



# Banknotes

A Bank of Botswana Quarterly Magazine



**4.**  
Governor  
Mokhele Mphahlele's  
International  
Recognition



**5.**  
Of Rising  
Prices, The  
Cost of Living,  
Inflation ...



**6.**  
Know your  
currency  
Beware of fake  
bank notes

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[www.bankofbotswana.bw](http://www.bankofbotswana.bw)



# EDITORIAL

The Bank of Botswana continues to interact with the media in an effort to improve general understanding of the technical issues as well as policies relating to the mandate of the Central Bank. It is considered important for the media to acquire a broad understanding of various activities and policies under the purview of the Bank, due to the unique role of the media as a channel for disseminating information to the general public. The media's sound understanding of the Bank's role in the economy would, in turn, encourage constructive feedback from both the media and the general public. The resulting informed interactions would enhance the Bank's credibility, which is very essential for policy effectiveness.



*"The Bank of Botswana Governor, Mrs Linah Mohohlo presenting a copy of the Monetary Policy Statement Report to the Honourable Minister of Finance and Development Planning, Mr Kenneth Matambo, after the MPS launch."*

In 2011, a workshop was held for the media, the objective of which was to share information on the functions, policies and related activities of the Bank of Botswana. Since then, the media has shown increased interest in understanding the Bank's policy actions as well as the technical aspects of central banking.

During 2012, the media sought the Bank's views and perspectives on several issues including the impact of fuel price increases, issuance of currency, currency counterfeiting, exchange rates, interest rates, the bond issuance programme, the Pula Fund, licensing of banks, regulation and supervision, inflation trends, the domestic

economy, and the world economic recession. The Bank responded to the enquiries on the various issues in a timely manner to the extent possible in an effort to meet its accountability obligations, ensure transparency in the conduct of its policies and perform its out-reach function, as well as information dissemination.

This edition of Banknotes highlights responses to the questions raised by the media so far this year. The edition also summarises the Mid-Term Review of the 2012 Monetary Policy Statement, which was launched in February this year as well as recent international accolades conferred on Governor Mohohlo.



*Listening attentively to the Governor's presentation are, from left to right: the Director of the Research Department at the Bank of Botswana Dr Kealeboga Masalila, Dr T. Nyamazabo, Secretary for Economic Affairs, Ministry of Finance and Development Planning, Deputy Governor, Bank of Botswana Mr Oduetse Motshidisi, and Deputy Governor, Bank of Botswana Mr Moses Pelaelo.*

As expected, the 2008/2009 global financial crisis created legitimate apprehension and concerns in the media and public regarding its economic and financial impact on the domestic economy.

## 2.1 The 2008/2009 Global Recession: Economic Effects, Policy Responses and Lessons

In response to these concerns, the Bank explained to the media that like many other developing countries, Botswana was directly and indirectly affected by the global recession, which was precipitated by the financial crisis due to the openness of the economy; and that the adverse impact continued to linger to some degree into 2012.

### (a) Economic Effects of the 2008/2009 Recession

#### (i) **International Trade and the overall Balance of Payments:**

It was pointed out that Botswana's direct trade links with the world economy were strong during 2008/2009 and progressively strengthening. Since the total of exports and imports accounts for some 80 per cent of the country's economic activities measured as total gross domestic product (GDP), the Country is affected by global economic events. It was further explained that Botswana exports diamonds, other minerals and some non-traditional exports to the major markets, especially in Europe and the USA. Therefore, the economic downturn experienced in the trading partners adversely affected export performance. Since diamond exports contribute over half of total earnings from exports of goods and services, the merchandise trade account of the balance of payments deteriorated as imports remained high against a decline in exports; and the overall external balance as indicated by the level of foreign exchange reserves declined by P10.7 billion from P68.6 billion in December 2008 to P57.9 billion at the end of December 2009.

**(ii) Government Revenue and Expenditure:** The Bank added that diamond exports also account for nearly 40

percent of government revenues. Therefore, the global economic recession reduced Government revenue due to a fall in exports of diamond and other minerals as well as receipts from businesses financed by foreign direct investment. Despite the revenue constraints, Government minimised the severity of the impact of the recession on social welfare and economic activity by prioritising development project spending and continued provision of social services. As a result, the 2008/09 budget deficit of P4.7 billion was 5.4 percent of GDP. In an effort to restore fiscal sustainability, Government put in place expenditure restraints which included a freeze on public sector salaries.

**(iii) Economic Growth and Employment:** The impact of the recession on overall economic growth and impact on several sectors was highlighted in the Bank's 2009 Annual Report (page 67). As stated in the Annual Report, GDP declined by 6.7 percent in 2009 compared to growth of 2.8 percent in 2008, reflecting the contraction of the mining sector by 38.4 percent in the first nine months of 2009, mainly due to lower exports of rough diamonds. In addition, the manufacturing sector recorded a 6.7 percent decline in the first three quarters of 2009, due to the negative impact on the domestic diamond cutting and polishing industry and garment production for export. The recession also affected employment for a number of reasons including, first, the reduced revenue which constrained Government's spending on development projects; second, there were redundancies and retrenchments in the mining and quarrying sectors; and third, employment in agriculture and manufacturing also declined.

