



# **MONETARY POLICY STATEMENT 2012**

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## **1. INTRODUCTION**

- 1.1 *The main purpose of the annual Monetary Policy Statement (MPS) is to fulfil the Bank of Botswana's obligation of accountability and transparency in the formulation and implementation of monetary policy. Accordingly, this MPS reviews economic trends during 2011, examines the main determinants of price developments and the extent to which inflation deviated from the Bank's medium-term inflation objective range of 3 – 6 percent. In addition, the MPS evaluates prospective economic and financial developments that are likely to affect the outlook for inflation in the medium term and, in turn, the Bank's policy choices for the ensuing year. Overall, the Bank seeks to foster policy credibility with a view to anchoring public expectations of low, predictable and sustainable level of inflation.*
- 1.2 *As predicted in the 2011 MPS, inflation remained above the medium-term objective range of 3 – 6 percent in 2011; it increased from 7.4 percent in December 2010 to 9.2 percent in December 2011. This increase in inflation reflected mainly the impact of the increase in food prices and some administered prices, including fuel (Section 3). Demand pressures on inflation were generally low, with household spending constrained by modest growth in public sector wages. Overall, restrained government recurrent spending, and a reduction of development expenditure also contributed to moderate demand pressures on inflation. However, money supply increased at an annual rate of 4.4 percent in 2011, against the background of an acceleration in credit growth and an increase in foreign exchange reserves. All in all, economic performance was robust, with output for the twelve months period to September 2011 being 4.1 percent higher compared to the corresponding period in 2010.*
- 1.3 *World economic performance weakened in 2011, partly due to the impact of transitory factors in major economies, including supply-chain disruptions following the earthquake in Japan and high commodity prices in the first half of 2011. In addition, longer term factors, such as aggressive fiscal consolidation measures, sovereign debt crisis in the euro area, high rates of unemployment in major economies and associated loss of business and consumer confidence, moderated global economic growth. Delay in resolving the European sovereign debt problem heightened the likelihood of a global banking crisis, with resultant volatility of financial markets<sup>1</sup> undermining demand and global trade. In the circumstances, there was a softening of global commodity prices and lower inflationary pressures.*
- 1.4 *The policy rate (Bank Rate) was maintained at 9.5 percent in 2011, following a 0.5 percentage point decrease in December 2010. This policy stance was influenced by the positive medium-term inflation outlook, even in the face of potential for short-term price developments contributing to expectations of high inflation.*

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<sup>1</sup> Credit rating agencies downgraded the sovereign debt credit ratings of several countries and some major banks in 2011 and in early 2012, thus contributing to volatility in world markets.

*The exchange rate policy was implemented such that there was a modest downward crawl of the nominal effective exchange rate, given that Botswana inflation was above the anticipated inflation of trading partner countries. However, bilateral exchange rates fluctuated significantly and, in 2011, the Pula appreciated by 5.8 percent against the South African rand and depreciated by 13.8 percent against the SDR.*

- 1.5 *Looking ahead, inflation is expected to remain above the medium-term objective range in the short term due to the lingering impact of the increase in administered prices in 2011 and in early 2012. Nevertheless, it is projected to converge to the 3 – 6 percent medium-term objective range in the second half of 2012, in the context of low domestic demand pressures and benign foreign inflationary pressures associated with below-trend domestic and global economic activity. Upside risks to the inflation outlook include any substantial increase in administered prices and government levies, and international food<sup>2</sup> and oil prices beyond current projections. However, this is balanced against the downside risks emanating from an easing of international commodity prices, including oil prices.<sup>3</sup>*

## **2. MONETARY POLICY FRAMEWORK**

- 2.1 *The Bank's monetary policy objective is to achieve price stability, which is defined as sustained inflation within the medium-term objective range of 3 – 6 percent. Such a low and predictable level of inflation contributes towards the broader national objective of attaining sustainable economic growth and development through promoting savings mobilisation and productive investment and, at the same time, fostering international competitiveness of domestic producers.*
- 2.2 *In pursuit of the objective of price stability, the Bank uses interest rates and open market operations to affect demand conditions in the economy and, ultimately, the rate of price increases. Changes in interest rates and the availability of loanable funds influence choices with respect to credit demand and saving and, in turn, the determination of aggregate demand. Domestic demand conditions<sup>4</sup> and other factors, such as foreign inflation, the exchange rate, changes in administered prices and taxes, contribute to the level of inflation. Public expectations with respect to the future level of inflation also influence price changes by firms and wage adjustments.*

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2 *Although the United Nations Food and Agriculture Organisation reports a steady decline in world food prices in the second half of 2011, with food inflation of -5.4 percent between November and December 2011, international food prices remain generally higher and more volatile than in 2010.*

3 *For oil prices, the upside risk emanates from the escalation of tensions in the Middle East (Iran in particular) that could result in a significant reduction in the supply of oil and, in turn, higher prices. On the other hand, there is a downside risk due to the weak economic performance in Europe, such that the balance of risks is downward.*

4 *In this instance, the rate of change in prices is associated with the variation in demand/supply conditions in the economy, influenced by a change in interest rates and the exchange rate. Technically, this relates to the net impact of changes in real interest rates and real exchange rates, which are referred to as “real monetary conditions”, on the availability of credit and domestic industry competitiveness.*

- 2.3 *The monetary policy framework entails an assessment of prospective developments in various factors that can influence price movements, thereby allowing the Bank to generate an inclusive and broad-based forecast for inflation in the medium term that, in turn, informs the monetary policy response. In this way, the Bank determines the factors (including public inflation expectations) that are likely to lead to a longer-lasting deviation of inflation from the objective range and those that have a transitory impact, as indicated by the duration of their disaggregated effect on the inflation forecast.*
- 2.4 *Among others, the Bank monitors the output gap<sup>5</sup> as a leading indicator of the direction of inflation resulting from economic factors that cause domestic demand to deviate from the economy's capacity to supply goods and services (long-term output trend). A sustained level of economic performance above trend is potentially inflationary and could signal the need to increase interest rates to dampen inflationary pressures, while output below trend could require a reduction of interest rates to stimulate economic activity. In general, the Bank will adjust monetary policy in response to a sustained deviation of the inflation forecast from the objective range, and where the causal factors could be influenced by domestic monetary policy action.*
- 2.5 *In this regard, the regular meetings of the Bank's Monetary Policy Committee (MPC) allow for periodic and timely review of economic developments, related inflation outlook, and the implications for the direction of monetary policy. The outcome of the MPC meetings is disseminated to stakeholders immediately after each meeting, in order to help anchor inflation expectations and contribute towards sustained policy credibility, which is critical in achieving long-term price stability.*
- 2.6 *The achievement of price stability supports international competitiveness of domestic producers through stabilising the real effective exchange rate (REER) in the context of the crawling band exchange rate mechanism. In this respect, attaining inflation equal to that prevailing in trading partner countries would indicate that the competitiveness of Botswana producers is stable at the existing nominal effective exchange rate (NEER). However, if Botswana's inflation differs from that of trading partner countries, a stable REER is attained by adjusting the NEER of the Pula to the extent of the differential. This means that when Botswana's inflation objective is higher than the forecast inflation of trading partner countries, there would be a downward crawl of the NEER in order to maintain international competitiveness of exports and domestic tradeable goods. Conversely, an upward crawl would be implemented in the event of the domestic inflation objective being lower than forecast inflation of trading partner countries. However, it is important to emphasise that the best way to achieve durable improvement in international competitiveness of domestic producers is through gains in productivity.*
- 2.7 *Overall, the direction of both the REER and real interest rates, as measured by the real monetary conditions index, provides an indication of policy performance and*

