



CENTRAL BANK OF LESOTHO

STATEMENT OF MONETARY POLICY COMMITTEE

12 May 2009

1. Introduction

The Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) met at its 19th meeting on 12th May 2009 to discuss the recent economic developments and their implications on monetary policy operations. The deliberations are held to ensure that the price stability mandate of the Bank is achieved. This mandate is attained through the maintenance of adequate level of foreign reserves, which are kept to support the parity between the South African (SA) rand and the loti.

The membership in Common Monetary Area (CMA) allows Lesotho to benefit from monetary policy actions in SA. Furthermore, the arrangement is a model towards realising the continent's resolve and SADC's goal of harmonising macroeconomic policies, specifically, monetary policy. Thus the MPC sets the minimum target level of external reserves and monitors performance of open market operations (auction of treasury bills) in achieving the target.

The Committee met against the backdrop of worsening global financial crisis. The global economy experienced recession in the latter part of 2008, which continued in the first quarter of 2009. The recession is more pronounced in the developed economies, whose second round effects impacts negatively on the exports sector of the developing countries. As a result, unemployment is rising in most developed and developing countries and asset prices are tumbling. The region has not been spared effects of the crisis. South Africa is experiencing a slowdown in economic growth which may affect Lesotho's employment through retrenchment of migrant

mineworkers, and fiscal policy through a reduction in SACU revenue. In addition, regional currencies are experiencing volatility, raising concerns on mounting debt service costs and inflationary pressures.

However, the Committee was encouraged by policy responses across the world and in the region. The group of 20 countries (G20) resolved at its meeting in April 2009 to augment efforts to support developing countries weather the crisis. The Committee noted the need for easing of monetary policy to complement fiscal policy, and welcomed the South African Reserve Bank's (SARB's) actions to continue to reduce interest rates in its recent meetings. The Committee will continue to monitor the domestic financial sector to ensure stability in these challenging times.

2. Inflation Developments

The Committee noted that inflation rate maintained a downward trend after reaching a peak of 12.1 per cent in September 2008. It measured 10.1 per cent in March, due mainly to the overall slowdown in non-food prices. The Committee acceded to the possibility of a continued slowdown in overall inflation developments in the coming months. This was mainly attributable to a continued decrease in producer price index and stability of the international crude oil prices at around US\$50 per barrel, and the subdued global economic performance. These developments also translated into further reductions in domestic fuel prices in May 2009.

The Committee took note of inflation developments in SA, which continued to be above the target range of 3 to 6 per cent. Inflation, as measured by the re-weighted and reconstituted consumer price index for all urban areas, increased to 8.6 per cent in February 2009 and then moderated to 8.5 per cent in March. This new measure replaced the CPIX as the target instrument of the SARB. The SARB expects inflationary pressures to ease in the coming months as a result of the low prices of crude oil and a continued decrease in producer price index. Therefore, the SARB's MPC reduced its key interest rate, the repo rate, by 100 basis points in line with conditions prevailing in the global economy.

3. Prospects for the Maintenance of Price Stability

a. Balance of Payments

The volatile exchange rate of the local currency continues to pose the main upside risk to the inflation outlook. The loti is currently trading at around M8.30 against the US dollar, a level better than that which prevailed at the time of the previous MPC meeting, but higher than levels that prevailed a year ago. However, the Net International Reserves (NIR) remained adequate to underwrite the fixed exchange rate system due to positive net financial inflows in the balance of payments.

As a result, the current account surplus in March was recorded at almost the same level as that realised in December 2008. This was largely on account of the rise in current transfers which more than offset the fall in income. However, official reserves decreased to 7.3 months of imports compared with 8.6 months of import cover in the fourth quarter of 2008.

The accumulation of foreign reserves is important for monetary policy in Lesotho to underwrite the fixed exchange rate arrangement with SA. This is particularly so with the observed shrinkage in export earnings in the face of the global economic turmoil. The IMF expects the output to contract by 1.3 per cent in 2009, before recovering gradually to 1.9 per cent in 2010. World trade is also expected to contract by 9.5 per cent in 2009.

b. Fiscal Balance Outlook

Government budgetary operations continued to support favourable macroeconomic environment. Nonetheless, the period realised a higher fiscal deficit following implementation of Civil Servants defined contributory pension scheme in January 2009. The position is expected to improve in the first quarter of the fiscal year 2009/10.

4. Monetary Policy Stance

While maintaining an import cover of no less than 5 months and observing movements in the exchange rates, the Committee decided to revise the NIR target range upwards. At this level, NIR is deemed sufficient to underwrite the fixed exchange rate arrangement between the loti and the SA rand.

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