



## CENTRAL BANK OF LESOTHO

### STATEMENT OF MONETARY POLICY COMMITTEE

21 October 2008

#### **1. Introduction**

At its 16<sup>th</sup> meeting held on 21<sup>st</sup> October 2008, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) discussed inflation-related developments and made policy decisions to maintain price stability.

The Committee sets the Net International Reserves (NIR) targets range that it deems sufficient to underwrite the rand loti-peg while meeting the country's foreign currency obligations. This serves the price stability objective of the CBL.

#### **2. Inflation Developments**

The Committee noted that the global economy continues to experience high inflationary pressures emanating from strong increases in commodity prices in the recent months. This problem is exacerbated by the limited scope to increase interest rates, due to the credit crunch that has depressed aggregate demand and overall economic activity in major economies.

Inflation continued to accelerate in the Common Monetary Area, with all members (Namibia, Lesotho, South Africa and Swaziland) experiencing double digit inflation rates. The rate of inflation targeted by the South African Reserve Bank, the CPIX, rose to 13.6 per cent on annual basis in August, from 10.9 per cent in May. The growth was driven by strong oil and food prices, as well as higher wage settlements. However, it was observed that interest rate increases undertaken in the past months

are bearing fruit. Private sector credit and household consumption expenditure slowed down in the recent months. The fall in the international price of oil could also reduce inflationary pressures.

Lesotho imports the bulk of its inflation from South Africa due to a large proportion of imports from the neighbouring country. Thus, inflation developments in South Africa impact price developments in Lesotho. Domestic inflation rose from 10.5 per cent in July to 11.2 per cent in August. The growth was driven by increase in both the food and non-food component. Food inflation jumped from 14.7 per cent in July to 15.2 per cent in August, while non-food inflation rose from 6.6 per cent to 7.5 per cent during the same period. The broad-based growth in prices indicates that high food and fuel prices have filtered into prices of other commodities and services in the economy.

### **3. Prospects for the Maintenance of Price Stability**

#### **a. Balance of Payments**

The balance of payments statement points to an accumulation of foreign reserves, which improved from 7.2 months of import cover in the first quarter of 2008 to 7.4 months in the second quarter. The current account increased significantly in the quarter to June, driven by an increase in exports and current transfers (due to SACU non-duty receipts).

The accumulation of foreign reserves is important for monetary policy in Lesotho, which relies on strong reserve position to underwrite the fixed exchange rate system. This in turn allows closer partnership with other CMA countries in fighting excessive inflation.

The Committee observed that it is sitting at a time when currency markets are under turmoil. The exchange rate of loti against US dollar depreciated from a low of around M7.235 early in August to above M10.50 on 20 October. Rapid depreciation of the

loti could increase Lesotho's import bill leading to a build up in inflationary pressures.

#### **b. Fiscal Balance Outlook**

Government operations continue to impact favourably on the domestic inflation environment. Strong receipts from the SACU revenue pool and restrained expenditure levels (as share of GDP) are resulting in budget surpluses which are used to build up government reserves held with the banking system. The government achieved an overall budget surplus estimated at 6.1 per cent of GDP for the quarter ended June 2008, following a balanced budget in March.

#### **4. Monetary Policy Stance**

The build up in external reserves and government budget surpluses augured well for the Net International Reserves (NIR) which stood at US\$939.8 million on 17 September 2008. The Committee, therefore, decided to keep the NIR target unchanged at US\$450 - 500 million.

However, the Committee expressed concern on the rapid depreciation of the loti in the recent weeks. If sustained, the depreciation could adversely affect the outlook on inflation.

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**GOVERNOR**

**21 October 2008**