Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

July 27, 2021

1. The Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC) is committed toconducting monetary policy to *achieve and maintain price stability* and thus overall macroeconomic stability. The committee held its 90th meeting on July 27, 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 89th MPC meeting of May 24, 2021, there has been a general pickup in global demand. This has been accompanied by improvements in rates of vaccination and increased policy support. However, global growth prospects in the near-term remain uncertain and uneven across countries. 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.

3. The International Monetary Fund (IMF) World Economic Outlook report of April 2021 revised up the 2021 global gross domestic product (GDP) forecasts to 6 per cent, from the 5.5 per cent forecast in January 2021. Similarly, growth in the sub-Saharan African region is expected to accelerate by 3.4 per cent in 2021, an upward revision of 0.2 per cent from the January 2021 forecast. Global economic activity improved during the first quarter of 2021, although in a manner that was uneven across countries. Updates to the IMF forecasts will be released later today.

4. US real GDP increased at the annual rate of 0.4 per cent in the first quarter of 2021, following a decline of 2.4 per cent in the quarter ending December 2020. In the Euro Area, real GDP contracted by 1.8 per cent in the first quarter, after a decline of 4.9 per cent in quarter four of 2020. Japan's real GDP fell by 1.3 per cent in the first quarter of 2021, following growth of 2.8 percent in the previous quarter. The first quarter real GDP in the UK contracted by 6.1 per cent annually, a slight improvement from a decline of 7.3 per cent in the last quarter of 2020. In emerging market economies, 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. Economic growth improved in India in the first quarter of 2021, rising by 1.6 percent, compared to 0.5 percent in December 2020. Although growth in South Africa improved slightly in the first quarter of 2021, it was still negative, contracting by an annual 3.2 percent in that period, following a decline of 4.2 per cent in the previous quarter. Recent unrest and resultant economic damage in the country could have lasting adverse effects that are likely to affect neighboring countries, especially those within the Southern African Development Community (SADC) and Common Momentary Area (CMA) of Southern Africa. This comes on the back of the deep macroeconomic linkages such countries have with the South African economy.

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

6. Global financial markets reflected rising volatility and mounting global risk sentiment. This came on the back of surging cases of COVID-19 variants and talks of possible unwinding of stimulus in some key jurisdictions. Yields in emerging markets, especially South Africa, barely changed and remained subdued on the short and long end. Despite rising global risk appetite, recent lootings in KwaZulu-Natal and Gauteng, coupled with lockdowns and the spread of COVID-19 variants have led to investors being net sellers of South African assets. The rand is expected to continue to show resilience, with likely downside risks in the medium term, on the back of existing structural impediments.

7. The CBL's Composite Indicator of Economic Activity (CIEA) reflects that economic activity improved by 5.5 per cent in May, compared with the 3.3 per cent growth

recorded in the preceding month. This was mainly as a result of loosening of COVID-19 induced restrictions in the review period. The domestic economic 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. Continued spikes in infection rates could bode negatively for growth and general economic recovery in the short to medium term.

8. In the first quarter of 2021, 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 6.0 per cent in June 2021, compared to 6.9 per cent in May of the same year. The largest contributors to the June inflation rate include food; electricity, gas and other fuels; and transport subcomponents.

9. The broad measure of money supply (M2) declined by 3.3 per cent in the second quarter of 2021, relative to a 1.3 per cent decline in the first quarter. The decrease was due to a contraction of 2.1 percent in Net Foreign Assets, as well as a 4.4 per cent fall in Net Domestic Assets. Private sector credit extended by banks increased by 1.8 percent in June 2021, compared to a moderate decline of 0.1 per cent in the quarter ending March 2021. Loans and advances extended to business enterprises increased by a marginal 0.2 percent in the quarter under review, relative to a 1.1 percent growth in the preceding quarter. Similarly, total credit granted to households rose by 2.3 per cent in the quarter ending June, relative to a 0.5 per cent in the quarter ending March.

10. The current account recorded a surplus equivalent to 1.1 per cent of GDP in the first quarter of 2021, from a deficit of 1.8 per cent of GDP in the preceding 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 4.5 months in the first quarter of 2021, compared to 4.3 months in the previous quarter.

11. The Government budgetary operations recorded a fiscal deficit equivalent to 9.0 per cent of GDP during the first quarter of 2021, as opposed to a revised fiscal surplus of 12.9 per cent of GDP in the last quarter of 2020.

12. In summary, although some signs of recovery are starting to emerge, global economic growth prospects remain uneven and clouded by the uncertainty surrounding possible resurgence of the virus and emergence of new variants, and the roll-out of vaccines at the country level. 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.

13. 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$800 million to US$780 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 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.

14. 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