MONETARY POLICY REPORT

APRIL 2021

BANK OF BOTSWANA

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

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1. PREFACE

1.1 Purpose of the report

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

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

1.2 Monetary policy framework

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

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

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

1.3 Decision-making process

Monetary policy is implemented in line with the decisions of the MPC. The Committee comprises: the Governor (Chairman); Deputy Governors; the Chief Operating Officer; Director and Deputy Directors of the Research and Financial Stability Department responsible for monetary policy and financial stability; Director and Deputy Director of the Financial Markets Department responsible for the domestic market operations; and Director of the Banking Supervision Department. The MPC holds six pre-scheduled meetings or more per year, as necessary, during which the monetary policy stance is determined. Prior to the commencement of the year, the dates for the MPC meetings for the ensuing year are announced.

1.4 Announcement of the monetary policy decision

The monetary policy decision is announced through a Press Release shortly after each MPC meeting. The Press Release informs the public of the Committee's decision regarding the Bank Rate and the reasons for the policy choice. The Governor holds a Press Briefing to allow for interaction with members of the media and to promote understanding of the Bank's economic analysis and policy stance (See Box 5 for further information on central bank communication).

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

2. EXECUTIVE SUMMARY

In 2021, monetary policy will be implemented in the context of projections for higher inflation in the near to medium term, associated with upward adjustment of taxes/levies and administered prices, a modest recovery in domestic demand resulting from the deployment of COVID-19 vaccines, and expected modest increase in foreign prices. Overall, the current state of the economy and the outlook for both domestic and external economic activity provide scope for maintenance of an accommodative monetary policy to support economic activity.

The Bank's formulation and implementation of monetary policy focuses on entrenching expectations of low, sustainable and predictable level of inflation through a timely response to price developments. The Bank remains committed to responding appropriately to preserving price and financial stability without undermining economic activity.

At the April 2021 meeting, the MPC concluded that the short-term adverse developments in the domestic economy occurred against a potentially supportive policy environment, hence the Bank Rate was maintained at 3.75 percent. Overall, risks to the inflation outlook are currently assessed to be skewed to the upside. Upside risks include the potential increase in international commodity prices beyond current forecasts, aggressive action by governments (for example, the Economic Recovery and Transformation Plan (ERTP)) and major central banks to bolster aggregate demand including successful rollout of the COVID-19 vaccination programmes. Persistence of supply constraints due to possible travel restrictions and lockdowns could also lead to higher prices. In addition, domestically-based risk factors relate to second round effects of the recently announced increases in administered prices. However, these risks are moderated by the possibility of weak domestic and global economic activity, which could be exacerbated by periodic lockdowns and other forms of restrictions due to the emergence of new COVID-19 variants and slow rollout of vaccines, and the possible decline in international commodity prices. Furthermore, the emergence of implementation capacity constraints, if any, could hinder the effectiveness of policy stimulus and ERTP initiatives, thus resulting in lower inflation.

Headline inflation averaged 2.6 percent in the first quarter of 2021, higher than the 2.2 percent in the first quarter of 2020, mostly accounted for by the increase in prices of food and vehicles, as well as domestic retail fuel prices. Inflation is projected to be higher in the short term compared to the February 2021 projection, with the possibility of breaching the upper bound of the Bank's 3 – 6 percent objective range in the second quarter of 2021. However, inflation is projected to revert to within the objective range in the first quarter of 2022. The expected higher inflation in the near term mainly reflects inflation persistence, the upward adjustment in user fees for direct broadcast satellite services, the announced increase in water tariffs, a higher rate of depreciation of the Pula against the South African rand, as well as the upward revision in forecasts for trading partner countries inflation and international commodity prices than previously projected.

Gross Domestic Product (GDP) contracted by 7.9 percent in 2020, compared to 3 percent growth in 2019, attributable to the contraction in output of both the mining and non-mining sectors, resulting from the negative impact of the COVID-19 pandemic containment measures on domestic economic activity. The 2020 contraction is in line with the 7.7 percent contraction projected by the MFED in the February 2021 Budget Speech. The prevailing accommodative monetary conditions, reforms to further improve the business environment, and government interventions against COVID-19, including vaccine rollouts, the implementation of the ERTP and the Industry Support Facility, should generally be positive for economic activity in the medium term. The domestic economy is forecast to rebound to a growth of 8.8 percent in 2021.

Annual growth in commercial bank credit decelerated to 3.6 percent in February 2021, compared to 10.2 percent in February 2020, reflecting, in part, the somewhat subdued demand for credit, as well as restrictive supply of credit by banks on account of the uncertainty created by the COVID-19 pandemic.
At the end of February 2021, foreign exchange reserves amounted to P55.8 billion, a decrease of 15.6 percent from P66.1 billion in February 2020. The decrease was a result of the drawdown in the foreign

exchange reserves to finance imports (mainly fuel, power, equipment, food and related items), government financial obligations, such as external loan servicing, payment for construction of two major bridges and funding of embassies as well as outward investments by pension funds and other institutional investors. The current account of the balance of payments (BoP) recorded a reduced deficit of P3.8 billion in the fourth quarter of 2020, compared to a revised deficit of P6.4 billion in the corresponding period of 2019. The overall BoP was in deficit by P17.2 billion for the twelve months to February 2021, compared to a deficit of P13.2 billion in the twelve months to February 2020.

Following the latest annual exchange rate policy review in January 2021, an annual downward rate of crawl of 2.87 percent was maintained for 2021, with a view to enhancing domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. Consequently, the nominal effective exchange rate (NEER) of the Pula depreciated by 2.7 percent in the twelve months to March 2021. Against the basket currencies, the Pula depreciated by 10.5 percent against the South African rand but appreciated by 4.2 percent against the SDR in the twelve months to March 2021. In the year to February 2021, the real effective exchange rate (REER) depreciated by 2 percent due to the higher downward rate of crawl (2.6 percent) than the positive inflation differential (0.6 percent) between Botswana and trading partner countries.

Global economic output growth for the second half of 2020 was better than anticipated and a stronger performance is expected in 2021, due to additional fiscal support and as most countries deploy effective COVID-19 vaccines. However, most economies experienced a slowdown of growth during the fourth quarter of 2020 compared to the third quarter, as a result of tightened restrictions put in place to contain the surge in infections and the emergence of the new variants of the COVID-19 virus. The United States of America’s (US) GDP grew by an annualised 4.3 percent in the fourth quarter of 2020, slowing from a record expansion of 33.4 percent in the third quarter, as the increase in COVID-19 cases and restrictions on activity moderated consumer spending. Similarly, GDP growth in the UK was 1.3 percent in the fourth quarter of 2020, significantly lower than an expansion of 16.9 percent in the third quarter, driven mostly by a substantial fall in private consumption as the economy was put under lockdown to curb the spread of the COVID-19 virus. Growth in the euro area contracted by 0.7 percent in the fourth quarter of 2020, from an expansion of 12.5 percent in the third quarter, as the eurozone countries tightened COVID-19 containment measures at the end of the year. Regionally, South African output expanded by an annualised 6.3 percent in the fourth quarter of 2020, following a substantial increase of 67.3 percent in the third quarter of 2020; in the main due to the base effects.

The global economic outlook was revised upwards in the IMF’s April 2021 World Economic Outlook (WEO) on account of stronger-than-expected recovery across regions in the second half of 2020, as well as additional policy support in advanced economies and the rollout of effective COVID-19 vaccines across the world. Prospects for advanced countries are much stronger owing to expectations of widespread vaccine availability compared to emerging market economies. In the April 2021 WEO, the global economy is forecast to expand by 6 percent in 2021, from an estimated contraction of 3.3 percent in 2020, reflecting expectations of strengthening of activity in the latter part of the year largely induced by additional fiscal support and the rollout of the effective COVID-19 vaccination programmes.

The global rough diamond price index increased in the first quarter of 2021 as COVID-19 restrictions continued to ease in most countries across the world, thus improving the manufacturers’ demand for rough diamonds and diamond trade, generally. In the first quarter of 2021, international oil prices (Brent crude and OPEC) increased slightly to above USD60 per barrel, influenced by expansion in demand associated with positive developments concerning the COVID-19 vaccine and its rollout. Meanwhile, the United Nations’ Food and Agriculture Organisation (FAO) food price index increased in the first quarter of 2021, mainly due to the rise in vegetable oil, cereal and dairy prices. Moreover, the recovery in global demand following relaxation of some COVID-19 containment measures added some impetus on food prices.

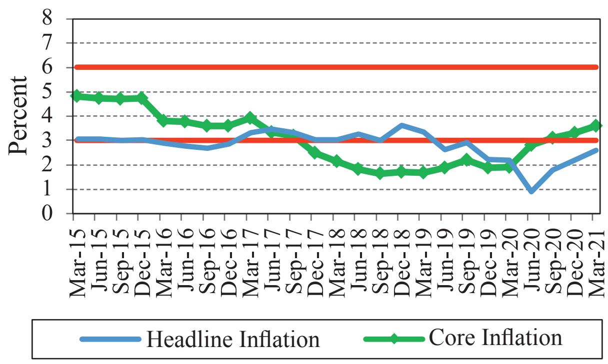
3. RECENT ECONOMIC DEVELOPMENTS

3.1 Inflation environment

Headline inflation increased in the first quarter of 2021

Headline inflation averaged 2.6 percent in the first quarter of 2021, from 2.2 percent in the first quarter of 2020 (Chart 3.1), mostly accounted for by the increase in prices of food and vehicles, as well as fuel. Headline inflation rose from 2.4 percent in February to 3.2 percent in March 2021 (Table 3.1), reverting to within the Bank's medium-term objective range of 3 – 6 percent. The increase in inflation between February and March 2021 mainly reflects the upward ajustment in domestic fuel prices in March 2021, which is estimated to have increased inflation by approximately 0.68 percentage points.

Chart 3.1: Botswana Headline and Core Inflation

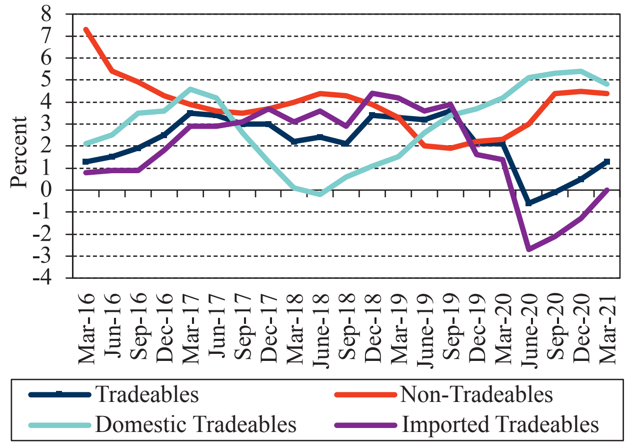


Source: Statistics Botswana and Bank of Botswana
Note: Core Inflation is headline inflation excluding administered prices.

Prices for domestic tradeables increased while those of imported tradeables decreased in the first quarter of 2021

Inflation for domestic tradeables increased from an average of 4.2 percent in the first quarter of 2020 to an average of 4.8 percent in the first quarter of 2021, reflecting the increase in food prices (Chart 3.2). In contrast, imported tradeables inflation decreased from an average of 1.4 percent to zero in the same period, reflecting the base effects associated with the downward adjustment in domestic fuel prices in the first quarter of 2020. As a result, all tradeables inflation decreased from an average of 2.1 percent in the first quarter of 2020 to an average of 1.3 percent in the coresponding quarter in 2021, while inflation for non-tradeables increased from an average of 2.3 percent to an average of 4.4 percent in the same period. In March 2021, domestic tradeables, imported tradeables, non-tradeables and all tradeables inflation were 5 percent, 1.3 percent, 4.4 percent and 2.3 percent, respectively.

Chart 3.2: Inflation for Tradeables and Non-Tradeables



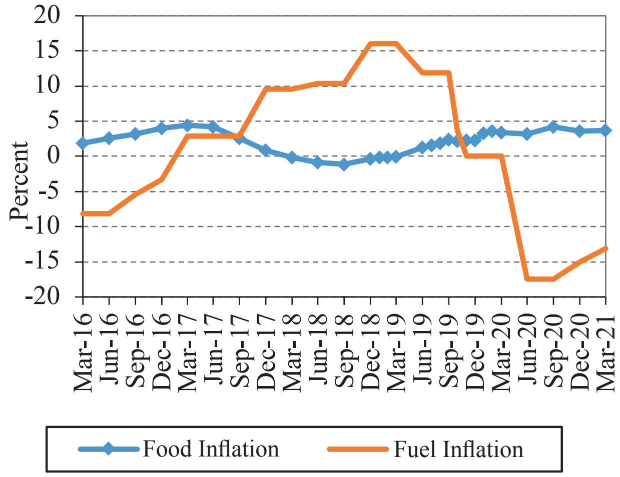
The upward trend in non-tradeables inflation from June 2019 and domestic tradeables inflation from June 2018 is mainly due to the increase in prices for administered items and food, respectively. The increase in food prices was partly a result of bad weather conditions experienced in the 2018/19 ploughing season, and the economic disruptions occassioned by COVID-19 in 2020.

Accordingly, therefore, upward trends in both non-tradeables and domestic tradeables inflation are not a result of domestic demand pressures, as the output gap is estimated to be negative (Section 4.2 refers).

