



CENTRAL BANK OF LESOTHO

STATEMENT OF MONETARY POLICY COMMITTEE

24 February 2009

1. Introduction

The Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) met at its 18th meeting on 24th February 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. The reserves are kept to support the parity between the South African (SA) rand and the loti which, in turn, facilitates a coordinated approach to inflation management with the South African Reserve Bank (SARB).

Thus 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 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 US experienced recession in the latter part of 2008 and more countries continue to be affected by the problem. Unemployment is rising in most developed countries and asset prices are tumbling. The housing mortgage problem resulted in a banking crisis and credit crunch, which in turn are adversely affecting other sectors such as the car industry, steel and manufacturing as a whole. The region has not been spared effects

of the crisis. South Africa is experiencing a slowdown in economic growth while Lesotho saw a fall in manufacturing and mining activity. In addition, regional currencies are depreciating, 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. Unprecedented measures have been taken in the developed world to address the housing market problem, the banking crises and to stimulate the economies. The budget speeches rendered in South Africa and Lesotho in the recent weeks revealed efforts to mitigate against economic slowdown and to assist failing sectors. The Committee noted the need for easing of monetary policy to complement fiscal policy, and applauded the South Africa Reserve Bank's actions 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 is on a downward trend after reaching a peak of 12.1 per cent in September 2008. It closed the year at 10.6 per cent, due mainly to the overall slowdown in food and fuel prices. The deceleration in food component of the Consumer Price Index (CPI) largely reflected the slower increases in prices of cereals, bread and vegetables. The Committee acceded to the possibility of a continued slowdown in overall inflation developments in the coming months. This was mainly attributable to a stability of the international crude oil prices at around \$40 per barrel, and the subdued global economic performance. These developments also translated into further reductions in domestic fuel prices.

The Committee took note of inflation developments in SA, which continued to be above the target range of 3 to 6 per cent. However, there were signs of moderation in December when the CPIX, increased by 10.3 per cent, a figure approaching a single digit for the first time since March 2008. The SARB expects inflationary pressures to ease in the coming months as a result of the falling prices of crude oil and a continued

decrease in producer price index. This was supported by data on household consumption expenditure and private sector credit, which showed that the aggregates remained on a downward trend in recent months. 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 M10.00 against the US dollar, a level similar to 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 was recorded at 15.2 per cent of GDP in December 2008, following a 10.9 per cent of GDP in the third quarter. This was largely on account of the rise in income and current transfers. Consequently, official reserves increased to 8.6 months of imports cover in the fourth quarter.

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. Accordingly, the International Monetary Fund significantly downgraded its forecast for the global economic growth in 2009 to 0.5 per cent.

b. Fiscal Balance Outlook

Government budgetary operations continued to support favourable macroeconomic environment. The fiscal balance has been in surplus in recent periods, thereby accumulating reserves with the banking sector. The fiscal deficit, equivalent to 0.8 per cent of GDP, was realised in the fourth quarter of 2008. The deficit was mainly

attributed to recurrent expenditures, which rose in response to government commitment to improve service delivery.

4. Monetary Policy Stance

On the basis of the above discussions and the actual NIR position valued at US\$966.65 million on the 20th February 2009, the Committee decided to keep the NIR target unchanged at US\$450- 500 million. 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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GOVERNOR

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