Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

November 24, 2020

1. Since the September 22 meeting of the Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC), the COVID-19 pandemic has continued to take its toll on the world, unleashing devastating human and economic suffering. While progress attained in November towards a vaccine bodes well for growth in the medium term, the global economic downturn in the wake of the virus remains severe and broad based across all economic sectors, affecting advanced, emerging as well as developing economies. A return to pre-pandemic levels of economic growth is likely to take a number of years. The most recent global growth forecasts from the International Monetary Fund (IMF)[1] expect global growth to contract by 4.4 per cent in 2020 compared to an earlier projection of 4.9 per cent in June 2020 . Similarly, growth in sub-Saharan Africa is expected to decline by 3.0 per cent in 2020 relative to June 2020 projection of 3.2 per cent.

2. There are fears the pandemic will likely come in waves over time as is being observed in other countries, such as Europe, India and the United States (US). General consensus remains that a strong global economic recovery will partly depend on how soon a vaccine for the virus can be made widely available and how quickly and safely countries are able to resume economic activity.

3. Global economic activity generally remained in contraction territory, following predominantly negative second quarter growth. Although the severity of the third quarter slowdown was generally observed across developed, emerging and developing economies, China maintained its positive growth momentum during this

[1] The IMF's October 2020 World Economic Outlook (WEO) expects global economic growth to contract by 4.4 per cent in 2020, compared to an earlier projection of 4.9 per cent in June 2020.

time. Recent macroeconomic data points to signs of a pick-up in global economic activity, albeit in a manner that is uneven between and within countries and at levels much lower than at the start of 2020. This is despite unprecedented monetary and fiscal policy easing by countries including the US and China, as well as an easing of lockdown conditions in some countries around the world.

4. Labour market developments show signs of slight improvement, altough risks to economic outlook remain prominent and tilted to the downside, emanating mainly from the continued spread of the coronavirus, a continuation of trade and geo-political tensions, and other country-specific factors. Inflationary pressures were a mixed bag in advanced economies in the third quarter of 2020. In the US, the rate of inflation increased. While it declined in the Euro Area and the UK. The monetary policy stance remained accommodative across advanced economies, with rates in the US, the Euro Area and UK kept close to the effective lower bound.

5. Data on economic activity in emerging market economies is expected to present mixed outcomes. China's economic growth increased by 4.9 per cent in the third quarter of 2020, on account of industrial production, exports and consumer spending. The November 2020 forecast of South African growth by the South African Reserve Bank (SARB) is a contraction of 8.0 per cent in 2020, relative to the 8.2 per cent forecasted decline in September. Headline and core consumer price inflation are forecasted to average 3.2 and 3.3 per cent in 2020, respectively.

6. Global financial markets reflected signs of easing, low volatility and market risk together with a rising risk appetite. This came in light of the US presidential elections as well as due to positive strides in the development of a COVID-19 vaccine. Yields in emerging markets, especially South Africa, were subdued on the short and long end. Investors were net sellers of South African assets, citing the country's precarious debt sustainability in the face of a widening fiscal deficit. The expected result is a weakening of the rand in the short term, with high downside risks and volatility.

7. In the domestic economy, the CBL acted timeously to mitigate the effects of the COVID-19 shock and maintain macroeconomic stability. The CBL has continued to emphasize that preserving adequate reserves to guarantee the peg is of paramount importance, given the fixed exchange rate's role as the key anchor of macroeconomic stability. Within the constraints of the exchange rate peg, the Bank

has taken various measures to preserve favourable financing conditions for all sectors, thereby supporting the economy and safe guarding price and financial stability during this difficult time. The measures that included the lowering of the key policy rate by 275 basis points since March 2020, the negotiating of fee reductions with mobile network operators and the raising of prudential limits on mobile money transactions, have contributed to the resilience of households and firms.

8. Domestic economic performance in the third quarter of 2020, as measured by the CBL's Quarterly Indicator of Economic Activity (QIEA), increased by 9.4 per cent, relative to a revised 14.2 per cent contraction in the second quarter. The welcomed improvement was driven by a rebound in domestic demand and supply, albeit at levels still below those experienced prior to the pandemic. The domestic economy is projected to contract by a revised 6.0 per cent in 2020, due to the economic fallout of the COVID-19 pandemic. The output contraction is expected to be led by a decline in economic activity in the textiles and clothing industry, construction industry and mining industry. In the medium term, the economy is projected to recover gradually and grow at an average rate of 4.33 per cent over the period 2021 – 2022. The recovery is conditional on developments related to COVID-19 containment, however, it is likely to come largely at the back of a strong rebound in the mining and construction industries as well as a broad-based recovery as the COVID-19 containment measures are gradually lifted. The domestic policy responses to the COVID-19 pandemic are also expected to boost the recovery.

9. In the labour market, all the three sectors that are monitored by the Bank experienced a decline in employment numbers. The highest drop emanated from migrant mine workers, followed by Government employment and lastly, employment in the manufacturing sector.

10. The rate of inflation, measured by year-on-year percentage change in consumer price index (CPI), registered 5.6 per cent in October 2020 relative to 5.9 per cent in September 2020. This was mainly due to an increase in Food and Non-Alcoholic Beverages as well as clothing and footwear. In terms of the outlook, the revised annual inflation rate is projected to register a revised 5.0 per cent in 2020 before increasing to 5.2 per cent and 5.3 per cent in 2021 and 2022, respectively.

11. Money supply, as measured by M2, increased by 4.3 per cent in the third quarter, following a decline of 0.7 per cent in the second quarter. The increase was due to a rise in net foreign assets and net domestic assets. Private sector credit improved by 2.1 per cent in the quarter ending September 2020, compared to a decrease of 6.1 per cent in the quarter ending June 2020.

12. The current account balance worsened in the third quarter, on account of an increased deficit on the goods account as imports rose faster than exports. Consequently, the gross international reserves as measured in months of import cover, declined to 4.1 months from a revised 5.9 months, in the previous quarter, despite a moderate increase in official reserves.

13. Government budgetary operations registered a fiscal deficit of 4.3 per cent of GDP during the second fiscal quarter ending September 2020, relative to a revised surplus of 13.8 per cent in the first quarter of the fiscal year ending June 2020.

14. In summary, global economic activity remained under pressure in the face of growing risks to the economic outlook that include the spread of the coronavirus as well as a continuation of geo-political and trade tensions. Domestically, growth is showing signs of recovery but the path remains uncertain. Risks to the domestic economic outlook include the possible spread of COVID-19 and the effectiveness of the infection control measures, exposure to international economic developments, domestic structural rigidities and policy uncertainty.

15. Having considered the Net International Reserve (NIR) developments and outlook, regional inflation and interest rate outlook, domestic economic conditions and the global economic outlook, the MPC decided to:

    i. Increase the NIR target floor from US$540 million to US$635 million. The NIR target remains consistent with the maintenance of the exchange rate peg between the loti and the South African rand.

    ii. Maintain the CBL rate at a rate of 3.50 percent per annum. The rate, set at this level, will ensure that the domestic cost of funds remains aligned with the rest of the region.

16. The Committee will continue to monitor the global developments and their likely impact on domestic macroeconomic conditions, especially the CBL net international reserves (NIR), with the aim of taking corrective action when needed.

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