



## CENTRAL BANK OF LESOTHO

### STATEMENT OF MONETARY POLICY COMMITTEE

7 July 2009

#### **1. Introduction**

The Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) held its 20<sup>th</sup> meeting on 07<sup>th</sup> July 2009 to discuss the recent economic developments and their implications on monetary policy operations. This meeting is held to review and monitor the Bank's prime mandate of price stability. The mandate is pursued by anchoring monetary policy to that of South Africa through the peg of loti to the rand. It allows Lesotho to benefit from the anchor economy's monetary policy regime of inflation targeting, as a large part of Lesotho's inflation is imported from the neighbouring country. The Committee maintains adequate foreign reserves to underwrite the currency peg. It 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 noted the ongoing global economic downturn, with SA officially pronounced to be in a recession for the first time in more than ten years. The current downturn follows a recession experienced in the developed world in the latter part of 2008, and continued in the first half of 2009. The recession in the developed world impacts negatively on the exports sector of the developing countries such as South Africa and Lesotho. Asset prices are dwindling and unemployment is rising in most developed and developing countries. The South African mining industry retrenched a sizable number of employees, the consequences of which will be felt more in Lesotho due to the long standing labour relationship between the two economies. This has

potential to affect Government budgetary position and the country's balance of payments.

In spite of this, the Committee expects recovery in the coming months, driven by expansionary policy responses undertaken across the globe. The group of 20 countries (G20) resolved at its meeting in April 2009 to augment efforts to support developing countries weather the crisis. The African Union summit recently completed in Libya identified agriculture as a key alternative for sustainable development. The Committee will continue to monitor the domestic economic developments to ensure stability in these challenging times, and facilitate recovery.

## **2. Inflation Developments**

In contrast to developments in international oil prices, inflation rate maintained a downward trend observed in recent months. It measured 8.9 per cent in May, due mainly to the overall slowdown in food and non-food prices. However, the Committee was cautious about the overall inflation developments in the coming months consequent to episodes of international crude oil price increases which was trading at over US\$60 per barrel compared with US\$50 per barrel at the time of the previous meeting of the MPC.

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 8.0 per cent in May 2009. Food prices inflation declined from 13.6 per cent to 12.1 per cent during the same period, but remained the main contributor to the inflation outcome. Housing and utilities inflation became the second largest contributor to the outcome, mainly due to a 29.6 per cent increase in electricity prices and a 15.1 per cent rise in the cost of maintenance and repairs. However, deflationary pressures are also present, as evidenced by producer price inflation, which fell by 3.0 per cent in May. In its meeting held on 24<sup>th</sup> to 25<sup>th</sup> June 2009, the South African Reserve Bank's Monetary Policy Committee decided to keep its key interest rate, the repo rate, unchanged at 7.5 per cent in line with conditions prevailing in the global and domestic economy.

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

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

The exchange rate of the loti fluctuated against the US dollar between the range of about R7.85 and R8.25 since the previous meeting of the MPC. 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. NIR was recorded at US\$893.19 million at the end of June 2009, compared with the narrow money (M1) worth US\$537.73 million. This is equivalent to 1.7 per cent coverage of M1 in circulation.

The global downturn has resulted in a significant decline in Lesotho's exports in the first quarter of 2009, mainly diamond and textile exports. This has potential to result in a deficit on the current account of the balance of payments. However, external debt service for April and May 2009 was registered at a meagre US\$3.8 million and US\$1.8 million, respectively.

The outlook for the global economy could remain under pressure for most of the year before slowly recovering. Therefore, 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 and the higher Government liabilities on external debt.

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

Government budgetary operations continued to support favourable macroeconomic environment. Nonetheless, the period realised some hiccups resulting from functional problems related to the newly introduced Integrated Financial Management Information System (IFMIS) of Government. As a result, Government expenditure in the coming quarter could increase once the system is running efficiently.

### **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 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.

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**GOVERNOR**

**07 July 2009**