**(iv) Banking Sector:** It was, however, observed that the credit crunch crisis and the global recession did not have a first round direct effect on the domestic financial sector due to weak direct linkages. Moreover, the Bank's strong supervisory and regulatory regime ensured that domestic banks remained sound, solvent and highly liquid.

### (b) The Bank's Monetary Policy Responses

The media also enquired about the proactive and preventive mechanisms adopted by the Central Bank during the crisis. It was explained that based on its mandate, the Bank's policy reaction focused on any impact the recession would have had on inflation, economic growth, the balance of payments and the soundness of the banking system. Monetary Policy Response to Inflation in 2008: Both international and domestic factors contributed to a downward trend in inflation during the recession. For the major part of 2008, domestic inflation progressively rose and reached a peak of 15.1 percent in August due to the combined effect of high international commodity prices, especially oil and food; a rise in Government expenditure, as well as domestic credit and increases in administered prices including transport fares. Moreover, the medium-term inflation outlook was not positive. In response to the unfolding unfavourable inflation prospects, the Bank Rate was



raised from 14.5 percent to 15.50 percent in June, 2008 to restrain inflation by slowing down the rate of credit expansion which partly financed aggregate expenditure. Towards the end of 2008, the cumulative effects of the global recession began to slow down economic activity in major trading partner countries considerably. In addition, international commodity prices fell following a slack in global demand due to a rise in unemployment and idle industrial capacity which resulted in a decline in world inflation. The spillover of these developments was reflected in a contraction of the domestic economy and a steady fall in inflation. In view of the favourable medium-term inflation outlook and in order to partly counteract the adverse effects of the recession on domestic economic activity, Bank Rate was reduced from 15.5 percent to 15 percent in December 2008.

**(c) Monetary Policy Responses to Inflation during 2009-2011:**

The downward trend in economic growth and inflation continued throughout 2009 and inflation fell to 5 percent in November, 2009, the lowest level in almost a decade and was within the 3-6 percent inflation objective up to March 2010. It was against this background that the Bank rate was reduced on five different occasions by 5 cumulative percentage points to 10 percent by the end of 2009. Although inflation rose during 2011 - reflecting increases in administered prices as well as a rise in the cost of oil and food imports - the outlook for domestic inflation was considered positive as food and oil prices subsided towards the end of the year. Accordingly, the Bank rate was reduced further from 10 percent to 9.50 percent in December 2011 and has remained at this level ever since.

**(d) Effectiveness of Monetary Policy During the Recession**

With regard to the effectiveness of monetary policy, it was explained that both Government spending and the easing of monetary policy contributed to the strong expansion of the non-mining sector and the overall economy recorded positive growth during the last half of 2009. Government provided a fiscal economic stimulus by maintaining high levels of development spending which was partly financed by drawing on savings accumulated through past budget surpluses. In addition, reductions in Bank Rate stimulated bank lending to finance both consumption and investment. In other words, both fiscal and monetary policies moderated the severity of the recession on domestic business activity and incomes, generally.

**(e) Lessons Learnt from the Global Financial Crisis**

The media also enquired about the lessons the Bank drew from the recent financial crisis and global recession. There was additional interest in possible strategies that would be adopted to prevent or address similar crises. The Bank's responses to these questions covered both external and domestic factors in recognition of Botswana's inter-connectedness with the world economy.

**(i) Global Strategies:** It was pointed out that globally, many countries recognise the need for a serious overhaul of the regulatory infrastructure for banks, since the recession was precipitated by the systemic weaknesses and or

inadequacies of the supervision and regulation of banks, especially in the USA, the UK and the Euro zone. It was also essential that multilateral organisations should effectively conduct their economic management surveillance role in both developing and developed economies.

**(ii) Strengthening Banking Supervision:** At domestic level, it was pointed out that Botswana recognises the need for effective and vigilant banking supervision which include banks' strong capitalization; good corporate governance; prudent risk management; and maintenance of adequate liquidity. Care should also be taken to prevent crisis contagion through excessive exposure to foreign banks via correspondent banking relationships, offshore placements and other cross-border banking business transactions.



*Veteran politicians and former Cabinet Ministers Mr David Magang and Dr Gaositwe Chiepe respectively, are regular guests at the Bank of Botswana economic briefings and launches of the MPS and the Annual Report. They are seen here during one of the presentations held in the Bank of Botswana Auditorium.*

**(iii) Maintenance of an Adequate Level of Foreign Exchange Reserves:**

Another domestic strategy of interest to the media was the importance of maintaining an adequate level of foreign exchange reserves. The Bank shared the view regarding the need to maintain a high level of foreign exchange reserves which serves two objectives. First, the reserves are a buffer that can be drawn upon during periods of adverse external shocks to exports and other inflows of foreign exchange. During the recession a drawdown of part of these savings held abroad minimised disruptions to imports of goods and services needed for both consumption and investment. The reserves are also a means of transferring the savings generated from the current exploitation of mineral wealth to future generations. For these reasons, the media was assured of the importance of a continued build-up of a healthy level of international reserves. It was added that the investment strategies pursued by the Bank of Botswana mitigated the risks to the international reserves and minimised the market losses during the crisis.

