MONETARY POLICY REPORT

AUGUST 2023

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

Monetary Policy Report
August 2023

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Table of Contents

1. PREFACE

1.1 Purpose of the report

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

The MPR 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 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 (MoF), 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 has traditionally used the Bank Rate (Monetary Policy Rate (MoPR) as of April 2022)[1] to influence short-term market interest rates to steer the economy through 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 range, while considering the prevailing rate of crawl of the exchange rate mechanism, prospects for economic growth and developments relating to the stability of the financial system. The policy horizon is up to 3 years, and evaluated on a rolling basis, because monetary policy affects price developments with an estimated lag of up to four quarters. A proactive approach to setting policy necessitates a continuous review of the inflation outlook.

The monetary policy stance is signalled by the MoPR. To support this signal, the Bank uses open market operations, which entail, primarily, auctioning of the Bank of Botswana Certificates (BoBCs) using fixed rate full allotment system, engaging in repo/reverse repo transactions with commercial banks (primary dealers), and a one-month BoBC paper to help address some of the structural liquidity positions and support the construction of the short-end of the yield curve.

1.3 Decision-making process

Monetary policy is implemented in line with the decisions of the Monetary Policy Committee (MPC). Effective February 14, 2023, and as required by the Bank of Botswana (Amendment) Act, 2022, the MPC comprises nine members, four of which are independent external members appointed by the Minister. Three external members have been appointed. The five internal members are the Governor, two Deputy Governors, head of department responsible for economic research and head of department responsible for treasury operations (See Box 4 for further details). 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] Effective April 28, 2022, the MoPR is used as the policy signaling rate in place of the Bank Rate (see Box 2 for further details).

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 MoPR 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.

The first MPC meeting of the year, held in February, is accompanied by the issuance of the Monetary Policy Statement, through which the Bank reports on inflation trends, policy performance and the likely policy posture for the ensuing year. Subsequently, the MPR is produced for the April, August and October meetings. 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 2023, monetary policy is being implemented in the context of projections for lower inflation in the short-to-medium term, associated with projected relatively low international commodity prices particularly food and fuel, dissipating impact of increases in administered prices in 2022 and subdued domestic demand. Overall, the Bank projected the domestic economy to operate below full capacity in the short term and, therefore, not generate demand-driven inflationary pressures. However, with inflation projected to be within the objective range in the medium term and closer to the upper bound, the Bank maintained the MoPR at 2.65 percent at the August 2023 MPC meeting, following a cumulative 151 basis points policy rate increase in 2022.

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.

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

The global economic outlook for 2023 was revised slightly upwards in the International Monetary Fund (IMF)'s July 2023 World Economic Outlook (WEO) Update, largely on account of stronger-than-expected economic performance in some major economies (US, UK, Italy and Spain) in the first quarter of 2023. However, global output growth remains broadly restrained due to lower consumer demand associated with higher borrowing costs and inflation, which significantly eroded purchasing power. Thus, prospects for growth in both advanced economies and emerging market economies remain broadly restrained. Growth is forecast to moderate from 2.7 percent in 2022 to 1.5 percent in 2023 for advanced economies, while it is expected to remain unchanged at 4 percent for emerging market economies in the same period. Overall, the global economy is forecast to slow down from an expansion of 3.5 percent in 2022 to 3 percent in 2023.

Global commodity prices decreased in the second quarter of 2023, but remained above pre pandemic levels, in part, due to aggressive interest rate hikes by major central banks to combat high inflation, as well as the appreciation of the US dollar. Thus, international oil prices decreased, averaging below USD80 per barrel in the second quarter of 2023. Similarly, diamond prices decreased in the second quarter of 2023, mainly due to the decline in demand, amid high inflation and rising interest rates. Meanwhile, the United Nations' Food and Agriculture Organization (FAO) food price index decreased in the second quarter of 2023, mainly due to modest demand resulting from global economic slowdown, as well as the easing of international oil prices, an input in food production.

Domestically, headline inflation averaged 6.1 percent in the second quarter of 2023, from 11.4 percent in the second quarter of 2022, mostly accounted for by the dissipating impact of the increase in administered prices in the second quarter of 2022, as well as the restrained growth in the prices of food and alcoholic beverages. Inflation breached the lower bound of the objective range in July 2023 but is expected to revert to the objective range from the first quarter of 2024 into the medium term. Compared to the June 2023 forecast, inflation is projected to be significantly lower in the short term, mainly reflecting the impact of the recent decrease in domestic fuel prices.

Inflation could be higher than projected in the event international commodity prices were to increase beyond current forecasts, supply and logistical constraints persist and the reversal of global economic integration (geo-economic fragmentation) gains pace. Furthermore, any possible upward adjustment in administered prices that is not factored in the current projection may lead to higher inflation. However, inflation could be lower than anticipated because of the possibility of weaker global economic activity, possible disinflationary effects of higher monetary policy rates globally, stronger-than-anticipated appreciation of the Pula against the South African rand, and restrained international commodity prices.

Botswana's real GDP grew by 5.4 percent in the twelve months to March 2023, compared to a higher growth of 13.3 percent in the year to March 2022. The slowdown was attributable to base effects associated with high GDP growth rate recorded in 2021, following the relaxation of the COVID-19 containment measures. Reforms to further improve the business environment, and implementation of the Economic Recovery and Transformation Plan (ERTP) and the potentially expansionary two-year Transitional National Development Plan (TNDP), should generally be positive for economic activity in the medium term. The domestic economy is forecast to grow by 3.8 percent in 2023.

In the year to June 2023, commercial bank credit growth accelerated to 6.3 percent, compared to 5.2 percent in twelve months to June 2022, associated with higher growth of business credit reflecting loan issuance and higher utilisation of credit facilities. Meanwhile, money supply (M2) increased annually by 3.9 percent in the year to June 2023, compared to 7.2 percent in June 2022.

At the end of June 2023, the official foreign exchange reserves were estimated at P66.1 billion, an increase of 22 percent from P54.2 billion in June 2022, and translated into 9.2 months of import cover. The current account of the balance of payments (BoP) is estimated to have recorded a surplus of P2.6 billion in the first quarter of 2023, compared to a revised surplus of P1.5 billion in the corresponding period in 2022.

An annual downward rate of crawl of 1.51 percent was implemented from January 1, 2023, with a view to enhancing domestic industry competitiveness. Consequently, the nominal effective exchange rate (NEER) of the Pula depreciated by 2.1 percent in the twelve months to July 2023. Against the basket currencies, the Pula appreciated by 2.5 percent against the South African rand and depreciated by 5.7 percent against the Special Drawing Rights (SDR) in the twelve months to July 2023. In the year to July 2023, the REER depreciated by 4.6 percent, due to depreciation of the NEER amid negative inflation differential between Botswana and its trading partner countries, in the same review period.

3. RECENT ECONOMIC DEVELOPMENTS

3.1 Recent global economic developments

Global growth subdued

According to the July 2023 WEO Update, the global economy is estimated to have grown by 3.5 percent in 2022, compared to an expansion of 6.3 percent in 2021 (Table 3.1). The lower growth for 2022 was partly due to the impact of the Russia-Ukraine war, renewed outbreak of COVID-19 in the first half of 2022, which resulted in lockdowns in China, as well as sustained inflationary pressures and associated high inflation expectations, leading to interest rate hikes that resulted in significant tightening of financial conditions across the globe.

Meanwhile, economic activity turned out better than anticipated in the first quarter of 2023, particularly in advanced economies (US, UK, Italy and Spain).

The US economic growth expands

The US real output expanded by an annualised 2.4 percent in the second quarter of 2023, from 2 percent in the first quarter of 2023. The expansion in output in the second quarter of 2023 was mainly because of the increases in consumer spending, state and local government spending, federal government spending, private inventory investment and non-residential fixed investment, which were partly offset by decreases in exports and residential fixed investment.

Euro area remains subdued

In the euro area, GDP growth grew by an annualised 0.3 percent in the second quarter of 2023 after stalling in the first quarter, and above market expectation of 0.2 percent growth. The subdued growth was a result of high inflation, although moderating, which continued to restrain household spending.

Furthermore, supply chain bottlenecks contributed to restrained output growth in the same quarter. Among the bloc's largest economies, output in Italy contracted by 0.3 percent, while it grew by 0.5 percent and 0.4 percent in France and Spain, respectively, while it stalled for Germany, in the same period.

UK growth subdued

GDP in the UK grew by 0.2 percent in the second quarter of 2023, from 0.1 percent in the first quarter. The expansion reflects strong growth in household consumption, manufacturing, hospitality activities, as well as government consumption expenditure on public administration, defence and health.

Emerging markets' growth improved

Output growth in emerging markets improved in the first quarter of 2023, primarily due to the reopening of China, as well as the slowdown in growth of global commodity prices particularly food and fuel. The higher growth for the economic group also indicates the removal of COVID-19 restrictions and governments' efforts to stimulate economic activity.

The Indian economy grew, year on year, by 6.1 percent in the first quarter of 2023, compared to 4.5 percent in the fourth quarter of 2022, and above the market expectation of 5 percent, as input cost pressures eased, thus significantly increasing private consumption, services exports and manufacturing.

Meanwhile, China's economy expanded annually by 6.3 percent in the second quarter of 2023, accelerating from the 4.5 percent growth in the first quarter of 2023, but lower than the market expectation of 7.3 percent. The higher growth in the second quarter of 2023 reflected the base effects associated with the removal of stringent COVID-19 restrictions, as well as the acceleration of growth in industrial production and services sector.

South African economy expanded

Regionally, output in South Africa rose, quarter on quarter, by 0.4 percent in the first quarter of 2023, from a downwardly revised decline of 1.1 percent in the fourth quarter of 2022, thus escaping a technical recession despite outrageous power outages that have significantly curtailed economic activity. The slight expansion in output in the first quarter of 2023 was driven by manufacturing (1.5 percent) and finance, real estate and business services (0.6 percent).

Table 3.1: Growth Estimates and Projections

	Estimate		Projection	
	2021	2022	2023	2024
Global	**6.3**	**3.5**	**3.0**	**3.0**
Advanced economies	**5.4**	**2.7**	**1.5**	**1.4**
USA	5.9	2.1	1.8	1.0
Euro area	5.3	3.5	0.9	1.5
UK	7.6	4.1	0.4	1.0
Japan	2.2	1.1	1.4	1.0
EMDEs	**6.8**	**4.0**	**4.0**	**4.1**
China	8.4	3.0	5.2	4.5
Brazil	5.0	2.9	2.1	1.2
India	9.1	7.2	6.1	6.3
Russia	5.6	-2.1	1.5	1.3
South Africa	4.7	1.9	0.3	1.7
Botswana	**11.9**	**5.8**	**3.7 (3.8)**	**4.3 (4.4)**

Source: IMF WEO Update July 2023 and MoF for Botswana.
Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts by the MoF.

Global commodity prices

Diamond prices decreased in the second quarter of 2023

The global rough diamond price index decreased by 1.2 percent from 182.08 points in the first quarter of 2023 to 179.80 points in the second quarter, mainly due to a decline in demand, amid high inflation, rising interest rates and a shift towards spending on travel and experiences. The global rough diamond price index averaged 165.1 points in July 2023.

The global polished diamond price index also decreased by 2.2 percent from 213.2 points in the first quarter of 2023 to 208.47 points in the second quarter of 2023, amid a rise in inventory levels due to weaker demand and global economic outlook. The global polished diamond price index averaged 224.88 points in July 2023.

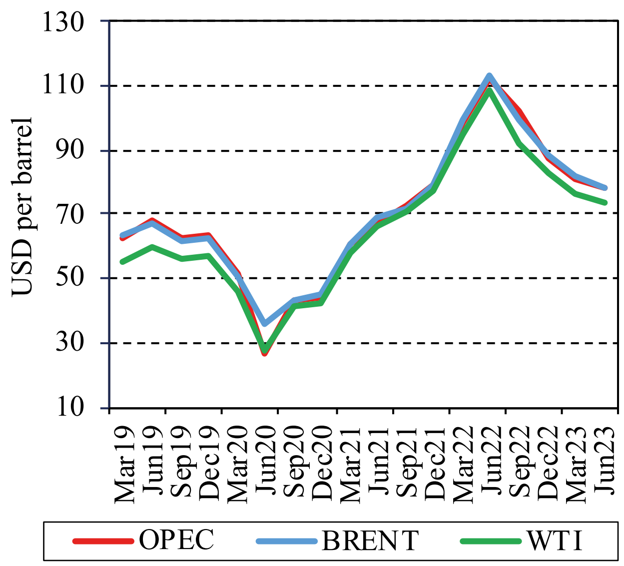
Oil prices decreased in the second quarter of 2023

International oil prices decreased in the second quarter of 2023, although remaining above the pre pandemic levels (Chart 3.1). The price of Organization of the Petroleum Exporting Countries (OPEC) reference crude oil basket, Brent crude and West Texas Intermediate (WTI) decreased by 3 percent, 4.1 percent and 3.1 percent, from an average of USD80.56 per barrel, USD81.36 per barrel and USD75.96 per barrel in the first quarter of 2023 to an average of USD78.28 per barrel, USD78.09 per barrel and USD73.72 per barrel, respectively, in the second quarter.

The decline in oil prices was due to restrained demand resulting from continued aggressive interest rate hikes by most central banks to combat high inflation, as well as appreciation of the US dollar. In addition, the resumption of crude oil exports by Libya and traders' fear that a brewing banking crisis could dent global economic growth, resulted in the decrease in oil prices.

In contrast, international oil prices increased, month-on-month, in July 2023. The OPEC reference crude oil basket, Brent crude and WTI prices increased by 7.8 percent, 7 percent and 8.9 percent to an average of USD81.06 per barrel, USD80.10 per barrel and USD76.39 per barrel, respectively. The increase in oil prices was mainly driven by OPEC's agreement to cut production by 2 million barrels per day, as well as Saudi Arabia and other OPEC oil producers' decision to voluntarily increase their production cuts by an extra amount totalling 1.6 million barrels per day effective May 2023, thus taking the cartel's production cuts to 3.66 million barrels per day. Moreover, the increase in demand for oil associated with the reopening of China, the world's largest oil importer, and the reduction in shale oil inventories also contributed to the increase in oil prices in the same period.

