool for borrowing by licensed commercial banks from the Bank will be extended to include corporate bonds listed and traded on the Botswana Stock Exchange.

Other measures to help the economy included reducing the Bank Rate by a cumulative 100 basis points in 2020 to 3.75 percent.

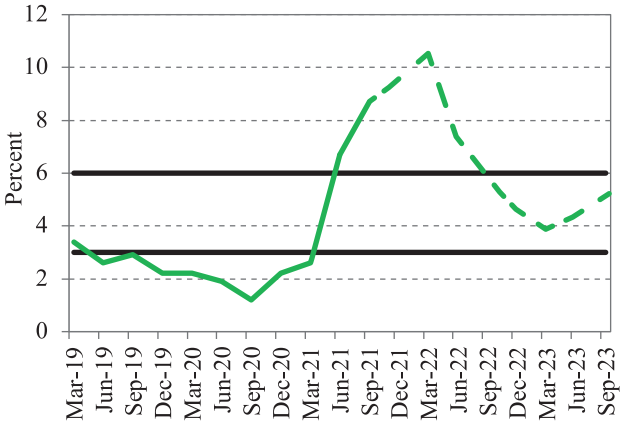
4.3 Monetary policy and the inflation outlook

Inflation is forecast to remain above the upper bound of the Bank's 3 - 6 percent objective range in the short term. However, inflation is expected to revert to within the objective range in the third quarter of 2022. The projection takes into account the anticipated increase in domestic demand in response to the overall accommodative monetary conditions; the anticipated increase in domestic fuel prices in the fourth quarter of 2021; the expected increases in private school fees and electricity tariffs in 2022; the revision in forecasts for trading partner countries inflation; the likely increase in international commodity prices; the anticipated appreciation of the Pula against the rand; and the base effects associated with adjustments in VAT and administered prices in 2021. Overall, risks to the inflation outlook are assessed to be skewed to the upside.

Inflation is projected to be higher in the near term

Inflation is projected to remain above the upper bound of the objective range in the short term, mainly reflecting the impact of the transitory supply-side factors. Nonetheless, inflation is expected to revert to within the objective range in the third quarter of 2022 (Chart 4.4), mainly on account of the dissipating impact of the upward adjustment in VAT and administered prices, during 2021, from the inflation calculation.

Chart 4.4: Botswana Headline Inflation Forecast



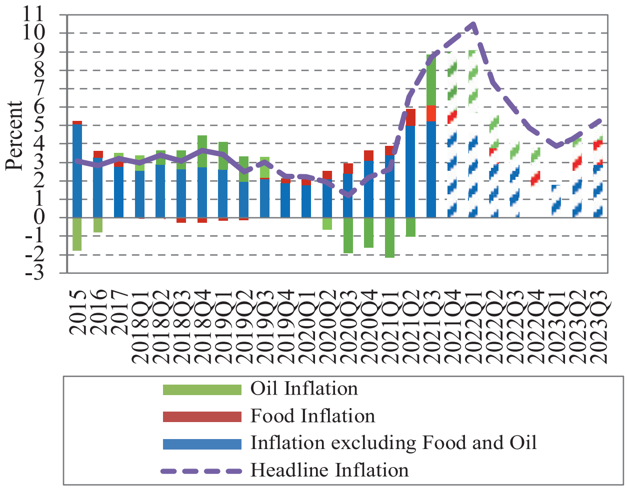
Source: Bank of Botswana

The projection takes into account the anticipated increase in domestic demand in response to the overall accommodative monetary conditions; the recent increase and the likely additional increase in domestic fuel prices in fourth quarter of 2021; the expected increases in private school fees and in electricity tariffs in 2022; the revision in forecasts for trading partner countries inflation; the likely increase in international commodity prices; the anticipated appreciation of the Pula against the South African rand in the medium term; and the base effects associated with adjustments in VAT and administered prices in 2021. The recent increase in domestic fuel prices in the fourth quarter of 2021, effected on October 8, 2021, added approximately 0.64 percentage points to inflation in the fourth quarter. The increase in private school fees in the first quarter of 2022 and the rise in electricity tariffs in the second quarter of 2022 are expected to add 0.21 percentage points and 0.27 percentage points to inflation in the respective quarters. Meanwhile, according to the September 2021 BES, the business community expect inflation to slightly breach the upper bound of the Bank's 3 - 6 percent objective range in 2021, but to revert to within the objective range in 2022.

