Central Bank of Lesotho

STATEMENT OF THE MONETARY POLICY COMMITTEE

July 28, 2020

1. Since the May 22 meeting of the Central Bank of Lesotho's (CBL's) Monetary Policy Committee (MPC), the outbreak of the coronavirus pandemic continues to devastate communities and disrupt economic activities in many countries across the globe, more especially in major and developing economies. According to the International Monetary Fund's (IMF's) June 2020 World Economic Outlook (WEO), global economic growth is expected to contract by 4.9 per cent in 2020, compared to an earlier projection of 3 per cent in April 2020. This anticipated decline in global growth will be much worse than the downturn experienced during the 2008-09 financial crisis. Similarly, growth in sub-Saharan Africa is expected to decline by 3.2 per cent in 2020. The meeting is occurring against the continuing unfolding of the COVID-19 pandemic. While Lesotho was the last country to register confirmed cases on the continent, the number of infections are rising exponentially and threatening to put pressure on the healthcare system. Sadly, fatalities have also started to pick up. Indications are that the worst of the pandemic is still ahead. There are fears the pandemic will likely come in waves over time as is being observed in other countries, in Europe and US. General consensus is that a strong global economic recovery will partly depend on how soon a vaccine for the virus can be found and made widely available and how quickly and safely countries are able to resume economic activity.

2. Global economic activity is expected to face further headwinds in the second quarter of 2020 following negative growth in the first quarter. A major drag on economic output remains the global spread of the COVID-19 pandemic and associated infection control measures undertaken by authorities around the globe.

This is despite unprecedented monetary and fiscal policy easing by countries including the US and China, as well as an easing of lockdown conditions in some countries around the world. Labour market developments show signs of further global deterioration, as risks to economic outlook remain prominent and tilted to the downside, emanating mainly from the continued spread of the coronavirus, a re-escalation of trade and geo-political tensions, and other country-specific factors.

3. Inflationary pressures largely subsided in advanced economies in the second quarter of 2020. In the US, UK, the Euro Area and Japan, the rates of inflation decreased. The monetary policy stance remained accommodative across advanced economies, with rates in the US, the Euro Area and UK kept close to the zero lower bound.

4. Economic activity in emerging market economies, including China and South Africa was a mixed bag. China's economic growth increased by 3.2 per cent in the second quarter of 2020, on account of industrial production, exports and investment spending. In South Africa, coronavirus infection control measures and low business confidence are expected to undermine growth prospects in the medium term, while risks to long-term growth are expected to emanate largely from structural challenges. The July 2020 forecast of South African headline inflation by the South African Reserve Bank (SARB) averages 3.4 per cent in 2020, with the forecast of core inflation lower, at 3.3 per cent in the same year.

5. Global financial markets reflected extreme volatility due to the COVID-19 health crisis. Yields in emerging markets, especially South Africa, have been rising on the long end and sliding on the short end. The country's increasing public debt to GDP leaned against investment inflows to moderate an otherwise improved global risk sentiment, as lockdown measures eased and economies started reopening. The expected result is a moderate strengthening of the rand, with high downside risks and volatility.

6. In the domestic economy, the CBL acted timeously to contain the effects of the COVID-19 shock and maintain macroeconomic stability. 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 support the economy. These include cutting its

policy rate from 6.25 per cent in March to 3.75 per cent in May 2020.The Bank also postponed the implementation of Basel II.5 to avoid associated rise in capital requirements, and to allow banks to strengthen their balance sheets. Commercial banks have been directed to consider relief measures, including payment holidays of up to three months, for previously performing borrowers affected by the COVID crisis. Insurance companies have been directed to offer three-month premium holidays, continue claims processing, and allow three-month delay in policy renewals. The CBL has also encouraged the use of mobile money, including negotiating fee reductions with mobile network operators and raising prudential limits on transactions.

7. Economic performance in the second quarter of 2020 has generally been weak. According to the CBL measure of economic activity, output declined by 1.2 per cent in May 2020, relative to a 1.3 per cent decrease in April. Although the decline reflected restricted domestic and international economic activity due to lockdowns, it was moderate given the partial lifting of the lockdown during the review month.

8. The domestic economy is projected to contract by 5.7 per cent in 2020, due to the economic fallout of the COVID-19 pandemic. The output contraction is expected to be led by a decline in economic activity in the textiles and clothing industry (-25.4 per cent), construction industry (-20.9 per cent) and mining industry (-27.6 per cent). In the medium-term, the economy is projected to recover gradually and grow at an average growth rate of 5.1 per cent over the period 2021 – 2022. The growth recovery is conditional on developments related to COVID-19 containment. However, the expected recovery 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. The domestic policy responses to the COVID-19 pandemic are also expected to boost the recovery.

9. In the labour market, there were mixed signals across the three sectors that are monitored by the Bank. There was an increase in employment in both government and manufacturing in the first quarter of 2020, consistent with the period before widespread global lockdowns took effect, while employment of migrant mine workers continued on a downward trajectory in the same period.

10. The rate of inflation, measured by year-on-year percentage change in consumer price index (CPI), increased from 4.0 per cent in May 2020 to 4.9 per cent in June 2020. This was mainly due to an increase in the prices of the following categories in the basket; *Food and non-alcoholic beverages, Clothing and footwear, Furnishings, Household Equipment and Routine Maintenance of the House, Recreation and culture, Education and Alcohol and Tobacco.* In terms of the outlook, the annual inflation rate is projected to register 4.2 per cent in 2020 before increasing to 4.7 per cent and 5.2 per cent in 2021 and 2022, respectively.

11. Money supply, as measured by M2, decreased by 0.9 per cent in the quarter ending June 2020, following an increase of 3.2 per cent in March 2020. The decrease was due to a fall in net domestic claims which was moderated by an increase in over net foreign assets. Private sector credit declined by 6.1 per cent in June 2020, compared to an increase of 4.5 per cent in March 2020.

12. The balance of payments position improved in the first quarter, on account of a decline in the trade account deficit together with a higher surplus in the primary and secondary income accounts. Consequently, gross international reserves rose to 4.7 months of import cover from 4.3 months in the previous quarter.

13. Government budgetary operations were estimated to have realised a fiscal deficit of 9.1 per cent of GDP in May 2020 relative to a revised surplus of 20.4 per cent of GDP in the previous month.

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 re-escalations of geo-political and trade tensions. Domestically, growth has remained subdued. Risks to the domestic economic outlook include the possible spread and the infection control measures of COVID-19, 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$530 million to US$550 million. The NIR target remains consistent with the maintenance of the exchange rate peg between the loti and the South African rand.

ii. Decrease the CBL rate from 3.75 percent per annum to 3.50 percent per annum. The rate, set at this level, will ensure that the domestic cost of borrowing and lending remain aligned with the cost of funds elsewhere in 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.

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