Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

4th April 2023

1. On April 4th 2023, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho held its 100th meeting. During the meeting, the Committee considered global, regional, and domestic economic developments, as well as the financial markets developments.

2. The Committee noted that global economic prospects had generally improved. The IMF has revised the projected world output growth upwards to 2.9 per cent in 2023 from 2.7 per cent that was forecasted in October 2022. Although high global inflation rates and Russia-Ukraine war remain a threat to global recovery, growth is expected to be boosted by resilient consumer demand and a steady fall in inflation in most economies.

3. GDP estimates for the last quarter of 2022 pointed to a slowdown in economic activity for most economies. Elevated inflationary pressures arising from the effects of Russia-Ukraine war and tighter financial conditions continued to hamper growth. Japan was an exception as growth edged slightly higher due to relatively stronger aggregate demand following the re-opening of the economy from the COVID-19 lockdowns. In China, growth remained low as the economy continued to battle the effects of COVID-19 infections following the relaxation of the strict zero-COVID-19 policy. Economic growth in South Africa fell sharply from 4.2 per cent in the third quarter to 0.9 per cent in the fourth quarter of 2022. The decline was attributable to prolonged power outages, which have had a negative impact on mining and manufacturing output.

4. The unemployment rate remained relatively unchanged in most economies. In the UK, the unemployment rate edged slightly higher on account of workers' strikes, demanding better pay amid elevated inflation and high interest rates. In Japan, the unemployment rate improved as the economy slowly recovered from COVID-19 and absorbed more workers into the labour market.

5. lnflationary pressures continued to ease in most countries because of declining food and oil prices. The renewal of The Black Sea Grain Initiative is expected to further reduce inflationary pressures given the improved supply of grains and other food stuffs from Ukraine. Despite the slowdown observed recently, the inflation rate remained above target rates set by most central banks. Most central banks maintained tight monetary policy stance in a bid to further reduce inflation. At its sitting held on 30th March 2023, the South African Reserve Bank MPC increased the repo rate by 50 basis points in an effort to drive down inflation towards the mid-point of its target rate.

6. Short-term yields in advanced economies closed lower as financial stability concerns mounted following the recent banking sector crisis in the US and Europe. In emerging market economies, China's short-term yields closed lower as the economy continued to experience deflation stemming from muted demand following the gradual re-opening of the economy from the strict zero-COVID-19 policy. Long-term yields generally fell in advanced economies due to the panic caused by the banking sector distress. In China, long-term yields fell as a result of the accommodative monetary policy aimed at supporting the ailing economy while South Africa's long-term yields increased on account of persistent power cuts and the country's grey listing by the Financial Action Task Force.

7. Domestic economic activity weakened in January 2023. It was estimated to have declined by 2.6 per cent due to the weak performance of the transport, construction and financial sub-sectors. In terms of the outlook, the economy is expected to improve largely on account of construction activities of which LHWP Phase II will contribute the largest share.

8. Despite the declining global food prices, domestic food prices have been pushed higher by the weaker domestic currency. As such, domestic inflationary pressures heightened in February 2023 mainly driven by increasing food prices. Inflation rose to 7.4 per cent in February compared to 6.8 per cent observed in January 2023.

9. Money supply increased by 1.7 per cent in February 2023. This resulted from a significant increase in commercial banks foreign assets. Commercial banks' assets were boosted by construction activities relating to LHWP Phase II, which received substantial inflows that provided a boost to commercial banks deposits. Private sector credit rose because of credit extended to businesses while credit extended to households remained unchanged.

10. The current account balance deteriorated further in the fourth quarter of 2022. The deficit on the current account expanded to 11.9 per cent of GDP in the fourth quarter, from a deficit of 0.2 per cent of GDP in the third quarter of 2022. The weak performance of the current account was due to the widening trade account deficit. This was attributable to a sharp fall in exports, particularly diamonds and textiles and clothing exports while imports registered further growth. The stock of reserves, measured in months of import cover, fell to 4.0 from 4.8 recorded in the preceding quarter.

11. Government budgetary operations pointed to a deterioration in February 2023 compared to the preceding month. The fiscal balance was estimated to have recorded a deficit equivalent to 14.8 per cent of GDP in February 2023 compared to a deficit of 1.2 per cent of GDP in January 2023. This was attributable to a sharp decline in government revenue, which outpaced the fall in expenditure. The stock of public debt was estimated to have increased to 54.2 per cent of GDP in February 2023, compared to 52.3 per cent of GDP recorded in January 2023.

12. The level of CBL's Net International Reserves (NIR) deteriorated between January and March 2023. This was a result of commercial banks' net outflows during the review period. However, the NIR remained above the target floor of USD640 million set by the MPC in its meeting in January 2023; which was adequate to support the loti-rand exchange rate peg. The NIR is expected to improve in the second quarter of 2023 due to the anticipated recovery in SACU revenue.

13. In summary, global economic prospects for 2023 have generally improved. Growth is expected to be boosted by pent-up demand and a faster fall in inflation in most economies. Inflation is expected to continue decelerating due to amongst others improved supply of grains and other food stuffs from Ukraine following the renewal of the Black Sea Grain Initiative. The domestic economy is projected to improve in the medium-term on account of construction activities associated with the LHWP Phase II project.

14. Having considered the NIR developments and outlook, regional inflation and interest rate outlook, domestic economic conditions and the global economic outlook, the MPC decided to:

    i. ***Maintain NIR target floor at USD640 million. At this level, the NIR target will be sufficient to maintain a one-to-one exchange rate peg between Loti and the South African Rand.***

    ii. ***Increase the CBL Rate by 25 basis points; from 7.25 per cent per annum to 7.50 per cent per annum.***

15. The Committee will continue to closely assess the global economic developments and their impact on the domestic economy especially the Net International Reserves (NIR) and respond accordingly.

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