Core inflation to decrease in the short term

Inflation excluding food and fuel prices is forecast to decrease in the short term, on account of the dissipating impact of the upward adjustment in VAT and administered prices from the inflation calculation. Nonetheless, core inflation is expected to rise marginally in the medium term mainly reflecting the expected improvement in non-mining output growth (Chart 4.5).

Chart 4.5: Headline Inflation and its Components

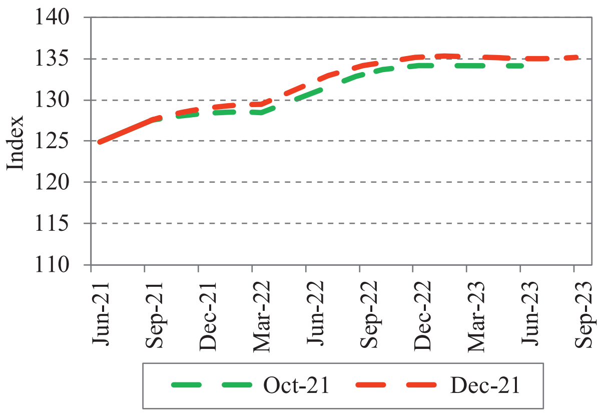


Source: Bank of Botswana

International food prices to increase

Compared to the October 2021 forecast, international food prices have been revised upwards over the forecast horizon. However, international food prices are expected to stabilise in the medium term (Chart 4.6). The upward revision reflects increased demand that is unmet due to production lags arising from supply and logistical disruptions caused by COVID-19 containment measures and the anticipated lower crop production resulting from bad climatic conditions in some regions.

Chart 4.6: International Food Prices FAO Index

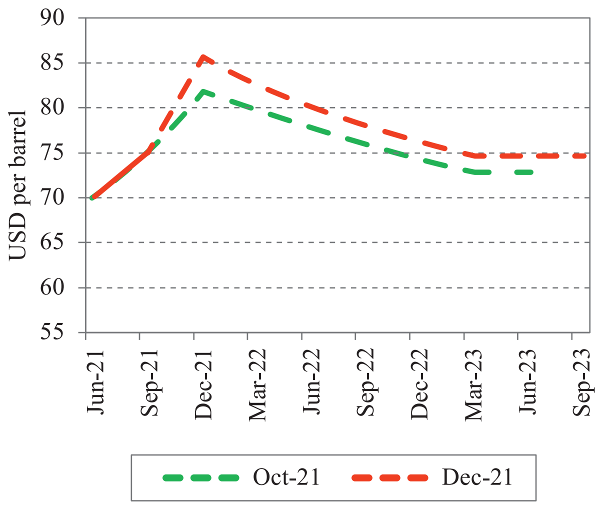


Source: Bloomberg

International oil prices revised upwards

Relative to the October 2021 projection, international oil prices have been revised upwards in the short to medium term (Chart 4.7). The upward revision in prices is due to the expected recovery in global oil demand following the relaxation of some COVID-19 containment measures amid the rollout of vaccines, stimulus programmes around the world, as well as OPEC's decision to maintain its tight supply management and the supply bottlenecks in US shale emanating from effects of the hurricanes experienced in the third quarter of 2021. Moreover, the upward revision reflects the surge in global oil demand due to shortage of gas and coal.