Chart 3.1: International Oil Prices



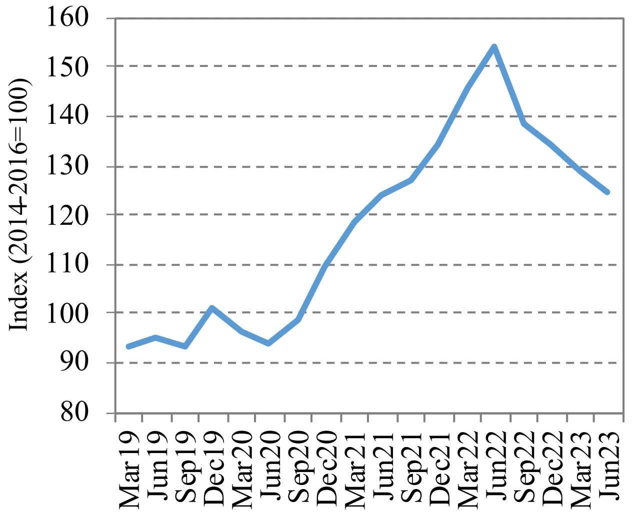
Source: Bloomberg

Food prices decreased in the second quarter of 2023

According to FAO, the global food price index averaged 124.7 points in the second quarter of 2023, a 3.4 percent decrease from an average of 129.1 points in the first quarter of 2023 (Chart 3.2). The decrease was attributable to the Black Sea grains export deal between Ukraine, Russia, Turkey and the United Nations, increased seasonal supply from some commodity exporting countries, as well as the easing of international oil prices, an input in food production.

Meanwhile, according to the United Nations FAO, global food prices increased by 1.3 percent between June and July 2023, mainly due to a significant increase in vegetable oils price index, following Russia's decision to terminate Black Sea Grain Initiative in July 2023. However, this was partially offset by the decline in the sugar price index, together with small decreases in the price indices for cereals, dairy and meat.

Chart 3.2: Food Price Index

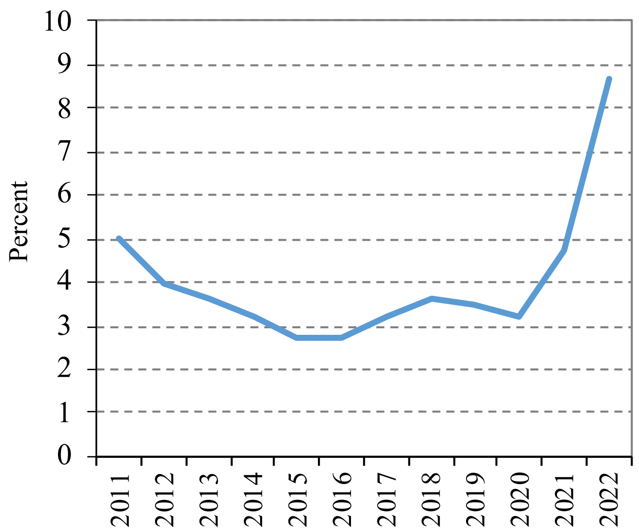


Source: FAO

Inflation decreased across the regions

Inflation for advanced economies decreased from 7.1 percent in the first quarter of 2023 to 5.7 percent in the second quarter[2], due to relatively lower food and fuel prices, rapid monetary policy tightening and squeezing of household budgets, as well as waning COVID-19 pandemic related fiscal support. Similarly, for emerging market economies, inflation decreased from 6.3 percent to 5.1 percent in the same period. Global inflation increased from 4.7 percent in 2021 to 8.7 percent in 2022 (Chart 3.3).

Chart 3.3: Global Inflation

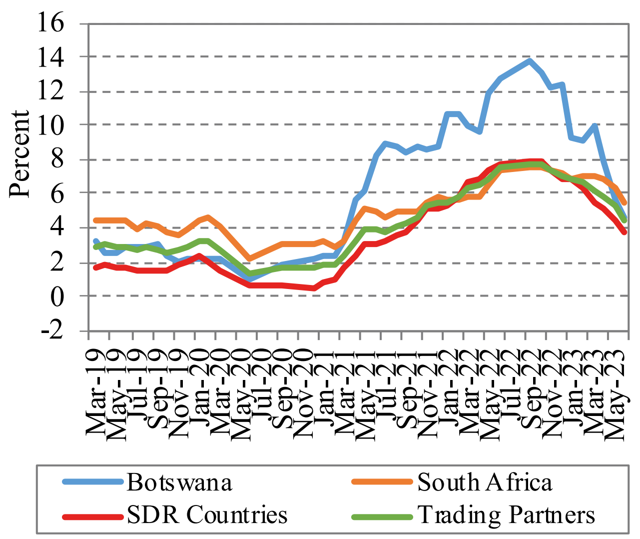


Source: IMF April 2023 WEO

In South Africa, headline inflation decreased from 7 percent in the first quarter of 2023 to 6.2 percent in the second quarter of 2023. Similarly, inflation decreased from 6.3 percent in May 2023 to 5.4 percent in June 2023, falling within the South African Reserve Bank (SARB)'s target range of 3 – 6 percent.

The average trade-weighted inflation for Botswana's trading partners decreased from 7 percent in the second quarter of 2022 to 5.2 percent in the second quarter of 2023 (Chart 3.4). Meanwhile, trade-weighted inflation for Botswana's trading partners was 4.5 percent in June 2023, a decrease from 5.3 percent in May.

Chart 3.4: Botswana Inflation and International Inflation



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

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

Monetary policy divergence across the globe

In the recent policy decisions, most advanced economies have continued to tighten their monetary policy rates (Table 3.2). The European Central Bank (ECB) increased the deposit rate, refinancing rate and lending rate by 25 basis points to 4.25 percent, 4.5 percent and 3.75 percent, respectively, in July 2023, the nineth consecutive increase to combat inflationary pressures. Since the commencement of the central bank's tightening cycle in July 2022, ECB officials have implemented an unprecedented 425 basis point increase in rates, marking the fastest tightening pace in its history. The Governing Council reported that it will continue with the tightening cycle and was ready to respond as necessary to preserve price stability and maintain financial stability in the region.

In July 2023, the US Federal Open Market Committee (FOMC) increased the target policy rate by 25 basis points to 5.25 – 5.50 percent, as inflation remained elevated. The Fed noted the US banking system was sound and resilient, however, tighter credit conditions for households and businesses are likely to weigh economic activity, employment and inflation. In assessing the appropriate stance of monetary policy, the FOMC stated that it will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, as well as economic and financial developments.

The Bank of England (BoE) increased the Bank Rate by 25 basis points to 5.25 percent in August 2023, the fourteenth consecutive hike since December 2021, and pushing borrowing costs to the highest level since 2008, to bring inflation back to the 2 percent target. Moreover, the BoE reiterated that further increases in the Bank Rate may be required, should inflationary pressures persist. Meanwhile, the BoE noted that the UK banking system remains resilient amid the recent banking crisis.

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 percent at the July 2023 meeting. In addition, the BoJ announced that the Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) as necessary with upper limits of about 12 trillion yen and about 180 billion yen, respectively, on annual paces of increase in their amounts outstanding. The BoJ also reiterated that it will take extra easing measures if needed to support economic activity.

In emerging market economies, the Central Bank of Brazil cut the policy rate by 50 basis points to 13.25 percent due to an improvement in the inflation dynamics. The Committee judged that the improvement on the inflation scenario, reflecting in part the lagged effects of monetary policy, together with the reduction of longer-term inflation expectations, gave the necessary confidence to start a gradual cycle of monetary policy easing. Conversely, the Central Bank of Russia (CBoR) raised the key policy rate by 350 basis points to 12 percent at an unscheduled meeting on August 15, 2023, the highest level since April 2022. The CBoR indicated that the risk to the inflation outlook was on the upside and signalled that it will hike the rates at the upcoming meetings if inflationary pressures persist.

In August 2023, the People's Bank of China (PBoC) reduced the one-year Loan Prime Rate (LPR) by 10 basis points to 3.45 percent to support economic recovery. The five-year LPR was maintained at 4.20 percent.

The SARB maintained the repo rate at 8.25 percent in July 2023, to anchor inflation expectations more firmly around the mid point of the 3 – 6 percent target range. The SARB judged the policy rate to be restrictive, consistent with elevated inflation expectations and the inflation outlook. The SARB considered risks to the inflation outlook to be on the upside and expected headline inflation to average 6 percent (down from 6.2 percent) in 2023.

In August 2023, the Reserve Bank of India (RBI) maintained the policy rate at 6.5 percent for the third consecutive meeting. The RBI projected that headline inflation would increase in the near term on account of supply disruptions due to adverse weather conditions. Nevertheless, the RBI remains focused on withdrawal of accommodative policy stance to ensure that inflation progressively aligns with target, while supporting growth.

Table 3.2: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting	Likely Policy Decision at the Next Meeting
Bank of Botswana	August 2023	2.65	No change	No indication of the direction of policy.
SARB	July 2023	8.25	No change	No indication of the direction of policy but will respond to new data and risks
US Federal Reserve	July 2023	5.25–5.50	Increased by 25 basis points	No indication of the direction of policy but is prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. Also, continue to reduce its holdings of treasury securities, agency debt and mortgage-backed securities.
BoE	August 2023	5.25	Increased by 25 basis points	Further tightening of the Bank Rate would be required if inflationary pressures persist
ECB	July 2023	4.25	Increased by 25 basis points	Monitoring current market tensions closely, and ready to respond as necessary to preserve price stability and maintain financial stability in the region.
BoJ	July 2023	-0.10	No change	Will not hesitate to take additional easing measures if necessary; it also expects short- and long-term policy interest rates to remain at their present or lower levels
PBoC	August 2023	3.45	Decreased by 10 basis points	No indication of the direction of policy
Brazil	August 2023	13.25	Decreased by 50 basis points	The inflation profile gives confidence to gradually ease monetary policy.
India	August 2023	6.50	No change	RBI remains focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth, and is prepared to undertake policy responses, should the situation so warrant.
Russia	August 2023	12.00	Increased by 350 basis points	Increase the policy rate at the forthcoming meetings if inflationary pressures persist.

Source: Various central banks' websites.

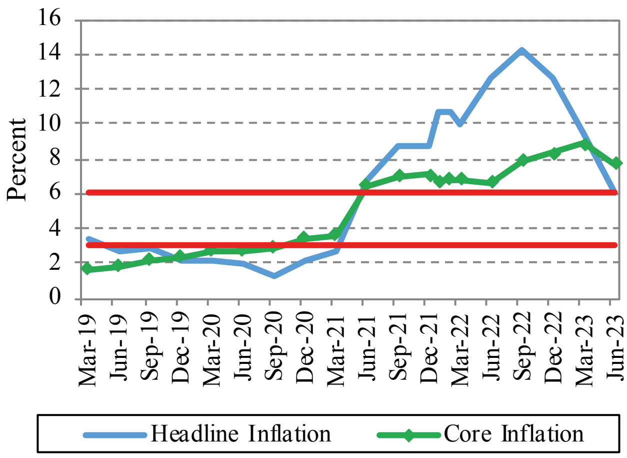
3.2 Domestic inflation environment

Headline inflation decreased in the second quarter of 2023

Headline inflation averaged 6.1 percent in the second quarter of 2023, from 11.4 percent in the second quarter of 2022 (Chart 3.5 and Table 3.3). The decrease in inflation in the second quarter of 2023 was mostly accounted for by the dissipating impact of the increase in administered prices in the second quarter of 2022 (domestic fuel prices, Botswana Housing Corporations (BHC) rentals and public transport fares), which altogether had added 3.48 percentage points to headline inflation, as well as restrained growth in the prices of food and non-alcoholic beverages.

Similarly, headline inflation decreased significantly from 4.6 percent in June 2023 to 1.5 percent in July 2023, the lowest value since the 1 percent registered in August 2020, breaching the lower bound of the Bank's medium-term objective range of 3 – 6 percent, and was significantly lower than the 14.3 percent in July 2022. The fall in inflation between June and July 2023 was mainly due to base effects associated with the upward adjustment in domestic fuel prices effected on June 28, 2022, which added 1.13 percentage points to headline inflation in July 2022. Furthermore, inflation fell on account of the downward adjustment in domestic fuel prices effected June 21, 2023, which subtracted 0.59 percentage points from headline inflation.

Chart 3.5: Botswana Headline and Core Inflation



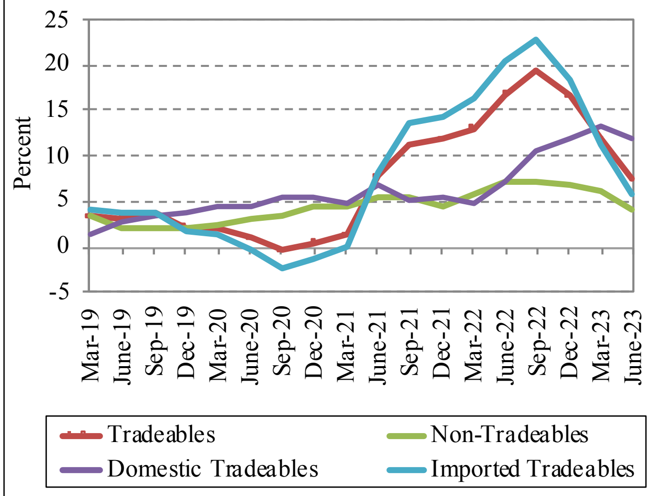
Source: Statistics Botswana and Bank of Botswana
Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic tradeables increased while they decreased for imported tradeables in the second quarter of 2023

Inflation for domestic tradeables increased from an average of 5.2 percent in the second quarter of 2022 to an average of 11.9 percent in the second quarter of 2023 (Charts 3.6), due to the increase in value added tax (VAT) in April 2023. However, imported tradeables inflation decreased from an average of 18.7 percent to an average of 5.9 percent in the same period due to the decrease in fuel prices, as well as the base effects associated with the increase in domestic fuel prices in the corresponding period in 2022.

