

**CENTRAL BANK OF LESOTHO**

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## **I. Introduction**

The fourth quarter of 2008 continued to be characterized by uncertainty about the world economy as indications of possible recession emerged strongly. Economic activity in the United States (US) further contracted by 3.8 per cent in December 2008 compared with 0.3 per cent registered in the previous quarter. The Euro-zone and the South African economies are also showing strong signs of a weakening economic activity. As expected, there are indications that the crisis is spreading through to the emerging market economies; the Chinese economy slowed down to 6.8 per cent during the quarter. A downward trend in the price of commodities, world wide, continued in the fourth quarter. In particular, the average prices of crude oil, gold and platinum declined in the fourth quarter. A similar trend was observed in the price of maize and wheat.

The economy of Lesotho, like the rest of the world showed strong indications of economic slowdown. Diamond production declined by 60.9 per cent during the quarter as the price of rough diamonds is reported to have fallen by 30.0 per cent to 50.0 per cent. Moreover, two mines reported suspension of operations during the quarter under review. In the secondary sector, electricity and water consumption fell by 2.8 per cent and 17.2 per cent, respectively on a quarterly basis. Despite the earlier resilience the secondary sector is beginning to feel the negative impact. In the tertiary sector, retail sales turnover rose by 12.2 per cent during the quarter under review, even though the communications sub-sector continued to decline.

Employment in the Lesotho National Development Corporation (LNDC)-assisted companies rose by 2.7 per cent in December 2008 mainly due to the temporary workers. However, employment in the manufacturing sector remains vulnerable to the global economic slowdown. The level of employment in the public sector continued to increase as Government intensified efforts to improve service delivery in areas of health, education and public service. The number of migrant mineworkers remained relatively unchanged. However, if sustained, the observed decline in the price of gold and platinum and other commodities that are mined in South Africa, may negatively affect the number of Basotho employed in the South African mining industry.

In line with the global developments, inflationary pressures in Lesotho seem to be abating. Inflation rate rose 10.6 per cent in December 2008 compared with 12.1 per cent in September 2008 mainly due to the slowdown in food and fuel prices. In South Africa, the South African Reserve Bank's targeted inflation measure; CPIX remained above the target band, 3 to 6 per cent, at 10.3 per cent at the end of the fourth quarter.

In the financial sector, money supply grew due to a significant increase in net foreign assets and the smaller decline in domestic credit. Interest rates movements in the region are beginning to reflect the loosening monetary policy environment in response to the global economic slowdown and the ease in inflationary pressures. The key interest rate in Lesotho, the 91-day Treasury bill rate as well as the prime lending and deposit rates reflected these developments.

Government budgetary operations are estimated to have registered a deficit equivalent to 0.8 per cent of GDP mainly due to an increase in recurrent expenditure coupled with a decline in

total revenue and grants. All components of recurrent expenditure registered some increase. The stock of public debt stock rose by 18.0 per cent during the quarter compared with 1.2 per cent in the previous quarter due to the disbursements coupled with the currency depreciation.

The external sector continued to register some surpluses, driven mainly by the continued current account surpluses that emanate from the current transfers, in particular, SACU revenue, leading to further accumulation of international reserves which stood at 8.6 months of import cover.

## **II. International Economic Developments**

### **United States (US)**

Preliminary estimates indicate that the US economy shrank during the quarter under review. The real Gross Domestic Product (GDP) contracted by 3.8 per cent in the review period compared with the revised decline of 0.5 per cent registered in the previous quarter. The fourth quarter's growth decline resulted mainly from a fall of 3.5 per cent in consumer spending, which makes up to two-thirds of the US economy. Americans had to cut back on consumption as a result of credit crunch followed by economic slowdown. The biggest decline was observed in spending on durable goods. In addition, the slump in the housing market continued and homebuilders reduced spending by 23.6 per cent. Spending by businesses on equipment and software also plunged by 27.8 per cent on quarterly basis.

The unemployment rate rose to 7.2 per cent during the quarter from 6.1 per cent in the previous quarter. The consumer price index (CPI) increased at a lower annual rate of 4.1 per cent in December 2008 compared with 4.9 per cent in September. The deceleration was mainly due to declining oil prices and the weak domestic demand, which put downward pressure on retail prices. The Federal Reserve Bank's Open Market Committee (FOMC) cut the benchmark lending rate by 175 basis points during the quarter, leaving it to close the quarter at 0.25 per cent.

The decline in the US economy is expected to have negative spill over effects on Lesotho's economy since the bulk of Lesotho's exports are destined for the US.

**Table 1: Key World Economic Indicators**

	Real GDP Growth		Inflation Rate		Key Interest Rate		Unemployment Rate	
	QIII	QIV	QIII	QIV	QIII	QIV	QIII	QIV
China	9.00	6.80	4.60	1.20	7.20	5.31	9.50	9.00
Euro Area	0.60	-1.50	3.60	1.60	4.25	2.50	7.50	8.00
India	7.60	N/A	9.00	9.70	9.00	6.50	7.20	6.80
Japan	-0.50	-4.60	2.30	0.20	0.50	0.10	4.20	4.40
South Africa	2.90	-1.80	13.10	9.50	12.00	11.50	23.20	N/A
United States	-0.50	-3.80	4.90	4.10	2.00	0.25	6.10	7.20

**Source:** Bloomberg, The Economist, STATSSA and SARB

### **Euro-zone<sup>1</sup>**

The Euro-area also realised economic contraction in the fourth quarter. Its real GDP fell by 1.5 per cent following an increase of 0.6 per cent in the previous quarter. Growth declines were recorded across the region and of the four biggest economies in the region, Germany shrank the most at 2.1 per cent followed by Italy at 1.8 percent, the French economy fell by 1.2 per cent and Spain by 1.0 per cent. The weak industrial production in the Euro-zone contributed to the economic contraction as it fell further by monthly rates of 1.2 and 1.6 per cent in October and November, respectively following a fall of 1.8 per cent in September.

The harmonised unemployment rate in the Euro-zone increased marginally from 7.5 per cent in September to 8.0 per cent in December. Inflation, as measured by changes in the Harmonised Index of Consumer Prices (HICP), decelerated from 3.6 per cent in September to 1.6 per cent in the last month of the fourth quarter. At this level, the inflation rate is below the target rate of 2.0 per cent as determined by the European Central Bank (ECB). Thus the ECB reduced its benchmark lending rate from 4.75 per cent in the last quarter to close the review quarter at 2.0 per cent.

<sup>1</sup> Euro-zone: Austria, Belgium, Cyprus, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia and Spain. (Cyprus and Malta joined on the 1<sup>st</sup> January 2008).

## **South Africa (SA)**

SA's economy showed signs of deterioration during the quarter under review. The seasonally adjusted real GDP declined at an annualised rate of 1.8 per cent compared with an increase of 2.9 per cent in the third quarter mainly as a result of growth contractions of 3.5 and 0.1 per cent in "manufacturing" and "electricity, gas and water" industries, respectively.

Inflation as measured by the consumer price index excluding interest on mortgage bonds (CPIX), declined in December 2008 but still remained above the targeted range of 3 to 6 per cent. The CPIX increased at a lower rate of 10.3 per cent in December compared with 13.1 per cent in September. The main drivers of this deceleration were the decline in the price of petrol and the lower increase in food inflation. In the light of the deteriorating economic performance and signs of abating inflation, the South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) reduced the repo rate to 11.5 per cent at the end of the review quarter from 12.0 per cent at the end of the previous quarter.

Due to close trade links between Lesotho and SA, economic developments in SA impact directly on Lesotho's economy. The contraction in economic growth could imply lower demand for imports from Lesotho and the weak performance in the mining industry could negatively affect the number of Basotho migrant mineworkers in the SA mines.

## **Asian Emerging Markets and Japan**

### **China**

Preliminary estimates indicate that GDP growth in the world's fourth-largest economy decelerated to 6.8 per cent in the final quarter of the year compared with 9.0 per cent in the third quarter of 2008. The deceleration was a result of a slowdown in investment, which is attributable to lack of credit arising from the financial crisis. Another culprit is the fall in the demand for China's exports, which has led to the closure of a number of Chinese factories and a decline in employment.

The rate of inflation fell below the People's Bank of China (PBC)'s target of 3.0 per cent to 1.2 per cent in the review period from 4.6 per cent in September 2008, mainly on account of the decline in fuel and food prices. The PBC lowered the one-year benchmark lending rate by 189 basis points to close the fourth quarter at 5.3 per cent compared with 7.2 per cent in the third quarter.

Developments in the Chinese economy may have implications for Lesotho. The deceleration in China's inflation may have a positive impact for Lesotho's economy, since Lesotho imports most of the manufacturing sector's inputs from China.

### **Japan**

Japan's economy registered a negative growth rate of 4.6 per cent in the fourth quarter of 2008 following 0.5 per cent in the previous quarter mainly due to a decline in exports and domestic consumption. The weak economic performance was also reflected by the leading indicators of economic growth. Industrial production, declined by 9.6 per cent in November as



manufacturers reduced production to cope with slowing world demand. Household spending also fell at a monthly rate of 4.6 per cent in December. These developments may be viewed as an indication that economic growth in Japan decelerated during the quarter under review.

The Japanese unemployment rate worsened to 4.4 per cent in December compared with 4.2 per cent at the end of the previous quarter. The core CPI, which excludes prices of fruits, vegetables and fish, increased by an annual rate of 0.2 per cent in December compared with an increase of 2.3 per cent in September. The slowdown in inflation led the Bank of Japan (BOJ) to cut its key interest rate down to 0.1 per cent during the quarter from 0.5 per cent in the last quarter.

## **India**

India's economy exhibited mixed signals during the review quarter. Industrial production in India registered a monthly decline of 0.4 per cent in October followed by an increase of 2.4 per cent in November. This compared with a rise of 4.8 per cent in September 2008. The November increase emanated from the stronger performance of the mining, manufacturing and electricity sectors, which grew at respective rates of 0.5, 2.4 and 3.1 per cent.

The rate of inflation was 9.7 per cent in December compared with 9.0 per cent in August. Consequently, the Reserve Bank of India (RBI) reduced its repurchase rate by 250 basis points during the quarter. Thus it closed the quarter at 6.5 per cent.

## **Commodity Prices**

### **Overview**

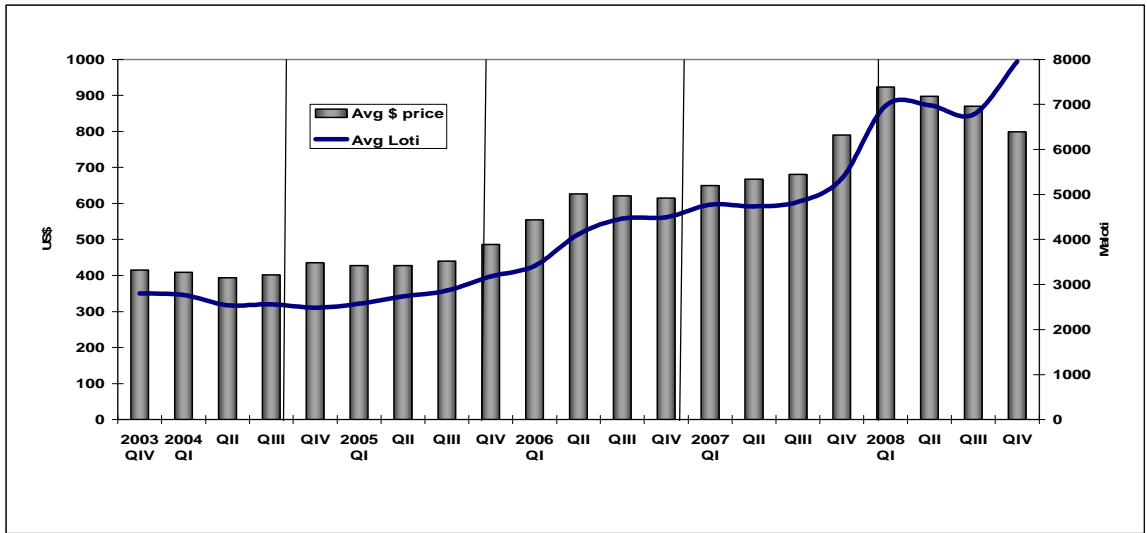
The prices of minerals and agricultural products continued to decline during the quarter under review. This fall in prices is in line with the global economic downturn and its accompanying decline in demand. All the prices fell, both in US\$ and rand terms, except the price of gold, which rose in rand terms as the effect of the depreciation of the rand against the US\$ dollar offset that of the decline in global demand and other factors that led to the fall in the US\$ price.

### **Mineral Products**

#### **Gold**

The average price of gold fell from US\$869.78 per ounce in the previous quarter to US\$ 828.78 an ounce in the fourth quarter. In Rand terms, the average price of gold increased by 21.9 per cent from R6 771.24 per ounce in the last quarter to R8 254.65 due to the depreciation of the Rand against the US\$ during the quarter.

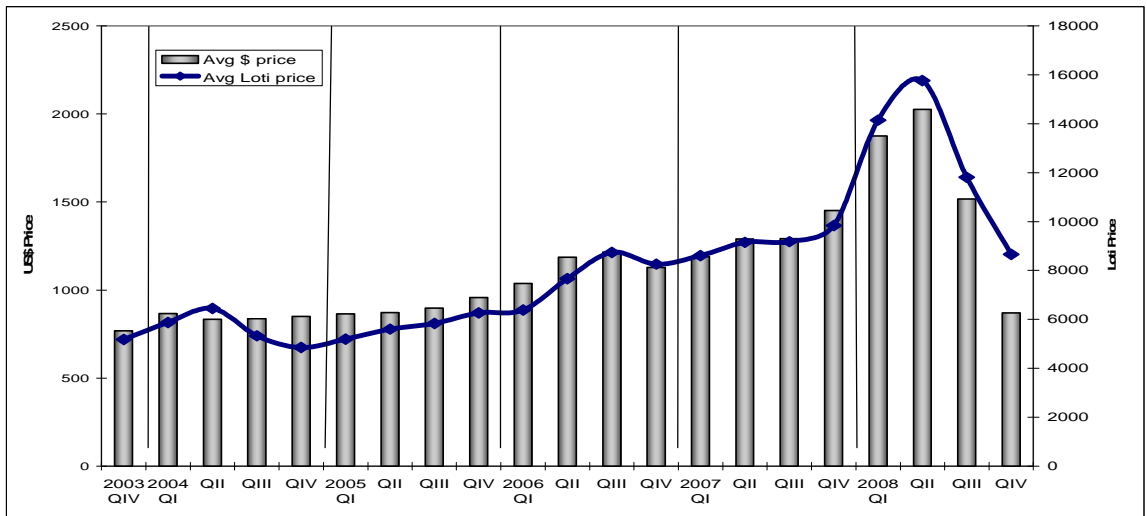
**Figure 1: Average Price of Gold**



**Platinum**

The average price of platinum decreased from US\$1 516.96 per ounce in the previous quarter to US\$869.70 per ounce in the fourth quarter of 2008. In Rand terms, the average price of platinum fell by 26.7 per cent from R11 817.12 per ounce in the previous quarter to R8 662.21 per ounce during the review quarter. As the demand for and hence the production of new vehicles deteriorated along with the global demand, the demand for platinum, which is used in the production of catalytic converters that control emissions from vehicles, fell and dragged its price along.