Core inflation measures increased in the first quarter of 2021

The trimmed mean inflation (CPITM) increased to 2.5 percent in the first quarter of 2021 from 1.9 percent in the first quarter of 2020, while inflation excluding administered prices (CPIXA) averaged 3.6 percent compared to 2.7 percent in the same period due to the increase in prices for food and non-alcoholic beverages (Table 3.1). Similarly, inflation excluding food and fuel (CPIXFF) averaged 4.4 percent in the first quarter of 2021, higher than the 2.3 percent in the corresponding quarter of 2020, attributable, in part, to the base effects associated with the upward adjustment in electricity tariffs in 2020. In March 2021, CPITM, CPIXA and CPIXFF were 2.8 percent, 3.9 percent and 4.6 percent, respectively.

Chart 3.3: Food and Fuel Inflation



Source: Statistics Botswana and Bank of Botswana

Table 3.1: Annual Price Changes for Categories of Goods and Services (Percent)

Category of commodities	Basket Weights	March 2021	Q1 2021	Q1 2020
Food and non-alcoholic beverages	13.6	4.0	3.7	3.4
Alcoholic beverages and tobacco	4.3	7.1	6.7	4.9
Clothing and footwear	6.0	2.8	2.8	1.6
Housing, water, electricity, gas and other fuels	17.5	7.2	7.1	1.5
Furnishing, h/h equipment and routine maintenance	4.9	2.0	2.0	2.9
Health	3.4	2.3	2.2	0.8
Transport	23.4	1.4	-0.6	0.9
Communications	6.9	0.8	0.8	0.3
Recreation and culture	2.8	1.7	1.6	-0.3
Education	4.6	1.7	1.7	4.7
Restaurants and hotels	3.7	1.7	1.6	3.7
Miscellaneous goods and services	9.0	1.4	1.3	5.1
Annual Inflation (All items)	**100.0**	**3.2**	**2.6**	**2.2**
CPITM		2.8	2.5	1.9
CPIXA		3.9	3.6	2.7
CPIXFF		4.6	4.4	2.3

Source: Statistics Botswana and Bank of Botswana calculations

Box 1: Administered Prices

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

There are currently 51 administered items (12.8 percent) out of the 400 items in the Botswana CPI basket, accounting for a significant weight of 32.3 percent in the basket (Table 3.2). Changes in the prices of these items, therefore, have a significant influence on inflation and inflation expectations. For this reason, the Bank monitors and calculates the prospective and actual impact of the changes in administered prices on inflation, with a view to inform the forward-looking monetary policy framework of the Bank.

Table 3.2: Administered Items

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

Source: Statistics Botswana

3.2 Recent domestic economic developments

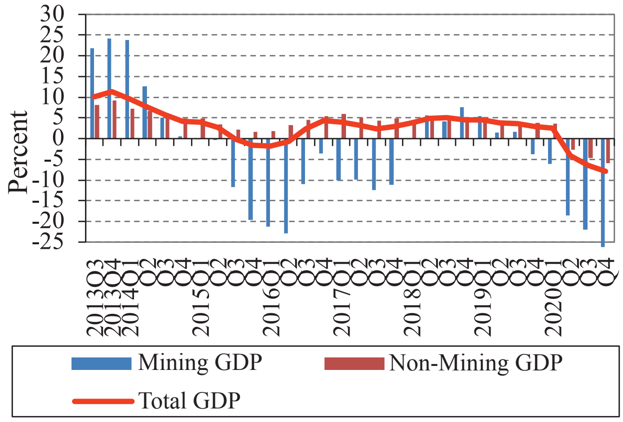
GDP contracts in 2020

Real GDP contracted by 7.9 percent in 2020, compared to 3 percent growth in 2019 (Chart 3.4 and Table 3.3). The decline in output is attributable to the contraction in production of both the mining and non-mining sectors, resulting from the negative impact of the COVID-19 pandemic containment measures on overall domestic economic activity. The 2020 contraction is in line with the 7.7 percent contraction projected by the MFED in the February 2021 Budget Speech. Mining output contracted significantly by 26.2 percent compared to a lesser contraction of 4.1 percent in 2019, mainly due to weaker performance of the diamond, coal, soda ash and the 'other' mining subsectors. In 2020, overall global demand and sales of rough diamonds were adversely affected by the COVID-19 international travel restrictions. Coal output contracted by 8.7 percent attributed to lower demand at Morupule B power station, which was operating below capacity, due to ongoing remedial works at the plant.

Non-mining GDP contracted by 5.9 percent in 2020 compared to the 3.9 percent growth in 2019. The decline in non-mining GDP was mainly due to contractions in output of the trade, hotels and restaurants[1] (-14.8 percent), construction (-11 percent), manufacturing (-8.7 percent), transport and communications (-7.7 percent), social and personal services (-1.9 percent) and finance and business services (-1.2 percent) sectors. In addition, the deceleration in growth of general government, from 3.7 percent to 2.8 percent and water and electricity, from 8.4 percent to 5.1 percent contributed to the overall output decline of the non-mining sector. Meanwhile, output for the agriculture sector increased by 2.3 percent in 2020 following a contraction of 0.1 percent in 2019. The increase in Agriculture output resulted from increased production from all subsectors in the period under review.

Meanwhile, Statistics Botswana reported that real GDP contracted by 4.1 percent in the fourth quarter of 2020, from 1.7 percent growth in the fourth quarter of 2019[2].

Chart 3.4: GDP Growth Rates



Source: Statistics Botswana
Note: Growth rates are reported on a rolling 12-month basis.

In terms of GDP by expenditure, government final consumption increased to 4.3 percent in 2020, compared to 3.3 percent in 2019 (Table 3.3). This was attributable to the acceleration in growth of central government consumption and local government consumption, from 3.5 percent to 4.4 percent and 2.1 percent to 3.5 percent, respectively. Meanwhile, household final consumption grew by 0.2 percent compared to 4.2 percent registered in the previous period. The lower growth in household final consumption was mainly due to a contraction in non-marketed household final consumption[3] and expenditure by non-profit institutions.

Gross fixed capital formation (GFCF) contracted by 8.2 percent in 2020, compared to the 6.6 percent growth in the corresponding period in the previous year. The contraction in GFCF was mainly due to a decline of 11 percent in investment in construction from a growth of 3.9 percent in 2019.

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1 This sector also includes tourism.

2 Statistics Botswana calculates annual GDP growth for a given quarter on the basis of quarterly output in that period compared to the output for the corresponding quarter in the previous year.

3 Marketed household consumption refers to goods and services purchased for consumption by households.

Table 3.3: Real GDP Growth by Sector and Expenditure (Percent)

	2019 Q4	2020 Q3	2020 Q4
Total GDP	**3.0**	**-6.4**	**-7.9**
By Sector			
Mining	-4.1	21.9	-26.2
Non-Mining	3.9	-4.7	-5.9
Agriculture	-0.1	1.3	2.3
Manufacturing	2.8	-7.9	-8.7
Water and Electricity	8.4	*18.7* (-21.7)	5.1
Construction	3.0	-9.5	-11.0
Trade, Hotels and Restaurants	4.5	*-12.4* (-12.7)	-14.8
Transport and Communications	5.1	-4.8	-7.7
Finance and Business Services	5.9	-0.2	-1.2
General Government	3.7	3.0	2.8
Social and Personal Services	3.0	-1.8	-1.9
By Expenditure			
Government Final Consumption	3.3	*4.5* (4.7)	4.3
Household Final Consumption	4.2	*1.7* (1.8)	0.2
Gross Fixed Capital Formation	6.6	*-6.8* (-7.0)	-8.2
Exports	-16.1	*-32.4* (-32.3)	-21.4
Imports	11.7	*3.9* (-2.7)	4.3

Note: The figures in italics are revisions of the figures in brackets, previously reported in the Q3 estimates.

Source: Statistics Botswana and Bank of Botswana Calculations

Diamond production decreased in the fourth quarter of 2020

Debswana produced 4.3 million carats of diamonds in the fourth quarter of 2020, 27.6 percent lower than the 5.9 million carats produced in the corresponding period in 2019. The overall significant decline in production was mainly driven by planned reductions in production in line with the lower demand for rough diamonds due to the COVID-19 pandemic and the related measures to safeguard the workforce. The COVID-19 containment measures and the resultant limited midstream diamond cutting and polishing activities, particularly in India, adversely affected the demand for rough diamonds. Debswana's production target for 2021 has been set at 23 million carats, while production guidance for the larger De Beers Group has been revised downwards to 32-34 million carats (previously 33-35 million carats).

Production by Lucara Diamond Corporation (Karowe Mine) increased by 15.8 percent to 100 059 carats in the fourth quarter of 2020, from 86 422 carats in the corresponding period in 2019.[4] The mine continued operations throughout the COVID-19 pandemic period, hence the increase in production is mainy attributable to increased recovery of special stones (single diamonds in excess of 10.8 carats) and the re-processing of tailings in the period under review. Special stones accounted for 6.7 percent of total carats recovered during the period. With respect to quarterly performance, production for the fourth quarter of 2020 increased by 12.5 percent to 100 059 carats from 88 909 carats in the third quarter of 2020. In July 2020, Lucara announced a ground-breaking partnership agreement to supply the HB Group, headquartered in Antwerp, Belgium, with diamonds larger than 10.8 carats from the Karowe Mine for the rest of 2020.

Budget deficit recorded in the third quarter of the 2020/21 fiscal year

Government budget was in deficit of P5.6 billion in the third quarter of the 2020/21 fiscal year (Table 3.4). The deficit was mainly due to the lower mineral revenue in the revised budget, largely reflecting the negative impact on diamond sales by travel restrictions aimed at containing the spread of the COVID-19 pandemic. Regarding other major revenue streams, domestic taxes (Value Added Tax (VAT) and Non-Mineral Income Tax) fell short of the projected tax collections in the revised budget, mainly due to the deferment of income tax payments by some businesses, as part of the fiscal relief measures to alleviate the impact of the COVID-19 pandemic on domestic business and the domestic economy at large. Total government expenditure and net lending was P18.2 billion, higher than the P17.3 billion originally anticipated.

Government expenditure has been revised upwards to P69.4 billion for the 2020/21 fiscal year, which is P1.7 billion higher than the original budget. The budget deficit has also been revised significantly upwards to P21 billion from the original P5.2

[4] Lucara's production for the fourth quarter of 2020 accounts for a very small proportion of total global production and a significant part of the value of the Company's production is mainly attributable to large and higher-quality diamonds from Karowe Mine.

billion, reflecting the downward revision of revenue and grants from P62.4 billion to P48.3 billion.

Table 3.4: Quarterly Budget Outturns (P Million)

	Total Revenues and Grants	Total Expenditure and Net Lending	Budget Surplus/ Deficit
2019/20 Q3	11 960	15 953	-3 992
2019/20 Q4	11 713	16 614	-4 901
2020/21 Q1	12 788	14 303	-1 515
2020/21 Q2	10 284	17 636	-7 362
2020/21 Q3	12 643	18 199	-5 556

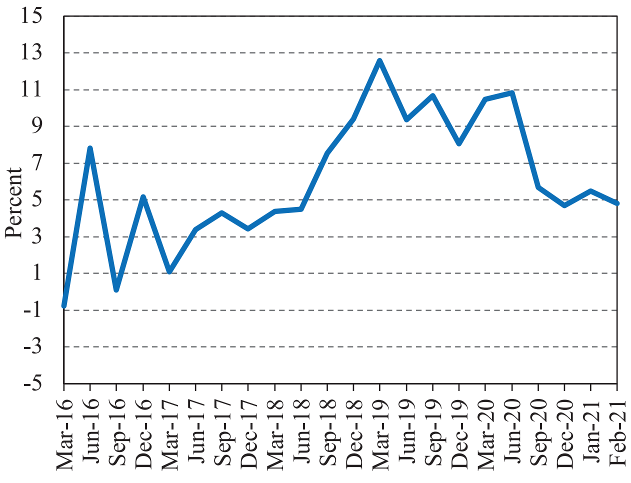
Source: Cash Flow Unit, Ministry of Finance and Economic Development

3.3 Monetary developments

Growth in banking sector assets decelerated in February 2021

Annual growth in banking sector assets decelerated from 9.3 percent in February 2020 to 4.8 percent in February 2021 (Chart 3.5). This was due to the decrease in holdings of Bank of Botswana Certificates (BoBCs), primary reserve requirements and outstanding reverse repos. The overall decrease in the growth of loans and advances, which accounted for the largest proportion of commercial banks' assets (62.9 percent) also contributed to the deceleration.

Chart 3.5: Year-on-Year Commercial Banks' Growth in Total Assets



Source: Commercial Banks

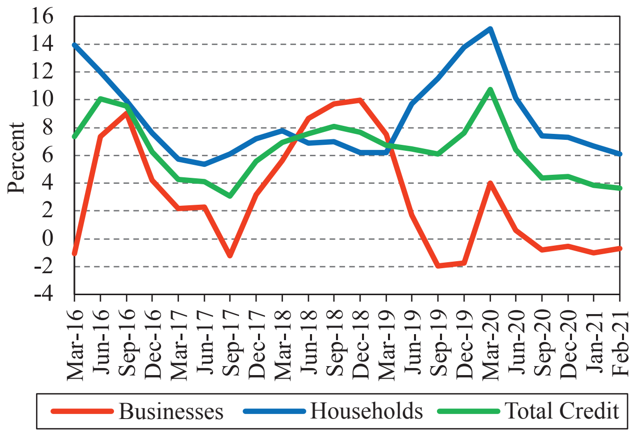
Credit growth decelerated in the year to February 2021

Growth in commercial bank credit declined from 10.2 percent in February 2020 to 3.6 percent in the twelve-month period to February 2021 (Chart 3.6). The deceleration in commercial bank credit growth is, in part, indicative of the somewhat subdued demand for credit, as well as restrictive supply of credit by banks on account of the uncertainty related to the COVID-19 pandemic.

