STATEMENT OF THE MONETARY POLICY COMMITTEE

September 22, 2020

1. Since the July 28 meeting of the Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC), the COVID-19 pandemic has continued to take its toll on the world, unleashing devastating human and economic suffering. The global economic downturn in the wake of the virus has been severe and broad based across all economic sectors, affecting advanced, emerging as well as developing economies. A return to pre-pandemic levels of economic growth is likely to take a number of years. The most recent global growth forecasts from the International Monetary Fund (IMF)[1] expect global growth to contract by 4.9 per cent in 2020. This anticipated decline will be much worse than the downturn experienced during the 2008-09 financial crisis. Similarly, growth in sub-Saharan Africa is expected to decline by 3.2 per cent in 2020.

2. The MPC meeting is taking place against the continuing unfolding of the COVID-19 pandemic. While Lesotho was the last country to register confirmed cases on the continent, the number of infections continues to rise and threaten to put pressure on the healthcare system. Indications are that the worst of the pandemic is still ahead. There are fears the pandemic will likely come in waves over time as is being observed in other countries, in Europe, India and the United States (US). General consensus remains that a strong global economic recovery will partly depend on how soon a vaccine for the virus can be found and made widely

[1] The IMF's June 2020 World Economic Outlook (WEO) expects global economic growth to contract by 4.9 per cent in 2020, compared to an earlier projection of 3 per cent in April 2020.

available and how quickly and safely countries are able to resume economic activity.

3. Global economic activity experienced a sharp contraction in the second quarter of 2020, following negative growth in the first quarter. Although the severity of the second quarter slowdown was generally observed across developed, emerging and developing economies, China was the only exception, registering positive growth during this time. Recent macroeconomic data points to signs of a pick-up in global economic activity, albeit in a manner that is uneven between and within countries and at levels much lower than at the start of 2020. A major drag on economic output remains the global spread of the COVID-19 pandemic and associated infection control measures undertaken by authorities around the globe. This is despite unprecedented monetary and fiscal policy easing by countries including the US and China, as well as an easing of lockdown conditions in some countries around the world.

4. Labour market developments show signs of further global deterioration, as risks to economic outlook remain prominent and tilted to the downside, emanating mainly from the continued spread of the coronavirus, a re-escalation of trade and geo-political tensions, and other country-specific factors. Inflationary pressures largely subsided in advanced economies in the second quarter of 2020. In the US, UK, the Euro Area and Japan, the rates of inflation decreased. The monetary policy stance remained accommodative across advanced economies, with rates in the US, the Euro Area and UK kept close to the effective lower bound.

5. Data on economic activity in emerging market economies presented mixed outcomes. China's economic growth increased by 3.2 per cent in the second quarter of 2020, on account of industrial production, exports and investment spending. In South Africa, economic output declined by 17.1 percent, across all sectors except agriculture during the same period, annually. The September 2020 forecast of South African growth by the South African Reserve Bank (SARB) is a contraction of 8.2 per cent in 2020, relative to the 7.3 per cent forecasted decline in July. Headline and core consumer price inflation are forecasted to average 3.3 and 3.4 per cent in 2020, respectively.

6. Global financial markets reflected signs of moderate volatility despite less stringent lockdown conditions across economies and an improvement in US-China trade tensions. Yields in emerging markets, especially South Africa, declined on the short and long end. Investors renewed their interest in South African assets following a reopening of the economy. This was despite the country's increasing public debt to GDP and a worsening current account deficit. The expected result is slight strengthening in the rand, with high downside risks and volatility.

7. In the domestic economy, the CBL acted timeously to mitigate the effects of the COVID-19 shock and maintain macroeconomic stability. The CBL has continued to emphasize that preserving adequate reserves to guarantee the peg is of paramount importance, given the fixed exchange rate's role as the key anchor of macroeconomic stability. Within the constraints of the exchange rate peg, the Bank has taken various measures to support the economy during this difficult time. The measures that have included the lowering of the key policy rate by 275 basis points since March 2020, the negotiating of fee reductions with mobile network operators and the raising of prudential limits on mobile money transactions, have contributed to the resilience of households and firms.

8. Domestic economic performance in the second quarter of 2020, as measured by the CBL's Quarterly Indicator of Economic Activity (QIEA), fell drastically, by 12.6 per cent, relative to a revised 2.4 per cent decline in the first quarter. The domestic economy is projected to contract by a revised 6.4 per cent in 2020, due to the economic fallout of the COVID-19 pandemic. The output contraction is expected to be led by a decline in economic activity in the textiles and clothing industry, construction industry and mining industry. In the medium-term, the economy is projected to recover gradually and grow at an average growth rate of 4.6 per cent over the period 2021 – 2022. The growth recovery is conditional on developments related to COVID-19 containment, however, it is likely to come largely at the back of a strong rebound in the mining and construction industries as well as a broad-based recovery as the COVID-19 containment measures are gradually lifted. The domestic policy responses to the COVID-19 pandemic are also expected to boost the recovery.

9. In the labour market, there were mixed signals across the three sectors that are monitored by the Bank. Government employment increased marginally in the second quarter of 2020, while employment in the manufacturing sector and migrant mine workers declined.

10. The rate of inflation, measured by year-on-year percentage change in consumer price index (CPI), increased from 5.6 per cent in July 2020 to 6.0 per cent in August 2020. This was mainly due to an increase in the prices of *Food and non-alcoholic beverages and Clothing and footwear.* In terms of the outlook, the revised annual inflation rate is projected to register 5.1 per cent in 2020 before increasing to 5.2 per cent and 5.4 per cent in 2021 and 2022, respectively.

11. Money supply, as measured by M2, increased by 1.1 per cent in July 2020, following a decline of 1.7 per cent in June 2020. The increase was due to a rise in net foreign assets, which was moderated by a softening in net domestic assets. Private sector credit improved marginally by 0.5 per cent between June and July 2020, compared to a decrease of 4.0 per cent in June 2020.

12. The balance of payments position improved in the second quarter, on account of an increased surplus on the secondary income account together with a reduced deficit on the services account. Consequently, gross international reserves rose to 6.5 months of import cover from 4.7 months in the previous quarter.

13. Government budgetary operations registered a budget surplus of 12.0 per cent of GDP during the first fiscal quarter ending June 2020, relative to a revised deficit of 5.5 per cent in the last quarter of the fiscal year ending March 2020.

14. In summary, global economic activity remained under pressure in the face of growing risks to the economic outlook that include the spread of the coronavirus as well as re-escalations of geo-political and trade tensions. Domestically, growth has remained subdued. Risks to the domestic economic outlook include the possible spread and the infection control measures of COVID-19, exposure to international economic developments, domestic structural rigidities and policy uncertainty.

15. Having considered the Net International Reserve (NIR) developments and outlook, regional inflation and interest rate outlook, domestic economic conditions and the global economic outlook, the MPC decided to:

    i. Decrease the NIR target floor from US$550 million to US$540 million. The NIR target remains consistent with the maintenance of the exchange rate peg between the loti and the South African rand.

    ii. Maintain the CBL rate at a rate of 3.50 percent per annum. The rate, set at this level, will ensure that the domestic cost of borrowing and lending remain aligned with the cost of funds elsewhere in the region.

16. The Committee will continue to monitor the global developments and their likely impact on domestic macroeconomic conditions, especially the CBL net international reserves (NIR), with the aim of taking corrective action when needed.

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