**Figure 2: Average Price of Platinum**



The fall in the prices of gold and platinum does not bode well for the SA mining sector and employment prospects for Lesotho’s migrant mine workers. This could result in a decline in the profitability of SA mining companies and have spill-over effects on migrant mineworkers’ remittances to Lesotho.

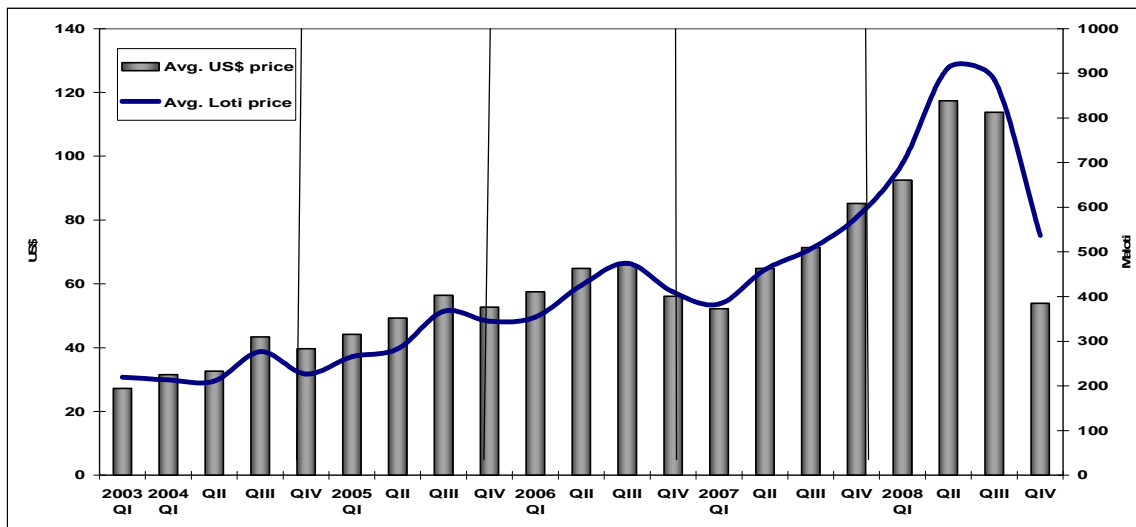
## Oil

During the quarter under review, the average price of crude oil recorded a significant decrease of 52.3 per cent, from US\$113.77 per barrel in the third quarter to US\$53.90 per barrel. The current global economic slowdown is contributing to the recent decline in oil demand.

In Maloti terms, the price fell by 39.4 per cent, from M886.27 per barrel in the previous quarter to M536.84 per barrel. It is expected that this fall in the price of crude oil, in both US Dollar and Rand terms, will help reduce inflationary pressure in Lesotho.

Due to the developments in the international oil prices, there were three downward revisions of fuel prices in Lesotho during the review quarter. The pump price of petrol in Lesotho closed the review quarter lower at M6.55 per litre. The price of diesel and illuminating paraffin also closed the quarter lower at M8.75 per litre and M6.20 per litre, respectively. These compare with M9.25 per litre of petrol, M10.70 per litre of diesel and M9.70 per litre of illuminating paraffin at the end of the quarter ending September 2008.

**Figure 3: Average Price of Oil**

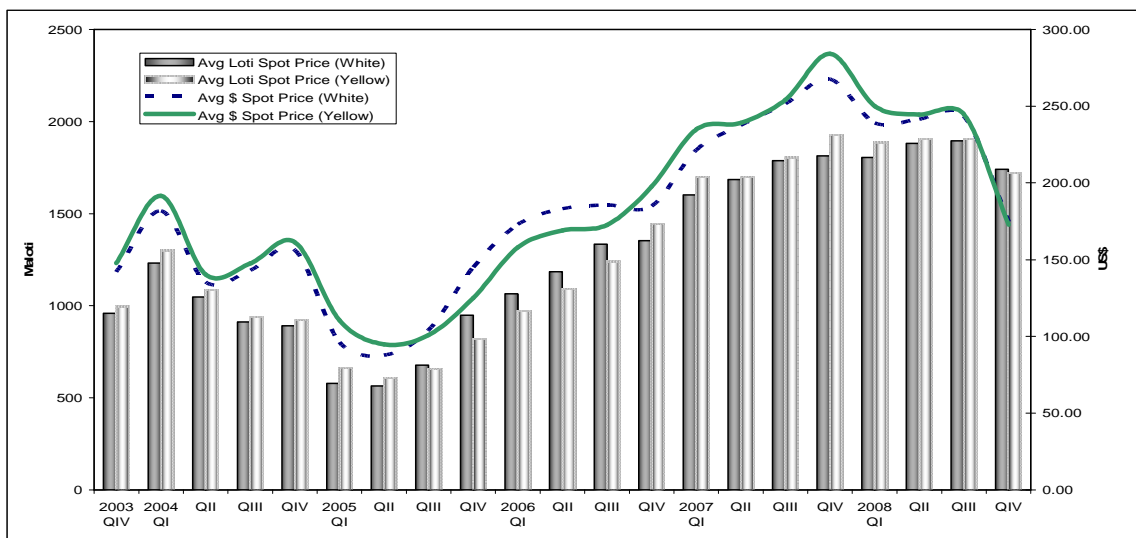


## Agricultural Products

### Maize

The average prices of both white and yellow maize declined during the quarter under review. The average spot price of the former fell from US\$243.48 per tonne to US\$174.78, while that of yellow maize declined from US\$244.65 in the previous quarter to US\$172.81 per tonne in the review quarter. In Maloti terms, these translate into a decrease from M1 895.48 per tonne to M1 740.84 per tonne for white maize and from M1 904.57 per tonne in the previous quarter to M1 721.22 per tonne during the quarter under review for yellow maize.

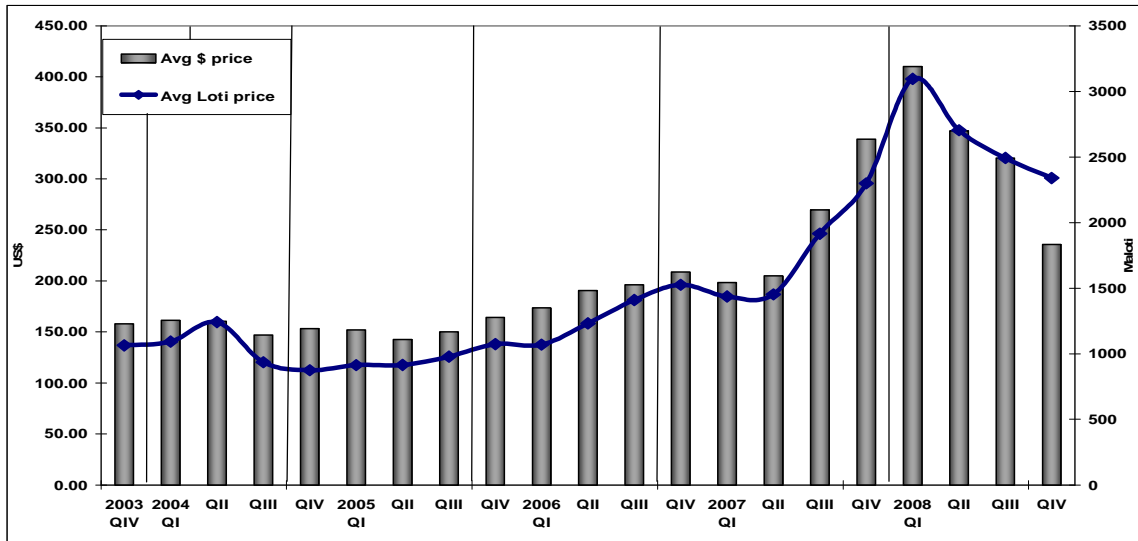
**Figure 4: Average Spot Prices of Maize**



### Wheat

The quarterly average spot price of wheat decreased by 26.8 per cent from US\$320.49 per tonne registered in the third quarter to US\$234.62 recorded during the quarter under review. In Maloti terms, the average spot price of wheat decreased from M2 492.94 per tonne in the last quarter to M2 346.78 per tonne in the quarter under review.

**Figure 5: Average Spot Prices of Wheat**



### III. Real Sector, Employment and Price Developments

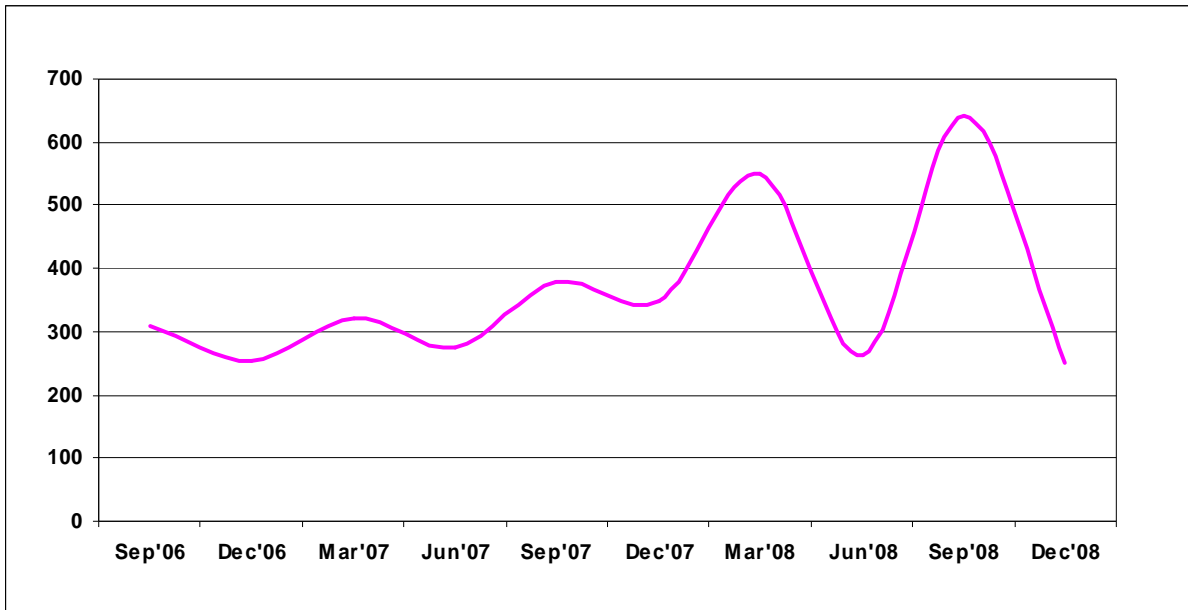
#### Overview

Overall, the real sector of the economy shows weakening economic performance mainly due to the global economic slow down. The impact is visible in mining, manufacturing and water and electricity sub sectors.

#### Primary Sector Developments

The diamond production index declined from 641.0 points in September to 250.8 points for the period ending in December mainly driven by the weak demand for diamonds in the face of the global economic slow down. It is reported that the price of rough diamonds have declined by 30 per cent to 50 per cent. This has led to the suspension of operations in Lihobong Mining Development Company (Pty) Ltd in Lesotho.

**Figure 6: Diamond Production Index**  
(2005: QI=100)



Source: Department of Mines and Geology

## Secondary Sector Developments

### Electricity Consumption

Electricity consumption is estimated to have decreased by 2.8 per cent on a quarterly basis, with the fall observed mainly in 'domestic' and 'commercial and industrial' categories, which is in line with the fall in exports and water consumption due to firms cutting production costs in the face of slowdown in the global economy.

**Table 2: Electricity Consumption**  
(Million Maloti)

	2008							
	QI		QII		QIII		QIV	
	Kwh	Value	Kwh	value	Kwh	value	Kwh <sup>+</sup>	Value <sup>+</sup>
<b>General Purpose</b>	21.63	14.30	20.08	13.19	29.12	16.34	29.84	16.76
<b>Domestic</b>	36.57	17.23	40.85	23.18	41.17	24.90	40.00	26.27
<b>Commercial &amp; Industrial</b>	62.83	3.58*	78.17	34.88	80.93	35.88	77.09	35.75
<b>Total</b>	121.03	35.10	139.10	71.25	151.22	77.12	146.92	78.79

**Source:** Lesotho Electricity Authority and Lesotho Electricity Company

\*Does not include maximum demand charge

+ Preliminary

### **Water Consumption**

Consumption of water declined by a seasonally adjusted 17.2 per cent in December 2008 compared with 11.0 per cent in September 2008 mainly due to the slowdown of activities in the wet industries which include the textile and clothing sub-sector. This decline is consistent with the 'industrial' category that slowed down by 20.1 per cent on a quarterly basis and 4.3 per cent on an annual basis.

**Table 3 : Water Consumption**

(Units in Million kilo-litres; value in Million Maloti)

		<b>Domestic</b>	<b>Industrial</b>	<b>Other</b>	<b>Total</b>
<b>2007</b>	<b>IV</b>				
	Units	0.91	1.29	0.78	2.98
	Value	3.65	6.34	2.77	12.76
	Units*		1.16		2.69
<b>2008</b>	<b>I</b>				
	Units	0.87	1.18	0.52	2.56
	Value	3.65	5.83	2.58	12.06
	Units*		1.40		2.99
<b>II</b>	Units	0.95	1.46	0.62	3.03
	Value	4.38	8.15	3.77	16.30
	Units*		1.48		3.08
<b>III</b>	Units	0.87	1.46	0.55	2.88
	Value	5.67	8.67	3.77	17.53
	Units*		1.39		2.74
<b>IV</b>	Units	0.76	1.23	0.53	2.52
	Value	4.97	8.03	4.22	17.22
	Units*				2.27

**Source:** Water and Sewerage Authority

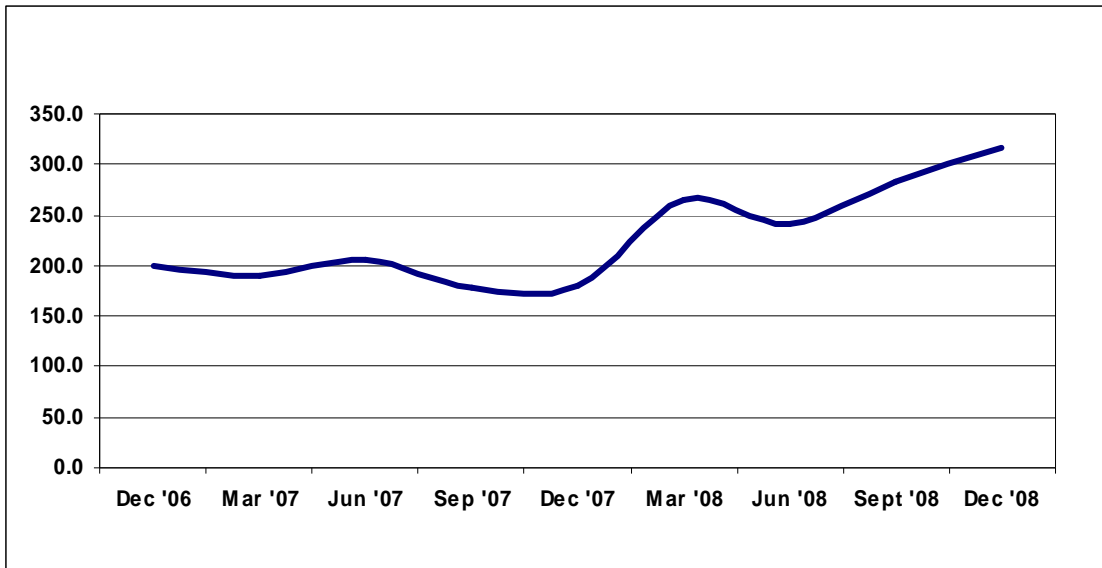
\*denotes seasonally adjusted figures

**Tertiary Sector Developments****Sales Turnover**

The value of sales turnover increased by 12.2 per cent and 78.8 per cent on a quarterly basis and annual basis, respectively. The quarterly rise indicates higher consumer demand despite high interest rates. It is expected that retail sales will soon reflect the general slow down in the rest of the economy.