Growth in household loans decreased to 6.1 percent in the twelve months to February 2021, from 15.2 percent in the corresponding period in 2020. In particular, there was a significant decline in credit card advances. Furthermore, there was a deceleration in growth for mortgages and personal unsecured lending which is mostly accessed through scheme loan arrangements, and motor vehicle loans in February 2021. Despite the deceleration in household credit growth, the share of the sector in total lending by commercial banks increased to 65.2 percent in February 2021, from 63.7 percent in February 2020.

Lending to the business sector contracted by 0.7 percent in the twelve months to February 2021, compared to an increase of 2.3 percent in the corresponding period in 2020. Meanwhile, credit to businesses excluding parastatals contracted by 2.3 percent in the year to February 2021 compared to a 1.2 percent annual contraction in February 2020. The decline in credit to businesses excluding parastatals was mainly due to decreased utilisation of overdraft facilities by some companies in the manufacturing, agriculture and construction sectors, among others. Credit to parastatals increased by 18.1 percent in the year to February 2021, compared to the 78.4 percent expansion in the twelve months to February 2020. The credit to parastatals tends to be "bumpy" due to periodic government financing and support.

Chart 3.6: Year-on-Year Commercial Banks' Growth in Total Credit

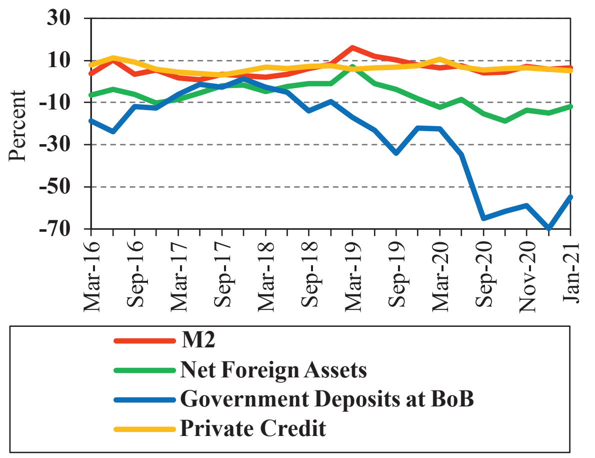


Source: Commercial Banks

Growth in money supply in January 2021

Annual growth in money supply (M2) was 6.6 percent in January 2021, higher than the 5.8 percent in the corresponding period in 2020 (Chart 3.7). The relatively higher growth in money supply was largely a result of the decrease in government deposits at the Bank of Botswana to fund government operations. Meanwhile, there was a deceleration in credit to the private and parastatals sectors as well as net foreign assets.

Chart 3.7: Year-on-Year Growth in Money Supply



Source: Other Depository Corporations and Bank of Botswana

The 7-day BoBC stop-out yields decreased in the first quarter of 2021

The 7-day BoBC stop-out yield decreased from an average of 1.45 percent in the first quarter of 2020 to 1.04 percent in the corresponding period in 2021. Similarly, the real rate of interest decreased from an average of -0.73 percent to an average of -1.55 percent in the same period.

Meanwhile, the stop-out yield for the 7-day BoBC was unchanged at 1.04 percent for the third consecutive month in March 2021. The real rate of interest for the 7-day BoBC decreased from -1.33 percent in February to -2.09 percent in March 2021, reflecting the increase in the inflation rate.

Effective October 30, 2020, the Bank discontinued the issuance of the 91-day BoBCs. This followed the re-introduction of the 3-month Treasury Bill, after Government increased the bond issuance programme from P15 billion to P30 billion. Box 2 discusses reforms to monetary operations.

S&P Global Ratings affirms Botswana's credit rating and maintains the negative economic outlook

In March 2021, S&P Global Ratings (S&P) affirmed Botswana's sovereign credit rating for long-term foreign and domestic currency bonds at "BBB+", and "A-2" for short-term foreign and domestic currency bonds. The negative economic outlook was maintained on account of the risks that the COVID-19 pandemic continues to pose to the country's economic and fiscal performance over the next twelve months. S&P indicated that the affirmation of the ratings was underpinned by strong, stable and predictable institutional frameworks; modest net general government debt levels; relatively strong net external position; and the positive impact of the monetary policy framework, all of which contribute to macroeconomic stability. S&P noted that the ratings were dependent on the trajectory of the COVID-19 pandemic, vaccination rates and movement restrictions which could influence the demand for diamonds. The economic outlook could be revised to stable if the country's public budget performance improved, resulting in increased fiscal and external buffers. On the other hand, the ratings could be lowered if sustainable recovery in the demand and prices for diamonds waned, resulting in weaker fiscal and external performance than the credit agency's current forecasts.

Moody's downgrades sovereign credit rating but changed Botswana's outlook from negative to stable

In April 2021, Moody's Investors Service downgraded Botswana's sovereign credit rating for long-term bonds, denominated in both domestic and foreign currency, from 'A2' to 'A3'. However, the economic outlook was changed from negative to stable. The downgrade is due to the reduction in the capacity of Government to absorb future shocks as a result of the erosion of fiscal buffers, ocassioned by the COVID-19 pandemic, and relatively weaker economic resilience, reflecting the less diversified economy. The revision of the outlook reflects broadly balanced risks, continued strong financial position despite downside risks to the post-pandemic fiscal consolidation path, low political risk, prudent policy making, limited risks pertaining to Government liquidity and external vulnerability. The ratings could be revised upwards if there is improved resilience to shocks, reduced vulnerability of the budget structure and notable progress on economic diversification.

Box 2: Reforms to Monetary Operations Framework

The Bank continues to monitor developments in money market liquidity conditions. In addition, the Bank evaluates monetary policy implementation framework on a regular basis for effectiveness and introduces refinements where necessary. In that regard, the Bank discontinued the issuance of the 91-day BoBCs effective October 30, 2020 and reintroduced the 3-month Treasury Bill (T-Bill). The decision to abolish the 91-day paper and reintroduce the 3-month T-Bill followed the decision by Government, as authorised by Parliament, to increase the ceiling of the bond issuance programme from P15 billion to P30 billion. The discontinuation of the issuance of the 91-day BoBCs is intended to avoid competition with the 3-month T-Bill and, therefore, supports the building up of the Government T-Bill market. In addition, the discontinuation of the 91-day BoBC allows for a clear separation between monetary policy operations and debt management and is in line with best international practice.

Moreover, since the introduction of the Primary Reserve Requirement Averaging (PRRA) in 2019, most commercial banks continue to actively use it as a tool for effective management of liquidity and the Bank envisages that this will, over time, lead to reduced demand for excess reserves held by commercial banks for precautionary purposes, thus freeing up additional resources for productive lending. Additional reforms to the monetary operations framework, in particular, changes to the anchor policy rate and interest rate structure aimed at strengthening the monetary policy transmission mechanism remain work-in-progress.

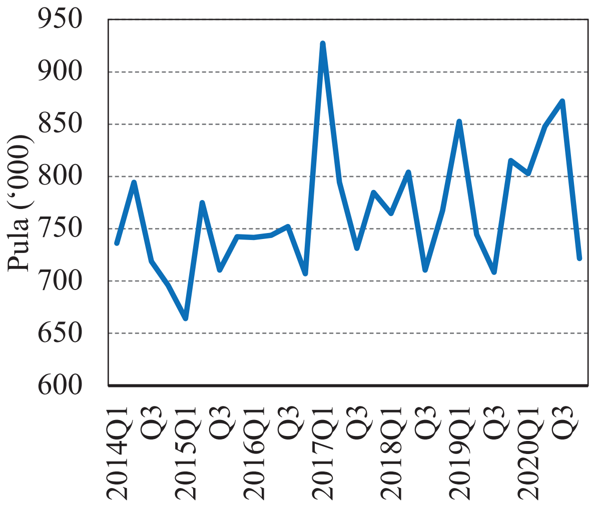
3.4 Asset markets

Property market generally weakened in the fourth quarter of 2020

According to the latest (2020Q4) Riberry Report[5], the residential rental market weakened in the fourth quarter of 2020, compared to the third quarter of 2020, due to weaker demand for both the upper and middle-end properties. However, the lower-end properties enjoyed a good rental market in terms of both demand and supply, despite the COVID-19 lockdowns in the second and third quarters of 2020.

The average price for residential properties sold in the fourth quarter of 2020 decreased by 17.4 percent to P720 000 compared to the previous quarter (Chart 3.8), reflecting the lower number of high valued properties traded in the quarter under review. Looking ahead, the demand for lower-end, medium and prime located residential housing is expected to improve given the affordability of properties in these categories compared to those in the upper-end market.

Chart 3.8: Riberry Average Prices



The market for office space remains weak due to increasing supply from completed construction developments, such as the Botswana Unified Revenue Service building at the Gaborone Central Business District (CBD). Despite the COVID-19 movement restrictions and general weak demand for office space, there was some take-up of office space, although limited, at the CBD by Government, a major consumer, as well as by some corporates. Going forward, the supply of office space is likely to increase further, given the ongoing construction projects and planned office buildings at the CBD, such as by the Botswana Housing and Water Utilities Corporations. These will further exert downward pressure on rentals, especially in the decentralised office locations.[6] Meanwhile, the outbreak of COVID-19 pandemic has resulted in most companies allowing their employees to work from home, and this could negatively affect the demand for office space.

Similar to the previous quarter, the demand for retail space remains fair across all market segments, while the supply is expected to increase on completion of the ongoing construction of a major shopping centre in the CBD, while another one is proposed for Mogoditshane. In addition, other centres with good demand for retail space are Jwaneng, Lobatse, Selibe Phikwe, Maun, Francistown, Mahalapye and Letlhakane. This is because most of these locations have a few retail schemes at planning and/or construction stage and are to be anchored by reputable supermarkets. With regard to industrial property, the supply of unoccupied big warehouse space has decreased, while the demand has improved.[7] Meanwhile, the availability of prime location industrial space is expected to decrease going forward, given that most of the centrally located industrial land is almost fully developed and occupied.

Stock market index declines

The Domestic Companies Index (DCI) declined by 12.9 percent in the twelve months to March 2021 compared to a reduction of 5 percent in the year to March 2020 (Chart 3.9). The decline was mainly due to the lower share prices for Turnstar, Seedco, FNBB, and Letshego, which fell by 29.3 percent, 24.1 percent, 22.5 percent and 20 percent, respectively, in the same period.

According to Stockbrokers Botswana, the sustained decline in the DCI was reflective of the

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

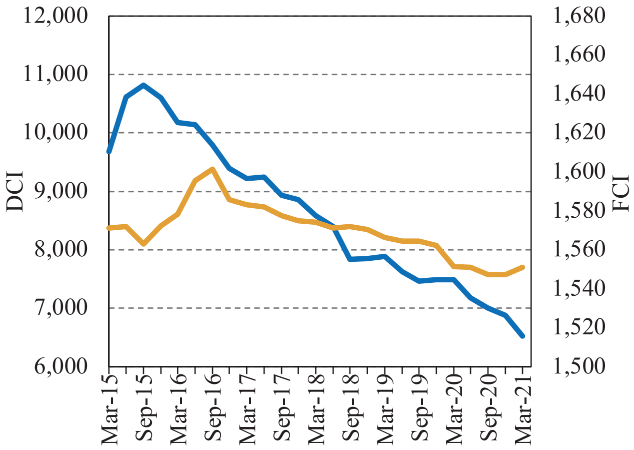
6 Prime rentals are about P100/m^2. However, rentals in secondary areas such as Gaborone International Finance Park (also known as Kgale Mews), situated at the foot of Kgale Hill adjacent to Game City Shopping Mall cost P75/m^2, while prime industrial areas like Gaborone International Commerce Park cost P65/m^2.

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

low trading activity and liquidity, as well as sluggish corporate earnings due to the restrained economic environment.

The Foreign Companies Index (FCI) declined by 0.03 percent in the year to March 2021, compared to a decline of 1 percent in the corresponding period ending in March 2020 (Chart 3.9). This was largely attributed to the year-on-year decrease in the share price for Tlou (-37.5 percent) and Minergy (-27.3 percent), on account of low trading activity and liquidity.

Chart 3.9: Stock Market Indices



Source: Botswana Stock Exchange

3.5 Balance of payments (BoP)

Current account records a deficit in the fourth quarter of 2020

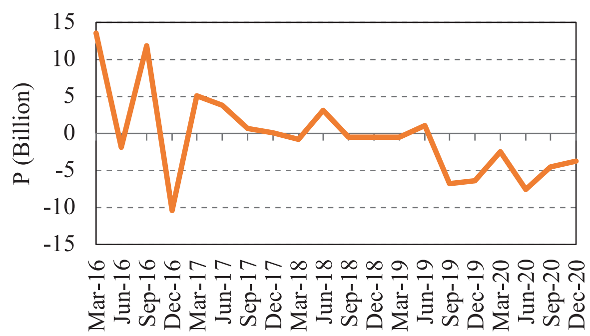
The current account is estimated to have recorded a deficit of P3.8 billion in the fourth quarter of 2020, compared to a revised deficit of P6.4 billion during the corresponding period in 2019 (Chart 3.10). The merchandise trade, services and primary income accounts recorded a combined deficit of P7.7 billion, which was partly offset by a surplus of P3.9 billion in the current transfers account, which is dominated by the Southern African Customs Union (SACU) revenue receipts. Exports increased by 30.8 percent from P13.3 billion to P17.4 billion, while imports increased by 20 percent from P18.5 billion to P22.2 billion, leading to a deficit of P4.9 billion in the merchandise trade account.