Chart 4.7: International Oil Prices



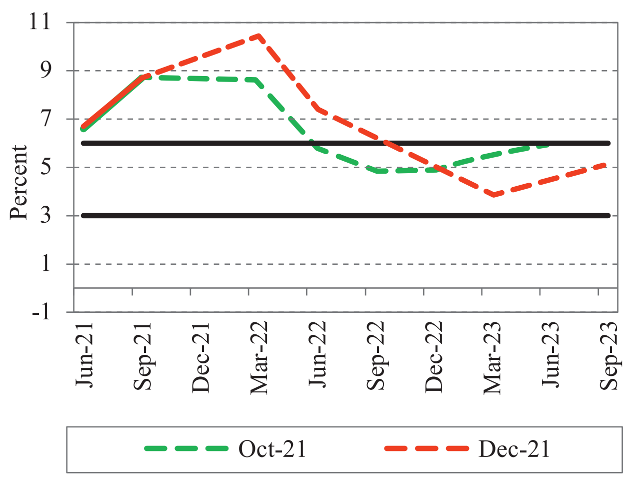
Source: Bloomberg

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

Inflation forecast revised upwards in the short term

Compared to the October 2021 forecast, inflation is projected to be higher in the short term, mainly due to the expected increase in domestic fuel prices in the fourth quarter of 2021 and private school fees in the first quarter of 2022, as well as the upward revision in forecasts for trading partner countries inflation and international commodity prices. However, the current inflation projection is lower in the medium term on account of slightly tight monetary conditions (Chart 4.8). See annexure for the inflation forecast summary.

Chart 4.8: Botswana Headline Inflation Revision



Source: Bank of Botswana

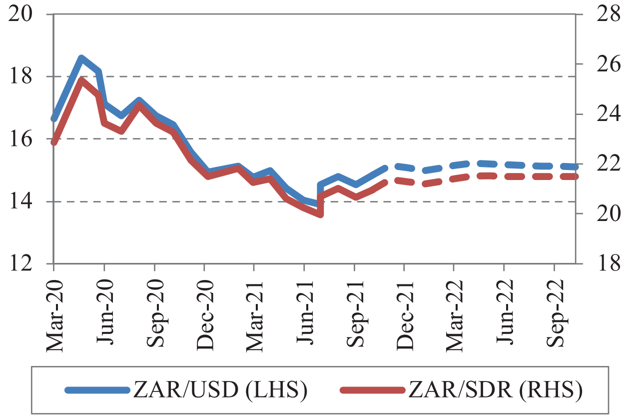
Exchange rate movements

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, the daily changes in the value of the Pula against other currencies are a result of movements in the cross rates of the South African rand and the SDR constituent currencies against each other, and their relative weights in the composite currency basket.

The South African rand is expected to depreciate against all major trading currencies in the next four quarters (Chart 4.9) due to the country's poor economic fundamentals (weak economic growth, high public debt and widening budget deficit)[12], power supply constraints[13], as well as poor-performing highly indebted state-owned enterprises, which may compromise the pace of domestic economic recovery. Meanwhile, uncertainty in investor sentiment towards emerging market assets is expected to continue putting pressure on the South African rand.

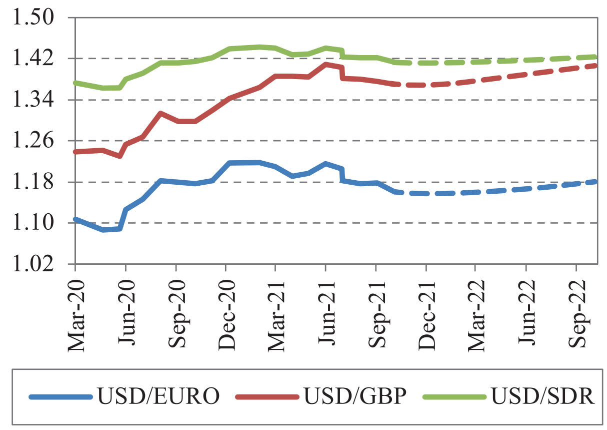
However, the external environment remains favourable to the South African rand due to rising commodity prices which have provided support to South Africa's significant raw material and precious metal export sector, supporting the country's trade balance.