**Figure 7: Value of Sales Turnover**  
(Million Maloti)



Source: Lesotho Revenue Authority

### Telephone Statistics

The total number of telephone calls decreased by 13.3 per cent and 59.6 per cent on a quarterly basis and annual basis, respectively. The telecommunications sub-sector is expected to remain strong due to the innovations that are being carried out, but the decline in incomes may squeeze its profitability.

**Table 4: Telephone Traffic Statistics**

		<b>SA Outgoing Calls</b>	<b>International Calls</b>	<b>Total Calls</b>	
<b>2007</b>	<b>IV</b>	No. of calls (millions)	5.07	0.22	5.29
		No. of calls*			5.34
		Total Duration (million minutes)	5.65	0.8	6.45
		Nominal Value (million maloti)	12.99	6.17	19.16
<b>2008</b>	<b>I</b>	No. of calls (millions)	4.97	0.21	5.18
		No. of calls*			5.51
		Total Duration (million minutes)	5.73	0.75	6.48
		Nominal Value (million maloti)	13.19	6.09	19.28
	<b>II</b>	No. of calls (millions)	4.76	0.2	4.96
		No. of calls*			5.6
		Total Duration (million minutes)	5.74	0.68	6.41
		Nominal Value (million maloti)	13.19	5.411	18.61
	<b>III</b>	No. of calls (millions)	2.58	0.17	2.75
		No. of calls*			2.49
		Total Duration (million minutes)	4.15	0.57	4.72
		Nominal Value (million maloti)	9.54	4.49	14.03
	<b>IV</b>	No. of calls (millions)	2.02	0.12	2.14
		No. of calls*			2.16
		Total Duration (million minutes)	3.41	0.39	3.8
		Nominal Value (million maloti)	7.85	2.69	10.54

**Source:** Tele-Com Lesotho and Vodacom Lesotho

\* Adjusted for seasonality.

## Investment Expenditure

### Imported Motor Vehicles

The number of imported motor vehicles decreased by a seasonally adjusted 33.1 per cent on a quarterly basis and increased by 41.4 per cent on an annual basis. The downturn on quarterly basis was mainly in the 'cars' and 'vans' categories.

**Table 5: Motor Vehicle Imports<sup>+</sup>**  
(Value in Million Maloti)

		Cars	Vans	Trucks	Buses	Tractors	M/Cycles	Trailers	Total
<b>2007</b>									
<b>IV</b>	Value	20.63	32.83	2.97	7.58	0.41	0.05	0.90	65.38
	Units*								576.95
	Units	230	224	13	24	9	2	13	515
<b>2008</b>									
<b>I</b>	Value	15.02	51.60	8.85	5.05	1.04	0.01	0.62	82.19
	Units*								428.95
	Units	206	306	16	18	3	1	6	556
<b>II</b>	Value	39.02	66.21	17.78	14.46	0.95	0.09	0.58	139.68
	Units*								787.90
	Units	373	404	46	46	6	2	8	885
<b>III</b>	Value	37.96	138.49	18.34	25.57	1.57	0.11	1.065	223.11
	Units*								1220.4
	Units	455	736	34	75	17	4	20	1341
<b>IV</b>	Value	27.44	56.16	18.92	15.60	0.92	1.44	1.16	243.30
	Units*								816
	Units	269	314	32	68	13	16	9	729

**Source:** Avis Fleet Services Lesotho and Customs Department

\*denotes seasonally adjusted figures

+Includes imports of second hand cars

## Employment Developments

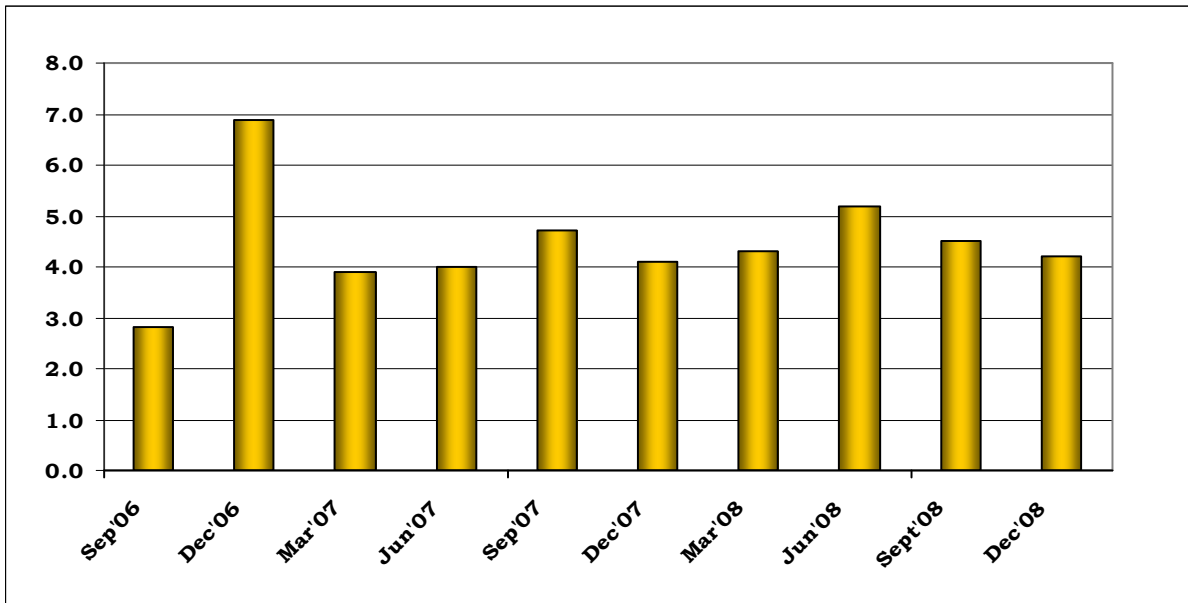
Employment of LNDC-assisted companies declined by 2.9 per cent on a quarterly basis from 48 621 to 47 204 employees while on an annual basis it increased by 1.2 per cent. The decline was mainly attributable to economic downturn in the United States (US) which affected manufacturing sub-sector employment. The sub-sector employs about 50 per cent of the total employment figure in Lesotho. As such, any negative developments in the sub-sector have serious consequences for the economy of Lesotho. It is expected that employment of LNDC-assisted companies would remain under pressure for the rest of 2009 on account of global economic slowdown, particularly US recession.

**Table 5: Employment Trend of LNDC-Assisted Companies**

Period	QI	QII	QIII	QIV
2008	45650	45549	48621	47204
2007	47731	49392	46772	46633
2006	40459	45140	46189	47462
2005	41985	40111	39597	43131
2004	52532	53525	52922	50607
2003	43525	46960	49862	51187
2002	36906	39255	42011	43773

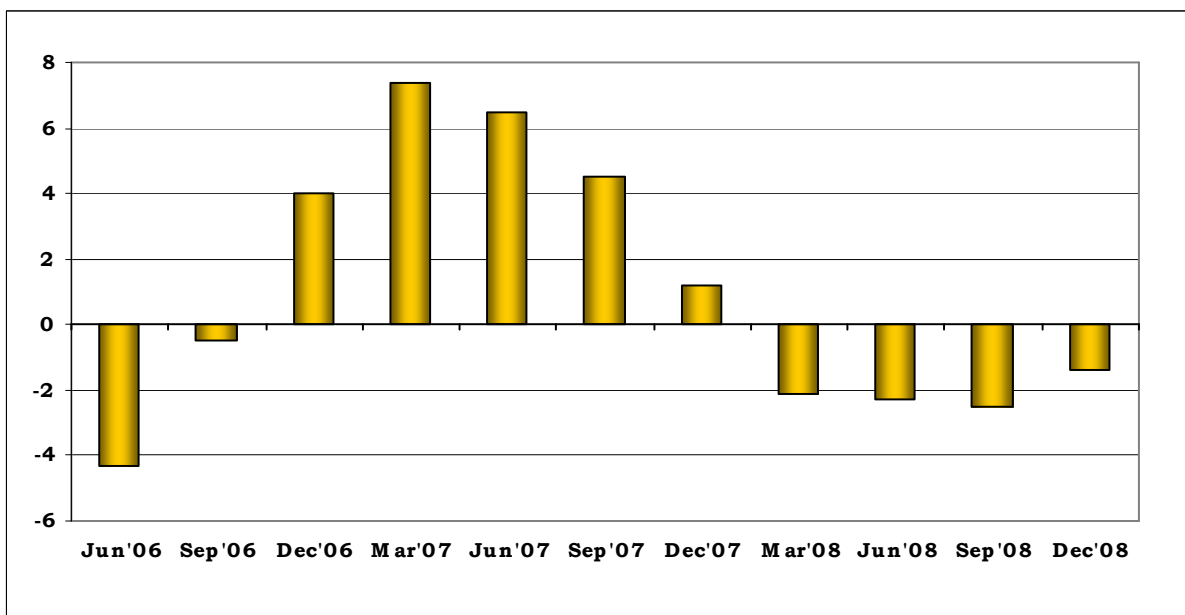
**Source:** Lesotho National Development Corporation

**Figure 8: Government Employment**  
(Annual Percentage Change)



The number of government employees rose by 1.06 per cent on a quarterly and 4.2 per cent on annual basis. This increase is attributable to government's effort to employ more teachers in line with free education initiative. There was also an increase in employment in the general civil service.

**Figure 9: Migrant Mineworkers Employment**  
(Annual Percentage Change)



The number of migrant mineworkers remained largely unchanged on a quarterly basis at 52 710 employees. However, the number declined from 53 467 to 52 710 on an annual basis, equivalent to 1.4 per cent driven mainly by the decline in the prices of gold and platinum, as a result of global economic downturn during the review period. There are reports that if the decline in the price of gold is sustained, mines in South Africa may begin to cut jobs significantly.

### **Price Developments**

The rate of inflation registered 10.6 per cent for the quarter ending December 2008. This is lower than the 12.1 per cent recorded for the quarter ending September 2008. The decrease was driven mainly by the following categories: “food and non-alcoholic beverages’ at 14.3 per cent compared with 16.5 per cent recorded in the previous quarter, “housing, electricity, gas and other fuels” at 16.5 per cent compared with 19.7 per cent registered in the previous quarter and “transport” at 11.4 per cent compared with 14.3 per cent in the previous quarter. The Lesotho’s inflation rate was higher than the South African CPIX which registered 10.3 per cent in the review period. It is, however, notable from Figure 8 that the inflation rate in both South Africa and Lesotho has started declining as prices of oil and food fall.

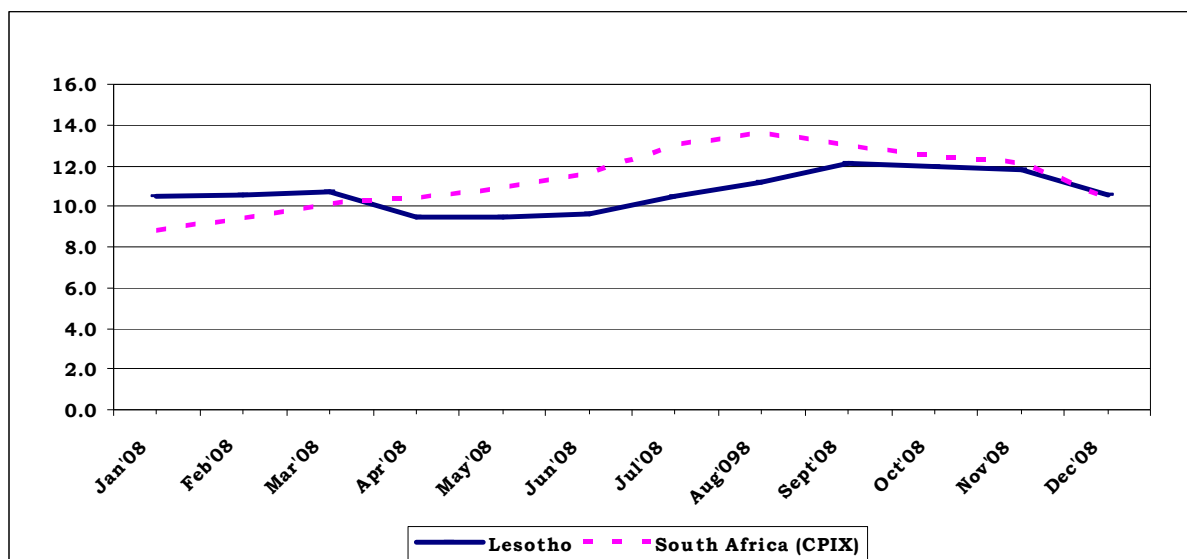
**Table 6: Inflation Rate**

(Annualised Percentage Change: April 1997=100)

	Weight	2008				
		Aug	Sept	Oct	Nov	Dec
All items	100.0	11.2	12.1	12.0	11.8	10.6
Food and non-alcoholic beverages	39.8	15.1	16.5	16.3	15.7	14.3
Alcoholic beverages & Tobacco	6.4	4.7	5.6	5.8	5.8	5.5
Clothing & footwear	15.6	7.4	7.3	6.5	6.7	5.8
Housing, electricity gas & other fuels	3.7	20.3	19.7	19.4	17.8	16.5
Furniture, households equipment & routine maintenance of house	17.0	4.7	5.5	5.6	6.2	6.2
Health	1.4	1.8	2.3	1.8	1.8	1.9
Transport	7.8	14.0	14.3	15.3	14.9	11.4
Communication	0.1	0.0	0.0	0.0	0.0	0.0
Leisure, entertainment & Culture	1.2	3.6	4.0	4.9	5.1	7.6
Education	3.2	2.6	2.8	2.9	2.8	2.9
Restaurant & Hotels	0.4	8.5	9.4	11.0	11.7	11.5
Miscellaneous goods & services	3.2	6.4	7.3	7.1	8.5	8.3

**Source:** Bureau of Statistics, Lesotho

**Figure 10: Annual Inflation Rate for Urban Households**  
(Percent)



#### IV. Monetary and Financial Developments

##### Determinants of Money Supply

The broad measure of money supply grew by 11.5 per cent in the quarter under review following a decline of 7.8 per cent in the previous quarter. It increased by 19.7 per cent on annual basis, up from a growth of 16.3 per cent in September 2008. This led to acceleration in real money supply from a 3.8 per cent growth in the third quarter to a 9.1 per cent increase in December, partially due to a slowdown in inflation between periods.

