3.5 Monetary developments

Lower growth in banking sector assets
Annual growth in banking sector assets decreased from 6.5 percent in January 2018 to 4 percent in February 2018 (Chart 3.5). This was partly due to a decrease in the Bank of Botswana’s net foreign assets and the growth of balances due from foreign banks.

Credit growth remains cautious
Annual growth in commercial banks’ credit remained the same (4.9 percent) in January 2018 as in the previous month (Chart 3.5). This was reflected by stable growth in lending to the business sector (mainly due to the steady growth in credit extended to resident businesses) and a negligible decrease of 0.1 percent in growth in lending to households.

Bank Rate unchanged
At the August 2017 MPC meeting, the Bank Rate was maintained at 5.5 percent on account of a positive inflation forecast, an outlook, which is consistent with the Bank’s medium-term inflation objectives, demand pressures and the modest increase in foreign prices. The policy stance was also assessed to be supportive of economic activity.
VISION

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

MISSION

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

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

1.1 Purpose of the report
The Monetary Policy Report (MPR) is the main medium through which the Bank of Botswana (the Bank) informs the public about the conduct of monetary policy on a regular or timely basis. It serves to meet the public’s expectation of a transparent and accountable central bank in fulfilling the monetary policy mandate set out in the Bank of Botswana Act (Cap 55:01).

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

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

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

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

1.3 Decision-making process
Monetary policy is implemented in line with the decisions of the MPC. The Committee comprises: the Governor (Chairman); Deputy Governors; the Chief Operating Officer; Director and Deputy Directors of the Research and Financial Stability Department responsible for monetary policy and financial stability; Director and Deputy Director of the Financial Markets Department responsible for the domestic market operations; and Director of the Banking Supervision Department. The MPC holds six pre-scheduled meetings per year, at which the monetary policy stance is determined. However, the Committee can meet more often if need be. Prior to the commencement of the year, the dates for the MPC meetings for the ensuing year are announced.
1.4 **Announcement of the monetary policy decision**

The monetary policy decision is announced through a Press Release shortly after each MPC meeting. The Press Release informs the public of the Committee’s decision regarding the Bank Rate and the reasons for the policy choice. The Governor holds a Press Briefing to allow for interaction with members of the media and to promote understanding of the Bank’s economic analysis and policy stance.

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

In 2020, monetary policy is being implemented in the context of prospects for low inflation in the medium-term, associated with subdued domestic demand resulting from the adverse effects of the COVID-19 disease containment measures. This has throttled both domestic and external economic activity. The restrained increase in personal incomes and expected modest increase in foreign prices also contribute to the projected low inflation. Overall, the current state of the economy and the outlook for both domestic and external economic activity provide scope for maintenance of an accommodative monetary policy to support economic activity. Thus, the Bank Rate was maintained at 4.25 percent at the August 2020 MPC meeting.

The risks to the inflation outlook remain skewed to the downside, reflective of weak domestic and global economic activity, which could be exacerbated by periodic lockdowns due to prolonged COVID-19 infections, and the possible decline in international commodity prices. These risks are moderated by the potential increase in international commodity prices beyond current forecasts, aggressive action by governments and major central banks to bolster demand, as well as the anticipated supply constraints due to travel restrictions and lockdowns, though abating.

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 ensure price stability without undermining economic activity.

Headline inflation averaged 1.9 percent in the second quarter of 2020, lower than the average of 2.6 percent in the second quarter of 2019, accounted for by the decrease in domestic fuel prices in April and June 2020. Inflation is forecast to remain below the lower bound of the Bank’s 3 - 6 percent medium term objective range in the short term, mainly due to the reduction of domestic fuel prices and the disinflationary pressures anticipated from the adverse impact of the COVID-19 pandemic. However, inflation is expected to revert to within the objective range in the third quarter of 2021, influenced by the accommodative policy stance; the stimulus to activity derived from government economic recovery and transformation plan; the likely increase in international commodity prices; the expected upward adjustment in electricity tariffs; as well as base effects associated with decrease in fuel prices in 2020.

Gross Domestic Product (GDP) grew by 2.6 percent in the twelve months to March 2020, compared to a faster expansion of 4.5 percent in the year to March 2019, mainly attributable to a contraction in output for the mining sector and a deceleration in the non-mining activity. Output for 2020 is projected to contract by 8.9 percent (MFED projections) mainly due to the negative impact of the COVID-19 pandemic. However, the prevailing accommodative monetary conditions, reforms to further improve the business environment and government interventions against COVID-19, including the economic recovery and transformation plan, would generally be positive for economic activity in the medium term.

Commercial bank credit increased by 6.4 percent in June 2020, albeit lower than 6.5 percent in the corresponding period in 2019, reflecting in part, the availability of bank funding/liquidity, as well as increased demand for household loans, particularly unsecured lending and vehicle loans, influenced by the increase in public service salaries in 2019. However, the increase was lower than the annual increase of 10.7 percent recorded in March 2020. Lending to the business sector declined as a result of loan repayments by some companies in the manufacturing sector.

Foreign exchange reserves amounted to P63.6 billion at the end of June 2020, a decrease of 11.4 percent from P71.8 billion in June 2019. The decrease was a manifestation of the balance of payment (BoP) deficit, given the subdued exports compared to higher growth rates for imports and government spending.
obligations. The current account of the balance of payments recorded a deficit of P7.2 billion in the second quarter of 2020, compared to a revised deficit of P219 million during the same period in 2019.

The nominal effective exchange rate (NEER) of the Pula depreciated by 1.1 percent in the twelve months to July 2020, consistent with the transition from an annual upward rate of crawl of 0.3 percent implemented in 2019 to an annual downward rate of crawl of 1.51 percent and 2.87 percent implemented effective January 2020 and May 2020, respectively. The Pula appreciated by 10.3 percent against the South African rand but depreciated by 9.5 percent against the Special Drawing Rights (SDR) in the twelve months to July 2020. In the year to June 2020, the real effective exchange rate (REER) depreciated by 1.3 percent because of lower inflation in Botswana than in trading partner countries, as well as the downward rate of crawl being implemented.

Global economic output grew by 2.9 percent in 2019, lower than the 3.6 percent for 2018. The negative impact of the COVID-19 containment measures continued into the second quarter of 2020 globally. The United States of America (US) GDP contracted further by 32.9 percent in the second quarter of 2020 from a contraction of 5 percent in the first quarter, due to negative contributions from personal consumption expenditures, particularly services. Similarly, growth in the euro area contracted by 12.1 percent in the second quarter of 2020, steeper than the 3.6 percent contraction in the first quarter. GDP in the United Kingdom (UK) contracted by 20.4 percent in the second quarter of 2020, reflecting the decline in the services, production and construction industries, following a decline of 2.2 percent in the previous quarter. Economic activity softened in the emerging market economies due to weaker external and domestic demand, tighter financial conditions and low commodity prices. Meanwhile, in South Africa, output contracted by 2 percent in the first quarter of 2020.

The global economic outlook was revised further downwards in the June 2020 World Economic Outlook (WEO) Update, on account of the ongoing unprecedented exogenous shock caused by the COVID-19 pandemic. The virus has spread to more than 200 countries around the world, having more negative impact on social and economic activity in the first half of 2020 than was originally anticipated, and the recovery is projected to be more gradual than previously forecast. The June 2020 WEO Update forecasts the global economy to contract by 4.9 percent in 2020 (1.9 percentage points lower than the April 2020 forecast), before rebounding to a growth of 5.4 percent in 2021 as economic activity normalises, buoyed by policy support.

The global rough diamond price index decreased in the second quarter of 2020 against the backdrop of deteriorating demand by manufacturers resulting from the travel restrictions and social distancing measures. In the second quarter of 2020, international oil (Brent crude and OPEC) prices decreased, considerably, to average slightly above USD25 per barrel, influenced by excess supply, against sluggish demand. Meanwhile, the United Nations’ Food and Agriculture Organisation (FAO) food price index decreased in the second quarter of 2020, as prices of sugar, dairy and meat fell.
3. **RECENT ECONOMIC DEVELOPMENTS**

3.1 **Inflation environment**

**Headline inflation decreased in the second quarter of 2020**

Headline inflation averaged 1.9 percent in the second quarter of 2020 and was lower than the 2.6 percent average inflation in the second quarter of 2019 (Chart 3.1), accounted for by the decrease in domestic fuel prices effected in April and June 2020. The adjustments are estimated to have reduced inflation by approximately 1.78 percentage points in the second quarter. Headline inflation was constant between June and July 2020 at 0.9 percent (Table 3.1), and, therefore, lower than the Bank’s medium-term objective range of 3 – 6 percent.

**Inflation excluding administered prices and inflation excluding food and fuel increased, while trimmed mean decreased in the second quarter of 2020**

The trimmed mean inflation (CPITM) decreased to 1.5 percent in the second quarter of 2020, from 2.6 percent in the second quarter of 2019, while inflation excluding administered prices (CPIXA) averaged 2.7 percent compared to 1.9 percent in the same period due to the increase in prices for food and non-alcoholic beverages (Table 3.1). Inflation excluding food and fuel (CPIXFF) averaged 2.9 percent in the second quarter of 2020, higher than the 1.5 percent in the corresponding quarter of 2019, attributable to the upward adjustment of electricity tariffs in April 2020 by 22 percent (Table 3.1). In July 2020, CPITM, CPIXA and CPIXFF were 1 percent, 2.8 percent and 2.7 percent, respectively.
Box 1: Administered Prices

Administered price items in the CPI basket are goods or services for which prices are set or controlled by the Government outside the normal free market price determination. These price adjustments are however, to some degree, influenced by general price developments. For example, cost adjustments in some administered prices are often justified as a way of catching up with market prices, a response to higher input costs and a move towards cost recovery. However, monetary policy does not have any direct influence on these price changes and would therefore, not trigger a direct policy response. Policy may, nevertheless, respond to the resultant second round effects as free market prices also react.

