



Bank of Botswana

2023 MONETARY POLICY STATEMENT

by

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Governor

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Introduction

Distinguished Guests, I am honoured and delighted to present the 2023 Monetary Policy Statement. Allow me to extend a special word of welcome to the Guest of Honour, Honourable Minister of Finance, Ms Peggy Onkutlwile Serame and our new Permanent Secretary in the Ministry, Mr Olesitse Masimega. On behalf of the Board, Management and Staff of the Bank of Botswana, we are grateful to you all, Distinguished Guests, for having made the time to attend the Monetary Policy Statement Launch.

Monetary Policy Statement – Historical Transitions and Communication Attributes

Honourable Minister and our Esteemed Guests, 2023 is a momentous year for the Bank of Botswana and for progress in monetary policy formulation. It is the 25th anniversary (that is, the Silver Jubilee) of the use of the Monetary Policy Statement by the Bank to anchor monetary policy formulation, since its first public launch by the then Governor, the late Mr Baledzi Gaolathe in 1998. Furthermore, following the passing of the Bank of Botswana (Amendment) Act, 2022, this year's Monetary Policy Statement is a precursor to implementation of significant changes to the mandate and institutional arrangements for the conduct of monetary policy and fostering financial stability. I will shortly outline the significance of these changes. It suffices to note, however, that the imminent commencement and implementation of the recently promulgated Bank of Botswana (Amendment) Act is a historic culmination of operational changes and influences, designed to sustain an accountable, transparent and predictable monetary policy formulation process.

Allow me, therefore, Distinguished Guests, to reflect on the past 25 years, and recall the significant milestone transitions and their related impact on the effectiveness of monetary policy in

Botswana. **First**, and notable, is the public announcement of the annual inflation objective from 2002, initially set at 4 – 6 percent and, later, the current medium-term objective range of 3 – 6 percent. **Second**, is the adoption of the forecast-based monetary policy framework, with a medium-term horizon in 2008. **Third**, is the establishment of a modelling and forecasting infrastructure and deepening of the necessary skills and governance arrangements to ensure excellence in execution and process credibility. **Fourth**, is the successive changes in institutional arrangements, for example, constitution of a Monetary Policy Committee, regularity of meetings, publication of the calendar of MPC meetings for the ensuing year and the quarterly Monetary Policy Report, as well as entrenchment of communication channels. **Fifth**, and as a result of these innovations, the country transitioned to a long period of low inflation environment and, from June 2013 to 2020, inflation was either within or below the 3 – 6 percent desired objective range. To make the point clearer, at the onset of the COVID-19 pandemic in early 2020, the average inflation in Botswana was 2.2 percent, having progressively decreased from 5.9 percent in 2013. Regrettably, the advent of a series of exogenous shocks (COVID-19 and Russia–Ukraine war) caused major disruptions in production and supply of goods and services, globally and here at home, resulting in a sharp rise in prices, notably for

food, and energy prices. Even, in this instance, the existence of a disciplined and predictable framework, supported by other complimentary macroeconomic policies, ensured appropriately calibrated responses and deployment of relevant instruments.

This achievement, and “trust in the process” in part, signifies the role the publication and launch of the Monetary Policy Statement plays as a critical aspect of governance and policy formulation; in this regard, integrating elements of accountability and being effectively an operational instrument.

With regard to accountability, the three key aspects are **(a)** clear articulation of the monetary policy framework, and how it relates to prospects for effective conduct of policy and the price stability mandate; **(b)** reporting on the conduct of monetary policy and, in turn, the impact on the inflation outcome relative to the objective over the specified medium-term horizon; and **(c)** evaluating or validating the inflation outcome in comparison with the forecast, and relatedly, the realisation of initial assumptions and credibility of explanations for any deviations.

As a policy tool or instrument, the Monetary Policy Statement relays relevant information for decision making by firms and households, across the economy. The information

disseminated includes review of global and domestic economic and policy developments, as well as the outlook for the year ahead. Furthermore, the related clear statements on prospective policy posture serve to influence market responses in relation to balance sheet management (including liquidity management) and short-term market interest rates. Ultimately, the information contained in the Monetary Policy Statement helps transmit policy, influence economic decisions, and the formation of inflation expectations. In the absence of destabilising shocks, the inflation expectations should converge to the desired 3 – 6 percent objective range, in the medium-term.

Impact of the Bank of Botswana (Amendment) Act, 2022

Honourable Minister, and Esteemed Guests, I will now provide highlights of the changes to the governance and institutional arrangements in the Bank of Botswana (Amendment) Act, 2022 that are critical for effective conduct of monetary policy and entrenchment of credibility of the framework.