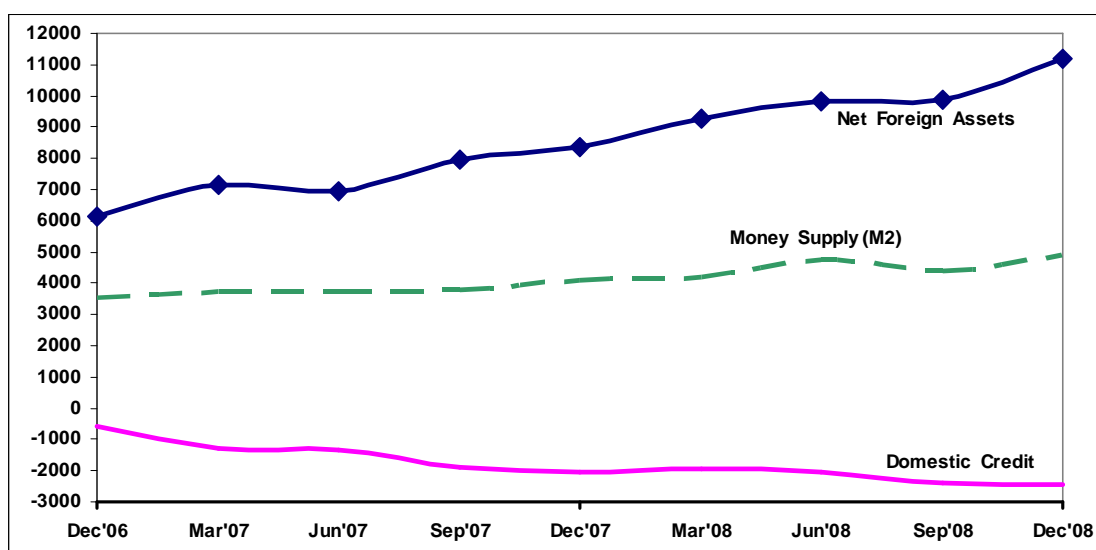
The growth in nominal money supply is not expected to generate inflationary pressures, as it is in line with transactions demand for money as estimated by the growth in nominal GDP. Growth in nominal GDP is estimated at 14.5 per cent for 2008.

The year-on-year growth in money supply could be attributed to a combination of two factors: stronger increase in net foreign asset of the banking sector, and a smaller decline in net domestic assets (see Figure 11). Growth in net foreign assets was higher in December at 33.6 per cent year-on-year compared with 24.8 per cent in September. Domestic credit declined by a lower 19.4 per cent on annual basis as a result of a slowdown in credit to the private sector and statutory bodies.



**Figure 11: Overview of Recent Monetary Developments**

(Million Maloti: End of Period)



**Table 7: Determinants of Money Supply**

(Million Maloti: Changes)

Determinants	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Net foreign assets	438.1	895.5	526.2	70.3	1281.1
Domestic credit	-161.7	137.3	-126.3	-345.5	-60.4
Net Claims on Govt	-224.2	50.6	-257.4	-408.0	-33.5
Statutory bodies	3.2	-1.3	-2.4	-3.5	-0.4
Private sector	55.5	79.6	159.6	66.0	-26.5
Other items, net	-38.5	935.2	-171.4	94.2	718.3
Money Supply (M2)	313.0	97.5	571.3	-369.3	502.4

### Components of Money Supply

The growth in money supply was reflected by a jump in narrow money, which increased by 15.7 per cent in the quarter under review. This was a recovery following a decline of 10.9 per cent in the third quarter of 2008. Two components of narrow money showed an increase in the fourth quarter: demand deposit and currency in circulation at 18.6 and 6.8 per cent,

respectively. The third component, deposits of statutory bodies held with the Central Bank, declined by 15.7 per cent during the same period.

Quasi money fell by 2.4 per cent in December 2008, following an increase of 4.4 per cent in the preceding quarter. As Table 9 below indicates, both components of quasi money, savings deposits and time deposits, contracted during the period under review.

**Table 8: Money Supply**  
(Million Maloti; End of Period)

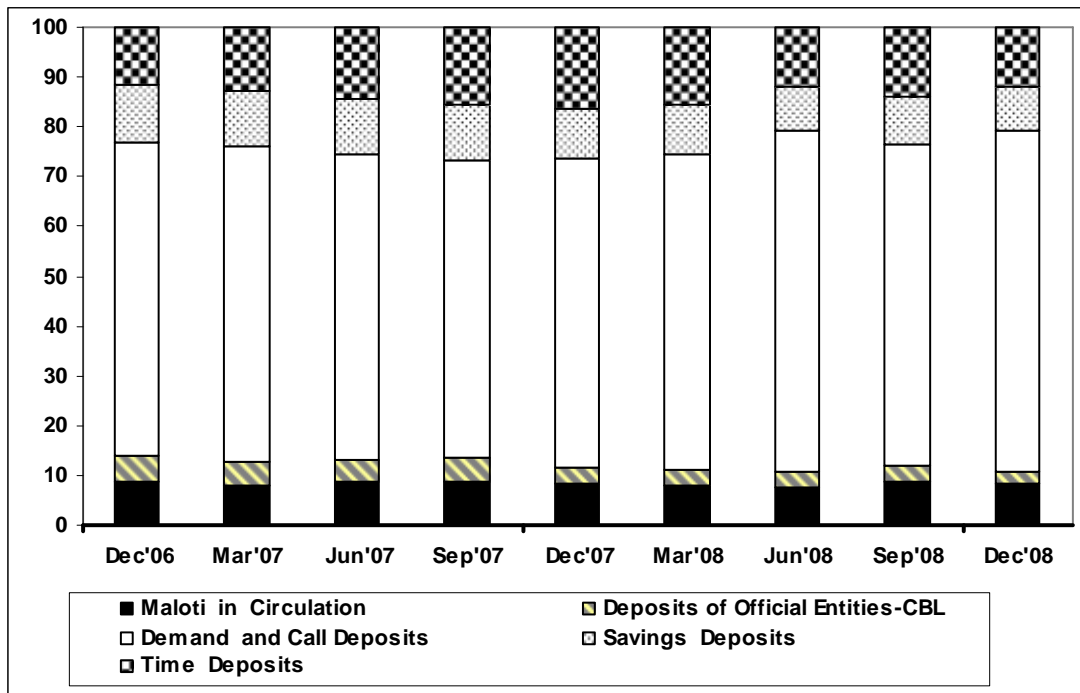
	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Money Supply (M2)	4079.1	4176.5	4747.9	4378.6	4881.0
Money (M1)	2988.3	3112.6	3760.4	3347.8	3874.8
Maloti with public Demand deposits <sup>1</sup>	399.3	331.0	368.9	379.6	402.1
Deposits of official Entities with CBL	2508.6	2640.5	3248.6	2817.9	3346.1
	140.4	141.1	142.9	150.3	126.7
Quasi-Money	1090.8	1063.9	987.5	1030.7	1006.2
Savings deposits	404.0	411.4			
			427.9	424.4	423.1
Time deposits	686.8	652.5	559.7	606.3	583.1

<sup>1</sup> includes call deposits

NB: Totals may not tally due to rounding off

Demand deposits accounted for the largest portion of broad money in December 2008, and its share improved from 64.5 per cent in September 2008 to 68.6 per cent at the end of the fourth quarter (see Figure 12). Time deposits took the second largest share, though its share fell from 13.8 per cent in the third quarter to 11.9 per cent in December due to the 3.8 per cent decline during the period. Savings deposits and deposits of official entities with the Central Bank experienced a decline in their share to broad money, while the share of Maloti with public remained steady at around 8 per cent

**Figure 12: Components of Money Supply**  
(Percentage shares)



### Commercial Banks' Deposits by Holder

Deposits of the private sector and statutory bodies held by commercial banks increased by 12.9 per cent in the quarter to December 2008. This followed a decline of 9.2 per cent in the three months ended September 2008. The growth emanated from a rise in deposits of the private sector, especially demand deposits which increased by 40.9 per cent in the review period. Conversely, savings and time deposits decreased by 0.3 and 5.0 per cent respectively. Statutory bodies withdrew from their deposits in the fourth quarter, leading to a fall of 52.5 per cent. This followed a decline of 5.3 per cent in the previous quarter.

**Table 9: Commercial Banks' Deposits by Holder**

(Million Maloti: End of Period)

	2007	2008			
	Dec	Mar	Jun	Sep	Dec
<b>Total Deposits</b>	3662.7	3693.7	4225.2	3836.4	4340.8
<b>Private Sector</b>	2930.6	3117.7	3462.0	3113.9	3997.4
Demand deposits	1968.8	2186.3	2602.6	2220.0	3128.2
Savings deposits	403.9	411.1	427.7	424.3	423.0
Time deposits	557.9	519.8	431.7	469.6	446.2
<b>Statutory Bodies</b>	732.1	576.2	763.2	722.5	343.5

NB: Totals may not tally due to rounding off

**Liquidity of Commercial Banks**

Liquidity ratio, a measure of commercial banks' readiness to honour withdrawals of deposits, improved to 73.1 per cent in December 2008 from 70.2 per cent in September 2008. Lesotho's liquidity ratio has traditionally been high due to relatively low extension of credit. The private sector accesses low levels of credit relative to their deposits as a result of the alleged culture of non-repayment of loans and a deficiency of bankable projects. The latter is partly influenced by weak property rights, lack of credit worthiness indicators such as credit information registry, and non-permanent personal identification due to the use of passports. The structural impediments are being addressed under a programme supported by the Millennium Challenge Account of the US government.

The rise in the liquidity ratio was driven by an increase in liquid assets such as balances with foreign banks, which was stronger than the effect of growth in deposit liabilities. As Table 11 below shows, the increase in placements with foreign banks overshadowed decreases in other components of liquidity such as Maloti cash held, securities and placements with local banks including the Central Bank.

**Table 10: Components of Commercial Banks' Liquidity**  
(Million Maloti: End of Period)

COMPONENT	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Maloti Notes and Coins	62.9	55.8	43.8	59.1	79.2
Rand Notes and Coins	45.0	36.4	27.3	37.4	56.4
Balances due from Lesotho Banks	511.4	690.1	843.5	828.2	775.0
Balances due from Foreign Banks	2261.5	1719.1	2205.0	1687.1	2547.3
Clearing Balances with CBL	-3.0	2.3	103.1	269.6	75.2
CBL Bills	0.0	0.0	0.0	0.0	0.0
Lesotho Government Securities	483.6	452.0	476.84	471.4	404.2

The credit to deposit ratio declined from 39.4 per cent in the third quarter to 34.1 per cent in the last quarter of the year. The fall was influenced by a 13.1 per cent increase in deposits of the private sector and statutory bodies, and a 2.0 per decline in their credit. The ratio indicates that commercial banks have a lot of scope, in terms of the level of their deposits, for extending credit to the public. It is expected that credit extension will grow in the next five years after the structural impediments are removed.

**Table 11: Consolidated Balance Sheet of Commercial Banks**

(Million Maloti: End of Period)

	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Net foreign assets	2185.8	2371.4	2792.5	2162.8	2921.1
Deposits with CBL	132.8	32.0	103.1	269.6	75.2
Credit:	1797.8	1825.5	2001.3	2057.9	1934.8
Statutory Bodies	51.5	50.1	47.7	44.3	43.8
Private Sector	1213.5	1242.6	1404.0	1466.5	1437.0
Government securities	559.3	532.8	552.5	547.1	454.0
Assets/Liabilities	4116.4	4228.9	4896.9	4490.3	4855.9
Private sector deposits <sup>2</sup>	3662.7	3963.7	4225.2	3836.4	4340.7
Government deposits	154.8	146.6	169.7	167.7	194.1
Capital, reserves & other, net	298.8	118.6	502.0	186.2	320.9

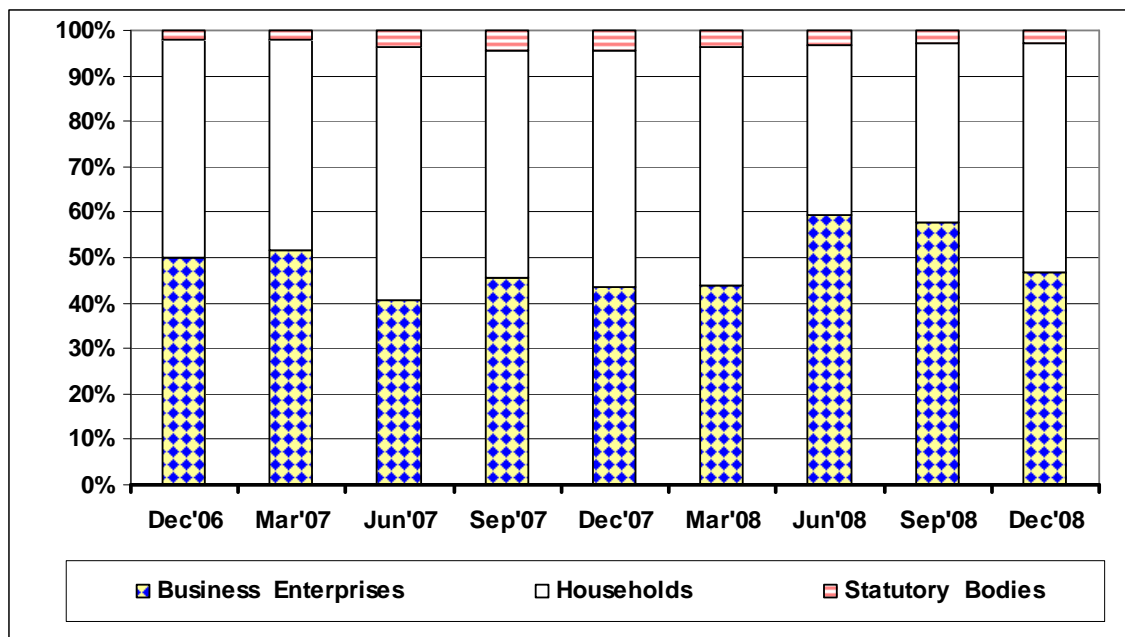
<sup>2</sup> includes statutory bodies' deposits.**Demand for Money****Domestic Credit**

Total credit to the private sector and statutory bodies declined by 2.0 per cent in the fourth quarter of 2008. The fall followed an increase of 4.3 per cent in September 2008. Both credit to the private sector and statutory bodies declined in the review period. However, the largest decline emanated from strong repayment of loans by the business sector. Credit to the private sector fell modestly during the period, while credit to statutory bodies declined by 2.0 per cent.

**Table 12: Domestic Credit Excluding Net Claims on Government**  
(Million Maloti: End of Period)

	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Domestic Credit	1236.6	1318.8	1448.8	1510.7	1480.9
Credit to private sector	1185.2	1268.6	1401.0	1466.5	1437.0
Business enterprises	683.6	731.0	871.5	874.5	693.3
Households	501.6	537.6	529.2	592.0	743.8
Credit to statutory bodies	51.5	50.1	47.7	44.2	43.8

**Figure 13: Distribution of Credit by Holder**  
(Percentage shares)



### Credit to Private Sector

The decline in credit to the private sector in the quarter to December 2008 reflected a fall in credit to business enterprises. The latter fell by 20.7 per cent in December following an increase of 0.3 per cent in the third quarter. The decrease was driven by repayments of loans

which offset extension of new credit to the sector. Conversely, credit to households increased by 25.6 per cent during the period. This reflects a strong consumer demand despite high interest rates. The increase is in line with the rise in sales turnover during the period. The developments resulted in credit to households accounting for a higher share of credit than credit to business. As Figure 13 above indicates, the share of credit to households increased from 39.2 per cent in the third quarter to 50.2 per cent in December 2008.

### **Credit to Statutory Bodies**

Credit to statutory bodies declined slightly during the fourth quarter, and experienced a 2.0 per cent decrease in its share. Its share to total non-government credit stood at 3 per cent at the end of the quarter.

### **Sectoral Distribution of Credit<sup>2</sup>**

Total distribution of credit to all sectors of the economy, including statutory bodies but excluding government and non-performing loans, declined by 30.1 per cent in December 2008 following a 0.1 per cent fall registered in September 2008. The decline was broad-based, with most industries experiencing a decline in credit.