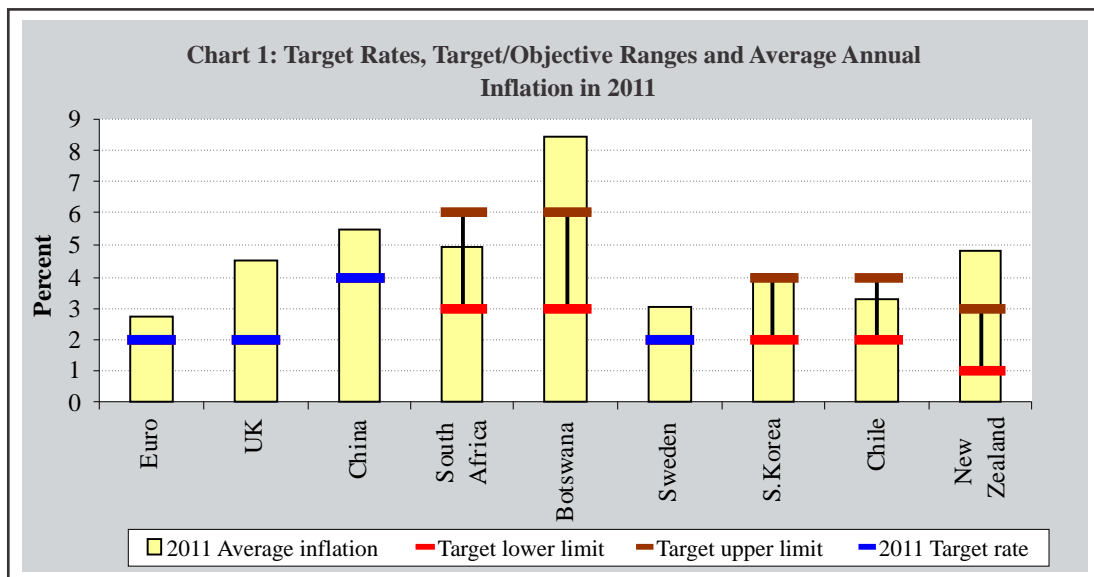
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5 *The output gap refers to the difference between long-term trend output, as an indicator of productive capacity, and actual output.*

*the likely influence of monetary policy on inflation and economic activity. Therefore, an increase in real interest rates and/or an appreciation of the REER would indicate a tightening of monetary conditions that would serve to mitigate inflationary pressures, but this could result in a slowdown in economic activity. On the other hand, a reduction in real interest rates and/or a depreciation of the REER would imply a loosening of monetary conditions, which may be necessary to stimulate output growth; this could, however, be potentially inflationary.*

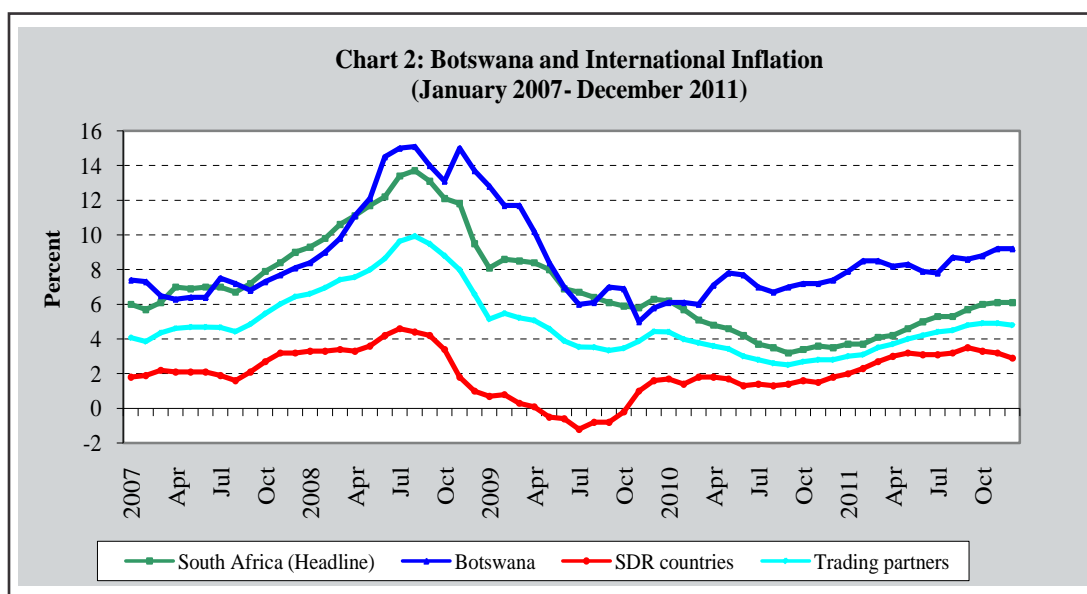
### 3. INFLATION TRENDS AND OTHER ECONOMIC DEVELOPMENTS IN 2011

3.1 *There was upward pressure on world inflation in the first half of 2011, particularly in emerging market economies, due to high commodity and food prices, which contributed to higher inflation than desirable in many countries (Chart 1). In contrast, price pressures eased towards the end of the year, as global demand and economic activity slowed. International oil prices (US light crude) peaked at USD120 per barrel at the end of April 2011, in response to political and social conflict in parts of the Middle East and North Africa. Subsequently, weak economic activity and the increase in supply contributed to a decrease in the price of oil to about USD100 per barrel at end-December 2011. Persistent low levels of capacity utilisation and high rates of unemployment in major economies also helped moderate global inflation. Overall, world inflation increased from 4.2 percent in 2010 to 4.6 percent in 2011 as output growth decelerated from 5.2 percent in 2010 to a projected 3.8 percent expansion in 2011.<sup>6</sup>*



6 World Economic Outlook Update published by the International Monetary Fund (January 2012).

3.2 The trade-weighted average inflation for Botswana's trading partner countries rose from 2.8 percent in 2010 to 4.8 percent in December 2011 (Chart 2).<sup>7</sup> In SDR countries<sup>8</sup>, inflation increased significantly from 1.8 percent in 2010 to 2.9 percent in December 2011, mostly due to the increase in commodity prices and consumption tax adjustments (particularly in the UK).<sup>9</sup> South Africa's headline inflation rose markedly from 3.5 percent in 2010 to 6.1 percent in December 2011, thus marginally breaching the upper end of the country's medium-term target range of 3 – 6 percent. This was attributable, in large part, to a fast increase in food prices.



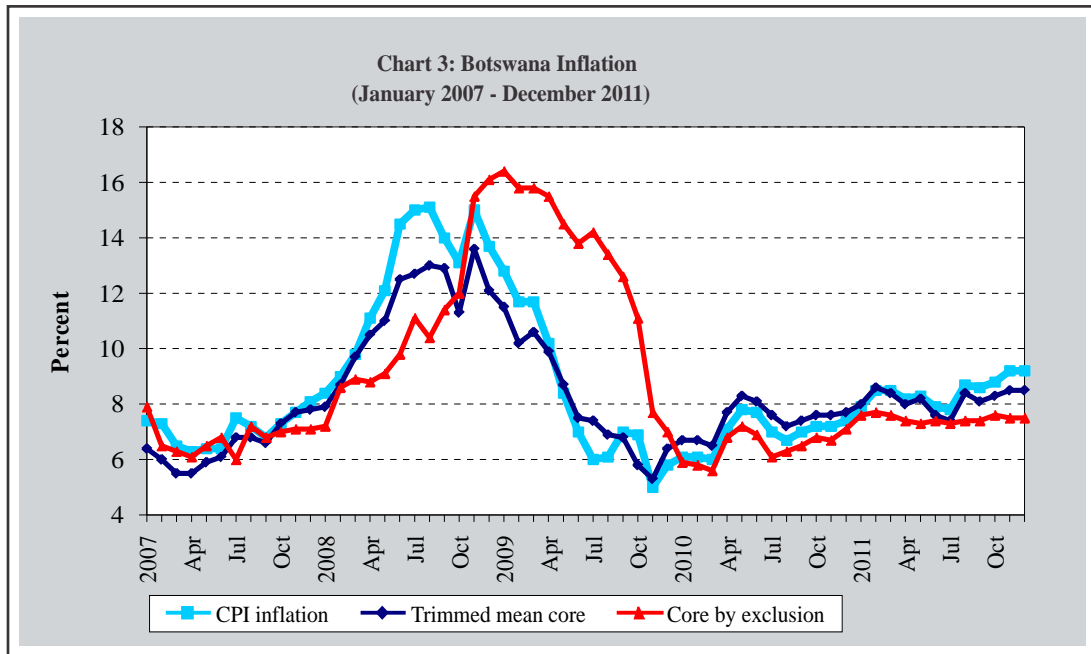
Source: Statistics Botswana (formerly Central Statistics Office)

