Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

September 28, 2021

1. The CBL's Monetary Policy Committee (MPC) is committed to conducting monetary policy to *achieve and maintain price stability* and thus overall macroeconomic stability. The Committee held its 91st meeting on September 28, 2021, to review recent economic developments and determine the adequacy of monetary targets. During the meeting, the Committee considered international, regional and domestic economic developments as well as financial markets' conditions.

2. Since the 90th MPC Meeting of July 27, 2021, the highlight of global macroeconomic and financial developments was the approval by the Board of Governors of the IMF, on August 2, 2021, of a general allocation of Special Drawing Rights (SDRs) equivalent to US$650 billion (about SDR456 billion). This allocation, which became effective on August 23, 2021, is the largest in the history of the IMF. It is intended to boost global liquidity and help liquidity-constrained countries in their efforts to address the impact of COVID-19 pandemic on their economies. A total of SDR193 billion was distributed to the emerging and developing economies, out of which Lesotho received SDR65 million (US$95.18 million).

3. As a result of the new SDR allocation, Lesotho's official reserves increased by approximately US$18.96 million to US$843.17 million recorded on the 17th September 2021. The NIR position was above the current NIR target floor (US$780.00 million) by approximately US$63.17 million.

4. Since the previous meeting, the downside risks to global growth have become more pronounced, stemming from the resurgence of COVID-19 infections, a larger share of unvaccinated people in emerging and developing countries and the possible retreat in policy accommodation. Global growth remains vulnerable to new mutations of the virus, vaccine availability and lack of uniformity in rates of country vaccinations. Further downside risks include global trade tensions, limited policy space and possible

tightening of containment measures as infections rise.

5. The International Monetary Fund (IMF) World Economic Outlook report of July 2021 forecasts 2021 global gross domestic product (GDP) to grow by 6.0 per cent. Similarly, growth in the sub-Saharan African region is expected to accelerate by 3.4 per cent in the same year. Both projections remain unchanged from the Fund's April 2021 report. Global economic activity broadly improved during the second quarter of 2021. Growth in the advanced economies was led by the United States (US) while China led growth in emerging market economies.

6. US real GDP increased at the annual rate of 12.2 per cent in the second quarter of 2021, following a moderate increase of 0.5 per cent in the quarter ending March 2021.China realized an annual real GDP growth of 7.9 per cent in the second quarter, compared to 18.3 per cent the first quarter. Growth in South Africa improved in the second quarter of 2021, rising by an annual 19.2 per cent in that period, following a decline of 2.6 per cent in the previous quarter. Although the third wave of the virus has peaked in South Africa, rising inflation, weaker commodity export prices and the social unrest in July could have lasting adverse effects that are likely to affect neighbouring countries, especially those within the Southern African Development Community (SADC) and Common Monetary Area (CMA).

7. Global labour market developments largely improved during August 2021 on account of loosened lockdown restrictions, vaccination efforts and attempts to return to normalcy. On price developments, positive inflation rates were reported in the US, UK, Euro Area, China, India and South Africa in August 2021, while they were negative in Japan. The monetary policy stance across advanced economies remained accommodative, with policy rates in the US, the Euro Area and the UK kept close to zero.

8. Global financial markets reflected rising volatility and mounting global risk sentiment. This came on the back of persistently high rates of COVID infections and talks of possible unwinding of stimulus in some key jurisdictions. Yields in emerging markets, especially South Africa, showed mixed signals; rising moderately on the short end while declining on the long end. Despite rising global risk appetite, expected global tapering has led to investors being net sellers of South African assets. The rand is expected to weaken in the latter quarter of the year, on the back of weak local investment expenditure, escalating debt and existing structural impediments.

9. Interest rates in the CMA countries remained accommodative between July and September 2021, with the key policy rates and prime lending rates in the region averaging 3.63 per cent and 7.49 per cent, respectively. While the Lesotho policy rate

continues to be aligned with, and on the lower end of, those of the sub-region, the prime lending rate in the month of August 2021 remained considerably higher at 8.2 per cent, which is 120 basis points above the sub-region's lowest rate, which is that of South Africa, and 70 basis points above the sub-region's second highest rate, which is that of Namibia.

10. The CBL's Composite Indicator of Economic Activity (CIEA) reflects that domestic economic activity slowed by 0.3 per cent in July, compared with a 0.6 per cent decline recorded in the preceding month. This was mainly as a result of tighter COVID-19 induced restrictions in the review period. The domestic economic recovery remains largely conditional on developments related to the trajectory of virus infections, COVID-19 containment measures and the rollout of vaccines. Continued spikes in infection rates could bode negatively for growth and general economic recovery in the short to medium term.

11. In the second quarter of 2021, domestic labour market conditions remained weak in all three sectors that are monitored by the Bank. This was primarily on account of COVID-19lockdown restrictions. The rate of inflation, as measured by the year-on-year percentage change in the consumer price index (CPI), was 5.2 per cent in August 2021, compared to 5.5 per cent in July of the same year. The largest contributors to the August inflation rate include food; electricity, gas and other fuels; and transport subcomponents.

12. The broad measure of money supply (M2) declined by 2.7 per cent between June and July 2021. The decrease was due to a contraction of 27.0 per cent in Net Foreign Assets, which was moderated by a 3.4 per cent rise in Net Domestic Assets. Private sector credit extended by banks increased by 0.5 per cent in July 2021, compared to a 0.2 per cent decline in June 2021. Loans and advances extended to business enterprises declined by 1.8 per cent in July, relative to a 4.5 per cent decline in the preceding month. Similarly, total credit granted to households rose by 1.3 per cent in July, following a rise in both personal loans and mortgages by 1.4 and 1.2 per cent in June, respectively.

13. The current account recorded a deficit equivalent to 11.3 per cent of GDP in the second quarter of 2021, relative to a surplus of 1.3 per cent of GDP in the preceding quarter. The deterioration in the current account was driven mainly by a decline in the secondary income account surplus, together with the increased deficit on the goods account. Consequently, the gross international reserves, as measured in months of import cover, fell to 4.2 months in the second quarter of 2021, compared to 4.5 months

in the previous quarter.

14. The Government budgetary operations recorded a fiscal surplus equivalent to 6.0 per cent of GDP during the second quarter of 2021, as opposed to a revised fiscal deficit of 9.3 per cent of GDP in the previous quarter.

15. In summary, although some signs of recovery are starting to emerge, global economic growth prospects remain uneven and clouded by the uncertainty surrounding the possible resurgence of the virus and emergence of new variants, and the uneven roll-out of vaccines at the country level. Domestically, any prospects for growth have to be weighed against existing uncertainties. The Committee notes gains and progress made on vaccination and encourages maintenance of the pace in order to pave way for easing of restrictions and attainment of herd immunity. Risks to the domestic economic outlook include the possible spread of COVID-19 and the effectiveness of the infection control measures, exposure to international economic developments, domestic structural rigidities and policy uncertainty.

16. 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$780 million to US$760 million. At this level, 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 per cent per annum. The rate, set at this level, will ensure that the domestic cost of funds remains aligned with the rest of the region.

17. The Committee will continue to monitor the global developments and their likely impact on domestic macroeconomic conditions, especially the net international reserves (NIR), to take corrective action when needed.

A.R. Matlanyane (PhD)
GOVERNOR

For Enquiries
Ephraim Moremoholo (Mr)
+266 22232094
emoremoholo@centralbank.org.ls