Most sectors undertook sizable repayments of loans during the quarter probably due to high interest rates and expected global economic slowdown. Credit to manufacturing fell in line with the slowdown of growth in manufactured exports. It reflects the effect of a decline in consumer demand in the main export market, the US. The transport, storage and communications subsector experienced a 14.7 per cent decrease in credit in the quarter to December, after declining by 14.2 per cent in September. However, its share of total credit increased to 32.0 per cent in December 2008 from 26.2 per cent in September 2008.

The construction was the only sector that saw a major increase in credit during the quarter, rising by 24.1 per cent following a 4.9 per cent decline in the third quarter. The sector continues to benefit from infrastructural developments driven by the government and its partners, especially road construction.

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<sup>2</sup> Data on sectoral distribution has been revised following data correction efforts of one of the commercial banks where some credit to business enterprises were wrongly classified as being granted to households. The revision corrects the overestimate of credit extended to households.

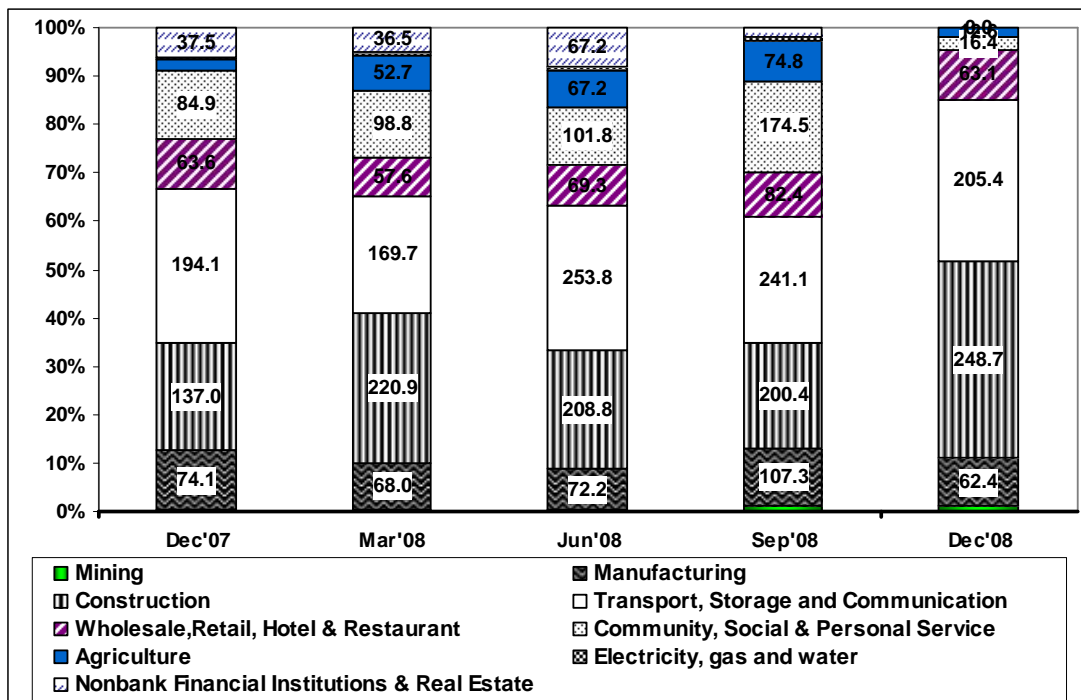


**Table 13: Sectoral Distribution of Credit to Enterprises**

(Million Maloti: End of period)

SECTOR	2008			
	Mar	Jun	Sep	Dec
Agriculture	52.7	67.2	74.0	12.6
Mining	3.8	3.8	11.4	6.8
Manufacturing	80.5	84.5	107.3	62.4
Construction	221.7	210.7	200.4	248.7
Transport, storage and communication	197.3	281.0	241.1	205.4
Electricity, gas and water	3.8	6.3	7.8	7.2
Wholesale, retail, hotel and restaurant	70.3	81.8	82.4	83.1
Non-bank financial institutions and real estate	40.5	71.1	18.1	0.0
Community, social and personal services.	110.3	113.2	174.5	16.4
All sectors	781.2	919.7	918.7	642.6

**Figure 14: Commercial Banks' Credit to Business Enterprises**  
(Percentage shares)



### Net Claims on Government

At the end of the fourth quarter, the banking system's net claims on Government fell by about M30 million. As Table 15 below shows, this was lower than the 11.5 per cent reduction in net claims between June and September 2008. The reduction was due to an increase in the net creditor position of the government with the Banking system.

The net creditor position of the government by the CBL increased as a result of a rise in deposits which overshadowed a 67.4 per cent increase in claims. Government deposits excluding those in a blocked account increased by 5.8 per cent between September and December 2008. The net claims by the commercial banks decreased as government increased its deposits with the commercial banks. Claims on government by commercial banks rose by 3.7 per cent during the review period.

**Table 14: Banking System's Net Claims on Government**

(Million Maloti: End of Period)

Holder	2007		2008		
	Dec	Mar	Jun	Sep	Dec
Commercial banks	404.5	386.2	382.8	379.3	259.9
Claims on Government	559.3	532.8	552.5	547.1	454.0
o/w MP T Bills <sup>3</sup>	470.3	457.9	455.2	468.2	454.0
Less Government deposits	154.8	146.6	169.7	167.7	194.1
CBL	-3728.8	-3660.0	-3914.0	-4318.5	-4232.6
Claims on Government <sup>4</sup>	263.3	327.7	311.7	316.6	529.9
Less Government deposits	3992.3	3987.7	4115.7	4635.1	4762.5
o/w blocked account	537.8	510.3	509.5	535.0	424.8
Total Net Claims	-3324.3	-3273.8	-3531.7	-3939.2	-3972.7

<sup>3</sup> 'MP T Bills' means monetary policy treasury bills<sup>4</sup> IMF loans on-lent to the GOL**Net Foreign Assets**

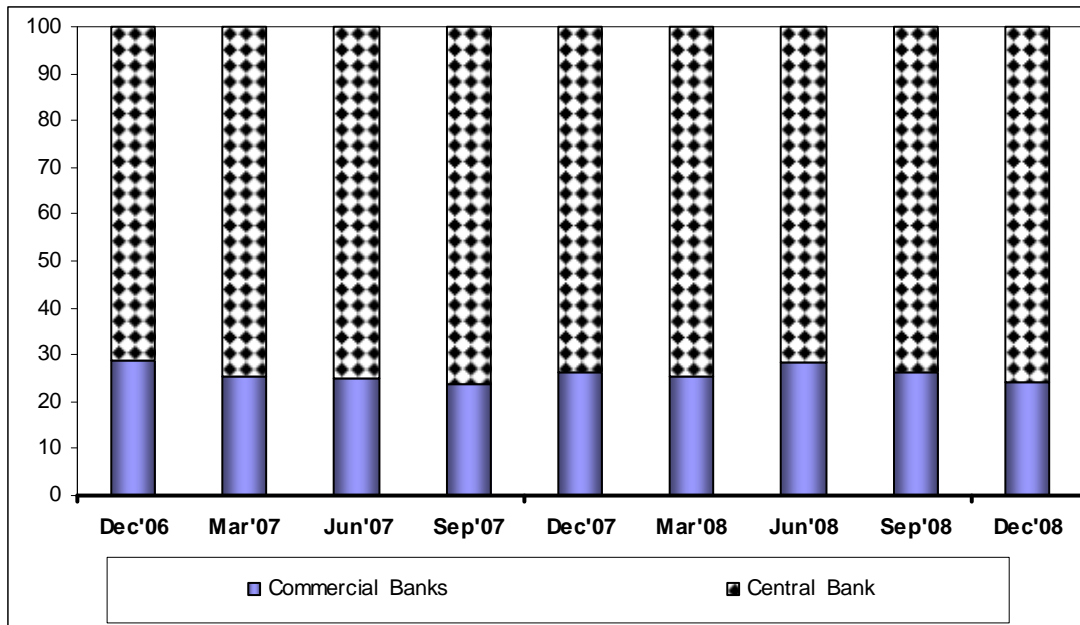
Net foreign assets of the banking system improved by 13.0 per cent at the end of December 2008, following a slight increase in September. The net foreign assets have been above M9 billion since the first quarter of 2007. The rise in the last quarter of 2008 was a result of increases in both the CBL and the commercial banks' net foreign assets.

The reason behind the rise in the CBL's net foreign assets was the strong performance of the current account in the balance of payments accounts, whose surplus improved by 39.9 in the review quarter. However, the increase in net foreign assets partly reflected revaluation gains as the loti depreciated against major currencies.

**Table 15: Banking System's Foreign Assets and Liabilities**  
(Million Maloti: End of Period)

Holder	2007	2008			
	Dec	Mar	Jun	Sep	Dec
A. Commercial Banks	2200.3	2371.4	2792.5	2162.8	2921.1
Foreign Assets	2273.7	2448.4	2858.4	2208.3	3013.7
Foreign Liabilities	-73.4	-77.0	-65.9	-45.5	-90.7
B. Central Bank of Lesotho	6177.3	6887.2	7028.8	7728.7	8251.6
Foreign Assets	6786.3	7560.4	7725.8	8430.4	8989.2
Foreign Liabilities	-609.0	-673.2	-697.0	-701.7	-737.7
Net Total	8377.6	9258.6	9821.2	9891.5	11172.6

**Figure 15: Net Foreign Assets**  
(Percentage shares)



## Money Market Developments

### Overview

The level of Treasury bill holdings increased by 37.7 per cent during the last quarter of 2008. The total amount of securities issued during this period was M738.3 million. The increase in the stock of securities issued was mainly as a result of the introduction of new tenures, the 273-day and 364-day securities. As Table 17 below indicates, the yield on the 91-day treasury bills declined from 11.91 per cent in September to 10.62 per cent in December despite the increase in total stock of securities offered. This was in line with interest rate movements in the region as well as strong demand for domestic securities.

Commercial bank holdings continued to constitute the largest proportion of Treasury bill holdings at 65.8 per cent. However, they had fallen by 24.5 per cent compared with their share in September 2008. Holdings by the non-bank sector registered a three-fold growth during the review period, which was stronger than the 3.7 per cent rise in the holding of the banking sector.

**Table 16: Holding of Treasury Bills**  
(Face Value; Million Maloti)

Type of Holder	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Total	560.2	533.0	533.2	537.7	544.6
Banking System	470.6	458.2	455.5	468.5	485.8
Central Bank	0.3	0.3	0.3	0.3	0.3
Commercial Banks	470.3	457.9	455.2	468.2	485.5
Non-Bank Sector	89.6	74.8	77.7	69.2	58.8
NBFIs	0.3	0.3	0.3	0.3	0.3
Others	89.3	74.5	77.4	68.9	57.9
Memorandum Item					
Average Yield (percent)	9.33	9.76	10.16	11.91	10.66

### Money Market and Short-term Interest Rates

At the end of December 2008, most money market rates maintained levels observed in the third quarter of 2008. Contrarily, major interest rates in the neighbouring South Africa, which

influences regional interest rates due to the Common Monetary Area agreement, fell during the same period. Deposits rates in Lesotho remained unchanged between September and December 2008, except the call deposit and the saving rates which rose by 10 to 42 basis points. The domestic prime lending rate also remained steady at 16.58 per cent during the review quarter.

The 91-day Treasury bill rate increased slightly to 10.05 per cent in December while its South African counterpart fell by 2.4 per cent during the period. However, the Lesotho rate remained below its South African counterpart due to strong demand for government securities in the domestic market.

**Table 17: Major Money Market Interest Rates**

(Percent: End of Period)

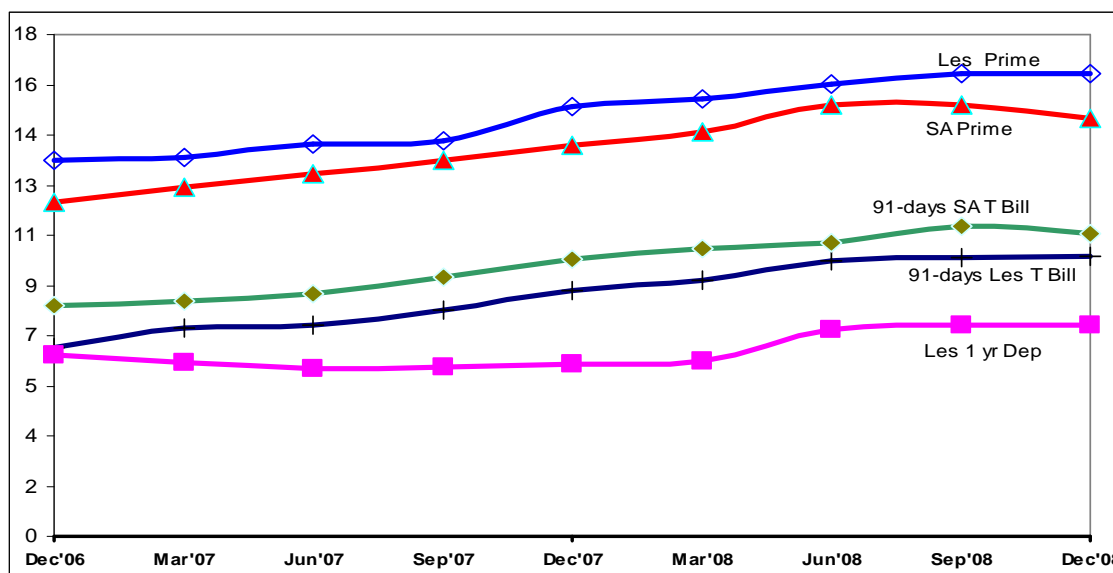
Interest Rates by Type	2007	2008			
	Dec	Mar	Jun	Sep	Dec
Central Bank					
T Bill Rate – 91 Days	8.82	9.21	9.91	10.01	10.05
Lombard Rate	12.82	13.21	13.81	14.01	14.05
Commercial Banks <sup>5</sup>					
Call	4.37	5.20	5.02	6.75	7.75
Time:					
31 days	4.88	6.25	5.41	5.54	5.54
88 days	5.38	5.55	6.09	6.22	6.22
6 months	5.63	5.75	6.52	6.60	6.60
1 year	6.17	6.28	7.42	7.57	7.57
Savings	4.67	4.59	5.04	5.04	5.48
Prime	15.42	15.67	16.25	16.58	16.58
South Africa*					
Repo	10.50	11.00	12.00	12.00	11.50
T Bill Rate – 91 Days	9.96	10.29	10.55	11.11	10.84
Marginal Lending Rate	15.50	16.00	17.00	17.00	16.50
Prime	14.00	14.50	15.50	15.50	15.00

\* Figures for South Africa were obtained from the SARB

<sup>5</sup> Average rates by commercial banks

Unlike in the previous quarter when the SARB kept its key rate unchanged, the repurchase rate was reduced by 50 basis points towards the end of the fourth quarter. Commercial banks in South Africa responded immediately by reducing their prime lending rates by the same margin (see Table 17). However, banks in Lesotho kept their lending rates unchanged in the remaining days of 2008.

