



CENTRAL BANK OF LESOTHO

STATEMENT OF MONETARY POLICY COMMITTEE

3 August 2010

1. Introduction

At its meeting held on the 3 August 2010, the Central Bank of Lesotho Monetary Policy Committee (MPC) observed that the global economy continues on a weak recovery path. Unemployment rates in major economies continue to be high despite historically low global interest rates. The domestic economy showed signs of low inflation. However, government budgetary operations and the external sector deteriorated due to a decrease in customs revenue.

The Committee decided to revise the targeted minimum level for the Net International Reserves (NIR) from USD700 million to USD956 million. The new target is a performance criterion for the end of September 2010, agreed with the International Monetary Fund under a three-year Extended Credit Facility (ECF) signed in May 2010. Another quantitative benchmark for end September monitored by the Bank is a ceiling on the Bank's Net Domestic Assets (NDA) of M1884.0 million. The ECF is intended at supporting Government's effort to maintain macroeconomic stability following adverse effects of the global financial crisis and the shortfall in SACU revenue in the new fiscal year.

The new NIR target is expected to cope with any foreign currency demand of the economy which could be in excess of supply, while allowing the Central Bank to continue to maintain the fixed exchange rate arrangement between the local currency, loti, and the South African currency, the rand. The fixed exchange rate arrangement enables Lesotho's inflation developments to be anchored to those of its main trading

partner South Africa, which targets an annual inflation rate between 3 and 6 per cent. The NDA target ensures that the bank does not finance government deficits, an action that could lead to a buildup in inflationary pressures or reduce the NIR to unfavourable levels.

2. Inflation Developments

The Committee observed that inflation rate remained low during the second quarter of 2010. It closed the quarter at 4.5 per cent up from 4.2 percent in March 2010. Marginal price increases for food and non-food items ensured that the inflation rate remained low. However, international prices of oil pose a significant risk to the inflation outlook. The price of crude oil has been on the increase since the last quarter of 2009, when it was below \$50 a barrel on average. During the second quarter of 2010, the price of crude oil averaged \$76.49 per barrel. South Africa's annual inflation rate was recorded at 4.2 per cent in June 2010.

3. Prospects for the Maintenance of Price Stability

a. Balance of Payments

Balance of payments figures for the first quarter of the fiscal year 2010/11 are yet to be finalised. The Committee noted that the external position could come out worse than the preceding quarter due to a significant fall in SACU non-duty receipts in the new fiscal year. The current account balance had improved to a deficit equivalent to 9.1 per cent of GDP in the last quarter of the 2009/10 fiscal year, from a deficit of 14.4 per cent of GDP during the fourth quarter of 2009 due to an improvement in diamond exports and current transfers. Official reserves had remained almost unchanged at 6.7 months of import cover in the quarter to March 2010.

b. Fiscal Balance Outlook

Similarly, government budgetary operations are expected to have deteriorated in the first quarter of the fiscal year 2010/11 due to a combination of lower SACU revenue and payment of arrears from the preceding fiscal year. The government deficit was equivalent to 8.8 per cent of GDP in the first quarter of 2010, following a surplus of 11.2 per cent of GDP in the preceding quarter.

4. Monetary Policy Stance

Net International Reserves (NIR) of the Central Bank of Lesotho were recorded at USD956.2 million on 30 July 2010. At this level, the reserves were close to the minimum level targeted by the Committee, which is USD956 million for the end of September 2010. The Committee agreed to monitor the performance of the NIR closely and to adjust auction amounts in a manner that leads to a buildup in the external reserves.

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GOVERNOR

3 August 2010