Diamond exports, which accounted for 91.1 percent of total exports of goods in the fourth quarter of 2020, increased from P12 billion in the fourth quarter of 2019 to P15.8 billion in the fourth quarter of 2020. During the same period, diamond imports increased from P5.3 billion to P8.6 billion. The increase in diamond trade mainly stemmed from recovery in demand by rough diamonds polishing companies in India, following the easing of COVID-19 related lockdown and movement restrictions.

The other commodities that contributed to an increase in exports include salt and soda ash (85.7 percent), gold (64.1 percent) and textiles (34.3 percent). Commodities that contributed to an increase in imports are metal and metal products, vehicles and transport equipment, and salt ores and related products, that increased by 35.4 percent, 15 percent, and 14.9 percent, respectively.

The negative balance in the income account resulted from the payments of investment income to foreign investors, mainly by direct investment enterprises (dominated by the mining sector), which paid out about P1.2 billion.

Chart 3.10: Quarterly Current Account Balance



Source: Bank of Botswana

The financial account records a surplus in the fourth quarter of 2020

The financial account registered an estimated surplus of P1.8 billion during the fourth quarter of 2020, compared to a revised deficit of P205 million in the fourth quarter of 2019. The surplus was mainly attributable to an increase in offshore investments, particularly by pension fund managers.

The balance of payments in deficit in February 2021

The overall BoP was in deficit by P17.2 billion for the twelve months to February 2021, compared to a deficit of P13.2 billion in the twelve months to

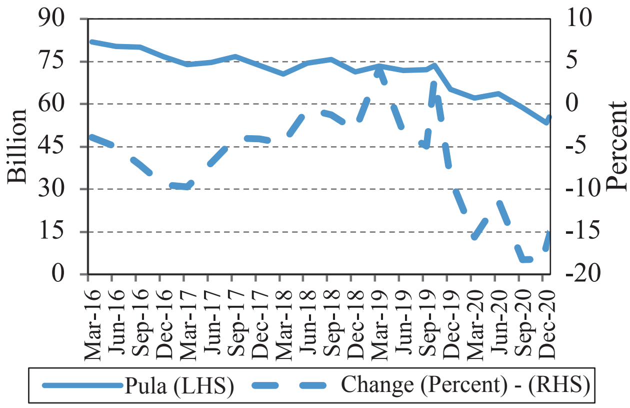
February 2020. The deficit mainly resulted from larger payments for imports and financing of other government obligations, such as external loan servicing and funding of embassies.

Foreign exchange reserves decrease

As at the end of February 2021, foreign exchange reserves amounted to P55.8 billion, a decrease of 15.6 percent from P66.1 billion in February 2020 (Chart 3.11). The decrease was due to drawdowns to finance the balance of payments deficit and other government obligations.

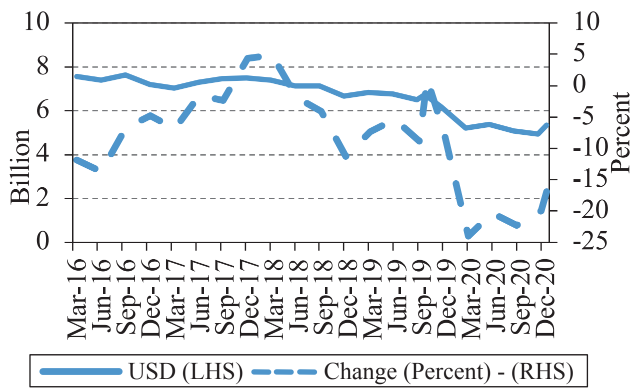
In foreign currency terms, the level of reserves decreased by 13.6 percent from USD5.9 billion in February 2020 to USD5.1 billion in February 2021 (Chart 3.12). The reserves also decreased by 18.6 percent from SDR4.3 billion to SDR3.5 billion in the same period. The level of reserves as at the end of February 2021 was equivalent to 10.5 months of import cover of goods and services.

Chart 3.11: Foreign Exchange Reserves in Pula and Annual Percentage Change



Source: Bank of Botswana

Chart 3.12: Foreign Exchange Reserves in US Dollars and Annual Percentage Change



Source: Bank of Botswana

3.6 Exchange rate developments

Following the latest annual policy review (Box 3), an annual downward rate of crawl of 2.87 percent was maintained for 2021. This downward rate of crawl was implemented from May 1, 2020[8] with a view to enhance domestic industry competitiveness in response to the adverse impact of the COVID-19 pandemic on the economy. The Pula basket weights were also maintained at 45 percent for the South African rand and 55 percent for the SDR, guided by Botswana's trade pattern and international transactions.

Bilaterally, the Pula depreciated against the South African rand by 10.5 percent but appreciated against the SDR by 4.2 percent in the twelve months to March 2021 (Chart 3.13). Against the SDR constituent currencies, the Pula appreciated by 10.3 percent against the Japanese yen, 7.9 percent against the US dollar and 1.4 percent against the euro, while it depreciated against the British pound and Chinese renminbi by 3.1 percent and 0.2 percent, respectively.

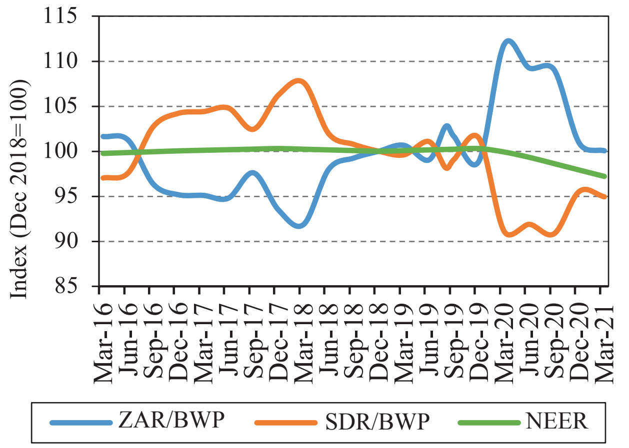
The movement of the Pula against the SDR constituent currencies largely reflects the performance of the South African rand against the SDR constituent currencies. Notably, in the same review period, the South African rand appreciated by 16.5 percent against the SDR. With respect to the SDR constituent currencies, the South African rand appreciated by 23.3 percent against the Japanese yen, 20.6 percent against the US dollar, 13.3 percent against the euro, 11.5 percent against the Chinese renminbi and 8.3 percent against the British pound.

The performance of the South African rand against most of the major trading currencies was mainly due to both international and domestic factors. Internationally, the South African rand was supported by prospects of a faster global economic recovery amid upbeat Chinese manufacturing

8 Effective May 2020, the Bank implemented an annual downward rate of crawl of 2.87 percent. This was complementary to the reduction in the Bank Rate in April 2020 and contributed to further easing of real monetary conditions to help promote domestic economic activity.

Purchasing Managers Index (PMI)[9] for March 2021, as well as the newly proposed US President Biden's USD2.25 trillion infrastructure development plan. On the other hand, South Africa's trade surplus was better-than-expected in February 2021 (trade surplus increased by 133.2 percent from a revised surplus of R12.42 billion in January to R28.96 billion in February 2021).

Chart 3.13: Nominal Exchange Rate Indices

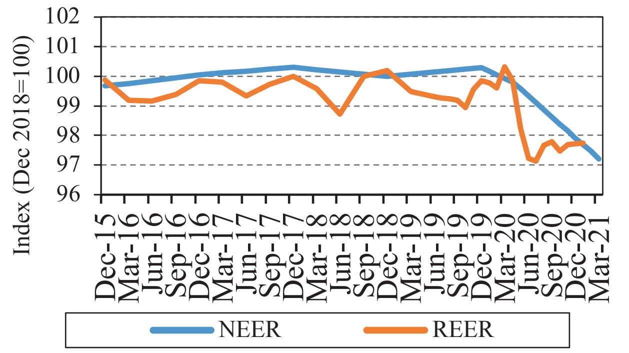


Source: Bank of Botswana

NEER depreciated in March 2021

The NEER of the Pula depreciated by 2.7 percent in the twelve months to March 2021 (Chart 3.14), consistent with the downward annual rates of crawl of 1.51 percent and 2.87 percent implemented effective January and May 2020, respectively.

Chart 3.14: Nominal and Real Effective Exchange rates



Source: Bank of Botswana

REER depreciated in February 2021

The REER depreciated by 2 percent in the twelve months to February 2021 (Chart 3.14), due to the higher downward rate of crawl (2.6 percent) than the positive inflation differential (0.6 percent) between Botswana and trading partner countries. With respect to bilateral movements against the Pula basket currencies, the real Pula exchange rate (using headline inflation) depreciated by 2.5 percent against the South African rand and 1.6 percent against the SDR. Against the SDR constituent currencies, the local currency depreciated by 6.5 percent against the euro, 4.1 percent against the British pound, 3.5 percent against the Chinese renminbi, but appreciated against the US dollar and the Japanese yen by 2.5 percent and 2.1 percent, respectively.

[9] China's manufacturing PMI stood at 51.9 percent in March, up 1.3 percentage points compared with 50.6 percent in February 2021. China's manufacturing sector has remained expansionary for 13 months in a row.

Box 3: Botswana's Exchange Rate Framework

The Exchange Rate Policy

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

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

Current Exchange Rate Framework

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

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

3.7 Recent global economic developments

Global growth subdued

The April 2021 WEO was more optimistic on growth prospects than the January 2021 WEO Update, on account of stronger than anticipated global economic recovery in the second half of 2020 as most countries eased lockdowns and adopted to new ways of living. Thus, the global economy is estimated to have contracted by 3.3 percent in 2020 (Table 3.5), a 0.5 percentage points upgrade from the January 2021 WEO Update. The decline in global output growth for 2020 was markedly lower than the 0.1 percent contraction recorded in the 2008/09 financial crisis, and the worst contraction since the Great Depression of the 1930s. Furthermore, for the first time, all regions experienced negative growth in 2020, as the outbreak and spread of the COVID-19 virus constrained demand and disrupted supply chains on an unprecedented scale. Meanwhile, there continues to be uncertainty with respect to the magnitude and duration of the adverse impact of the pandemic on the global economy, even as vaccines are being administered in some countries.

The US economy slowed, albeit remaining robust

US output grew by an annualised 4.3 percent in the fourth quarter of 2020 (revised from an estimate of 4.1 percent), slowing from a record expansion of 33.4 percent in the third quarter, as the increase in COVID-19 cases and restrictions on activity moderated consumer spending. The realised expansion in the fourth quarter reflected increases in exports, non-residential fixed investment, consumer spending, residential investment and inventories. For 2020, US GDP contracted by 3.5 percent, the worst performance since 1946, but slightly less severe than the forecast of a 3.6 percent decline, compared with a 2.2 percent growth in 2019.

Euro area growth decreases

In the euro area, GDP contracted by 0.7 percent in the fourth quarter of 2020, from an expansion of 12.5 percent in the third quarter. The contraction reflected the reinforcement of restrictions and lockdowns aimed at curbing the spread of the pandemic, which weighed down on demand and economic activity. Among the bloc's largest economies, output in France and Italy contracted by 1.4 percent and 1.9 percent, respectively, but increased slightly by 0.3 percent in Germany and 0.4 percent in Spain, in the fourth quarter of 2020. For 2020, euro area GDP fell by 6.6 percent, from a growth of 1.3 percent in 2019.

UK economy eases

GDP in the UK grew quarter-on-quarter by 1.3 percent in the fourth quarter of 2020, easing from an expansion of 16.9 percent in the third quarter of 2020, driven mostly by substantial fall in private consumption as the economy was put under lockdown to curb the spread of the COVID-19 virus. Despite the slowdown, the economy performed better than the market expectation of 0.5 percent in the fourth quarter of 2020, attributable to the increase in government consumption and fixed investment. For 2020 as a whole, UK GDP is estimated to have contracted by 9.8 percent, the larget annual fall on record, compared to the 1.4 percent growth in 2019.

Emerging markets' growth expand

For emerging market economies, output growth picked up in the fourth quarter of 2020, primarily due to improved external and domestic demand arising from relaxation of containment measures that were imposed to slow the spread of COVID-19. Growth was also supported by continued strong output growth in China, as well as accommodative monetary and fiscal stimulus implemented to cushion the economies from the COVID-19 pandemic. Meanwhile, China remained ahead of the global curve in terms of its recovery trajectory. The economy's output grew by 18.3 percent in the first quarter of 2021, from 6.5 percent in the fourth quarter of 2020, though lower than market expectation of 19 percent. The increase in output reflected higher retail sales, as domestic consumption, a key driver to growth, improved. Moreover, growth was boosted by the resilient export sector as well as continued government support for smaller firms. For 2020 as a whole, GDP in China grew by 2.3 percent.

In India, GDP grew year-on-year by 0.4 percent in the fourth quarter of 2020, from a contraction of 7.3 percent in the third quarter, but slightly below market forecast increase of 0.5 percent. The expansion was the first in three quarters as the government opened economic activities in phases from June after several lockdowns in late-March

2020. Expansion in both private and public spending, gross fixed capital formation, construction, real estate as well as manufacturing sectors contributed positively to the overall growth of the economy.

South African economy slows

Regionally, output in South Africa expanded by an annualised 6.3 percent in the fourth quarter of 2020, lower than the substantial increase of 67.3 percent in the third quarter of 2020, but beating market expectations of a 5 percent expansion. The largest drivers of growth in the fourth quarter were manufacturing, trade and transport industries, which expanded by 21.1 percent, 9.8 percent and 6.7 percent, respectively, following the easing of COVID-19 lockdown restrictions.