As a result, all tradeables inflation decreased from an average of 15 percent in the second quarter of 2022 to an average of 7.4 percent in the second quarter of 2023, while inflation for non-tradeables also decreased from an average of 6.4 percent to 4.1 percent in the same period, mainly due to the base effects associated with the upward adjustment of public transport fares and BHC rentals in 2022. In July 2023, domestic tradeables, imported tradeables, non-tradeables and all tradeables inflation were 7.9 percent, -1.9 percent, 3 percent and 0.5 percent, respectively.

Chart 3.6: Inflation for Tradeables and Non-Tradeables



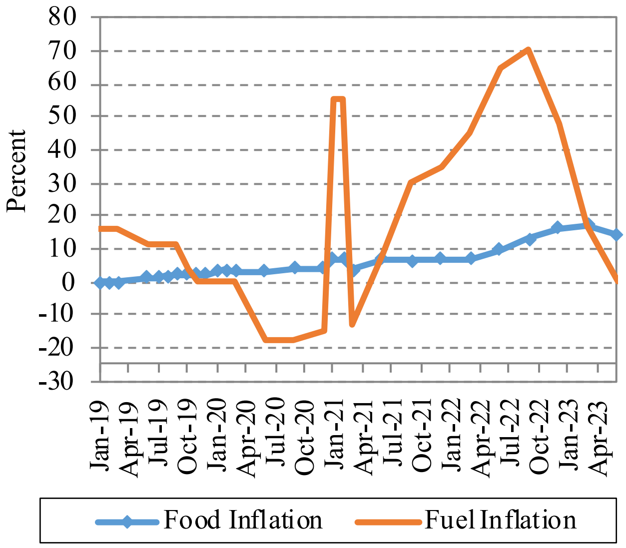
Source: Statistics Botswana

Generally, there has been a downward trend in non-tradeables inflation since June 2022 and domestic tradeables inflation from March 2023, mainly due to the base effects associated with upward adjustment in prices for administered prices in 2022 and restrained growth in food prices, respectively. The decrease in food prices was partly a result of the decrease in oil prices, an input in food production.

Core inflation measures diverged in the second quarter of 2023

The trimmed mean inflation (CPITM) decreased to 5.6 percent in the second quarter of 2023, from 8.7 percent in the second quarter of 2022, while inflation excluding administered prices (CPIXA) averaged 7.7 percent, from 6.3 percent (Table 3.3), due to the increase in prices of Air Botswana air fares. However, inflation excluding food and fuel[3] (CPIXFF) averaged 5.6 percent in the second quarter of 2023, lower than the 6.4 percent recorded in the corresponding quarter in 2022, due to base effects associated with the increase in public transport fares in the second quarter of 2022. In July 2023, CPITM, CPIXA and CPIXFF were 2.5 percent, 5.9 percent and 4 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	July 2023	Q2 2023	Q2 2022
Food and non-alcoholic beverages	13.6	10.7	14.6	8.0
Alcoholic beverages and tobacco	4.3	5.1	4.6	4.9
Clothing and footwear	6.0	5.6	5.9	3.8
Housing, water, electricity, gas and other fuels	17.5	0.9	1.5	7.4
Furnishing, h/h equipment and routine maintenance	4.9	5.3	6.5	5.0
Health	3.4	2.7	3.6	2.2
Transport	23.4	-7.6	5.6	30.0
Communications	6.9	2.4	2.5	0.5
Recreation and culture	2.8	1.9	5.3	4.2
Education	4.6	5.1	5.1	2.5
Restaurants and hotels	3.7	5.8	6.1	4.5
Miscellaneous goods and services	9.0	8.5	8.3	8.4
Annual Inflation (All items)	**100.0**	**1.5**	**6.1**	**11.4**
CPITM		2.5	5.6	9.3
CPIXA		5.9	7.7	6.3
CPIXFF		4.0	5.6	6.4

Source: Statistics Botswana and Bank of Botswana calculations

[3] Food inflation decreased from an average of 17.4 percent in the first quarter of 2023 to an average of 14.6 percent in the second quarter of 2023, while fuel inflation decreased substantially from an average of 16.7 percent to an average of 0.3 percent in the same period (Chart 4.3). Food inflation decreased to 12.9 percent in June 2023 from 14.3 percent in May 2023, while fuel inflation was unchanged at -4.3 percent in the same period.

3.3 Recent domestic economic developments

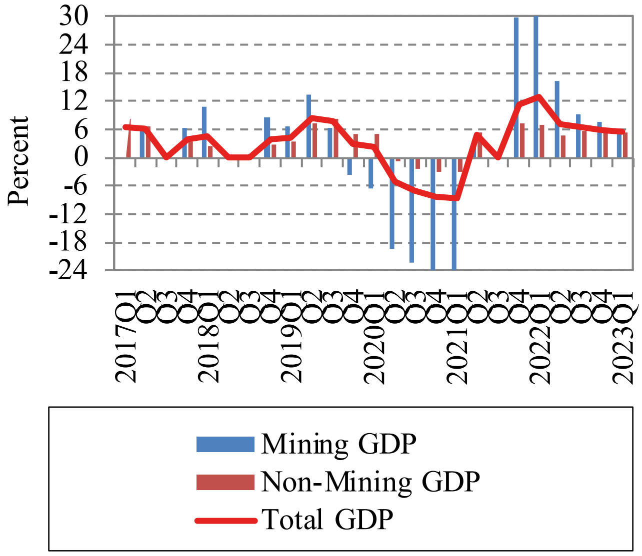
GDP growth decelerated in first quarter of 2023

Real GDP grew by 5.4 percent in the twelve months to March 2023, compared to a higher growth of 13.3 percent in the year to March 2022 (Chart 3.8). The substantially higher growth rate in the year to March 2022 was due to recovery from the contraction in 2021, due to COVID-19 pandemic. The slowdown in 2023 occurred across both the mining and non-mining sectors. The slowdown in 2023 occurred across both the mining and non-mining sectors. Mining GDP grew by 5 percent in the year ending March 2023, a notable deceleration from the 41.9 percent recorded in the year to March 2022. This was due to a slower growth in output of most sub-sectors, led by mining of diamonds, which decelerated to 4.4 percent in the year to March 2023, compared to a higher growth of 44.1 percent in the previous year. Meanwhile, output of mining of gold and other metal ores sub-sectors contracted in the year to March 2023, because of resource depletion as the lifespan of the Mupane Mine approaches the end.

Non-mining GDP grew by 5.4 percent in the 12-month period to March 2023, compared to a higher growth of 7.3 percent in the corresponding period in 2022. The slowdown in output was due to the deceleration of output growth for most sectors, namely, Construction; Manufacturing; Diamond Traders; Transport and Storage; Wholesale and Retail; Real Estate Activities; Accommodation and Food Services; Professional, Scientific and Technical Activities; Information and Communication Technology; Administrative and Support Activities; Education; Human Health and Social Work; and Other Services sectors.

Meanwhile, Statistics Botswana reported a 5.4 percent increase in real GDP in the first quarter of 2023[4], as opposed to an increase of 6.8 percent in the first quarter of 2022.

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, growth in Government Final Consumption increased by 3.2 percent in the twelve months to March 2023, compared to a growth of 3.1 percent in the corresponding period in 2022. The marginal growth was largely due to the acceleration in growth of individual consumption (which comprises government education and health), from 0.3 percent to 3.1 percent, in the review period, while collective consumption[5] growth decelerated from 3.9 percent to 3.3 percent, in the review period.

Household Final Consumption grew by 5.3 percent in the 12-month period ending in March 2023, compared to a growth of 3.1 percent recorded in the corresponding period ending in March 2022. The expansion in Household Final Consumption mainly reflects the increase in household consumption and expenditure, and Non-profit Institutions Serving Households (NPISH).

Gross Fixed Capital Formation (GFCF) increased marginally by 0.2 percent in the year to March 2023, compared to a growth of 4 percent in the previous year. The deceleration in GFCF was due to the 3.7 percent and 11.7 percent contractions in investment in transport equipment and plant, machinery and other equipment sub-sectors, respectively, on account of COVID-19 base effects. Meanwhile, other sub-sectors recorded positive growth rates.

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

[5] 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.

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

	2022Q1	2022Q4	2023Q1
Total GDP	**13.3**	**5.8**	**5.4**
By Sector:			
Mining and Quarrying	41.9	7.5	5.0
Non-Mining	7.3	5.3	5.4
Agriculture, Forestry & Fishing	0.3	2.4	1.9
Manufacturing	13.1	8.2	6.1
Water and Electricity	2.7	48.6	51.5
Construction	8.4	3.2	3.7
Wholesale & Retail	12.3	5.8	5.8
Diamond Traders	29.3	17.6	24.6
Transport and Storage	5.9	4.1	5.2
Accommodation & Food Services	11.7	4.3	4.2
Information & Communication Technology	4.4	5.6	5.8
Finance, Insurance & Pension Funding	0.6	2.3	2.9
Real Estate Activities	7.8	3.6	4.0
Professional, Scientific & Technical Activities	6.0	3.0	3.2
Administrative & Support Activities	9.7	3.7	3.4
Public Administration & Defence	4.0	4.4	4.0
Human Health & social work	6.1	3.6	3.7
Education	1.8	1.9	3.2
Other services	6.3	2.4	2.4
By Type of Expenditure:			
Government Final Consumption	3.1	3.0	3.2
Household Final Consumption	3.1	4.7	5.3
Gross Fixed Capital Formation	4.0	-0.6	0.2
Exports of Goods and Services	4.5	-5.6	-4.9
Imports of Goods and Services	-7.0	-11.8	-14.9

Source: Statistics Botswana and Bank of Botswana Calculations.

Diamond production increased in the second quarter of 2023

Debswana Diamond Company produced 5.8 million carats of diamonds in the second quarter of 2023, 5.6 percent higher than the 5.5 million carats produced in the corresponding period in 2022, due to processing of higher-grade ore at the Orapa Mine. Meanwhile, Debswana's production target for 2023 is 24.1 million carats, the same as in 2022, while production guidance for the larger De Beers Group is at 30 - 33 million carats, subject to trading conditions and potential COVID-19-like disruptions.

Production at Lucara Diamond Corporation (Karowe Mine) increased by 4.8 percent to 90 497 carats in the second quarter of 2023, from 86 317 carats produced in the corresponding period in 2022. The increase was mainly attributable to the increased number of special stones (greater than 100 carats in weight) translating into 6.6 percent of the total weight of recovered carats in the second quarter of 2023, compared to the weight of 6.1 percent registered in the second quarter of 2022.

Budget deficit recorded in the fourth quarter of the 2022/23 fiscal year

Government budget was in a deficit of P0.9 billion in the fourth quarter of the 2022/23 fiscal year (Table 3.5). The deficit was mainly due to underperformance of VAT, emanating from the effects of reduction of VAT in August 2022, from 14 percent to 12 percent for eight months to help ease the burden of high inflation on consumers. Regarding other major revenue streams, the Southern African Customs Union (SACU) revenues and mineral revenues were generally in line with the 2022/23 budget. Total government expenditure and net lending was P19.6 billion, higher than the P19.1 billion anticipated in the revised budget.

The preliminary budget outturn for the 2022/23 fiscal year (April 2022–March 2023), was a surplus of P0.01 billion, compared to a significant estimated budget deficit of P4.9 billion, reflecting better performance in revenues and grants, as well as lower public expenditure. Total public expenditure amounted to P74.1 billion, which is P2.3 billion lower than the revised budget (or 97 percent of the revised budget estimate). For the 2023/24 fiscal year, it is expected that the deficit will be P7.6 billion or 2.8 percent of GDP. Total revenue and grants, and total expenditure are projected to increase to P79.8 billion and P87.4 billion, respectively, in the 2023/24 fiscal year.

Table 3.5: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2021/22 Q4	21 012	17 740	3 272
2022/23 Q1	20 438	19 793	645
2022/23 Q2	17 264	18 287	-1 023
2022/23 Q3	17 670	16 386	1 283
2022/23 Q4	18 727	19 623	-896

Source: Cash Flow Unit, Ministry of Finance

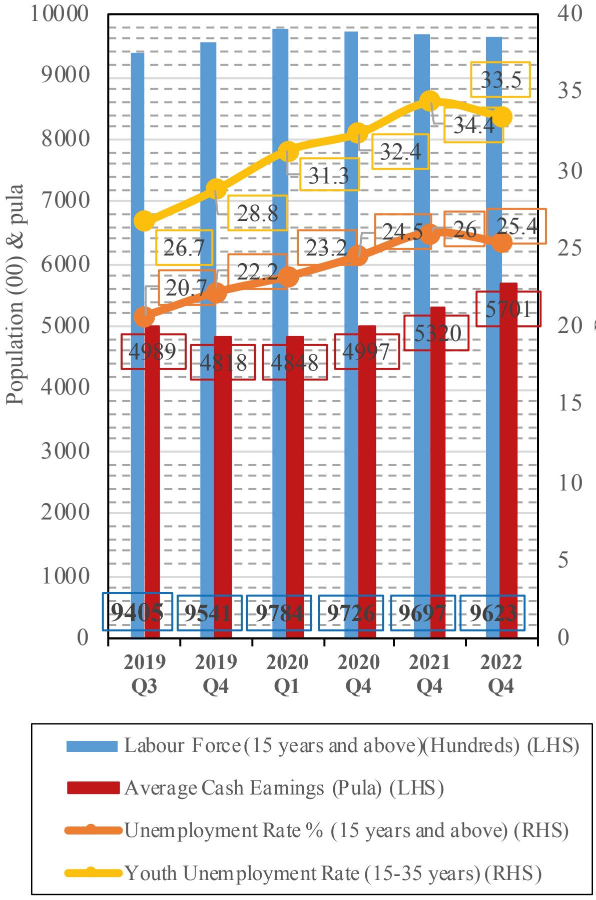
Labour Force and Wage Developments Trends[6]

According to Statistics Botswana's Quarterly Multi-Topic Survey (QMTS) report for the fourth quarter of 2022, the unemployment rate was 25.4 percent in the fourth quarter of 2022, compared to 26 percent in the fourth quarter of 2021 (youth unemployment rate also declined to 33.5 percent from 34.4 percent). The survey also indicates that formal sector employment declined by 1.6 percent in the review period.

