



CENTRAL BANK OF LESOTHO

STATEMENT OF MONETARY POLICY COMMITTEE

1 September 2009

1. Introduction

At its 21st meeting held on 1st September 2009, 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 met.

The Committee observed that the global economic contraction continued in the second quarter of 2009, albeit at a slower rate. Major economies such as the US, Euro area, and in the region, South Africa, shrank by less than half the rates observed in the first quarter of the year. In addition, inflation pressures continued to fall, creating room for interest rate cuts by policy makers. Euro area and South African key interest rates were reduced by 50 and 200 basis points, respectively, between March and June 2009. South Africa reduced its key interest rate further to 7.00 per cent on 14 August 2009. The key interest rate in the US was held constant at 0.25 per cent during the same period.

However, unemployment levels continued to worsen in most countries across the globe. This indicated that the return to full recovery in real global economic activity, which requires a turnaround in incomes and improvement in credit worthiness of households in worsely affected major economies, could take some time.

The domestic economy showed signs of partial improvement in the second quarter of 2009. Diamond mining production increased more than two fold, boosting exports

and the current account. It was influenced by a 15 per cent rise in the average price of rough diamonds during the second quarter of 2009. Domestic consumption of electricity also rose by 17 per cent on a quarterly basis, partly as a result of an increase in electricity consumption during the winter season. The number of imported motor vehicles declined slightly. However, textile manufacturing continued to suffer from the fall in incomes in the US. Exports of textile and clothing declined by 8.6 per cent in the second quarter and employment in the manufacturing sector fell by 1.0 per cent. Imports of petroleum products also declined by 30.2 per cent, despite the generally steady trend of domestic fuel prices in the quarter ending June 2009. Employment in the government sector improved moderately while mine workers employment declined by 2.8 per cent to 47,354 workers.

2. Inflation Developments

Inflation continued on a downward trend, registering 8.1 per cent at the end of June 2009 from 8.9 per cent in May. The decline in the inflation rate reflected a broad slowdown in price increases of various items. Both the food and non-food components of inflation declined between May and June. The food component recorded an increase of 11.3 per cent in June from 12.1 per cent in May. Bread and Cereals; fruits and vegetables; as well as milk and eggs categories fell, while the meat component increased. It is worth noting that the slowdown in inflation in the region is sluggish compared with developments in major economies such as the US and Euro area, which are experiencing a decline in the general price level.

The decline in the domestic inflation rate was in line with decreases in inflation rates of other Common Monetary Area (CMA) countries. Namibia's inflation rate fell to 9.1 per cent in June 2009, the highest rate in the region; Swaziland's inflation rate declined in line with Lesotho's to 7.9 cent while South Africa's inflation rate dropped to 6.9 per cent.

3. Prospects for the Maintenance of Price Stability

a. Balance of Payments

The rebound in diamond exports strengthened the balance of payments position, leading to a higher current account surplus and an improvement in the Net International Reserves (NIR) position of the Central Bank. NIR rose to US\$976.1 million at the end of July from US\$893.2 million in June due mainly to receipt of SACU revenue quarterly payment. These overshadowed the decline in textile and clothing exports on balance of payments.

b. Fiscal Balance Outlook

Preliminary estimates indicated that government budgetary operations realised a large surplus in the second quarter of 2009. The surplus was mainly influenced by expenditure slowdown resulting from capacity constraints in operating the newly introduced Integrated Financial Management Information System (IFMIS) of Government. The Committee expects government expenditure to pick up in the coming quarters when the system is running as expected.

4. Monetary Policy Stance

The Committee was satisfied with the performance of the NIR and decided to retain the NIR target range of US\$500 million to US\$550 million. At this level, NIR is deemed sufficient to underwrite the fixed exchange rate arrangement between the loti and the South African rand. The Committee noted that the recovery in diamond exports was encouraging, while muted activity in the textile manufacturing sector and pending catch-up in government expenditure could limit further growth in the NIR level.

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GOVERNOR

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