**Figure 16: Short-Term Interest Rates**  
(Percent Per Annum)



## V. Government Finance

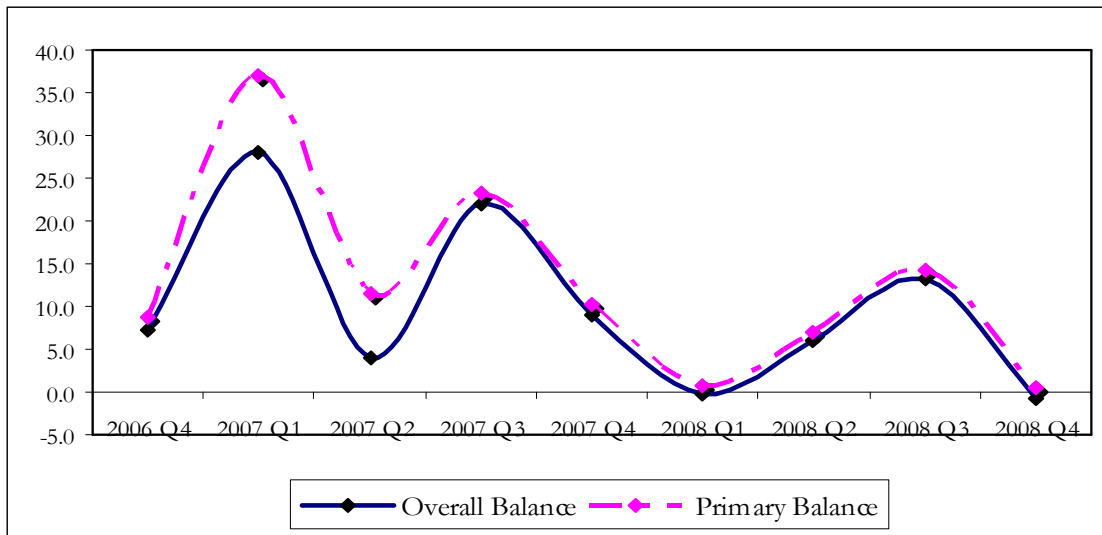
### Summary of Budget Outturn

During the review period, preliminary estimates on budget outturn indicated a deficit equivalent to 0.8 per cent of GDP. The deficit was realised on account of increase in recurrent expenditure. This was in contrast to a budget surplus equivalent to 13.3 per cent of GDP in the previous quarter. Total revenue and grants are estimated to have declined marginally by 1.2 per cent. The primary balance<sup>3</sup> was slightly higher at 0.4 per cent of GDP, largely reflecting small interest payments.

Government expenditure and net lending grew by 6.7 per cent during the same period. It accounted for 66.5 per cent of GDP, compared with 53.2 per cent recorded in the previous period, while revenue stood at 65.7 per cent of GDP compared with 66.5 per cent in the third quarter. As a share of total expenditure, recurrent expenditure stood at 82.3 per cent, compared with 17.7 per cent for expenditure on capital formation.

<sup>3</sup> Primary balance is a good indicator of budgetary operations since it excludes interest costs on public debt.

**Figure 17: Primary Balance versus Overall Balance**



## Revenue

Total revenue, including grants, declined by 1.2 per cent during the period under review. This was mainly attributed to a 57.0 per cent increase in grants, and a lower increase in domestically generated revenue. SACU revenue continued to dominate tax revenue during the period under review, registering a staggering 62.4 per cent of total share, while the income tax and VAT occupied 16.9 per cent and 13.2 per cent, respectively.



**Table 18: Government Revenue**  
(Million Maloti)

	2007/08	2008/09			
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep Revised	Oct-Dec * Preliminary
Total Revenue and Grants	1790.7	1778.6	2041.8	2223.2	2196.1
Total Revenue	1766.2	1748.8	1985.1	2151.4	2165.3
<i>Tax Revenue</i>	1562.5	1497.4	1866.3	1898.0	1964.4
Customs	959.1	959.1	1225.2	1225.2	1225.2
Non-customs	603.4	538.3	641.1	672.7	739.1
Income Taxes	293.4	301.8	390.1	392.6	331.0
Taxes on goods & services	287.6	230.5	248.5	277.2	258.6
Other Taxes	22.4	6.0	2.5	2.9	149.6
<i>Non-Tax Revenue</i>	203.8	251.4	118.8	253.5	200.9
Of which: Water royalties	81.0	67.0	77.9	96.7	81.6
Grants	24.5	29.8	56.7	71.7	30.8

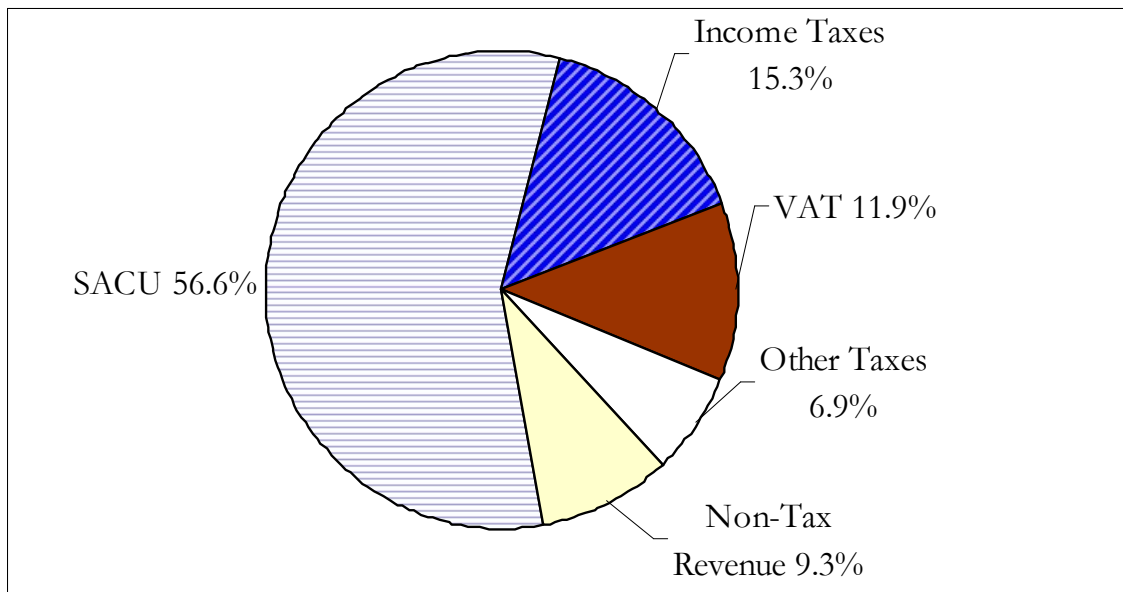
**Source:** Ministry of Finance and Development Planning (MoFDP)

\*Preliminary estimates

In contrast to 14.6 per cent growth in the previous quarter, VAT collections fell by 4.0 per cent in December 2008. The decrease in VAT was despite festive activities. Income tax decreased by 15.7 per cent following 29.3 per cent and 43.2 per cent drop in personal income tax and other income taxes respectively, which more than moderated 53.6 per cent rise in company tax. The fall in collections from the other tax component was largely attributed to a reduction in withholding tax collections.

The non-tax revenue dropped by 20.7 per cent in December 2008, compared with a two-fold growth during the previous period. The plunge in non-tax revenue was driven by 15.6 per cent and 23.9 per cent fall in water royalties and other property income, respectively. Non-tax revenue also comprises administrative fees, dividends, interest on loans on-lent to public enterprises. Development grants remained relatively small, despite effectiveness of a number of grant-supported projects. This item is expected to improve in the future with more projects gaining momentum.

**Figure 18: Sources of Government Revenue**



### **Expenditure**

Government expenditure and net lending rose by 25.0 per cent during the review period, driven mainly by 36.1 per cent growth in recurrent expenditure, which more than offset a 9.4 per cent decrease in capital expenditure. The growth in recurrent expenditure was driven by all expenditure categories, with wages and salaries contributing more.

Wages and salaries surged by 35.8 per cent during the period under review. Transfers and subsidies increased by 44.8 per cent, reflecting subventions to semi-autonomous institutions which more than offset 10.4 per cent drop in pensions and gratuities. In an endeavour to improve service delivery, government has expanded the structures to realise that goal. As a result, expenditure on goods and services expanded by 30.0 per cent during the reporting period. In response to currency depreciation, interest payments increased by 15.4 per cent, mainly aided by a 27.1 per cent rise in the foreign interest payments.

**Table 19: Government Expenditure**  
(Million Maloti)

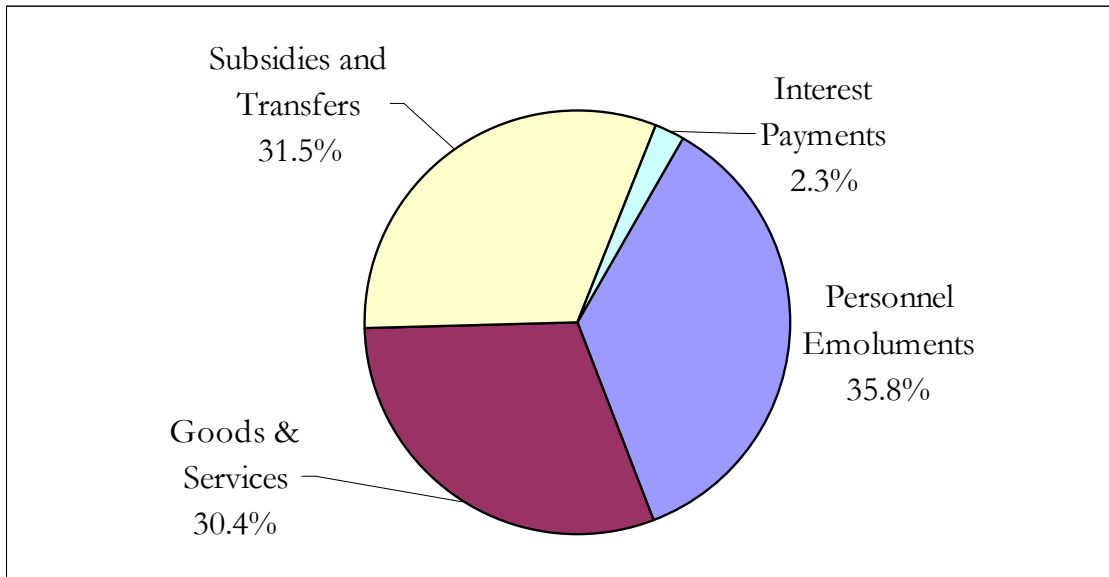
	2007/08	2008/09			
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep Revised	Oct-Dec * Preliminary
Total Expenditure & Net Lending	1523.1	1788.4	1837.9	1778.4	2222.9
Recurrent Expenditure	1207.7	1208.5	1306.7	1344.4	1829.1
Personnel Emoluments	407.1	406.9	479.0	482.8	655.7
Interest Payments	34.8	30.9	30.2	35.9	41.5
Foreign	14.2	12.5	13.1	17.7	22.5
Domestic	20.6	18.4	17.1	18.2	19.0
Other Expenditure	765.7	770.8	797.5	825.6	1132.0
Capital Expenditure	315.5	582.8	531.8	434.5	393.8
Net Lending	0.0	-2.9	-0.6	-0.5	0.0

**Source:** MoFDP

\*Preliminary estimates

It was earlier mentioned that capital expenditure fell by 9.4 per cent during the reporting period, following an 18.3 per cent in the previous period. The decrease was mainly aided by a 31.0 per cent and 7.9 per cent cutback in expenditure funded by Government and grants respectively, which more than moderated the hike in loan funded component. Nonetheless, government-funded expenditure on development projects continued to dominate, accounting for 55.9 per cent of total expenditure, while loan and grant-funded expenditures accounted for 36.3 per cent and 7.8 per cent, respectively. This is expected to improve in the near future with more construction of roads, health and water related infrastructure.

**Figure 19: Recurrent Expenditure by Type**



### **Financing**

It was mentioned that Government budgetary operations was projected to result in a fiscal deficit equivalent to 0.8 per cent of GDP during the period under review. The deficit was financed by borrowing from foreign sources. This method of borrowing bodes well for development, especially if it benefits projects with high returns. It should, however, be cautioned that Government needs to restrain recurrent expenditure in order to realise fiscal sustainability. Furthermore, measures to diversify revenue sources needs to be intensified to reduce reliance on SACU revenue.

**Table 20: Government Financing**

(Million Maloti)

	2007/08		2008/09		
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep Revised	Oct-Dec * Preliminary
Financing	-267.6	9.8	-203.9	-444.8	26.8
Foreign	-23.0	-26.0	50.6	-36.1	69.1
Loan drawings	30.7	36.7	82.2	33.6	142.8
Amortization	-53.7	-62.7	-31.6	-69.7	-73.7
Domestic	-244.6	35.8	-254.5	-408.7	-42.3
Bank Financing	-224.2	50.6	-257.4	-408.0	-33.5
Non – Bank	-20.3	-14.8	2.9	-0.7	-8.8

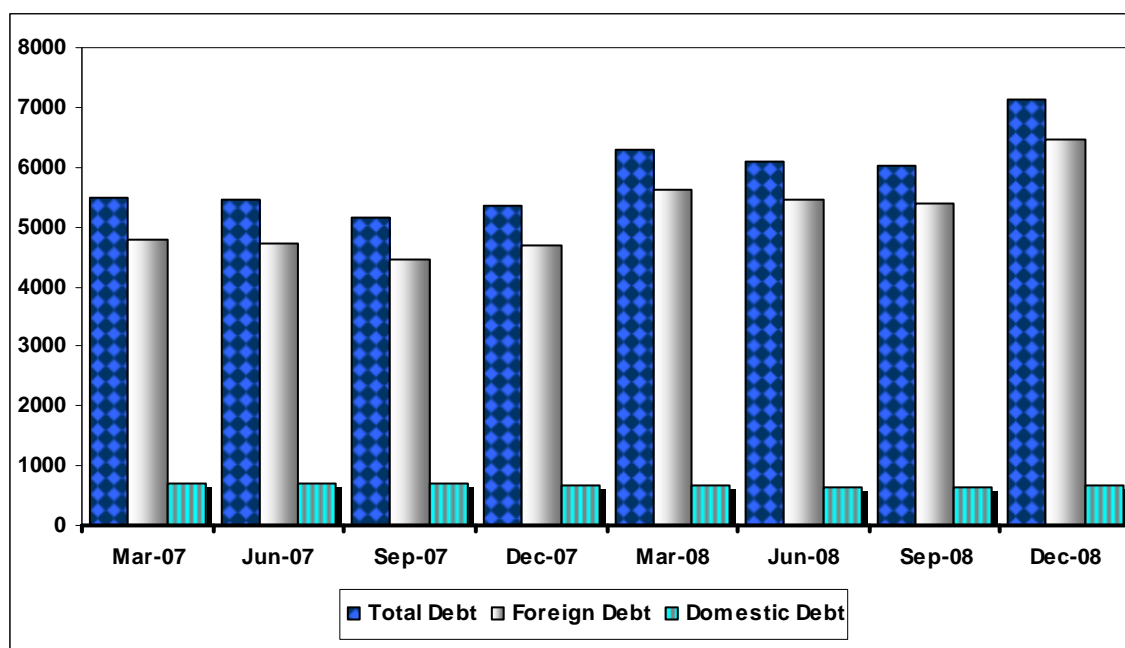
Source: MoFDP

**Public Debt****Overview**

Government basically incurs foreign and domestic debt to finance its budget deficit. Total debt increased by 18.0 per cent during the quarter under review compared to a decline of 1.2 per cent in the previous quarter. This was attributable to escalated disbursements of 142.8 million in the current quarter, coupled with currency depreciation against the major currencies in which debt is contracted.