The **first** is clear specification, by the law, of the dual but ranked mandates of the Bank, namely, domestic price stability and financial stability. This provides clarity on what ranks first and, therefore, in the event of multiple challenges facing the

economy and/or competing objectives, the Bank should be “laser-focused” on the price stability objective.

Second, the Bank will be given, by the Minister, an explicit designation of inflation objective, numerical definition of price stability, referred to as monetary policy framework in the new Act. In turn, the Bank will have de jure operational independence to pursue its primary objectives, and in the performance of its core functions under the Act. What this means, in practice, is that the Bank will have unfettered operational autonomy to use any instrument in its “toolkit” to seek to achieve monetary and financial stability objectives and, of course, be held accountable by Government and the public.

Third, the Amendment Act provides for establishment of a statutory Monetary Policy Committee. It shall comprise nine members, four of which shall be non-Bank of Botswana employees, appointed by the Honourable Minister, being professional and independent persons, not representing any sector of the economy, with knowledge and experience relevant to the functions of the Monetary Policy Committee. The remaining five internal members are the Governor, who shall be the Chairman, the two Deputy Governors, and the heads of

department responsible for economic research and for treasury operations.

Fourth, is the establishment of a statutory Financial Stability Council, to coordinate the monitoring and assessment of financial sector vulnerabilities and systemic risks and any responses that may be required, including the implementation of the macroprudential policy framework for Botswana. The Council comprises the Governor, who shall be the Chairman, the Permanent Secretary in the Ministry responsible for Finance, Chief Executive Officer of the Non-Bank Financial Institutions Regulatory Authority, Director of the Deposit Insurance Scheme, and the Director General of the Financial Intelligence Agency.

Finally, in relation to financial stability mandate and financial safety nets, the new Bank of Botswana (Amendment) Act provides for the establishment of a Deposit Insurance Scheme. The establishment of the Scheme, especially during the period of no eminent banking crisis, is indeed beneficial; it enables gradual and progressive build-up of funds up to a specified, target threshold that will be available to compensate insured deposits, in the event of actual failure of a member financial institution; thus, mitigating threats to financial stability. Details,

in this regard, would be provided following commencement of the new Bank of Botswana (Amendment) Act, 2022.

Honourable Minister and Distinguished Guests, these legal, institutional, policy and operational reforms, together with the proposed re-enactment of the Banking Act; and the ongoing work on a comprehensive payments law, will place the country's central banking laws and practices at par with those of jurisdictions who have escaped the so-called "middle income trap"; thus lay the foundation for the governance and institutional architecture required for sustained pursuance of sound macroeconomic policy management in a high income country, by 2036.

Monetary Policy Framework and Objective

Distinguished Guests, the objective of the Bank's monetary policy is to achieve price stability, defined as a low, stable and predictable level of inflation, currently, within the 3 – 6 percent objective range, over the medium-term. What this means is this: in the context of the economy of Botswana, given its structure and level of development, and in order to achieve durable,

sustainable and inclusive economic growth, price increases should not persist below 3 percent or above 6 percent.

Monetary policy formulation also considers safeguarding the stability of the financial system. A sound and stable financial system is critical for effective transmission of monetary policy signals, facilitating the flow of funds and liquidity, as well as risk mitigation in support of economic activity. In this regard, price stability, as well as conducive monetary and financial conditions, foster effective mobilisation of savings, productive investment, prudent allocation of credit, international competitiveness of domestic firms and, ultimately, balanced economic development.

Overall, therefore, the conduct of monetary policy as well as sustained focus on financial stability, support the national policy objectives of employment creation and sustainable and inclusive economic growth. Price and financial stability also help preserve the value of incomes and long-term savings, especially for low-income earners and pensioners, with less opportunity or other means to protect the erosion of the purchasing power of their incomes or financial wealth.

Honourable Minister, Distinguished Guests, against the backdrop of this outline of the monetary policy framework, historical evolution and the roles of the Monetary Policy Statement, I will now address, in turn, **first**, the global trends that have influenced inflation in Botswana; **second**, I will report on the conduct of monetary policy in 2022, internationally and here at home; and **third**, the medium-term inflation outlook and the likely policy stance in 2023.

External Economic Developments in 2022

The global economic performance and sentiment weakened in 2022, affected mostly by the ripple effects of the Russia-Ukraine war, aggressive monetary policy tightening by major central banks around the world and the lingering effects of the COVID-19 pandemic. Thus, the global economy is estimated to have expanded by 3.4 percent in 2022, a moderation from a growth of 6.2 percent in 2021.