3.3 Inflation in Botswana was above the medium-term objective range of 3 – 6 percent in 2011 (Chart 3), as influenced by a rapid increase in the cost of food and administered prices such as fuel, public transport and electricity (Chart 5). Notably, the annual increase in the cost of fuel added approximately 1.9 percentage points to inflation in 2011. Overall, upward adjustments in administered prices added approximately 2.3 percentage points to inflation in 2011. On the other hand, subdued prices for other sub-groups, including a 5.4 percent reduction in the cost of communication, held down overall CPI inflation.

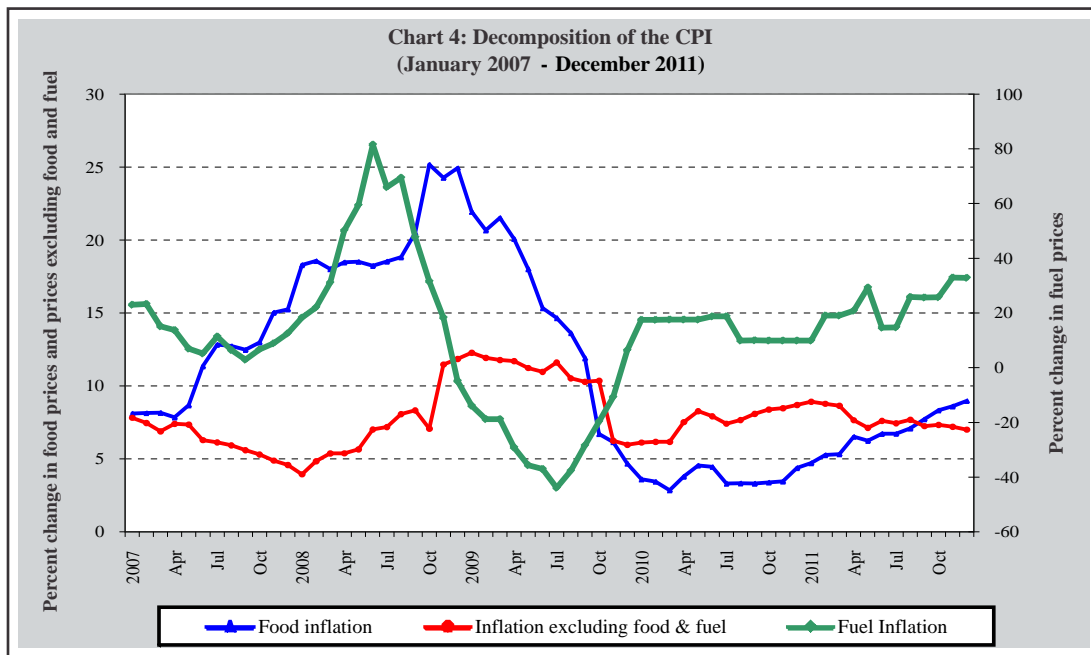
7 The trade-weighted average inflation comprises South Africa's headline inflation and the SDR countries' inflation.

8 USA, UK, Japan and the Eurozone.

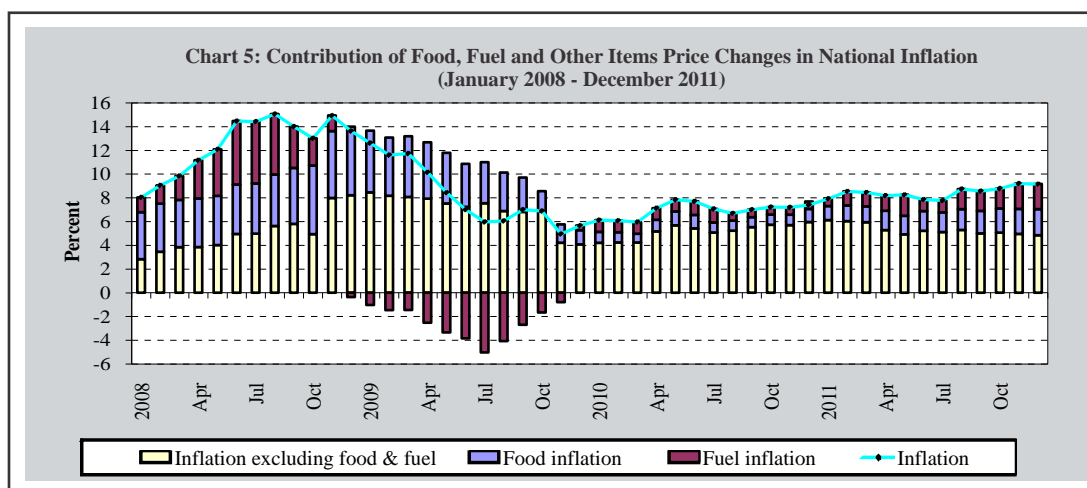
9 Inflation rose in all the SDR countries (except Japan, which is still experiencing deflation), with a more pronounced increase in the first six months of the year.



Source: Statistics Botswana (formerly Central Statistics Office)



Source: Statistics Botswana (formerly Central Statistics Office)



Source: Statistics Botswana (formerly Central Statistics Office)

- 3.4 Inflation rose from 7.4 percent in December 2010 to 8.5 percent in March 2011 (Chart 3), as a result of upward adjustment of school fees for private schools and an increase in fuel prices in the first quarter of the year. However, inflation eased to 7.9 percent in June, following reduction of telecommunication tariffs. Thereafter, inflation rose in the second half of the year in response to an adjustment of fuel prices and transport fares as well as an increase in the cost of food, health and household durables. Inflation excluding administered prices also rose, albeit at a slower rate, from 7.1 percent in December 2010 to 7.5 percent in December 2011, while the 16 percent trimmed mean measure of core inflation increased from 7.7 percent to 8.5 percent.
- 3.5 Demand pressures on inflation were low in 2011 in the context of below-trend domestic economic activity. In particular, household demand was constrained by the generally restrained growth in public sector wages<sup>10</sup> and an increase in administered prices, which tend to tighten discretionary spending. Government expenditure growth was similarly controlled with a view to balancing the budget by fiscal year 2012/13. At the same time, the level of foreign exchange reserves increased in 2011, in part due to higher export prices. In the circumstances, faster credit expansion helped to stabilise aggregate demand; and lending to businesses increased by 41 percent in 2011, compared to much slower growth of 11.3 percent in 2010. Similarly, credit to households grew by a higher rate of 15.8 percent in 2011 compared to 12.5 percent in the preceding year.<sup>11</sup> Overall, annual growth in credit to the private sector accelerated from 11.9 percent in December 2010 to 26.4 percent in December 2011 (Chart 7).<sup>12</sup>

10 Public officers' salaries were increased by 3 percent effective September 2011, following a public sector wage freeze for 3 consecutive years.

11 Since July 2011, there may be some anomalies in the components of total credit arising from the introduction of a new reporting format for commercial banks.