As a percentage of GDP, public debt was estimated at 53.2 per cent, compared with 45.1 per cent recorded in the previous period. Debt service ratio remained within the sustainability threshold during the review period. This is calculated as the ratio of debt service to exports of goods and services and factor income where necessary. External debt continued to occupy the lion's share of the total public debt, accounting for 90.7 per cent compared with a meagre 9.3 per cent of domestic debt. As a result, public debt remains vulnerable to foreign exchange volatility.

**Figure 20: Outstanding Public Debt**  
(Million Maloti: End of Period)



### External debt

External debt (or foreign debt) is defined as the liability of Government to creditors outside the country, or debt denominated in foreign currency. External debt increased by 20.1 per cent in the current quarter compared to a decline of 1.4 per cent in the previous quarter. The increase was observed on both bilateral and multilateral credits, which grew by 23.3 per cent and 20.3 per cent, respectively. As a result, multilateral debt marginally rose from 91.7 per cent of external debt recorded in the last quarter to 91.9 per cent. Loans from bilateral sources almost remained unchanged at 5.9 per cent observed in the last quarter, while that from financial institutions fell from 1.4 per cent to 1.2 per cent.

It was also observed that external debt accounted for 48.3 per cent of GDP compared to 40.2 per cent in the previous quarter. Nevertheless, concessional debt as a percentage of external debt improved marginally to 97.0 per cent compared with 95.0 per cent at the end of September 2008. The non-concessional debt maintained a downward trend, dropping by 35.6 per cent. This bodes well for Lesotho as it plays a critical role to ease debt service burden, and also to meet debt sustainability indicators.

Various rules of thumb have been developed by different institutions in an effort to assist countries to test for debt sustainability. These rules of thumb are used as early warning signals for debt sustainability, depending on the nature and composition of public debt stock. External debt service ratio rose from 2.5 per cent recorded in the previous period to 3.2 per cent. Excluding factor income, the ratio was recorded higher at 5.1 per cent compared with a 3.7 per cent in the second quarter.

**Table 21: External Debt**  
(Million Maloti)

	2007	2008			
	QIV	QI	QII	QIII	QIV
External Debt	4680.6	5626.5	5455.2	5378.3	6457.1
Bilateral Loans	296.3	275.1	261.2	316.7	390.6
Concessional	250.6	234.0	221.5	279.9	348.2
Non-concessional	45.7	41.1	39.7	36.8	42.4
Multilateral Loans	4220.8	5210.7	5058.5	4931.3	5932.6
Concessional	4099.3	5051.1	4900.4	4810.7	5892.0
Non-concessional	121.5	159.6	158.1	120.7	40.6
Financial Institutions	98.8	81.3	79.8	77.1	75.7
Concessional	29.4	24.0	24.0	21.5	21.5
Non-concessional	69.4	57.3	55.8	55.6	54.2
Suppliers' Credit	64.7	59.4	55.7	53.2	58.2

Source: MoFDP

### Domestic Debt

Domestic debt is a component of public debt which is denominated in local currency. Holding of domestic debt increased by 1.0 percent in the quarter under review compared to 2.3 per cent in the previous quarter. The increase reflects diversity in holding of debt portfolio by the banking sector, following introduction of the new and longer-dated-tenure Treasury bills and increased auction frequency. This was in spite of a 15.1 per cent decline in holding of domestic debt by the non-bank sector.

Short-term debt comprised Treasury bills issued for monetary policy purposes and development of the money market, while long-term debt represented a ten year bond issued to finance the restructuring of the financial sector in 1999. As a percentage of GDP, domestic debt increased slightly to 4.9 per cent.

## VI. Foreign Trade and Payments

### Overview

The external sector position continued to display surpluses in the period under review. This was marked by an overall balance which, in seasonally adjusted terms, registered a lower surplus of M566.9 million from M703.1 million observed in the previous quarter. The depreciation of the local currency during the quarter counterbalanced narrowing of the external sector surplus. Transaction balance, which represents the overall balance without the

effects of currency fluctuations, also narrowed to M34.1 million in the review quarter compared with M762.9 million recorded in the previous quarter, largely as a result of a decline in merchandise exports.

### Current Account

Current account continued to improve further in the fourth quarter of 2008. It widened to a surplus equivalent to M412.6 million in the review quarter from a revised M346.4 million in the previous quarter, due to an increase in income coupled with current transfers. A fall in payments for services also supported current account growth. Relative to GDP, current account recorded 15.2 per cent during the quarter compared with 10.9 per cent observed in the previous period.

**Table 22: Current Account Balance**  
(Million Maloti)

	2007	2008			
	QVI	QI	QII	QIII*	QIV <sup>+</sup>
<b>I. Current Account</b>	328.39	506.26	824.12	346.40	412.57
<b>(a) Goods</b>	-1382.65	-1399.37	-1223.39	-1724.69	-1705.87
Merchandise exports f.o.b.	1456.93	1445.27	1846.99	2216.05	1675.60
Of which diamonds	357.30	291.69	391.69	784.98	270.40
Of which textiles & clothing	842.01	877.11	942.73	880.96	876.67
Other exports <sup>#</sup>	257.62	276.37	512.57	550.11	528.53
Merchandise imports f.o.b.	-2839.58	-2844.64	-3070.38	-3940.74	-3381.47
<b>(b) Services</b>	-66.48	-63.03	-87.23	-109.20	-102.60
<b>(c) Income</b>	950.00	1020.96	1040.53	1096.87	1127.69
<b>(d) Current Transfers</b>	827.52	947.70	1094.21	1083.18	1093.35

\* Revised estimates

+ Preliminary estimates

# All other merchandise exports excluding 'textiles and clothing' and 'diamonds'



## **Merchandise exports**

Merchandise exports, in seasonally adjusted terms, fell by 24.1 per cent during the fourth quarter compared with a rise of 13.9 per cent observed in the previous quarter. The drop was attributed to a fall in both diamonds, and textiles and clothing exports. Diamond exports declined by 65.6 per cent in the review quarter due to, among other factors, a fall in diamond production and suspension of operations in Kao and Lihobong diamond mines in response to the global economic down turn. Textiles and clothing exports also continued to decline due to low global demand. However, on an annual basis, merchandise exports grew by 15.0 per cent. As a percentage of GDP, merchandise exports registered a lower rate of 52.7 per cent in the fourth quarter of 2008 compared with 69.7 per cent in the previous quarter.

## **Merchandise imports**

In seasonally adjusted terms, merchandise imports rose by 16.7 per cent during the period under review, in contrast to a fall of 4.3 per cent recorded in the previous quarter. In nominal terms, merchandise imports dropped by 14.2 per cent, largely on account of a decline in the value of imports from South Africa. Furthermore, slowdown of government and private vehicles imports contributed to a decline in imports. On an annual basis, merchandise imports grew by 19.1 per cent. As a percentage of GDP, merchandise imports recorded 106.3 per cent following 123.9 per cent registered in the previous quarter.

**Table 23: Value of Exports by Section of the S.I.T.C. #**  
(Million Maloti)

COMMODITY	2007	2008			
	QIV	QI	QII	QIII*	QIV+
0. Food & Live Animals	49.00	56.52	88.24	123.60	47.30
Cattle	0.00	0.08	0.00	0.01	0.00
Wheat Flour	21.53	26.84	48.43	46.38	17.59
Maize Meal	7.86	3.08	3.24	0.45	1.06
Other	19.61	26.52	36.57	76.76	28.65
1. Beverages & Tobacco	34.67	31.97	48.39	55.08	27.08
Beverages	34.67	31.97	48.39	55.06	27.08
2. Crude Materials	360.39	295.98	395.16	792.14	283.61
Textiles fibres	3.09	4.29	3.47	7.15	13.22
Of which Wool	3.09	3.94	3.17	6.44	12.82
Of which Mohair	0.00	0.36	0.30	0.71	0.39
Crude fertilizers & crude minerals	357.29	291.69	391.69	784.98	270.39
Of which Diamond	357.29	291.69	391.69	784.98	270.39
5. Manufactured Goods	11.25	34.67	68.00	36.26	32.11
Of which textiles yarn and fabric	8.06	19.42	47.71	21.79	17.16
Other manufactured goods	3.19	15.25	20.29	14.47	14.95
6. Machinery & Transport Goods	171.17	133.47	259.41	267.01	354.31
7. Miscellaneous					
Manufactured Goods	844.86	886.96	984.77	914.71	911.32
Of which clothing accessories	832.62	859.65	942.73	859.17	859.50
Other	12.19	27.31	32.04	55.54	51.82
8. Unclassified Goods	0.08	3.92	1.67	22.18	19.88
<b>TOTAL EXPORTS</b>	<b>1456.93</b>	<b>1445.29</b>	<b>1846.99</b>	<b>2216.00</b>	<b>1675.60</b>

Note: Totals may not tally due to rounding  
\* Revised estimates  
+ Preliminary estimates  
# Standard International Trade Classification

## Direction of Trade

During the quarter under review, Africa, particularly SACU, region became the largest destination of Lesotho's exports with a share of 44.9 per cent compared with 31.8 per cent registered in the previous quarter. Despite the weakening of economic growth, the US remained the second largest destination of Lesotho's exports with a share of 37.1 per cent in the review quarter, following 32.0 per cent in the previous quarter. The bulk of Lesotho's manufactured goods are destined to the US market. The third largest recipient of Lesotho's export was European market where a large portion of Lesotho's diamond exports is destined. It recorded a lower rate of 15.5 percentage share during the quarter from 35.4 per cent observed in the previous quarter. Lesotho's exports to the Asian market remained insignificant with a share of 0.8 per cent following 0.2 per cent registered in the previous quarter.

**Table 24: Direction of Trade - Exports and Re-Exports, f.o.b.**

(Million Maloti)

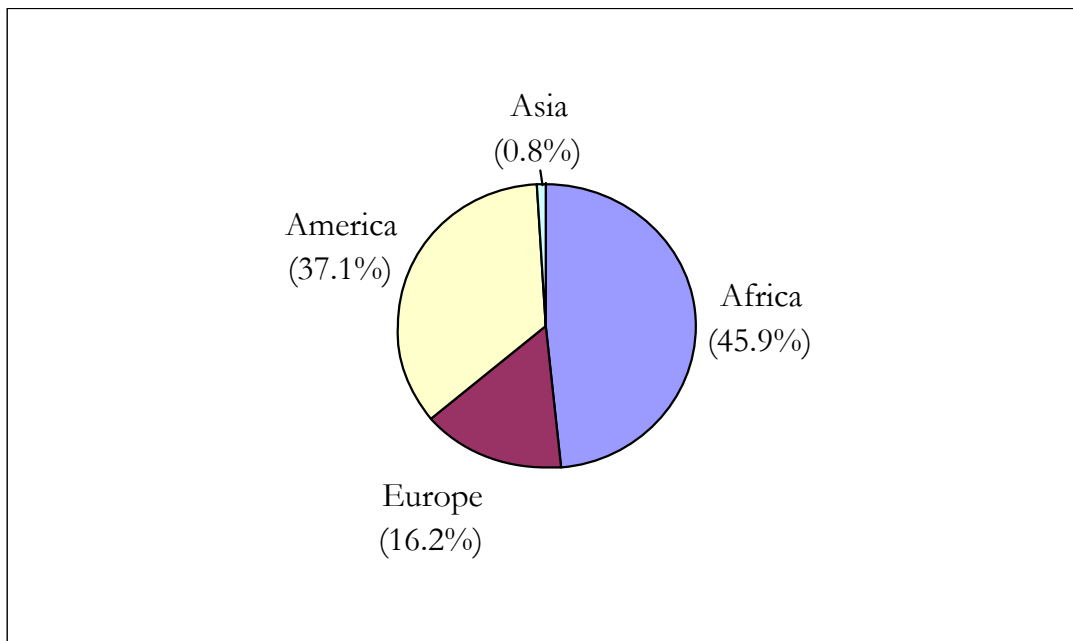
Region	2007	2008			
	QIV	QI	QII	QIII*	QIV <sup>+</sup>
World	1456.93	1445.27	1846.99	2216.05	1675.60
Africa	557.15	566.54	807.71	717.26	769.60
SACU	512.51	513.07	768.57	704.23	753.06
SADC	16.13	14.45	3.98	0.03	3.11
Other	28.55	39.02	35.16	13.00	13.43
Europe	360.34	295.85	391.29	783.87	271.48
EC	360.34	295.85	391.29	783.87	271.48
America	537.16	572.92	632.74	709.73	621.29
Asia	2.29	9.96	10.96	5.19	13.22

Note: Total may not tally due to rounding

\* Revised estimates

+ Preliminary estimates

**Figure 21: Direction of Merchandise Exports**



### **Services Account**

Net services displayed a lower net outflow of M102.6 million in the review period from that of M108.9 million recorded in the previous quarter. This emanated from a decline in payments of transportation services which plummeted by 11.6 per cent compared with a rise of 25.1 per cent observed in the previous quarter.

### **Travel**

During the fourth quarter, the value of net travel dropped to 7.9 per cent, following a rise of 27.1 per cent in the third quarter of 2008. The global financial crisis together with high global unemployment rate exerts downwards pressure on travel flows. This was indicated by a decline in travel receipts, which fell by 5.0 per cent during the quarter from a rise of 16.7 per cent in the previous quarter. Travel payments remained unchanged during the period under review.

### **Income**

Net income continued to increase during the review period. It rose by 2.9 per cent compared with 5.4 per cent registered in the previous quarter, largely driven by higher earnings on investment abroad. However, an increase in interest paid on official loans which rose by 27.1 per cent offset the growth in net income.

## **Labour income**

Labour income, in seasonally adjusted terms, declined by 0.1 per cent during the review period in contrast with a rise of 14.8 per cent recorded in the previous quarter. This was on account of a decline in the number of Basotho migrant mineworkers in SA, and thus a decrease in miners' remittances to Lesotho. The continued decline in the price of gold if sustained may lead to further retrenchment in the mining industry. On an annual basis, labour income rose by 15.3 per cent.

## **Investment Income**

Net investment income grew by 19.4 per cent to an inflow of M211.7 million in the period under review. The improvement was attributed to returns on CBL and commercial banks' investment portfolios. Investment inflows increased further by 14.9 per cent during the quarter from 5.7 per cent registered in the previous quarter. The observed growth was supported by depreciation of the local currency which boosted the value of investment portfolios outside the CMA region. In addition, high regional interest rates also increased earnings on investments.

## **Current Transfers**

During the quarter under review, current transfers, in seasonally adjusted terms increased marginally to M1.1 billion compared with a revised M1.0 million registered in the previous quarter. The slight improvement was on account of an increase in SACU non-duty receipts. On an annual basis, current transfers rose by 32.1 per cent.

## **Capital and Financial Account**

The capital and financial account registered an outflow equivalent to M184.2 million in the fourth quarter in contrast with an inflow of M1.1 billion recorded in the previous quarter, as a result of higher outflows on financial account. The observed performance was attributed to commercial banks' foreign assets which recorded an outflow of M805.4 million from an inflow of M650.1 million registered in the previous quarter. However, increased official loans disbursements during the quarter counterbalanced outflows of capital and financial account.

