Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

March 30, 2021

1. The Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC) is committed to the conduct of its monetary policy in line with the maintenance of macroeconomic stability in the country. The committee held its 88th meeting on March 30, 2021. During the meeting, it considered international, regional and domestic economic developments and financial markets' conditions, with a view to determine the adequacy of monetary targets. Since the 87th MPC meeting of January 21, 2021, many countries around the world have rolled out their COVID-19 vaccination programmes and others have approved further economic recovery and support measures. However, there have been some increases in the global spread of the virus, including its new variants. As a result, some countries have resuscitated or prolonged containment measures, which slow down economic activity.

2. Global growth prospects remain weak, uneven and largely dependent on the course of the virus and country progress in vaccinations. In its January 2021 World Economic Outlook Update, the International Monetary Fund (IMF) is forecasting global growth for 2021 to be 5.5 per cent, from 5.2 per cent that was forecast in October 2020. Similarly, the sub-Saharan Africa region is expected to grow by 3.2 per cent in 2021, an upward revision of 0.1 per cent from the October 2020 forecast.

3. Global economic activity was uneven during the fourth quarter of 2020, especially among advanced and emerging market economies. In the Euro Area, real GDP contracted by 5.1 per cent in the fourth quarter, after a decline of 5.0 per cent in the third quarter. US real GDP declined at the annual rate of 2.5 per cent, compared to a 2.8 per cent decline in the third quarter. In Japan, real GDP contracted by 1.2

per cent in the fourth quarter of 2020, relative to a decline of 5.8 per cent in the third quarter. The fourth quarter real GDP in the UK contracted by 7.8 per cent annually, a slight improvement from a decline of 8.7 per cent in the third quarter of 2020. In emerging market economies, China realized an annual real GDP growth of 6.5 per cent in the fourth quarter, compared to 4.9 per cent in the third quarter. Economic activity also rebounded in India in the fourth quarter of 2020, increasing by 0.4 per cent relative to a decline of 7.3 per cent in the third quarter. In contrast, in South Africa, real GDP declined by 4.1 per cent after declining by 6.2 per cent in the preceding quarter.

4. Global labour market developments remained susceptible to downside risks, largely due to some increases in the virus infections and associated transmission control measures. On price developments, positive inflation rates were reported in the US, UK, China, India and South Africa in the fourth quarter of 2020; while *deflation* (negative inflation rates) were realized in the Euro Area and Japan. The monetary policy stance across advanced economies remained accommodative, with policy rates in the US, the Euro Area and UK kept close to zero.

5. Global financial markets reflected mixed signs of volatility and easing market risk. This came in light of further economic recovery and support measures, and strides in global rollouts of the COVID-19 vaccine. Yields in emerging markets, especially South Africa, barely changed and remained subdued on both the short and the long ends. However, investors were net buyers of South African assets, with positive risk sentiment outweighing concerns emanating from negative debt developments. The rand is expected to remain range bound, with high downside risks and volatility.

6. The CBL's Monthly Indicator of Economic Activity (MIEA) reflects that economic activity declined by 5.5. per cent in January 2021, relative to a 4.6 per cent growth in December 2020. This was mainly as the result of the reintroduction of COVID-19 induced restrictions in the review month. The domestic economy is projected to contract by a revised 6.1 per cent in 2020, due to the economic fallout of the COVID-19 pandemic. The 2020 output contraction is expected to be broad based and led by a prolonged period of low economic activity in the secondary sector. In the medium term, the economy is projected to recover gradually and grow by 4.3 per cent in 2021 and at an average rate of 5.2 per cent over the period 2022 – 2023. The recovery remains largely conditional on developments related to potentially stronger and prolonged rise in virus infections, COVID-19 containment measures and the rollout of vaccines.

7. In the last quarter of 2020, domestic labour market conditions remained weak in all the three sectors that are monitored by the Bank. This was primarily on account of COVID-19 lockdown restrictions. The rate of inflation as measured by the year-on-year percentage change in consumer price index (CPI), was 5.6 per cent in February 2021, compared to 5.4 per cent in January of the same year. The increase emanated from both food and non-food components of the CPI basket. In terms of the outlook, domestic inflation is set to accelerate to 5.2 per cent in 2021 and to an average of 5.5 per cent over the period 2022 – 2023.

8. The broad measure of money supply (M2) increased by 2.3 per cent in February 2021, from a decline of 3.3 per cent in December 2020. The increase was supported by a 24.1 per cent growth in total banking sector net domestic assets, which was moderated by a 5 per cent decline in the sector's net foreign assets. Private sector credit extended by banks fell by 0.7 per cent in February 2021, after contracting by 0.2 per cent in January 2021. Loans and advances extended to business enterprises decreased by 0.9 per cent in February 2021, compared to a 0.9 per cent growth realized in January 2021. Similarly, total credit granted to households fell by 0.6 per cent in February 2021, relative to a decline of 0.5 per cent in January 2021.

9. The deficit in the current account narrowed to 2.6 per cent of GDP in the fourth quarter of 2020, from 10.6 per cent of GDP in the third quarter. The improvement in the current account was driven mainly by the performance of the trade and income accounts. Consequently, the gross international reserves, as measured in months of import cover, rose to 4.3 months in the fourth quarter of 2021, compared to 3.9 months in the previous quarter.

10. The Government budgetary operations recorded a fiscal surplus equivalent to 11.9 per cent of GDP during the third fiscal quarter of 2020/21, as opposed to a revised fiscal deficit of 2.7 per cent of GDP in the second fiscal quarter of 2020/21. The surplus indicated relatively higher collection of tax revenue.

11. In summary, the renewed rise of COVID-19 infections across the globe has led to further downward pressure on global economic activity. This comes despite evidence of the start of vaccination programmes in most countries around the world, as well as the approval of further stimulus. 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.

12. 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:

a) Increase the NIR target floor from US$670million to US$720 million. The NIR target remains consistent with the maintenance of the exchange rate peg between the loti and the South African rand.

b) 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.

13. 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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