**(f) Sustainable Fiscal Policy:** Another important lesson and desired strategy drawn from the recent recession was the importance of the sustainability of fiscal policy. The media was informed that Botswana attached great importance to the policy of sustainable budgeting. This policy avoids budget deficits for a protracted period in preference for balancing the budget over the medium term. Budget surpluses in good years are saved and drawn upon in during lean periods. In other words, the policy permits counter-cyclical fiscal policy macroeconomic policies which stimulates the economy to avoid a downturn, and avoids overheating the economy during a boom. The sustainable budgeting policy extends beyond the National Development Plan 10, and allows for modest surpluses that will smoothen the budgeting transition into a period when diamond revenues are forecast to decline. To achieve this objective, Government put in place expenditure restraints which included a freeze on public sector salaries.

**(g) Sound Monetary Policy and Vigilant Banking Supervision:** The media was further informed that a

coherent and independent monetary policy framework, including interest rate policy, was also an important lesson and strategy learned from the recent recession. It was explained that monetary policy instruments which principally comprise interest rates, reserve requirements and open market operations play a very important role in macroeconomic management. Banks mobilise financial savings and on-lend these resources for the financing of both consumption and investments, both of which are essential for economic development. However, monetary policy ensures that the rate of credit expansion is carefully controlled by changes in interest rates and other instruments to avoid inflation. Banks are also major channels for the smooth functioning of the payments system for both domestic as well as international transactions and are conduits for the transmission of monetary policy signals to the rest of the economy. It was explained that for these and other reasons, banking supervision and regulations must be robust and strictly enforced to ensure the soundness of the banking system.

## 2.2 | Government Note Issue Programme, Pula Fund, Inflation control, Lending Rates and Bank Licencing

**(a) Issuance of Bonds and Treasury Bills**

On September 2, 2012, P1 billion worth of a 6-month Treasury bill matured. Although the roll-over was oversubscribed, only P715 million was rolled-over in two auctions of 3-month and 6-month Treasury bills; the former were issued for the first time. It was explained that although the different bids were based on participants' respective analysis of the market conditions, auction rules do not obligate the Bank to accept all bids. Rather, under the uniform auction price format the Bank accepts bids at a cut-off price which is consistent with the fundamentals of the economy. Therefore, uncompetitive bids are rejected. The cut-off price of 5.06 percent for the 6-months Treasury bill at the September auction was unchanged from the previous auction which was held in March 2012.

The media wondered whether the absence of a bond auction in September, 2012 reflected an improvement in Government's finances or the cost of raising the funds through a bond. In response, it was explained that the issuance of bonds and Treasury Bills in Botswana is mainly for purposes of developing the domestic money and capital markets as opposed to Government's need to raise funds to finance budgetary expenditure since Government is committed to fiscal prudence. The Bank further explained that bonds are issued either when there was a roll-over of a maturing bond or as necessary; no bond had matured for a possible roll-over in September, 2012, and there was no need to float a new bond. Moreover, the timing of bond and Treasury bill issues do not necessarily coincide. The Bank also pointed out that under the Government's P15 billion Note Issue Programme, bonds are issued with maturities of 2 years, 5 years 10 years and 15 years.

**(b) The Pula Fund**

The media also sought to understand the background and objective of the Pula Fund. As a background, it was explained that one of the responsibilities of the Bank is to manage the Country's foreign exchange reserves. The reserves are the nation's financial resources denominated in major international reserve currencies, especially the United States dollar, the Euro, the Pound Sterling and Japanese yen. The foreign currencies that are invested in the major financial markets are mostly earned from exports in excess of import payments, net inward transfers, net foreign borrowing and net inward investment. The reserves are used for meeting various international payment obligations including imports of goods and services, as well as foreign debt servicing and repayments.

The Bank then elaborated that since 1994, the management strategy for foreign exchange reserves includes a sub-



division of the pool of these resources into portfolios, namely, the Pula Fund, which is invested in assets of a long-term maturity and the Liquidity Portfolio which comprises short-term investments. The investment guidelines for both portfolios are safety, liquidity, and return, with liquidity stressed for the Liquidity Portfolio and return emphasised more for the Pula Fund. Safety has the highest priority for both portfolios.

The Pula Fund is part of the nation's long-term saving and was established in order to bequeath a part of the national wealth to future generations, instead of exhausting it all to satisfy current needs. Moreover, part of the interest earned on the Pula Fund investments and even part of the balances may be used in times of adverse economic events that affect export and other foreign exchange receipts. Such a situation occurred during the recent global financial crisis and recession or severe drought when Government revenues were strained.

