Statement of the Monetary Policy Committee: July 2, 2010.

1. Introduction

1.1 At the meeting of July 2, 2010, the Bank's Monetary Policy Committee observed that the medium-term outlook for inflation remains positive. However, the Committee anticipated that inflation will, in the short-term, continue to be higher than the objective range due to the impact of the increase in value added tax (VAT), electricity tariffs and fuel prices. It is, therefore, expected that inflation will fall within the 3 – 6 percent objective range in the second half of 2011. It is further projected that, following contraction in 2009, the domestic economy will grow at a moderate rate in the short to medium-term, with below-trend output.

1.2 In part, the domestic output developments reflect similar positive prospects for world GDP, although there is a risk to global economic performance emanating from the debt problems in some European economies. Economic prospects, therefore, vary across countries, and this is reflected in the differences in policy responses. Monetary policy stimulus is maintained in several major economies, while measures are being undertaken to reduce the risk of unsustainable fiscal burdens and public debt. Meanwhile, there is tightening of monetary policy in some economies in response to the threat of inflation.

2. Recent Economic Developments

2.1 Domestic Inflation increased from around the upper end of the 3 – 6 percent objective range in the first quarter of 2010 to 7.1 percent and 7.8 percent in April and May 2010, respectively. The generalised rise in the rate of price changes in April was due to the increase in VAT from 10 percent to 12 percent, while the higher inflation in May was mostly the result of the increase in electricity tariffs. Overall, underlying inflation is restrained due to benign external price pressures and subdued domestic demand. However, the Bank is concerned that expectations of high inflation could be entrenched. It is, therefore, important to emphasise that when the effects of transitory factors are excluded, inflation would fall within the objective range.

2.2 Despite the robust 7.2 percent increase in output in the fourth quarter of 2009, GDP for the whole year was 3.7 percent lower than in 2008, largely reflecting the adverse impact of the global economic recession on mining output. Output in the mining sector fell by 20.9 percent in 2009, while non-mining output grew by 6.2 percent, supported by countercyclical policy measures.

2.3 Overall, non-mining output is estimated to be below trend with moderate pressures on inflation. This is reflected in subdued growth in money supply that is due to a reduction in foreign exchange reserves and lower rates of increase in both government expenditure and commercial bank credit to the private sector compared to the previous year.

3. Economic Outlook and Assessment of Risks

3.1 Although it is projected that world output will increase in 2010, it is anticipated that the pace of recovery will, in the short-term, be lower than earlier estimates due to fiscal and debt challenges in some of the major economies. Output growth in Asian economies, notably China, underpins projections for the faster rate of global economic recovery. Meanwhile, recent developments in major economies are likely to result in downward revision of the growth outlook. In particular, measures to consolidate the fiscal and public debt positions amount to withdrawal of policy stimulus and would also initially moderate demand. Overall, the world economy is projected to grow by 3.5 percent in 2010 and 3.3 percent in 2011, after a 2.5 percent decline in 2009. As this is still in the context of low levels of capacity utilisation, high rates of unemployment and well-anchored inflation expectations, it is expected that world inflation will be restrained.

3.2 After recovering in the second half of 2009, South Africa's GDP growth is expected to stabilise around a modest 3 - 4 percent in 2010, supported by improvement in global demand for base metals and manufacturing output, as well as growth in Asian market. However, output is projected to remain below potential, hence exerting low pressure on inflation, although there are upside risks to inflation, including the possible large upward adjustments in administered prices and increase in wages that are generally above the inflation target. The forecast is, nevertheless, for inflation to remain within target in the medium-term.

3.3 For Botswana, it is expected that GDP will remain below trend in the medium-term. Although exporting sectors will benefit from sustained recovery in world demand, growth of the domestic economy will be moderated due to reduced government spending. Moreover, it is anticipated that demand and its impact on economic activity will be subdued, thus reflecting public sector wage freeze, and the increase in VAT, administered prices and other levies. Nevertheless, the loosening of monetary policy in 2009 continues to be supportive of economic activity and will contribute to a narrowing of the output gap in the medium-term.

3.4 Overall, the low domestic demand pressures, together with the projected benign external inflationary pressures, contribute to the positive inflation outlook in the medium-term. In the short-term, inflation is projected to rise further due to the May 2010 increase in fuel prices. This adds to the impact of the increase in VAT and electricity tariffs. In the medium-term, inflation is expected to be within the objective range on a sustained basis from the second half of 2011. The risks to this outlook include further upward adjustment in administered prices and government levies. It is anticipated that the Pula exchange rate will be largely stable with minimal effect on domestic price developments.

4. Monetary Policy Stance

4.1 The current state of the economy and the assumptions on both the domestic and external economic outlook, as well as the inflation forecast, suggest that maintaining the prevailing level of interest rates is consistent with the achievement of the Bank's 3 – 6 percent inflation objective in the medium term. Accordingly, the Monetary Policy Committee decided to maintain the Bank Rate at 10 percent.