



## CENTRAL BANK OF LESOTHO

### STATEMENT OF MONETARY POLICY COMMITTEE

3 November 2009

#### **1. Introduction**

The Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) met for its 22<sup>nd</sup> meeting on 3<sup>rd</sup> November 2009, where it discussed inflation-related developments and made policy decisions for maintenance of price stability.

The Committee sets the Net International Reserves (NIR) target range that it deems sufficient to underwrite the rand-loti peg while meeting the country's foreign currency obligations. This serves the price stability objective of the CBL by anchoring monetary policy to that of South Africa, where the bulk of inflationary pressures in Lesotho emanates.

#### **2. Inflation Developments**

The Committee observed that major economies such as the US and Euro area continued to experience deflationary pressures in the second quarter of 2009. However, there is evidence that this trend is abating with US realising inflation in the third quarter. This could be an indication that the stimulus packages undertaken earlier are bearing fruit, as the contraction in economic activity in these regions has started to slow down. The emerging inflationary pressures could also be an effect of higher international oil prices.

Inflation is slowing down in the Common Monetary Area, with all members (Namibia, Lesotho, South Africa and Swaziland) experiencing falling inflation rates.

The rate of inflation in South Africa, the largest economy in the CMA, fell from 6.4 in August to 6.1 in September. The main contributors to the August inflation were housing and utilities, as well as miscellaneous goods and services. Lower inflation was also influenced by a strong currency and subdued demand pressures. Risks of higher inflation in the coming months are posed by higher-than-inflation wage settlements and proposed trebling of electricity tariffs over the next three years.

Lesotho imports the bulk of its inflation from South Africa due to a large proportion of imports from the neighbouring country. Thus, inflation developments in South Africa influence price developments in Lesotho. Domestic inflation decelerated to 5.6 per cent in August, on annual basis, from 6.9 per cent in the preceding month. The fall in inflation rate was driven by declines in both the food and non-food component. Food inflation rate declined from 8.9 per cent in July to 6.7 per cent in August, while non-food inflation slowed from 5.1 per cent per cent to 4.7 per cent during the same period. The broad-based slowdown in price increases indicates that slower inflation in South Africa, and lower local fuel prices have filtered into prices of most goods and services in the domestic economy.

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

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

The balance of payments statement points to a slight deterioration in official reserves, which fell from 7.3 months of import cover in the first quarter of 2009 to 7.2 months' cover in the second quarter. The current account surplus increased modestly in the second quarter of 2009, driven by an increase in exports and a fall in imports.

Adequate foreign reserves are important for monetary policy in Lesotho, which relies on a strong official reserve position to underwrite the fixed exchange rate system. This in turn allows closer partnership with other CMA countries in fighting excessive inflation.

## **b. Fiscal Balance Outlook**

Government operations in the second quarter of 2009 were characterised by under expenditure associated with temporary functionality problems of the newly installed Integrated Financial Management Information System (IFMIS). Government expenditure fell by an estimated 42.2 per cent on quarterly basis, dampening the effect of a 7.1 per cent decline in revenue and resulting in a surplus equivalent to 42.2 per cent of GDP.

## **4. Monetary Policy Stance**

The resilience of the balance of payments position and government budget surpluses augured well for the Net International Reserves (NIR) which stood at US\$1015.7 million on 15 October 2009. The Committee, therefore, decided to keep the NIR target unchanged at US\$500 - 550 million.

However, it noted that government budgetary operations should be monitored closely in the coming quarters as the ‘catch-up’ in government expenditure could lead to deterioration in official reserves.

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**GOVERNOR**

**3 November 2009**