Regarding other indicators, the survey showed that Government continued to be the single largest employer, with employment in public administration constituting 26.9 percent of total formal sector employment. In this regard, personal emoluments constitute the largest share (above 40 percent) of the government recurrent budget. Meanwhile, formal sector average earnings per month were estimated at P6 578 for citizens, P12 111 for non citizens and P6 803 for all employees in the fourth quarter of 2022, compared with P6 219 for citizens, P9 275 for non-citizens and P6 299 for all employees estimated for the fourth quarter of 2021. The average monthly earnings for all employees are estimated to have increased by 8 percent or P504 in the fourth quarter of 2022, from P6 299 estimated for the fourth quarter of 2021. In this regard, the average growth in monthly wages is less than the inflation rate and, hence, does not add to inflationary pressures.

A longer-term trend analysis of the QMTS data since the third quarter of 2019 indicates that the total labour force (15 years and above) increased by 2.3 percent to 962 319 persons in the fourth quarter of 2022, from 940 546 persons in the third quarter of 2019. Over the same period, the employed labour force declined by 3.7 percent. The overall unemployment rate was estimated at 25.4 percent in the fourth quarter of 2022, compared to 20.7 percent recorded in the third quarter of 2019. Youth labour force (15–35 years) increased by 2.1 percent, to 471 139 persons in the fourth quarter of 2022 from 481 441 persons in the third quarter of 2019. The youth unemployment rate, which continues to be a national concern, increased to 33.5 percent in the fourth quarter of 2022, compared to 26.7 percent in the third quarter of 2019. Meanwhile, average earnings for all employees increased by P712, from the P4 989 estimated for the third quarter of 2019.

Chart 3.9: Trends in selected Labour Force Indicators



Source: Statistics Botswana

6 The QMTS is conducted by Statistics Botswana. Since its inception in the third quarter of 2019, Statistics Botswana published the first QMTS (July-September 2019) Report in January 2020. This was followed by reports for the fourth quarter of 2019, first and fourth quarters of 2020, the fourth quarter of 2021, and the fourth quarter of 2022. However, the conduct of the rest of the quarterly surveys for 2020, 2021 and 2022 was hampered by the outbreak of COVID-19 and, subsequent, movement restrictions to contain the pandemic, and financial constraints to conduct surveys resulting in data gaps.

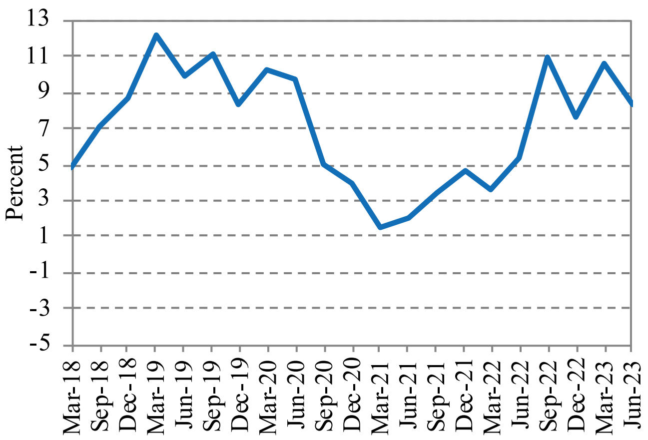
3.4 Monetary developments

Monetary and financial statistics coverage has expanded to include other financial corporations. See Box 1 for more details.

Banking sector assets growth accelerated in June 2023

Annual banking sector assets' growth increased from 5.4 percent in June 2022 to 8.4 percent in June 2023 (Chart 3.10). The increase was mainly due to the rise in balances at Bank of Botswana (particularly primary reserve requirements), and other assets (intra-bank balances, accounts receivables, cash in process of collection and other domestic investments). Meanwhile, loans and advances, which accounted for the largest proportion of commercial banks' assets (62.9 percent) in June 2023, increased by 6.3 percent, lower than the 6 percent increase in June 2022. Overall, growth in banking sector assets was mainly funded through customer deposits, which rose annually by 7.7 percent in the same period.

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

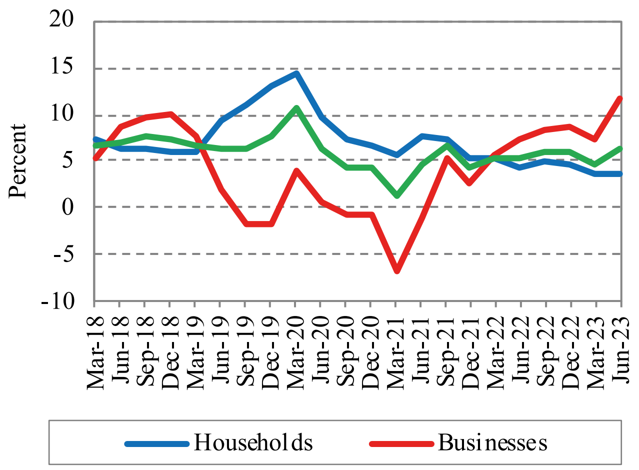


Source: Commercial Banks

Credit growth accelerated in the year to June 2023

Commercial bank annual credit growth accelerated from 5.2 percent in June 2022 to 6.3 percent in June 2023 (Chart 3.11), associated with higher growth in lending to the business sector due to issuance of new loans and increased credit utilisation.

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



Source: Commercial Banks

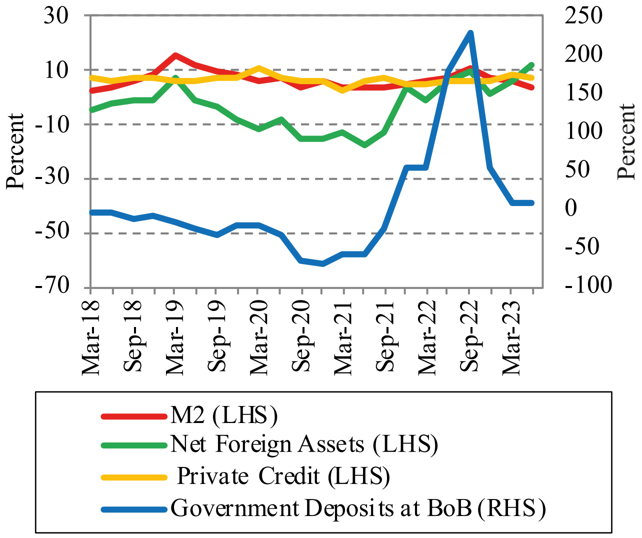
Lending to the business sector increased by 11.7 percent in the year to June 2023, higher than the 7.3 percent expansion in the corresponding period in 2022, reflecting utilisation of credit facilities by businesses aiming to increase activity or augment inventory/supply shortages to meet demand, during the continued recovery following relaxation of the COVID-19 restrictive measures. Credit to businesses excluding parastatals also increased by 4.3 percent in the year to June 2023, mainly due to loan issuances and high usage of overdraft facilities by some companies in mining, electricity and water, construction, transport and communications, and business services. Meanwhile, credit to parastatals increased by 127.6 percent in the year to June 2023, compared to the -18.9 percent decrease in the twelve months to June 2022, due to utilisation of overdraft facilities.

On the other hand, year-on-year growth in household loans decreased from 4.2 percent in June 2022 to 3.5 percent in June 2023. The lower growth in household credit was mainly attributable to the decline in growth of property and unsecured personal loans during the period under review, a possible reflection of the effects of the policy tightening in 2022 by the Bank of Botswana, which had a dampening effect on demand. Banks also likely restricted credit supply to guard against increase in default rates as the cost of credit became expensive. Meanwhile, motor vehicle, property and credit card-based loans increased in the year to June 2023. The share of the household sector in total lending by commercial banks decreased slightly from 66.1 percent in June 2022 to 64.3 percent in June 2023.

Money supply growth slowed in May 2023

Money supply (M2) grew by an annual rate of 3.9 percent in June 2023, lower than the 7.2 percent in the corresponding period in 2022 (Chart 3.12). The decelerated growth in money supply was mainly due to the increase in both annual growth of net foreign assets and private credit. Meanwhile, the increase in annual growth of credit to the parastatals' sector exerted an expansionary influence on the broad money liabilities of depository corporations.

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



Source: Other Depository Corporations and Bank of Botswana

Box 1: Expansion of Monetary and Financial Statistics (MFS) Coverage to Include Other Financial Corporations

The compilation of MFS is guided by the IMF compilation manual and guide, with a view to ensuring standardisation and, hence, international comparability of monetary and financial statistics. Countries are encouraged to compile and disseminate monetary statistics that cover the three Financial Corporations sub-sectors namely the central bank (CB), other depository corporations (ODCs), and other financial corporations (OFCs). Most IMF member countries compile the CB and ODCs data monthly and disseminate it within one or two months after the end of the reference period, while the OFCs, which constitute the broader set of monetary statistics in terms of institutional coverage, is compiled and disseminated on a quarterly basis.

A combination of the two (CB and ODCs) produces a depository corporation (DC), which has indicators that provide a link between the broad money supply and the DC's claims on resident and non-residents. Beyond the DC, there is also an increasing focus on the OFCs sub-sector and the financial corporations (FCs) sector, which when achieved, concludes the broader set of monetary and financial statistics in terms of financial sub-sectors coverage. The FCs sector contains consolidated data of the DCs and the OFCs sub-sectors. The FCs Survey is useful for analysing a country's financial sector claims on (that is, credit to) other sectors of the economy, the net foreign assets and the liquidity aggregates. The Survey can also be useful for monitoring the inter-connectedness between the financial sector and other sectors of the economy, as well as between the sub-sectors of the financial system, that is, the CB, ODCs and OFCs.

Financial Corporations Survey	
Assets	**Liabilities**
Net Foreign Assets Net Claims on Central Government Claims on Other Resident Sectors Other Items Net	Liquidity Aggregates

Following receipt of various IMF technical assistance missions on the expansion of MFS coverage to include OFCs, Botswana compiled and begun the dissemination of the OFCs data. Dissemination of the data through the IMF's Open Data Platform (hosted on the Bank's website in the National Summary Data Page) commenced with pension funds from May 2022, with data compilation backdated to January 2017. Meanwhile, compilation of the non-money market funds (non-MMFs) and insurance companies started from March 2021 and June 2021, respectively. In order to complete the OFCs coverage, compilation of micro-lenders data is scheduled, and will use data from March 2023. Locally, the dissemination of the full/complete OFCs data is earmarked for the Botswana Economic and Financial Statistics (BEFS) publication of September 2023.

Interpretation

OFCs data present aggregated assets and liabilities positions in a balance-sheet-like form, by category of financial instrument, currency (domestic and foreign), and counterpart institutional sector (often referred to as ***"from whom to whom")***. Since the pension funds data is reported monthly, quarterly data for non-MMFs, insurance companies and micro-lenders has been converted to monthly frequency by dragging the last reported quarter into the subsequent two months. The rationale for conversion is to smoothen the data, while matching the quarterly data to the monthly frequency for pension funds, central bank and ODCs.

The 7-day nominal BoBC yield increased in the second quarter of 2023
The 7-day nominal BoBC yield (MoPR) increased from an average of 1.65 percent in the second quarter of 2022 to an average of 2.65 percent in the second quarter of 2023, following the policy rate increase by the MPC in 2022. The real rate of interest for the 7-day paper also increased from -8.67 percent to -3.21 percent in the same period.

The stop-out yield for the 7-day BoBC was constant at 2.65 percent between June and July 2023. Meanwhile, the real rate of interest for the 7-day paper increased from -1.86 percent to 1.13 percent in the same period, reflecting the significant decrease in the inflation rate.

The stop-out yield on the 1-month BoBC, which was introduced in June 2022 to address some of the structural liquidity positions and support the construction of the short-end of the yield curve, averaged 2.98 percent in the second quarter of 2023. The real rate of interest for the 1-month paper averaged -2.90 percent in the same period.

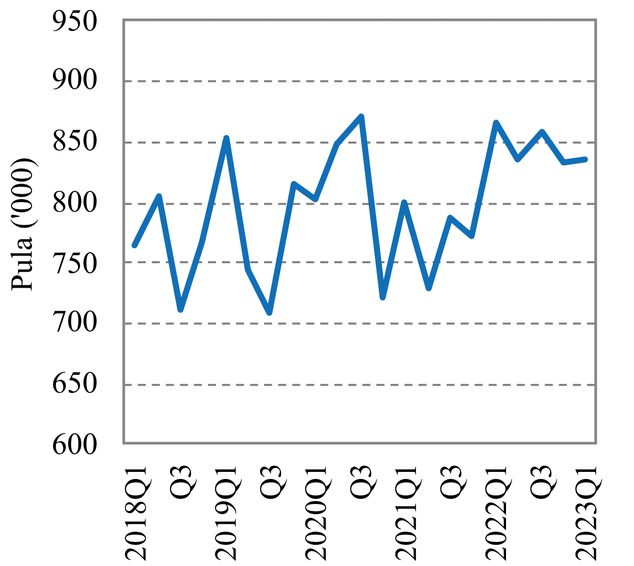
The stop-out yield on the 1-month BoBC decreased from 3.05 percent in June 2023 to 2.94 percent in July 2023. Meanwhile, the real rate of interest for the 1-month paper increased from -1.48 percent to 1.42 percent in the same period, reflecting significant decrease in the inflation rate.

Credit ratings
There was no credit rating action by both S&P and Moody's following consultations in February and March 2023, respectively. However, they published full surveillance reports in March and April 2023, respectively.[7]

3.5 Asset market prices

Property market generally remained fair in the first quarter of 2023
According to the latest (2023Q1) Riberry Report[8], the residential rental market showed signs of deterioration in the first quarter of 2023 compared to the fourth quarter of 2022, indicating a decline in rental of upper end properties. The rental market for low-end properties continued to enjoy reasonable demand, while mid-level houses for rent experienced weaker demand and increased supply. The average price for residential properties sold in the first quarter of 2023 increased by 0.6 percent to P834 973, compared to the previous quarter (Chart 3.13), reflecting an increase in the number of high-valued properties traded in the quarter under review.

