CENTRAL BANK OF LESOTHO

STATEMENT OF MONETARY POLICY COMMITTEE

09 September 2008

1. Introduction

At its 15th meeting held on 9th September 2008, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) discussed the latest monetary policy operations and inflation-related developments to ensure that the price stability mandate of the Bank is being achieved. The Bank's objective is attained through the maintenance of an adequate level of foreign reserves. The reserves are kept to underwrite the fixed exchange rate between the South African rand and the loti. This currency peg allows Lesotho to benefit from monetary policy actions of the South African Reserve Bank as the bulk of inflationary pressures in Lesotho emanate from the South African market. Thus the MPC sets minimum target levels of external reserves and undertakes open market operations (auction of treasury bills) to mop up excess liquidity.

2. Inflation Developments

The Committee noted that inflation rate picked up at 10.5 per cent in July, from 9.6 per cent observed in June. Food inflation recorded a higher growth of 14.7 per cent, driven by stronger increases in prices of bread and cereals, milk and eggs as well as meat. The non-food component of the Consumer Price Index (CPI) also experienced an increase during the period under review. It grew at an annual rate of 6.6 per cent, following a rise of 5.9 in June. Almost all sub components of the non-food category rose, indicating the presence of second-round effects of high global fuel prices. The domestic fuel price index jumped 16.9 per cent on annual basis in July. However, the Committee noted that domestic retail fuel prices declined in August and September in line with the crude oil price.

The Committee noted that inflation in South Africa continues to be above the inflation target of 3 to 6 per cent. The measure of inflation targeted by the SARB, the CPIX, increased by 13.0 per cent in July. The Strong increase was attributed mainly to increases in the food and fuel prices. In addition, broad-based price pressures were observed in other items of the CPIX. Other threats to inflation environment included accelerating producer inflation and strong private sector credit.

However, the SARB expects inflationary pressures to wane in the coming months as a result of a series of interest rate increases undertaken since last year. Indeed, household consumption expenditure and private sector credit showed signs of slowing down in recent months.

3. Prospects for the Maintenance of Price Stability

a. Balance of Payments

Net financial inflows in the balance of payments can increase domestic money supply and eventually exert upward pressure on prices. In the second quarter of 2008, the current account recorded an improved surplus. This was driven by receipts of SACU revenue and an increase in exports. Thus official reserves increased slightly to 7.4 months of imports.

b. Fiscal Balance Outlook

The effect of a strong increase in external reserves on money supply continues to be moderated by prudent fiscal management. The Government has largely saved windfalls from SACU, resulting in a build-up of deposits with the banking system. In the second quarter of the calendar year, the government realised a small budget surplus. The non-expansionary fiscal policy helped contain domestically generated inflationary pressures.

4. Monetary Policy Stance

The Net International Reserve (NIR) position on the 5th September 2008 was US$958.51 million. At this level, NIR is US$458.51 million above the current NIR target. Thus the Committee decided to keep the NIR target unchanged at US$450-500 million.

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