CENTRAL BANK OF LESOTHO

STATEMENT BY THE MONETARY POLICY COMMITTEE
14th November, 2006

1. Monetary Policy Stance

At its 8th meeting held on 14 November 2006, the Central Bank of Lesotho Monetary Policy Committee (MPC) decided to maintain the target range for Central Bank of Lesotho Net International Reserves (NIR) unchanged at US$400-$450 million[1] for the period November to December 2006. The Committee is satisfied that the target range would continue to allow the Central Bank to maintain the fixed exchange rate regime between the local currency, *loti*, and the South African currency, the rand. The fixed exchange rate arrangement benefits Lesotho with lower inflation and monetary stability.

2. Inflation Developments During the Third quarter of 2006

The Committee examined inflation developments during the third quarter of 2006. Inflation as measured by the changes in the Consumer Price Index (CPI) stood at 6.8 per cent in August 2006 compared with 6.6 per cent at the end of the second quarter of 2006. The increase was mainly due to the category 'food and non alcoholic beverages' whose index increased by 11.4 per cent in August. The second largest category 'furniture, households equipment and routine maintenance' decelerated from 4.7 per cent to 4.0 per cent in August. The index for the third largest category 'clothing and footwear' rose by 1.8 per cent in August 2006 compared with 2.9 per cent in June 2006. The committee noted that although there is some evidence that inflation may be easing, inflationary pressures are still eminent.

Uncertainties in the international oil prices still pose some risks although there are some signs that the price of crude oil is declining. The average price of crude oil declined to $57.49 per barrel in September 2006 from $67.29 per barrel in June 2006. In addition, during the third quarter, the

[1] Net international reserves of the Central Bank of Lesotho are defined as: liquid unencumbered foreign assets of the Central Bank less foreign liabilities.

loti exchange rate depreciated from M6.99 to M7.53 against the US dollar. The movement in the exchange rate was influenced mainly by interest rate hikes in the developed countries particularly the United States (US).

On the demand side of the economy, real economic activity measured by Gross Domestic Product (GDP) is projected to grow by a revised 4.8 per cent and 4.9 per cent in 2006 and 2007, respectively. The committee noted that on an annual basis, nominal money supply rose by 22.7 per cent in September 2006 compared with 16.7 per cent in June 2006. The observed growth in broad money is reflective of the prevailing inflationary conditions in the economy.

The Committee noted the improved economic activity in the manufacturing and mining sub-sectors. During the third quarter, total exports rose by 38.5 per cent compared with 20.1 per cent in the previous quarter. Exports of both diamonds and textiles increased substantially. The committee further noted the emerging importance of diamond exports to Lesotho's BOP. Letseng and Liqhobong mines are in operation and Kao is expected to commence soon. Employment in the manufacturing sector also showed some growth during the quarter. The number of Basotho employed in the LNDC assisted companies was recorded at 46189 in September 2006. This is 16.6 per cent higher compared to the same period last year.

3. Prospects for the Maintenance of the Fixed Exchange Rate Arrangement

Lesotho continues to enjoy the benefits of the fixed exchange rate regime with South Africa (SA). The benefits include monetary stability and low inflation. Inflation in SA measured by changes in CPI-X remained within the target range of 3 to 6 per cent at 5.1 per cent in September 2006. The continued inflationary pressures in SA have led to further increases in the repo rate. The repo rate stands at 8.5 per cent compared with 7.0 per cent at the end of June 2006.

a. Balance of Payments (BOP) Developments

The Committee then looked at the BOP developments during the third quarter of 2006. The BOP position in this period recorded an overall surplus equivalent to M641.5 million. The current account balance (CAB) also registered a surplus equivalent to 1.3 per cent of GDP compared with the deficit of 1.5 per cent of GDP in the previous quarter. These were mainly driven by the improved Southern African Customs Union (SACU) non duty receipts and strong growth in merchandise exports. The Committee noted that fiscal management has become more challenging in the context of an increased inflow of SACU non duty receipts. The Committee, therefore, noted the importance of building reserves given the uncertainty about future SACU inflows and Lesotho vulnerability to exogenous shocks.

b. Fiscal Balance Outlook

The importance of Government budgetary operations to the balance of payments outlook cannot be over-emphasised. The fiscal position in Lesotho continued to be favorable. During the third quarter of 2006, government budgetary operations were estimated to have resulted in a surplus equivalent to 6.2 per cent of GDP. This was due to the stronger growth in total revenue compared to total expenditure. Total revenue was recorded at 52.3 per cent of GDP while total expenditure was 46.2 per cent of GDP. The surplus position is expected to continue throughout the fiscal year in line with the 2006/2007 budget proposals.

4. The Monetary Policy Committee Decision

The Committee having considered all factors affecting foreign reserves concluded that the fiscal position has led to the situation where the actual level of NIR has been higher than its target range of US $400 to $450 million. At the end of October of 2006, the excess was $250.2 million. Consequently, the Committee maintained the target range for NIR at US$400 to US$450 million for the period November to December 2006.

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