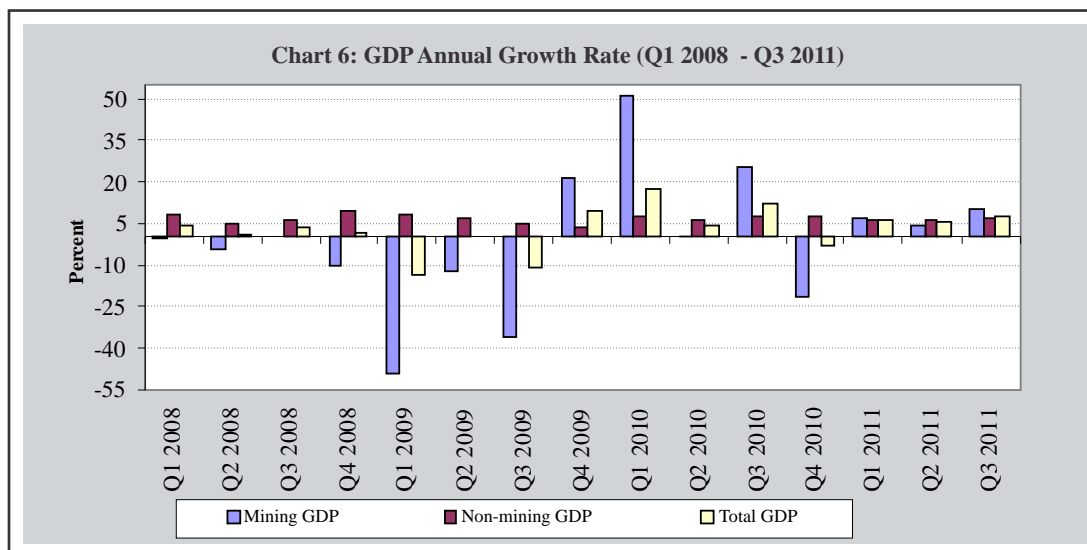
12 The significant growth is mainly attributable to new instalment loans and overdraft facilities extended to bank customers in various economic industries during the year, with credit to the household sector expanding as a result of aggressive marketing campaigns by some banks.



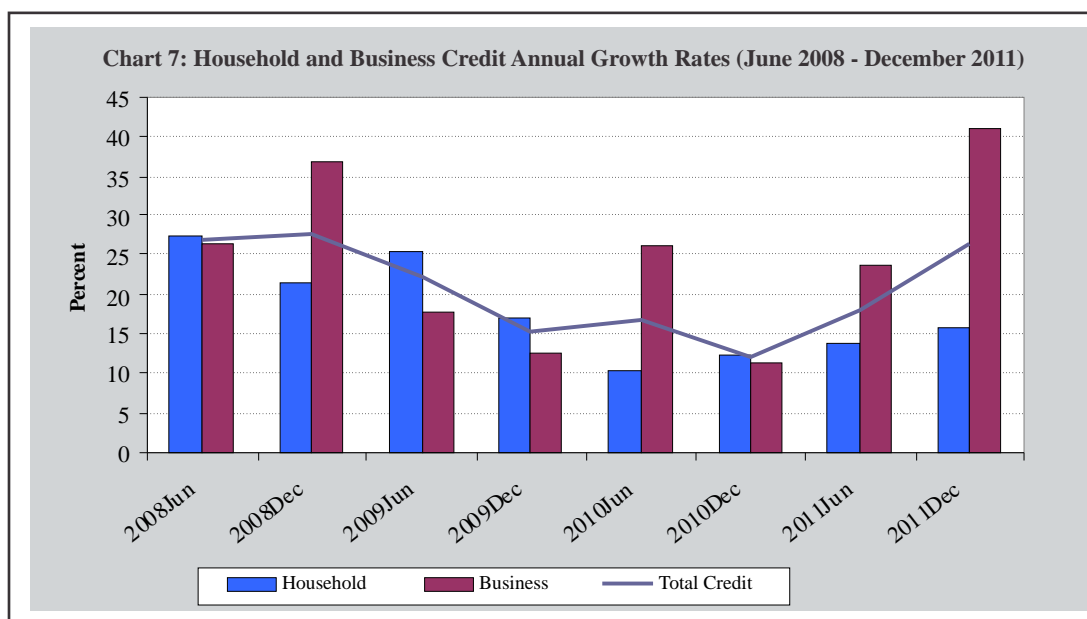
- 3.6 *As a result, and as was the case in 2010, broad money supply increased by 4.4 percent in 2011 under the additional influence of a 21.3 percent increase in net foreign assets in 2011 (11.1 percent decline in 2010).<sup>13</sup> In contrast, the 55.9 percent increase in government deposits at the Bank of Botswana was contractionary, as reflected in moderate growth in government expenditure. Total government recurrent and development spending is projected to increase by 8.9 percent in 2011/12, following a slight (0.7 percent) contraction in 2010/11. In particular, development expenditure is estimated to be virtually unchanged (0.3 percent decrease), while recurrent spending is projected to increase by 12.7 percent.*
- 3.7 *However, money supply growth in 2011 helped to support output expansion; it was estimated at 4.1 percent in the year to September 2011 (Chart 6 – annual GDP growth rates by quarter), and compares with the higher 10.7 percent of the corresponding period in 2010. This level of output growth was attributable to the performance of the non-mining sectors, which grew by 6.8 percent, with a particularly strong performance of the construction (26.7 percent), manufacturing (12.6 percent) and transport and communications (8.8 percent) sectors. In contrast, mining output fell by 1.7 percent compared to the previous year's growth rate of 21.5 percent.*

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13 *The increase in net foreign assets is mostly attributable to an 18.5 percent growth in foreign exchange reserves held by the Bank of Botswana, against the background of considerable improvement in revenue, with receipts from minerals and the Southern African Customs Union recovering strongly and sufficient to offset the continued strong growth in imports.*



Source: Statistics Botswana (formerly Central Statistics Office) and Bank of Botswana calculations.  
 Note: The growth rate is calculated as the percentage change in GDP for the current year's quarter over the level for the same quarter in the previous year.



Source: Bank of Botswana

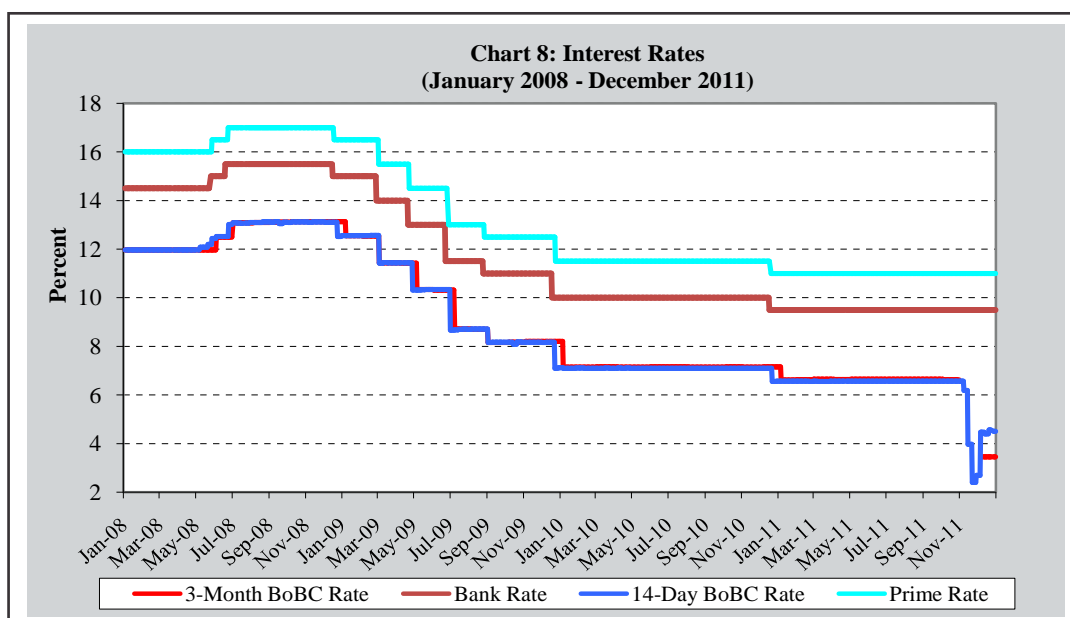
#### 4. IMPLEMENTATION OF MONETARY POLICY IN 2011