Table 3.5: Growth Estimates and Projections

	Estimate		Projection	
	2019	**2020**	**2021**	**2022**
Global	**2.8**	**-3.3**	**6.0**	**4.4**
Advanced economies	**1.6**	**-4.7**	**5.1**	**3.6**
USA	2.2	-3.5	6.4	3.5
Euro area	1.3	-6.6	4.4	3.8
UK	1.4	-9.9	5.3	5.1
Japan	0.3	-4.8	3.3	2.5
EMDEs	**3.6**	**-2.2**	**6.7**	**5.0**
China	5.8	2.3	8.4	5.6
Brazil	1.4	-4.1	3.7	2.6
India	4.0	-8.0	12.5	6.9
Russia	2.0	-3.1	3.8	3.8
South Africa	0.2	-7.0	3.1	2.0
Botswana	**3.0**	**-7.9**	**8.3 (8.8)**	**6.4 (5.5)**

Source: IMF WEO April 2021 and MFED for Botswana
Note: EMDEs stands for emerging market and developing economies, while figures in parentheses are forecasts from the MFED.

Global commodity prices

Rough diamond prices increased in the first quarter of 2021

The global rough diamond price index increased by 9.5 percent from 131.5 points in the fourth quarter of 2020 to 143.9 points in the first quarter of 2021 as most countries across the world continued to ease COVID-19 restrictions and rolled out effective vaccines, thus, improving manufacturers' demand and trade for rough diamonds. Meanwhile, the recovery in demand remains fragile owing to ongoing restrictions on the movement of both people and goods, and is expected to take some time to get back to pre-COVID-19 levels. The global rough diamond price index averaged 147.4 in March 2021.

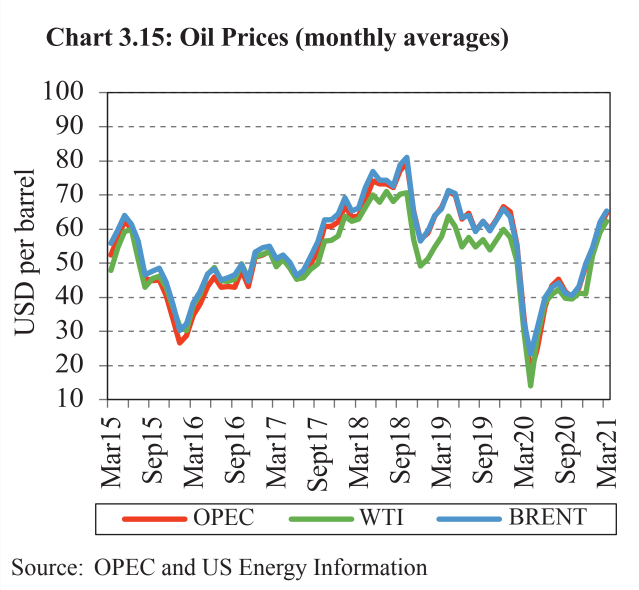
The global polished diamond price index increased slightly by 0.5 percent from 206.6 in the fourth quarter of 2020 to 207.7 in the first quarter of 2021. In March 2021, the global polished price index averaged 208.8 points, higher than the 207.7 points in February, as the polished market showed signs of improvement due to gradual increase in demand from the US and China.

Oil prices increased in the first quarter of 2021

International oil prices (Brent crude and OPEC) averaged slightly above USD60 per barrel in the first quarter of 2021 (Chart 3.15). The OPEC reference crude oil basket price and the Brent crude increased by 37 percent and 36 percent, from an average of USD43.95 per barrel and USD44.52 per barrel in the fourth quarter of 2020 to an average of USD60.01 per barrel and USD60.57 per barrel, respectively, in the first quarter of 2021. The price of the West Texas Intermediate (WTI) also increased by 35.9 percent from an average of USD42.56 per barrel to an average of USD57.84 per barrel in the same period. International oil prices increased in part, supported by OPEC and its allies' decision to extend production cuts by a month to April 2021 despite price surge.[10] The increase in oil prices was also influenced by expansion in demand associated with relaxation of lockdowns in many countries, as well as positive developments concerning the COVID-19 vaccine and its roll out.

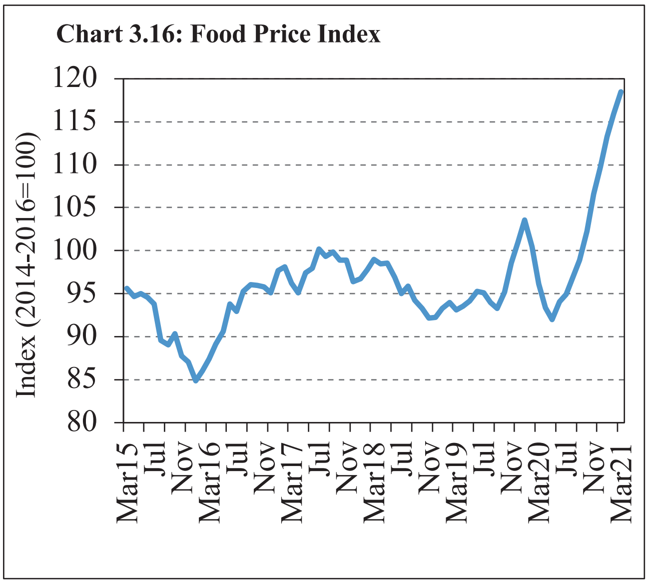
In March 2021, international oil prices (OPEC and Brent Crude) increased to above USD60 per barrel. The OPEC reference crude oil basket averaged USD64.56 per barrel, Brent crude averaged USD65.19, while the price of WTI averaged USD62.35 per barrel in March 2021. The increase in oil prices is, in part, due to tighter global supplies and hopes for a recovery in fuel consumption on the back of improvement in worldwide vaccination efforts and more fiscal stimulus.

[10] However, OPEC and its allies' have agreed to increase production by 350 000 barrels per day in both May and June and by 441 000 barrels a day in July 2021 but would likely revise this decision to meet the demand.



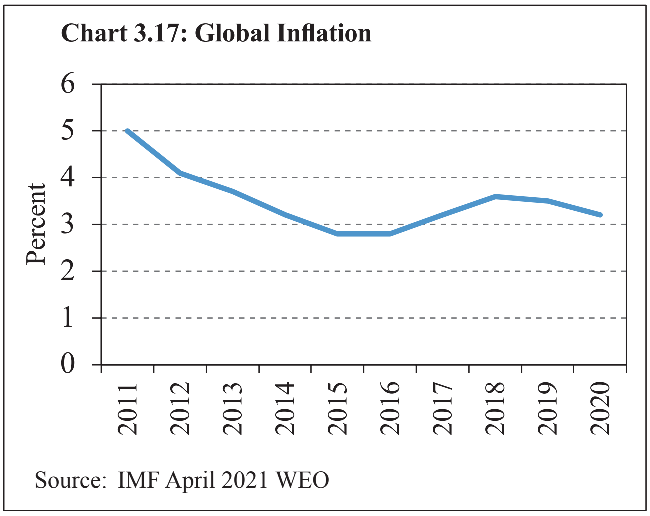
Food prices increased in the first quarter of 2021

According to the United Nations Food and Agriculture Organisation (FAO), the global food price index averaged 115.9 points in the first quarter of 2021, a 9.1 percent increase from an average of 106.2 points in the fourth quarter of 2020 (Chart 3.16). The increase in prices was attributable to higher vegetable oil, cereal and dairy prices. Moreover, brisk trade activity supported by the recovery in global demand following relaxation of some COVID-19 containment measures put some impetus on food prices. Furthermore, the rising concerns over production in the Southern hemisphere and dry conditions in many parts of Europe resulted in overall higher food prices. The food price index averaged 118.5 points in March 2021, an increase of 2.1 percent from February 2021, and 23.3 percent higher than in the corresponding period last year.



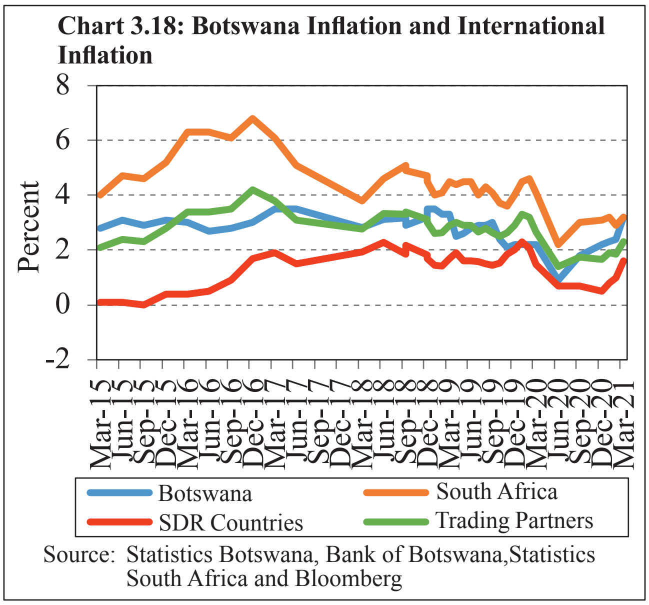
Global inflation remains low

Global inflation remains low, owing to subdued global economic demand. Inflation decreased from 1 percent in the third quarter to 0.8 percent in the fourth quarter of 2020 for advanced economies. Similarly, inflation decreased from 2.8 percent to 1.7 percent in emerging market economies in the same period. Global inflation declined from 3.5 percent in 2019 to 3.2 percent in 2020 (Chart 3.17).



In South Africa, headline inflation averaged 3.3 percent in 2020, lower than the 4.1 percent in 2019. Inflation increased from 2.9 percent in February 2021 to 3.2 percent in March, falling within the SARB's target range of 3 – 6 percent.

The average trade-weighted inflation for Botswana's trading partners (Chart 3.18) increased from 1.9 percent in February to 2.3 percent in March 2021.



Accommodative monetary policy stance maintained

In the most recent policy decisions in advanced economies (Table 3.6), the European Central Bank (ECB) maintained the deposit rate, refinancing rate and lending rate at -0.50 percent, zero and 0.25 percent, respectively, in April 2021, to support the Eurozone economy. The ECB also maintained the pandemic emergency purchase programme (PEPP) at €1 850 billion. Furthermore, asset purchases would continue at a monthly pace of €20 billion under its asset purchase programme (APP), along with additional net asset purchases of €120 billion that are earmarked to run for as long as necessary to reinforce the accommodative impact of its policy rates. Moreover, the net purchases under PEPP would continue until the end of March 2022, while the principal payments from maturing securities will be reinvested until at least the end of 2023. The ECB is expected to continue to provide ample liquidity through its refinancing operations as part of the measures for supporting economic recovery and counteracting the negative impact of the pandemic on the projected inflation path.

At the April 2021 meeting, the US Federal Open Market Committee (FOMC) left the target policy rate range unchanged at 0 - 0.25 percent, as indicators of economic activity and employment showed an improvement. Financial conditions remained accommodative, reflecting, in part, policy measures to support the economy and the flow of credit to households and businesses. The Fed indicated that it would continue to increase its holdings of Treasury securities and agency mortgage-backed securities by at least USD80 billion and USD40 billion per month, respectively, until substantial progress has been made toward the maximum employment and price stability goals. The FOMC further indicated that it expects to maintain the target range pending indications that economic recovery is entrenched, and on track to achieve maximum employment and price stability goals.

The Bank of England (BoE) maintained the Bank Rate at 0.1 percent and the total target stock of its asset purchases at £895 billion in March 2021, as the Committee judged that the existing stance of monetary policy remained appropriate. The BoE judged that the path of growth remained uncertain, and would depend on the evolution of the COVID-19 pandemic, measures taken to protect public health, and how households, businesses and financial markets respond to these developments. Moreover, inflation expectations were deemed anchored in the medium term.

The Bank of Japan (BoJ) kept its key short-term interest rate unchanged at -0.1 percent and maintained long-term government bond yield at around zero during the March 2021 meeting. In addition, the BoJ agreed to continue purchasing exchange-traded funds (ETFs) and Japan real estate investment trusts (JREITs) so that their amounts outstanding will increase annually to about 12 trillion yen and about 180 billion yen, respectively. However, for commercial paper (CP) and corporate bonds, the BoJ maintained their amounts outstanding at 2 trillion yen and about 3 trillion yen, respectively. In addition, until the end of September 2021, the bank will conduct additional purchases with an upper limit on the amount outstanding of these assets of about 20 trillion yen in total.

In emerging market economies, the Central Bank of Brazil increased the policy rate to 2.75 percent in March 2021 amid uncertainty about economic growth, and higher than expected path for inflation. Similarly, the Central Bank of Russia (CBoR) increased the key rate by 50 basis points to 5 percent in April 2021, following a 25 basis points increase at the previous meeting, as aggregate demand recovered and inflation expectations remained elevated. CBoR also signalled further rate increases at the upcoming meetings. Meanwhile, the People's Bank of China (PBoC) maintained the one-year Loan Prime Rate (LPR) for the twelfth consecutive month at 3.85 percent in April 2021, as the economy continues to recover from the downturn caused by the COVID-19 pandemic.

The South African Reserve Bank (SARB) maintained the repo rate at 3.5 percent in March 2021, following a cumulative 300 basis points rate cut in 2020 to support an economy that was already in recession before the pandemic shock. The SARB considered the risks to both the growth and inflation outlook to be balanced. The SARB expected inflation to be contained and to remain well below the 4.5 percent midpoint of the target range in 2021, due to the economic contraction and subsequent slow recovery. Moreover, the SARB noted that monetary policy had eased financial conditions and improved the resilience of households and businesses to the economic impact of COVID-19, while ensuring adequate liquidity in the domestic markets.

