MONETARY POLICY STATEMENT | 2023

STRATEGIC INTENT STATEMENTS

VISION

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

MISSION

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

- monetary stability;
- safe, sound and stable financial system;
- efficient payment mechanism;
- public confidence in the national currency;
- sound international financial relations;

and to provide:

– efficient banking services to its various clients; and

– sound economic and financial advice to Government.

MONETARY POLICY STATEMENT 2023

Moses D Pelaelo

Governor

February 22, 2023

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TABLE OF CONTENTS

1. INTRODUCTION

1.1 The Monetary Policy Statement (MPS) is published at the beginning of the year to inform stakeholders about the framework for the formulation and implementation of monetary policy by the Bank of Botswana (the Bank). In this regard, the Bank, through the MPS, reviews inflation trends and policy performance and articulates the policy choices for the ensuing year. The MPS, together with the quarterly Monetary Policy Reports and the Press Conferences after each Monetary Policy Committee (MPC) meeting, also serve to fulfil the public's expectation of a transparent and accountable central bank in pursuit of the monetary policy mandate, as enshrined in the Bank of Botswana Act (CAP 55:01). There are six MPC meetings a year.

1.2 The 2023 MPS, therefore, reports on the previous year's economic and policy developments and evaluates the determinants of changes in the level of prices and their impact on inflation in Botswana. In turn, there is an assessment of economic and financial developments that are likely to influence the inflation path in the medium term and the Bank's policy choices in 2023. These assessments are anchored on a robust Forecasting and Policy Analysis System. Thus, price developments and policy options are evaluated in the context of a forward-looking monetary policy framework, that entails policy responses to projected deviation of inflation from the Bank's medium-term inflation objective range of 3 – 6 percent or any anticipated adverse impact on financial stability. In this respect, the MPS promotes an understanding of prospective conduct of monetary policy during the course of the year in order to anchor public expectations to the objective of a low, predictable and sustainable level of inflation.

1.3 In 2022, global economic performance and sentiment were negatively affected mostly by the ripple effects of the Russia-Ukraine war, global monetary policy tightening and the lingering effects of the COVID-19 pandemic, particularly zero-COVID policies and lockdowns in China. In addition to the adverse impact on global economic activity, the war resulted in significantly elevated commodity prices and, therefore, inflationary pressures. In response, there was generalised aggressive increase in policy interest rates and, hence, tightening of financial conditions. According to the International Monetary Fund (IMF)'s January 2023 World Economic Outlook (WEO) Update, global inflation increased from 4.7 percent in 2021 to 8.8 percent in 2022[1], while the global economy is estimated to have expanded by 3.4 percent in 2022, lower than the 6.2 percent growth in 2021. Meanwhile, the continued roll-out of effective COVID-19 vaccinations in both advanced and emerging economies helped contain the spread of the virus and led to further relaxation of COVID-19 control measures, which offset some of the negative shocks experienced during the year.

1.4 In Botswana, real Gross Domestic Product (GDP) grew by 6.4 percent in the twelve months to September 2022, compared to a growth of 8.9 percent in the year to September 2021. Inflation remained above the Bank's medium-term objective range in 2022, averaging 12.2 percent in 2022.[2] Contributing to high inflation were the upward adjustments in administered prices and associated second-round effects; modest

[1] In advanced economies, inflation increased from 3.1 percent in 2021 to 7.3 percent in 2022, and from 5.9 percent to 9.9 percent for emerging market economies in the same period.

[2] Inflation breached the objective range in May 2021 (6.2 percent), and has remained above it since, and was 12.4 percent in December 2022.

recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines; and the increase in foreign prices, particularly food and fuel prices, due to supply disruptions caused by the Russia-Ukraine war; as well as the resultant elevated inflation expectations.

1.5 The Bank tightened the monetary policy stance during 2022 in view of projections of inflation likely to remain above the 3 – 6 percent objective range in the medium-term, and the associated indications of entrenched expectations for higher levels of inflation. The Monetary Policy Rate (MoPR)[3] was, therefore, increased by a cumulative 151 basis points to 2.65 percent in 2022 to anchor expectations for the desired low levels of inflation. Inflation peaked at 14.6 percent in August 2022 and, in general, has been on a downward trajectory since September 2022. Inflation is forecast to continue trending downwards and to revert to within the Bank's 3 – 6 percent medium-term objective range in the second quarter of 2024. This outlook is subject to significant upside risks, including the continuing adverse impact of the Russia-Ukraine war, COVID-19 pandemic, constrained supply relative to demand, global tightening of monetary policy to tame persistent inflationary pressures and, domestically, regular annual adjustments of administered prices, as well as prospective fiscal developments, namely implementation of potentially expansionary two-year Transitional National Development Plan (TNDP) and the reversion of the Value Added Tax (VAT) to 14 percent on expiry of the temporary relief measures that had been in place since August 2022. These risks are, however, moderated by the possibility of weak domestic and global economic activity, as well as restrained commodity prices.

1.6 The annual downward rate of crawl of the nominal effective exchange rate (NEER) of the Pula was maintained at 2.87 percent during 2022, as well as the Pula basket weights of 45 percent for the South African rand and 55 percent for the Special Drawing Rights (SDR). Consequently, the trade weighted NEER of the Pula depreciated in line with the downward rate of crawl in 2022. On the other hand, the real effective exchange rate (REER) appreciated by 2.1 percent in 2022, because of a higher positive inflation differential between Botswana and trading partner countries than the downward rate of crawl.

2. MONETARY POLICY FRAMEWORK

2.1 The primary objective of the Bank's monetary policy is to achieve price stability, which is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. Subject to attaining its primary mandate, the Bank shall contribute to the stability of the financial system and foster and maintain a stable, sound and competitive market-based financial system. A low and predictable level of inflation, along with conducive monetary and financial conditions foster effective savings mobilisation, productive investment and international competitiveness of domestic producers which, in turn, contribute to the broader national objectives of sustainable economic development and employment creation.

2.2 The monetary policy framework is forecast-based, with the medium-term outlook guiding the Bank's response to projected movements in inflation, while considering

3 In April 2022, the Bank introduced reforms to the monetary operations framework and adopted the yield on the 7-day Bank of Botswana Certificates (BoBCs) as the new policy rate (in place of the Bank Rate), known as the MoPR.

prospects for economic growth and developments relating to stability of the financial system. To this end, in formulating an appropriate policy stance, the Bank factors in projections of real monetary conditions[4], relevant domestic and international economic and financial developments, and their impact on the output gap[5] and, ultimately, inflation.

2.3 The Bank recognises the importance of communication in sustaining and reinforcing transparency, predictability and accountability with respect to the policy framework and actions; thus, fostering market participation, influencing expectations, policy credibility and, consequently, effective policy transmission. In that regard, besides the MPS, which is published in February each year, the Bank publishes three editions of Monetary Policy Reports, following the April, August and October MPC meetings. Furthermore, the Bank publishes a calendar of MPC meetings for the ensuing year and the Governor addresses a Press Conference and a Press Statement is issued after each meeting of the MPC, to disseminate the Bank's policy stance and allow for engagement with the media.

Reforms to Monetary Operations in 2022

2.4 The Bank continuously evaluates its monetary policy implementation framework aimed at strengthening the monetary policy transmission mechanism. In this respect, and as announced in the 2022 Monetary Policy Statement, the Bank introduced some reforms to the monetary policy operations in April 2022. These included, in the main, the discontinuation of the Bank Rate as the main anchor policy rate and the transition to the MoPR, which is an instrument-based policy rate (7-day BoBCs yield) for effective monetary policy transmission.

2.5 The transition also marked the introduction of an interest rate corridor with a 200-basis points width, comprising the Standing Deposit Facility (SDF) at 100 basis points below the MoPR and the Standing Credit Facility (SCF) at 100 basis points above the MoPR. The SDF and SCF serve as the floor and ceiling of the interest rate corridor, respectively, and commercial banks use both facilities at their own discretion for their daily liquidity management. The interest rate corridor is intended to help ensure that money market interest rates move within a reasonably close range around the MoPR and the close relationship between the policy rate and market interest rate provides the fundamental basis for effective monetary policy transmission. In addition, the reforms allow for the conduct of fine tuning operations (repos and reverse repos) which are to be issued infrequently during a primary reserve maintenance period at the discretion of the Bank upon evaluation of the general market liquidity. If offered, the fine tuning operations are conducted at the MoPR. Furthermore, the Bank introduced a 1-month BoBC in June 2022 for structural liquidity management and price discovery purposes, while the Prime Lending Rate has been liberalised, to be determined by the individual banks effective April 1, 2023. The Bank continues to analyse and monitor the impact of these reforms, with a special focus on their impact on the potency and effectiveness of monetary policy transmission.

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4 The real monetary conditions index (RMCI), which reflects the state of real monetary conditions, measures the relative looseness or tightness of monetary conditions and gauges the likely effect that monetary policy has on the economy through changes in the exchange rate and interest rates. The RMCI combines, through a weighted average, deviations of the real exchange rate and real interest rate from their respective trend values.

5 The output gap refers to the difference between actual output and long-term trend output (as an indicator of the productive capacity of the economy). A negative (positive) output gap means that the actual level of output for a given period is below (above) the trend level for that period, thus indicating that the economy is operating below (above) its estimated potential.

3. IMPLEMENTATION OF MONETARY POLICY AND RELATED ECONOMIC DEVELOPMENTS IN 2022

(a) External Developments

3.1 At the global level, many central banks, in both advanced and emerging market economies, aggressively tightened monetary policy to tame inflationary pressures and anchor inflation expectations. Accordingly, most central banks raised their policy rates from record lows to combat elevated inflationary pressures associated with higher food and fuel prices resulting from the Russia-Ukraine war, as well as supply and demand imbalances related to the COVID-19 pandemic (Appendix, Table A1). Thus, policymakers focused on reining in inflation towards their respective targets. Furthermore, in advanced countries, central banks continued with tapering the asset purchase programmes that were introduced in 2020 to support the financial sector and, in some instances, these have been completed (Appendix, Table A1). However, some central banks decreased their policy rates to stimulate economic activity amid the crisis, for example, China and Russia.

3.2 Overall, multiple shocks in 2022 resulted in lower global economic performance, thus generalised deceleration in the rate of output growth, across countries and regions. The adverse effects and influences included the negative spillovers from the Russia-Ukraine war, continued supply disruptions, elevated commodity prices, and increase in COVID-19 infections in India and China during the year, as well as the unwinding of monetary and fiscal policy support that was implemented to cushion the economies from the COVID-19 pandemic. In the circumstances, global GDP for 2022 is estimated to have expanded by 3.4 percent, from a higher rate of 6.2 percent in 2021 (Table 3.1).