There are currently 51 administered items (12.8 percent) out of the 400 items in the Botswana CPI basket, accounting for a significant weight of 32.3 percent (Table 3.2). Changes in the prices of these items, therefore, have a significant influence on inflation and inflation expectations. For this reason, the Bank monitors and calculates the prospective and actual impact of the changes in administered prices on inflation, with a view to inform the forward-looking monetary policy framework of the Bank.
<table>
<thead>
<tr>
<th>Item code</th>
<th>Administered prices</th>
<th>Weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>147</td>
<td>Monthly rent BHC House Type LC48</td>
<td>0.294</td>
</tr>
<tr>
<td>148</td>
<td>Monthly rent BHC Type 2 “Improved”</td>
<td>0.379</td>
</tr>
<tr>
<td>161</td>
<td>Water: 10kls per month</td>
<td>1.168</td>
</tr>
<tr>
<td>162</td>
<td>Water: 20kls per month</td>
<td>0.779</td>
</tr>
<tr>
<td>164</td>
<td>Electricity: 100kwh per month</td>
<td>2.143</td>
</tr>
<tr>
<td>165</td>
<td>Electricity: 500kwh per month</td>
<td>1.428</td>
</tr>
<tr>
<td>167</td>
<td>Paraffin per litre</td>
<td>0.064</td>
</tr>
<tr>
<td>237</td>
<td>Consultation with Government doctor</td>
<td>0.168</td>
</tr>
<tr>
<td>247</td>
<td>Rate to stay in a public hospital for 24 hours in a private ward (bed only)</td>
<td>0.799</td>
</tr>
<tr>
<td>261</td>
<td>Petrol per litre (95)</td>
<td>6.262</td>
</tr>
<tr>
<td>262</td>
<td>Diesel per litre (50ppm)</td>
<td>3.708</td>
</tr>
<tr>
<td>270</td>
<td>Road worthiness test</td>
<td>0.022</td>
</tr>
<tr>
<td>271</td>
<td>Bus fare, single, Gaborone: Mochudi</td>
<td>0.706</td>
</tr>
<tr>
<td>272</td>
<td>Minibus fare, Gaborone: Johannesburg</td>
<td>0.631</td>
</tr>
<tr>
<td>273</td>
<td>Taxi fare (not “special”)</td>
<td>0.794</td>
</tr>
<tr>
<td>274</td>
<td>Bus fare, single, Gaborone: Francistown</td>
<td>0.653</td>
</tr>
<tr>
<td>275</td>
<td>Minibus fare, within cities/towns/villages</td>
<td>0.913</td>
</tr>
<tr>
<td>278</td>
<td>Railway passenger’s fee</td>
<td>0.089</td>
</tr>
<tr>
<td>282</td>
<td>Local standard letter tariff rate</td>
<td>0.013</td>
</tr>
<tr>
<td>283</td>
<td>Air parcel to Europe (0.5 kg)</td>
<td>0.009</td>
</tr>
<tr>
<td>284</td>
<td>Rental of post office box</td>
<td>0.149</td>
</tr>
<tr>
<td>285</td>
<td>Standard letter (weight/size 120x235mm): air</td>
<td>0.021</td>
</tr>
<tr>
<td>291</td>
<td>Telephone installation</td>
<td>0.003</td>
</tr>
<tr>
<td>292</td>
<td>Telephone charges/rate between zones (per second charge)</td>
<td>0.004</td>
</tr>
<tr>
<td>293</td>
<td>Telephone charges/rate within zone (per second charge)</td>
<td>0.004</td>
</tr>
<tr>
<td>294</td>
<td>Telephone rate international (per second charge)</td>
<td>0.004</td>
</tr>
<tr>
<td>295</td>
<td>Telephone charges/rate to mobile (all mobiles)</td>
<td>0.005</td>
</tr>
<tr>
<td>296</td>
<td>Mascom charges/rate to all network (peak hour per minute charge)</td>
<td>0.697</td>
</tr>
<tr>
<td>297</td>
<td>Mascom charges/rate to all network (off/off - off peak hour per minute charge)</td>
<td>0.557</td>
</tr>
<tr>
<td>298</td>
<td>Orange charges/rate to all network (peak hour per minute charge)</td>
<td>0.697</td>
</tr>
<tr>
<td>299</td>
<td>Orange charges/rate to all network (off/off - off peak hour per minute charge)</td>
<td>0.557</td>
</tr>
<tr>
<td>300</td>
<td>Bmobile charges/rate to all network (peak hour per minute charge)</td>
<td>0.697</td>
</tr>
<tr>
<td>301</td>
<td>Bmobile charges/rate to all network (off/off - off peak hour per minute charge)</td>
<td>0.557</td>
</tr>
<tr>
<td>302</td>
<td>Mobile charge international charge (Orange + Mascom + Bmobile)</td>
<td>0.557</td>
</tr>
<tr>
<td>303</td>
<td>Prepaid phone card: short message service (SMS)</td>
<td>0.418</td>
</tr>
<tr>
<td>305</td>
<td>Mobile data pass (1GB; 1month)</td>
<td>0.836</td>
</tr>
<tr>
<td>328</td>
<td>Admission to premier league football match: uncovered stands</td>
<td>0.007</td>
</tr>
<tr>
<td>338</td>
<td>Kutfwano magazine</td>
<td>0.003</td>
</tr>
<tr>
<td>351</td>
<td>Senior Secondary School fees (public)</td>
<td>0.434</td>
</tr>
<tr>
<td>352</td>
<td>Junior Secondary School fees (public)</td>
<td>0.650</td>
</tr>
<tr>
<td>354</td>
<td>College and university fees (BA Social Science)</td>
<td>0.285</td>
</tr>
<tr>
<td>383</td>
<td>Employee contribution to medical aid: standard benefit, 1, salary (600+)</td>
<td>1.550</td>
</tr>
<tr>
<td>384</td>
<td>Employee contribution to medical aid: high benefit, 1, salary (5000 - 8000)</td>
<td>1.250</td>
</tr>
<tr>
<td>385</td>
<td>Fully comp. insurance: Toyota Corolla 1.3</td>
<td>0.791</td>
</tr>
<tr>
<td>388</td>
<td>Levy + loan (P3500) interest on Self Help Housing Agency plot</td>
<td>0.060</td>
</tr>
<tr>
<td>390</td>
<td>Driver’s license charge</td>
<td>0.025</td>
</tr>
<tr>
<td>391</td>
<td>Annual road tax: Hilux 2.0 pick-up</td>
<td>0.138</td>
</tr>
<tr>
<td>392</td>
<td>Annual road tax: Toyota Corolla 1.4</td>
<td>0.113</td>
</tr>
<tr>
<td>393</td>
<td>Fee for the issue of a passport</td>
<td>0.053</td>
</tr>
<tr>
<td>394</td>
<td>Council rates to house + plot valued at P200,000</td>
<td>0.091</td>
</tr>
<tr>
<td>397</td>
<td>Advertisement (20 words, Botswana Daily News newspaper)</td>
<td>0.025</td>
</tr>
<tr>
<td><strong>Total weight</strong></td>
<td></td>
<td><strong>32.259</strong></td>
</tr>
</tbody>
</table>
3.2 Recent domestic economic developments

GDP growth decelerates in the first quarter of 2020

Real GDP grew by 2.6 percent in the twelve months to March 2020, compared to a faster expansion of 4.5 percent in the year to March 2019 (Chart 3.3 and Table 3.3). The lower increase in output is attributable to the contraction in mining output and deceleration in output growth of the non-mining sector. Mining output contracted by 6.1 percent compared to a growth of 5.5 percent in the corresponding period ending March 2019, mainly due to weaker performance of the diamond, soda ash, copper and coal subsectors. In the twelve months period to March 2020, overall global demand for rough diamonds was adversely affected by the trade tension between the US and China, as well as mass protests in Hong Kong. Copper output contracted by 100 percent following cessation of production at the Mowana Mine in November 2018. Coal output decreased due to lower demand at Morupule B power station, which was operating below capacity, with one of the units placed under care and maintenance in the third quarter of 2019.

Non-mining GDP grew by 3.6 percent in the year to March 2020 compared to 4.3 percent in the corresponding period in 2019. The lower growth in non-mining GDP was mainly due to a deceleration in output growth of the trade, hotels and restaurants\(^1\), transport and communications, construction and manufacturing sectors. However, acceleration in growth of the finance and business services (6.1 percent) and general government (3.9 percent) sectors boosted overall growth of the non-mining sectors.

Meanwhile, Statistics Botswana reported that real GDP grew by 2.6 percent in the first quarter of 2020, from 4.2 percent in the first quarter of 2019\(^2\). A quarter-on-quarter comparison indicates that output in the first quarter of 2020 decreased by 0.9 percent compared to growth of 1.7 percent registered in the fourth quarter of 2019.

\(^1\) This sector also includes tourism.