In addition to the adverse impact on global economic activity, the prolonged Russia-Ukraine war resulted in significantly elevated commodity prices. In particular, food and energy prices rose sharply against the backdrop of supply chains not having fully recovered from the devastating impact of the

COVID-19 pandemic. Therefore, global inflation nearly doubled, from an average of 4.7 percent in 2021 to 8.8 percent in 2022.

Domestic Economic Developments in 2022

For Botswana, as the Honourable Minister indicated in the 2023 Budget Speech, real Gross Domestic Product is estimated to have expanded by 6.7 percent in 2022. Domestic inflation was above the objective range of 3 – 6 percent in 2022, with average inflation increasing from 6.7 percent in 2021 to 12.2 percent in 2022. This deterioration in the inflation profile was largely due to significant increases in administered prices during the year and the associated second-round effects.

Aggregate demand conditions, and as indicated by below potential economic activity, were modest and non-inflationary. Indeed, the recent labour force survey results by Statistics Botswana, which reports an unemployment rate of 25.4 percent in the last quarter of 2022, affirms the below-trend output growth. Furthermore, Government expenditure increased by 10.1 percent in the first seven months of the 2022/23 fiscal year compared to an expansion of 4.4 percent in the prior year. Within this, public sector personal emoluments rose by 7.1 percent, which was less than the annual inflation rate and, hence, would not be expected to add to inflationary pressures.

The other main driver of aggregate demand, namely growth in commercial bank credit, increased from 5.1 percent in 2021 to 6.2 percent in 2022, as both demand and supply of credit improved due to increased economic activity and prospects. Notably, growth in bank lending to businesses accelerated in 2022, as the economy opened, following the end of the State of Public Emergency in September 2021. In contrast, the annual increase in borrowing from commercial banks by the household sector moderated, possibly due to the impact of the higher cost of credit, as the Monetary Policy Rate was increased by a cumulative 151 basis points in 2022.

Global Monetary Policy Implementation in 2022

Honourable Minister, Distinguished Ladies and Gentlemen, at a global level, monetary policy implementation in 2022 was characterised by aggressive raising of policy rates by central banks in both advanced and emerging market economies, to tame inflationary pressures and anchor inflation expectations. Thus, policymakers focused on bringing inflation towards their respective targets. However, some central banks decreased their policy rates in 2022 to stimulate economic activity amid the crisis. Closer to home, the South African Reserve Bank increased the repo rate by 325 basis points to 7 percent in 2022

and, by another 25 basis points to 7.25 percent in January this year (2023).

Domestic Monetary Policy Implementation in 2022

Monetary policy in 2022 was conducted in an environment of projected elevated inflation, associated with upward adjustment of administered prices, a modest recovery in domestic demand resulting from the easing of COVID-19 containment measures, and relatively high foreign prices. In response, the Monetary Policy Rate was raised by a cumulative 1.51 percentage points to 2.65 percent in 2022. Consequently, the Prime Lending Rate of commercial banks increased from 5.25 percent to 6.76 percent in the same period, while deposit interest rates also generally rose. These policy actions were intended to tighten the hitherto ultra-loose financing conditions and anchor inflation expectations.

Distinguished Guests, the assessment of financial stability, as contained in the October 2022 Financial Stability Report, shows that the domestic financial system continues to be resilient, characterised by strong capital and liquidity buffers, moderate profitability, generalised institutional strength and good business performance across the industry, as well as being adaptive and innovative. Therefore, the financial sector

continues to be well-placed and resourced to support economic activity.

Reforms to Monetary Operations in 2022

Honourable Minister and Esteemed Guests, as you would recall, the Bank, in April 2022, introduced monetary operations reforms designed to enhance potency and effectiveness of monetary policy transmission. These included, in the main, **(a)** the discontinuation of the Bank Rate as the main anchor policy rate and the transition to the Monetary Policy Rate, which is the instrument-based policy rate (the 7-day Bank of Botswana Certificates yield); **(b)** an interest rate corridor with a 200-basis points width, comprising the Standing Deposit Facility at 100 basis points below the Monetary Policy Rate and the Standing Credit Facility at 100 basis points above the Monetary Policy Rate and **(c)** conditions for the conduct of supplementary Bank of Botswana Certificates auctions meant to sustain price discovery and desirable alignment of market yields, as well as to influence liquidity management by banks to be concentrated on the 7-day BoBC.