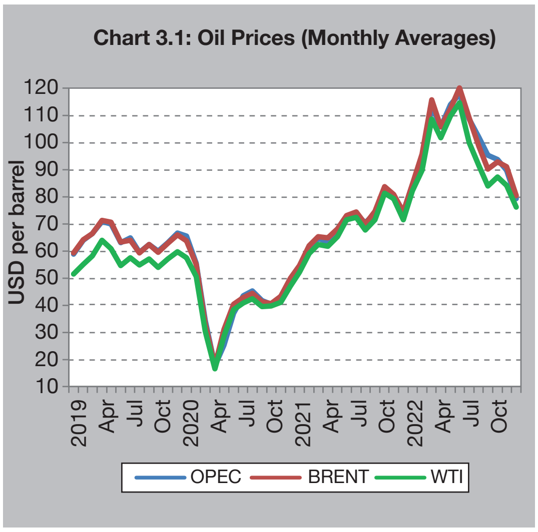
Table 3.1: Real GDP Growth Rates (Percent)

Category	Estimates		Projections	
	2021	2022	2023	2024
Global	**6.2**	**3.4**	**2.9**	**3.1**
Advanced economies	**5.4**	**2.7**	**1.2**	**1.4**
US	5.9	2.0	1.4	1.0
Euro area	5.3	3.5	0.7	1.6
UK	7.6	4.1	-0.6	0.9
Japan	2.1	1.4	1.8	0.9
EMDEs	**6.7**	**3.9**	**4.0**	**4.2**
China	8.4	3.0	5.2	4.5
Brazil	5.0	3.1	1.2	1.5
India	8.7	6.8	6.1	6.8
Russia	4.7	-2.2	0.3	2.1
South Africa	4.9	2.6	1.2	1.3
Botswana	**11.8**	**4.1 (6.7)**	**4.0 (4.0)**	**4.0 (5.1)**

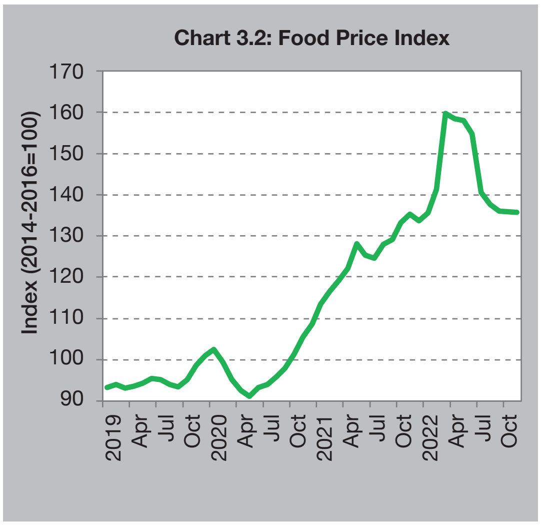
Source: IMF World Economic Outlook (WEO) Update January 2023 and Ministry of Finance (MoF) for Botswana.

Note: EMDEs stands for emerging market and developing economies; figures in parentheses are forecasts by MoF.

3.3 In 2022, global inflation increased, partly due to the rise in commodity prices, particularly food and oil, improved global economic demand as most economies continued to administer effective COVID-19 vaccines and eased movement restrictions, while supply constraints persisted. Global inflation is estimated to have increased from 4.7 percent in 2021 to 8.8 percent in 2022. The increase in oil prices was mainly a result of the Russia-Ukraine war and the consequent sanctions imposed on Russia by major European countries and the US. There was also upward pressure on oil prices emanating from political unrest in some producer countries, for example, Libya; failure by some members of the Organisation of the Petroleum Exporting Countries (OPEC) to increase output or meet their daily production quotas; continued drawdown of oil inventories; and global shortages of natural gas and coal that increased the demand for oil as a substitute. Thus, the price of the OPEC reference crude oil basket, Brent crude and West Texas Intermediate (WTI) increased by 7.1 percent, 8.9 percent and 7 percent to an average of USD76.68 per barrel, USD80.90 per barrel and USD76.52 per barrel in 2022, respectively (Chart 3.1).



Source: OPEC and US Energy Information Administration.



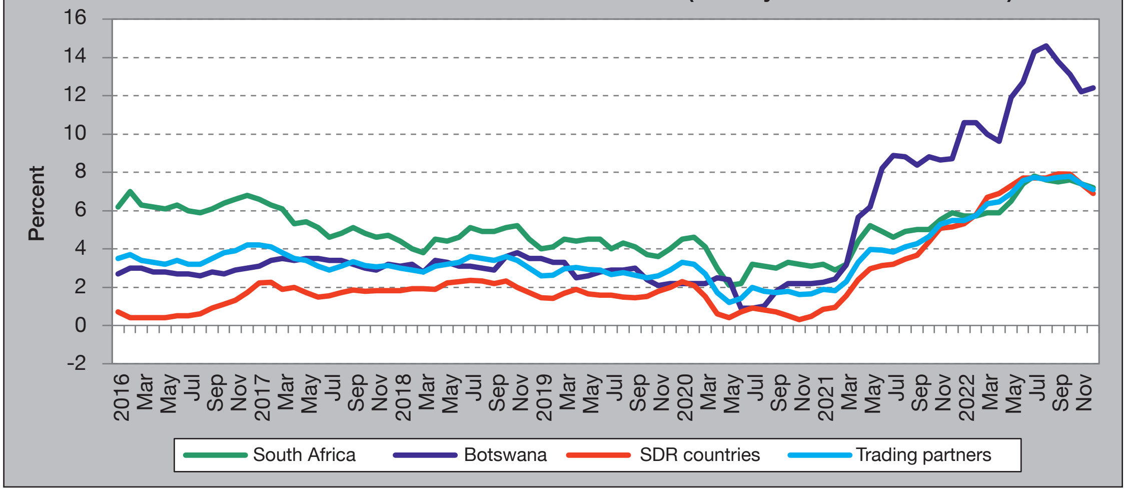
Source: Food and Agriculture Organisation.

3.4 Similarly, international food prices increased by 16 percent in 2022 compared to an expansion of 28.1 percent in 2021 (Chart 3.2), driven by a significant rise in prices of dairy, cereals and vegetable oils. The increase in the price of vegetable oils and cereals was due to the negative supply shocks associated with the Russia-Ukraine war, given that the two economies are the world's largest exporters of grains (wheat and maize) and sunflower oil, respectively, as well as bad weather conditions in Argentina, which significantly lowered crop yields. Prices of dairy products also rose mainly because of high input costs resulting from supply chain disruptions, labour shortages, the rise in the cost of production, particularly livestock feeds and oil prices. Overall, higher international oil and food prices exerted significant upward pressure on domestic inflation in 2022.

3.5 Inflation in the SDR countries (USA, UK, Japan, Eurozone and China) rose significantly from 5.1 percent in December 2021 to 6.9 percent in December 2022. Similarly, headline inflation in South Africa increased from 5.9 percent in December 2021 to 7.2 percent in December 2022 (averaging 6.9 percent for the year) and breached the country's target range of 3 – 6 percent in May 2022.

3.6 Consequently, the trade-weighted average inflation[6] for Botswana's trading partner countries increased from 5.5 percent in December 2021 to 7.1 percent in December 2022 (Chart 3.3).

Chart 3.3: Botswana and International Inflation (January 2016 - December 2022)

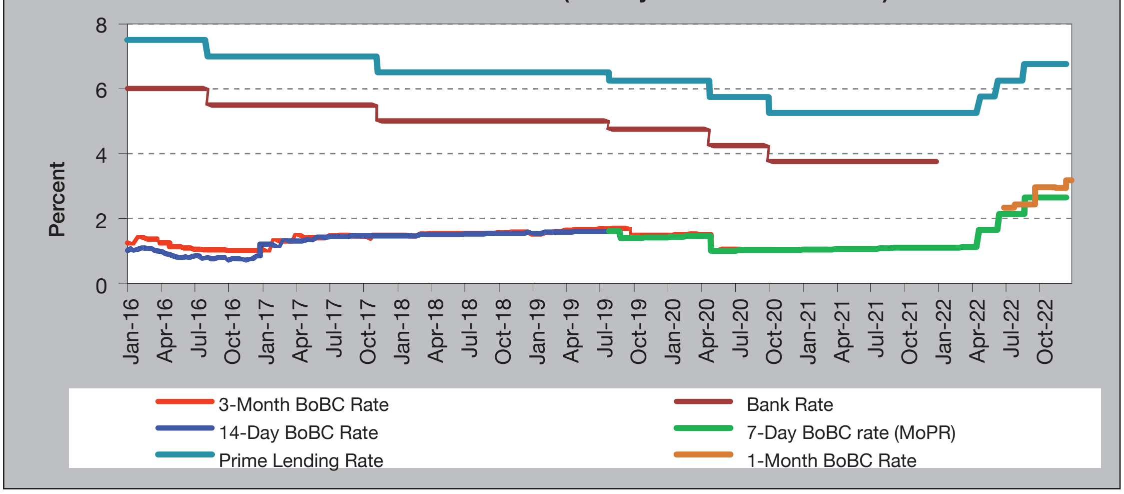


Source: Statistics Botswana and Bloomberg.

(b) Monetary Policy Implementation in Botswana

3.7 During 2022, monetary policy in Botswana was conducted in the context of projected elevated inflation associated with upward adjustment of administered prices, a modest recovery in domestic demand resulting from the easing of containment measures due to deployment of effective COVID-19 vaccines and projected relatively high foreign prices in the short term. In response, the monetary policy stance was contractionary to support the attainment of the Bank's price stability objective of 3 – 6 percent in the medium term. Hence, MoPR was increased 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 increased (Charts 3.4 and 3.5).

Chart 3.4: Interest Rates (January 2016 - December 2022)

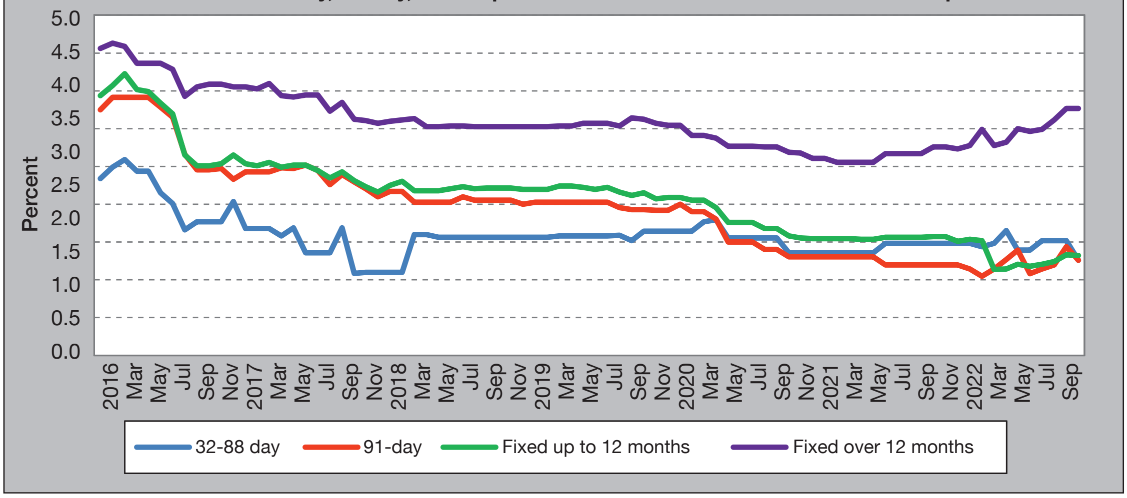


Source: Bank of Botswana and commercial banks.