\(^2\) Statistics Botswana calculates annual GDP growth for a given quarter on the basis of quarterly output in that period compared to the output for the corresponding quarter in the previous year.
Table 3.3: Real GDP Growth by Sector and Expenditure (Percent)

<table>
<thead>
<tr>
<th></th>
<th>2019 Q1</th>
<th>2019 Q4</th>
<th>2020 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total GDP</strong></td>
<td>4.5</td>
<td>3.0</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>By Sector</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mining</td>
<td>5.5</td>
<td>-3.9</td>
<td>-6.1</td>
</tr>
<tr>
<td>Non-Mining</td>
<td>4.3</td>
<td>3.8</td>
<td>3.6</td>
</tr>
<tr>
<td>Agriculture</td>
<td>2.6</td>
<td>-0.1</td>
<td>-0.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3.1</td>
<td>2.8</td>
<td>2.9</td>
</tr>
<tr>
<td>Water and Electricity</td>
<td>4.2</td>
<td>-6.3</td>
<td>8.5</td>
</tr>
<tr>
<td>Construction</td>
<td>3.5</td>
<td>3.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Trade, Hotels and Restaurants</td>
<td>5.4</td>
<td>4.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>6.2</td>
<td>5.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Finance and Business Services</td>
<td>5.1</td>
<td>5.9</td>
<td>6.1</td>
</tr>
<tr>
<td>General Government</td>
<td>3.6</td>
<td>3.7</td>
<td>3.9</td>
</tr>
<tr>
<td>Social and Personal Services</td>
<td>3.7</td>
<td>3.0</td>
<td>2.7</td>
</tr>
<tr>
<td><strong>By Expenditure</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government Final Consumption</td>
<td>3.0</td>
<td>3.3 (2.8)</td>
<td>4.1</td>
</tr>
<tr>
<td>Household Final Consumption</td>
<td>2.9</td>
<td>3.5 (3.1)</td>
<td>3.9</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>7.7</td>
<td>6.5 (6.8)</td>
<td>6.6</td>
</tr>
<tr>
<td>Exports</td>
<td>12.1</td>
<td>-16.6</td>
<td>-20.5</td>
</tr>
<tr>
<td>Imports</td>
<td>12.3</td>
<td>6.7</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: Statistics Botswana and Bank of Botswana calculations
Note: The figures in italics are revisions of the figures in brackets, previously reported in the 2019 Q4 estimates.

Diamond production decreased in the second quarter of 2020

Debezwana produced 1.8 million carats of diamonds in the second quarter of 2020, 68.1 percent lower than the 5.7 million carats produced in the corresponding period in 2019, due to lower production at Orapa and Jwaneng mines. Production at Orapa and Jwaneng mines decreased by 72.5 percent and 64.7 percent, respectively, in the review period. The overall significant decline in production was mainly due to a nation-wide lockdown and the implementation of COVID-19 containment measures to safeguard the workforce. Similar containment measures in the buyer countries and the resultant limited midstream diamond cutting and polishing capacity, particularly in India, adversely affected the demand for rough diamonds.

Production by Lucara Diamond Corporation (Karowe Mine) decreased by 7.4 percent to 101,203 carats in the second quarter of 2020, from 109,312 carats in the corresponding period in 2019. The mine continued operations throughout the COVID-19 pandemic period, hence the decrease in production is mainly attributable to lower recovery of smaller-sized diamonds and the absence of re-processing of tailings in the period under review. A total of 201 special stones (single diamonds larger than 10.8 carats) were recovered in the second quarter of 2020, including 9 diamonds greater than 100 carats. Special stones accounted for 6.4 percent of total carats recovered during the period. With respect to quarterly performance, production for the second quarter of 2020 increased by 10.6 percent from 91 536 carats in the first quarter of 2020. For 2020 as a whole, production outlook for Lucara remains highly uncertain due to COVID-19 restrictions.

Budget deficit recorded in the third quarter of the 2019/20 fiscal year

The Government budget deficit was P4.1 billion in the third quarter of the 2019/20 fiscal year (Table 3.4). The deficit was largely attributable to the less-than-anticipated revenue and grants, resulting from lower mineral revenue than was projected. Total revenues and grants were P11.8 billion in the third quarter of the 2019/20 fiscal year, compared to P15.2 billion anticipated in the revised budget for the year, assuming equal quarterly distribution. Total government expenditure and net lending was P16 billion, slightly lower than the anticipated P17.2 billion.

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3 Orapa output constitutes production from the cluster of Orapa, Damtshaa and Letlhakane mines.

4 Lucara’s production for the second quarter of 2020 accounts for a very small proportion of total global production and a significant part of the value of the Company’s production is mainly attributable to large and higher-quality diamonds from Karowe Mine.
Table 3.4: Quarterly Budget Outturns (P Million)

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<tr>
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<th>Total Revenues and Grants</th>
<th>Total Expenditure and Net Lending</th>
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</table>

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

3.3 Monetary developments

Growth in banking sector assets increased in June 2020

Annual growth in banking sector assets increased from 9.4 percent in June 2019 to 9.7 percent in June 2020 (Chart 3.4). This was due to the increase in holding of Bank of Botswana certificates, debt certificates and the overall increase in loans and advances (although lower than the March 2020 increase), which accounted for the largest proportion of commercial banks’ assets (62 percent), as well as growth in balances due from domestic banks.

Credit growth decreased in June 2020

Commercial bank credit slightly decelerated to 6.4 percent in June 2020, from 6.5 percent in the corresponding period in 2019 (Chart 3.5). The growth in commercial bank credit is, in part, indicative of the availability of bank funding/liquidity, associated with growth in customer deposits, which enabled banks to meet the rise in demand for credit. However, the growth in credit was subdued in comparison to the 10.7 percent recorded in March 2020, partly reflective of the effects of COVID-19 on the demand for loans as the economy was on lockdown during that time. Household loans increased by 10.1 percent in the twelve months to June 2020, compared to 9.7 percent in the corresponding period in 2019, particularly unsecured lending (accessed through scheme loan arrangements) and motor vehicle loans. The increase in household credit was, however, lower than the 15.1 percent recorded in March 2020.

Annual growth in lending to the business sector declined from 1.7 percent in June 2019 to 0.6 percent in the corresponding period in 2020. However, this was still higher than the 2.6 percent contraction in October 2019. The decrease was a result of repayments of some credit facilities; write-offs; decreased utilisation of overdraft facilities by companies in the manufacturing, transport and communications, agriculture, construction, as well as electricity and water sectors. Year-on-year credit to businesses excluding parastatals contracted by 1.6 percent in June 2020 compared to a decrease of 2.8 percent in the corresponding period in 2019. Meanwhile, utilisation of credit facilities by parastatals increased in the year to June 2020, owing to the uptake of loans in March 2020.
Growth in money supply increased in June 2020
Annual growth in money supply (M2) increased to 7.7 percent in June 2020, albeit lower than the 11.9 percent in the corresponding period in 2019 (Chart 3.6). The year-on-year increase in money supply in June 2020 reflects the expansionary effect of the decrease in net foreign assets (by 8.4 percent) and the increase in credit to the private and parastatal sectors (by 7 percent), as well as the decline in government deposits at Bank of Botswana (by 34.6 percent) to fund government operations.

Moody’s downgrades Botswana’s outlook from stable to negative
Following an out-of-calendar review in May 2020, Moody’s Investors Service affirmed Botswana’s rating of ‘A2’ for long-term bonds denominated in both domestic and foreign currency, but revised the outlook from stable to negative. This follows an earlier affirmation of both the credit rating and stable outlook in March 2020. The revision of the outlook reflects the increasing risks of lower growth, larger budget deficits and likely resultant increase in government borrowing. The outlook could be changed to stable if the observed deterioration of the fiscal sector caused by COVID-19 stabilises. The affirmation of the rating at ‘A2’ was underpinned by strong, albeit deteriorating fiscal and external buffers, in particular, relatively low public debt level, high debt affordability, as well as fiscal and external liquidity buffers that help in mitigating the impact of COVID-19.

S&P Global Ratings downgraded Botswana’s sovereign credit rating
Earlier in March 2020, S&P Global Ratings (S&P) had downgraded Botswana’s sovereign credit rating for long-term foreign and domestic currency bonds from “A-” to “BBB+”, and retained “A-2” for short-term foreign and domestic currency bonds. The stable economic outlook was maintained. S&P observed that the ratings were undermined by the prolonged weakening of the external market for diamonds, pressures on expenditure due to the increase in public sector wages for financial years 2019/20 and 2020/21, and the resultant expected gradual decline of the country’s strong fiscal and external buffers in the near to medium term. The stable outlook was premised on maintenance of relatively low external debt compared to external assets. The review acknowledged the robust institutional frameworks that foster fiscal prudence and low government debt, and monetary policy framework that support macroeconomic stability.

The nominal BoBC stop-out yields decreased in the second quarter of 2020 in response to the April 2020 Bank Rate reduction
The 3-month BoBC stop-out yield decreased from an average of 1.72 percent in the second quarter of 2019 to 1.21 percent in the corresponding period in 2020. Meanwhile, the real interest rate for the 3-month BoBC increased from -0.89 percent in the second quarter of 2019 to -0.71 percent in the corresponding period in 2020, reflecting the larger decrease in inflation rate compared to the decline in nominal interest rate in the same period. The 7-day BoBC stop-out yield decreased from an average of 1.45 percent in the first quarter of 2020 to 1.16 percent in the second quarter, while the real rate decreased from -0.67 percent to -0.71 percent in the same period.

The stop-out yield for the 7-day BoBC increased slightly from 1.01 percent in June 2020 to 1.02 percent in July. However, the 3-month BoBC stop-out yield decreased from 1.06 percent to 1.04 percent in the same period. The real rate of interest for the 7-day BoBC increased from 0.11 percent in June 2020 to 0.12 percent in July 2020, reflecting slightly higher nominal yields and the constant inflation rate while the real 3-month BoBC yield decreased from 0.16 percent to 0.14 percent in the same period as nominal yield declined. Box 2 highlights reforms to monetary operations.

5 The review was prompted by the risks associated with COVID-19 shocks, given Botswana’s strong dependency on the diamond industry for growth, exports and budget revenues.
Box 2: Reforms to Monetary Operations Framework and Response to Market Liquidity under COVID-19 Pandemic – April 2020

The Bank evaluates money market liquidity conditions and monetary policy implementation framework on a regular basis for effectiveness, and introduces refinements where necessary. In addition to reducing the Primary Reserve Requirement (PRR) from 5 percent to 2.5 percent, the Bank introduced the following measures to alleviate the impact of COVID-19 on market liquidity: repo facilities hitherto available only on an overnight basis are offered against eligible securities with maturity of up to 92 days; and subject to completing regulations and arrangements relating to valuation (haircuts) and custody, the collateral pool for borrowing by licensed commercial banks from the Bank of Botswana will be extended to include all corporate bonds listed and traded on the Botswana Stock Exchange.