In April 2021, the Reserve Bank of India (RBI) maintained the policy rate at 4 percent and the reverse repo rate at 3.35 percent, to support the economy hit-hard by the COVID-19 pandemic amid high inflationary pressure.

Table 3.6: Monetary Policy Decisions

Central Bank	Latest Meeting	Current Policy Rate (Percent)	Change from Previous Meeting
Bank of Botswana	April 2021	3.75	No change
SARB	March 2021	3.50	No change
US Federal Reserve	April 2021	0 – 0.25	No change
BoE	March 2021	0.10	No change
ECB	April 2021	0.00	No change
BoJ	March 2021	-0.10	No change
PBoC	April 2021	3.85	No change
Brazil	March 2021	2.75	Increased by 75 basis points
India	April 2021	4.00	No change
Russia	April 2021	5.00	Increased by 50 basis points

Source: Surveyed central banks' websites.

4. THE ECONOMIC AND POLICY OUTLOOK

4.1 Global economic prospects

The global economic outlook has been revised upwards on account of stronger-than-expected recovery across regions in the second half of 2020. Furthermore, additional policy support in advanced economies, mostly in the US and Japan as well as expectations of a vaccine-powered strengthening of activity later in the year, which outweigh the drag on near term momentum due to rising infections, have contributed to upward revisions of the global economic outlook. Meanwhile, prospects for advanced economies are much stronger owing to expectations of widespread vaccine availability compared to emerging market economies. Regionally, in South Africa, the growth outlook is projected to improve, mainly attributable to expected recovery in demand and improved business confidence resulting from rollout of effective COVID-19 vaccines. With regard to price developments, global inflation is forecast to increase to 3.5 percent in 2021 from 3.2 percent in 2020, consistent with the anticipated rise in international oil prices and recovery in global demand as most countries deploy effective COVID-19 vaccines.

Global economic outlook revised upwards

According to the April 2021 WEO, global output growth is forecast at 6 percent and 4.4 percent in 2021 and 2022, respectively, from an estimated contraction of 3.3 percent in 2020. The growth forecast for 2021 has been revised upwards by 0.5 percentage points, from the January 2021 WEO Update projections, reflecting the anticipated vaccine-powered recovery in the second half of the year as well as additional policy support in advanced economies such as the US and Japan. Similar to the January 2021 projections, all regions are projected to experience positive growth in 2021.

For advanced economies, output growth is forecast to expand by 5.1 percent in 2021, from a contraction of 4.7 percent in 2020. The 2021 projection is an improvement by 0.8 percentage points from the January 2021 WEO Update, mostly reflecting strong policy support particularly in the United States and Japan and the anticipated widespread availability of effective COVID-19 vaccines.

Upside risks to global economic growth include further favourable outcomes on vaccine manufacturing and distribution, as well as the effectiveness of containment measures generally, which could increase expectations of a faster end to the pandemic than assumed, thus boosting confidence among firms and households. Downside risks include possible recurrence of outbreaks in places that have gone past peak infection and the development of new and more problematic variants of the virus, logistical problems with procurement and distribution of COVID-19 vaccines particularly in emerging market economies, more severe and longer-lasting effects on potential output from the pandemic, as well as financial stress triggered by high debt levels and weak growth.

UK economy to expand in 2021

The UK economy is expected to grow by 5.3 percent in 2021, compared to a contraction of 9.9 percent in 2020, supported by the COVID-19 vaccination programme that is expected to ease movement restrictions. In addition, the already announced fiscal and monetary policy actions such as additional spending and asset purchases programme are expected to boost economic activity in the same period. Economic growth has been revised upwards by 0.1 percentage points to 5.1 percent in 2022 compared to the January 2021 forecast, supported in part by policy stimulus.

Output growth for US to expand

For the US, output is forecast to grow by 6.4 percent in 2021, before expanding by 3.5 percent in 2022, from an estimated contraction of 3.5 percent in 2020. The 2021 projection is an upward revision by 1.3 percentage points compared to the January 2021 forecast, reflecting carryover from the strong momentum in the second half of 2020 and additional support from the December 2020 fiscal package. Furthermore, US President Biden's USD1.9 trillion coronavirus stimulus package, which was signed into law in March 2021, is also expected to boost output growth of the United States in 2021 and 2022.

Growth for the euro area to expand

In the euro area, economic activity is projected to expand by 4.4 percent in 2021 (0.2 percentage points upgrade compared to the January 2021 WEO Update) from a decline of 6.6 percent in 2020. The upward revision of growth prospects in the economic bloc for 2021 reflects gains in momentum of vaccination campaigns, subsiding pressure on health systems and gradual relaxation of containment measures. GDP is forecast to increase by 3.8 percent in 2022, an upward revision from the 3.6 percent projection made in January 2021.

Emerging markets GDP expansion projected to be higher

Economic activity in emerging market and developing economies is projected to expand by 6.7 percent in 2021, from an estimated contraction of 2.2 percent in 2020. The 2021 economic performance has been revised upwards by 0.4 percentage points relative to the January 2021 WEO Update. The revision was primarily due to improved external and domestic demand arising from relaxation of containment measures that were imposed to slow the spread of COVID-19. Growth is also expected to be supported by continued strong output growth in China, as well as accommodative monetary and fiscal stimulus implemented to cushion the economies from the COVID-19 pandemic.

In China, prospects are much stronger than for most countries in the region, supported by effective containment measures, a forceful public investment response and central bank liquidity support, hence a forecast expansion of 8.4 percent and 5.6 percent for 2021 and 2022, respectively. In India, the upward revision of 1 percentage point to 12.5 percent for 2021 reflects carryover from a stronger-than-expected recovery in 2020 following the easing of lockdowns.

Growth in the South African economy to expand

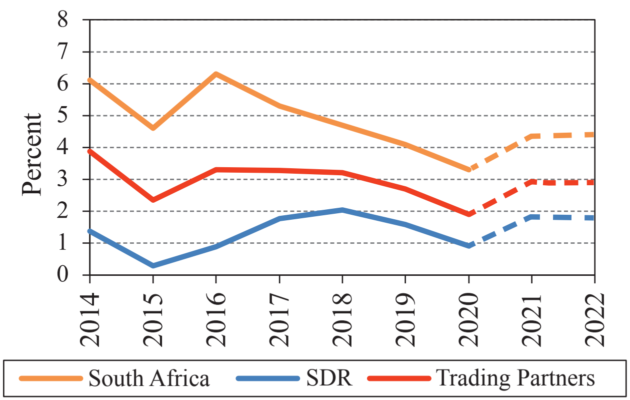
Growth prospects in South Africa are expected to improve on account of rollout of effective COVID-19 vaccines, supportive global economic activity as well as robust terms of trade and stronger exports. Therefore, South African output is forecast to expand by 3.1 percent and 2 percent in 2021 and 2022, respectively, from a contraction of 7 percent in 2020. Meanwhile, in March 2021, the SARB revised the GDP growth forecast for 2021 to 3.8 percent, from 3.6 percent, but for 2022, it was unchanged at 2.4 percent.

Global inflation to increase

Globally, inflation is expected to pick up in 2021, reflecting anticipated recovery in commodity prices, particularly oil, as well as global demand as most countries deploy effective COVID-19 vaccines. Inflationary pressures are expected to mount in advanced economies, reflecting the faster rollout of COVID-19 vaccines relative to other regions. On the contrary, emerging market economies are anticipated to face greater constraints in procurement and distribution, thus inflation for the region is expected to remain subdued, consistent with slowdown in growth of final demand and lower commodity prices. Thus, inflation for advanced economies is forecast to increase from 0.8 percent in 2020 to 1.7 percent in 2021, but to ease from 5.1 percent to 4.9 percent in emerging market economies in the same period. Overall, global inflation is forecast to increase from 3.2 percent in 2020 to 3.5 percent in 2021.

Meanwhile, South African inflation is forecast to average 4.3 percent in 2021, 0.3 percentage points higher than the January 2021 forecast by SARB, mainly reflecting anticipated recovery in domestic economic activity amidst the easing of lockdown restrictions and rollout of COVID-19 vaccines, as well as recovery in global commodity prices, particularly oil. Overall, inflation is anticipated to remain within the SARB's target range in 2021 and to rise further to around the midpoint of the target range in 2022 and 2023 (Chart 4.1).

Chart 4.1: South Africa and SDR Headline Inflation



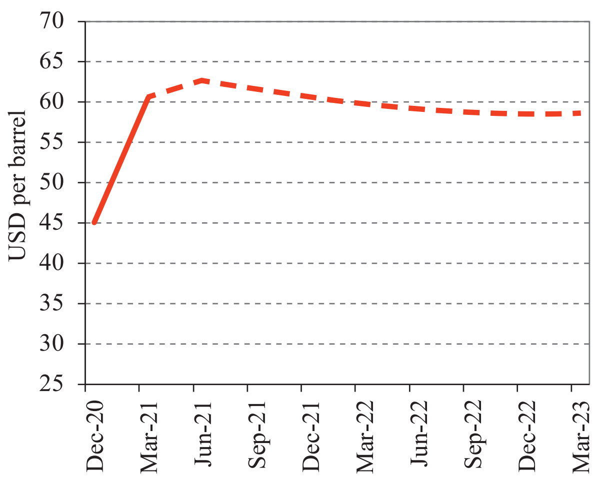
Source: SARB and Bloomberg

Global commodity prices to increase

Global rough diamond prices are expected to increase in the short to medium term, buoyed by rollout of effective COVID-19 vaccines. In addition, the easing of lockdowns and other containment measures are anticipated to continue to strengthen demand for jewellery, thus exerting inflationary pressure on rough diamond prices. Likewise, polished diamond prices are expected to rise in the short to medium term as prospects for global end-consumer demand improve. The easing of lockdowns in the cutting and polishing industry in India are also expected to improve jewellery sales.

In addition, international oil prices are projected to increase in the near term, (Chart 4.2), supported by the recovery in global demand following the relaxation of some COVID-19 containment measures and rollout of vaccines. Furthermore, positive developments on the economic front, supported by massive stimulus programmes around the world, are expected to boost the demand for oil in the second half of 2021. Meanwhile, the decision by OPEC and major oil producers to maintain last year's production cuts to prevent the market from being oversupplied, as well as attacks on Saudi Arabia's oil infrastructure are anticipated to increase oil prices in the near term. Overall, developments in the international oil market imply upward pressure on domestic inflation.

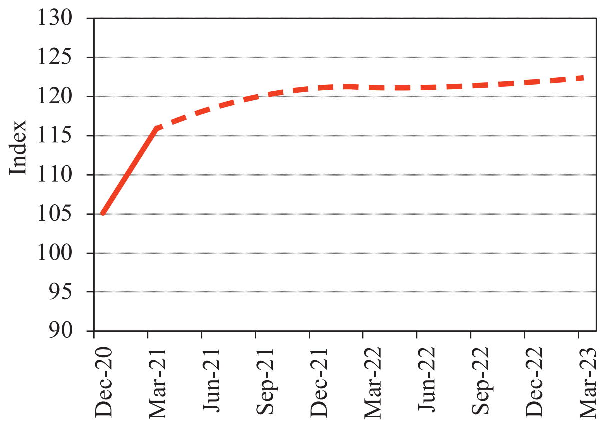
Chart 4.2: International Oil Prices



Source: Bloomberg

Global food prices are also expected to trend upwards in the short to medium term (Chart 4.3). The expected increase in food prices mainly reflects the increased demand and cost push pressures arising from supply disruptions caused by lockdowns and other containment measures that have reduced production hours and constrained the flow of goods. The COVID-19 pandemic has led to strong demand for basic food items, posed logistical challenges in harvesting and reduced supply. In Southern Africa, food prices are expected to increase in the short term due to anticipated lower crop production resulting from bad climatic conditions caused by tropical Cyclone Chalane and Eloise. Overall, there is potential modest upward pressure from international food prices on domestic inflation.

Chart 4.3: International Food Prices
FAO Index



Source: Bloomberg

4.2 Outlook for domestic economic activity

Projections by MFED indicate that GDP growth will rebound to 8.8 percent in 2021, from a contraction of 7.9 percent in 2020. Although the economy is anticipated to continue operating below its potential into the medium term, the recovery is expected to continue beyond 2021 in the backdrop of the prevailing accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including expected COVID-19 vaccine rollouts, the implementation of the ERTP and the Industry Support Facility, among others.

Higher output growth expected in 2021

MFED projects that GDP will expand by 8.8 percent in 2021, from a contraction of 7.9 percent in 2020, in part reflecting improving global economic prospects and balanced risks. Meanwhile, the IMF forecasts the domestic economy to rebound to 8.3 percent in 2021. The positive outlook for economic activity is anticipated to continue beyond 2021, albeit below trend, and supported by the prevailing accommodative monetary conditions, improvements in water and electricity supply, reforms to further improve the business environment, government interventions against COVID-19, including vaccine rollouts, the implementation of the ERTP and the Industry Support Facility, among others. Box 4 outlines Bank of Botswana's response to COVID-19.

The Bank's March 2021 Business Expectations Survey (BES) indicates that firms were more pessimistic about economic activity in the first quarter of 2021 compared to the previous quarter. Firms expect GDP to expand by 2.2 percent in the first and second quarters of 2021, consistent with the anticipated improvement in business conditions and the envisaged global economic recovery in 2021, which is, however, threatened by the emergence of the new variants of COVID-19. Overall, non-mining economic activity is anticipated to improve in the short term although continuing to operate below potential into the medium term.