4.1 Monetary policy was conducted against the background of uncertain global economic and policy developments, due in the main to the Eurozone sovereign debt crisis. At the same time, the March 2011 earthquake and tsunami in Japan led to disruption in production, thus adversely affecting output across the world. In addition, political unrest in some Middle East and North Africa countries

*contributed to volatility of international oil prices. Overall, growth in the world economy remained uneven and slowed in the second half of 2011. Persistent high unemployment rates and fiscal consolidation that is meant to reduce budget deficits and the debt burden in major economies were responsible for restraint in world demand. At the same time, uncertain prospects for resolution of the debt crisis in some of the European countries generated volatility in the financial markets and a risk of banking sector crisis.*

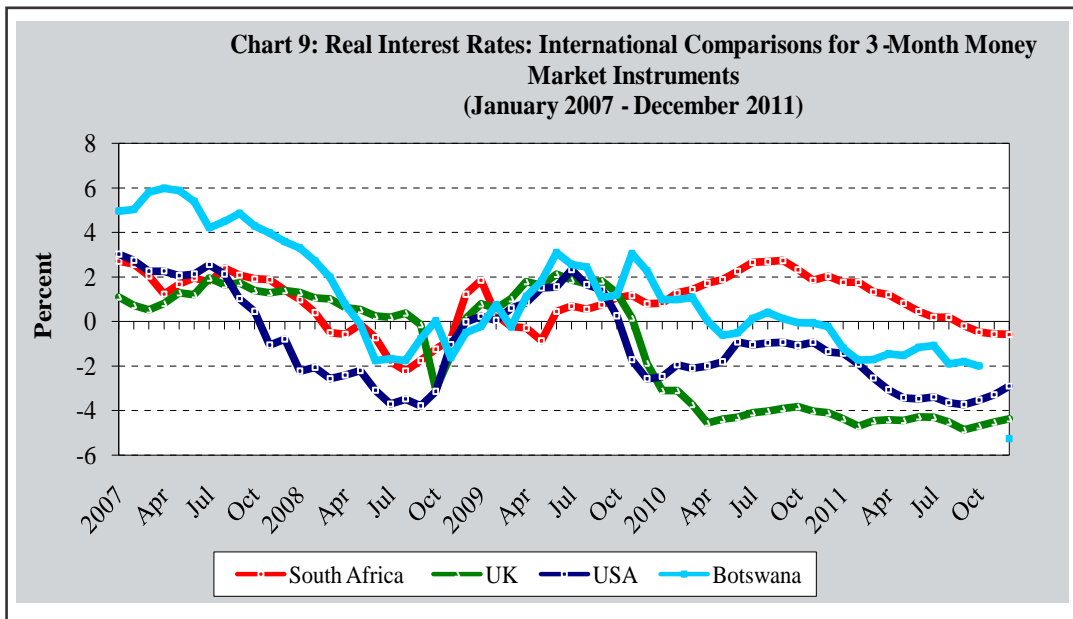
- 4.2 World inflation increased in 2011, thus reflecting volatile commodity and food prices, as well as robust performance in some of the emerging market economies. However, it was considered that inflation was less of a medium term threat given the slowing economic activity and persistent high unemployment as well as spare capacity in major economies. Hence, an accommodative monetary policy posture was generally maintained in 2011, although some central banks had tightened policy earlier in the year.*
- 4.3 In particular, the Federal Reserve Bank (Fed) of the USA and Bank of England maintained low policy interest rates in 2011, and this was complemented with quantitative easing. Following a period of tighter monetary policy, the European Central Bank reduced interest rates towards the end of the year and introduced additional measures to augment banking system liquidity. Similarly, some of the emerging market economies that had earlier raised interest rates, notably Brazil and China, did change their policy posture by year-end, while India maintained a tight monetary policy posture throughout the year.*
- 4.4 Implementation of monetary policy in Botswana was in the context of below-trend non-mining output, and this meant that there was a non-inflationary negative output gap. However, domestic inflation was higher than the 3 – 6 percent medium-term objective range due to a combination of external and transient factors. In consideration of the positive medium-term inflation outlook that reflected low demand pressures, below-trend economic performance (negative output gap) and benign external inflationary pressures, the Bank Rate was maintained at 9.5 percent in 2011. The commercial banks' prime lending rate was also unchanged at 11 percent.*
- 4.5 The Bank's implementation of monetary policy was supported by open market operations by way of absorption of excess liquidity in a bid to maintain the desired level of interest rates. As a related matter, the Bank implemented two measures to reduce the amount of liquidity that is mopped up through Bank of Botswana Certificates (BoBCs). First, effective July 1, 2011, the primary reserve requirement for commercial banks was increased from 6.5 percent to 10 percent and in November 2011, absorption of excess liquidity through issuance of BoBCs was confined to P10 billion. The objective of the latter measure is to encourage banks to actively seek and fund bankable projects that would contribute towards economic diversification. In the light of these developments, the 14-day BoBC yield, which had been constant at 6.56 percent from December 2010 to October 2011, decreased to 2.69 percent in November 2011. Shortly thereafter (December 2011), the 14-day BoBC yield increased to 4.51 percent. The average commercial bank 88-day deposit interest rate decreased from 5.49 percent in December 2010 to 4.08 percent in December 2011.*

4.6 The Bank also implemented a modest downward crawl of the Pula exchange rate in line with the policy objective of maintaining a stable inflation-adjusted exchange rate (REER) of the Pula against a trade-weighted combination of trading partner country currencies. The downward crawl and the resultant depreciation of the NEER was smaller than the differential between inflation in Botswana and the average inflation of trading partner countries (Charts 11 and 12). As such, the Pula depreciated by 2.5 percent against the trade-weighted composite trading partner country currencies. Overall, real monetary conditions, as measured by a combination of changes in the inflation-adjusted exchange rate and interest rates, were relatively tight in 2011 (Chart 10), thus contributing to moderate inflationary pressures. The policy loosening effect of the decrease in the inflation-adjusted interest rates was more than offset by an appreciation of the REER of the Pula. The real 14-day BoBC rate fell from -0.78 percent in December 2010 to -4.3 percent in December 2011, thus reflecting the increase in inflation.<sup>14</sup> The inflation raising effect of transient factors accounted for the 1.5 percent appreciation of the REER of the Pula.