Moreover, since the introduction of the Primary Reserve Requirement Averaging (PRRA) in 2019, most commercial banks actively use it as a tool for effective management of liquidity and the Bank envisages that this will over time lead to reduced demand for excess reserves held by commercial banks for precautionary purposes, thus freeing up additional resources for productive lending. In addition, as expected, the introduction of both the 7-day BoBC and PRRA in 2019 has improved liquidity management by both the Bank and the commercial banks.

The Bank is in the process of making further reforms to the monetary operations framework with a view to strengthening the monetary policy transmission mechanism. In particular, it is expected that after final decisions have been made, changes to the policy rate and establishing a more effective interest rate corridor to support development of the interbank market will be considered for implementation during the course of 2021.
3.4 Asset markets

Property market remains weak in the first quarter of 2020

According to the latest Riberry Report, the residential rental market weakened in the first quarter of 2020, compared to the fourth quarter of 2019 due to weaker demand for the upper and middle-end properties. However, the rental market enjoyed good demand and supply for properties in the lower-end. Meanwhile, the average price for residential properties sold in the first quarter of 2020 decreased by 1.6 percent to P802 379, compared to the previous quarter (Chart 3.7), reflecting the lower value of properties traded in the quarter under review. Looking ahead, the demand for lower-end, medium and prime located residential housing, is expected to improve given the relative affordability of properties in these categories relative to those in the upper-end market.

The market for office space remains weak due to increasing supply from completed construction developments, such as the Botswana Unified Revenue Service building at the Gaborone Central Business District (CBD). Despite the general weak demand for office space, there was reasonable take-up of office space at the CBD by Government, a major consumer, as well as by some corporates. However, as reported in the Riberry Report, this could change, more so that Botswana Government does not intend to acquire new office space in the short term. For office locations away from the CBD, such as the Gaborone International Finance Park and Gaborone International Commerce Parks, there is less demand, while some existing tenants are relocating from there to the CBD, which is considered more convenient. Going forward, the supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the CBD, such as by the Botswana Housing and Water Utilities Corporations. These will exert downward pressure on rentals, especially in the decentralised office locations.

Similar to the previous quarter, the demand for retail space remains fair across all market segments, while the supply of retail space is expected to rise due to the proposed major shopping centres in the CBD and Mogoditshane. In addition, other centres with good demand for retail space are Maun, Francistown, Mahalapye and Palapye. With regard to industrial property, the supply of unoccupied bigger warehouse space has decreased, while the demand has improved. Meanwhile, the availability for prime location industrial space is expected to decrease going forward, given that most of the centrally located industrial land is almost fully developed and occupied.

Stock market index declines

The Domestic Companies Index (DCI) declined further by 6.5 percent in the twelve months to July 2020 following a reduction of 8.9 percent in the year to July 2019 (Chart 3.8). The decline was mainly due to the lower share prices for Letshego, Stanchart and Seedco, which fell by 55.6 percent, 17.4 percent and 12.7 percent, respectively, in the same period.

According to Stockbrokers Botswana, the continuous decline in the DCI was reflective of the low trading activity and liquidity, as well as sluggish corporate earnings due to the restrained economic environment.

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

7 Prime rentals are about P100/m². 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/m², while prime industrial areas like Gaborone International Commerce Park cost P65/m².

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

9 Stockbrokers Botswana is a brokerage firm registered and licensed with the Botswana Stock Exchange Limited.
The Foreign Companies Index (FCI) declined by 0.9 percent in the year to July 2020, compared to a 0.3 percent decrease in the corresponding period ending in July 2019 (Chart 3.8). This was largely attributed to the year-on-year fall in the share price for Tlou (-60 percent), Lucara (-49.7 percent) and Minergy (-19 percent), on account of low trading activity and liquidity.

The third and fourth diamond sales cycles for 2020, that were scheduled for March and May, were cancelled due to the pandemic related restrictions. The other commodities that contributed to a decrease in exports include vehicles and transport equipment, salt and soda ash, meat and meat products and textiles, which fell by 94.6 percent, 83.7 percent, 81 percent and 72.1 percent, respectively. In addition to diamond imports, other commodities that contributed to a decrease in imports are metal and metal products, and vehicles and transport equipment that fell by 75.6 percent and 74 percent, respectively.

The negative balance in the income account resulted from the payments of investment income to foreign investors, mainly by the mining sector, which paid out about P2.9 billion in the second quarter of 2020.

The financial account registered an estimated net outflow of P4.9 billion during the second quarter of 2020 compared to a revised net outflow of P488 million in the second quarter of 2019. The outflow was mainly attributable to an increase in offshore investments, particularly by pension funds.

The Balance of Payments in deficit in June 2020
The overall BoP was in deficit of P16.3 billion for the twelve months to June 2020, compared to a deficit of P5.4 billion in the twelve months to June 2019.
Foreign exchange reserves decrease

As at the end of June 2020, foreign exchange reserves amounted to P63.6 billion, a decrease of 11.4 percent from P71.8 billion in June 2019 (Chart 3.10). The decrease was a manifestation of the BoP deficit, given the subdued exports compared to higher growth rates for imports and government spending obligations.

In foreign currency terms, the level of reserves decreased by 20.6 percent from USD6.8 billion in June 2019 to USD5.4 billion in June 2020 (Chart 3.11). The reserves also decreased by 20.4 percent from SDR4.9 billion to SDR3.9 billion over the same period. The level of reserves as at the end of June 2020 was equivalent to 11.8 months of import cover of goods and services.

3.6 Exchange rate developments

For 2020, the Bank’s implementation of the exchange rate policy (Box 3) entails the Pula basket weights of 45 percent for the South African rand and 55 percent for the SDR, which were maintained from 2019 and a downward annual rate of 1.51 percent and 2.87 percent implemented effective January and May 2020, respectively.¹⁰ In the absence of an inflation threat, the downward crawl anchors competitiveness of the domestic industry and contributes to loosening of real monetary conditions; hence support economic activity.

Bilaterally, the Pula appreciated by 10.3 percent against the South African rand, but depreciated by 9.5 percent against the SDR in the twelve months to July 2020 (Chart 3.12). In relation to the SDR constituent currencies, the Pula depreciated by 13.8 percent against the British pound, 12.6 percent against the euro, 10.5 percent against the Japanese yen, 6.9 percent against the US dollar and 5.6 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 currencies. Notably, in the same review period, the South African rand depreciated by 17.9 percent against the SDR. With respect to the SDR constituent currencies, the South African rand depreciated by 21.8 percent against the British pound, 20.7 percent against the euro, 18.8 percent against the Japanese yen, 15.6 percent against the US dollar and 14.4 percent against the Chinese renminbi.

As global factors continue to weigh on investor sentiment, emerging market currencies, including the South African rand weakened, as investors fled to safe-haven assets such as the US dollar. The rand also depreciated due to increasing risk aversion on account of escalating tensions between China and the US, that may have implications on global trade and economic prospects.

The South African rand was also negatively impacted by worries over the surge in COVID-19

¹⁰ Effective May 2020, the Bank is implementing an annual downward rate of crawl of 2.87 percent. This is complementary to the reduction in the Bank Rate in April 2020 and contributes to further easing of real monetary conditions in the economy.
Infections amid loosened coronavirus restrictions and, therefore, reactivated investor concerns about the impact of the pandemic on the economy. Moreover, the South African Reserve Bank (SARB), while cutting interest rates by 25 basis points to a record low of 3.5 percent in July 2020, signalled that it may have reached the end of its easing cycle; thus weighing on the South African rand in terms of prospects for additional stimulus.

\[ \text{Chart 3.12: Nominal Exchange Rate Indices} \]

![Chart 3.12: Nominal Exchange Rate Indices](chart)

**Source:** Bank of Botswana

**NEER depreciated in July 2020**

The NEER of the Pula depreciated by 1.1 percent in the twelve months to July 2020 (Chart 3.13), consistent with the transition from an annual upward rate of crawl of 0.3 percent implemented in 2019 to annual downward rates of crawl of 1.51 percent and 2.87 percent implemented effective January and May 2020, respectively.

\[ \text{Chart 3.13: Nominal and Real Effective Exchange rates} \]

![Chart 3.13: Nominal and Real Effective Exchange rates](chart)

**Source:** Bank of Botswana

**REER depreciated in June 2020**

The REER depreciated by 1.3 percent in the twelve months to June 2020 (Chart 3.13), due to lower inflation in Botswana (0.9 percent) than in the trading partner countries (1.4 percent), as well as the downward rate of crawl being implemented. With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) appreciated by 8.9 percent against the South African rand but depreciated by 8.9 percent against the SDR. Regarding the SDR constituent currencies, the Pula depreciated by 9.7 percent against the US dollar, 9.2 percent against the Japanese yen, 8.7 percent against the Chinese renminbi, 8.2 percent against the euro and 6.8 percent against the British pound.
Box 3: Botswana’s Exchange Rate Framework

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

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

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

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

Global growth subdued
According to the June 2020 World Economic Outlook (WEO) Update, global output growth for 2019 is estimated at 2.9 percent, lower than the 3.6 percent estimate for 2018 (Table 3.5). Growth in the first half of 2020 was adversely affected by the outbreak and spread of COVID-19 and the resultant protection measures than earlier anticipated. These measures include travel restrictions, social distancing and lockdowns leading to curtailed supply and demand and therefore, resulting in business closures, with more severe adverse impact on air travel, tourism and manufacturing, globally. Thus, the global economy is projected to contract sharply by 4.9 percent in 2020, 1.9 percentage points larger than the April 2020 WEO forecast.