Box 4: Bank of Botswana's response to the impact of COVID-19 pandemic

Botswana confirmed its first three-imported-cases of COVID-19 on March 31, 2020. As at April 30, 2021; there were 50 333 total cases (2 482 transferred out, 47 851 local cases, 45 645 local recoveries and 724 deaths) had been reported in the country. To curb the spread of the disease, the country was put on a 28-day lockdown (extreme social distancing) effective from midnight of April 2, 2020, with movement outside the home only restricted to essential goods and service providers. On April 9, 2020, Parliament approved His Excellency the President's request for a six-month state of emergency, which was extended by six months to April 2021 and later by another six months to September 30, 2021, to allow the country to adequately respond to the threat posed by COVID-19. Meanwhile, on March 26, 2021, Botswana started its COVID-19 vaccination programme, with priority given to people aged 55 years and above. By April 30, 2021, a total of 49 882 people (2 percent of the population) had received a first vaccine dose across the country, higher than that of South Africa and the African continent as a whole which had inoculated 0.5 percent and 0.9 percent (on average), respectively.

Botswana signed an agreement with the COVID-19 Vaccines Global Access (COVAX) Facility that gave the country an option to buy coronavirus vaccines for 20 percent of its population. On March 9, 2021, Botswana received a donation of 30 000 doses of the Covishield vaccine from India. The Covishield vaccines are the Oxford-AstraZeneca vaccines manufactured by the Serum Institute of India, the world's largest vaccine manufacturer. A shipment of 24 000 doses of the AstraZeneca COVID-19 Vaccine from South Korea, arrived in Botswana on March 27, 2021. It was the first shipment of 100 000 vaccines purchased by the Government of Botswana, enabled through the COVAX Facility and obtained from SKBioscience (South Korea). On April 25, 2021, Botswana's response to the COVID-19 pandemic received a boost with a 200 000 consignment of COVID-19 Sinovac vaccine donated by China. A further 200 000 vaccines have been purchased by the Government and expected to be delivered in due course.

For its part, the Bank of Botswana (the Bank) has undertaken measures to alleviate the adverse impact of COVID-19 on the Botswana economy, such as maintaining uninterrupted supply and availability of clean banknotes and coin, as well as banking services, primarily to Government and commercial banks. On the other hand, in an attempt to support the banking system, the Bank offered capital relief and support measures for commercial banks to enable them to satisfy capital requirements and address liquidity challenges as they continue to support economic activity under conditions of possible increase in credit risk. In this regard, since April 2020, the Bank has proceeded as follows:

- The prudential capital adequacy ratio for commercial banks operating in Botswana was reduced from 15 percent to 12.5 percent; and
- To alleviate any liquidity pressures on commercial banks, the following measures were introduced:
  - The cost of accessing overnight funding by licensed commercial banks from the Bank's Credit Facility is accessed at the prevailing Bank Rate (currently 3.75 percent) without the punitive 6 percentage points above the Bank Rate;
  - The Primary Reserve Requirement was reduced from 5 percent to 2.5 percent.
  - Repo facilities currently available only on an overnight basis are offered against eligible securities with maturities of up to 92 days; and
  - Subject to completing regulations and arrangements relating to valuation and custody, the collateral pool for borrowing by licensed commercial banks from the Bank was extended to include corporate bonds listed and traded on the Botswana Stock Exchange.

Other measures to help the economy included reducing the Bank Rate by a cumulative 100 basis points in 2020 to 3.75 percent. These measures were feasible against the backgound of prevaling monetary and fiscal policy space, a stable macroecomic environment, a sound banking system and relatively strong external balances at the onset of the COVID-19 pandemic.

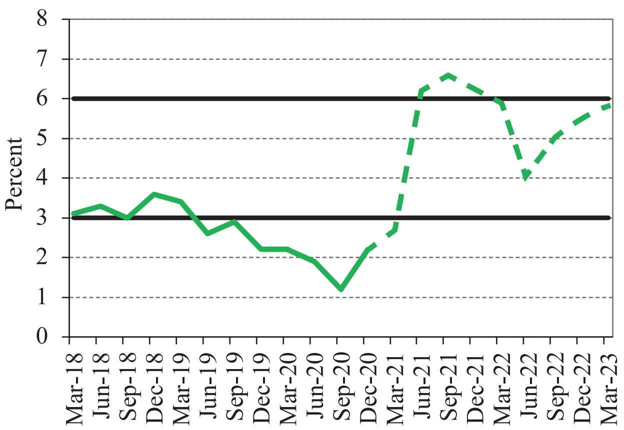
4.3 Monetary policy and the inflation outlook

Inflation is projected to be higher in the short term compared to the February 2021 projection, with the possibility of breaching the upper bound of the Bank's 3-6 percent objective range in the second quarter of 2021. However, inflation is expected to revert to within the objective range in the first quarter of 2022. The higher inflation in the near term mainly reflects inflation persistence, the upward adjustment in subscription fees by Multichoice Botswana, the announced increase in water tariffs, a higher rate of depreciation of the Pula against the South African rand, as well as the upward revision in forecasts for trading partner countries inflation and international commodity prices than previously projected. Overall, risks to the inflation outlook are assessed to be skewed to the upside.

Inflation projected to increase and breach the upper bound of the objective range in the short term

Inflation is forecast to increase in the near term and to breach the upper bound of the Bank's 3 - 6 percent objective range in the second quarter of 2021. Nonetheless, inflation is expected to revert to within the objective range in the first quarter of 2022 (Chart 4.4).

Chart 4.4: Botswana Headline Inflation Forecast



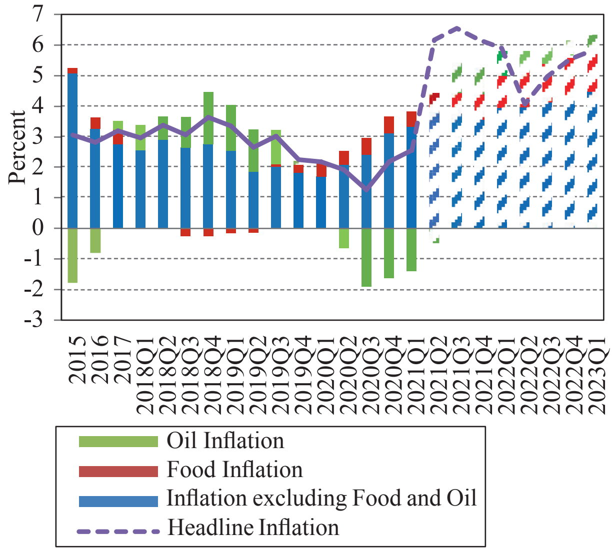
Source: Bank of Botswana

The projection takes into account the anticipated increase in domestic demand in response to the overall accommodative monetary conditions; the increase in VAT from 12 percent to 14 percent; an additional P1 per litre fuel levy; upward adjustment in electricity tariffs by 3 percent in 2021 and 4 percent in 2022; the increase in Botswana Housing Corporation (BHC) rentals; the introduction of sugar tax; the rise in subscription fees by Multichoice Botswana; the announced increase in water tariffs; the likely increase in international commodity prices; the upward revision of inflation forecasts for trading partner countries; the anticipated depreciation of the Pula against the South African rand; and the base effects associated with the decrease in fuel prices in 2020. Meanwhile, according to the March 2021 BES, the business community expects inflation to be within the objective range in 2021.

Core inflation to increase

Inflation excluding food and fuel prices is forecast to rise, reflecting the increase in administered prices in the second quarter of 2021 and the expected improvement in the non-mining output growth in 2021 (Chart 4.5).

Chart 4.5: Headline Inflation and its Components

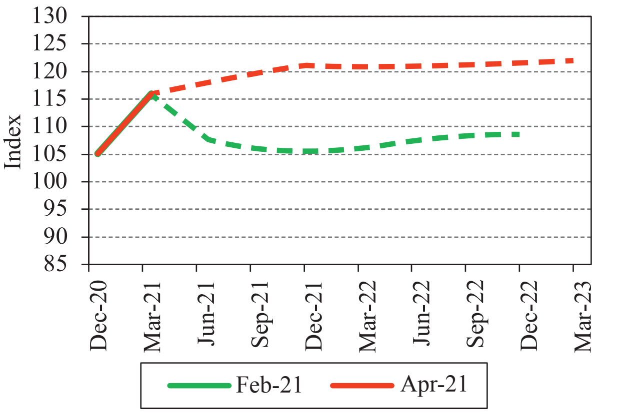


Source: Bank of Botswana

International food prices to increase

Compared to the February 2021 forecast, international food prices have been revised upwards in the short to medium term (Chart 4.6). The upward revision reflects the mismatch between increased demand and cost push pressures arising from supply disruptions caused by lockdowns and other COVID-19 containment measures that have reduced production hours and constrained the flow of goods. The revision also depicts higher energy costs and the anticipated lower crop production resulting from bad climatic conditions in some regions.

Chart 4.6: International Food Prices FAO Index

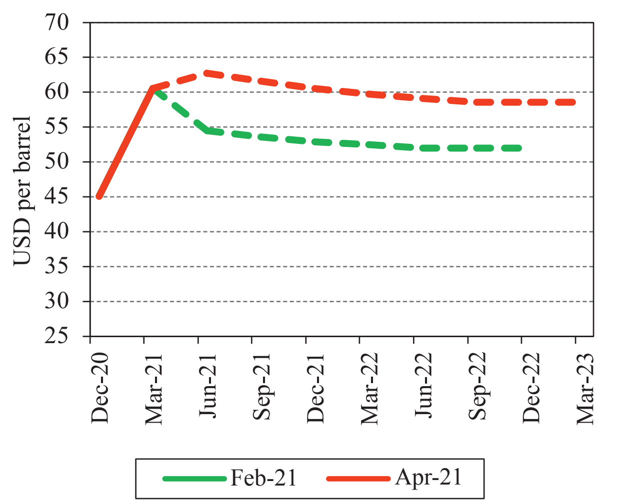


Source: Bloomberg

International oil prices revised upwards

Relative to the February 2021 projection, international oil prices have been revised upwards (Chart 4.7). The upward revision in prices is due to the expected recovery in global oil demand following the relaxation of some COVID-19 containment measures amid rollout of vaccines and stimulus programmes around the world, as well as OPEC and major oil producers' decision to maintain production cuts in 2021.

Chart 4.7: International Oil Prices



Source: Bloomberg

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

Inflation forecast revised upwards in the short term, with the possibility of breaching the upper bound in the second quarter of 2021

The April 2021 inflation forecast has been revised upwards in the short term compared to the February 2021 forecast, with the possibility of breaching the upper bound of the objective range in the second quarter of 2021. The higher inflation in the near term is on account of inflation persistence, the rise in subscription fees by Multichoice Botswana, the announced increase in water tariffs, a higher rate of depreciation of the Pula against the South African rand, as well as the upward revision in forecasts for trading partner countries inflation and international commodity prices than previously projected.

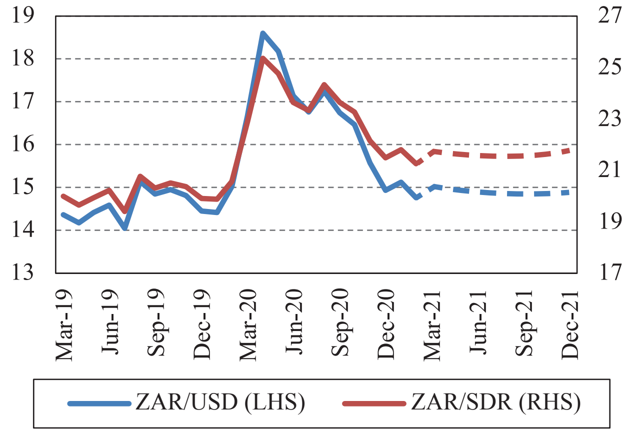
Exchange rate movements

The Pula exchange rate is determined by the performance of the Pula basket currencies and the rate of crawl. Once the basket composition and the rate of crawl (based on inflation differentials) have been determined, the daily changes in the value of the Pula against other currencies are a result of movements in the cross rates of the rand and the SDR constituent currencies against each other, and their relative weights in the composite currency basket.

The South African rand is expected to depreciate marginally against major trading currencies in the next three quarters, except the US dollar (Chart 4.8), due to a looming threat of increased COVID-19 infections and possible tighter lockdown restrictions, and their effect on the pace of the domestic economic recovery. This is on the backdrop of weak macroeconomic fundamentals, power supply constraints and cash-strapped state-owned enterprises. Meanwhile, unfavourable changes in investor sentiments towards emerging market assets are also expected to continue putting pressure on the South African rand.

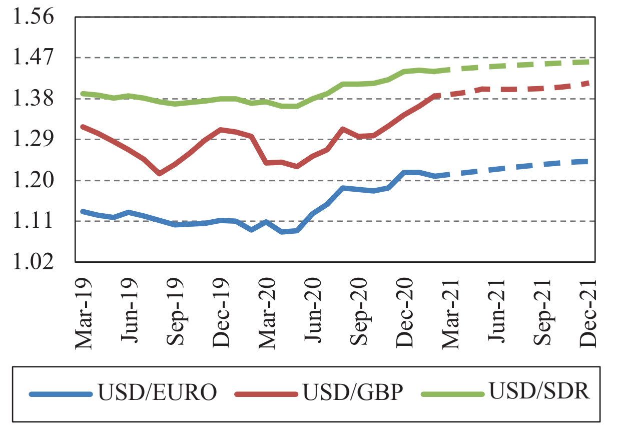
However, the favourable revised South African budget deficit projections and the approval of US President Biden's additional USD1.9 trillion fiscal stimulus are expected to sustain the strength of the South African rand in the short term.