Note: The 7-day BoBC was introduced on April 30, 2019, replacing the 14-day BoBC, while issuance of the 91-day BoBC was discontinued in October 2020. The 7-day BoBC yield replaced the Bank Rate as the policy rate on April 28, 2022, while the 1-month BoBC was introduced on June 28, 2022.

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

Chart 3.5: 32-88 day, 91-day, Fixed up to 12 months and Fixed over 12 months Deposit Rates



Source: Commercial banks.

3.8 Open market operations remained the main liquidity management tool in the domestic market, as well as in implementing decisions of the MPC. This entailed the use of BoBCs to mop-up excess liquidity[7] in order to maintain interest rates that are consistent with the monetary policy stance.

3.9 Open market operations were conducted in an environment of modest recovery in market liquidity, supported mainly by government spending. The relief measures introduced by the Bank in April 2020 to help alleviate any adverse impact of the COVID-19 pandemic on the economy and financial markets remained in place in 2022. Given that these measures were temporary and aimed at addressing any negative impact on the economy of an unfolding pandemic, and that the COVID-19 profile has generally improved, the measures were reviewed with effect from January 1, 2023, as follows:

(i) Overnight Borrowing through the Credit Facility

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

[7] Excess liquidity in the banking sector is defined here as the sum of commercial banks' overnight deposits at the central bank (current account), commercial banks' deposits in the Standing Deposit Facility (SDF), money absorbed through BoBCs, outstanding reverse repos less repos, Standing Credit Facility (SCF) and the credit facility. This is 'excess' in the sense that it is the net liquidity that the central bank has to absorb (take out of the system), over and above the structural liquidity that is held by the banks in the Primary Reserve Requirement accounts.

(ii) Repurchase Agreement Maturity

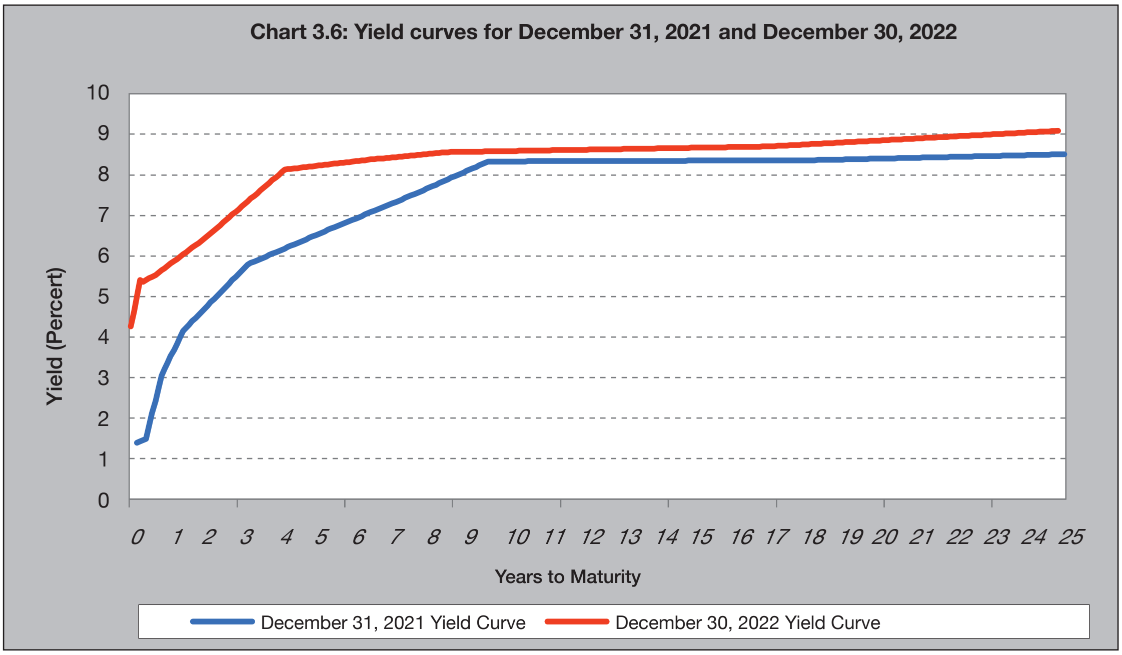
The maturity of repos and reverse repos facility has been reduced from 92 days to overnight and, consistent with the announced monetary operations reforms, the Bank's participation in the repo market will be minimal for fine-tuning purposes.

(iii) Collateral Pool

The dispensation to include all securities listed on the Botswana Stock Exchange Limited (BSEL) in the pool of eligible collateral for credit facilities provided to banks by the Bank is maintained, first and primarily, for liquidity management purposes and, second, to further deepen the domestic financial markets. This is subject to acceptable collateral margin and/or haircuts, as may be announced from time to time by the Bank of Botswana.

3.10 Meanwhile, commercial banks continue to actively use Primary Reserve Requirement Averaging (PRRA) as a tool for effective management of liquidity. Thus, most banks draw down their Primary Reserve Requirement (PRR) accounts to smoothen their liquidity requirements over the reserve averaging period. However, a few banks still prefer to continuously maintain the required balance instead of using the PRR account for liquidity management. Outstanding BoBCs amounted to P3.275 billion in December 2022, an increase from P2.3 billion in December 2021, reflecting an increase in liquidity resulting mainly from government spending. The stop-out yield for the 7-day BoBC increased significantly from 1.10 percent in December 2021 to 2.65 percent in December 2022, reflecting the upward adjustment in the MoPR in 2022. However, due to the larger increase in inflation compared to nominal interest rates between December 2021 and December 2022, the real rate of interest for the 7-day BoBC decreased from -6.99 percent to -8.51 percent. The yield on the 1-month BoBC increased from 2.34 percent when it was introduced in June 2022 to 3.18 percent in December 2022.

3.11 A comparison of Treasury Bills (T-Bills), Government bonds and BoBC yields as at the end of December 2021 and December 2022 indicates that yields generally increased across the maturity spectrum. Yields increased more at the shorter end of the curve, mainly because of the increase in the MoPR in 2022, amidst elevated inflation levels. They increased marginally at the longer end of the curve, a reflection of relatively slow response to policy changes by longer-dated instruments or expectations that inflation will be contained in the long term (Chart 3.6).

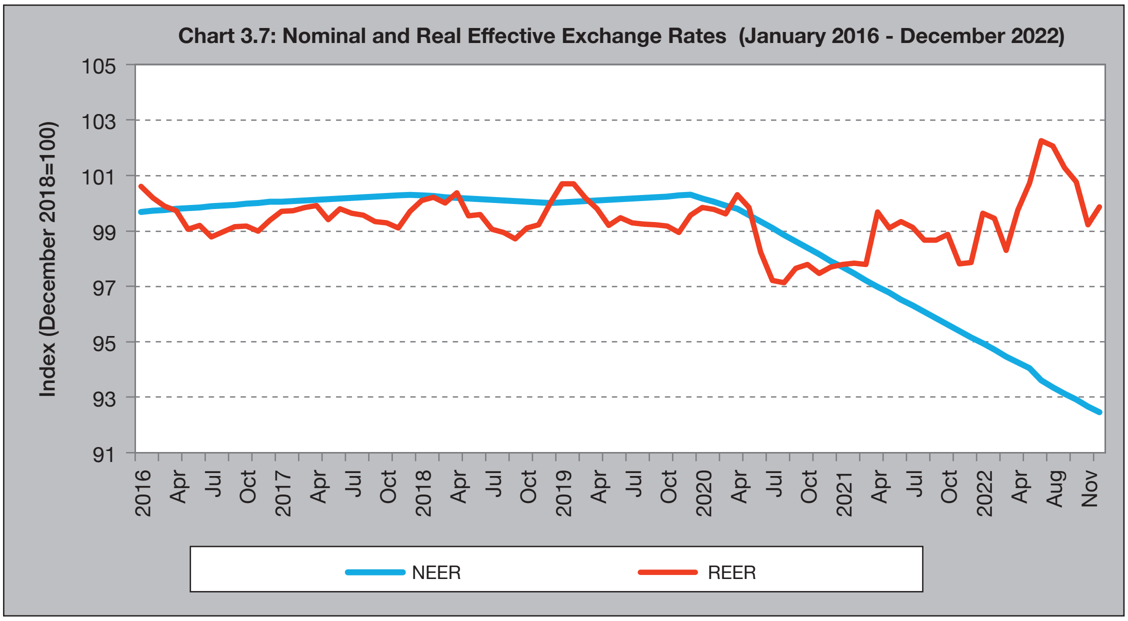


Source: Bank of Botswana.

(c) Implementation of Exchange Rate Policy

3.12 Implementation of the exchange rate policy in 2022 was in line with the objective of maintaining a stable inflation-adjusted trade-weighted exchange rate of the Pula. This entailed the Pula basket weights of 45 percent for the South African rand and 55 percent for the SDR, as well as an annual downward rate of crawl of 2.87 percent, which were maintained in the context of weak economic activity and largely unchanged trade pattern. It was assessed that the economy would benefit from a measured depreciation of the Pula against trading partners in order to support domestic industry competitiveness, given the continuing adverse impact of the COVID-19 pandemic on the economy and the unfavourable inflation differential.

3.13 Consequently, the trade-weighted NEER of the Pula depreciated in line with the downward rate of crawl in 2022. Meanwhile, the REER appreciated by 2.1 percent in 2022 (Chart 3.7), because of a higher positive inflation differential between Botswana and the trading partner countries than the downward rate of crawl, suggesting a loss of international competitiveness of domestic firms.



Source: Bank of Botswana.

3.14 The current exchange rate policy framework is anchored to a strong performance of foreign exchange reserves, which have improved from P56 billion and 9.1 months of import cover in December 2021 to P59.6 billion and 9.7 months of import cover in November 2022, due to the recovery in domestic economic performance, driven by improvement in external demand. The economic disturbances generated by the COVID-19 pandemic and Russia-Ukraine war demonstrated the importance of maintaining adequate levels of foreign exchange reserves in supporting the economy, as well as the flexibility inherent in the exchange rate framework in facilitating adjustments necessary to generate improvements in international competitiveness of the domestic industry.

3.15 Box 1 below explains the current exchange rate policy framework and the Pula exchange rate parameters for 2023, which were announced in December 2022.

BOX 1: THE PULA EXCHANGE RATE FRAMEWORK EXPLAINED

These are additional notes to the Press Release on Pula Exchange Rate, of December 22, 2022, issued by the Ministry of Finance.