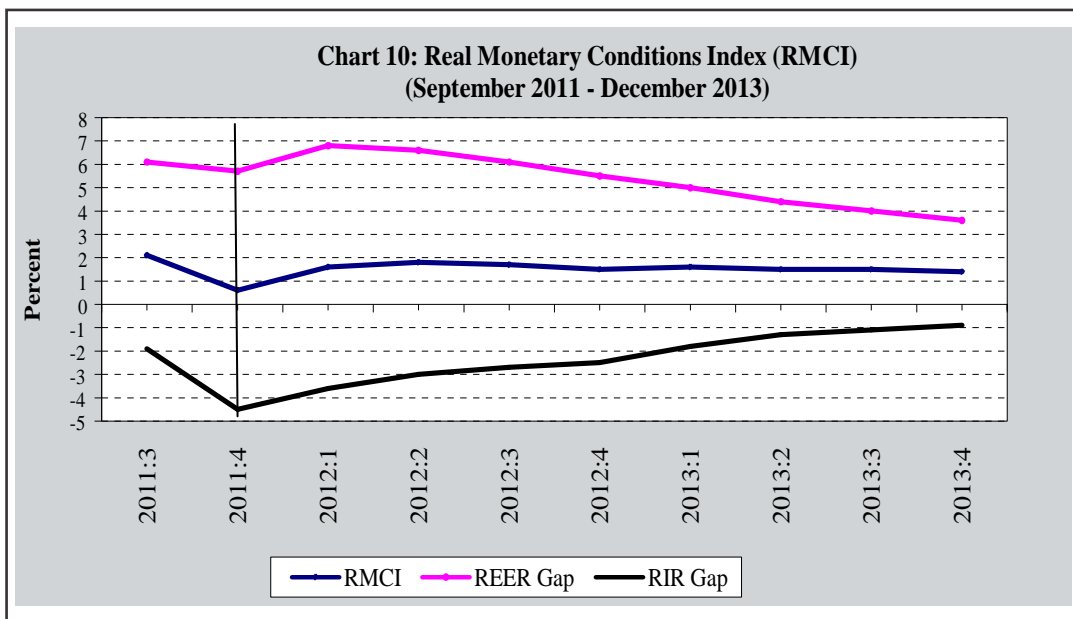


Source: Bank of Botswana

<sup>14</sup> Real 3-month money market interest rates were -5.3 percent, -0.6 percent, -4.4 percent, -2.9 percent and -2.8 percent in December 2011 for Botswana (3-month BoBCs), South Africa, UK, USA and the Eurozone, respectively.



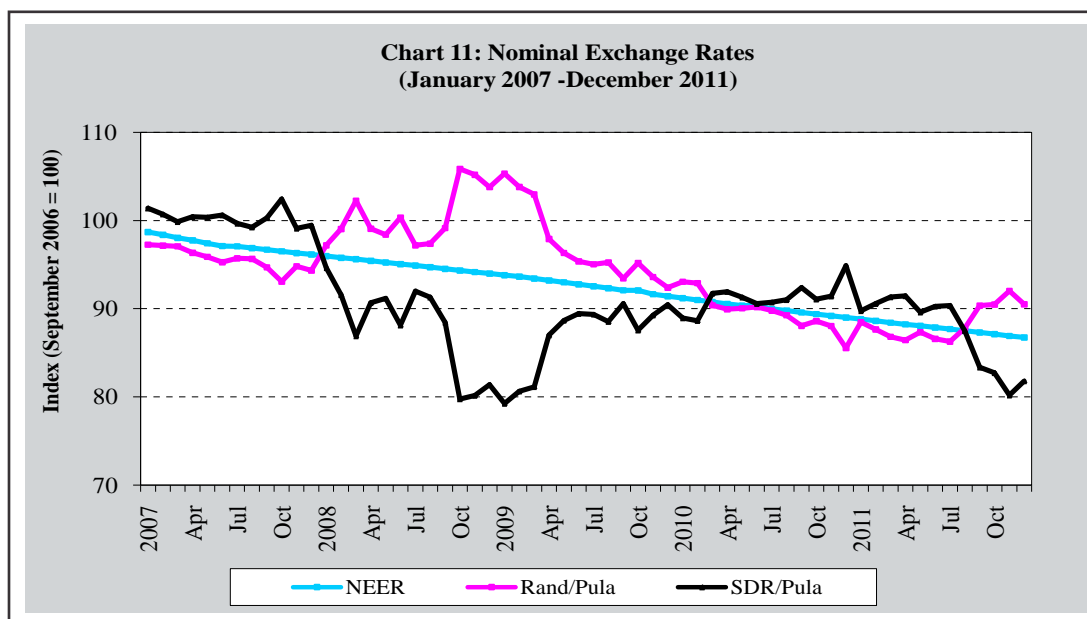
Source: Bank of Botswana.



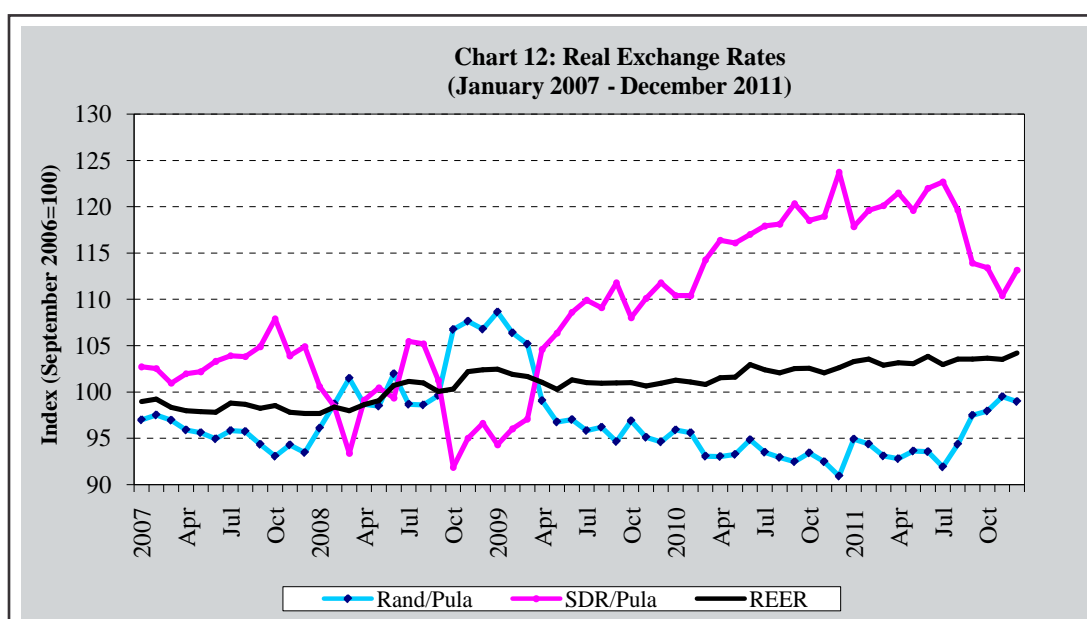
Source: Bank of Botswana.

Notes:

- (1) REER Gap is a measure of the deviation of the actual REER from its trend value.
- (2) Real Interest Rate (RIR) Gap is a measure of the deviation of the real interest rate (3-month real BoBC rate) from its trend value.
- (3) The Real Monetary Conditions Index (RMCI) is a weighted average of the REER Gap and RIR Gap.



Source: Bank of Botswana.



Source: Bank of Botswana.

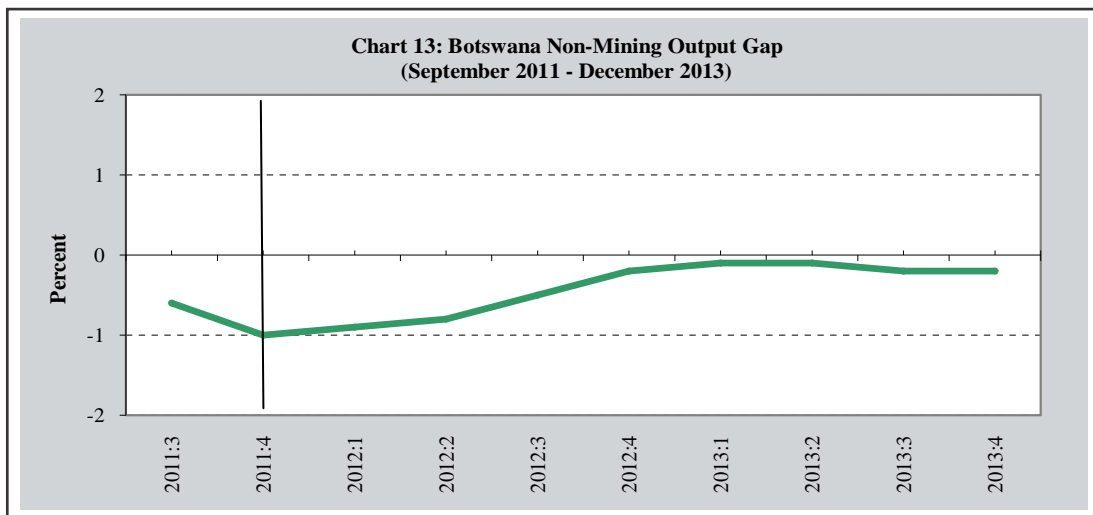
## 5. OUTLOOK FOR INFLATION

- 5.1 *Global output growth for 2012 is forecast to be lower than the 3.8 percent estimated for 2011 at 3.3 percent. This represents a downward revision from earlier projections of 4 percent growth for both 2011 and 2012 and reflects mainly the increased uncertainty relating to the Eurozone sovereign debt crisis. Moreover, failure by US authorities to agree on measures to reduce the government deficit could have a negative effect on the economy, as the imminent spending cuts and increase in tax will constrain demand.*