### **(c) The Bank's Mandate to Control Inflation**

On several occasions, the media misreported the Bank's mandate of maintaining monetary stability. The fulfilment of this mandate requires the Bank to pursue the objective of a stable, low and predictable level of inflation. It was clear from some misleading media reports on this matter that there was a lack of understanding of the technical issues involved in fulfilling this mandate. In fact, the misinformation was so serious in one press article that the Bank had to issue a Press Statement to clarify and explain the technical and other processes involved in implementing monetary policy in order to meet the inflation objective.

The Statement explained that under the Bank of Botswana Act, one of the primary objectives of the Bank is ensuring the maintenance of monetary stability, which encompasses price stability, defined as low and predictable level of inflation. From the perspective of the structure of the domestic economy, the Bank's operational definition of price stability is annual inflation within a 3-6 per cent range over the medium-term. It was further stated that this inflation range was close to the 3-5 per cent average range of inflation forecast in trading partner countries. In which case, the 3-6 per cent desired range supports export competitiveness within the broader national goal of maintaining a sustainable rate of economic growth, employment creation and social wellbeing. Higher inflation levels would adversely affect saving, investment, business expectations, fixed income groups, export competitiveness and, therefore, overall economic development.

With regard to its sources, it was pointed out that inflation resulted partly from price developments abroad which directly affect the cost of imported consumption goods and services, while higher prices of imported raw materials and machines ultimately get reflected in price increases of final products. It was added that other causes of inflation are higher rates of overall expenditure (domestic demand) in relation to the supply of goods and services in a given period as well as adjustment of administered prices on some goods and services in addition to Government levies. The Press Statement further pointed out that although the Bank had responsibility to control inflation through changes in Bank Rate and other instruments, the fundamental fact is that low inflation can be sustained by efficient production



(increase in output while minimising cost). For this reason, producers were encouraged to enhance productivity, which will benefit consumers and exports. It was also the Bank's view that while the reasons for increasing administered prices and utility tariffs are understandable, large price adjustments had potential to generate ripple effects that affect prices (inflation expectation) of other goods and services that would erode the living standards and well-being of households, especially those with fixed incomes.

It was added that the outlook was that this year's inflation would edge above the 3-6 per cent in the medium-term due, in part, to the increase in administered prices and tariffs as well as high food prices. As expected, the Bank would be monitoring and assessing the outlook as it unfolds and take appropriate action, as necessary, in pursuit of the medium-term inflation objective without undermining the much needed sustainable economic growth.

### **(d) Interest rates and Bank licensing**

The media also enquired whether the Central Bank imposed a ceiling on commercial bank charges. It was explained that the Bank placed no ceiling on commercial bank lending rates. However, there was a link between Bank Rate (a rate to which commercial bank transactions with the Central Bank are pegged) and the prime rate (a rate that banks charge their best customers). The spread between the Prime Rate and other lending rates depends on several factors including the credit risks (ability to pay), market risk (the extent to which market price movements and other factors would impact on the financial performance of the borrower) and other considerations that would be specific to each bank's business strategy.

With regard to requirements for the licensing of commercial banks, the media was advised to visit the Bank of Botswana website at [www.bankofbotswana.bw](http://www.bankofbotswana.bw) for detailed information on policy, required documentation and licensing procedures. It was also explained that banking licence applications are regularly published in the Government Gazette and that the issuance of a banking licence is similarly gazetted to ensure public awareness of banking licence applicants and their subsequent authorisation to conduct banking business in Botswana.



## 2.3 | Government Note Issue Programme, Pula Fund, Inflation control, Lending Rates and Bank Licencing

### (a) Fuel price increases

Journalists enquired whether the recent and previous fuel price increases would have an immediate impact on inflation. In response, the Bank explained that fuel has a



*Mr Leina Gabaraane, Chief Executive Officer of Stanbic Botswana poses a question during the economic briefing whilst the Managing Director of Phakalane Golf Estate Hotel Resort, Mr Lesang Magang (left) listens*

significant weight in the basket of consumer goods which comprise the Consumer Price Index (CPI). As a result, adjustments to fuel prices can have a noticeable direct immediate impact on inflation. It was also pointed out that fuel prices can indirectly raise the cost of transport and

energy, which would affect prices of other commodities and services.

With regard to other effects of a rise in fuel prices, the Bank stated that since household incomes have been rising very slowly for a while, households would tend to reduce their spending on fuel or drawdown on savings to meet the higher cost without cutting back on overall spending. It was also explained that higher fuel cost could raise the cost of production for businesses, but the Bank cautioned that faced with competition from producers of competing products or services and low turn-over of sales, the scope for passing on the higher production cost to consumers may be limited; in which case, business profit margins may have to be reduced.

It was also enquired whether Botswana's over reliance on other countries for fuel supplies contributes to higher fuel prices. It was explained that the Country is not an oil producer and is, therefore, bound to rely on fuel supplies from abroad and that oil prices are determined by international oil markets. At any rate, it was stressed that the volume of fuel imports is small by international comparison due to the small size of the domestic market. Therefore, from both perspectives, the Country is a taker of international fuel prices. That is why Government adjusts domestic fuel prices in response to international market trends. Under these circumstances, small but timely fuel price adjustments are preferable to delayed but larger changes, which would tend to be disruptive to the economic activity.