Definition of Exchange Rate

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

Exchange Rate Policy Frameworks

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

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

Botswana's Exchange Rate Policy Framework

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

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

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

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

Botswana's Exchange Rate Policy Objective

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

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

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

2023 Pula Exchange Rate Parameters

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

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

The Benefits of the Crawling Band Framework for Botswana

The benefits of the current crawling band framework are therefore as follows:

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

In contrast, alternative arrangements could have disadvantages as follows:

(a) With a small undiversified economy such as Botswana with irregular and lumpy foreign exchange flows, a floating exchange rate regime would imply large exchange rate fluctuations that could be debilitating to price determination and economic activity. In addition, there could be sustained movement of the exchange rate, especially appreciation, that can undermine competitiveness of the non-mining sector and, therefore, diversification efforts;

(b) as demonstrated in the past, a fixed hard peg would often require adjustments that are large and discrete with a destabilising disruptive impact. For example, a large devaluation with significant inflationary impact; and

(c) a peg to a single currency would imply the Pula being subject to fluctuations and shocks to the currency to which it is pegged and, in turn, policy responses that may be inimical or inconsistent with the needs of the domestic economy at the time.

Limits of Exchange Rate Adjustments on Industry Competitiveness

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

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

Transparency and Market Information

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

(d) Fiscal Policy

3.16 Government expenditure and net lending increased by 10.1 percent in the seven months (of the 2022/23 fiscal year) to October 2022 compared to an expansion of 4.4 percent in the corresponding period in 2021. Recurrent expenditure increased by 8.5 percent, while development expenditure rose by 17.9 percent in the seven months to October 2022. Overall spending included the 5 percent salary increment for public service employees effected in April 2022. Specific to development spending, the expansion was attributable to the resumption of some development projects that had been halted in the advent of the COVID-19 containment measures implemented in 2020.

3.17 The relatively high increase in revenue (23.8 percent), compared to overall spending, resulted in a net surplus of P4.8 billion in the seven months to October 2022, compared to a smaller surplus of P1.2 billion in the corresponding period in 2021. The revised estimate for the 2022/23 overall balance, announced in the February 2023 Budget Speech, is a deficit of P4.9 billion (2 percent of GDP), up from a much smaller deficit of P127.9 million (0.1 percent of GDP) in the final budget for 2021/22. This will result from the projected total revenue and grants of P71.5 billion and total expenditures and net lending of P76.4 billion, which compare with total revenue and grants amounting to P68.6 billion and total public expenditure of P68.7 billion, in 2021/22.

(e) Employment and Wage Developments

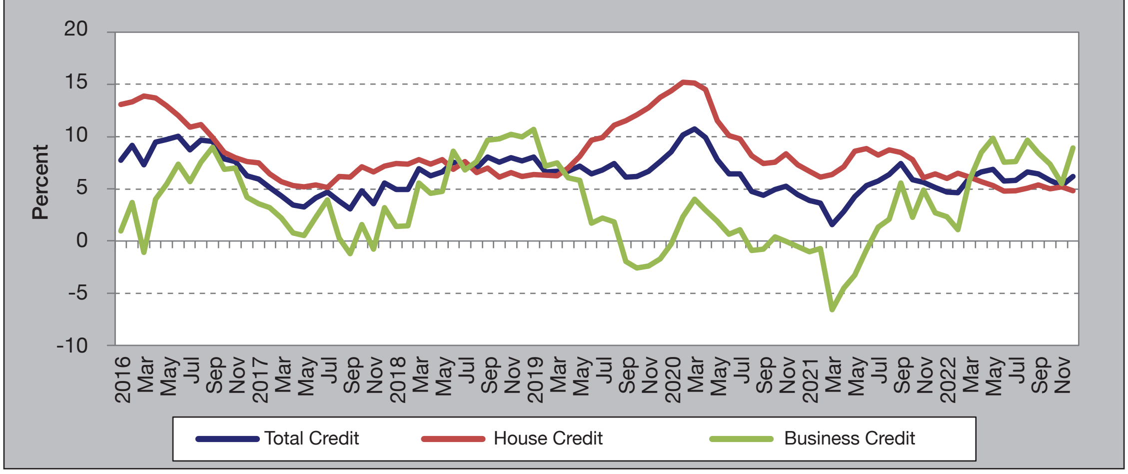
3.18 According to Statistics Botswana's Quarterly Labour Force Survey, the unemployment rate was 25.4 percent in the fourth quarter of 2022, compared to 26 percent in the fourth quarter of 2021 (youth unemployment rate also declined to 33.5 percent from 34.4 percent). The survey also indicates that formal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

3.19 Regarding other indicators, the survey showed that Government continued to be the single largest employer, with employment in public administration constituting 26.9 percent of total formal sector employment. In this regard, personal emoluments constitute the largest share (above 40 percent) of the government recurrent spending of the 2022/23 revised budget, about 10 percent of GDP. Meanwhile, formal sector average earnings per month were estimated at P6 578 for citizens, P12 111 for non-citizens and P6 803 for all employees in the fourth quarter of 2022, compared with P6 219 for citizens, P9 275 for non-citizens and P6 299 for all employees estimated for the fourth quarter of 2021. The average monthly earnings for all employees are, therefore, estimated to have increased by 8 percent or P504 between the fourth quarter of 2021 and the fourth quarter of 2022. In this regard, the average growth in monthly wages is less than the inflation rate and, hence, does not add to inflationary pressures.

(f) Credit and Financial Stability Review

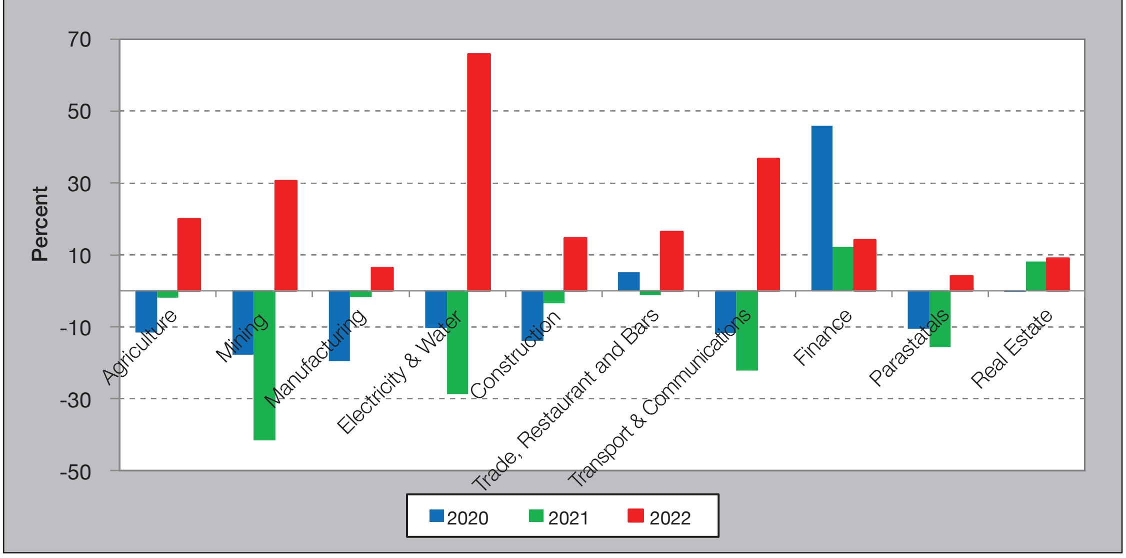
3.20 Annual growth in commercial bank credit accelerated to 6.2 percent in 2022, from 5.1 percent in 2021 (Chart 3.8). The faster growth in commercial bank credit was, in part, associated with the increase in loan uptake by businesses in the period under review, as the economy opened, following the end of the State of Public Emergency in September 2021. The impact of the increase in the MoPR was countered by the utilisation of credit facilities by businesses aiming to increase activity or augment inventory/supply shortages in order to meet demand, during the continued recovery following relaxation of the COVID-19 restrictive measures. Business sector credit grew, annually, by 8.9 percent in 2022, from 2.7 percent increase in December 2021. Meanwhile, credit to businesses excluding parastatals increased by 9.2 percent during 2022, compared to an annual expansion of 4.1 percent in 2021. The improvement in the allocation of credit to businesses was in the form of utilisation of overdraft facilities and loans extended to some companies in the agriculture, electricity and water, mining, transport and communication, as well as in real estate industries. Furthermore, there was increased use of credit facilities by parastatals (Chart 3.9).

Chart 3.8: Commercial Bank Credit Annual Growth Rates (January 2016 - December 2022)



Source: Commercial banks.

Chart 3.9: Annual Growth of Commercial Bank Business Credit by Industry



Source: Commercial banks.

3.21 For households, annual credit growth decelerated from 6.4 percent in 2021 to 4.8 percent in 2022. The lower credit growth was mainly attributable to the slower rate of increase in personal unsecured lending and property loans during the period under review, a possible reflection of the effects of the policy tightening in the second and third quarters of 2022 by the Bank of Botswana, which had a dampening effect on demand.

Banks also likely restricted credit supply in an attempt to guard against increase in default rates as the cost of credit becomes expensive. The share of mortgages in total household credit decreased from 23.1 percent to 22.3 percent in the same period. Meanwhile, the growth rate for credit extended to motor vehicle and for credit card balances was higher in the same period.

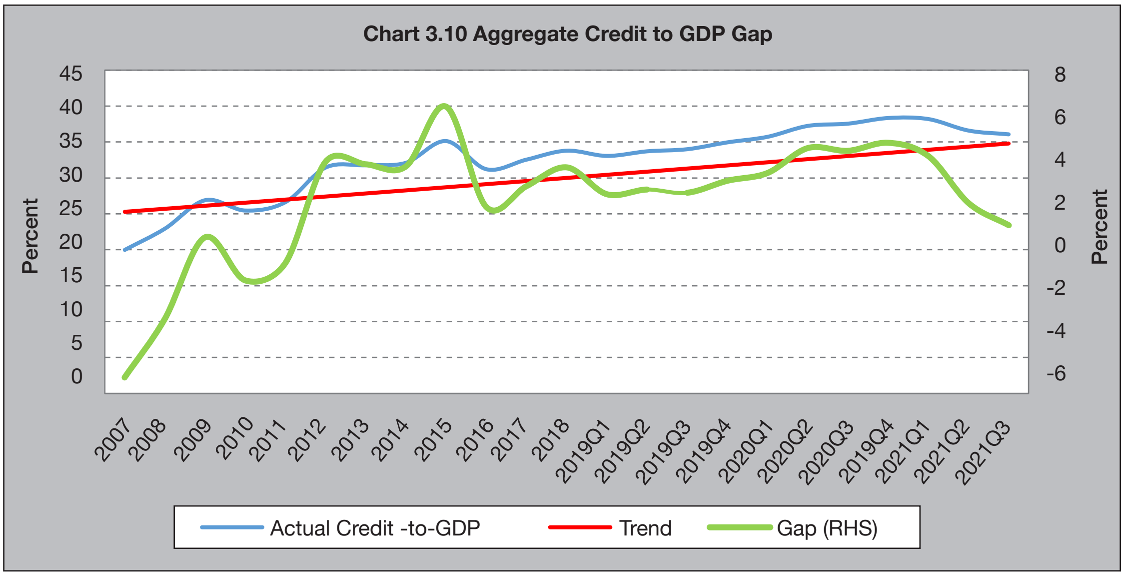
3.22 In general, the rate of increase of credit continues to be supportive of economic activity, although remaining comparatively low by global standards (Appendix, Table A2). Commercial bank credit to GDP ratio increased slightly (Table 3.2) in 2022, reflecting faster credit growth relative to output growth, but remains comparatively low relative to financial inclusion and development needs, as well as global trends. In this context, there continues to be scope for prudent credit extension to enhance support for economic activity. The assessment of vulnerabilities and risks to financial stability, as measured by the credit-to-GDP gap (Chart 3.10), also shows that the modest credit growth is commensurate with the rate of increase in GDP; hence signifying that the current level of credit relative to economic activity is sustainable and poses limited risk of overheating of the economy arising from excessive credit growth.