Chart 4.9: ZAR against USD and SDR



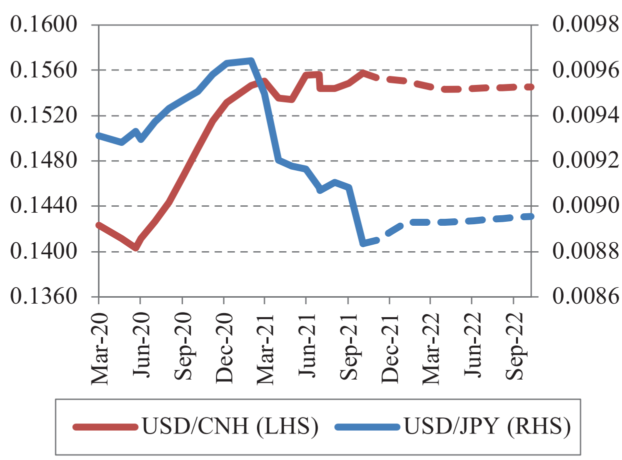
Source: Reuters

Chart 4.10A: Exchange Rates against USD



Source: Reuters

Chart 4.10B: Exchange Rates against the USD



Source: Reuters

The US dollar is expected to slightly depreciate against major international currencies in the next four quarters (Chart 4.10A and Chart 4.10B) on the back of global economic recovery prospects, lower US interest rates, delayed monetary policy tightening and concerns that the current US stimulus programs to alleviate the coronavirus

[12] In the 2020/21 fiscal year, South Africa recorded a revised budget deficit of 11.2 percent of GDP compared to 6.3 percent in 2019/20 and projected at 9.3 percent in 2021/22. It is the largest deficit ever recorded, as the COVID-19 pandemic and strict lockdown measures severely hit the country's fragile economy. Meanwhile, government debt is projected at 80.3 percent and 81.9 percent of GDP in the 2020/21 and 2021/22 fiscal years, respectively, compared to 63.3 percent in 2019/20. The prudent fiscal convergence targets for the SADC region member states are to keep public debt at less than 60 percent of GDP and a budget deficit of less than 3 percent of GDP.

[13] Eskom laid out its load shedding forecast schedule for the next 18 months, noting that it expects rolling blackouts to feature heavily in South Africa for the foreseeable future.

pandemic's economic fallout are inflating fiscal deficits. However, the global uncertainty and market volatilty from the COVID-19 pandemic is likely to influence investors to hold safe haven assets, such as the US dollar.

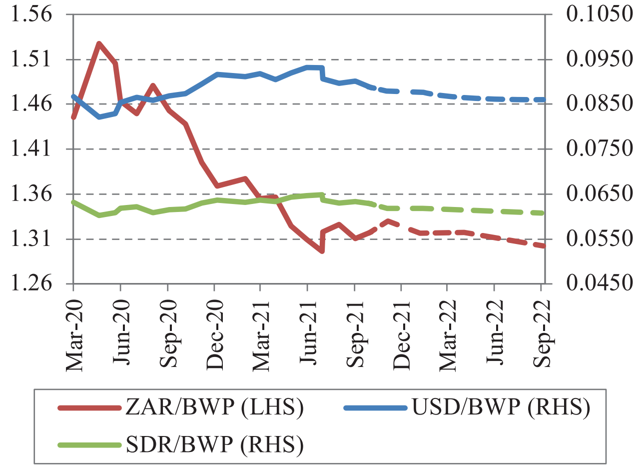
The British pound is expected to appreciate against the US dollar (Chart 4.10A) due to the potential monetary policy tightening by the Bank of England (BoE) before the end of 2021, which is expected to benefit the pound in the medium term. Meanwhile, the euro is expected to appreciate against the US dollar as the ECB is expected to tighten its policy interest rates earlier than in the US.

The Japanese yen is expected to appreciate against the US dollar due to its safe haven status as investors expect the steep rise in commodity prices to abate next year, which is likely to support a steady yen recovery.

The Chinese renminbi is expected to depreciate against the US dollar in the next four quarters (Chart 4.10B) as investors are concerned that global stock markets have been more vulnerable, especially with increased doubts over the Chinese real estate sector.

Overall, forecast movements of the SDR constituent currencies imply a marginal appreciation of the SDR against the US dollar (Chart 4.10A). The anticipated depreciation of the South African rand against the SDR is, however, expected to exert downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.11). However, the Pula is expected to slightly depreciate against the South African rand in the next four quarters. The performance of the Pula against the basket currencies is expected to have minimal impact on domestic inflation.

Chart 4.11: BWP Exchange Rates against ZAR, USD and SDR



Source: Reuters and BoB calculations

Risks are skewed on the upside

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

Box 6: Central Bank Communication on Monetary Policy

The last three decades bear witness to central banks progressively using public communication to support their policy objectives as well as enhance transparency in the formulation and implementation of effective monetary policy (Robison, 2020). The change has been necessitated by the growing recognition that central bank communication enhances both the transmission of monetary policy and the management of inflation expectations, which are fundamental to effective monetary policy.

