Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

31st January 2023

1. On the 31st January 2023, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho held its 99th meeting. During the meeting, the MPC considered global, regional, domestic as well as financial markets developments.

2. The Committee noted that global economic activity has been projected to slow down in 2023 as many economies continue to grapple with the cost-of-living crisis and high debt levels. In addition, the resurgence of COVID-19 in some countries and the escalating Russia-Ukraine war continue to weigh negatively on global economic recovery. According to the IMF, World Economic Outlook *Update*, the global economy is projected to slow down to 2.9 per cent in 2023.

3. Most economies showed signs of deterioration in real GDP in the third quarter of 2022. Growth was hampered by elevated inflationary pressures that weighed negatively on aggregate demand. China's economic performance improved in the third quarter, but lost momentum in the fourth quarter. The country continued to battle the effects of the ever-increasing COVID-19 infections following the lifting of a strict zero-COVID-19 policy. South Africa recorded higher than expected economic growth of 4.1 per cent, supported by increased agricultural productivity, among others. However, South Africa continues to face major headwinds due to prolonged load shedding affecting productivity in most industries.

4. Labour market conditions were broadly stable in most economies in the third quarter. The unemployment rate declined in some countries, in part, because of a fall in labour force participation. In China and the Euro Area in particular, the labour market was boosted by government financial support to companies, with the aim of retaining the workforce. For Japan, the unemployment rate fell due to further relaxation of COVID-19 restrictions.

5. On price developments, the MPC noted that inflationary pressures eased in most countries in December 2022, following the decline in oil prices. However, inflationary pressures continued to mount for the UK and Japan. Inflation in Japan rose due to higher cost of imports coupled with the prolonged weakness of the Japanese yen, whereas UK's inflation was fuelled by rising food prices. Most central banks continued to tighten their monetary

policy stance in a bid to reduce elevated inflationary pressures. In January 2023, the South African Reserve Bank raised its policy rate by 25 basis points. The softer rate hike was aligned with the cooling inflation and the need to support the economy, amidst weaker growth prospects due to power supply challenges.

6. Short-term yields rose sharply for most advanced economies because of elevated inflation pressures coupled with tight global financial conditions. In emerging markets, China's short-term yields closed lower in response to the People's Bank of China's decision to cut the required reserve ratio in a bid to stimulate the economy. Conversely, South Africa's short-term yields closed higher as the economy continued to battle with elevated inflationary pressures. Long-term yields rose for the Euro Area and the US amid fears of a recession. In the emerging market economies, long-term yields closed higher for China, while in South Africa, they were flat as investors dumped both equity and bonds in search of safe haven assets amid the on-going energy crisis.

7. Based on the composite indicator of economic activity (CIEA), the domestic economy continues to underperform on account of structural rigidities and policy uncertainty. The economic activity was estimated to have contracted by 2.0 per cent in November 2022 following a decline of 0.8 per cent in the preceding month, indicating weakened production and aggregate demand. In terms of the outlook, the economy is expected to improve, driven largely by construction projects.

8. Domestic inflation continued to moderate due to the decline in the non-food component. The inflation rate declined from 8.1 per cent in November to 8.0 per cent in December 2022. Despite the slowdown observed in recent months, inflation is expected to remain high in the medium term due to, amongst others, high food inflation and protracted supply chain disruptions.

9. Money supply fell by 0.2 per cent in the quarter ending in December 2022, compared to an increase of 5.5 per cent in the previous quarter. Credit to the private sector fell by 0.2 per cent, compared to 3.1 per cent increase in the quarter ending in September 2022. This fall was mainly attributable to credit extended to business enterprises while credit to households remained relatively unchanged.

10. The current account balance improved in the third quarter of 2022, driven by growth in exports. It registered a smaller deficit equivalent to 0.2 per cent of GDP compared to 10.8 per cent in the quarter to June 2022. Exports were boosted by textile and clothing exports to South Africa and the US, coupled with an increase in diamond exports.

11. Government budgetary operations recorded a surplus equivalent to 4.7 per cent of GDP in the fourth quarter of 2022 compared to a revised deficit of 6.0 per cent of GDP in the previous quarter. This reflected a significant decline in government expenditure against a slight increase in total revenue. The stock of public debt was estimated at 61.7 per cent of GDP, compared to a revised 62.2 per cent in the quarter ending in September 2022.

12. The level of CBL's net international reserves (NIR) improved between November 2022 and January 2023. It (the NIR) remained above the target floor of US$650 million set by the MPC in its meeting in November 2022 and adequate to support the loti-rand exchange rate peg. During the first quarter of 2023, the NIR is expected to decrease before recovering markedly in the second quarter of 2023 due to the anticipated recovery in SACU revenue.

13. In summary, economic activity continued to slow down for most economies. The global growth is expected to further weaken due to the ongoing Russia-Ukraine war and tighter global financial conditions. Inflation pressures in most economies remain high despite the slowdown observed in recent months. The domestic economy is expected to deteriorate further amid weaker global growth prospects and elevated inflation pressures.

14. Having considered the NIR developments and outlook, regional inflation and interest rate outlook, domestic economic conditions and the global economic outlook, the MPC decided to:

    i. ***Revise downwards the current NIR target floor of US$650 million to US$640 million. At this level, the NIR target will be sufficient to maintain a one-to-one exchange rate peg between the loti and the South African rand.***

    ii. ***Increase the CBL rate from 7.00 per cent per annum to 7.25 per cent per annum.***

15. The Committee will continue to closely assess the global economic developments and their impact on the domestic economy especially the Net International Reserves (NIR) and respond accordingly.

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