Chart 3.13: Riberry Average Prices



The market for office space remained weak due to increasing supply from completed construction developments, such as the Innovation Hub, Pinnacle Park and Botswana Accountancy College North campus. Furthermore, demand remains reasonable and slightly improved as Government took up some vacant properties. However, the merging of some parastatals is likely to curtail the growth of demand for office space by Government. In addition, there is a possible likelihood for a slowdown in uptake at the Central Business District (CBD) should Government institutions remain in their

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

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.

current premises and location. Furthermore, the supply of office space is projected to increase, given the ongoing construction projects and planned office buildings at the Gaborone CBD, such as by the Botswana Stock Exchange and Botswana Building Society Limited. These will further exert downward pressure on rentals, especially in the decentralised office locations.[9]

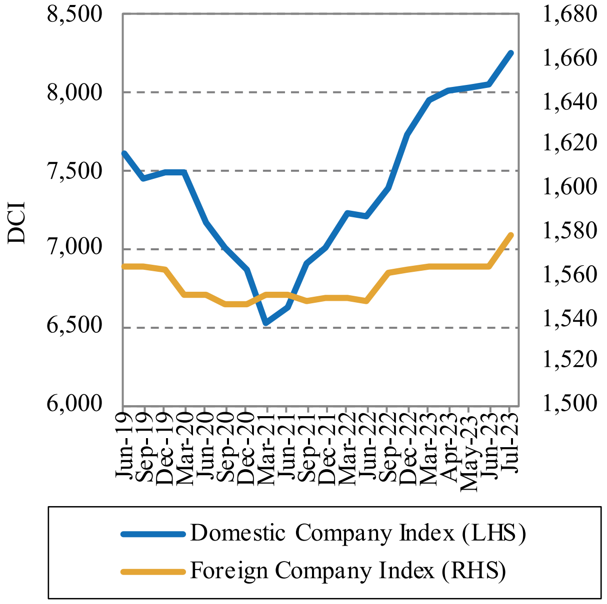
Similar to the previous quarter, the demand for retail space remained fair across all market segments, while the supply is expected to increase, as two malls are proposed for Mogoditshane. In addition, other centres with good demand for retail space are Jwaneng, Selibe Phikwe, Maun, Letlhakane, Francistown, Mahalapye and Lobatse. Most of these locations have a few retail schemes, to be anchored by reputable supermarkets, at planning and/or construction stage. Regarding industrial property, the supply of unoccupied big warehouse space has decreased, while the demand has improved.[10] Meanwhile, the demand for industrial space in prime locations is expected to improve going forward.

Stock market indices increased

The Domestic Companies Index (DCI) increased by 13.8 percent in the twelve months to July 2023, compared to an increase of 8.2 percent in the year to July 2022 (Chart 3.14). The increase was mainly due to the higher share prices for First National Bank of Botswana, Standard Chartered Bank and Chobe, which increased by 37.9 percent, 83.2 percent, and 39.2 percent, respectively, in the same period. The higher share prices were because of increased trading activity following the low base effects arising from the impact of the COVID-19 pandemic in 2021.

The Foreign Companies Index (FCI) increased by 1.2 percent in the year to July 2023, compared to an increase of 0.6 percent in the corresponding period in 2022 (Chart 4.9). The increase was largely due to the year-on-year increase in the share prices for New Gold (16.1 percent) and CA Sales (42.5 percent), on account of higher trading activity and liquidity.

Chart 3.14: Stock Market Indices



Source: Botswana Stock Exchange

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

Box 2: Reforms to Monetary Operations Framework

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

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

In addition, the reforms allow for the conduct of fine-tuning operations (repos and reverse repos) which are to be issued infrequently during a primary reserve maintenance period at the discretion of the Bank upon evaluation of the general market liquidity. If offered, the fine-tuning operations are conducted at the MoPR. Furthermore, the Bank introduced a 1-month BoBC for structural liquidity management and price discovery purposes, while the Prime Lending Rate (PLR) is determined by the individual banks effective April 1, 2023. The Bank continues to analyse and monitor the impact of these reforms, with a special focus on their impact on the potency and effectiveness of monetary policy transmission.

Furthermore, on January 1, 2023, the Bank of Botswana withdrew some of the COVID-19 relief measures introduced in April 2020. This withdrawal was against a background of the reduced severity and trajectory of COVID-19, given the successful vaccination programme, global economic recovery at the beginning of 2022 and resumption of normal domestic economic activity. The Bank, therefore, revised the COVID-19 relief measures as follows:

(a) the punitive interest rate for involuntary access to the Credit Facility (CF) by commercial banks to meet night settlement obligations was set at 8 percentage points above the prevailing MoPR. This facility is different from the other overnight facilities offered by the Bank, such as the SCF, accessed at the discretion of the individual bank, and the repurchase agreements (repos), offered at the discretion of the Bank. The CF is automatically availed to a bank that is overdrawn at the close of each business day, hence, the punitive interest rate since banks are not permitted, by law, to overdraw the settlement accounts held at the Bank of Botswana. The facility is also used for intraday temporary funding without attracting any charges, except that, at close of any trading day, the settlement accounts with the Bank of Botswana must have positive balances;

(b) the maturity of repos and reverse repos facility was reduced from 92 days to overnight and, consistent with the announced monetary operations reforms, the Bank's participation in the repo market is minimal for fine tuning purposes;

(c) the dispensation to include all securities listed on the Botswana Stock Exchange Limited (BSEL) in the pool of eligible collateral for credit facilities provided to banks by the Bank of Botswana was maintained to support listing on the BSEL and liquidity of the market. This is subject to acceptable collateral margins and/or haircuts, as may be announced from time to time by the Bank.

3.6 Balance of payments (BoP)

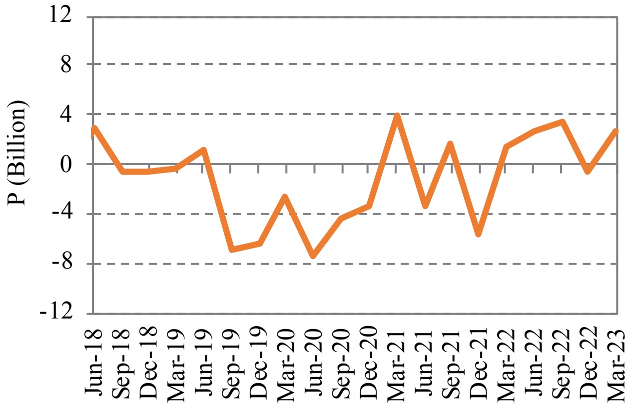
Current account recorded a surplus in the first quarter of 2023

The current account is estimated to have recorded a surplus of P2.6 billion in the first quarter of 2023, compared to a revised surplus of P1.5 billion in the corresponding period in 2022 (Chart 3.15). The improved surplus was primarily attributable to a higher trade surplus in addition to the net income inflows from the secondary income account. Exports amounted to P21.6 billion in the first quarter of 2023, a decrease of 16.6 percent from P25.9 billion in the corresponding period of 2022, while imports decreased by 21.5 percent from P24.6 billion to P19.3 billion, leading to a surplus of P2.2 billion in the merchandise trade account. SACU revenues, which dominate the secondary income account, amounted to P3.5 billion in the first quarter of 2023.

Diamond exports, which accounted for 83.9 percent of total exports of goods in the first quarter of 2023, decreased to P18.1 billion from P23.3 billion in the first quarter of 2022. During the same period, diamond imports decreased from P9.2 billion to P3.1 billion. The decrease in diamond trade mainly stemmed from the market being more cautious about the uncertain global macroeconomic outlook.

The other commodities that contributed to a decline in exports include gold (28.5 percent), meat and meat products (16.4 percent), iron and steel products (11.2 percent), and live cattle (6.6 percent). However, copper and nickel exports increased from P653.5 million to P1.4 billion, owing to increased production and copper sales by the US private equity company Cupric Canyon, which started production at Khoemacau Copper Mine in 2021. The decrease in imports was mainly driven by decreases in diamonds (66.5 percent), and chemicals and rubber products (13.9 percent).

Chart 3.15: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account recorded a positive net balance in the first quarter of 2023

The financial account is estimated to have recorded a positive net balance of P5.9 billion during the first quarter of 2023, implying that the country was a net creditor to countries abroad, compared to a negative net balance of P4.9 billion in the first quarter of 2022. The positive net balance was mainly attributable to a substantial increase in equity assets held abroad by local pension fund managers.

In 2022, the financial account recorded a negative balance of P1.4 billion, compared to a positive net balance of P4.9 billion in 2021, owing to a drop in foreign assets held by local pension funds during the first two quarters of 2022. This was subsequent to the repatriation of some of the offshore assets, resulting in a reduction of pension funds' offshore portfolio from 65.3 percent to 60.5 percent of their total assets.

The balance of payments was in deficit in the first quarter of 2023

The overall BoP recorded an estimated deficit of P1.7 billion during the first quarter of 2023, from a surplus of P2.2 billion during the corresponding period in 2022. The deficit was mainly attributable to foreign exchange outflows to meet the import bill and Government financial obligations.

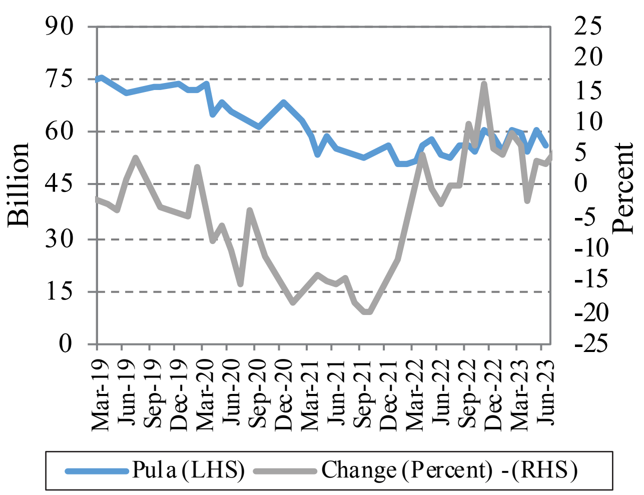
In 2022, the surplus was estimated at P4.5 billion, from a deficit of P2.9 billion in 2021.

Foreign exchange reserves increased

As at the end of June 2023, foreign exchange reserves were estimated at P66.1 billion, an increase of 22 percent from P54.2 billion in June 2022 (Chart 3.16). The increase in Pula terms was attributable to foreign exchange inflows from SACU, diamond exports, as well as exchange rate gains.

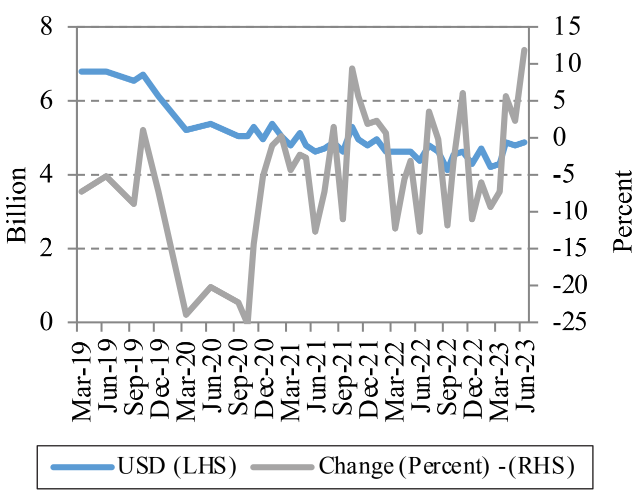
In foreign currency terms, the level of foreign exchange reserves increased by 11.4 percent from USD4.4 billion in June 2022 to USD4.9 billion in June 2023 and increased by 12.1 percent from SDR3.3 billion to SDR3.7 billion, during the same period (Chart 3.17). The level of foreign exchange reserves in June 2023 was equivalent to 9.2 months of import cover of goods and services.

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



Source: Bank of Botswana

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



Source: Bank of Botswana

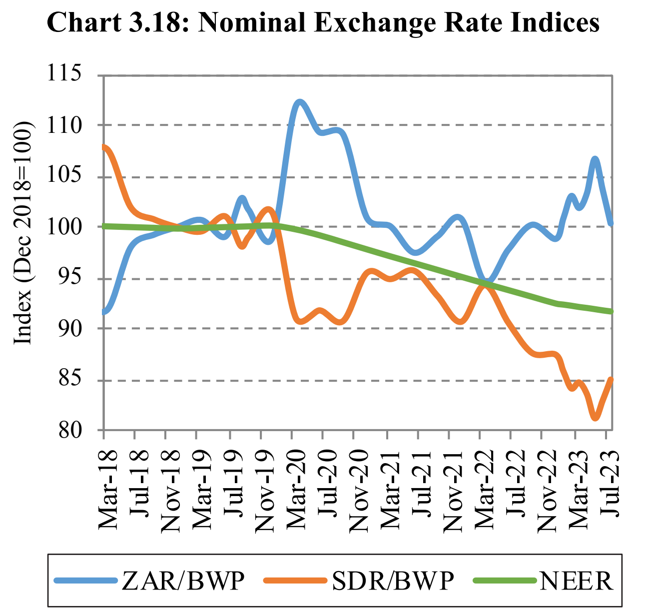
3.7 Exchange rate developments

For 2023, the Bank's implementation of the exchange rate policy entails an annual downward rate of crawl of 1.51 percent. This downward rate of crawl was implemented from January 1, 2023 with a view to enhancing domestic industry competitiveness. During the same period, the Pula basket weights were maintained at 45 percent for the South African rand and 55 percent for the SDR, guided by Botswana's trade pattern and international transactions. Box 3 explains the current exchange rate policy framework and the Pula exchange rate parameters for 2023, which were announced in December 2022.

In the twelve months to July 2023, the Pula appreciated by 2.5 percent against the South African rand but depreciated by 5.7 percent against the SDR (Chart 3.18). With respect to the SDR constituent currencies, the Pula depreciated by 11 percent against the euro, 9.1 percent against the British pound and 4.4 percent against the US dollar, while it appreciated by 2.2 percent against the Japanese yen and 1.3 percent against the Chinese renminbi.

The movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. Therefore, in the same review period, the South African rand depreciated by 7.9 percent against the SDR. With respect to the SDR constituent currencies, the South African rand depreciated by 13.1 percent against the euro, 11.3 percent against the British pound, 6.7 percent against the US dollar, 1.1 percent against the Chinese renminbi and 0.3 percent against the Japanese yen.

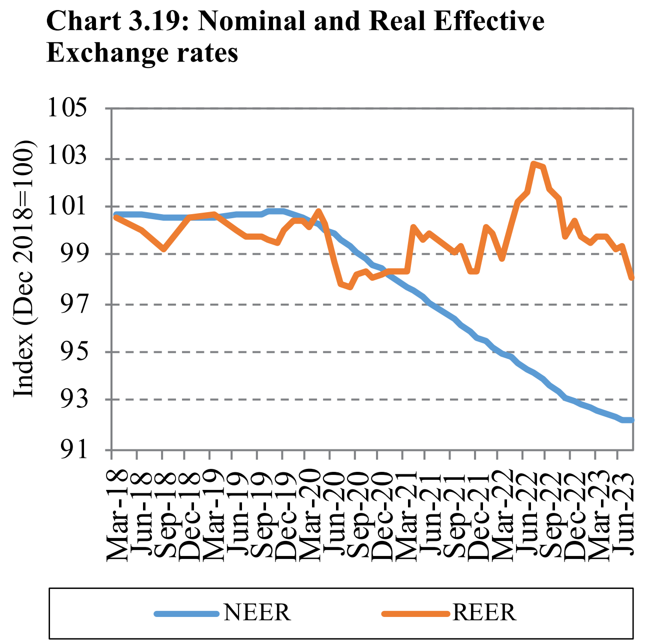
The South African rand depreciated significantly against most major currencies, driven by both domestic and global factors. The depreciation of the South African rand was mainly due to the impact of prolonged power outages in the country which dented investor sentiments and negatively impacted the operations of businesses. In addition, the South African rand depreciated along with other emerging market currencies on the back of deteriorating global risk sentiments amid fears of a possible global economic slowdown in 2023. Investors substituted riskier assets for safe haven assets priced in US dollars. Dented global investors' sentiment sparked by the diplomatic fallout between the United States and South Africa, following allegations that South Africa supported Russia with weapons and ammunition in December 2022, further weakened the currency, as South Africa was considered likely to face sanctions from the Western countries.



Source: Bank of Botswana

NEER depreciated in July 2023

The NEER of the Pula depreciated by 2.1 percent in the twelve months to July 2023 (Chart 3.19), consistent with the transition from the downward annual rate of crawl of 2.87 percent to a downward annual rate of 1.51 percent implemented in January 2023.



Source: Bank of Botswana

REER depreciated in July 2023

The REER depreciated by 4.6 percent in the twelve months to July 2023 (Chart 3.19), due to depreciation of the NEER (the rate of crawl) amid a negative inflation differential between Botswana and its trading partner countries in the same review period, suggesting a gain in Botswana's export competitiveness. With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) depreciated by 7.7 percent and 0.7 percent against the SDR and South African rand, respectively. The domestic currency depreciated by 14.2 percent against the euro, 13.6 percent against the British pound and 5.9 percent against the US dollar, while it appreciated by 3.2 percent against the Chinese renminbi and 0.4 percent against the Japanese yen.

Box 3: The Pula Exchange Rate Framework Explained

Definition of Exchange Rate

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

Exchange Rate Policy Frameworks

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

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

Botswana's Exchange Rate Policy Framework

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

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

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

Third, is the annual rate of crawl, which is the amount (rate) at which the exchange rate is allowed to gradually depreciate or appreciate. This amount reflects the projected inflation differential between Botswana and its trading partner countries. For example, 1.51 percent downward crawl for 2023; from the downward rate of crawl of 2.87 percent from May 2020 – December 2022).

Botswana's Exchange Rate Policy Objective

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

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

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

2023 Pula Exchange Rate Parameters

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

For 2023, it was determined that inflation in Botswana would be on average 1.51 percentage points higher than in the trading partner countries and, therefore, a 1.51 percent annual downward crawl would be implemented through small daily adjustments that would equal 1.51 percent over twelve months. It was also determined that the trade patterns remain largely unchanged and, therefore, maintained at 55 percent SDR and 45 percent South African rand.

The Benefits of the Crawling Band Framework for Botswana

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

In contrast, alternative arrangements could have disadvantages as follows:

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

Limits of Exchange Rate Adjustments on Industry Competitiveness

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

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

Transparency and Market Information

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

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook remains broadly restrained but revised slightly upwards for 2023 in the July 2023 WEO Update compared to the April 2023 projection. The upward revision is largely on account of stronger-than expected economic performance in some major economies in the first quarter of 2023. However, the global output outlook is restrained mainly due to lower consumer demand associated with higher borrowing costs and inflation. With regard to price developments, global inflation is projected to moderate, although remaining high, due to monetary policy tightening, squeezed household budgets and waning COVID-19 pandemic-related fiscal support.

Global economic growth to slowdown

According to the July 2023 WEO Update, global output growth is forecast at 3 percent for both 2023 and 2024, from an estimated expansion of 3.5 percent in 2022. The growth forecast for 2023 was revised upwards by 0.2 percentage points but unchanged for 2024, compared to the April 2023 projection, largely due to upward revisions for major economies, such as the US, UK, Italy and Spain due to stronger-than-expected economic performance in the first quarter of the year. Meanwhile, lower output growth in 2023 compared to 2022 is on account of challenging prospects for advanced economies, partly because of lower consumer demand associated with higher borrowing costs and inflation, which significantly eroded purchasing power.

For advanced economies, output is projected to decline from an expansion of 2.7 percent in 2022 to 1.5 percent in 2023 and decelerate further to 1.4 percent in 2024. The projected decline for 2023 is mainly a result of macroeconomic effects of elevated inflationary pressures and tightening of global financial conditions, as well as weaker consumer demand and erosion of purchasing power. Meanwhile, about 93 percent of advanced economies are projected to experience a moderation in growth in 2023.

Risks to the global economic outlook are assessed to be on the downside. These risks include possibility of persistent elevated inflationary pressures, thus prompting further monetary policy tightening than currently anticipated, possibility of systemic debt distress in emerging markets due to a combination of higher borrowing costs and lower growth, as well as underperformance of the recovery of China's economy.

UK economic growth to slow down

The UK economy is forecast to moderate to an expansion of 0.4 percent in 2023, from an estimated expansion of 4.1 percent in 2022. The anticipated slowdown in output growth in 2023 is due to tighter fiscal and monetary policies and financial conditions, as well as high energy retail prices, which weigh on household budgets. However, the 2023 projection is 0.7 percentage points higher compared to the April 2023 forecast, on account of stronger-than-expected consumption and investment, as well as a resilient financial sector, as the global banking stress dissipates. Economic activity is forecast to expand by 1 percent in 2024, thus remaining below the pre-pandemic levels.

Output growth for US to moderate

For the US, output is forecast to grow by 1.8 percent in 2023, a decline from an estimated expansion of 2.1 percent in 2022, and moderate further to an expansion of 1 percent in 2024. The 2023 projection is 0.2 percentage points higher compared to the April 2023 forecast, on account of resilient consumption growth in the first quarter of 2023.

Growth for the euro area to moderate

In the euro area, economic growth is projected to moderate to 0.9 percent in 2023 (0.1 percentage points higher compared to the April 2023 forecast), from an expansion of 3.5 percent in 2022, owing to the negative spill-over effects from the Russia-Ukraine war. The upward revision for 2023 is on account of anticipated higher growth in Italy and Spain due to stronger growth in the services and tourism sectors. Meanwhile, GDP growth for the region is expected to improve to 1.5 percent in 2024 (0.1 percentage points higher than the forecast made in April 2023).

Emerging markets GDP growth expected to remain stable

Economic activity in emerging market and developing economies is projected to remain stable at 4 percent between 2022 and 2023. The forecast for 2023 is 0.1 percentage points higher than the April 2023 forecast, mainly due to upward revisions of growth in large economies, particularly India, Russia and Brazil.

In India, growth is expected to decelerate from 7.2 percent in 2022 to 6.1 percent in 2023, before picking up to 6.3 percent in 2024, due to resilent domestic demand. However, the growth forecast for 2023 was an upward revision of 0.2 percentage points from April 2023 forecast, reflecting momentum from stronger-than-expected growth in the fourth quarter of 2022, as a result of stronger domestic investment.

Meanwhile, output for China is forecast to grow by 5.2 percent and 4.5 percent in 2023 and 2024, higher than the estimated expansion of 3 percent in 2022, largely due to the re-opening of the economy. Growth forecasts for 2023 and 2024 were unchanged compared to the April 2023 forecasts, as stronger-than-expected net exports continued to offset weaker investment.

Growth prospects for the South African economy remain weak

Regionally, growth prospects in South Africa are expected to remain restrained on account of tight monetary policy conditions to control inflationary pressures, restrained fiscal support, lingering supply bottlenecks, power outages, as well as the greylisting of the economy by the Financial Action Task Force in February 2023. Thus, South African output growth is forecast to slow down to 0.3 percent in 2023, from 1.9 percent in 2022, and to increase to 1.7 percent in 2024. Meanwhile, the projection for 2023 is 0.2 percentage points higher than in the April 2023 WEO, but for 2024, it is lower by 0.1 percentage points.

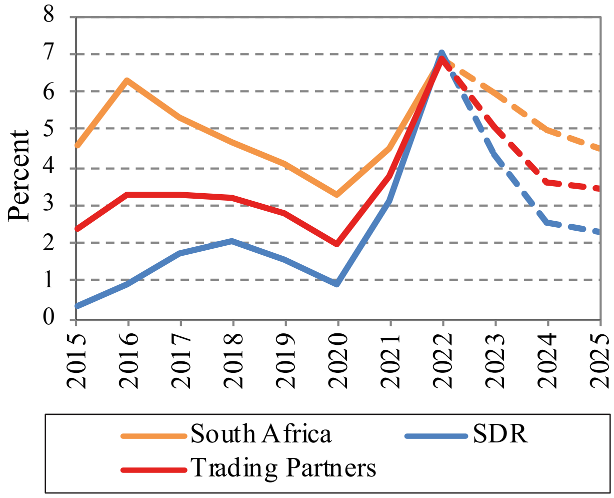
Meanwhile, in July 2023, the SARB revised the forecast for GDP growth for 2023 from 0.3 percent to 0.4 percent but maintained the 2024 projection at 1 percent. The subdued growth prospects are mostly due to energy and logistical constraints, which continue to weigh on South African economic activity.

Global inflation to moderate

Globally, inflation is expected to moderate in 2023, although remaining high, supported by the rapid monetary policy tightening, squeezing of household budgets and reversal of COVID-19 pandemic related fiscal support. Thus, inflation for advanced economies is forecast to ease from 7.3 percent in 2022 to 4.7 percent in 2023, while for emerging market economies, it is forecast to ease from 9.8 percent to 8.3 percent in the same period. Overall, global inflation is expected to ease from 8.7 percent in 2022 to 6.8 percent in 2023, and further moderate to 5.2 percent in 2024.

Meanwhile, the SARB forecasts South African inflation to average 6 percent and 5 percent in 2023 and 2024, respectively. The forecasts for 2023 and 2024 are 0.2 percentage points and 0.1 percentage points lower than the May 2023 projection, respectively, because of monetary policy tightening by the central bank. Overall, headline inflation reverted to within the SARB's 3 – 6 percent target range in June 2023 and is expected to sustainably revert to the mid-point of the target range by the third quarter of 2025 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



Source: SARB and Bloomberg

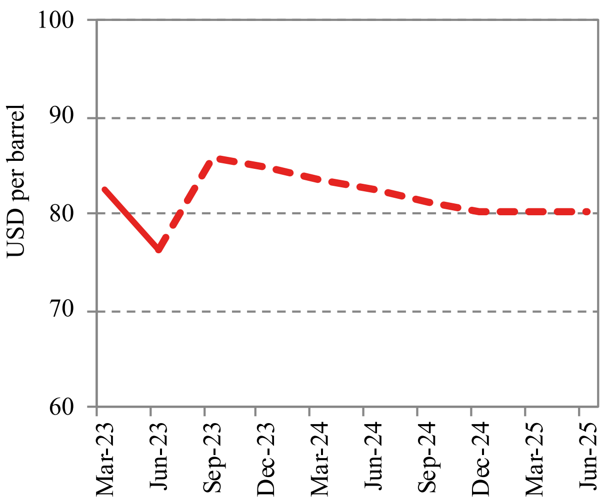
Diamond prices to trend downwards

Diamond prices are expected to continue trending downwards in the short term due to the anticipated slowdown in economic activity and decreased demand for the commodity, amid uncertainty in the US market.

International oil prices to increase

International oil prices are projected to increase in the short term (Chart 4.2). The projected increase in oil prices is on account of the continued Russia-Ukraine war, increased demand for oil associated with the reopening of China, the world's largest oil importer. Furthermore, the agreement between OPEC and its allies to cut production by 2 million barrels per day effective May 2023, as well as Saudi Arabia, and other OPEC oil producers' decision to voluntarily increase their production cuts by an extra 1.6 million barrels per day effective May 2023, thus taking the cartel's total production cuts to 3.6 million barrels per day, is expected to put upward pressure on oil prices in the short term.