*Governor Mohohlo in an informal conversation with the Managing Director of Botswana Building Society, Mr Pius Molefe after the launch of the MPS Report.*

The Mid-Term Review of Monetary Policy (MTR) outlines the monetary policy framework, highlights domestic inflation trends together with policy responses during the first half of 2012 and updates prospects for the remainder of the year.

### **Monetary Policy Framework**

The MTR reiterated that the Bank's monetary policy objective is to achieve price stability, defined as sustained low inflation within the medium-term objective range of 3 - 6 percent. Low and predictable level of inflation contributes to sustainable durable economic growth and development by encouraging savings and investment as well as promoting economic diversification by ensuring international competitiveness of domestic exports.

The Review further explains that monetary policy implementation is based on inflation forecasting over the medium term (three-year rolling period), a timeframe over which monetary policy can influence price developments. The inflation forecast incorporates current and prospective future developments that would have an impact on inflation, including indicators of overall domestic expenditure, changes in import prices, exchange rate movements, adjustments in administered prices and consumption taxes, as well as public expectations of future price trends.

It was explained that the Bank uses interest rates and open market operations to influence the rate of credit growth since bank loans finance expenditure which, if permitted to rise very rapidly in relation to available goods and services in a given period, has an effect on inflation. Deposit interest rates are also influenced in order to encourage financial

savings, which are then on-lent to finance investment and consumption spending.

However, it was cautioned that the policy response to pressures on inflation depends on whether or not the sources of inflation would respond to monetary policy action. In this regard, monetary policy may not respond to short-term increases in inflation, due to price adjustments to some items unless such price adjustments can create public expectation of a general increase in prices of other goods and services. For this reason, a distinction is made between factors that have a transitory impact on inflation, such as changes in administered prices and consumption taxes, and those that are likely to have a lasting effect (e.g. changes in indicators for aggregate expenditure) and are subject to monetary policy influence. Policy decisions are taken in a timely manner to any forecast of a significant and lasting deviation of inflation from the objective range. Some perspective on the sources of inflation is also obtained from comparisons of headline with alternative measures of inflation (the 16 percent trimmed mean and inflation excluding administered prices).

The details of the Bank's monetary policy framework and policy implementation procedures are published in each year's Monetary Policy Statement.

### **Inflation Trends during the First half of 2012**

As anticipated earlier in the year, inflation fell in the first half of 2012, to 7.3 percent in June 2012 from 9.2 percent in December 2011. The rate of price increase was lower for a wide range of goods and services (notably fuel and food prices) in the first half of 2012. When administered prices are excluded, inflation decreased from 7.5 percent in December 2011 to 6.4 percent in June 2012 and the 16 percent trimmed mean measure showed a decrease from 8.5 percent to 6.8 percent over the same period. All the three measures of inflation showed a fall in inflation. Inflation fell, in part, due to the dissipation of the impact of the 2011 increase in administered prices. More generally, however, the downward trend reflected the moderate expansion of domestic output which was below trend during the period. This implied that overall expenditure was not inflationary in the first half of 2012. As indicators of overall expenditure in the economy, household spending was restrained by weak growth in incomes. In addition, the rise in Government expenditure was a modest 5 percent in fiscal year 2011/12; the rate of increase is budgeted to fall marginally in fiscal year 2012/13. External sources of inflation were also moderate, although some uncertainties remained with respect to international prices of oil and food.

### **Monetary Policy Implementation**

Monetary policy is implemented by the Monetary Policy Committee (MPC) of the Bank, which meets six times a year.



Based on the medium-term inflation projections, the Committee assesses current domestic and external developments, as well as other factors that could potentially influence the outlook for inflation over the medium-term. This forward-looking approach to inflation control permits timely responses to anticipated economic and other events that would create a significant and lasting deviation of inflation from the 3-6 percent objective range. The decisions taken at each meeting are communicated through a Press Release in order to foster policy transparency and credibility as well as fulfil the accountability obligation. The communication is also a means through which the Bank expects to anchor expectations of price stability.

Although output was below trend and domestic expenditure growth was modest, inflation was forecast to remain above the 3-6 percent objective range in the short term,

but with prospects of a convergence towards the desired range in the medium term, in the absence of unexpected adjustments to administered prices and other supply shocks in the intervening period.

The Review also stated that since domestic inflation was higher than the average inflation in trading partner countries, the nominal exchange rate of the Pula crawled downwards by 1.2 percent in the six months to June 2012, in order to retain the international competitiveness of domestic exports. Bilaterally, the Pula depreciated by 1.6 per cent against the SDR, weakened by 2.7 percent against the US dollar and 1 percent against the rand.