As noted by Kahveci and Odabas (2016), the post-crisis transmission in central bank policy from mystery and inscrutability to the era of transparency, as well as the importance of 'forward-guidance' demonstrate how rapidly and radically the communication strategy has evolved. Evidently, communication has become a policy tool in its own right. Central bank communication, as defined by Blinder et al. (2008), is the information that the central bank makes available about its current and future policy objectives, current and prospective economic developments pertaining to key policy variables including inflation and output, risks to the inflation outlook and the likely path for future monetary policy decisions. Furthermore, the central bank communicates the rationale for its policy decisions.

The shift towards greater transparency is generally viewed as desirable in so far as it enhances effectiveness of monetary policy in anchoring economic agent's expectations for future policy changes, safeguarding independence, and legitimacy of central banks against the backdrop of enlarged mandates and greater public scrutiny. Furthermore, greater transparency increases predictability, accountability, and credibility of central banks.

The Bank of Botswana (the Bank), like most other central banks, recognises the importance of communication in sustaining and reinforcing transparency, predictability, and accountability with respect to the policy framework and actions; thus, fostering market participation, influencing expectations, policy credibility and, consequently, policy transmission. The Bank's communication function has evolved with the establishment of the Communications and Information Services Division, which deals with media relations, public education, the Knowledge Centre (Library), administration of the Bank's website (dissemination of Bank's information) and records management. A Communications Policy (approved in 2020) was developed to provide a framework for effective coordination of communication activities and dissemination of information. These efforts are aimed at enhancing understanding of the Bank's mandate and role in the economy by the public.

Through the Monetary Policy Statement, published at the beginning of the year, the Bank informs stakeholders about the framework for the formulation and implementation of monetary policy, where inflation trends and policy performance are reviewed and the policy choices for the ensuing year are articulated. The Monetary Policy Report (MPR) was introduced in August 2018 and presents the Bank's review of economic and inflation trends as well as policy performance. The report also provides an assessment of external and domestic economic and financial developments 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. Furthermore, the Bank publishes the MPC meeting dates for the year ahead and the Governor delivers a statement at a press briefing subsequent to each meeting of the MPC to allow for engagement with the media and dissemination of the Bank's policy stance. Following each MPC meeting, a Press Release is issued, informing the public of the Committee's decision regarding the Bank Rate and the reasons for the policy choice.

However, it is worth noting that as new communication technologies increasingly disintermediate traditional media by allowing for new ways of interaction, comprehension of the whole communication process - from the central bank at the sending end, the intermediation and interpretation of central bank messages through markets, media, and analysts, to the perception thereof by the recipients - becomes a crucial input into policy decisions. Thus, the Bank's communication is expected to adapt to these developments in pursuit of openness and transparency, and to enhance the effectiveness of policy transmission.

5. DECEMBER 2021 MONETARY POLICY COMMITTEE DECISION

At the meeting held on December 2, 2021, the Monetary Policy Committee (MPC) of the Bank of Botswana decided to maintain the Bank Rate at 3.75 percent. Inflation rose from 8.4 percent in September to 8.8 percent in October 2021, remaining above the upper bound of the Bank's medium-term objective range of 3 - 6 percent. The latest increase in inflation mainly reflects the upward adjustment in domestic fuel prices in October 2021. However, inflation is projected to revert to within the objective range in the third quarter of 2022, mainly on account of the dissipating impact of the upward adjustment, during 2021, of value added tax (VAT) and administered prices from the inflation calculation; which altogether contributed 5.9 percentage points to the current level of headline inflation.

Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistence of supply and logistical constraints due to lags in production; possible maintenance of travel restrictions and other COVID-19 containment measures; domestic risk factors relating to regular annual price adjustments; as well as second-round effects of the recent increases in administered prices and inflation expectations that could lead to generalised higher price adjustments. Furthermore, aggressive action by governments (for example, the Economic Recovery and Transformation Plan (ERTP)) and major central banks to bolster aggregate demand, as well as the successful rollout of the COVID-19 vaccination programmes, could add pressure to inflation.