Chart 4.8: ZAR against USD and SDR



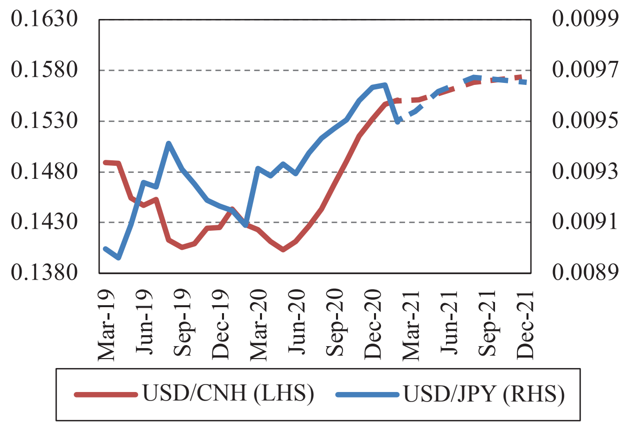
Source: Reuters

Chart 4.9A: Exchange Rates against USD



Source: Reuters

Chart 4.9B: Exchange Rates against the USD



Source: Reuters

The US dollar is expected to depreciate against major international currencies in the next three quarters (Chart 4.9A and Chart 4.9B), due to the expected improvement in business and investor confidence as the world economy recovers from the adverse impact of COVID-19. Furthermore, the recently approved USD1.9 trillion US government stimulus package, as well as the expectations that the Fed will continue its unprecedented monetary support, zero rates, quantitative easing and the possible introduction of negative interest rates in the near future, are expected to continue to weigh down on the US dollar. However, global uncertainty and market volatilty due to the impact of COVID-19 on the global economy is likely to influence investors to hold the world's most liquid currency, the US dollar, thus affecting this forecast.

The British pound is expected to strengthen against the US dollar on the back of the United Kingdom's impressive pace of COVID-19 vaccination, which could result in COVID-19 restrictions being phased out gradually in the first half of the year, leading to the improvement in economic activity. However, concerns about the Bank of England's likely extension of the bond-purchase programme may achieve the opposite outcome. Meanwhile, the euro is expected to appreciate against the US dollar as the euro area shows some signs of recovery from the pandemic.[11]

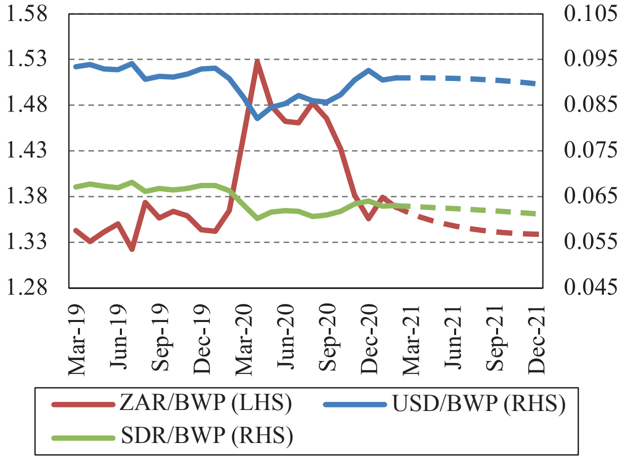
The Japanese yen is expected to appreciate against the US dollar as Japan's economic activity is expected to recover at a faster pace towards pre-pandemic levels. However, measures taken by the Fed and the Bank of Japan to cushion the effects of the pandemic are likely to affect this forecast.

The Chinese renminbi is expected to appreciate against the US dollar in the next three quarters (Chart 4.9B) as business activity in China is expected to continue to recover faster from COVID-19 and suffer less economic impairment than the rest of the world.

Overall, forecast movements of the SDR constituent currencies imply an appreciation of the SDR against the US dollar (Chart 4.9A). The anticipated depreciation of the South African rand against the SDR is, however, expected to exert marginal downward pressure on the Pula against the SDR constituent currencies in the forecast horizon (Chart 4.10). The expected depreciation of the Pula against the basket currencies will exert marginal upward pressure on domestic inflation.

[11] The manufacturing purchasing managers index (PMI) for the euro area increased from 48.8 in February to 52.5 in March 2021.

Chart 4.10: BWP Exchange Rates against ZAR, USD and SDR



Source: Reuters and BoB calculations

Risks are skewed on the upside

Overall, risks to the inflation outlook are assessed to be skewed to the upside. Upside risks include the potential increase in international commodity prices beyond current forecasts, aggressive action by governments (for example, ERTP) and major central banks to bolster aggregate demand including successful rollout of vaccines. Persistence of supply constraints due to possible travel restrictions and lockdowns could also lead to higher prices. Additional domestically-based risk factors relate to second round effects of recently announced increase in administered prices. However, these risks are moderated by the possibility of weak domestic and global economic activity, which could be exacerbated by periodic lockdowns and other forms of restrictions due to emergence of new COVID-19 variants and slow rollout of vaccines, and the possible decline in international commodity prices. Furthermore, the emergence of implementation capacity constraints, if any, could hinder the effectiveness of policy stimulus and ERTP initiatives, thus resulting in lower inflation.

Box 5: Central Bank Communication on Monetary Policy

The last three decades bear witness to central banks progressively using public communication to support their policy objectives as well as enhance transparency in the formulation and implementation of effective monetary policy (Robison, 2020). The change has been necessitated by the growing recognition that central bank communication enhances both the transmission of monetary policy and the management of inflation expectations, which are fundamental to effective monetary policy.

As noted by Kahveci and Odabas (2016), the post-crisis transmission in central bank policy from mystery and inscrutability to the era of transparency, as well as the importance of 'forward-guidance' demonstrate how rapidly and radically the communication strategy has evolved. Evidently, communication has become a policy tool in its own right. Central bank communication, as defined by Blinder et al. (2008), is the information that the central bank makes available about its current and future policy objectives, current and prospective economic developments pertaining to key policy variables including inflation and output, risks to the inflation outlook and the likely path for future monetary policy decisions. Furthermore, the central bank communicates the rationale for its policy decisions.

The shift towards greater transparency is generally viewed as desirable in so far as it enhances effectiveness of monetary policy in anchoring economic agents' expectations for future policy changes, safeguarding independence, and legitimacy of central banks against the backdrop of enlarged mandates and greater public scrutiny. Furthermore, greater transparency increases predictability, accountability, and policy credibility of central banks.

The Bank of Botswana (the Bank), like most other central banks, 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, policy transmission. The Bank's communication function has evolved with the establishment of the Communications and Information Services Division, which deals with media relations, public education, the Knowledge Centre (Library), administration of the Bank's website (dissemination of Bank's information) and records management. A Communications Policy (approved in 2020) was developed to provide a framework for effective coordination of communication activities and dissemination of information. These efforts are aimed at enhancing understanding of the Bank's mandate and role in the economy by the public.

Through the Monetary Policy Statement, published at the beginning of the year, the Bank informs stakeholders about the framework for the formulation and implementation of monetary policy, where inflation trends and policy performance are reviewed and the policy choices for the ensuing year are articulated. The Monetary Policy Report (MPR) was introduced in August 2018 and presents the Bank's review of economic and inflation trends as well as policy performance. The report also provides an assessment of external and domestic economic and financial developments likely to influence the inflation path in the medium term and, in turn, the Bank's future policy choices. In this respect, the MPR promotes an understanding of the conduct of monetary policy to anchor public expectations of a low, predictable, and sustainable level of inflation. Furthermore, the Bank publishes the Monetary Policy Committee (MPC) meeting dates for the year ahead and the Governor delivers a statement at a press briefing subsequent to each meeting of the MPC to allow for engagement with the media and dissemination of the Bank's policy stance. Following each MPC meeting, a Press Release is issued, informing the public of the Committee's decision regarding the Bank Rate and the reasons for the policy choice.

However, it is worth noting that as new communication technologies increasingly disintermediate traditional media by allowing for new ways of interaction, comprehension of the whole communication process - from the central bank at the sending end, the intermediation and interpretation of central bank messages through markets, media, and analysts, to the perception thereof by the recipients - becomes a crucial input into policy decisions. Thus, the Bank's communication is expected to adapt to these developments in pursuit of openness and transparency, and to enhance the effectiveness of policy transmission.

5. APRIL 2021 MONETARY POLICY COMMITTEE DECISION

At the meeting held on April 29, 2021, the Monetary Policy Committee (MPC) of the Bank of Botswana decided to maintain the Bank Rate at 3.75 percent. Inflation increased significantly from 2.4 percent in February to 3.2 percent in March 2021, reverting to within the Bank's medium-term objective range of 3 - 6 percent. The increase in inflation largely reflects the upward adjustment in domestic fuel prices in March 2021. Domestic inflation is forecast to breach the upper bound of the Bank's 3 – 6 percent objective range in the second quarter of 2021, driven mainly by supply-side factors. However, inflation is projected to revert to within the objective range in the first quarter of 2022.

Overall, risks to the inflation outlook are assessed to be skewed to the upside. Upside risks include the potential increase in international commodity prices beyond current forecasts, aggressive action by governments (for example, ERTP) and major central banks to bolster aggregate demand including successful rollout of vaccines. Persistence of supply constraints due to possible travel restrictions and lockdowns could also lead to higher prices. Additional domestically based risk factors relate to second round effects of recently announced increase in administered prices. However, these risks are moderated by the possibility of weak domestic and global economic activity, which could be exacerbated by periodic lockdowns and other forms of restrictions due to emergence of new COVID-19 variants and slow rollout of vaccines, and the possible decline in international commodity prices. Furthermore, the emergence of implementation capacity constraints, if any, could hinder the effectiveness of policy stimulus and ERTP initiatives, thus resulting in lower inflation.

Real Gross Domestic Product (GDP) contracted by 7.9 percent in 2020, compared to a growth rate of 3 percent in 2019. The decline in output is attributable to the contraction in output of both mining and non-mining sectors, mainly resulting from the impact of the strict COVID-19 pandemic containment measures. Mining output contracted by 26.2 percent in 2020 compared to a lower decline of 4.1 percent in 2019, mainly due to weaker performance of the diamond, soda ash, coal, prospecting and other mining subsectors. Non-mining GDP contracted by 5.9 percent in 2020 compared to a growth rate of 3.9 percent in 2019. The decline in non-mining GDP was mainly due to contractions in output of the trade, hotels and restaurants, construction, manufacturing, transport and communications, social and personal services, and finance and business services sectors. In addition, the deceleration in growth of general government and water and electricity contributed to the overall output decline of the non-mining sector.

Projections by the Ministry of Finance and Economic Development and the International Monetary Fund (IMF) suggest a rebound in economic growth for Botswana in 2021. The Ministry projects a growth rate of 8.8 percent in 2021, compared to the earlier estimated growth rate of 7.7 percent, before moderating to a growth rate of 5.5 percent in 2022. On the other hand, the IMF forecasts the domestic economy to grow by 8.3 percent in 2021 compared to an earlier projection of 8.7 percent in the January 2021 World Economic Outlook Update; this is expected to moderate to a growth rate of 6.4 percent in 2022. The growth outcome will largely depend on the successful vaccine rollout as it will enable opening up the economy to align with the projections. The disparity in forecasts attest to the challenges of making forward projections when there is uncertainty about the duration of constrained economic activity, the resultant adverse impact on productive capacity, as well as the speed of resumption of production and pace of recovery in demand.

Meanwhile, the lingering adverse effects of the COVID-19 pandemic containment measures pose uncertainty and challenges given Botswana's high vulnerability to external shocks, notably, on diamond prices and demand, tourism and delays in the importation of supplies. Nonetheless, the economy is projected to have performed better in the first quarter of 2021 compared to the fourth quarter of 2020, given the gradual easing of COVID-19 movement restrictions and vaccine rollouts in the first quarter.

Economic activity in South Africa is expected to improve as the South African Reserve Bank projects GDP to grow by 3.8 percent in 2021, before slowing to 2.4 percent in 2022. Global output growth is forecast at 6 percent in 2021 reflecting the anticipated vaccine-powered recovery later in the year and additional policy support in advanced economies. However, global output growth is anticipated to moderate to 4.4 percent in 2022, as some economies return to their pre-COVID levels.

The Monetary Policy Committee recognised that the short-term adverse developments in the domestic economy occur against a growth-enhancing environment including accommodative monetary conditions; improvements in water and electricity supply, reforms to further improve the business environment and government interventions against COVID-19, including vaccine rollouts, and the implementation of ERTP and Industry Support Facility. In addition, successful implementation in this regard should anchor the growth of exports and preservation of a sufficient buffer of foreign exchange reserves which have recently fallen to P55.8 billion (10.5 months of import cover) compared to P65.2 billion in December 2019 (13 months of import cover).

Overall, it is projected that the economy will operate below full capacity in both the short and medium term and, therefore, not creating any inflationary pressures, going forward. The projected increase in inflation in the short-term is primarily due to transitory administered price changes and supply side factors that, except for second round effects, would not normally attract monetary policy response.

In this context, the MPC decided to continue with the accommodative monetary policy stance and maintain the Bank Rate at 3.75 percent. The Bank stands ready to respond appropriately as conditions dictate.

The remaining MPC meetings for 2021 are scheduled as follows:

June 17, 2021

August 19, 2021

October 21, 2021

December 2, 2021