Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

January 29, 2019

1. The Central Bank of Lesotho (CBL) Monetary Policy Committee (MPC) held its 75th meeting on the 29th January 2019. In pursuit of the CBL main mandate of maintaining price stability, the Committee considered international, regional and domestic economic developments and financial markets' conditions, to determine appropriate monetary policy action.

2. Global output is projected to have grown by 3.7 per cent in 2018, compared to 3.8 per cent attained in 2017. Softer growth momentum was observed in a number of countries including Germany, Japan and Italy, amongst others, in the second half of 2018. For 2019, global growth is projected at 3.5 per cent, as weaknesses experienced in the second half of 2018 are expected to spill over into 2019. Risks to the outlook are tilted to the downside. The main risks emanate from trade tensions between the US and China, tightening global financial conditions, and the weaker outlook for some key emerging market and developing economies arising from country-specific factors.

3. Global inflationary pressures have eased as a result of the decline in the prices of international crude oil and agricultural commodities, which is explained, in part, by subdued demand from China. Consequently, policy rates were either increased or kept unchanged in the fourth quarter of 2018. In advanced economies, policy rates were hiked by the US and the UK, while they were kept unchanged in the Euro Area and Japan. In most emerging market economies, policy rates remained unchanged.

4. Economic activity in South Africa remains weak, constrained by sluggish private sector fixed investment and volatile production in key sectors. The growth outlook remains challenging with risks skewed to the downside. Aggregate demand is subdued as a result of weaker levels of consumer and business confidence, which are hampering fixed capital formation. The headline inflation decelerated to 4.5 per cent in December, from 4.9 per cent in September 2018. In consideration of the moderation in the upside risks to the inflation outlook, the key South African monetary policy rate (repurchase rate) was kept unchanged at 6.75 per cent.

5. Concerning the domestic economy, activity weakened in November relative to the previous month. As indicated by the CBL measure of economic activity, output increased at a lower rate of 0.3 per cent in November, compared with an increase of 0.7 per cent in October. This was at the back of weaker performance by the manufacturing sector. In the labour market, employment by the LNDC-assisted firms grew by 4.4 per cent on an annual basis, in the third quarter of 2018. In contrast, the number of Basotho migrant workers in the South African mining industry continued to fall.

6. Domestic inflationary pressures have eased in line with the global developments. The annual rate of inflation, measured by the change in the CPI for all items, fell to 4.9 per cent in December 2018 from 5.6 per cent in November. The main contributors to this decrease were "*housing, electricity, gas & other fuels*" and "*transport*", which fell in line with domestic prices of fuel, on the back of decreases in the international oil prices. *The "food and non-alcoholic beverages"* also moderated. The appreciation of the Loti against major currencies also contributed to the decline in inflationary pressures.

7. Broad money supply (M2) increased by 4.3 per cent in December 2018, following an increase of 7.0 per cent in September 2018. The increase in M2 resulted from a rise in net foreign assets of the banking system that outweighed the decline in domestic claims. Private sector credit continued on an upward trend, boosted by growth in credit to households, which increased by 4.0 per cent in December 2018, following an increase of 1.7 per cent in September. In contrast, credit extended to business enterprises fell by 4.1 per cent in December after an increase of 5.3 per cent in September 2018.

8. The external sector position remained healthy, with the overall balance of payments registering a surplus of 5.7 per cent of gross domestic product (GDP) in the third quarter of 2018, following that of 7.0 per cent of GDP in the second quarter. In turn, gross international reserves were 4.3 months of imports cover in September 2018.

9. Government budgetary operations were estimated to have resulted in a fiscal deficit of 6.9 per cent of GDP in November 2018, following a surplus of 4.1 per cent of GDP in September 2018. The deterioration in the fiscal position was at the back of an increase in spending that was accompanied by a decline in revenue. The deficit was financed by a reduction in government deposits and issuance of a treasury bond. Given Lesotho's fixed exchange rate system under the Common Monetary Area of Southern Africa (CMA), a healthy fiscal position is essential to support maintenance of adequate international reserves that is necessary to bolster the exchange rate parity.

10. In conclusion, the Committee noted that global growth momentum has softened, with risks tilted to the downside. In the domestic economy, activity remained weak, while inflationary pressures eased, consistent with global developments. Pressure on government budgetary operations remain a major concern for macroeconomic stability.

11. Having considered the above developments, the MPC decided to:
    1) Increase the NIR target floor from US$690 million to US$745 million.
    2) Maintain the CBL rate at 6.75 per cent per annum.

12. 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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