These risks are, however, moderated by the possibility of weak domestic and global economic activity, with a likely further dampening effect on productivity due to supply-chain bottlenecks, disease containment measures and other forms of restrictions in response to the emergence of new COVID-19 variants. A slow rollout of vaccines, resulting in the continuance of weak economic activity and the possible decline in international commodity prices could also result in lower inflation, as would capacity constraints in implementing the ERTP initiatives.

Real Gross Domestic Product (GDP) grew by 4.9 percent in the twelve months to June 2021, compared to a contraction of 5.1 percent in the corresponding period in 2020. The increase in output is attributable to the expansion in production of both the mining and non-mining sectors, resulting from an improved performance of the economy from a low base in the corresponding period in the previous year. Mining output increased by 3 percent in the year to June 2021, on account of a 3.2 percent increase in diamond mining output, compared to a contraction of 19.3 percent in 2020. Similarly, non-mining GDP grew by 5.4 percent in the twelve-month period ending June 2021, compared to a decrease of 0.7 percent in the corresponding period in 2020. The increase in non-mining GDP was mainly due to expansion in output for construction, diamond traders, transport and storage, wholesale and retail and real estate.

Projections by the Ministry of Finance and Economic Development and the International Monetary Fund (IMF) suggest a rebound in economic growth for Botswana in 2021. The Ministry projects a growth rate of 9.7 percent in 2021, moderating to a growth of 4.3 percent in 2022. On the other hand, the IMF forecasts the domestic economy to grow by 9.2 percent in 2021; and this is expected to moderate to a growth of 4.7 percent in 2022. The growth outcome will partly depend on the successful vaccine rollout.

According to the October 2021 World Economic Outlook (WEO), global output growth is forecast at 5.9 percent in 2021 and to moderate to 4.9 percent in 2022, as some economies return to their pre-COVID levels. The South African Reserve Bank, for its part, projects that the South African GDP will grow by 5.2 percent in 2021, and slow to 1.7 percent in 2022.

The MPC notes that the short-term adverse developments in the domestic economy occur against a growth-enhancing environment. These include accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including the vaccination rollout programme. In addition, the successful implementation of ERTP should help anchor the growth of exports and preservation of a sufficient buffer of foreign exchange reserves, which amounted to P53.5 billion (10 months of import cover) at the end of November 2021.

Overall, it is projected that the economy will operate below full capacity in the short to medium term and, therefore, not creating any demand-driven inflationary pressures, going forward. The projected increase in inflation in the short term is primarily due to transitory supply-side factors that, except for second-round effects and entrenched expectations (for example, through price adjustments by businesses, contractors, property owners and wage negotiations), do not normally attract monetary policy response.

In this context, the MPC decided to continue with the accommodative monetary policy stance and maintain the Bank Rate at 3.75 percent. The Bank stands ready to respond appropriately as conditions dictate.

The MPC meetings for 2022 are scheduled as follows:

Date		***Time***
Thursday	*February 24, 2022*	*0830 hours*
Thursday	*April 28, 2022*	*0830 hours*
Thursday	*June 16, 2022*	*0830 hours*
Thursday	*August 25, 2022*	*0830 hours*
Thursday	*October 20, 2022*	*0830 hours*
Thursday	*December 1, 2022*	*0830 hours*

Annex: Inflation Forecast Summary for the December 2021 MPC Meeting

	Actual 2021			**Forecast**									
				2021		2022					2023		
	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3
Inflation	2.6	6.7	8.7	9.5 (8.7)	6.9 (6.7)	10.4 (8.6)	7.3 (5.8)	5.8 (4.9)	4.6 (4.9)	7.0 (6.1)	3.9 (5.5)	4.4 (5.9)	5.1 (5.9)

Note: Figures in parentheses represent the previous MPC forecast (October 2021)

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

Domestically

1. The expected increase in private school fees in the first quarter of 2022
2. A possible increase in domestic fuel prices in response to developments in international oil prices

Externally

1. Trading partner inflation revised upwards in the short term
2. International commodity prices (food and oil) revised upwards
3. Pula forecast to be relatively stable against the rand in the near term

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