Table 3.2: Commercial Bank Credit-to-GDP Ratio

	Percent of GDP			
	2019	2020	2021	2022[2]
Total Commercial Bank Credit[1]	**35.2**	**38.2**	**33.1**	**36.5**
Business	**12.8**	**13.3**	**11.2**	**12.6**
Parastatals	1.0	1.0	0.7	1.3
Agriculture	0.8	0.8	0.6	0.7
Mining	0.3	0.3	0.1	0.2
Manufacturing	1.1	0.9	0.7	0.9
Construction	0.6	0.5	0.4	0.5
Trade	2.5	2.8	2.3	2.4
Transport and Communications	0.4	0.3	0.2	0.3
Finance and Business Services	**2.6**	**3.1**	**3.0**	**2.8**
Real Estate	2.5	2.6	2.3	2.4
Households	**22.2**	**25.0**	**21.9**	**23.8**
Retail Credit[3]	16.7	19.1	16.9	18.3
Mortgage	5.5	5.9	5.1	5.6

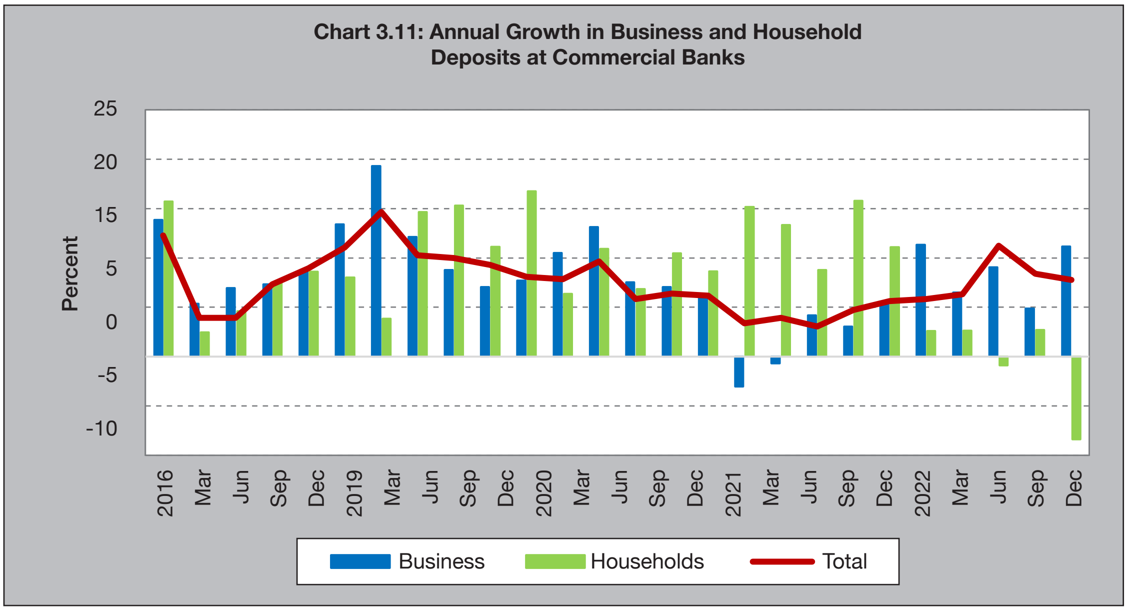
Source: Commercial banks, Statistics Botswana and Bank of Botswana calculations.

Notes:
1. Although not shown in the table, electricity and water, other and nonresident subsectors are included in the business credit-to-GDP ratio.
2. Data covering the twelve months to September 2022.
3. Includes motor vehicle, personal and credit card loans.



Source: Bank of Botswana

3.23 The rate of growth of household deposits decreased to 8.4 percent in December 2022, compared to 15.8 percent in December 2021, while business deposits (excluding parastatals) increased by 11.1 percent from 3 percent during the same period. Overall, total deposits at commercial banks increased by 7.8 percent, compared to 4.7 percent growth in the prior year (Chart 3.11). Given the slower increase in bank lending than the increase in bank deposits, the financial intermediation ratio slightly decreased from 81.7 percent in December 2021 to 80.5 percent in December 2022, signalling the underutilisation of deposits as borrowing costs were elevated following monetary policy tightening by the Bank and in an environment of subdued economic activity.



Source: Commercial banks

3.24 Overall, notwithstanding the challenges caused by the onset of the COVID-19 pandemic, vulnerabilities that could elevate risks to financial stability remain contained, as reported in the published October 2022 Financial Stability Report. In particular, the financial sector was assessed to be resilient and characterised by strong capital and liquidity buffers, moderate profitability as well as being adaptive and innovative. The enduring stability of the financial system is supported by sound macroeconomic environment, efficient and robust market infrastructure, prudently managed banks, and effective regulation and supervision. While economic performance is constrained by the lingering impact of COVID-19 and the fallout from the Russia-Ukraine war, proactive policy actions, including the prevailing accommodative real monetary conditions, and expansionary fiscal policy support, continue to anchor the soundness of the financial sector.

3.25 Banks' asset quality was assessed to be good in 2022, characterised by a decline in credit default rates as the ratio of non-performing loans (NPLs) to total bank credit fell to 3.8 percent in November 2022, from 4.1 percent in November 2021. Nevertheless, there continues to be a risk to asset quality associated with the high proportion of the relatively more expensive unsecured lending (at 71.9 percent of household credit in November 2022) in commercial bank credit. This profile of assets potentially exposes the household sector to any sudden and sharp increase in borrowing costs or loss of employment. The risks are, however, moderated to the extent that credit is widely distributed to many employees in different sectors of the economy, a large proportion of whom are in the public sector. Moreover, the extension of credit to salaried individuals enables proper credit evaluation using ascertained sources of income as the basis for determining repayment capacity. Furthermore, credit risk is mitigated in cases of loans that are protected by insurance for loss of employment. Overall, the capital, asset quality, liquidity and profitability levels that meet prudential requirements indicate a generally sound and stable banking system (Table 3.3).

Table 3.3: Selected Performance Indicators of the Banking Sector

Capital Adequacy (Percent)	Dec 2020	Dec 2021	Mar 2022	June 2022	Sep 2022	Nov 2022
Core Capital to Unimpaired Capital	68.0	64.8	67.0	68.4	66.5	66.0
Tier 1 Capital to Risk-Weighted Assets[1]	13.5	12.0	12.5	12.0	11.8	12.1
Capital Adequacy Ratio (CAR)[2]	19.7	18.5	19.4	18.8	18.6	19.1
Asset Quality (Percent)						
NPLs to Gross Loans	4.2	4.3	4.2	4.0	3.4	3.8
NPLs Net of Specific Provisions to Unimpaired Capital	7.4	9.2	8.7	8.8	8.5	8.1
Specific Provisions to NPLs	62.8	45.7	57.6	56.2	55.1	54.4
Liquidity (Percent)						
Liquid Assets to Deposits (Liquidity Ratio)[3]	21.4	16.6	16.6	17.4	18.3	17.1
Advances to Deposits (Intermediation Ratio)	81.4	81.9	82.3	82.3	79.8	80.4
Profitability/Efficiency (Percent)						
Return on Average Assets (ROAA)	1.6	1.7	1.9	2.0	2.1	2.2
Return on Equity (ROE)	15.1	19.2	21.7	26.8	26.1	…
Cost to Income	64.9	63.3	60.5	60.3	57.2	56.7

Source: Bank of Botswana.
1. Prudential lower limit is 7.5 percent – Basel II/III.
2. Prudential lower limit is 12.5 percent.
3. The minimum statutory requirement is 10 percent.

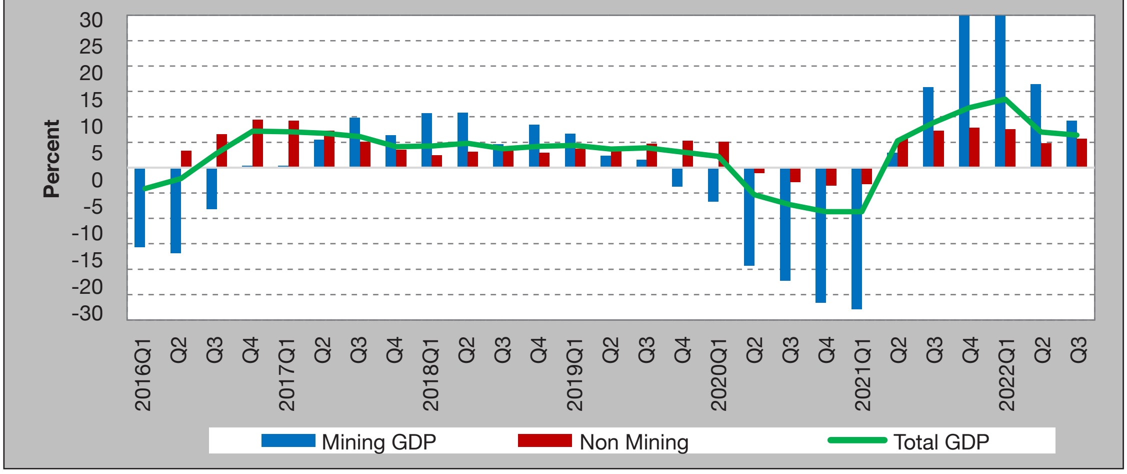
3.26 Growth in broad money supply (M2) was 10 percent in the year to October 2022, compared to 3.9 percent in the corresponding period in 2021. The growth of money supply resulted from an increase in credit to the private and parastatals sectors to fund growth enhancing opportunities. Meanwhile, there was, in part, an offsetting effect from the increase in net foreign assets and public sector deposits at the Bank of Botswana. By component, current account (transferable) deposits increased by 10.1 percent, while interest bearing deposits increased by 10.5 percent in the year to October 2022. Deposits in foreign currency accounts increased by 38.2 percent in the same period. The ratio of money supply to GDP (a measure of financial deepening) decreased to 42.4 percent in the year to September 2022, compared to 48.7 percent in 2021, signalling shortage of liquidity in the economy (in the prevalence of COVID-19 base effects).