*Governor Mohohlo thanking the Honourable Minister*

#### 4.1 Forbes Africa Magazine: Africa's 20 Most Prominent Women

In both 2011 and 2012, the Governor of the Bank of Botswana, Mrs Linah Mohohlo, has been listed as one of Africa's 20 Most Prominent Women by Forbes Africa Magazine. The list includes Liberian President Ellen Johnson Sirleaf, Minister Ngozi Okonjo-Iweala of Nigerian, President Joyce Banda of Malawi, Governor Gill Marcus of the South African Reserve Bank, Vice President Joyce Mujuru of Zimbabwe and South Africa's Dr Mamphela Ramphele. The women were recognised for their respective roles in promoting economic growth and development of Africa, and contributions to the continent's future success. The selection was based on the views and comments of third parties and social media feedback.

Governor Mohohlo was cited for managing monetary policy in one of Africa's most successful economies, observing that the Governor is "a central banker through-and-through" who has served in various capacities since joining the Bank in 1976 and as Governor since 1999. The magazine also referred to Mrs Mohohlo's work at the International Monetary Fund (IMF), and her ex-officio membership of the Board of Governors of the IMF representing Botswana as well as membership of other boards.

Governor Mohohlo is humbled by the Forbes Africa magazine recognition. She expressed gratitude for the dedicated support of Bank of Botswana colleagues as well as other stakeholders who, she feels, should share in the commendation.

#### 4.2 Official Monetary Financial Institutions Forum (OMFIF): Lifetime Achievement Award

On August 23, 2011, OMFIF awarded Governor Linah Mohohlo its Lifetime Achievement Award at a ceremony hosted by the South African Reserve Bank in Pretoria. The OMFIF citation document stated that Governor Mohohlo was being honoured for "services over many years to further African integration and understanding through support for transparency and discipline in economic policy." In his remarks during the award ceremony, Mr Hendrik du Toit, Chief Executive of Investec management, said Governor Mohohlo's well-known independence provided a first-class example for central bankers throughout the world.

As part of her acceptance address for the award, Governor Mohohlo observed that "... you will agree that what we think of ourselves may be important, but it is encouraging when observers' thoughts of ourselves are positive. In the circumstances, I am humbled by the generous gesture of the Forum, an organisation which has now attained international stature and influence in advancing the cause of prudential management of international finance." She concluded: "I accept the Award with humility. I accept it on my own behalf and on behalf of colleagues at the Bank of Botswana and counterparts elsewhere; because without their support over the years, this Award would not have been within reach."



# 5 OF RISING PRICES, THE COST-OF-LIVING, INFLATION AND MONETARY POLICY



The issues of inflation and price stability are topical, and occupy a special place in the public psyche. It is not surprising, therefore, that the public, including the media, takes keen interest in the Bank's posture towards price stability and how it implements monetary policy. Of significance to the public are rising prices and their impact on the cost-of-living. Public perceptions may often be at variance with the Bank's stance about prices and inflation because people feel differently when, for example, actual food and retail fuel pump prices increase or when they read about rising food prices in Botswana or South Africa (the major source of food imports). Media reports of actual or potential increases in prices of goods and services may contribute to anxiety about the inflation outlook because any reported price increase may be deemed to imply rising inflation.

In this edition of Banknotes, the term inflation is examined: what it means and at what point in an environment of rising prices the term is applicable and why maintaining low and stable prices is important.

## What is Inflation?

Inflation is a sustained increase in the general price level. Since the general price level is not observable in practice, a measure of inflation that is observable over specified periods is often adopted. The typical and widely used measure of inflation is the consumer price index (CPI), which is based on the notion of a typical or representative 'shopping basket' for a household. Since prices of goods and services are often not directly comparable, an inflation measure, such as the CPI, provides a single composite number (or 'index') that combines prices (or 'sub-indices') of all expenditure items included in the CPI basket and which can be calculated for given successive periods. The CPI, computed in this manner, does not show the actual level of the expenditure items in the CPI basket, but rather the degree to which the basket items as a whole have changed relative to a specified past period. Thus, the rates

of change in the CPI over time will provide a measure of the general level of inflation and not the change in the price of individual basket items or expenditure categories within the CPI basket. This, therefore, provides the fundamental reason for the differences between the Bank's posture towards prices and inflation and public perceptions of inflationary conditions.

To illustrate the calculation of inflation, Table 1 below (which is an extract of inflation data published by Statistics Botswana), shows that indices of expenditure categories in the CPI basket were converted to equal 100 in September 2006. Statistics Botswana collects prices each month for the individual items and adds the percentage changes to the indices. The Table shows that between September 2006 and January 2010, the estimated increase in food prices is 51.1 percent (from 100 to 151.1); 20.4 percent increase (from 100 to 120.4) in the cost of education; and a 5.4 percent decrease (from 100 to 94.6) in the cost of communications. The average increase for all goods and services (All Items Index) was 31.4 percent (from 100 to 131.4), which represents the rise in the cost-of-living over this period.