US economy enters a technical recession in the second quarter of 2020
In the US, output contracted further by 32.9 percent in the second quarter of 2020, compared to a contraction of 5 percent in the first quarter. The decline in economic activity reflects negative contributions from personal consumption expenditures, particularly services, such as health care, non-residential fixed investment, residential fixed investment, exports, predominantly travel services, private inventory investment as well as state and local government spending that were partly offset by positive contribution from federal government spending. The realised contraction was the largest in the recorded economic history of the US but was lower than the market expectation of a contraction of 34.1 percent and followed lockdown measures adopted in mid-March and April 2020 to contain the spread of COVID-19, thereby curtailing many people from participating in economic activities.

Euro area growth contracted further
In the euro area, economic growth contracted by 12.1 percent in the second quarter of 2020, steeper than the 3.6 percent contraction in the first quarter. All the major economies in the economic bloc contracted further as lockdowns imposed to contain the spread of the pandemic hit global demand and economic activity. Output growth in Spain, Italy, France and Germany shrank by 18.5 percent, 12.4 percent, 13.8 percent and 10.1 percent, respectively.

UK economy enters a technical recession in the second quarter of 2020
GDP in the UK contracted by 20.4 percent in the second quarter of 2020, following a decline of 2.2 percent in the first quarter of 2020. This marked the largest fall in the UK GDP since 1955 and reflects the ongoing public health restrictions and social distancing that have been put in place in response to the COVID-19 pandemic. The contraction reflects the fall in output from the services (-19.9 percent), construction (-35 percent) and production (-16.9 percent) sectors.

Emerging markets’ growth moderated
For emerging market economies, output growth softened, primarily due to weaker external and domestic demand. Moreover, tightening financial conditions, capital outflows and low commodity prices weighed on economic activity in emerging countries. China avoided a recession as the economy grew by 3.2 percent in the second quarter of 2020, from a contraction of 6.8 percent in the first quarter of 2020, as industrial production, a gauge of manufacturing, mining and utilities, rose by 4.8 percent, while retail sales of consumer goods fell by 1.8 percent, albeit better than the 2.8 percent decline in May 2020.

In India, GDP grew year-on-year by 3.1 percent in the first quarter of 2020, lower than the 4.7 percent expansion in the fourth quarter of 2019, the slowest growth since quarterly data became available in 2004, but beating market expectations of a 2.1 percent rise. Contraction in the manufacturing sector, faster decline for gross fixed capital formation and exports, private spending and inventories as well as the slowdown in construction, contributed to the overall slowdown of the economy.

South African economy in a recession
Regionally, output in South Africa contracted by 2 percent in the first quarter of 2020, following a contraction of 1.4 percent in the fourth quarter of 2020. This marked the third consecutive quarter of contraction, mainly because of the faltering foreign demand and disrupted global supply chains. Meanwhile, Moody’s credit rating agency downgraded South Africa to junk-status\[11\] Junk rating means that there is a bigger chance that the South African government would not be able to pay back its debts.
at its review meeting of March 2020, due to continuing deterioration in the fiscal strength and structurally weak growth, which are not expected to be effectively addressed by the existing policy actions.

Table 3.5: Growth Estimates and Projections

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Source: IMF WEO Update June 2020 and MFED for Botswana.
Note: EMDEs stands for emerging market and developing economies.

Global commodity prices

Diamond prices decreased in the second quarter of 2020

The global rough diamond price index decreased by 8 percent from 137.8 points in the first quarter of 2020 to 126.6 points in the second quarter of 2020 as the spread of the COVID-19 virus and counter-pandemic measures implemented around the globe severely disrupted trade of diamonds and suppressed manufacturers’ demand for rough diamonds. Moreover, the decline reflects the deteriorating consumer and investor sentiment, excess supply of smaller diamonds and underperformance in the Indian consumer market amid lockdown extensions in several provinces. Social unrest in Hong Kong protests as well as the China-India border tensions curtailed retail sales and exports of diamonds.

In July 2020, the global rough diamond price index averaged 126.1 points, unchanged from June 2020, as the spread of COVID-19 continued to weigh on global economic activity. Meanwhile, De Beers has launched an e-commerce site that provides registered buyers an alternative way of purchasing rough diamonds in addition to the company’s existing limited-time auctions, thus creating an opportunity for sales during the weak market. Customers would be able to buy 10 percent of De Beers’ rough diamonds immediately and at any time of the day, with the available goods ranging from very high end to low end items, with prices visible to customers at the point of purchase. Moreover, the company is allowing diamond viewings outside Botswana, with customers permitted to defer purchase of goods they have contracted to buy.

The global polished diamond price index decreased by 1 percent from 209.7 in the first quarter of 2020 to 207.7 in the second quarter of 2020. In July 2020, the global polished price index averaged 204.2 points, lower than the 208.3 points in June. The virus has had ripple effects on diamond supply chains due to the worldwide lockdown; thus, the prevailing weaker demand for diamond jewellery and liquidity constraints had an impact on sales of luxury goods, including diamond jewellery.

Oil prices decreased significantly in the second quarter of 2020

International oil prices (Brent crude and OPEC) averaged slightly above USD25 per barrel in the second quarter of 2020 (Chart 3.14). The OPEC reference crude oil basket price and the Brent crude decreased by 48.5 percent and 37.8 percent, from an average of USD51.68 per barrel and USD50.53 per barrel in the first quarter of 2020 to an average of USD26.63 per barrel and USD31.43 per barrel, respectively, in the second quarter of 2020. The price of the West Texas Intermediate (WTI) also decreased by 39.8 percent from an average of USD46.13 per barrel to an average of USD27.79 per barrel in the same period. International oil prices decreased as a result of excess supply and reduced demand for crude oil due to less mobility and containment measures against the COVID-19 pandemic.

International oil prices increased in July 2020, and were above USD40 per barrel. The OPEC reference crude oil basket averaged USD43.42

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12 WTI is a grade of crude oil used as a benchmark for oil pricing in the US.
per barrel, Brent crude averaged USD42.81, while the price of WTI averaged USD40.75 per barrel in July 2020. The increase in oil prices is, in part, due to the hopes of a success in finding a COVID-19 vaccine as positive results in vaccine trials outweighed concerns over a resurgence in virus cases.

**Chart 3.14: Oil Prices (monthly averages)**

Source: OPEC and US Energy Information

**Food prices decreased in the second quarter of 2020**

According to the United Nations’ Food and Agriculture Organisation (FAO), the global food price index averaged 92.3 points in the second quarter of 2020, a 2.2 percent decrease from an average of 94.4 points in the corresponding period in 2019. The decrease in prices was attributable to lower sugar, dairy and meat prices. Moreover, the continued negative economic effects of COVID-19 on consumption patterns and overall demand, as well as lower international oil prices resulted in lower food prices. The food price index averaged 94.2 points in July 2020, an increase of 1.2 percent from June 2020, but 1 percent lower than in the corresponding period last year (Chart 3.15). The increase in international food prices in July 2020 marked the second month-on-month increase since the beginning of the year, amid market uncertainty posed by COVID-19. The increase in food prices is mainly due to expansion in demand associated with relaxation of lockdowns in many countries.

**Chart 3.15: Food Price Index**

Source: Food and Agriculture Organisation

**Global inflation unchanged in 2019**

Global inflation was unchanged at 3.6 percent in 2018 and 2019 (Chart 3.16). For advanced economies, inflation decreased from 2 percent in 2018 to 1.4 percent in 2019. Conversely, inflation increased from 4.8 percent to 5 percent in emerging market economies in the same period. In South Africa, headline inflation averaged 4.1 percent in 2019, lower than the 4.6 percent in 2018. Inflation increased from 2.2 percent in June 2020 to 3.2 percent in July 2020, remaining within the SARB’s target range of 3 - 6 percent.

**Chart 3.16: Global Inflation**

Source: IMF April 2020 WEO

The average trade-weighted inflation for Botswana’s trading partners increased from 1.2 percent in May 2020 to 1.4 percent in June (Chart 3.17).
Mixed monetary policy developments

In the most recent policy decisions in advanced economies (Table 3.6), the European Central Bank (ECB) maintained the deposit rate, refinancing rate and lending rate at 0.50 percent, zero percent and 0.25 percent, respectively, as the Committee adopted a wait-and-see approach to assess the effectiveness of a series of unprecedented measures taken over the past months to support the bloc’s economy amid the coronavirus crisis. With a view to support economic activity, the ECB maintained the pandemic emergency purchase programme (PEPP) at €1350 billion. The net purchases under PEPP would be made to the end of June 2021, with maturing purchases reinvested until at least the end of 2022. The ECB also continued with asset purchases at a monthly pace of €20 billion under its asset purchase programme (APP), along with temporary net asset purchases of €120 billion.

At the July 2020 meeting, the US Federal Open Market Committee (FOMC) left the US Federal Funds Rate range unchanged at 0 – 0.25 percent. The Committee observed that the ongoing public health crisis would weigh heavily on economic activity, employment, and inflation in the near term, and posed considerable risks to the economic outlook over the medium term. In addition, the Fed indicated that it would maintain the target range until it was confident that the economy had weathered recent events and was on track to achieve its maximum employment and price stability goals. Moreover, the Fed would continue to buy Treasury securities, as well as agency residential and commercial mortgage-backed securities to sustain the smooth functioning of the market. The Fed also announced the extension of its dollar swap lines and the temporary repurchase agreement facility for international monetary authorities until March 31, 2021.

The Bank of England (BoE) maintained the Bank Rate at 0.1 percent and the size of its total stock of asset purchases at £745 billion in August 2020. The Committee judged that the economy would take longer to recover from the coronavirus-induced recession than initially anticipated, and warned about the risks of cutting interest rates below zero. Moreover, the BoE expected CPI inflation to fall further below the 2 percent target, largely reflecting the direct and indirect effects of COVID-19.

