Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

November 22, 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 92nd meeting on November 22, 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 91st MPC Meeting of September 28, 2021, 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, resistance to vaccination and lack of uniformity in rates of country vaccinations. Further downside risks include rising inflation, weaker commodity export prices, limited policy space and possible tightening of containment measures as infections rise.

3. The International Monetary Fund (IMF) World Economic Outlook report of October 2021 forecasts 2021 global gross domestic product (GDP) to grow by 5.9 per cent. Similarly, growth in the sub-Saharan African region is expected to accelerate by 3.7 per cent in the same year. Global economic activity broadly decelerated during the third quarter of 2021.

4. US real GDP grew at a slower annual rate of 4.9 per cent in the third quarter of 2021, following an increase of 12.2 per cent in the quarter ending June 2021. Similarly, real GDP in the Euro Area expanded at the annual rate of 3.7 per cent in the quarter ending in September 2021, a weaker pace relative to 14.2 per cent in the preceding quarter. Japan's real GDP declined by 0.8 per cent in the review

period, following a growth of 7.6 per cent in the second quarter of 2021. In the UK, real GDP increased by 6.6 per cent in the third quarter of 2021, slowing down from 23.6 per cent in the previous quarter.

5. China realized an annual real GDP growth of 4.9 per cent, slowing down from 7.9 per cent in the second quarter of 2021. Although economic growth in the South African economy grew strongly in the first half of 2021, the second half of the year is expected to show mixed results. This is largely on the back of rising inflation, weaker commodity export prices and the social unrest in July. These developments could also have lasting adverse effects on neighbouring countries, especially those within the Southern African Development Community (SADC) and Common Monetary Area (CMA).

6. Global labour market developments largely improved during the third quarter of 2021 on account of eased lockdown restrictions, vaccination efforts and attempts to return to normalcy. On price developments, positive inflation rates were reported in the UK, Euro Area and South Africa in the third quarter of 2021. Conversely, the inflation rate eased in China and India while it remained unchanged in the US during the same period. 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.

7. Global financial markets reflected mixed global risk sentiment. This came on the back of persistently high rates of COVID-19 infections, talks of possible unwinding of stimulus in some key jurisdictions as well as easing international trade tensions. Yields in emerging markets, especially South Africa increased on the short and long end. Consequently, investors were net sellers of South African equity and net buyers of bonds. 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.

8. The CBL's Composite Indicator of Economic Activity (CIEA) reflects that domestic economic activity slowed by 1.1 per cent in the third quarter, compared with a 3.7 per cent increase recorded in the preceding quarter. This was mainly a result of negative growth in the manufacturing and production side of the economy, which was moderated by an improvement of the demand side. Domestic economic recovery remains largely conditional on developments related to the trajectory of virus infections, COVID-19 containment measures and the rollout of vaccines.

Possible spikes in infection rates could bode negatively for growth and general economic recovery in the short to medium term.

9. In the third quarter of 2021, domestic labour market conditions showed mixed signals, albeit largely tilted to the downside in sectors that are monitored by the Bank. This was primarily on account of COVID-19 induced supply-side disruptions and subdued demand in Lesotho's trading partners. The rate of inflation, as measured by the year-on-year percentage change in the consumer price index (CPI), was 6.2 per cent in October 2021, compared to 5.4 per cent in September of the same year. The largest contributors to the October inflation rate include food; electricity, gas and other fuels; and transport subcomponents.

10. The broad measure of money supply (M2) increased by 0.28 per cent between the second and third quarters of 2021. The increase was due to an increase of 16.3 per cent in domestic claims, which was moderated by a 1.4 per cent decline in Net Foreign Assets. Private sector credit extended by banks increased by 4.7 per cent in the third quarter of 2021, compared to a 1.8 per cent rise in the second quarter. Loans and advances extended to business enterprises increased by 7.3 per cent during the review period, relative to a 0.2 per cent growth in the preceding quarter. Similarly, total credit granted to households rose by 3.8 per cent in the third quarter, following a rise of 2.3 per cent in the quarter ending June 2021.

11. The current account recorded a deficit equivalent to 7.4 per cent of GDP in the third quarter of 2021, relative to a larger deficit of 10.2 per cent of GDP in the preceding quarter. The moderate deficit in the current account was driven mainly by a worsening of balances in the services account, primary income and secondary income accounts. Consequently, the gross international reserves, as measured in months of import cover, increased to 5.7 months in the third quarter of 2021, compared to 4.2 months in the previous quarter.

12. The Government budgetary operations remained under pressure, as expenditure grew faster than revenue during the review period. This therefore resulted in a marginal fiscal deficit.

13. In summary, although steady advances in vaccinations and strong policy support have sustained confidence and global economic recovery, prospects for global economic growth remain uneven among advanced, emerging and developing economies. The recovery is vulnerable to the uncertainty surrounding further waves of the COVID-19 virus and the emergence of new variants. This is coupled with the uneven roll-out of vaccines at the country level, upside risks to inflation due to supply chain disruptions as well as possible tightening of financial conditions. Domestically, any prospects for growth have to be weighed against existing uncertainties. The Committee notes gains and progress made on vaccination and encourages the maintenance of the pace to pave way for the 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.

14. 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. Maintain the NIR target floor at 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.

b. Increase the CBL rate from 3.50 per cent per annum to 3.75 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.

15. 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.

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