(g) Output and Price Developments

3.27 Real GDP in Botswana grew by 6.4 percent in the twelve months to September 2022 compared to a growth of 8.9 percent in the year to September 2021. The slowdown in output growth is attributable to the deceleration in production of both the mining and non-mining sectors. It is worth noting that the high growth rate in the year ending September 2021 was mainly due to economic recovery from the low base associated with the negative impact of the COVID-19 pandemic containment measures which were more stringent in 2020. Mining output grew by 9.2 percent in the year ending in September 2022, a notable deceleration from 15.8 percent in the corresponding period in 2021. This was due to a slower growth in output of most sub sectors, led by the mining of diamonds, which declined to 9 percent in the year to September 2022, compared to a growth of 16.3 percent in the previous twelve month period. Non-mining GDP grew by 5.7 percent in the year to September 2022, compared to a higher growth of 7.2 percent in the corresponding period in 2021, due to the deceleration of output growth for most sectors, namely, construction; wholesale and retail; diamond traders; transport and storage; information and communication technology; real estate activities; professional, scientific and technical activities; administrative and support activities; human health and social work; and other services. Meanwhile, year on year, GDP increased by 6.3 percent in the third quarter of 2022, a slowdown from a higher growth of 8.9 percent in the corresponding period in 2021.[8]

[8] The 6.3 percent annual growth reported in the economic briefing release by Statistics Botswana (SB) is calculated based on quarterly output compared to the corresponding period the previous year. Thus, SB reports year-on-year growth based on quarterly GDP.

Chart 3.12: Annual Real GDP Growth Rate (2016Q1-2022Q3)

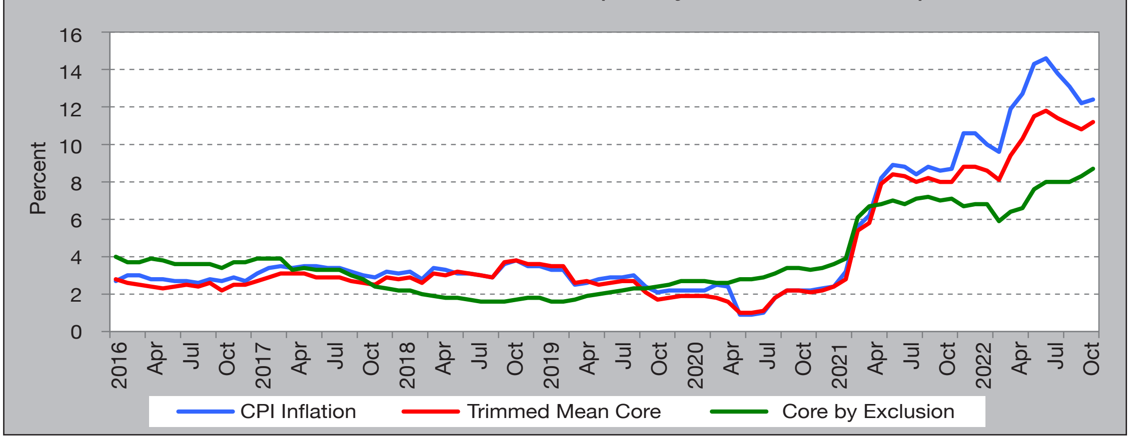


Source: Statistics Botswana and Bank of botswana calculations.

3.28 Inflation was above the Bank's inflation objective range of 3 – 6 percent in 2022, against the background of improved domestic demand, upward adjustment in administered prices, as well as higher foreign inflation.

3.29 Inflation increased significantly from an average of 6.7 percent in 2021 to an average of 12.2 percent in 2022, thus remaining above the Bank's 3 – 6 percent objective range since May 2021 (Chart 3.13). The high inflation in 2022 was mainly due to significant upward adjustment of administered prices, which added 5.2 percentage points to inflation during the year and associated second-round effects. However, inflation generally trended downwards from September 2022 and was 12.4 percent in December 2022, higher than the 8.7 percent in December 2021. Food price inflation also increased from 7.2 percent in December 2021 to 16.9 percent in December 2022, in the context of significant domestic price increases for bread and cereals, oils and vegetables. Regarding core inflation measures, the 16 percent trimmed mean inflation[9] increased from 8 percent in December 2021 to 11.2 percent in December 2022, while inflation excluding administered prices increased from 7.1 percent to 8.7 percent in the same period.

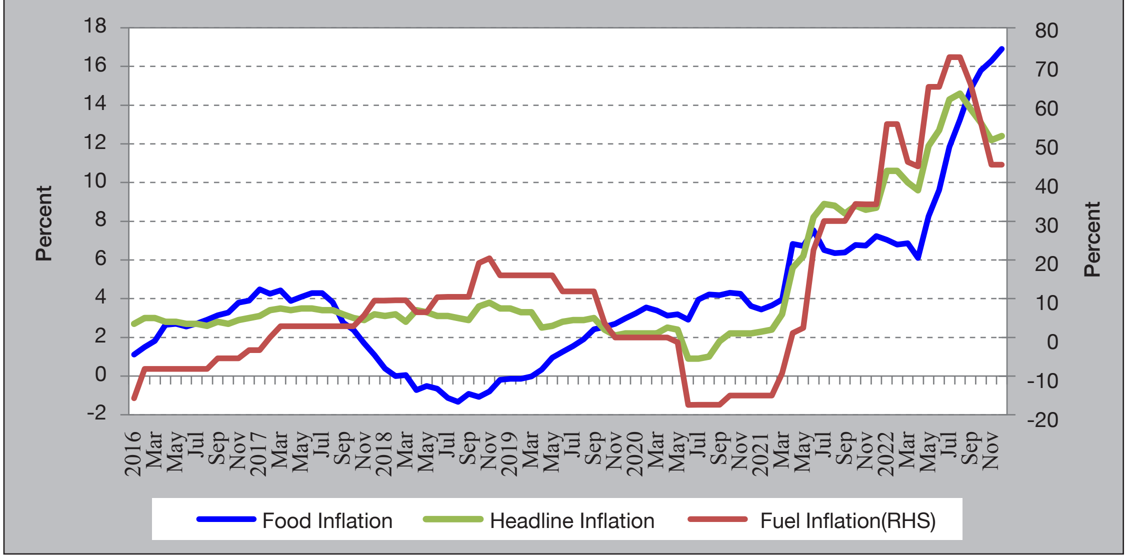
Chart 3.13: Botswana Inflation (January 2016 - December 2022)



Source: Statistics Botswana

[9] Removes 8 percent (by weight) of the commodity sub-groups with the largest price changes at each of the ends of an ordered series of price changes in any given month.

Chart 3.14: Headline, Food and Fuel Inflation (January 2016-December 2022)



Source: Statistics Botswana

4. OUTPUT AND INFLATION OUTLOOK

(a) Global Economic Prospects

4.1 The January 2023 WEO Update anticipates a moderation in global economic growth, from 3.4 percent in 2022 to 2.9 percent in 2023, against the backdrop of the ongoing Russia-Ukraine war and tightening financial conditions in most regions; more aggressively in advanced economies, to contain elevated inflationary pressures. The slowdown in output growth is also consistent with challenging prospects for advanced economies, in part, due to lower consumer demand associated with higher inflation and borrowing costs which have significantly eroded purchasing power. However, the growth forecast for 2023 is 0.2 percentage points higher than the October 2022 projection, largely due to positive surprises and greater-than-expected resilience in numerous economies, as well as the reopening of Chinese economy in January 2023. Overall, risks to the global economic outlook are assessed to be on the downside. These include the possibility of China's economy stalling, likely escalation of Russia-Ukraine war and stagflation. The resurgence of COVID-19 and possible debt distress could also slow down global economic activity. Nonetheless, the global economy is not expected to fall into recession in 2023.

4.2 Growth in advanced economies is projected to decline from the expansion of 2.7 percent in 2022 to 1.2 percent in 2023, mostly reflecting macroeconomic effects of elevated inflationary pressures and sharp tightening of global financial conditions, as well as weaker consumer demand and erosion of purchasing power. Meanwhile, about 90 percent of advanced economies are projected to experience a decline in growth in 2023. Among these economies is the US, which is expected to experience a slower growth of 1.4 percent in 2023 from 2 percent in 2022, reflecting lower consumer demand because of higher interest rates. Furthermore, the rate of output expansion in the euro area is forecast to decline from 3.5 percent in 2022 to 0.7 percent in 2023, reflecting the spill-over effects from the Russia-Ukraine war, with expected slowdown in economic activity among the bloc's largest economies. In the UK, economic activity is projected to contract by 0.6 percent in 2023, from an estimated growth of 4.1 percent in 2022, as elevated inflation continues to reduce purchasing power, and tighter fiscal and monetary policies actions take a toll on spending and investments.

4.3 For emerging market and developing economies, growth is expected to rise slightly from 3.9 percent in 2022 to 4 percent in 2023. The higher growth projection for 2023 is mainly due to upward revisions of large economies, particularly Russia and China. Output growth in China is projected to increase in 2023, largely due to the re-opening of the economy. However, about half of the emerging markets countries are expected to experience lower growth in 2023, reflecting less favourable external conditions, and the distress associated with aggressive tightening of financial conditions and monetary policy in advanced economies.

4.4 Global inflationary pressures are projected to moderate in 2023, although remaining high, due to rapid monetary policy tightening, squeezing of household budgets and waning COVID-19 pandemic-related fiscal support. Moreover, the projected disinflation emanates from expected lower commodity prices. Thus, inflation for advanced economies is forecast to decrease from 7.3 percent in 2022 to 4.6 percent in 2023, while for emerging market economies, it is forecast to decrease from 9.9 percent to 8.1 percent. Consequently, global inflation is expected to ease from 8.8 percent to 6.6 percent in the same period. However, prolonged supply chain disruptions due to both the pandemic and the Russia-Ukraine war may persist for a while, thus keeping prices higher than expected.

4.5 Inflation is forecast to average 4.4 percent and 5.4 percent in the SDR countries and South Africa, respectively, in 2023. Therefore, average inflation for trading partner countries is forecast at 4.8 percent, which is 3 percentage points lower than the 7.8 percent average forecast inflation for Botswana in 2023; an inflation differential requiring a downward rate of crawl of the Pula exchange rate (NEER) to maintain stability of the REER. Moreover, there continues to be a need to support economic activity, in particular, international competitiveness of the domestic industry. Against this background, an annual downward rate of crawl of 1.51 percent of the NEER is being implemented for 2023. The Pula basket weights were maintained at 45 percent for the South African rand and 55 percent for the SDR.

