

Box 1: Monetary Policy Inflation Objective Range for Botswana

The primary objective of monetary policy is to maintain price stability, defined as a low, stable and predictable level of inflation. A key aspect of monetary policy is defining the target range or objective range for the inflation rate. This helps make central bank actions and communication to be transparent and predictable, which reduces uncertainty and enhances economic stability.

There are multiple factors that are taken into consideration when determining the objective range. These include an analysis of the historical movement of inflation over the years, the relationship between inflation and economic growth and a comparative analysis with trading partners. The historical movement of inflation gives an idea of the long-term trend of inflation and influences inflation expectations of businesses and households over time. Historical inflation trends often also shape the perceived credibility of the central bank. A track record of successfully managing inflation bolsters a central bank's reputation, while past failures can make it difficult to convince the public of the central bank's commitment to new targets.

The relationship between inflation and economic growth is generally viewed as demonstrating some threshold effects. That is, up to a certain inflation level, there may be little or no negative impact on growth. However, once inflation surpasses this threshold, it can become detrimental to economic growth. Moreover, stable and predictable inflation creates a favourable environment for long-term investments. When inflation is volatile or too high, it introduces uncertainty into the decision-making process of firms and individuals. Such unpredictability can deter investments, as businesses find it harder to project returns and costs. In the case of households, it might discourage savings and erode purchasing power, hence resulting in lower demand and economic activity.

Using a threshold model in the case of Botswana, Phetwe and Molefhe (2016)² estimated the threshold level of inflation at 6.9 percent using quarterly data for the period 1994 to 2014. These results imply that inflation below the threshold level has a positive effect on GDP growth while inflation above the threshold has a negative effect on economic growth. This study demonstrated that the inflation objective that was below the threshold was appropriate.

In 2023, an evaluation was done to ascertain the relevance of the 3 – 6 percent objective range given the changes over the years, including the changes in the consumer price index basket. The 2023 review estimated the same threshold model used by Phetwe and Molefhe, but with an updated dataset extending to 2022Q4. The updated analysis confirmed the current medium-term objective range of 3 – 6 percent suitable to define price stability in Botswana, estimating a threshold inflation rate of 5.4 percent for total GDP growth and 5.8 percent for non-mining GDP growth.

Regionally, most target ranges are consistent with the Southern African Development Community (SADC)'s convergence guide of 3 – 7 percent (see Table below). Across Africa, some central banks with inflation targeting regimes and forward-looking monetary policies have inflation targets that are single digits. Botswana's current medium-term objective range of 3 – 6 percent is in line with the SADC guide and consistent with those prevailing across Africa.

Some Inflation Targets in SADC and Africa

Country	Inflation Target/Objective (Percent)
South Africa	3 – 6
Mauritius	2 – 5
Tanzania	5
Zambia	6 – 8
Mozambique	<10
Uganda	5
Ghana	8 (±2)
Kenya	5 (±2.5)

Source: Central Bank Websites

- 1 Consumer price index (CPI) represents the cost of living of a representative household in Botswana relative to a chosen/specified base period. The current base period is September 2018. The index is constructed by Statistics Botswana based on regular monthly surveys of prices of a basket of goods and services across the country. In principle, the changes in consumer prices (inflation) are a result of demand and supply dynamics.
- 2 Phetwe M., and Molefhe L. (2016). Inflation and Economic Growth: Estimation of a Threshold level of inflation in Botswana. *Bank of Botswana Research Bulletin*, 29(1):13–23.