While it is early days to make a conclusive statement on the impact and effectiveness, the Bank observes, with satisfaction, that these policy reforms were well received by the market and

there are some positive indications of more effective transmission of monetary policy signals on short-term market interest rates. For example, generally, the interest rates respond to the policy rate changes and the interbank rate trades within the interest rate corridor.

As previously announced, a fundamental change is that, with effect from April 1, 2023, individual banks will be allowed to independently determine their own Prime Lending Rate. Preparatory consultations with banks were undertaken during 2022 and the expectation is that banks are ready to implement this. The differential between the current Prime Lending Rate for all banks of 6.76 percent and the policy rate at 2.65 percent is sufficiently broad, providing commercial banks significant flexibility in pricing decisions, for both deposits and credit to their customers. Given that Botswana banks are safe, sound and prudently managed, the Bank of Botswana is confident that commercial banks will continue to be disciplined and rational in determining the Prime Lending Rate for high quality credits or prime borrowers.

Global Economic Prospects in 2023

Honourable Minister, Distinguished Ladies and Gentlemen, now looking ahead to prospective economic developments in

2023. Global economic growth is expected to moderate to 2.9 percent in 2023, from 3.4 percent in 2022. However, growth prospects are varied and uneven across regions and reflect uncertainty surrounding the Russia-Ukraine war and COVID-19, as well as the scale of monetary policy tightening to contain inflationary pressures across the globe.

Regarding price developments, global inflation is projected to moderate in 2023, although remaining high, due to expected lower commodity prices, rapid-paced monetary policy tightening, squeezing of household budgets and withdrawal of COVID-19 pandemic related fiscal support. In this environment, it is anticipated that monetary policy will remain restrictive in most economies to tame inflationary pressures.

Domestic Economic Prospects in 2023

Honourable Minister, Distinguished Ladies and Gentlemen, the domestic economy is forecast to grow by 4 percent in 2023, compared to an estimated expansion of 6.7 percent in 2022, as growth in the mining sector moderates. Notwithstanding this, the expansion projected for 2023 is premised on improvement of growth performance of the non-mining sectors. The effective implementation of the Economic Recovery and Transformation Plan, implementation of the two-year Transitional National

Development Plan, conducive domestic financing conditions associated with accommodative monetary policy and sound financial environment underpin impetus for positive economic prospects.

Honourable Minister, regarding inflation, the immediate backdrop is that inflation is worryingly high, having been above the Bank's medium-term objective range of 3 – 6 percent in 2022, peaking at 14.6 percent in August. However, inflation has generally been on a downward trajectory since September 2022 and is forecast to revert to the Bank's 3 – 6 percent medium-term objective range in the second quarter of 2024.

This projected trajectory for inflation is premised on the following factors. **First**, the dissipating impact of the earlier increases in administered prices. **Second**, the recent reduction in domestic fuel prices. **Third**, the expected decrease in international commodity prices and implementation of a smaller downward annual rate of crawl for the Pula exchange rate. **Fourth**, the projected economic growth, of 4 percent in 2023, is below potential growth; and, therefore, output gap remains negative, hence non-inflationary. **Fifth**, the projected trading partner inflation is within the Bank's medium-term objective range of 3 – 6 percent. **Sixth**, the inflation forecast also

incorporates the known forthcoming increases in administered prices (for example, Botswana Housing Corporation (BHC) rentals and electricity tariffs) and the likely impact of Value Added Tax (VAT) reverting to 14 percent.

Notwithstanding, I should be quick to point out that the risks to the inflation outcome are skewed to the upside. Notably, the potential increases in international commodity prices beyond current forecasts; adverse economic and price effects of the protracted Russia-Ukraine war; persistence of supply and logistical constraints due to lags in production; the uncertain COVID-19 profile and ongoing tension between China and the United States over South China Sea and Taiwan.

Domestically, the risks for higher inflation relate to possible annual price adjustments in administered prices that are not factored in the current projections; entrenched expectations for higher inflation and any realised upward pressure on wages, which could lead to higher general price adjustments; short-term consequences of import restrictions; and prospective fiscal developments, notably implementation of potentially expansionary two-year Transitional National Development Plan, and overshooting of prices in advent of reversion of the Value Added Tax to 14 percent. These risks are, however,

moderated by the possibility of weak domestic and global economic activity, as well as restrained commodity prices.