Chart 4.2: International Oil Prices



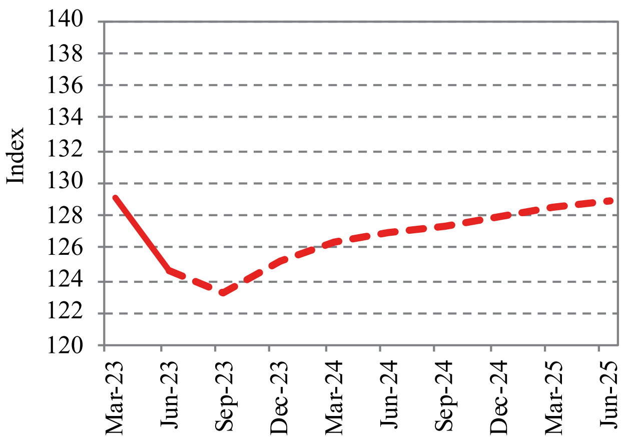
Source: Bloomberg

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

International food prices to increase

Global food prices are also expected to trend upwards in the short term (Chart 4.3). The anticipated increase in international food prices is driven by the termination of the Black Sea Grain Initiative and the ongoing strikes by Russia on Black Sea ports, as well as the anticipated increase in international oil prices in the short term, as oil is used as input in food production.

Chart 4.3: International Food Prices FAO Index



Source: Bloomberg
Note: Approximated using forecasts for international sugar and wheat prices

In Southern Africa, food prices are expected to remain elevated in the short term, compared to pre-pandemic levels, due to low rainfall experienced in the 2022/23 ploughing season, as well as risks associated with bad climatic conditions, such as the impact of Cyclone Freddy. Meanwhile, the anticipated El Nino in the region for the 2023/24 ploughing season could result in another drought year. Food production in Southern Africa is anticipated to decline by 1.4 percent in Zambia, 1 percent in Namibia and by 6.2 percent in Eswatini during the 2023/24 ploughing season due to expected lower rainfall. Meanwhile, food production in South Africa is forecast to increase by 1.1 percent in the same period.

Overall, there is potential marginal upward pressure from international food prices on domestic inflation in the short term.

4.2 Outlook for domestic economic activity

According to the Ministry of Finance, GDP is expected to grow by 3.8 percent and 4.4 percent in 2023 and 2024, respectively. This growth will be supported by the prevailing accommodative monetary conditions, improvements in some non-mining sectors, such as water and electricity and finance, insurance and pension funds; reforms to further improve the business environment; and the expansionary fiscal policy, among others. However, the economy is anticipated to continue operating below its potential into the medium term.

Output growth to moderate in 2023

Ministry of Finance estimates GDP to grow by 3.8 percent and 4.4 percent in 2023 and 2024, respectively. Growth in 2024 is attributable to the recovery of mining activity. It is also anticipated that performance of the non-mining sectors will improve, underpinned by, among others, improvements in electricity and water supply, as well as finance, insurance and pension funds sectors. Furthermore, reforms[11] to further improve the business environment, as well as implementation of the ERTP and the potentially expansionary two-year TNDP are anticipated to restore economic activity and improve incomes, facilitate expansion of productive capacity, accelerate economic transformation and build economic resilience. In addition, the recent announcement of agreement in principle between the Government of Botswana and De Beers Group on new Debswana Mining Licence and new sales agreement is expected to be positive for medium-term growth. However, given the downside risks to global economic activity, including weaker global demand and adverse impact of the Russia-Ukraine war, the growth trajectory remains uncertain.

The Bank's June 2023 Business Expectations Survey (BES) indicates that firms were less optimistic about business conditions in the second quarter of 2023, compared to the previous quarter. The reduced level of optimism is reflected by firms' expected slowdown in economic activity; hence, some expect deceleration in exports and imports of goods and services; and investment in plant and machinery, compared to the March 2023 survey. Nonetheless, firms expect GDP to have expanded by 3.7 percent in the second quarter of 2023, in line with the anticipated improvement in the performance of sectors such as manufacturing. Overall, non-mining economic activity is anticipated to improve into the medium term. Meanwhile, the below trend output in the short term is also consistent with the high unemployment rate (25.4 percent as at the fourth quarter of 2022) and restrained growth in real wages.

[11] These include, among others, the promulgation of the Credit Information Act and Movable Property Act, both of which have the potential to make credit more accessible.

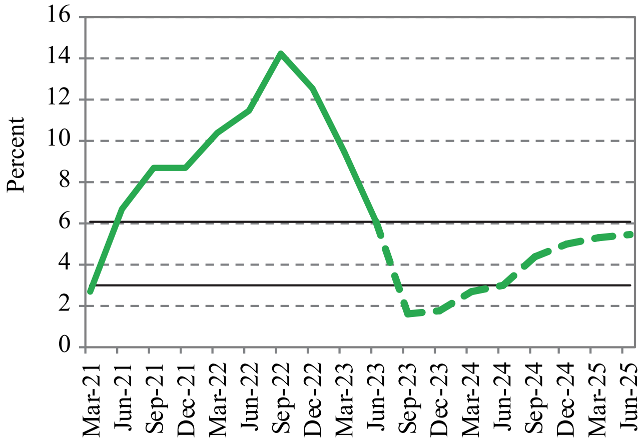
4.3 Monetary policy and the inflation outlook

Inflation breached the lower bound of the Bank's objective range in July 2023. The fall and breach in inflation is due to the recent decrease in domestic fuel prices and the downward revision in trading partner countries' inflation in the short term. However, inflation is expected to revert to the objective range from the first quarter of 2024. The inflation forecast has been revised significantly downwards in the near term compared to the June 2023 forecast.

Inflation is projected to remain below the lower bound in the short term

Inflation breached the lower bound of the objective range in July 2023, mainly because of the impact of dissipating effects of the earlier increase in domestic fuel prices in July 2022, as well as the impact of the decrease in domestic fuel prices effected on June 21, 2023. However, inflation is expected to remain below the lower bound temporarily and revert to within the objective range from the first quarter of 2024 into the medium term (Chart 4.4).

Chart 4.4: Botswana Headline Inflation Forecast

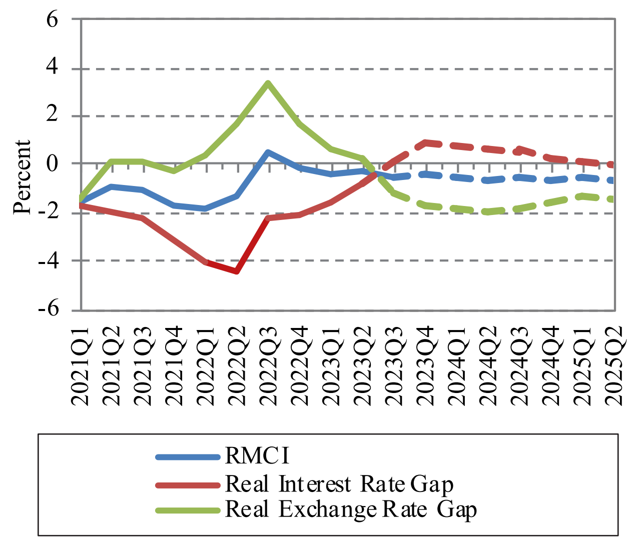


Source: Bank of Botswana

The projection also considers the anticipated growth in domestic output in response to the generally prevailing accommodative monetary conditions (Chart 4.5), and the base effects associated with adjustments in administered prices in 2022.

The decrease in domestic fuel prices effected on June 21, 2023 reduced inflation by 0.59 percentage points in the third quarter of 2023. Meanwhile, the August 2023 inflation projection is lower than expectations in the June 2023 BES where the business community expects inflation (on average) to remain above the Bank's objective range in 2023 at 7.4 percent.

Chart 4.5: Real Monetary Conditions

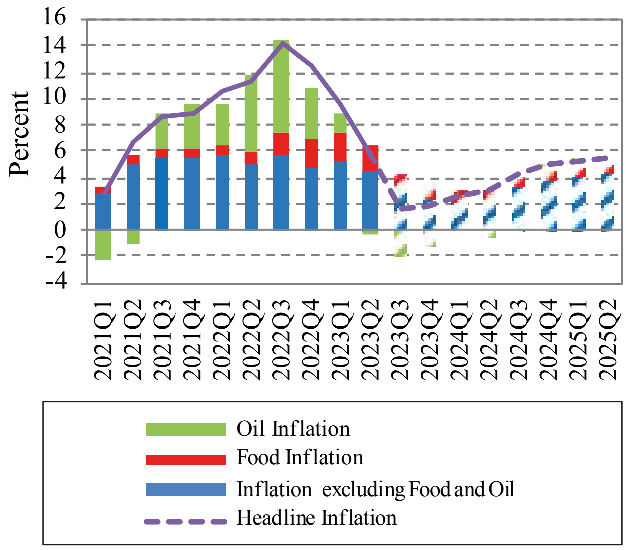


Source: Bank of Botswana

Core inflation to fall in the short term

Inflation, excluding food and fuel prices, is forecast to fall in the short term, on account of the dissipating impact of the upward adjustment in administered prices in 2022 from the inflation calculation (Chart 4.6).

Chart 4.6: Headline Inflation and its Components



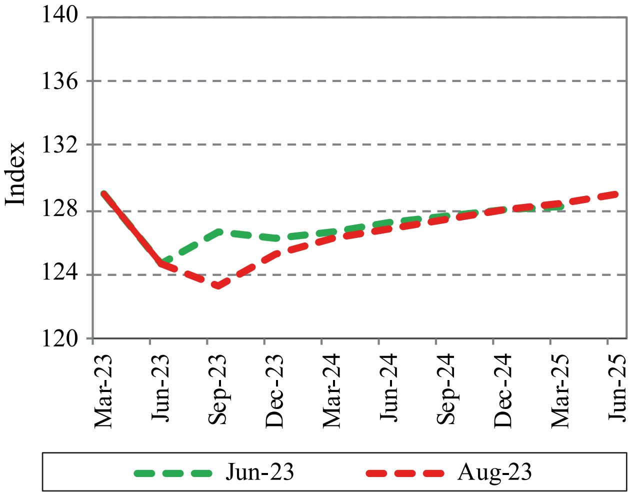
Source: Bank of Botswana

International food prices to trend upwards in the medium term

Compared to the June 2023 forecast, international food prices have been revised downwards in the near term, but broadly unchanged into the medium term (Chart 4.7). The downward revision is mainly due to the rise in maize production, with increases also expected for rice and sorghum, and prospects of a significant recovery in production in Brazil, the world's largest sugar producer and exporter.

However, the upward trend in international food prices into the medium term is due to the anticipated surge in grain prices on the global markets caused by Russia's decision to pull out of the Black Sea grain deal. Additionally, the upward revision in forecasts for international oil prices contributed to expected higher international food prices as oil is used as an input in food production.

Chart 4.7: International Food Prices FAO Index

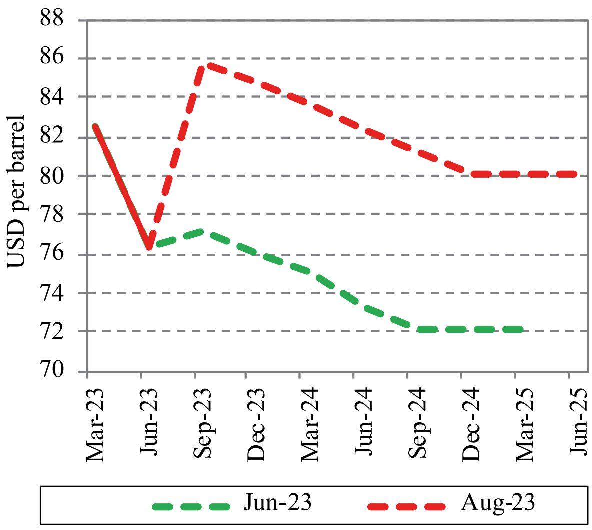


Source: Bloomberg

International oil prices revised upwards

Relative to the June 2023 projection, international oil prices have been revised upwards in the short-to-medium term (Chart 4.8), mainly due to the escalating war between Russia and Ukraine, which threatens supply; the recent decision by OPEC and its allies to extend crude oil production cuts until the end of 2024; and potential declines in worldwide oil stockpiles throughout 2023. Although forecast to rise in the short term, international oil prices are expected to trend downwards due to a weakening global demand outlook emanating from the effects of repeated interest rate hikes by major central banks to fight elevated inflation.

Chart 4.8: International Oil Prices



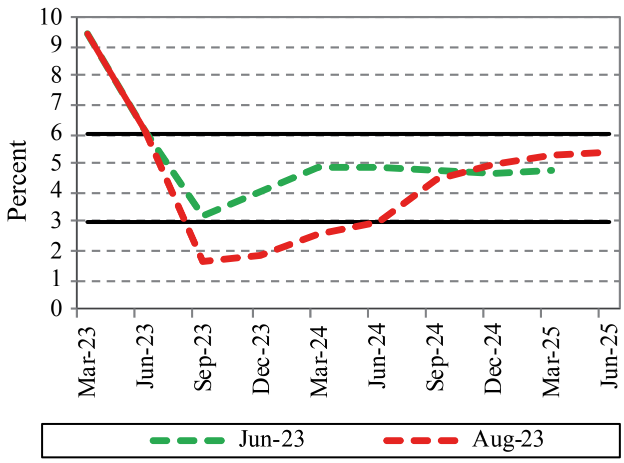
Source: Bloomberg

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

Inflation forecast revised downwards in the near term

Compared to the June 2023 forecast, domestic inflation is projected to be significantly lower in the near term, mainly due to the decrease in domestic fuel prices effected on June 21, 2023, a significantly lower July 2023 inflation outturn and the downward revision in recent forecasts of international food prices and trading partner countries' inflation (Chart 4.9).

Chart 4.9: Botswana Headline Inflation Revision



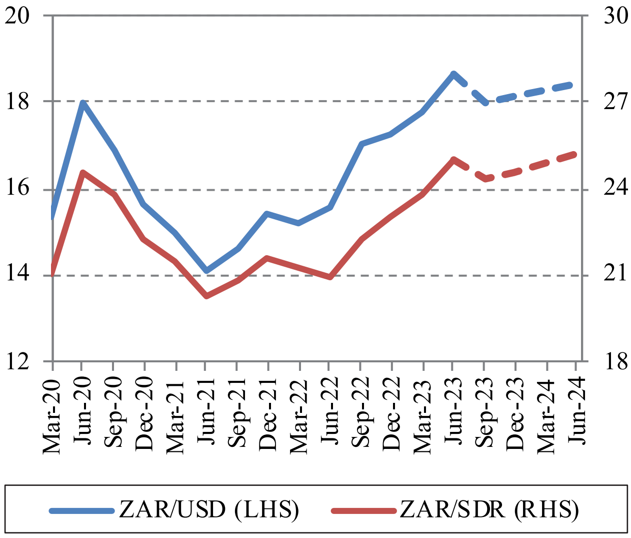
Source: Bank of Botswana

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.