By implication, in order for the purchasing power of money to be maintained over time, the equivalent of P1000 in September 2006 was P1,314 in January 2010. In other words, for purposes of buying common household items, what P1000 could buy in September 2006 is equivalent to what P1,314 could buy in January 2010.

For the twelve months to July 2011, the estimated increase in food prices is 6.8 percent (from 156.4 to 167.0); 10.5 percent for education (from 120.5 to 133.2) and a 5.4 percent decline in the cost of communications (from 96.4 to 91.2). For all goods and services (All Items index) the increase was 7.7 percent (from 138.6 to 149.3) and this represents the rise in the cost-of-living in the period. P1,077 in July 2011 is equivalent to P1000 in July 2010 in purchasing power terms. In other words, a basket of goods and services that cost P1000 in July 2010 would be worth P1,077 in July 2011. In contrast, the Bank's 3-6 percent inflation objective aims to have an increase in the cost of such a basket of goods and services from P1000 to between P1030 and P1060 over a twelve-month period.

A further point to underscore about inflation is that it is not uncommon that sub-indices within an index such as the CPI will move in opposite directions and offset each other,

	All Items	Food	Alcohol	Clothing	Housing	Furnishing	Health	Transport	Comm
Sep '06	100	100	100	100	100	100	100	100	100
Jan '10	131.4	151.1	165.8	116.9	119.9	130.6	124.9	120.6	94.6
Jul '10	138.6	156.4	177.4	122.9	127.3	138.0	128.1	130.3	96.4
Jan '11	141.8	158.2	183.4	127.5	129.1	142.3	128.7	133.7	96.4
Jul '11	149.3	167.0	192.2	134.4	138.2	149.5	133.6	143.4	91.2

such that the net effect may be neutral (inflation barely changing), negative (inflation falling) or positive (inflation rising). As demonstrated above, the communications index fell over time while the food and education indices increased and offset each other. Thus, for an increase in prices to be considered as a rise in overall inflation the total price of the whole range of products included in the CPI basket (as reflected in the All Items Index), should have risen. It is important to recognise that any rise in the price of an important consumption item does not necessarily signal rising inflation.

Prices are said to be stable if, on average, they neither increase (as they do in periods of inflation) or decrease (as they do in periods of deflation) over time, as a result of which money retains its value over time. However, price stability is generally defined as low, stable and predictable inflation, for instance, as in the 3-6 percent inflation objective in Botswana and South Africa and 2 percent in the United Kingdom and Euro zone.

### Why is Price Stability Important?

There are a number of benefits that flow from an environment of stable prices, as follows:

**(a) Facilitation of economic growth:** stable prices improve long-term decision-making by economic agents (individuals and corporate) as they provide a degree of certainty which is important for savings, purchasing, borrowing and investment decisions. Naturally, this enhances the productive potential of the economy. The converse of this is that inflation increases the risks in long-term planning and investment.

**(b) Reduction in the cost of borrowing:** low and stable prices provide scope for keeping interest rates low and thus lower the cost of borrowing, whilst also reducing uncertainty and risk and, therefore, making low returns on savings more acceptable. In the circumstances, the financial system is more able to mobilise resources for lending for productive and profitable investment.

**(c) Enhancement of trade competitiveness:** if domestic inflation is sustained at low levels relative to inflation prevailing in trading partner countries, exports will become more competitive and sell well in export markets. As a result of improved export performance, the possibility for expansion of domestic business and generation of employment increases.

**(d) Enhancement of social stability:** stable prices are important for social stability because unpredictable changes in, and rapidly rising, prices can result in financial losses through the erosion of incomes and the value of

savings. This can cause considerable social disharmony as people (typically the poor) with limited options for hedging their savings against inflation are fully exposed to the losses.



*Governor Mohohlo and the Chief Executive Officer of First National Bank, Mrs Lorato Boakgomo-Ntakhwana enjoy a light moment after one of the economic briefings delivered by the Governor*

### Role of Monetary Policy in Price Developments

Price stability, as defined by a sustainable, low and predictable level of inflation within a 3 - 6 percent medium-term objective (3-year rolling period), is the objective of the monetary policy of the Bank of Botswana. Monetary policy responds to a sustained deviation of the inflation forecast from the objective range in order to achieve price stability in the medium term. Policy does not respond to all factors that may cause inflation to deviate from the objective range as some of the causal factors are not only transitory (have a temporary effect on inflation) but may be outside the control of the Bank. Changes in oil prices, utility prices, valued added tax, administered prices and government levies are notable transitory factors over which monetary policy has no control. Policy seeks to influence price developments or inflation by affecting domestic demand conditions and public expectations of the future level of inflation. The achievement of price stability is not an end in itself, but a means to achieving macroeconomic stability which, in turn, contributes to economic growth, employment and social stability.