2023 Monetary Policy Stance

Honourable Minister, Distinguished Ladies and Gentlemen, as currently projected, the medium-term outlook for inflation remains favourable, in the context of dissipation of the effects of the increase in administered prices, moderate growth in both domestic and global economic activity, as well as moderation in external price developments. Ordinarily, this should augur well for maintenance of accommodative monetary policy that is consistent with inflation reverting, on a sustained basis, to within the objective range of 3 – 6 percent in the medium term. Hence, the Bank will maintain an accommodative monetary policy stance in 2023. However, given the upside risks to the inflation outlook in the medium-term, the policy posture may need to be calibrated to respond, in an appropriate, timely and measured manner, to price developments in 2023.

Regarding the exchange rate policy implementation, as announced at the beginning of the year and broadly consistent with Botswana's trade pattern, the weights of the constituent currencies in the Pula Basket are 45 percent for the South African rand and 55 percent for the Special Drawing Rights. A

downward rate of crawl of 1.51 percent of the nominal effective exchange rate is also being implemented in 2023, which entails marginal inflationary pressures as the Pula exchange rate depreciates through the downward crawl. Nevertheless, the overriding focus is on maintaining global competitiveness of the domestic industry and supporting economic growth through maintenance of a stable real effective exchange rate (that is, the composite Pula exchange rate adjusted for inflation differentials between Botswana and its trading partner countries).

Distinguished guests, let me also point out that, the exchange rate policy framework is anchored on strong performance and adequacy of the foreign exchange reserves. These improved slightly from P56 billion or 9.1 months of import cover in December 2021 to P59.6 billion or 9.7 months of import cover in November 2022, partly due to recovery in domestic economic performance, as driven by improvement in external demand. Therefore, to the extent that sustainability of the current exchange rate framework continues to be supported by an adequate level of foreign exchange reserves, the inherent flexibility imbedded in a crawling band exchange rate regime facilitates adjustments of the rate of crawl of the Pula exchange

rate necessary to generate improvements in international competitiveness of the domestic industry, as may be warranted.

Honourable Minister and Esteemed Guests, as indicated earlier, the reforms to monetary operations introduced in 2022 are expected to enhance monetary policy transmission by inducing the desired market response to monetary policy and monetary operations adjustments. In particular, designation of the Monetary Policy Rate as the anchor policy rate enables direct linkage to liquidity management decisions and determination of interbank market interest rates by commercial banks, hence ultimate transmission of any policy changes to the rest of the economy, as desired. In addition, the freeing up of the Prime Lending Rates to be independently determined by individual commercial banks should facilitate market competition and fair pricing of loans and other credit products. The Bank will, nevertheless, closely monitor implementation of this dispensation and steadfastly enforce good business conduct and alignment with the desired outcome.

Furthermore, as well as embedding the operational processes around these reforms, the Bank will continue to project its communication capabilities and instruments to convey the messages relating to economic and financial developments; the

main drivers of inflation and anticipated profile and trajectory, including estimation of the difference between potential and actual output; and how this evaluation informs the rationale for monetary policy action or posture. As an additional tool and improvement to its operations, the Bank will harness social media, data analytics and leading economic indicators to entrench nowcasting of economic variables that come with a lag as an integral part of modelling and analytical work.

Conclusion

As I conclude, Honourable Minister and Distinguished Ladies and Gentlemen, I wish to underscore that the Bank is committed to ensuring price and financial stability: that is, broadly monetary and financial conditions necessary for sustainable economic growth and welfare enhancement. To achieve this, in an environment of elevated inflation, key stakeholders need to play their part.

That is, the banks, as key transmitters of monetary policy impulse, should continue to prudently perform the expected financial intermediation functions bestowed upon them by their banking licence. Market analysts and the media should accurately and appropriately represent the analysis and communication by the Bank of Botswana. The domestic industry should enhance innovation, productivity and

competitiveness; thus, attractiveness and demand (both domestic and global) for Botswana produced goods and services. In addition, existing good governance and institutional arrangements, as well as deference to credible policy frameworks should be sustained or improved. Finally, all stakeholders should moderate their inflation expectations in deference to the regular communication by the Bank on the inflation profile.

Distinguished Guests, for its part, while pursuing its policy objectives and mandates, the Bank is committed to ensuring that macroeconomic policies are aligned and, accordingly, the policy choices and responses to promote price and financial stability are undertaken in the broader context and interest of fostering inclusive economic development and building a broad-based, resilient economy. Hence, the requisite need to respond in a properly calibrated and timely manner to sustained high level of inflation and threats to financial stability.

Honourable Minister, Distinguished Ladies and Gentlemen,
I thank you for your kind attention.