In emerging market economies, the SARB reduced the repo rate further by 25 basis points to 3.50 percent in July 2020, resulting in a cumulative 300 basis points cut since January 2020. The cut in the repo rate was to ease financial conditions and improve the resilience of households and firms to the short-term economic implications of COVID-19. In addition, the SARB eased regulatory requirements on banks and ensured adequate liquidity in domestic markets. The SARB noted that the economic contraction and slow recovery will keep inflation well below the midpoint of the target range in 2020.

The Bank of Japan (BoJ) kept its key short-term interest rate unchanged at -0.1 percent and maintained longterm government bond yield at around zero percent during its July 2020 meeting. In addition, the BoJ agreed to purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase annually to about 12 trillion yen and about 180 billion yen, respectively.

In emerging market economies, the SARB reduced the repo rate further by 25 basis points to 3.50 percent in July 2020, resulting in a cumulative 300 basis points cut since January 2020. The cut in the repo rate was to ease financial conditions and improve the resilience of households and firms to the short-term economic implications of COVID-19. In addition, the SARB eased regulatory requirements on banks and ensured adequate liquidity in domestic markets. The SARB noted that the economic contraction and slow recovery will keep inflation well below the midpoint of the target range in 2020.

The Central Bank of Russia (CBoR) cut the key rate by 25 basis points to 4.25 percent in July 2020, as inflationary pressures remained on the downside and economic recovery was expected to be gradual. The CBoR indicated that it expected to maintain the accommodative stance going forward. Similarly, the Central Bank of Brazil cut the policy rate by 25 basis points to an all time low of 2 percent in August 2020 to mitigate the effects of the COVID-19 pandemic. However, it indicated that there were constraints for further easing of policy and that any changes to the current degree
of stimulus would be gradual and depended on the outlook for fiscal policy and inflation.

The People’s Bank of China (PBoC) maintained the one year Loan Prime Rate for the fourth consecutive month at 3.85 percent in August 2020, amid signs of economic recovery. Similarly, the Reserve Bank of India (RBI) maintained the policy rate at 4 percent in August 2020 to ensure that inflation remained within target going forward, following a recent increase in prices due to the COVID-19 pandemic. In addition, the RBI maintained its reverse repo rate at 3.35 percent and the marginal standing facility rate at 4.25 percent. The RBI also indicated that it would continue with the accommodative stance of monetary policy to achieve the medium-term inflation target as well as support economic growth. Furthermore, the RBI indicated that it would allow restructuring of corporate loans by banks in order to ease debt strains on companies and lenders.

Table 3.6: Monetary Policy Decisions

<table>
<thead>
<tr>
<th>Central Bank</th>
<th>Latest Meeting</th>
<th>Current Policy Rate (Percent)</th>
<th>Change from Previous Meeting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Botswana</td>
<td>August 2020</td>
<td>4.25</td>
<td>No change</td>
</tr>
<tr>
<td>SARB</td>
<td>July 2020</td>
<td>3.50</td>
<td>Decreased by 0.25 percent</td>
</tr>
<tr>
<td>US Federal Reserve</td>
<td>July 2020</td>
<td>0 – 0.25</td>
<td>No change</td>
</tr>
<tr>
<td>BoE</td>
<td>August 2020</td>
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<td>No change</td>
</tr>
<tr>
<td>ECB</td>
<td>July 2020</td>
<td>0.00</td>
<td>No change</td>
</tr>
<tr>
<td>BoJ</td>
<td>July 2020</td>
<td>-0.10</td>
<td>No change</td>
</tr>
<tr>
<td>PBoC</td>
<td>August 2020</td>
<td>3.85</td>
<td>No change</td>
</tr>
<tr>
<td>Brazil</td>
<td>August 2020</td>
<td>2.00</td>
<td>Decreased by 0.25 percent</td>
</tr>
<tr>
<td>India</td>
<td>August 2020</td>
<td>4.00</td>
<td>No change</td>
</tr>
<tr>
<td>Russia</td>
<td>July 2020</td>
<td>4.25</td>
<td>Decreased by 0.25 percent</td>
</tr>
</tbody>
</table>

Source: Various central banks’ websites.
4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook has been revised further downwards, on account of the ongoing unprecedented exogenous shock caused by the COVID-19 pandemic. The virus has spread to more than 200 countries around the world, having more negative impact on social and economic activity in the first half of 2020 than anticipated, hence the downward revision of all the regions’ growth for 2020. Meanwhile, the recovery is projected to be more gradual than previously forecast, owing to persistent social distancing into the second half of 2020 as well as substantial damage to the supply chain potential. Regionally, in South Africa, apart from the pre-existing negative impact of prolonged power supply shortages and the country’s credit rating being downgraded to ‘junk’ status by major credit rating agencies, the growth outlook is projected to remain subdued due to the health crisis resulting from the increased COVID-19 pressures. With regard to price developments, global inflation is forecast to decline from 3.6 percent in 2019 to 3 percent and 3.3 percent in 2020 and 2021, respectively, consistent with the subdued global demand owing to income losses amid the COVID-19 pandemic.

Global economic outlook revised downwards

According to the June 2020 WEO Update, global output is forecast to contract by 4.9 percent in 2020, 1.9 percentage points lower than the April 2020 projections, markedly worse than the 2008/09 financial crisis, and it is expected to be the worst economic crisis since the Great Depression of the 1930s. Moreover, for the first time, all regions are projected to experience negative growth in 2020, with recovery projected to be more gradual than previously forecast. Meanwhile, the global economic growth is expected to rebound to 5.4 percent (0.4 percentage points lower than in April 2020 WEO) in 2021, as economic activity normalises, buoyed by policy support.

For advanced economies, output growth is forecast to contract by 8 percent in 2020, from 1.7 percent in 2019. The 2020 projection is 1.9 percentage points lower than the April 2020 WEO projection, reflecting the stronger-than-anticipated negative impact of lockdowns and imposed social distancing in the first half of 2020. The social distancing is expected to continue into the second half of the year resulting in weaker private consumption and a rise in precautionary saving. However, investment is expected to be subdued as firms defer capital expenditure amid high uncertainty. Meanwhile, growth is projected to rebound to 4.8 percent in 2021. The 2021 projection is 0.4 percentage points higher than the April 2020 WEO estimate and is premised on effective fiscal and financial countermeasures deployed by several countries since the beginning of the pandemic.

Overall, risks to global output growth remain skewed to the downside. They include possible recurrence of outbreaks in places that have gone past peak infection, requiring the reimposition of some containment measures, a prolonged decline in economic activity leading to firm closures and tightening financial conditions.

UK economic prospects revised downwards for 2020

The UK economy is expected to contract by 10.2 percent in 2020 (3.7 percentage points lower than in the April 2020 WEO), compared to an expansion of 1.4 percent in 2019. The downward revision in 2020 reflects more severe economic fallout in the first half of the year than anticipated due to the COVID-19 pandemic. However, economic growth is expected to pick up to 6.3 percent in 2021, supported in part by policy stimulus.

Output growth for US to decline

For the US, output is forecast to decline by 8 percent in 2020, before expanding to 4.7 percent in 2021, from the growth of 2.3 percent in 2019, as the fiscal and monetary stimulus in place are expected to offset the detrimental effects of COVID-19. However, the growth forecasts are 2.1 percentage points and 0.2 percentage points lower for 2020 and 2021, respectively, relative to the April 2020 WEO.

Growth for the euro area to contract

In the euro area, economic activity is projected to contract by 10.2 percent in 2020 (2.7 percentage
points lower than in the April 2020 WEO) from the growth of 1.3 percent in 2019. Growth forecasts for the economic bloc have been revised downward, with some of the largest economies; France, Italy and Spain expected to experience the largest unprecedented contractions of over 12 percent each, after being hard hit by the pandemic. The downward revision relative to the April 2020 WEO reflects the anticipated prolonged effects of the lockdown measures adopted in March 2020 and persistence of social distancing arising from fear of contagion. Overall, the high level of uncertainty surrounding the virus and its duration is likely to drive the euro area into a recession.

**Emerging markets GDP expansion projected to be lower**

Economic activity in emerging market and developing economies is projected to contract by 3 percent in 2020, from an estimated expansion of 3.7 percent in 2019. The 2020 economic performance has been revised downwards by 2 percentage points relative to the April 2020 WEO. The revisions reflect anticipated large disruptions to economic activity due to COVID-19, and the negative impact of a fall in commodity prices for the exporters. The downgrade also takes into account larger spillovers from weaker external demand. Meanwhile, economic growth is projected to increase by 5.9 percent in 2021, 0.7 percentage points lower than the April 2020 WEO projection.

In China, the outbreak of the virus has added pressure on the economy as it resulted in low industrial activity and exports, owing to the decrease in the number of working days hence a downward revision of 0.2 percentage points to 1 percent for 2020, relative to the April 2020 forecast. However, it is expected that the policy stimulus will be supportive of economic activity in 2020. In India, the downward revision of 6.4 percentage points for 2020 reflects the weaker outlook for growth in domestic demand than previously envisaged amid reimposition of full and partial lockdown in several states across the country that have extended into the third quarter of 2020.

**Growth in the South African economy to contract significantly**

Growth prospects in South Africa are expected to be constrained by the pre-existing electricity supply shortages, and sluggish demand as a result of weaker business confidence, following the downgrade of the country’s credit rating to ‘junk’ status by major credit rating agencies. The country is also hard hit by the COVID-19 global pandemic, with daily increases in reported number of infections and deaths. This is expected to result in weaker local demand, while exports would also be constrained by supply chain disruptions. Overall, the country-wide lockdown and other containment measures to prevent the spread of COVID-19 are expected to dent the economy that is already in a recession. Therefore, South African output is forecast to contract by 8 percent in 2020, but to rebound to a growth of 3.5 percent in 2021, compared to 0.2 percent growth in 2019. The revisions are 2.2 percentage points and 0.5 percentage points lower for 2020 and 2021, respectively. As a result, in July 2020, the SARB revised forecasts of GDP growth for 2020 and 2021 to -7.3 percent and 3.7 percent, from -7 percent and 3.8 percent, respectively.