A question often asked is that if monetary policy cannot reliably control the cost-of-living, what is the point of it? The answer is that the role of monetary policy is not to control the cost-of-living. The point of implementing monetary policy is to bring about some measure of certainty to planning and to the long-term decision-making of both individuals and institutions, by ensuring that the inflationary environment is conducive to doing so. The Bank's pursuit of the objective of price stability is precisely to bring about the benefits of such stability, these being: the reduction in economic uncertainties and risks associated with longer-term decision-making; promotion of competitiveness of the country's tradeable sector; promotion of the generation of reasonable returns on savings; and, hence, improvement in the efficiency and effectiveness of financial intermediation.

	Recreation	Education	Restaurants	Misc. G & S
	100	100	100	100
	109.9	120.4	155.6	114.4
	115.6	120.5	166.6	121.0
	117.1	133.2	172.7	122.6
	124.5	133.2	183.7	126.7



# 6

## KNOW YOUR CURRENCY: BEWARE OF FAKE BANKNOTES

The Bank designs Pula banknotes with special security features to avoid counterfeiting. It is important that the public has thorough knowledge of the security features, which, coupled with vigilance, is expected to reduce instances of fraud perpetrated through the circulation of counterfeit banknotes. Although it has been a year since the Bank detected fake P20 and P200 banknotes, the public is urged to continue to exercise vigilance, particularly during periods of increased currency circulation and public holidays in order to avoid being taken advantage of by fraudsters. In particular, due care must be exercised when receiving payments in high denomination banknotes of P200, P100 and P50 to ensure that only genuine banknotes are circulated.

In determining whether a particular banknote is genuine or not, the public should continue to use posters and other publicity material distributed by the Bank, as reference to reinforce their knowledge of all the essential

features of the Pula banknotes. In that regard, the public is advised to pay particular attention to the features listed in the table below.

Previous counterfeits were mainly poor photo/scanned copies of genuine banknotes with metallic features such as the holographic stripe and the windowed security thread appearing as black/grey or brown patches on the surface of the banknotes. Furthermore, the fake banknotes were made of ordinary commercial paper and, therefore, had a smooth surface and were much lighter in colour when compared to genuine banknotes.

Any suspicious banknotes discovered should be immediately reported to the nearest police station and the Bank's offices in Gaborone and Francistown. If in doubt, do not accept any banknotes suspected to be counterfeit or proceeds of crime. Instead, seek assistance from the nearest police station, commercial bank or the Bank's offices.

**Shows the rampant zebra together with the value numeral.**

**Blind Recognition**  
Four blue dots appear on the front right hand edge of the banknote

**Micro Lettering**  
The letters 'BOB' can be read under very strong magnification.

**Holographic Stripe**  
Holographic stripe shows a coat of arms and switching 100 and diamond images.

**Window Security Thread**  
The red to green colour shifting thread comes to the surface of the back on the banknote at regular intervals and the text 'BOB 100' can be read. The thread appears as a continuous line when held up to the light.





Banknote Feature	Detail for Proper Identification of Genuine Banknotes
Paper feel	Genuine banknote paper has a general rough feel and does not have a smooth surface.
Paper colour	The colours of a counterfeit banknote invariably do not exactly match those of the genuine banknotes. It is, therefore, important to closely pay attention to the colours of the various banknote denominations.
Holographic stripe	The holographic stripe on the high denomination banknotes (P200, P100 and P50) has switching images thereon; the public is encouraged to tilt the banknote, at various angles, to ascertain if indeed they can observe the switching images within one area of the holographic stripe of a particular banknote. Switching images of a zebra's head and the numeral 200 can be observed on the P200; those of a diamond and the numeral 100 on the P100; and those of a king fisher and the numeral 50 on the P50 banknote.
Serial numbers	Unlike in the old series banknotes where the serial numbers of each denomination had a different letter prefix, in the current circulating banknotes, the serial numbers start with a two letter prefix ranging from "AA" to "ZZ" followed by a seven digit serial number. The public should, therefore, expect to see banknotes starting with prefixes "AA", "AB", "AC", "AD" to "ZZ". The Bank has already issued into circulation some banknotes with serial numbers starting with prefixes "AA", "AB" and "ZZ". Banknotes with these serial numbers are genuine, provided all the other security features are present.
Other tips	(a) always examine each banknote closely upon receipt; (b) do not receive banknotes in dark or poorly lit places; (c) examine banknotes individually when received in a bundle; and (d) pay close attention to worn out or soiled banknotes.



# KNOW YOUR MONEY

**Portrait**  
Motswana Lady Teacher and Pupils - Nurturing our future.



**Enhanced Intaglio**

A raised print effect can be felt by rubbing a finger over the printing.

**Watermark**

Shows the rampant zebra together with the value numeral.

**Blind Recognition Feature**

Five purple dots appear on the front right hand edge of the banknote.

**Micro Lettering**

The letters 'BOB' can be read under very strong magnification.

**Holographic Stripe**

Holographic stripe shows coat of arms and switching 200 and zebra head images.

**Back Image**  
Shows zebras at a waterhole



**Windowed Security Thread**

The red to green colour shifting thread comes to the surface on the back on the banknote at regular intervals and the text 'BOB 200' can be read. The thread appears as a continuous line when held up to the light.



**Look for security features on all notes**