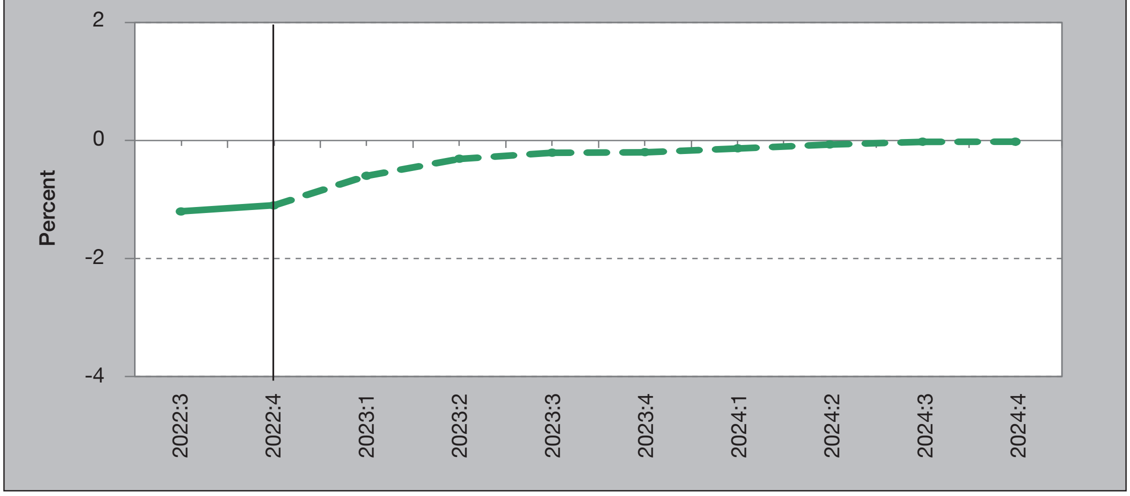
(b) Domestic Economic Prospects

4.6 Domestically, real GDP is projected to expand by 4 percent in 2023, from an estimated expansion of 6.7 percent in 2022, as growth in the mining sector moderates. However, it is anticipated that performance of the non mining sectors will improve, underpinned by, among others, improvements in electricity and water supply, as well as finance, insurance and pension funds sectors. Furthermore, Government interventions to mitigate the impact of COVID-19, including the implementation of the Economic Recovery and Transformation Plan and the TNDP, are anticipated to restore economic activity and improve incomes, facilitate expansion of productive capacity, accelerate economic transformation and build economic resilience. However, given the downside risks to global economic activity, including the possible resurgence of COVID-19, weaker global demand and adverse impact of the Russia-Ukraine war, the growth trajectory remains uncertain. Although improving, the non-mining output is expected to continue operating below potential in 2023 (Chart 4.1).

4.7 As announced in the 2023 Budget Speech, Government continues to run a budget deficit during the first year of the two-year TNDP, to be financed through both domestic and external borrowing, as well as drawing from the Government Investment Account.

Domestic borrowing will entail the issuance of Government debt securities in the form of bonds and Treasury Bills, while external borrowing will be in the form of loans from bilateral and multilateral official financial institutions.

Chart 4.1: Botswana Non-Mining Output Gap (September 2022 - December 2024)



Source: Bank of Botswana.

4.8 Inflation has generally been on a downward trend since September 2022. It is projected that the downward trend will be sustained and that inflation will revert to within the Bank's 3 – 6 percent medium-term objective range in the second quarter of 2024 (Chart 4.2), mainly on account of the dissipating impact of the earlier increases in administered prices, the recent reduction in domestic fuel prices[10], the expected decrease in international commodity prices and implementation of a smaller downward annual rate of crawl for the Pula exchange rate.

4.9 The projection also considers the anticipated increase in economic activity supported by both fiscal policy and relatively accommodative monetary conditions; the impact of the recent increase in private school fees in January 2023; the impact of the price increase in Kgalagadi Breweries Limited (KBL) products effective February 1, 2022; the expected upward adjustment of Botswana Housing Corporation (BHC) rentals and electricity tariffs in April 2023 and April 2024[11]; as well as the possibility of higher prices due to resumption of the 14 percent VAT following implementation of the Government's temporary inflation relief measures introduced on August 1, 2022.

4.10 Overall, risks to the inflation outlook are assessed to be skewed to the upside. These risks include the potential increase in international commodity prices beyond current forecasts; persistence of supply and logistical constraints due to lags in production; the adverse economic and price effects of the protracted Russia-Ukraine war; the uncertain COVID-19 profile; and ongoing tension between China and the United Sates over South China Sea and Taiwan. On the domestic front, the risks for higher

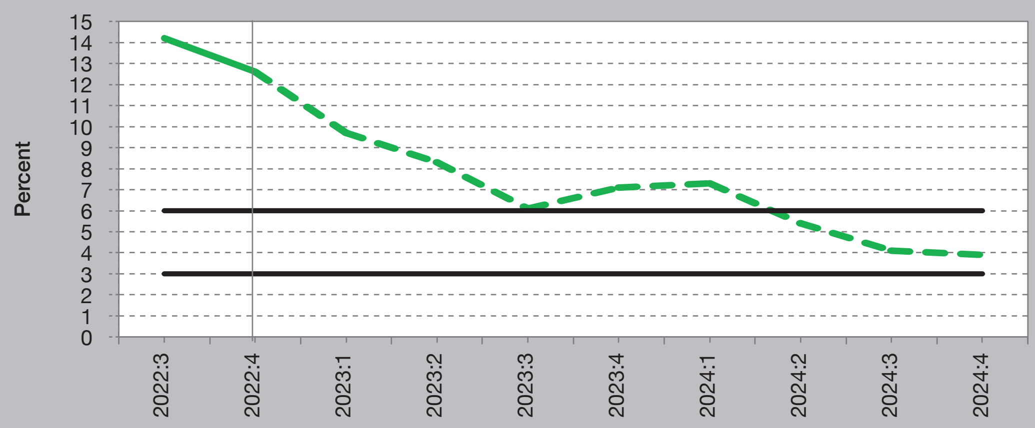
10 The recent decrease in domestic fuel prices on December 22, 2022 and January 13, 2023, is anticipated to reduce inflation by approximately 0.83 percentage points in the first quarter of 2023.

11 The increase in private school fees is envisaged to have a net impact of approximately 0.02 percentage points, while the price increase in KBL's products will add approximately 0.81 percentage points to inflation in the first quarter of 2023. The increase in BHC rentals and electricity tariffs is expected to add approximately 0.21 percentage points and 0.3 percentage points, respectively, to inflation in the second quarter of 2023 and 2024.

inflation than currently projected relate to possible annual adjustments in administered prices not included in the forecast; short term consequences of import restrictions; prospective fiscal developments, namely implementation of potentially expansionary two-year TNDP; the possibility of a higher than projected impact of the resumption of the 14 percent VAT (from 12 percent) in the second quarter of 2023; upward pressure on wages across the country emanating from the 5 percent increase in public service salaries effective April 1, 2023; and entrenched expectations for higher inflation which could lead to higher general price adjustments. There is also a likelihood of an upward adjustment in domestic fuel prices, in response to any increase in international oil prices.

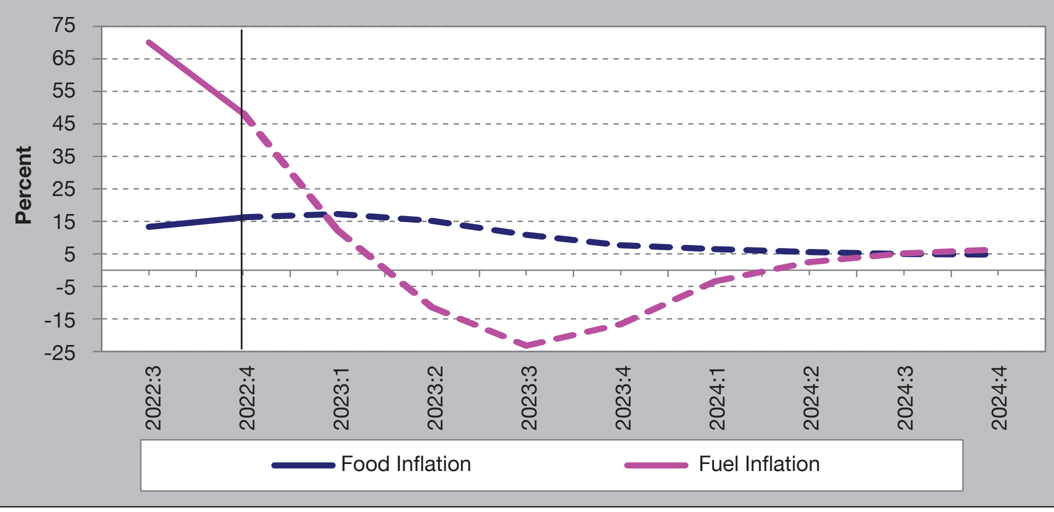
4.11 These risks are, however, moderated by the possibility of weaker-than-anticipated domestic and global economic activity due to geo political tensions and possible restrictions in response to any emergence of new COVID-19 variants. Lower international commodity prices than currently projected could also result in lower inflation, as would capacity constraints in project implementation. Meanwhile, according to the December 2022 Bank's Business Expectations Survey, the business community expects inflation to remain above the Bank's objective range in 2023.

Chart 4.2: Annual Headline Inflation Forecasts for the Medium Term (September 2022 - December 2024)



Source: Bank of Botswana.

Chart 4.3: Domestic Fuel and Food Inflation Forecasts for the Medium Term (September 2022 - December 2024)



Source: Bank of Botswana.

5. THE 2023 MONETARY POLICY STANCE AND THE BANK OF BOTSWANA (AMENDMENT) ACT, 2022

5.1 An evaluation of the determinants of inflation and factors affecting financial stability suggests that the level of inflation will be within the objective range in the medium term, reflective of the moderation in international commodity prices and expected slowdown in global economic activity. Furthermore, the current levels of credit growth to both businesses and households are considered sustainable and aligned to growth in nominal GDP and/or incomes. Overall, the recent and prospective developments for both domestic (disinflationary inflation outlook and a stable financial environment) and external economic activity suggest that the prevailing accommodative monetary policy stance is consistent with inflation reverting to within the Bank's 3 – 6 percent objective range in the medium term. In the context of the economy operating below potential in the short-to-medium term, the assessment is that the economy could benefit from a measured depreciation of the Pula against trading partners to support domestic industry competitiveness; hence implementation of the exchange rate policy will entail a 1.51 percent downward rate of crawl in 2023.