**Table 25: Capital and Financial Account**  
(Million Maloti)

	2007	2008			
	QIV	QI	QII	QIII*	QIV <sup>+</sup>
<b>I. Capital and Financial Account</b>	-83.21	330.96	117.74	1083.26	-184.20
Capital Account	24.50	29.80	6.70	47.30	30.80
Financial Account	-107.71	301.16	111.04	1035.96	-215.00
Special Financing – LHWP	50.97	37.79	49.93	22.88	27.49
<b>II. Reserve Assets</b>	-116.19	-774.19	-165.33	-704.65	-558.82

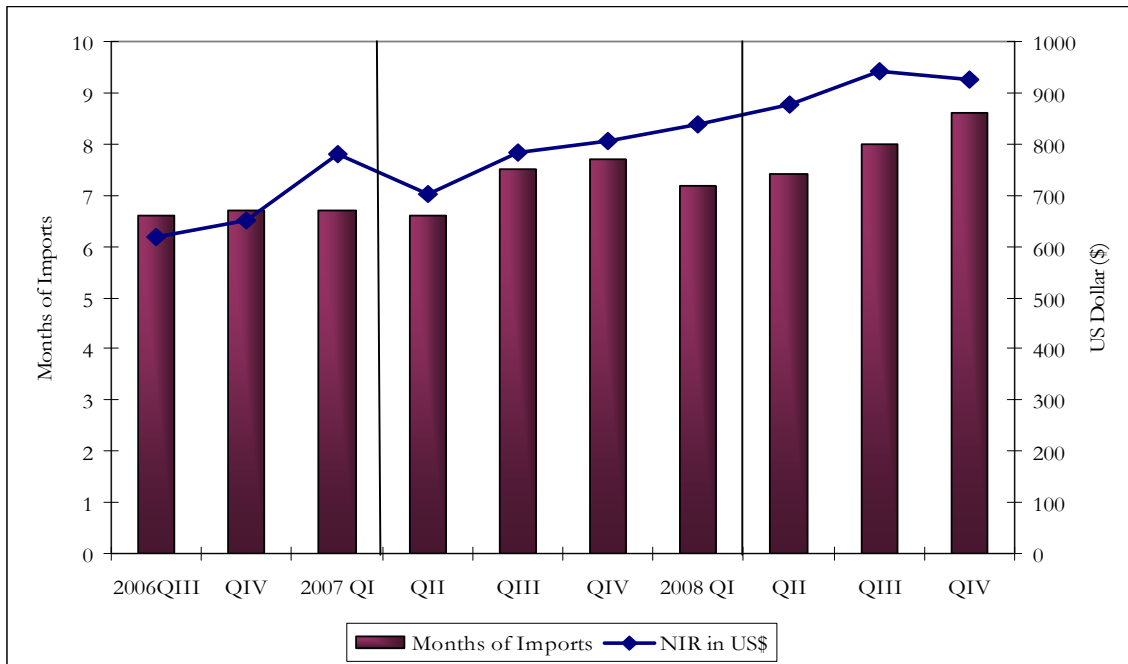
\* Revised estimates

+ Preliminary estimates

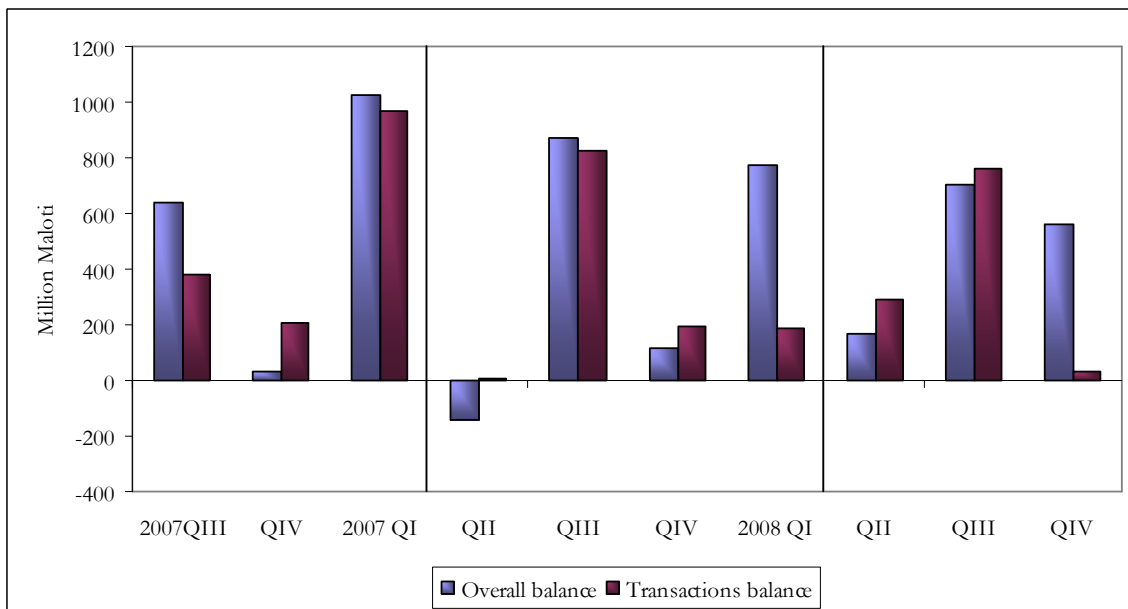
### Reserve Assets

Gross reserves rose to M9.0 billion during the quarter following that of M8.4 billion in the previous quarter. As a result, gross official reserves measured in months of import cover, increased to 8.6 months from 8.0 months registered in the previous quarter. However, the Net International Reserves (NIR) fell by 1.8 per cent to US\$924.8 million during the quarter, compared with the rise of 7.5 per cent observed in the previous quarter.

**Figure 22: Reserve Assets**



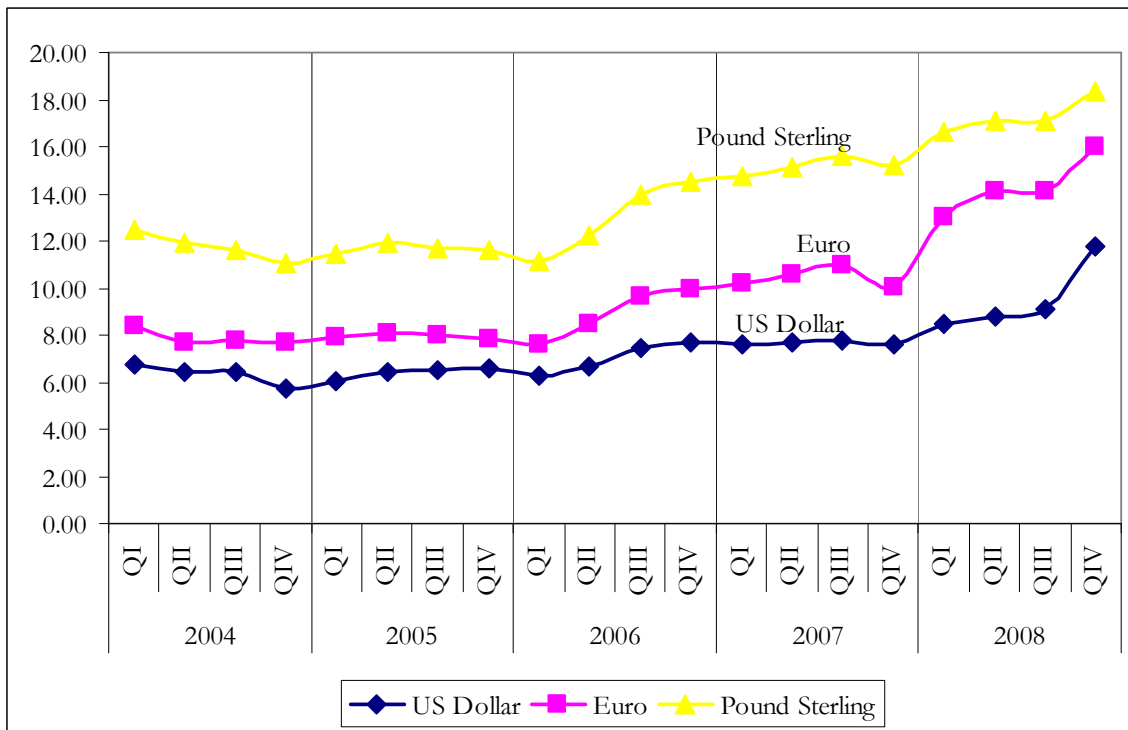
**Figure 23: Balance of Payments**



## Exchange Rates

The local currency continued to show some weakness against major trading currencies in the quarter under review. In real terms, the Loti which is pegged to the SA Rand depreciated further by 29.5 per cent against the US Dollar, due to among other factors, the global financial turmoil. Against the Euro and Pound Sterling, the loti depreciated by 13.1 per cent and 7.2 per cent, respectively.

**Figure 24: Real Exchange Rate of the Loti against Major Currencies**





## STATEMENT OF MONETARY POLICY COMMITTEE

21 October 2008

### 1. Introduction

At its 16<sup>th</sup> meeting held on 21<sup>st</sup> October 2008, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) discussed inflation-related developments and made policy decisions to maintain price stability.

The Committee sets the Net International Reserves (NIR) targets range that it deems sufficient to underwrite the rand – loti peg while meeting the country's foreign currency obligations. This serves the price stability objective of the CBL.

### 2. Inflation Developments

The Committee noted that the global economy continues to experience high inflationary pressures emanating from strong increases in commodity prices in the recent months. This problem is exacerbated by the limited scope to increase interest rates, due to the credit crunch that has depressed aggregate demand and overall economic activity in major economies.

Inflation continued to accelerate in the Common Monetary Area, with all members (Namibia, Lesotho, South Africa and Swaziland) experiencing double digit inflation rates. The rate of inflation targeted by the South African Reserve Bank, the CPIX, rose to 13.6 per cent on annual basis in August, from 10.9 per cent in May. The growth was driven by strong oil and food prices, as well as higher wage settlements. However, it was observed that interest rate increases undertaken in the past months are bearing fruit. Private sector credit and household consumption expenditure slowed down in the recent months. The fall in the international price of oil could also reduce inflationary pressures.

Lesotho imports the bulk of its inflation from South Africa due to a large proportion of imports from the neighbouring country. Thus, inflation developments in South Africa impact price developments in Lesotho. Domestic inflation rose from 10.5 per cent in July to 11.2 per cent in August. The growth was driven by increase in both the food and non-food component. Food inflation jumped from 14.7 per cent in July to 15.2 per cent in August, while non-food inflation rose from 6.6 per cent to 7.5 per cent during the same period. The broad-based growth in prices indicates that high food and fuel prices have filtered into prices of other commodities and services in the economy.

### **3. Prospects for the Maintenance of Price Stability**

#### **a. Balance of Payments**

The balance of payments statement points to an accumulation of foreign reserves, which improved from 7.2 months of import cover in the first quarter of 2008 to 7.4 months in the second quarter. The current account balance increased significantly in the quarter to June, driven by an increase in exports and current transfers (due to SACU non-duty receipts).

The accumulation of foreign reserves is important for conduct of monetary policy in Lesotho, which relies on strong reserve position to underwrite the fixed exchange rate system. This, in turn, allows closer partnership with other CMA countries in fighting excessive inflation.

The Committee observed that it is sitting at a time when currency markets are under turmoil. The exchange rate of loti against US dollar depreciated from a low of around M7.235 early in August to above M10.50 on 20<sup>th</sup> October. Rapid depreciation of the loti could increase Lesotho's import bill, leading to a build up in inflationary pressures.

## **b. Fiscal Balance Outlook**

Government operations continue to impact favourably on the domestic inflation environment. Strong receipts from the SACU revenue pool and restrained expenditure levels (as share of GDP) are resulting in budget surpluses which are used to build up government reserves held with the banking system. The government achieved an overall budget surplus estimated at 6.1 per cent of GDP for the quarter ended June 2008, following a balanced budget in March.

## **4. Monetary Policy Stance**

The build up in external reserves and government budget surpluses augured well for the Net International Reserves (NIR) which stood at US\$939.8 million on 17 September 2008. The Committee, therefore, decided to keep the NIR target unchanged at US\$450 - 500 million.

However, the Committee expressed concern on the rapid depreciation of the loti in the recent weeks. If sustained, the depreciation could adversely affect the outlook on inflation.

M.P. Senaoana (PhD)

**GOVERNOR**

**21 October 2008**

# STATEMENT OF MONETARY POLICY COMMITTEE

18 December 2008

## 1. Introduction

At its 17<sup>th</sup> meeting held on 18<sup>th</sup> December 2008, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) discussed the latest monetary policy operations, developments in the external sector and inflation-related developments to ensure that the price stability mandate of the Bank is achieved. The Bank's objective is attained through maintenance of adequate level of foreign reserves. The reserves are kept to endorse the fixed exchange rate between the South African (SA) rand and the loti. This currency peg allows Lesotho to benefit from the monetary policy action of the South African Reserve Bank (SARB), as the bulk of inflationary pressures in Lesotho emanate from the SA market. Thus the MPC sets minimum target levels of external reserves and monitors performance of open market operations (auction of treasury bills) on meeting this target.

## 2. Inflation Developments

The Committee noted that inflation rate peaked at 12.1 per cent in September 2008 and slowed down marginally to 12.0 per cent in October 2008. The rise in food prices remained the main driver of inflation at 16.3 per cent. The non-food component of the Consumer Price Index (CPI) also experienced an increase during the period. It grew at an annual rate of 7.8 per cent, compared with a 6.6 per cent increase observed in the previous meeting of the MPC. However, the Committee noted the possibility of a slowdown in overall inflation developments in the coming months. This is mainly due to a significant reduction in the price of international crude oil prices, which was trading at \$40 per barrel, compared to \$83 per barrel observed in the previous MPC meeting. These developments also translated into a cumulative decline in domestic petrol prices by more than R3.30 per litre since August 2008.

The Committee observed that inflation in SA continues to be above the target of 3 to 6 per cent. However, there were signs of moderation in October, the measure of inflation targeted by the SARB, the CPIX, increased by 12.4 per cent after peaking at 13.6 per cent in August. Moreover, the SARB expects inflationary pressures to decline in the coming months as a result of the favourable international crude oil prices and a series of interest rate hikes effected since 2006. Indeed, household consumption expenditure and private sector credit declined in recent months. In addition, the SARB's MPC reduced its key interest rate in line with conditions prevailing in the global economy and in international financial markets.

### **3. Prospects for the Maintenance of Price Stability**

#### **a. Balance of Payments**

Net financial inflows in the balance of payments can increase domestic money supply and eventually exert upward pressure on prices. In the third quarter of 2008, the current account surplus was recorded at 9.3 per cent of GDP, following a 26.5 per cent of GDP in the second quarter. This was largely due to the higher volume of imports. However, official reserves continued to rise, registering 8.0 months of imports in the third quarter.

#### **b. Fiscal Balance Outlook**

The effect of a strong increase in external reserves on money supply continues to be moderated by decreases in net claims on government. Government budgetary operations resulted in an estimated surplus equivalent to 13.0 per cent of GDP in the third quarter of 2008. This was mainly aided by improvements in tax and non-tax revenue. The non-expansionary fiscal policy helped contain domestically generated inflation.

### **4. Monetary Policy Stance**

The Net International Reserve (NIR) position on the 12<sup>th</sup> December 2008 was US\$959.26 million. At this level, NIR is US\$459.26 million above the current NIR target and deemed sufficient to cater for trade with the rest of the world even in the presence of exchange rate

volatility. Thus the Committee decided to keep the NIR target unchanged at US\$450- 500 million.

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**GOVERNOR**

**18 December 2008**

## VII. Statistical Tables