



## **CENTRAL BANK OF LESOTHO**

### **STATEMENT OF MONETARY POLICY COMMITTEE**

**14 March 2007**

#### **1. Monetary Policy Stance**

The Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) sat for its 9<sup>th</sup> Meeting on 14 March 2007. The Committee reviewed performance of open market operations and inflation developments in the recent months to ensure that its price stability mandate is being achieved.

At the time the Committee met, the Bank was targeting a Net International Reserves (NIR) range of USD400.0 million to USD450.0 million. This NIR level was deemed sufficient to meet demands for the sale of the loti for other currencies, without undermining the fixed exchange rate system. The rand-loti peg allows Lesotho to benefit on the relatively lower imported inflation from South Africa, which forms a significant part of the domestic inflation.

#### **2. Inflation Developments during the Fourth Quarter of 2006**

The Committee observed that the latest inflation rate figures showed a slight increase. The inflation rate was constant at 6.9% in November and October 2006, from a steady 6.8% recorded in September and August. This modest growth was driven by increases in the prices of the following categories: food and non-alcoholics; alcoholic beverages and tobacco; and housing, electricity, gas and other fuels. On the contrary, inflation rate of the following categories: clothing and footwear, and household equipment and routine maintenance of households, slowed down between October and September.

The two components have a combined weight of 32.6% in the Consumer price Index basket.

The Committee noted that the country might not face significant inflationary pressures in the next three months. The inflation rate is estimated to have ended the year at 6.8%, and averaged 6.1% for the whole year. Inflation in South Africa experienced a deceleration during the review period. It was moderated by a slow down in the rate of increase of food prices, private sector credit, production price inflation and international oil prices. In addition, wage inflation and the exchange rate effect remained subdued during the period under review. These developments imply that inflation imported from South Africa would remain modest in the coming months.

The monetary sector continued to show signs of inflationary pressures. Broad money, M2, grew in excess of 30% on an annual basis in January 2007. This growth was way higher than the estimated 12.9% increase in nominal GDP for 2006. The growth in money supply was driven mainly by the rise in net foreign assets during the period.

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

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

The Committee noted that trade and transactions between Lesotho and other countries might not cause inflationary pressures in the economy. The current account continued to record surpluses in the fourth quarter of 2006, though the surplus narrowed by around M60.0 million on a quarterly basis due to a decline in exports. Imports rose by a seasonally adjusted 1.5% between the two quarters. The slight increase was attributed to the recovery in the manufacturing sub-sector, which led to an increase in imported inputs. This implies subdued import demand (thus modest imported inflation) from the government and private sector during the period. The steady import demand by the general public could also be a result of the slow down in seasonally adjusted labour income, which decelerated by 0.3% during the quarter. The capital account recorded a net outflow of M81.2 million in the last quarter compared with M24.6 million in the preceding quarter. Reserves are estimated to cover 6.5

months of import for the year of 2006. However, the Committee noted the negative effects of the possible decline in SACU revenue on the Lesotho current account sustainability in the context of working towards the SADC customs union. Thus there is a need to diversify the economy and look at other options to mitigate the expected negative impact.

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

Excessive government expenditure over revenues that is financed through the borrowing from the banking system (either through direct credit or selling of securities) can result in a built up of inflationary pressures in the economy. However, in the case of Lesotho, the MPC noted that the Government continued to show prudence in fiscal management during the reporting period. The fiscal position has been recording surpluses in the present fiscal year, due to increased SACU revenue and deliberate expenditure control. The Budget outturn indicated a surplus equivalent to 7.1% of GDP in the last quarter of 2006. This has resulted in moderate inflationary pressures emanating from government behaviour.

#### **4. Monetary Policy Committee Decision**

The strong foreign currency inflows from SACU receipts, exports, grants and labour income; and the relatively lower financial outflows through imports and repayment of liabilities has resulted in the built up of official reserves. The NIR stood at USD729.7 million at the end of February 2007. At this level, the reserves were in excess of the lower limit by USD329.7 million. Therefore, the Committee concluded that the external reserves were adequate to underwrite the rand-loti peg, and that the peg continued to serve the Bank's objective of price stability well given the moderate inflationary pressures imported from South Africa. The Committee also observed that the widening margin between the Lesotho and South African 91-day treasury bill rates could encourage local investors to transfer funds abroad and thus reduce the NIR level. It decided to maintain the target range of NIR unchanged at US\$400 to \$450 million, and to review it at the next meeting to take into account the growth in imports over time.