Nevertheless, growth prospects for the US appear positive, with a projected increase in production and a decrease in the unemployment rate. While it is anticipated that economic activity will remain buoyant in the emerging market economies (mainly China and India) and some developing countries, output growth is expected to decelerate in the context of earlier policy tightening and fall in foreign demand. In contrast, it is projected that the Eurozone will go into recession in 2012.

- 5.2 Overall, there are different policy challenges across countries, given diverse growth cycles and limitations of policy instruments. A number of advanced economies continue to focus on initiatives to provide short-term support to economic activity and sustain resilience of the financial sector and its ability to support the real economy. At the same time, medium to long-term fiscal consolidation plans are being devised and implemented; this includes rescue packages for countries with severe debt problems. In the circumstances, it is expected that monetary policy will remain accommodative. However, with interest rates at minimum levels, major central banks will continue with quantitative easing and other unconventional policy instruments in order to sustain financial intermediation and stimulate demand. Given lower growth, uncertain prospects for trade and a receding threat of inflation in emerging market economies, it is expected that the easing of monetary policy that was initiated in the last half of 2011 will be maintained.
- 5.3 Global inflationary pressures are expected to ease, given flat commodity prices and restrained global output growth that is associated with aggressive fiscal consolidation measures, weak business and consumer confidence and subdued demand. Furthermore, persistent low levels of capacity utilisation and high unemployment in major economies continue to have a moderating influence on inflation. Global inflation is, therefore, projected to decline from 4.6 percent in 2011 to 3.4 percent in 2012. In emerging market countries, underlying inflationary pressures are likely to be at a relatively high level given buoyant economic activity and relatively low unemployment. Meanwhile, there are upside risks emanating from a possible increase in international food prices. On the other hand, there are downside risks to the world inflation outlook in view of a possible easing of international commodity prices and a further dampening of economic activity.
- 5.4 Inflation in SDR countries for 2012 is forecast to be lower at 1.8 percent (2.9 percent in 2011). Headline inflation in South Africa is projected to increase from an average of 5 percent in 2011 to 5.8 percent in 2012. Given Botswana's medium term inflation objective range of 3 – 6 percent and forecast average trading partner inflation range of 3 – 5 percent, there should be a marginal downward crawl of the NEER in 2012. In the circumstances, it is expected that the influence of external price developments (through imported inflation and changes in the exchange rate) on domestic inflation will be benign.

5.5 *Moderate output expansion is projected for the domestic economy, with persistence of the negative non-mining output gap (Chart 13). Mining output will be largely influenced by new ventures as existing producers are not likely to change production significantly, albeit subject to maintenance of foreign demand. For the non-mining sectors, output will be restrained in the context of modest local demand. Overall, it is projected that the non-mining sector output will be below trend; thus a negative output gap (Chart 13).<sup>15</sup> In particular, performance could be weighed down by the limited fiscal stimulus and sluggish growth in personal incomes, given the unchanged level of government expenditure (a marginal 0.1 percent increase in total government expenditure is budgeted for 2012/13).*



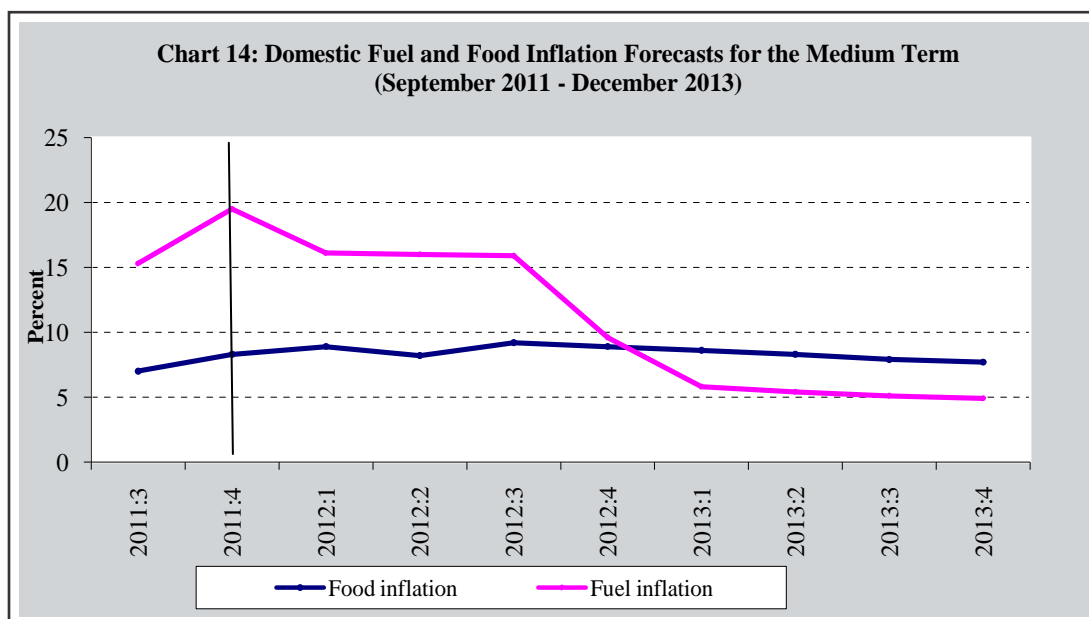
Source: Bank of Botswana.

5.6 *The Bank's September 2011 Business Expectations Survey (BES) shows some weakening in sentiment for business prospects in 2012. Notably, exporters were less confident, and this could be reflective of uncertainty in respect of policy developments and economic performance in major export markets, such as the euro area and USA. Non-exporters concerns are related to the impact of lower government expenditure. Inflation expectations are downwards, albeit above the 3 – 6 percent medium-term objective range.*