**Global inflation to be moderate**

Globally, there are indications of emerging disinflationary pressures in 2020, emanating from slower global output growth. In the short term, supply chain bottlenecks are expected to put upward pressure on prices of some goods and services but this could be broadly offset by weaker demand-side pressures underpinned by shorter working hours, cancellation of some scheduled purchases of goods and services and persistence of lockdowns across the world. Global inflation is forecast at 3 percent and 3.3 percent in 2020 and 2021, respectively, from 3.6 percent in 2019. In advanced economies, disinflationary pressures are expected to mount, mainly due to the anticipated lower inflation in the US and euro area, which are currently experiencing high cases of infections and fatalities occasioned by COVID-19. Similarly, for emerging market economies, inflation is expected to decrease in 2020, consistent with slowdown in growth of final demand and lower commodity prices.

Meanwhile, South African inflation is forecast to average 3.4 percent in 2020, the same forecast as in May 2020, mainly reflecting weaker economic activity amidst the COVID-19 pandemic, as well as subdued global inflationary pressures. Overall, inflation is anticipated to remain within
the SARB’s target range but below the midpoint in 2020 (Chart 4.1).

International oil prices expected to recover
International oil prices are projected to recover in the short term to medium term, although remaining at low levels (Chart 4.2), due to the gradual easing of travel restrictions and lifting of lockdowns which will lead to an increase in demand for oil by both air and road transport users, supported by the agreement by major international oil producers to cut production between May 2020 and April 2022. Moreover, the expected decline in global oil inventories should also contribute to the increase in international oil prices. Overall, developments in the international oil market imply a potential modest upward pressure on domestic inflation.

Diamond prices expected to recover modestly
Global rough diamond prices are expected to recover in the second half of 2020, although remaining low, as travel restrictions and social distancing measures are being lifted gradually, and the majority of trade activity and buying opportunities are gradually being availed virtually. Nonetheless, global rough diamond prices are expected to remain subdued in the medium term. In addition, the increase in polished diamond inventories due to weak global demand and lack of funds resulting from late repayments by diamond traders in countries adversely affected by the pandemic is anticipated to add downward pressure on diamond prices.

Likewise, polished diamond prices as well as diamond jewellery prices are expected to fall in 2020 as prospects for global end-consumer demand remain restrained. The continued disruptions and closure of cutting and polishing activity in India is also expected to slow down the polished diamonds and jewellery sales. Risks to the global diamond industry are skewed to the downside, in the context of uncertainty surrounding the spread of the COVID-19 and proliferation of synthetic diamonds, as well as weak downstream sentiment related to macroeconomic and geopolitical factors. Overdue payments owed by diamond traders in China and Hong Kong also pose massive liquidity risk to the diamond cutting and polishing industry.

Global food prices to increase
Global food prices are expected to trend upwards in the second half of 2020 (Chart 4.3). The expected increase in food prices mainly reflects the increased demand and costpush pressures arising from supply disruptions caused by lockdowns and other containment measures that have reduced production hours and made the flow of goods difficult. In Southern Africa, food prices are expected to also increase in the short term due to anticipated lower crop production resulting from bad climatic conditions. From a consumer basket perspective, prices are also expected to rise temporarily supported by the projected decrease in exports volumes in the short-term, with some major food producing countries imposing export quotas in response to the COVID-19 workplace safety measures that have significantly affected
industrial production across the globe. Recovery in international oil prices add to the anticipated increase in food production costs and, hence, higher food prices beyond the second quarter of 2020. Overall, there is potential modest upward pressure from international food prices on domestic inflation.

Chart 4.3: International Food Prices
FAO Index

Source: Bloomberg
4.2  Outlook for domestic economic activity

GDP growth for 2020 is expected to be significantly lower than the pre-COVID-19 projection of 4.4 percent. However, the prevailing accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including the economic recovery and transformation plan, would generally be positive for economic activity in the medium term, although the economy would continue to operate below its potential.

Lower growth expected in domestic output
Before the outbreak of COVID-19, real GDP growth for 2020 was projected to expand by 4.4 percent. However, given the downside risks to global economic activity, mainly emanating from the outbreak of COVID-19, global demand and commodity prices (including for rough diamonds) have fallen, thereby dampening future economic performance. For Botswana, this pandemic poses added uncertainty and challenges given Botswana’s high vulnerability to external shocks, notably, diamond production and demand, tourism and possible disruption of imported supplies either from South Africa or through South African ports of entry.

In line with these anticipated global developments, growth forecasts for the domestic economy by the MFED have been revised downwards. GDP is, therefore, projected to decline by 8.9 percent in 2020, from an earlier forecast of a 13.1 percent contraction, before rebounding to 7.7 percent in 2021. The decline is attributed to the expected sharp contraction in output of major economic sectors, such as trade, hotels and restaurants (-27.4 percent); mining (-24.5 percent); construction (-6 percent); manufacturing (-3.9 percent); and transport and communications (-2.5 percent). Box 4 outlines Bank of Botswana’s response to COVID-19.

The Bank’s June 2020 Business Expectations Survey (BES) indicates a deterioration in the level of confidence among businesses in 2020, largely due to the anticipated negative impact of COVID-19 on business operations. Therefore, non-mining activity is anticipated to decline in the short term and to grow below potential into the medium term. Meanwhile, the IMF forecast the domestic economy to contract by 9.6 percent in 2020 before rebounding to 8.6 percent in 2021.
Box 4: Bank of Botswana’s response to the impact of COVID-19 pandemic

Botswana confirmed its first three-imported-cases of COVID-19 on March 31, 2020. As at August 27, 2020, 1562 total cases (959 transferred out, 603 local cases, 199 local recoveries and six local deaths) had been reported in the country. To curb the spread of the disease, the country was put on a 28-day lockdown (extreme social distancing) effective from midnight of April 2, 2020, with movement outside the home only restricted to essential goods and service providers. On April 9, 2020, Parliament approved His Excellency the President’s request for a six-month state of emergency to allow the country to adequately respond to the threat posed by COVID-19. The lockdown was extended to May 20, 2020, after which, was replaced by a zoning strategy combined with thirteen check points between zones. The greater Gaborone zone was put under a two-week lockdown at the end of July, following an announcement of 30 new cases in one day (July 30) in the capital city. The lockdown was lifted on August 14, 2020.

As an open economy that is integrated with regional global economies, Botswana is affected through several channels, among others, local infections; weaker global demand affecting exports (diamonds and tourism, for example); disruption to global supply chains affecting local production and project execution; and disruptions caused by containment and mitigation measures imposed by Government. Other channels include the impact of disruption of economic activity on the banking system and likely reduction in fiscal and external buffers; as well as the weak performance of, and panic, in the global markets that, invariably, will negatively impact on the nation’s official foreign exchange reserves. Overall, IMF estimates that the domestic economy will contract by 9.6 percent in 2020, before rebounding to 8.6 percent in 2021, while the MFED projects a sharp deterioration of 8.9 percent contraction and a modest recovery of 7.7 percent growth in 2021.

- Bank of Botswana (the Bank) has undertaken the following measures to alleviate the adverse impact of COVID-19 on the Botswana economy: The Bank will maintain uninterrupted supply and availability of clean banknotes and coin, as well as banking services, primarily to Government and commercial banks.

- With a view to support the banking system, the Bank offered capital relief and support for commercial banks to enable them to satisfy capital requirements and address liquidity challenges as they continue to support economic activity under conditions of possible increase in credit defaults and impairments as well as the need for additional lending. In this regard:

  - The prudential capital adequacy ratio for commercial banks operating in Botswana has been reduced from 15 percent to 12.5 percent; and
  
  - To alleviate any possible pressure on the commercial banks and extend potential additional sources of liquidity, the following measures have been introduced:

    - The cost of accessing overnight funding by licensed commercial banks from the Bank’s Credit Facility is accessed at the prevailing Bank Rate (currently 4.25 percent) without the punitive 6 percentage points above the Bank Rate;
    
    - Repo facilities currently available only on an overnight basis will be offered against eligible securities with maturities of up to 92 days; and
    
    - Subject to completing regulations and arrangements relating to valuation and custody, the collateral pool for borrowing by licensed commercial banks from the Bank will be extended to include corporate bonds listed and traded on the Botswana Stock Exchange.
    
    - In addition, consistent with provisions of the Electronic Payments Services Regulations, the limits on mobile money transactions have been raised as follows: maximum single transaction, from P5 000 to P10 000; maximum daily transaction, from P10 000 to P15 000; and maximum monthly aggregate, from P20 000 to P30 000.
    
    - At the MPC meeting held on April 30, 2020, the Bank Rate was reduced by 50 basis points from 4.75 percent to 4.25 percent, and the PRR from 5 percent to 2.5 percent, in the context of a suppressed medium-term inflation outlook, associated with subdued domestic demand resulting from the adverse effects of the lockdowns occasioned by the outbreak and subsequent spread of COVID-19.

Given that the full extent of economic and financial disruption from COVID-19 is yet to be established, the measures currently expended by the Bank will continue to be revised as the need arises.

Source: Bank of Botswana
4.3 Monetary policy and the inflation outlook

Inflation is forecast to remain below the lower bound of the Bank’s 3 - 6 percent objective range in the short term. However, inflation is expected to revert to within the desired objective range in the third quarter of 2021. Compared to the June 2020 forecast, inflation is projected to be higher in the medium term, reflecting the expected upward adjustment in electricity tariffs and prospective increase in international commodity prices. Overall, risks to the inflation outlook remain skewed to the downside, reflective of weak domestic and global economic activity, which could be exacerbated by periodic lockdowns in response to recurring COVID-19 infections, as well as the possible decline in international commodity prices. These risks are moderated by the potential increase in international commodity prices beyond current forecasts, aggressive policy actions to bolster demand, as well as the anticipated supply constraints due to travel restrictions and lockdowns.

