Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

January 26, 2021

1. Since the November 24 meeting of the Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC), the COVID-19 pandemic has continued to pose serious risks to global public health and economic growth. Progress attained in November towards a vaccine coupled with the subsequent vaccine rollouts in December in much of the developed world bodes well for growth in the medium term. However, the global economic downturn in light of the virus remains severe, especially following the discovery of new and possibly more transmittable variants in different parts of the world. A return to pre-pandemic levels of economic growth is likely to be gradual and uneven. The most recent global growth forecasts from the International Monetary Fund (IMF)[1] expect global growth to contract by 4.4 per cent in 2020 compared to an earlier projection of 4.9 per cent in June 2020. Similarly, growth in sub-Saharan Africa is expected to decline by 3.0 per cent in 2020 relative to June 2020 projection of 3.2 per cent.

2. The pandemic has started to reveal itself in waves as is being observed in Europe and the United States (US). General consensus remains that a strong global economic recovery will partly depend on the reliable availability of vaccines, speed of vaccination campaigns, attainment of widespread immunity as well as how quickly and safely countries are able to resume economic activity.

3. Global economic activity is expected to have remained in contraction territory in the last quarter of 2020, following predominantly negative third quarter growth. The slowdown in the fourth quarter of 2020 is likely to be general across developed,

[1] The IMF's October 2020 World Economic Outlook (WEO) expects global economic growth to contract by 4.4 per cent in 2020, compared to an earlier projection of 4.9 per cent in June 2020.

emerging and developing economies. However, China continues to register positive growth momentum, making it the only country among major economies to do so. This is despite unprecedented monetary and fiscal policy easing by other major economies including the US and the European Union.

4. Labour market developments show signs of slight improvement, although risks to economic outlook remain prominent and tilted to the downside, emanating mainly from the continued spread of the coronavirus, likely developments in trade and geo-political matters, and other country-specific factors. Inflationary pressures were a mixed bag in advanced economies. In the US and the Euro Area, the rate of inflation remained the same, while it declined in China and the United Kingdom. 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 is expected to present mixed outcomes. China's economic growth increased by 6.5 per cent in the fourth quarter of 2020, on account of investment spending, manufacturing output, exports and consumer spending. The January 2021 forecast of South African growth by the South African Reserve Bank (SARB) is a contraction of 7.1 per cent in 2020, relative to the 8.0 per cent forecasted decline in November 2020. Headline and core consumer price inflation averaged 3.3 per cent in 2020, respectively.

6. Global financial markets reflected mixed signs of volatility and market risk, with the risk appetite tilted to the upside. This came in light of stimulus talks in the US coupled with positive strides in rollouts of the COVID-19 vaccine. Yields in emerging markets, especially South Africa, barely changed and remained subdued on the short and long end. However, investors were net buyers of South African assets, this was despite the country's precarious debt sustainability in the face of a widening fiscal deficit. The rand is expected to remain at relatively weak levels in the short term, with high downside risks and volatility.

7. In the domestic economy, 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 preserve favourable financing conditions for all sectors, thereby supporting the

economy and safe-guarding price and financial stability during this difficult time. The measures, such as the lowering of the key policy rate by 275 basis points since March 2020, have contributed to the resilience of households and firms.

8. Domestic economic performance in November 2020, as measured by the CBL's Monthly Indicator of Economic Activity (MIEA), increased by 7.1 per cent, relative to1.7 per cent increase in October. This welcomed improvement was driven by a rebound in domestic demand and supply, albeit at levels still below those experienced prior to the pandemic. The domestic economy is projected to contract by a revised 6.6 per cent in 2020, due to the economic fallout of the COVID-19 pandemic. The output contraction is expected to be led by a prolonged period of low economic activity in the services sector as well as in the textiles and clothing, construction and mining industries. In the medium term, the economy is projected to recover gradually and grow at an average rate of 5.1 per cent over the period 2021 – 2022. The 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.

9. In the labour market, all the three sectors that are monitored by the Bank experienced a decline in employment numbers in the quarter ending September 2020. The highest drop emanated from migrant mine workers, followed by Government employment and lastly, employment in the manufacturing sector.

10. The rate of inflation, measured by year-on-year percentage change in consumer price index (CPI), registered 5.7 per cent in December 2020 relative to 5.6 per cent in November 2020. This was mainly due to an increase in Food and Non-Alcoholic Beverages as well as Alcohol and Tobacco. Headline inflation averaged 4.9 per cent in 2020. In terms of the outlook, inflation rate is projected to register 5.2 per cent and 5.4 per cent in 2021 and 2022, respectively.

11. Money supply, as measured by M2, fell by 1.7 per cent in November 2020, relative to a 5.4 per cent growth in October 2020. The decrease was due to a fall in net foreign assets, despite this having been moderated by a rise in net domestic assets. Private sector credit rose by 0.8 per cent in November 2020 compared to a decrease of 0.3 per cent in October 2020.

12. The current account balance worsened in the third quarter, on account of an increased deficit on the goods account as imports rose faster than exports. Consequently, the gross international reserves as measured in months of import cover, declined to 4.1 months from a revised 5.9 months, in the previous quarter, despite a moderate increase in official reserves.

13. Government budgetary operations registered a fiscal deficit of 5.9 per cent of GDP in November 2020, relative to a surplus of 18.9 per cent in September. Indicators point to a dwindling share of capital expenditure in total expenditure relative to recurrent spending.

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 likely developments in geo-political and trade matters. Domestically, any prospects for growth have to be weighed against existing uncertainties. 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.

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. Increase the NIR target floor from US$635million to US$670 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 funds remains aligned with the rest of 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.

A.R. Matlanyane (PhD)
GOVERNOR

Contact Person:

Ephraim Moremoholo

+266 22232094

emoremoholo@centralbank.org.ls