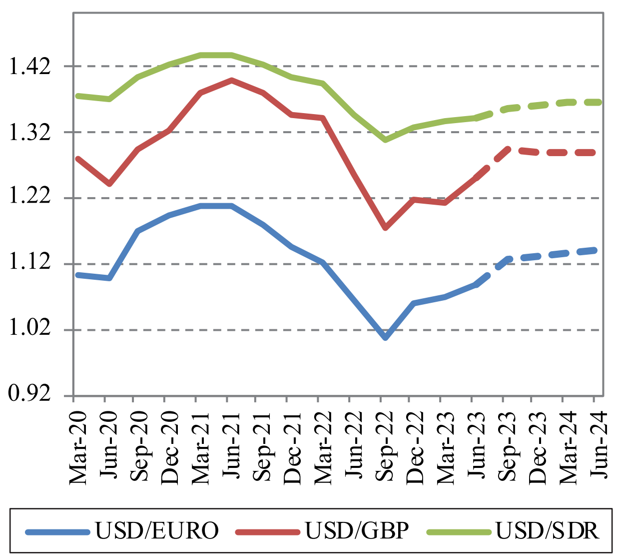
The South African rand is expected to appreciate against the US dollar in the third quarter but to depreciate against the US dollar and the SDR in the medium term (Chart 4.10) due to poor economic fundamentals (weak economic growth outlook, high public debt, and high budget deficit), power supply constraints, as well as poor-performing state-owned enterprises. These factors are expected to limit the growth of domestic economic output in the forecast period and consequently, dampen investor confidence for South African assets. Meanwhile, uncertainty over the developments of the Russia-Ukraine war, fears of a global economic slowdown on the back of high inflation and aggressive monetary policy tightening in most major economies, as well as unfavourable changes in investor sentiments towards emerging market assets (of which the South African rand is part) are expected to continue putting pressure on the South African rand.

Chart 4.10: ZAR against USD and SDR



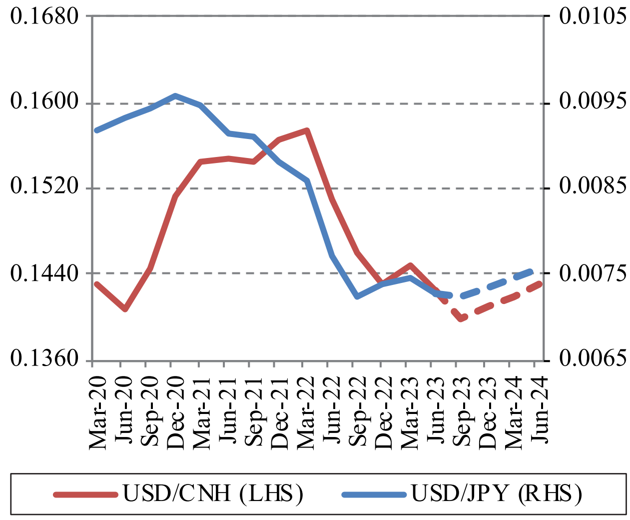
Source: Bloomberg

Chart 4.11A: Exchange Rates against USD



Source: Bloomberg

Chart 4.11B: Exchange Rates against the USD



Source: Bloomberg

The US dollar is expected to slightly depreciate against most major international currencies in the short term (Chart 4.11A and Chart 4.11B) due to easing US inflation, which has raised expectations that the Fed may be nearing the end of its monetary policy tightening cycle. However, the global uncertainty emanating from the war between Russia and Ukraine and fears of a global recession, are likely to influence investors to hold the safe-haven currency, like the US dollar, thus affecting this forecast.

The British pound is expected to appreciate marginally against the US dollar (Chart 4.11A) as the currency became more attractive to investors because of its widening interest rate differential over other developed economies. Bank of England Governor, Andrew Bailey, stated that policymakers are committed to bringing down the UK inflation rate to its 2 percent target. The inflation rate eased to 7.9 percent in June 2023, which is the lowest level since March 2022, but the statement suggests the central bank's commitment to maintaining its aggressive policy tightening. Meanwhile, the euro is also anticipated to appreciate against the US dollar as the ECB interest rate increases are starting to take effect on the economy.[12] The annual inflation rate in the euro area decreased to 5.5 percent in June 2023, the lowest level since January 2022, but above the ECB's target of 2 percent, bolstering expectations that the ECB will continue its monetary policy tightening.

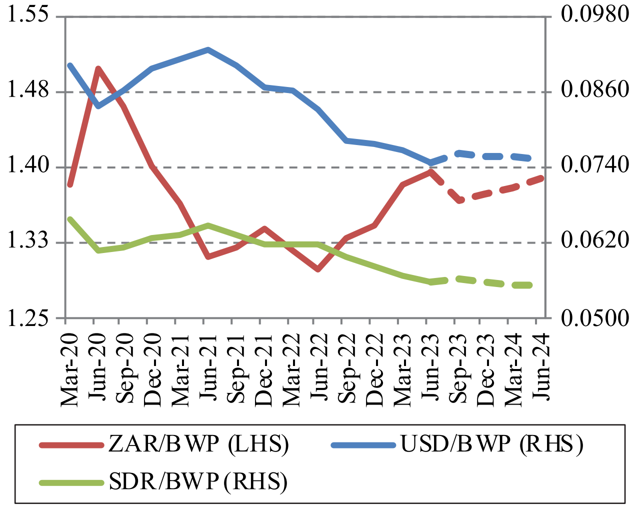
The Japanese yen is expected to appreciate against the US dollar, due to its safe-haven status, prompted by increasing investor risk aversion, amid uncertainty emanating from the Russia-Ukraine war and anticipated slowdown in economic activity. However, the Bank of Japan has signalled its commitment to keeping monetary policy accommodative despite a global shift towards tighter monetary settings.

The Chinese renminbi is expected to depreciate against the US dollar in the third quarter of 2023 but appreciate in the medium term (Chart 4.11B), as investors are increasingly optimistic that the Chinese authorities will unveil stimulus measures to support growth amid China's weak post-pandemic recovery. The People's Bank of China and the National Financial Regulatory Administration extended a policy released last year aiming to support the real estate market, which allows developers to postpone or swap their loans.

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

The anticipated depreciation of the South African rand against the SDR is expected to result in a depreciation of the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.12). However, the Pula is expected to depreciate against the South African rand in the third quarter but appreciate in the medium term. The projected appreciation of the Pula against the South African rand in the short term is expected to exert marginal downward pressure on domestic inflation.

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



Source: Bloomberg and BoB calculations

Risks to the inflation outlook

Inflation could be higher than projected in the event international commodity prices were to increase beyond current forecasts, supply and logistical constraints persist and the reversal of global economic integration (geo-economic fragmentation) gains pace. Furthermore, any possible upward adjustment in administered prices that is not factored in the current projection may lead to higher inflation. However, inflation could be lower than anticipated because of the possibility of weak domestic and global economic activity, possible disinflationary effects of higher monetary policy rates globally, stronger-than-anticipated appreciation of the Pula against the South African rand, and restrained international commodity prices.

[12] The euro zone interest rates have risen by 400 basis points in the last year to 4 percent in June 2023.

Box 4: Bank of Botswana (Amendment) Act, 2022

In July 2022, Parliament passed the Bank of Botswana (Amendment) Act, 2022 (the Act), which introduces new provisions to enhance the Bank's powers to achieve the price and financial stability mandates. The new changes are discussed below.

Dual Mandate for the Bank of Botswana

Section 4 (2) of the Act incorporates a financial stability mandate for the Bank in addition to the primary mandate of maintaining price stability. Under the new legislation, the primary objective of the Bank shall be to achieve and maintain domestic price stability. Subject to attaining its primary mandate, the Bank shall contribute to the stability of the financial system and foster and maintain a stable, sound and competitive market-based financial system. In addition to making explicit the twin-mandates of the Bank, the provision further endows the Bank with operational independence in pursuit of its primary objectives, and in the performance of its functions under the Act.

Revised Composition of the Monetary Policy Committee

One of the major changes in the Act is the establishment of a statutory Monetary Policy Committee (MPC) under Section 19 A of the Act. The MPC shall be composed of 9 members, being the Bank of Botswana Governor, deputy Governors, head of department responsible for economic research and head of department responsible for treasury operations and 4 external members, with relevant skills and knowledge on the functions of the MPC, appointed by the Minister of Finance.

Establishment of a Statutory Financial Stability Council

Section 54 B of the amended Act establishes Financial Stability Council (FSC), which shall be responsible for preserving the stability of the financial system; ensuring cooperation between members with respect to the assessment of the build-up of economic and financial sector systemic risks in Botswana; developing coordinated policy responses to risks including crisis management; and making recommendations, issuing warnings or opinions addressed to regulatory bodies regarding financial institutions. The FSC shall comprise the Governor, who shall be the Chairman, the Permanent Secretary in the Ministry responsible for Finance, Chief Executive Officer of the Non-Bank Financial Institutions Regulatory Authority, Director of the newly established Deposit Insurance Scheme for Botswana, and the Director General of the Financial Intelligence Agency. The FSC was previously established through a memorandum of understanding between participating institutions.

Provision for the Establishment of a Deposit Insurance Scheme

Section 43 A of the amended Act provides for the establishment of a Deposit Insurance Scheme to provide insurance against loss of part or all insured customer deposits in a bank. The Deposit Insurance Scheme shall be established and operate in a manner that will contribute to the stability of the financial system in Botswana and minimise exposure to loss for customers.

5. AUGUST 2023 MONETARY POLICY COMMITTEE DECISION

At the meeting held on August 24, 2023, the Monetary Policy Committee (MPC) of the Bank of Botswana maintained the Monetary Policy Rate (MoPR) at 2.65 percent.

Headline inflation decreased significantly from 4.6 percent in June to 1.5 percent in July 2023, breaching the lower bound of the Bank's medium-term objective range of 3 – 6 percent. The fall in inflation was mainly due to the dissipating impact of the earlier increase in domestic fuel prices in the corresponding period in 2022 (base effects). Furthermore, inflation fell on account of the downward adjustment in domestic fuel prices effected on June 21, 2023. Inflation is forecast at 1.2 percent for August 2023 and the MPC projects that inflation will remain below the lower bound of the objective range temporarily and revert to within the objective range from the first quarter of 2024 into the medium term. The projected low inflation is due to, among others, subdued domestic demand and the downward revision in recent forecasts of international food prices and trading partner countries' inflation.

The risks to this inflation profile/trajectory were assessed to be balanced. The MPC observes that inflation could be higher than projected if international commodity prices increase beyond current forecasts, supply and logistical constraints persist and the reversal of global economic integration (geo-economic fragmentation) gains pace. Furthermore, any possible upward adjustment in administered prices that is not factored in the current projection may lead to higher inflation. However, inflation could be lower than anticipated because of the possibility of weaker domestic and global economic activity, possible disinflationary effects of higher monetary policy rates globally, stronger-than-anticipated appreciation of the Pula against the South African rand and restrained international commodity prices.

According to the July 2023 World Economic Outlook Update, global output growth for 2022 is estimated at 3.5 percent and is forecast to moderate to 3 percent in both 2023 and 2024. South African real gross domestic product (GDP) grew by 1.9 percent in 2022. The South African Reserve Bank expects growth to weaken to 0.4 percent in 2023 but to improve to 1 percent in 2024. For Botswana, real GDP increased by 5.8 percent in 2022, lower than 11.9 percent recorded in 2021. The Ministry of Finance projects GDP to grow by 3.8 percent and 4.4 percent in 2023 and 2024, respectively.

The MPC notes the growth-enhancing economic transformation reforms and supportive macroeconomic policies being implemented. These include accommodative monetary conditions, improvement in water and electricity supply, implementation of the Economic Recovery and Transformation Plan and the two-year Transitional National Development Plan, as well as reforms to further improve the business environment (for example, the promulgation of the Credit Information Act and Movable Property Act, both of which have the potential to make credit more accessible). In addition, the recent announcement of agreement in principle between the Government of Botswana and De Beers Group on a new Debswana Mining Licence and new Sales Agreement is expected to be positive for medium-term growth.

The MPC recognises that, in addition to the dissipating impact of increases in administered prices in 2022, the economy is expected to operate below full capacity in the short term and, therefore, not generate demand-driven inflationary pressures. However, inflation is forecast to be within the objective range in the medium term and closer to the upper bound. Therefore, the MPC decided to maintain the MoPR at 2.65 percent.

Accordingly,

(a) the 7-day Bank of Botswana Certificates, repos and reverse repos will be conducted at the MoPR of 2.65 percent;
(b) the Standing Deposit Facility (SDF) Rate is maintained at 1.65 percent, 100 basis points below the MoPR; and
(c) the Standing Credit Facility (SCF) Rate remains at 3.65 percent, 100 basis points above the MoPR.

The remaining MPC meetings for 2023 are scheduled as follows:

October 26, 2023
December 7, 2023

Annex: Inflation Forecast Summary for August 2023 MPC Meeting

	Actual							Forecast									
	2022					2023		2023			2024					2025	
	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2	Q3	Q4	Annual Average	Q1	Q2
Inflation	10.4	11.4	14.2	12.6	12.2	9.4	6.1	2.1 (3.2)	2.5 (5.0)	5.0 (5.7)	3.2 (4.9)	3.6 (4.9)	4.3 (4.8)	4.8 (4.7)	4.0 (4.8)	5.0 (4.8)	5.1 (4.8)

Note: Figures in parentheses represent the previous MPC forecast (June 2023)

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

Domestically

Domestically

1. The decrease in domestic fuel prices effected June 21, 2023
2. The significantly lower inflation outturn for July 2023

Externally

1. Downward revision of international food prices and trading partner countries' inflation in the short term

NOTE

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