Inflation projected to remain below the objective range in the short term

Inflation is forecast to remain below the lower bound of the Bank’s 3 - 6 percent objective range for the remainder of 2020 and the first two quarters of 2021 (Chart 4.4).

The subdued inflation in the near term mainly reflects the downward adjustment of domestic fuel prices and the disinflationary pressures anticipated from the adverse impact of the COVID-19 pandemic on both the domestic and global economic developments. Inflation is expected to revert to within the objective range in the third quarter of 2021, in response to the overall accommodative policy stance, higher international commodity prices and the expected upward adjustment in electricity tariffs in the second quarters of 2021 and 2022.

Meanwhile, according to the June 2020 BES, the business community expect inflation to be within the objective range in both 2020 and 2021.

Core inflation to increase in the short to medium term

Inflation excluding food and fuel prices is forecast to rise in the short to medium term, due to the projected increase in electricity tariffs in 2021 and 2022 and the expected improvement in non-mining output growth (Chart 4.5).

International food prices to increase

Compared to the June 2020 forecast, international food prices have been revised upwards in the short to medium term (Chart 4.6). The upward revision reflects the mismatch between increased demand and relatively low supply of food.
International oil prices revised upwards
Relative to the June 2020 projection, international oil prices have been revised upwards in the short to medium term (Chart 4.7). The upward momentum in prices is due to the expected decline in global oil inventories as a result of the gradual easing of travel restrictions and lifting of lockdowns, as well as the agreement by oil producers to cut oil production to curtail the recent fall in oil prices.

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

Inflation forecast revised upwards in the medium term
The August 2020 inflation forecast has been revised downwards in the short term compared to the June 2020 forecast, on account of the substantial downward adjustment of domestic fuel prices in the second quarter of 2020. However, the projection is higher in the medium term, reflecting the expected increase in electricity tariffs and international commodity prices.

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 marginally against major currencies in the next four quarters (Chart 4.8), as the global economy recovers from the apex of the COVID-19 pandemic and as investor appetite for riskier emerging market assets, such as the South African rand, rebounds. The adverse economic impact of the spread of COVID-19 in South Africa is expected to lessen as the country substantially lifts lockdown restrictions and allows for more economic activity to resume. However, speculation that the country might impose further lockdown restrictions in some provinces as the number of COVID-19 cases increase will limit the recovery of the South African rand.

In response to the threat of a global recession posed by the spread of COVID-19, central banks across the world have engaged in providing further monetary accomodation, including liquidity support to ensure smooth functioning of markets. Therefore, monetary policy easing in developed economies is expected to benefit the South African rand against the US dollar, despite the fragile domestic economic outlook, as investors continue to seek high yielding assets.
The US dollar is expected to slightly depreciate against most major international currencies in the next four quarters (Chart 4.9A and Chart 4.9B), due to the expected improvement in investor risk sentiment and risks posed by the US national elections in November 2020. Moreover, due to the surge in COVID-19 infections, as well as increasing unemployment claims in the US, investors are expecting a continuation of the Fed’s unprecedented monetary support, zero interest rates, quantitative easing and possibly an introduction of negative interest rates in the near future. However, global uncertainty and market volatility due to the impact of COVID-19 on the global economy is likely to influence investors to hold the world’s most liquid currency, the US dollar, thus affecting this forecast.

The British pound is expected to appreciate against the US dollar on the back of improving risk sentiment supported by multiple factors, such as the progress made in the discovery of COVID-19 vaccine and optimism surrounding Brexit developments. Results of COVID-19 vaccine trials developed by different firms, such as the joint effort between AstraZeneca and Oxford researchers, showed strong immune response to the virus. In addition, risk sentiment is influenced by hopes that talks between the EU and UK will result in an agreement being reached by October 2020. However, this forecast is weighed down by rising tensions between China and the UK. Meanwhile, the euro is also expected to appreciate against the US dollar, despite the Eurozone’s highly uncertain outlook, due to optimism brought by the signing of a historic recovery fund deal by EU leaders. The fund is expected to provide support to EU members as their economies try to recover from the COVID-19 crisis.

The Japanese yen is expected to be relatively stable against the US dollar due to its safe-haven status. Moreover, the yen currently serves as a refuge for US poll risks associated with the upcoming elections and sustained COVID-19 infections in the US.

The Chinese renminbi is expected to appreciate against the US dollar in the next four quarters (Chart 4.9B) as business activity in China is projected to recover faster from COVID-19 and suffer less economic impairment than the rest of the world. The expectation is partly attributable to room that the PBoC currently has in conducting monetary policy, as well as its ability to direct the credit dynamics. Since the COVID-19 outbreak,

\[13\] UK banned Huawei from its 5G networks, arguing that giving Huawei access to this network posed significant risks to the country, and China is likely to retaliate.

\[14\] The recovery fund will use 750 billion euros, including 390 billion of non-repayable grants. The agreement extends to a 2021-2027 budget of 1.1 trillion euros.
the PBoC has deviated from the trend of asset purchases (as is the case in many developed and some emerging markets economies) to focusing on the credit channel to stimulate the economy.

Overall, forecast movements of the SDR constituent currencies would result in the slight appreciation of the SDR against the US dollar (Chart 4.9A). The Pula is expected to appreciate against the SDR currencies, albeit at a slower rate compared to the South African rand appreciation; thus resulting in a depreciation\(^{15}\) of the Pula against the South African rand (Chart 4.10). The expected depreciation of the Pula against the South African rand will exert marginal upward pressure on domestic inflation.

![Chart 4.10: BWP Exchange rates against ZAR, USD and SDR](chart.png)

Risks on the downside
The overall risks to the inflation outlook are on the downside, reflective of weak domestic and global economic activity, which would be exacerbated by periodic lockdowns due to prolonged COVID-19 infections, and the possible decline in international commodity prices. These risks are moderated by the potential increase in international commodity prices beyond current forecasts, aggressive action by governments and major central banks to bolster demand, as well as the anticipated supply constraints due to travel restrictions and lockdowns, though abating.

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\(^{15}\) The movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies.
5. AUGUST 2020 MONETARY POLICY COMMITTEE DECISION

At the meeting held on August 20, 2020, the Monetary Policy Committee (MPC) of the Bank of Botswana decided to maintain the Bank Rate at 4.25 percent. Inflation was constant at 0.9 percent between June and July 2020 and remained below the lower bound of the Bank’s objective range of 3 – 6 percent. However, inflation is forecast to revert to within the objective range in the third quarter of 2021.

The COVID-19 pandemic and consequent containment measures have severely throttled economic activity globally and domestically as production, supply chains, project implementation and provision of goods and services are constrained. Similarly, consumption and spending are disrupted, hence domestic demand pressures and foreign prices remain subdued. Consequently, overall risks to the inflation outlook are skewed to the downside. However, inflation may rise above current forecasts if international commodity prices increase beyond current projections and in the event of upward price pressures occasioned by supply constraints due to travel restrictions and lockdowns.

Real Gross Domestic Product (GDP) grew by 2.6 percent in the twelve months to March 2020, compared to a faster expansion of 4.5 percent in the corresponding period in 2019. The lower increase in output is attributable to the contraction in mining output and deceleration in output growth of the non-mining sector. Mining output contracted by 6.1 percent compared to a growth of 5.5 percent in the corresponding period in 2019, mainly due to weaker performance of the diamond, soda ash, copper and coal subsectors. Non-mining GDP grew by 3.6 percent in the year to March 2020 compared to 4.3 percent in the corresponding period in 2019. The lower growth in non-mining GDP was mainly due to a deceleration in output growth of the trade, hotels and restaurants, transport and communications, construction and manufacturing sectors.

Projections by the Ministry of Finance and Economic Development and the International Monetary Fund (IMF) suggest a deterioration in economic growth for Botswana in 2020. The Ministry estimates that the economy will decline by 8.9 percent in 2020, from an earlier forecast of a 13.1 percent contraction, before rebounding to growth of 7.7 percent in 2021. The IMF forecasts the domestic economy to contract by 9.6 percent in 2020 compared to 5.4 percent in the April 2020 World Economic Outlook, before rebounding to a growth of 8.6 percent in 2021. Even with recovery in 2021, the contraction in 2020 equates, approximately, to a two-year loss of output. The disparity in forecasts attest to the challenges of making forward projections when there is uncertainty about the duration of constrained economic activity, the resultant adverse impact on productive capacity, as well as the speed of resumption of production and pace of recovery in demand.

Broadly, the contraction in GDP reflects the substantial curtailment of economic activity due to the necessary measures implemented to contain the spread of COVID-19 and safeguard human life. The resultant decrease in global demand and disruption in supply chains, as well as curtailed economic activity locally, has affected several sources of economic growth for Botswana. Notably, these include exports, such as minerals and tourism as well as non-food retail economic activity.

The global economy is projected to contract by 4.9 percent in 2020 but to rebound to 5.4 percent in 2021, anchored by unprecedented policy and resource support by individual countries and multilateral institutions. However, the recovery projections are fraught with uncertainty with respect to several critical factors, namely, the intensity and effectiveness of containment measures; the extent of supply disruptions; fiscal and market financing constraints; shifts in spending patterns; trends in commodity prices; and, ultimately, business and consumer confidence. A similar pattern of developments pertains with regard to Botswana.

The MPC, however, recognised that the short-term adverse developments in the domestic economy occur against a potentially supportive environment including accommodative monetary conditions; reforms to further improve the business environment; concerted efforts by government to mitigate the impact of COVID-19; as well as the likely impact of the economic recovery and transformation plan. These would generally be positive for economic activity in the medium term. Therefore, the MPC decided to continue with
the accommodative monetary policy stance and maintain the Bank Rate at 4.25 percent.

The remaining MPC meetings for 2020 are scheduled as follows:

October 8, 2020

December 3, 2020