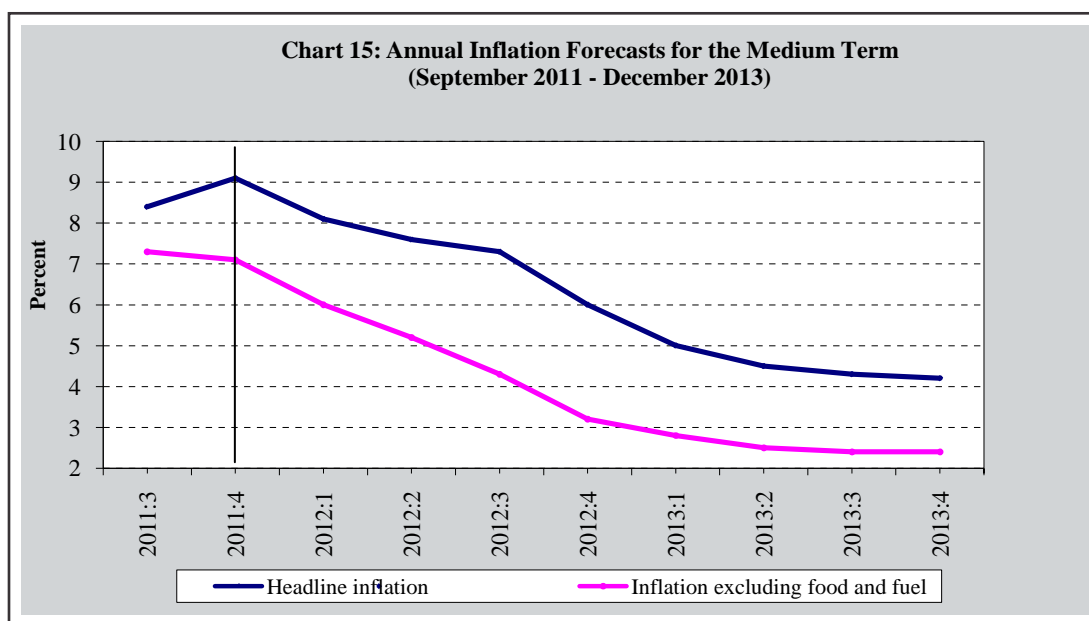
5.7 *In view of projected below-trend economic activity and subdued disposable incomes, it is anticipated that domestic demand pressures on inflation will be low in 2012, as will the impact of foreign price developments. Moreover, it is expected that inflation will fall due to base effects in the absence of a significant increase in administered prices, as was the case in 2011. Nevertheless, there are upside risks to the inflation outlook due to any substantial upward adjustment in administered prices and government levies and an increase in international food and oil prices beyond current projections (Chart 14). However, this is balanced with the downside risks associated with the likely fall in international commodity prices and a possible weaker global economic activity. Overall, inflation is forecast to remain above the medium-term objective range in the short term; it is forecast to converge to the medium-term objective range of 3 – 6 percent in the second half of 2012 (Chart 15).*

<sup>15</sup> *The projected negative output gap does not necessarily imply that output growth will be negative; rather, it means that actual output will be below the trend level.*





Source: Bank of Botswana.



Source: Bank of Botswana.

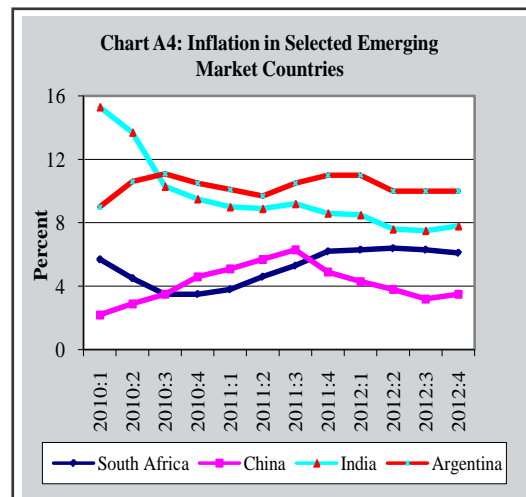
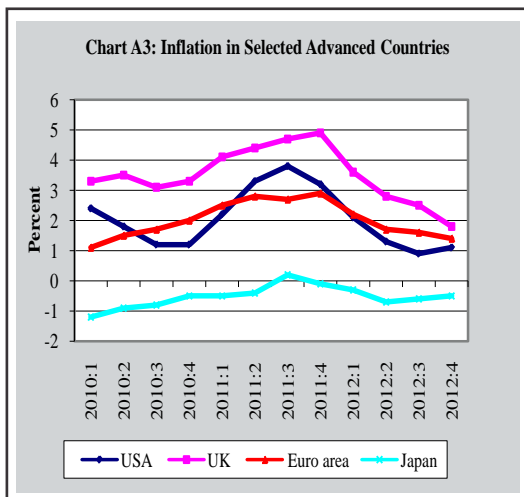
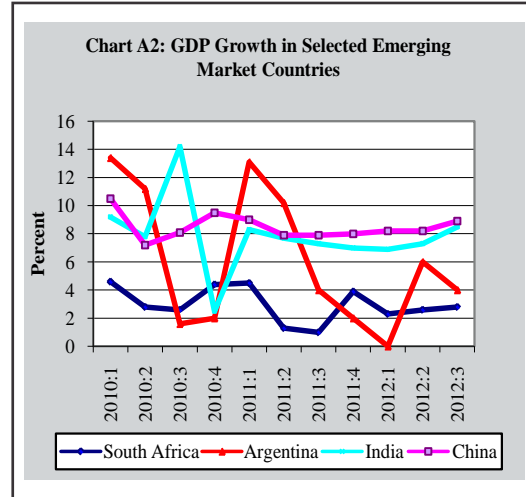
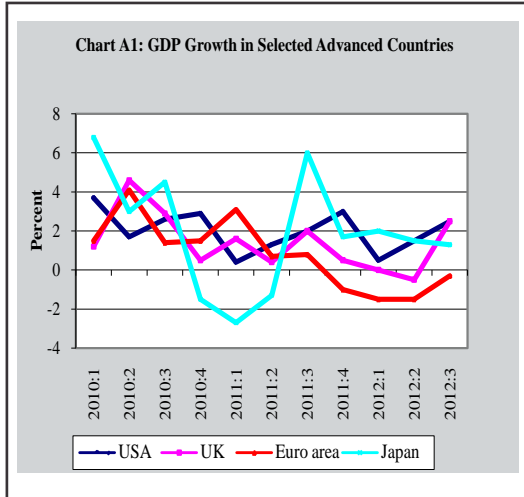
## **6. 2012 MONETARY POLICY STANCE**

- 6.1 *In the context of the current monetary policy stance and the forecast influence on price developments, it is anticipated that domestic inflation will converge to the medium-term objective of 3 – 6 percent in the second half of 2012, against the background of restrained underlying demand pressures and projected below long-term trend output. Prospects for low and stable inflation in the medium term suggest an accommodative monetary policy stance, which would be supportive of economic activity in an environment where fiscal stimulus is constrained by the need to rebuild financial balances.*
- 6.2 *However, persistent inflation above the medium-term objective range pose a challenge for monetary policy implementation as inflation expectations may have an upward bias. Therefore, the formulation and implementation of monetary policy will need to take account of the impact of short-term price developments on medium-term inflation expectations. Accordingly, the Bank will respond in a timely manner to any sustained deviation of inflation from the medium-term inflation objective of 3 – 6 percent, in order to engender expectations of a low and predictable level of inflation.*
- 6.3 *The Bank's implementation of the exchange rate policy will entail a modest downward crawl of the nominal Pula exchange rate, given that the upper end of the Bank's inflation objective remains higher than the forecast average inflation of trading partner countries. This is in the best interest of international competitiveness of domestic industries and the enhancement of sustainable economic diversification.*

## **7. CONCLUSION**

- 7.1 *The global economic recovery has slowed, due in part to transient factors such as the 2011 earthquake and tsunami in Japan and political unrest in the Middle East and North African countries. The euro area debt crisis also added its impact to the already troubled global economy. The result is that global economic activity will moderate in 2012. While world inflation is expected to remain largely subdued as a result of the levelling off of international commodity prices and a possible fall in global output expansion, there is a risk that there could be a substantial increase in food and oil prices that could generate upward pressures on inflation.*
- 7.2 *Domestic inflation is forecast to remain above the medium term inflation objective range of 3 – 6 percent in the short term, and decrease in the second half of the year in the context of low domestic demand, benign external price developments and base effects. In the circumstances, the Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low and sustainable inflation in the medium term, through timely responses to price developments. Needless to add, the Bank remains committed to responding appropriately to all economic and financial developments to attain price stability in the medium term, without undermining sustainable economic growth.*

**Output Growth and Inflation for Selected Countries**



Source: JP Morgan Chase

Note: Data from Q1 2012 to Q4 2012 are forecasts