5.2 The Bank will continue to respond appropriately to changes in the banking system liquidity conditions through relevant instruments. Overall, the Bank encourages prudent management, investment and productive allocation of financial resources, with a view to promoting growth-supporting intermediation and durable financial stability. In this regard, for effective policy transmission, the Bank guides the determination of the level and direction of market interest rates that are consistent with the monetary policy stance. The Bank also promotes effectiveness of the interbank market in addressing liquidity positions of individual banks. In addition, the Bank contributes to financial stability through prudential and market conduct supervision of commercial and statutory banks and promotes, as well as participates in, coordinated regulation of the broader financial system.

5.3 The Bank evaluates its monetary policy implementation framework on a regular basis for effectiveness, with a view to introducing refinements where necessary. In this regard, 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 MoPR 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 (PLR) to be independently determined by individual commercial banks should facilitate market competition and fair pricing of credit and other lending products. The Bank will, nevertheless, monitor implementation of this dispensation and enforce good business conduct and alignment with the desired outcome.

5.4 In July 2022, the Parliament passed the Bank of Botswana (Amendment) Act, 2022 (the Act), which introduces new provisions to enhance the Bank's powers to achieve the price and financial stability mandates. The Bank will, therefore, implement the following amendments in 2023:

(a) adopt the ranked dual mandate for the Bank. Section 4 (2) of the Act incorporates a financial stability mandate for the Bank in addition to the primary mandate of maintenance of domestic price stability. Under the new legislation, the primary objective of the Bank shall be to achieve and maintain domestic price stability. Subject to attaining its primary mandate, the Bank shall contribute to the stability of the financial system and foster and maintain a stable, sound and competitive market-based financial system;

(b) explicit designation of the inflation objective by Government and, thereafter, operational independence in pursuit of its primary objectives, and in the performance of its functions under the Act. That is, going forward and once the new Act is operational, the medium-term inflation objective will be determined by the Minister; and the new statutory MPC will have de jure operational autonomy to conduct monetary policy as appropriate to achieve the inflation objective determined by the Minister;

(c) change the composition of the MPC. The amended Act (Section 19 B) adds diversity to the composition of the MPC, which shall comprise nine members, four of which shall be independent external members. The five internal members shall be Governor (who shall be the Chairman), the two Deputy Governors, head of department responsible for economic research and head of department responsible for treasury operations. The four external members shall be appointed by the Minister, to be independent persons, not representing any sector of the economy and who are not employees of the Bank, with knowledge and experience relevant to the functions of the MPC;

(d) establish a Statutory Financial Stability Council. The amended Act (Section 54 B) establishes a statutory body to be known as a Financial Stability Council (FSC), which shall be responsible for preserving the stability of the financial system; ensuring cooperation between members with respect to the assessment of the build-up of economic and financial sector systemic risks in Botswana; developing coordinated policy responses to risks including crisis management; and making recommendations, issuing warnings or opinions addressed to regulatory bodies regarding financial institutions. The FSC shall comprise the Governor, who shall be the Chairman, the Permanent Secretary in the Ministry responsible for Finance, Chief Executive Officer of the Non-Bank Financial Institutions Regulatory Authority, Director of the Deposit Insurance Scheme, and the Director General of the Financial Intelligence Agency;[12] and

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

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12 Currently, and prior to commencement of the Bank of Botswana (Amendment) Act, the Financial Stability Council is not a statutory body and is established by a memorandum of understanding between participating institutions.

6. CONCLUSION

6.1 Domestic inflation was above the Bank's objective range of 3 – 6 percent in 2022, averaging 12.2 percent, mainly reflecting upward adjustments in administered prices and higher imported inflation. Meanwhile, global inflation is forecast to decrease in 2023, although remaining high, due to aggressive monetary policy tightening across the regions.

6.2 It is projected that inflation in Botswana will revert to within the objective range in the second quarter of 2024, mainly on account of the dissipating impact of the earlier increases in administered prices, the recent reduction in domestic fuel prices, the expected decrease in international commodity prices and implementation of a smaller downward annual rate of crawl for the Pula exchange rate. The Bank's formulation and implementation of monetary policy will focus on entrenching expectations of low, predictable and sustainable inflation, through timely response to price developments, while ensuring that credit and other market developments are in line with durable stability of the financial system. The Bank remains committed to monitoring economic and financial developments with a view to ensuring price and financial stability, without undermining sustainable economic growth.

6.3 Broadly, the Bank contributes to macroeconomic stability and policy congruence through the pursuit and attainment of its primary objectives and coordination with relevant institutions with respect to price and financial stability, as well as stability of the inflation-adjusted trade-weighted exchange rate. By focusing and delivering on its specific roles, the Bank contributes to maintenance of a conducive environment for structural reforms and transformation initiatives to gain traction, potentially leading to higher rates of economic growth needed for transition to a high-income status. Given that monetary policy is accommodative (as indicated by negative real interest rates and therefore supportive real monetary conditions) and fiscal policy is expansionary, immediate implementation of transformation initiatives and structural reforms are expected to raise prospects for faster growth and economic diversification. Against this background, enhanced productivity/innovation (including greater production capacity) of industry and effectiveness of support institutions and service providers would help improve growth prospects for the economy in an environment of price and financial stability.

APPENDIX

Table A1: 2022 Monetary Policy Decisions

Central Bank	Policy Rate as at December 2022	Policy Change from Previous Year	Asset Purchase Programmes	Likely Policy Decision in 2023
United States Federal Reserve	4.25 – 4.50 percent	Increased by 425 basis points	• At the June 2022 Federal Open Market Committee (FOMC) meeting: reduced the size of the Fed's balance sheet holdings of Treasury securities by USD30 billion; holdings of agency mortgage-backed securities by USD17.5 billion monthly. • From September 2022, the Fed doubled the pace of monthly reductions of its holdings of treasury securities by USD60 billion, as well as agency debt and mortgage-backed securities by USD35 billion.	• Increase policy rate in 2023, in order to attain a stance that is sufficiently restrictive to return inflation to the 2 percent target over time. Also, continue to reduce its holdings of treasury securities, agency debt and mortgage-backed securities.
Bank of England	3.50 percent	Increased by 325 basis points	• Began tapering its asset holdings of UK government and corporate bonds financed by the issuance of BoE reserves by ceasing to reinvest in maturing assets in February 2022. • In addition, to reverse the quantitative easing, the BoE started selling some of the £895 billion UK government and corporate bonds. The aim was to reduce asset holdings by £80 billion over a period of twelve months.	• Further increases in the Bank Rate may be warranted, but by a lower magnitude than currently.

Central Bank	Policy Rate as at December 2022	Policy Change from Previous Year	Asset Purchase Programmes	Likely Policy Decision in 2023
European Central Bank[13]	2.50 percent	Increased by 250 basis points	• Recalibrated targeted longer-term refinancing operations (TLTROs) rate by linking it to the average deposit facility rate or the average rate on the main refinancing operations for the remaining maturity of respective TLTRO III, to accelerate tightening of monetary policy and normalise financing conditions and reduce bank's balance sheet. • The Pandemic Emergency Purchase Programme, introduced in 2020, was conducted at a lower pace in January 2022 and purchases discontinued at the end of March 2022, only reivestments of redemptions on maturing assests purchased under the programe to run until the end of 2024. • Net purchases under the asset purchase programme (APP) continued in 2022, but was revised upwards to a monthly pace of €90 billion in the second quarter of 2022, to cushion the economy against uncertainities associated with the Russia-Ukraine war. The APP was concluded in the third quarter of 2022, there were no more net purchases, only reivestments of redemptions until early 2023.	• Further interest rates increases are possible and will be based on the evolving inflation and economy dynamics. • The APP is expected to decline at a measured and predictable pace as the ECB will no longer reinvest all of the principal from maturing securities. An initial prediction states that it will decline by an average of €15 billion per month until the third quarter of 2023 and its subsequent decline will be determined over time

13 The ECB has three key policy rates. These are the interest rate on the main refinancing operations, as well as the interest rates on the marginal lending facility and the deposit facility. The interest rate presented above is on the main refinancing operations.

Central Bank	Policy Rate as at December 2022	Policy Change from Previous Year	Asset Purchase Programmes	Likely Policy Decision in 2023
Bank of Japan	-0.1 percent	No change	• Continued buying risky assets, such as exchange traded funds at an annual pace of ¥12 trillion and Japanese real estate trust funds (J-REIT) at an annual pace of ¥180 billion to cap upward pressure on yields resulting from global swings. • In June 2022, the BoJ defended its ceiling on the 10-year Japanese Government bonds (JBGs) by buying over ¥16 trillion worth of bonds. • Purchased Commercial Paper (CP) and corporate bonds with an upper limit on the amount outstanding of about ¥20 trillion in total, until the end of March 2022.	• Will not hesitate to take additional easing measures if necessary; it also expects short- and long-term policy interest rates to remain at their present or lower levels.
Bank of Botswana	2.65 percent	Increased by 151 basis points	Not applicable	• No indication of the direction of policy.
South African Reserve Bank	7.00 percent	Increased by 325 basis points	Not applicable	• Increase in 2023
People's Bank of China	3.65 percent	Decreased by 15 basis points	Not applicable	• Maintain an accommodative monetary policy stance. Indicated that policy tightening across the globe is limiting China's room for further monetary policy easing.
Central Bank of Brazil	13.75 percent	Increased by 450 basis points	Not applicable	• Reinforces that future monetary policy steps can be adjusted and will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.
Reserve Bank of India	6.25 percent	Increased by 225 basis points	Not applicable	• Increase in 2023 likely, but no indication on the magnitude. RBI remains focused on withdrawal of accommodative measures to ensure that inflation remains within the target going forward, while supporting growth.
Central Bank of Russia	7.5 percent	Decreased by 100 basis points	Not applicable	• No indication of the direction of policy; will continue to use the latest data to adapt monetary policy in future meetings.

Table A2: Credit to Private Sector by Banks (Percent of GDP)

	2018	2019	2020
United States of America	52.2	52.2	54.3
United Kingdom	133.7	132.3	146.6
India	50.3	50.8	54.7
China	157.8	165.4	182.9
Singapore	117.7	119.7	130.6
Chile	82.1	87.2	88.7
Rwanda	21.4	21.4	25.0
Mauritius	75.3	78.1	91.9
Namibia	81.7	91.2	97.6
Kenya	31.2	30.8	32.1
South Africa	59.9	60.4	62.0
Botswana	**34.7**	**36.0**	**39.8**

Source: World Bank's World Development Indicators.

Notes:
1. Domestic credit to the private sector by banks refers to financial resources provided to the private sector by other depository corporations (deposit taking corporations except central banks), such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment. For some countries, these claims include credit to public enterprises.
2. Data for 2021 and 2022 is not available.

NOTE

NOTE

MONETARY POLICY COMMITTEE MEETING DATES FOR 2023

Date	Venue
February 22 - 23	Bank of Botswana
April 27 - 28	Bank of Botswana
June 14 - 15	Bank of Botswana
August 23 - 24	Bank of Botswana
October 25 - 26	Bank of Botswana
December 6 - 7	Bank of Botswana

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